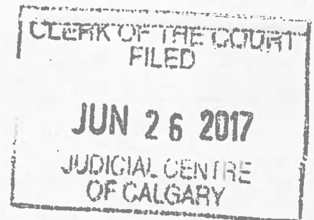

COURT FILE NUMBER	1601-11552
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
APPLICANT	NATIONAL BANK OF CANADA IN ITS CAPACITY AS ADMINISTRATIVE AGENT UNDER THAT CERTAIN AMENDED AND RESTATED CREDIT AGREEMENT DATED JANUARY 15, 2016, AS AMENDED
RESPONDENT	TWIN BUTTE ENERGY LTD. IN THE MATTER OF THE RECEIVERSHIP OF TWIN BUTTE ENERGY LTD.
PARTY FILING THIS DOCUMENT	CRG FINANCIAL LLC
DOCUMENT	**WRITTEN BRIEF OF CRG FINANCIAL LLC** **(Reply re: *Ad Hoc* Committee Application re: Subordination)** ***June 30, 2017*** **Honourable Mr. Justice Jeffrey**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	McMillan LLP TD Canada Trust Tower, Suite 1700 421 7th Avenue S.W. Calgary, Alberta Canada T2P 4K9 Phone: 416.865.7841 Fax: 416.865.7048 **Andrew Kent / Caitlin Fell** *Counsel for CRG Financial LLC*

I. OVERVIEW

1. This Brief is submitted by CRG Financial LLC ("**CRG**"). CRG Financial is the holder of certain trade claims (the "**CRG Trade Claims**") owing by Twin Butte Energy Ltd. ("**Twin Butte**") in the approximate amount of $1 million. CRG Financial submits this Brief as a supplement to the Reply Brief of FTI Consulting Canada Inc., in its capacity as court-appointed receiver (the "**Receiver**") of Twin Butte filed June 20, 2017 (the "**Receiver's Brief**") and in opposition to the Brief of Argument of the *Ad Hoc* Committee of Debenture Holders filed June 7, 2017 (the "***Ad Hoc* Brief**").

2. The Receiver takes the position that the holders of 6.25% unsecured debentures (the "**Debentures**") issued under the Convertible Debenture Indenture between Twin Butte and Valiant Trust Company dated December 13, 2013 (the "**Indenture**") are subordinated in right and payment to all Senior Indebtedness (as that term is defined in the Indenture), including all trade claims.

3. CRG agrees and adopts the Receiver's position on the subordination for the reasons set out in the Receiver's Brief. Set out below are supplemental arguments that the Debentures are fully subordinated to all Senior Indebtedness.

4. The Indenture is clear that all of the Debenture Liabilities (as defined under the Indenture), which includes all indebtedness, liabilities and obligations of Twin Butte under the Indenture, are postponed and subject in right of payment to the full payment of Senior Indebtedness.

5. In purchasing the CRG Claims, CRG relied on that subordination.

6. The language contained in the Short Form Prospectus dated December 6, 2013 offering the sale of the Debentures (the "**Prospectus**") describes the Indenture and the subordination of the Debentures. The Prospectus is certified by Twin Butte, the board of directors of Twin Butte and the underwriters as containing full, true and plain disclosure.

7. The Receiver has determined, based on the clear wording of the Indenture, that the claims of Debenture holders are subordinated to all Senior Indebtedness. A ruling by a receiver on the validity of a claim should not be lightly interfered with by the Court.

8. The Ad Hoc Committee is incorrect in its assertion that no unsecured creditor can benefit from the subordination provisions in the Indenture because they are not parties to the Indenture. The exceptions to privity of contract have been met in these circumstances entitling holders of Senior Indebtedness to rely on the subordination provisions in the Indenture.

9. There are no limitations or actions required by a holder of Senior Indebtedness to rely on or invoke the subordination provisions in the Indenture. A holder of Senior Indebtedness is not required to request any confirmation of subordination.

10. Further, it would be oppressive and contrary to the reasonable expectations of CRG and other holders of Senior Indebtedness if the subordination provisions of the Indenture were not enforced by or on behalf of Twin Butte.

11. The Ad Hoc Committee is in direct breach of the Indenture by bringing this application. Accordingly, the application should be dismissed and all costs of holders of Senior Indebtedness in respect of this application should be paid in full.

II. BACKGROUND

12. CRG relies on the facts set out in the Receiver's Brief, and in particular, the recitation of the provisions in the Indenture which confirms the subordination of the Debentures to trade claims.

13. CRG is a firm that specializes in giving creditors holding claims against insolvent entities an opportunity to receive cash for their claims without the time, risk, and expense associated with a lengthy insolvency proceeding.[1]

14. CRG has acquired trade claims from various trade creditors in the approximate amount of $1,000,000.[2]

[1] Affidavit of Joseph Brosnan sworn June 26, 2017 [**Tab 1**].
[2] *Ibid.*

III. ANALYSIS

A. Subordination is Unequivocal

15. The Indenture is clear that all of the Debenture Liabilities (as defined under the Indenture), which includes all indebtedness, liabilities and obligations of Twin Butte under the Indenture, are postponed and subject in right of payment to the full payment of Senior Indebtedness. In addition, the Indenture makes clear that the order of payment upon any liquidation is first to any Senior Indebtedness free and clear of all Debenture Liabilities.[3]

16. Accordingly, using the ordinary and grammatical meaning of the words in the Indenture, it is clear that the Debentures are unequivocally subordinated to the Senior Indebtedness, including the trade claims.

B. Reliance by holders of Trade Claims on the Subordination Language

17. Prior to purchasing the CRG Trade Claims, CRG conducted due diligence as to the validity and the priority of the trade claims *vis-a-vis* other debt of Twin Butte.[4] As part of its diligence, CRG read the Prospectus and relied on the following subordination language in the Prospectus to conclude that the trade claims it was purchasing would be paid in priority to the Debentures[5]:

> Rank: The Debentures will be direct, unsecured obligations of the Corporation and **will be fully subordinated to all Senior Indebtedness**. [...]
>
> Subordination: The payment of the principal and premium, if any, of, and interest on, **the Debentures will be subordinated and postponed**, and subject in right of payment in the circumstances referred to below and more particularly as set forth in the Indenture, **to the full and final payment of all Senior Indebtedness of the Corporation**.
>
> The Indenture will provide that **in the event of any insolvency or bankruptcy proceedings, or any receivership**, [...] **then holders of Senior Indebtedness will receive payment in full before the**

[3] Indenture, Art 5.1 and 5.2.
[4] Affidavit of Joseph Brosnan sworn June 26, 2017, unfiled [Tab 1].
[5] *Ibid.*

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holders of Debentures will be entitled to receive any payment or distribution of any kind or character.... [Emphasis added.]

18. The Prospectus, including the subordination language, is represented by the company, the board of directors of the company and the underwriters as constituting full, true and plain disclosure of all materials facts relating to the Debentures.

19. If the Debentures were represented by the company in the Prospectus as being on a *pari passu* basis with the trade claims, CRG would either (i) not have purchased the CRG Trade Claims at all; or (ii) would have paid far less to acquire the trade claims in order to mitigate against receiving a reduced recovery that would result from a pro-rata distribution with the Debenture holders as opposed to a recovery if the trade claims were paid in priority.[6]

20. CRG relied on the statements made by the Company in the Prospectus in purchasing the CRG Trade Claims.[7] It would be an oppressive and inequitable result if holders of trade claims who placed substantial reliance on the subordination found themselves ranking *pari passu* with the Debenture holders completely contrary to such representations.

21. In purchasing Debentures, holders of Debentures were also aware as a result of the Prospectus and the terms of the Indenture that the Debentures would be subordinated in full to the payment of trade claims.

C. There is no Damages Claim

22. The Ad Hoc Committee attempts to create a fictional claim in addition to their claim for principal and interest accruing under the Indenture, known as the "Debenture Damages Claim" in the Ad Hoc Committee Brief. The Debenture Damages Claim is based on the assertion that the Indenture was breached as a result of the court-appointed Receiver consummating a sale of the assets of Twin Butte, with the approval of the Court.

23. The commencement of the receivership of Twin Butte constituted an event of default under the terms of the Indenture. There can be no incremental damages arising from an

[6] *Ibid.*
[7] *Ibid.*

alleged further default as a result of the court-appointed Receiver selling the assets of the company if the debt was already due and payable.

24. Further, earlier in these proceedings the Debenture holders attempted to take credit for the asset sale in their application as to whether the Debenture holders should share equally and pro rata with the professional costs incurred by the Ad Hoc Committee. The Ad Hoc Committee cannot now object to the sale transaction and claim damages.

25. Even if the theory of the "Debenture Damages Claim" had merit, which it does not, it is clear that the term "Debenture Liabilities" includes all liabilities under the Indenture, which liabilities, including any notional "Debenture Damages Claim" are fully subordinated pursuant to Article 5 of the Indenture.

D. The Receiver as a Court Officer is Required to Respect the Subordination

26. A court-appointed receiver is an officer of the court and is required to act in a fiduciary capacity with respect to all interested parties. This duty involves maximizing recovery for all creditors and treating all creditors in a fair manner in accordance with applicable law.[8]

27. Prior to making a distribution, the receiver has a duty to ascertain what creditors have claims, the amount of such claims, and their priority.[9]

28. In this circumstance, the Receiver has concluded that that the Debentures are subordinated to Senior Indebtedness. A ruling by a receiver on the validity of a claim should not be lightly interfered with by the Court as the Court would be stepping into the shoes of the receiver and dealing with matters that are really the proper function of the receiver.[10]

29. In making a distribution, the receiver has the right to avoid an oppressive result amongst creditors which would be contrary to applicable law, the law in this case being the terms of the Indenture. In this circumstance, the Receiver is complying with applicable law by respecting the subordination provisions contained therein.

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[8] *Re Philip's Manufacturing Ltd.* 12 CBR (3d) 149 (BCCA) **[Tab 2]**; see also *Re Ravelston Corp.* (2005), 24 CBR (5th) 256 (ONCA) **[Tab 3]**.
[9] *bcIMC Construction Fund Corp. v Chandler Homer Street Ventures Ltd.*, 2008 CarswellBC 1421 (BCSC) **[Tab 4]**.
[10] *Pont v Brown et al*, 1974 CarswellOnt 82 (ONSC) **[Tab 5]**.

30. Further, by enforcing the subordination provisions of the Indenture on behalf of Twin Butte, the Receiver is avoiding an unjust, inequitable and oppressive result.

E. Trade Creditors have a right to rely on the Terms of the Indenture as an Exception to Privity of Contract

31. The Ad Hoc Brief is incorrect in its assertion that no unsecured creditor can benefit from the subordination provisions in the Indenture because they are not parties to the Indenture.

32. While the law on privity of contract provides that, as a general rule, a contract cannot confer rights or impose obligations arising under it on any person except the parties to it, there are exceptions to this rule which are clearly applicable in the circumstances.[11]

33. The case law provides that where it can be established that the parties to the contract intended the relevant provision of the contract to confer a benefit on a third party and that the actions of the third party in question came within the scope of contract, then a third party can seek to rely on the terms of such contract notwithstanding the rule of privity.[12]

34. Under the Indenture, the company and the Indenture trustee, on behalf of the Debenture holders, clearly intended to confer a benefit on the holders of Senior Indebtedness. Section 5.16 of the Indenture provides that each of Twin Butte and the Debenture Trustee each agree that Article 5 (the subordination provisions) are an inducement and consideration to holders of Senior Indebtedness to give or continue credit to Twin Butte or to acquire Senior Indebtedness and that holders of Senior Indebtedness may accept the benefit of the subordination in Article 5 by giving or continuing credit to Twin Butte, in each case without notice to the Debenture trustee, and without the holder of Senior Indebtedness having to establish reliance on Article 5.[13]

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[11] *London Drugs Ltd. v Kuehne & Nagel International Ltd.*, 1992 CarswellBC 315 (SCC) **[Tab 6]**, see also *Fraser River Pile & Dredge Ltd. v Can-Dive Services Ltd.*, 1999 CarswellBC 1927 (SCC) **[Tab 7]**.
[12] *Fraser River Pile & Dredge Ltd. v Can-Dive Services Ltd.*, 1999 CarswellBC 1927 at para 32 (SCC) **[Tab 7]**.
[13] Indenture, Art 5.1 6.

35. The provisions of section 5.16 of the Indenture clearly intend to confer a benefit on the holders of Senior Indebtedness by inducing them to give credit or acquire such indebtedness.

36. With respect to the second part of the test, the actions of holders of Senior Indebtedness to acquire such indebtedness or to give credit and to rely on the subordination provisions in a distribution by the Receiver clearly comes within the scope of the Indenture. Accordingly, the exceptions to the rule of privity are established and the Ad Hoc Committee cannot rely on privity of contract to prevent holders of Senior Indebtedness from enforcing the subordination provisions of the Indenture.

37. This position is consistent with Ontario Superior Court's decision in *Re Stelco*[14], which found that the senior debt holders were entitled to enforce the subordination provision in the note indenture as third party beneficiaries of the subordination.

F. There is a Trust Established for the Benefit of Senior Indebtedness

38. The Ad Hoc Committee cites the Ontario Court of Appeal's decision in *Re Stelco*[15] as a basis to suggest that there is no privity in these circumstances because there is no trust provision in the Indenture.

39. In *Re Stelco,* the Ontario Court of Appeal dealt with an appeal of the decision of the Ontario superior court, which as mentioned above, found that the senior debt holders were entitled to enforce the subordination. In addition, the Ontario Superior Court found that the senior debt holders were also entitled to enforce the subordination provisions as beneficiaries of a trust.

40. The Ontario Court of Appeal in *Re Stelco,* only dealt with the issue of the trust and confirmed that the senior debt holders could rely on trust principles to provide an exception to the privity of contract doctrine, entitling them to enforce the subordination provisions.

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[14] 2006 CarswellOnt 4857 (ONSCJ) **[Tab 8]**.
[15] 2007 ONCA 483 **[Tab 9]**.

41. The Ad Hoc Committee in its brief specifically asserts that in the Indenture, there is no such trust provision addressing subordination and distributions in an insolvency proceeding and therefore this case is distinguishable from *Re Stelco*[16]. This is an incorrect and misleading statement. Section 5.5 of the Indenture explicitly contains a trust provision pursuant to which if any payment is made to the Debenture Trustee, such payment must be held in trust for the benefit of Senior Indebtedness:

> **...unless and until such default or event of default shall have been cured or waived or ceased to exist, such payments shall be held in trust for the benefit of, and, if and when such Senior Indebtedness shall have become due and payable...**[Emphasis Added.][17]

42. Accordingly, as in the case in *Re Stelco*[18], while holders of Senior Indebtedness are not parties to the Indenture, they are entitled to rely on the trust established in the Indenture entitling them to enforce the subordination and turnover provisions as an exception to the doctrine of privity of contract.

G. There are no Conditions Precedent for the Subordination to be Effective

43. There are no limitations or actions required by a holder of Senior Indebtedness to rely on the subordination provisions in the Indenture contrary to the assertions of the Ad Hoc Committee.

44. The *Ad Hoc* Committee suggests that because no Senior Creditor requested a confirmatory agreement from Twin Butte of their status as constituting Senior Indebtedness under clause 5.7 of the Indenture, the Subordinated Debentures are not subordinated. This argument fails for three reasons.

45. Firstly, the last sentence of section 5.7 states: "**<u>However, nothing herein shall impair the rights of any Senior Creditor who has not entered into such an agreement</u>**."[19]

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[16] *Ibid.*
[17] Indenture, Art 5.5.
[18] *Re Stelco*, 2007 ONCA 483 **[Tab 9]**.
[19] Indenture, Art 5.7.

46. Secondly, in addition, in section 5.2(x), the Indenture specifically provides that the rights and priority of the Senior Indebtedness and the subordination of the Debentures "**shall not be affected by: (x) any other matter whatsoever**".[20]

47. Thirdly, the language in section 5.7 is permissive such that a Senior Creditor **is not** required to request a written agreement confirming that the Debentures are subordinated. Section 5.7 provides that: "...the Debenture Trustee shall enter into a written agreement or agreements as the Senior Creditor **may** reasonably request providing that such Persons are entitled to all the rights and benefits of this Article 5 as a Senior Creditor."[21]

The Ad Hoc Committee is in breach of the terms of the Indenture and the Application Should be Dismissed

48. In bringing this application, the Ad Hoc Committee is in direct breach of section 5.5 of the Indenture. Accordingly, this application should be dismissed and the Ad Hoc Committee should be responsible, directly or indirectly, for paying all costs in connection with this application of holders of Senior Indebtedness.

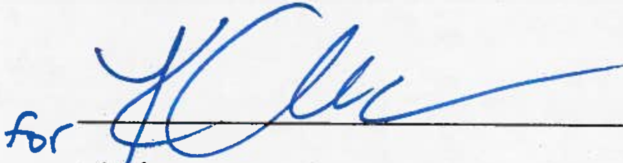
49. Under section 5.5 of the Indenture, upon an event of default of the Indenture, neither the Debenture trustee nor the holders of Debentures shall be entitled to institute proceedings for the collection of payment until the Senior Indebtedness has been paid in full.[22]

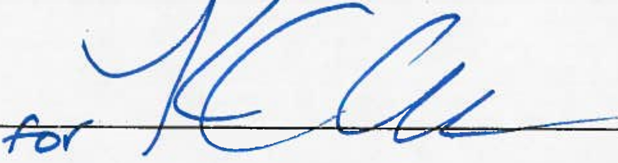
IV. CONCLUSION AND RELIEF SOUGHT

50. For all the reasons stated herein, CRG respectfully requests the Court's confirmation that the holders of Debentures are subordinate to Senior Indebtedness. In addition, CRG requests that holders of Debentures can't ask for, or receive, any distributions until the Senior Indebtedness is paid in full and, in order to avoid preference risks, that general unsecured claims ranking *pari passu* with the Senior Indebtedness are paid in full prior to payment to Debenture holders. CRG Financial requests that its legal costs of responding to this action be paid in full out of the receivership estate.

[20] Indenture, Art 5.2.
[21] Indenture, Art 5.7.
[22] Indenture, Art 5.5.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 26th DAY OF June, 2017.





Andrew Kent
McMillan LLP

Caitlin Fell
McMillan LLP

TABLE OF AUTHORITIES

1. Affidavit of Joseph Brosnan, sworn June 26, 2017
2. *Re Philip's Manufacturing Ltd.* 12 CBR (3d) 149 (BCCA)
3. *Re Ravelston Corp.* (2005), 24 CBR (5th) 256 (ONCA)
4. *bcIMC Construction Fund Corp. v. Chandler Homer Street Ventures Ltd.*, 2008 CarswellBC 1421 (BCSC)
5. *Pont v. Brown et al*, 1974 CarswellOnt 82 (ONSC)
6. *London Drugs Lid, v. Kuehne & Nagel International Lld.,* 1992 CarswellBC 315 (SCC)
7. *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.,* 1999 CarswellBC 1927 (SCC)
8. *Re Stelco Inc.,* 2006 CarswellOnt 4857 (ONSCJ)
9. *Re Stelco Inc., 2007 ONCA 483* (ONCA)

TAB 1

COURT FILE NUMBER	1601-11552
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
APPLICANT	NATIONAL BANK OF CANADA IN ITS CAPACITY AS ADMINISTRATIVE AGENT UNDER THAT CERTAIN AMENDED AND RESTATED CREDIT AGREEMENT DATED JANUARY 15, 2016, AS AMENDED
RESPONDENT	TWIN BUTTE ENERGY LTD. IN THE MATTER OF THE RECEIVERSHIP OF TWIN BUTTE ENERGY LTD.
PARTY FILING THIS DOCUMENT	CRG FINANCIAL LLC
DOCUMENT	**AFFIDAVIT**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	McMillan LLP TD Canada Trust Tower, Suite 1700 421 7th Avenue S.W. Calgary, Alberta Canada T2P 4K9 Phone: 416.865.7841 Fax: 416.865.7048 **Andrew Kent / Caitlin Fell** *Counsel for CRG Financial LLC*

AFFIDAVIT OF JOSEPH BROSNAN

(Sworn June 26, 2017)

I, JOSEPH BROSNAN, of the city of Cresskill in the state of NEW JERSEY, SWEAR AND SAY THAT:

1. I am an Analyst at CRG Financial, LLC ("**CRG Financial**"). I have been directly involved with the Twin Butte Energy Ltd. ("**Twin Butte**") file at CRG Financial since approximately April, 2017. I have personal knowledge of the matters deposed to in this Affidavit, except where state to be based upon information, in which case I believe the same to be true.

2. I am authorized to make this Affidavit on behalf of CRG Financial, as a holder of approximately $1,000,000 in trade claims against Twin Butte (the "**CRG Trade Claims**").

3. CRG Financial is a firm that specializes in giving creditors holding claims against insolvent entities an opportunity to receive cash for their claims without the time and expense associated with a lengthy insolvency proceeding.

4. CRG Financial acquired trade claims from various trade creditors in the approximate amount of $1,000,000.

5. Prior to purchasing the CRG Trade Claims, I conducted due diligence as to the validity and the priority of the trade claims *vis-a-vis* other debt of Twin Butte.

6. As part of that diligence, I read the Short Form Prospectus (the "**Prospectus**") dated December 6, 2013 offering the sale of the Convertible Debentures (the "**Debentures**") issued under an Indenture between Twin Butte and Valiant Trust Company dated December 13, 2013.

7. CRG Financial relied on the following subordination language in the Prospectus to conclude that the trade claims CRG Financial was purchasing would be paid in priority to the Debentures:

> Rank: The Debentures will be direct, unsecured obligations of the Corporation and **will be fully subordinated to all Senior Indebtedness**. [...]
>
> Subordination: The payment of the principal and premium, if any, of, and interest on, **the Debentures will be subordinated and postponed**, and subject in right of payment in the circumstances referred to below and more particularly as set forth in the Indenture, **to the full and final payment of all Senior Indebtedness of the Corporation**.
>
> The Indenture will provide that **in the event of any insolvency or bankruptcy proceedings, or any receivership**, [...] **then holders of Senior Indebtedness will receive payment in full before the holders of Debentures will be entitled to receive any payment or distribution of any kind or character...**. [Emphasis added.]

8. If through our diligence we had found that the Debentures ranked *pari passu* with the trade claims rather than subordinate, CRG Financial would either:

(a) not have purchased the CRG Trade Claims at all; or

(b) would have paid far less to acquire the trade claims in order to mitigate against receiving a reduced recovery that would result from a pro-rata distribution with the Debenture holders as opposed to a recovery if the trade claims were paid in priority.

9. I swear this Affidavit in support of CRG Financial's written submissions in reply to the Motion by the Ad Hoc Committee of Debenture holders.

SWORN BEFORE ME at the City of Cresskill, in the State of New Jersey, on June 26, 2017.

A Notary Public for taking Affidavits *(or as may be)*

JOSEPH BROSNAN

ALLISON R. AXENROD
NOTARY PUBLIC
STATE OF NEW JERSEY
ID # 2405665
MY COMMISSION EXPIRES MARCH 14, 2021

TAB 2

1992 CarswellBC 490
British Columbia Court of Appeal

Philip's Manufacturing Ltd., Re

1992 CarswellBC 490, [1992] 5 W.W.R. 549, [1992] B.C.W.L.D. 1683, 12 C.B.R. (3d) 149, 15 B.C.A.C. 247, 27 W.A.C. 247, 34 A.C.W.S. (3d) 443, 69 B.C.L.R. (2d) 44, 92 D.L.R. (4th) 161

PHILIP'S MANUFACTURING LTD. v. COOPERS & LYBRAND LIMITED (Receiver-Manager of PHILIP'S MANUFACTURING LTD.) and HONGKONG BANK OF CANADA

Hinkson, Taylor and Cumming JJ.A.

Heard: June 4, 1992
Judgment: June 23, 1992
Docket: Doc. Vancouver CA015543/CA015587

Counsel: *Murray A. Clemens* and *Gordon Turriff*, for appellants.
David Lunny, for respondent.

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

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
  XIX.3 Arrangements
    XIX.3.d Effect of arrangement
      XIX.3.d.ii Stay

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
  XIX.5 Miscellaneous

Debtors and creditors

VII Receivers
  VII.7 Actions involving receiver
    VII.7.e Practice and procedure
      VII.7.e.iv Miscellaneous

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act

Receivers --- Actions by and against — Actions against receiver

Receivers — Costs and remuneration — Advances — Receiver-manager entitled to pay itself only "reasonable amounts".

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The company obtained an ex parte order for protection under the *Companies' Creditors Arrangement Act*, staying proceedings against it and authorizing it to file a plan of reorganization within six months. A bank that held a debenture of the company successfully applied to have the stay lifted. An interim receiver was appointed in the bankruptcy proceeding and the bank appointed a receiver-manager; one party served for both appointments. The company's appeal from the order setting aside the stay was later allowed and the receiver-manager was ordered to return control of the company to its officers and directors. By that time, the receiver-manager had advanced more than $320,000 to itself for its fees and legal expenses. Of that amount, $146,204 was taken in reliance on a discretionary-advances provision in the order appointing the receiver-manager on the eve of its removal from control of the company's affairs. On application by the company, the receiver-manager was ordered to return the $146,204. The receiver-manager and the bank appealed.

Held:

The appeals were dismissed.

The order allowing discretionary advances was not a right, but a special privilege. As an officer of the court the receiver-manager had to exercise such privilege fairly and with due regard to its fiduciary duties. The receiver-manager had no right to advance itself moneys in fear that the order by which it was appointed would be terminated or stayed. The advances taken were not reasonable ones, fairly taken for the purposes for which the privilege was granted.

Table of Authorities

Cases considered:

Canada Deposit Insurance Corp. v. Greymac Mortgage Corp. (1991), 2 O.R. (3d) 446 (Gen. Div.) [affirmed (1991), 4 O.R. (3d) 608 (C.A.)] — *referred to*

Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd., 8 C.B.R. (3d) 31, [1991] 5 W.W.R. 577, 81 Alta. L.R. (2d) 45, 81 D.L.R. (4th) 280, 7 C.E.L.R. (N.S.) 66, 117 A.R. 44, 2 W.A.C. 44 (C.A.) [additional reasons at (1991), 8 C.B.R. (3d) 31 at 55, 84 Alta. L.R. (2d) 257, 86 D.L.R. (4th) 567, 3 C.P.C. (3d) 100, 120 A.R. 309, 8 W.A.C. 309 (C.A.), leave to appeal to S.C.C. refused (1992), 8 C.B.R. (3d) 31n, 7 C.E.L.R. (N.S.) 66n, 83 Alta. L.R. (2d) 1xvi (note), 86 D.L.R. (4th) 567n] — *referred to*

Parsons v. Sovereign Bank of Canada, [1913] A.C. 160 (P.C.) — *referred to*

Royal Trust Co. v. Montex Apparel Industries Ltd., 17 C.B.R. (N.S.) 45, [1972] 3 O.R. 132, 27 D.L.R. (3d) 551 (C.A.) — *referred to*

Statutes considered:

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

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

Appeals from order reported at 12 C.B.R. (3d) 133, 91 D.L.R. (4th) 105, 68 B.C.L.R. (2d) 162, [1992] 5 W.W.R. 537 (S.C.), additional reasons at (1992), 91 D.L.R. (4th) 766 (B.C. S.C.) directing receiver-manager to return advances that it had paid to itself.

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The judgment of the court was delivered by *Taylor J.A.*:

1 These are appeals from a decision of Mr. Justice Macdonald [12 C.B.R. (3d) 133, 68 B.C.L.R. (2d) 162, 91 D.L.R. (4th) 105, [1992] 5 W.W.R. 537 (S.C.), additional reasons at (1992), 91 D.L.R. (4th) 766 (B.C. S.C.)] directing that the receiver-manager appointed by court order in a bank debenture action repay $146,204 which it took from the debtor in advances against its charges and legal expenses during and after the hearing of an appeal to this court which resulted in the receivership being stayed.

2 A partial account of the history of this action and the related litigation is necessary in order to explain the unusual problem which has led to the appeals.

3 The respondent Philip's Manufacturing Ltd., a building materials supplier, having fallen into financial difficulty, obtained ex parte on September 3, 1991, an order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, appointing a "monitor" and restraining legal proceedings against the company for six months so that it might make an arrangement with its creditors. The existence of this order made it impossible for the appellant Hongkong Bank of Canada, the company's principal creditor, to enforce its debenture securing the company's indebtedness to it of more than $2,500,000. The period of protection has since been extended to August 28, 1992.

4 On December 9, 1991 the Hongkong Bank brought on an application to set aside Mr. Justice Macdonald's order and this application was granted by Mr. Justice Scarth [(1991), 9 C.B.R. (3d) 17, 4 B.L.R. (2d) 134 (B.C. S.C.)].

5 On that same day another of the company's creditors obtained an order under the *Bankruptcy Act* [R.S.C. 1985, c. B-3] appointing the appellant Coopers & Lybrand interim receiver of the company's assets pending hearing of its petition. On the following day, December 10, 1991, the bank commenced action on its debenture. On December 11, 1991 the company applied for leave to appeal Mr. Justice Scarth's order and that application was denied the next day by a judge of this court in chambers. On December 13, 1991 the bank obtained from Mr. Justice Josephson an order in its debenture action appointing the appellant Coopers & Lybrand receiver-manager. The order authorized the bank to take advances in a "reasonable amount" from time to time against its fees and disbursements prior to the fixing of its remuneration and passing of accounts.

6 Less than a week later, on December 19, 1991, the company applied to this court for a review of the refusal of the chambers judge to grant leave to appeal the order of Mr. Justice Scarth. Coopers & Lybrand (to which I shall refer simply as "the receiver") had by then assumed its duties as interim receiver and receiver-manager. On December 30, 1991 the company was declared bankrupt, and the receiver appointed trustee.

7 On January 17, 1992 this court reversed the decision of its chambers judge and granted the company leave to appeal the order of Mr. Justice Scarth.

8 Shortly thereafter, on January 29, 1992, Mr. Justice Lambert made an order in chambers, to which I shall later refer, staying the order of Mr. Justice Scarth and rendering the receiver's function that of a "caretaker" pending disposition of the appeal. The appeal was heard on March 16 and 17, and allowed on March 18, 1992 [(1992), 67 B.C.L.R. (2d) 84, 9 C.B.R. (3d) 25, 4 B.L.R. (2d) 142 (C.A.)]. The result was to revive the order of Mr. Justice Macdonald under the *Companies' Creditors Arrangement Act*, with the consequence that all further proceedings against the company including those in the bank's debenture action were again stayed. The order was made effective two days later, so as to allow for orderly re-transfer of control of the business from the receiver to the directors of the company.

9 During the period of just over three months for which it had been in control of the company's affairs — that is to say, from December 9, 1991 to March 20, 1992 — the receiver withdrew more than $320,000 in advances against its fees and disbursements from funds received from customers of the company in payment of their accounts. Of this sum $171,204 was taken during the hearing in this court of the appeal against the order of Mr. Justice Scarth or after the appeal was allowed. The result was that on resumption of its efforts to reorganize its affairs under the *Companies' Creditors*

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Arrangement Act the company found itself with greatly reduced receivables and funds on hand, and with significantly diminished prospects of being able to achieve a reorganization as contemplated by the statute.

10 The matter of the advances taken by the receiver came before Mr. Justice Macdonald on April 16 and 28, 1992, and on May 4, 1992, he made the order which is the subject of the two appeals before us, one by the receiver and one by the bank.

11 Mr. Justice Macdonald noted that of the $171,204 taken by the receiver during the last five days of its control of the business $25,000 was taken without authority as an advance against its fees and expenses in the capacity of trustee in bankruptcy and that it had returned this to the company five weeks later, on April 24, 1992. The judge ordered the receiver to pay interest on that sum for the period of the withholding. The receiver's appeal against that part of Mr. Justice Macdonald's order was abandoned during the hearing before us.

12 In respect of the balance of the moneys taken, being $146,204, the receiver relied as its authority on the provision for discretionary advances contained in the order of Mr. Justice Josephson of December 13, 1991.

13 The order of Mr. Justice Josephson provides, among other things, that the receiver might "employ such assistance as it may consider necessary for the purpose of preserving the assets or carrying on the business" and that its proper expenditures should form a charge on the company's assets in priority to the debenture. The order concludes as follows:

> THIS COURT FURTHER ORDERS that the Receiver Manager shall pass its accounts from time to time before a District Registrar of this Honourable Court and at the time of passing such accounts, the District Registrar may fix the remuneration and indemnification of the Receiver-Manager, who shall be at liberty before passing its accounts and applying to have its remuneration fixed *to pay itself in respect of its services as Receiver-Manager of the Assets a reasonable amount, either monthly or at such longer intervals as it deems appropriate, which amounts shall constitute an advance against its remuneration and its own expenses when fixed* and which said remuneration together with its own expenses shall form a charge upon the Assets in priority to all other charges, save and except those imposed by statute which cannot be postponed to the charge thus created.
>
> THIS COURT FURTHER ORDERS that the requirement of a Receiver-Manager's Bond or Security be dispensed with.
>
> THIS COURT FURTHER ORDERS that the Receiver Manager may from time to time apply to This Honourable Court for directions and guidance in the discharge of its duties hereunder.

It is under the provision which I have emphasized, contained in the third-from-last clause of the order, that the receiver has sought to justify the taking of the funds in issue.

14 The funds which Mr. Justice Macdonald ordered returned to the company consist of moneys taken between March 16 and 20, 1992, that is to say during the two days on which the appeal against the decision of Mr. Justice Scarth was being heard and, after it had been decided adversely to the bank and the receiver, during the two-day transitional period allowed by the court. The advances taken during this period amounted to more than half of the total in advances taken by the receiver during the period of slightly over three months for which it had control of the company's affairs and included $35,000 paid directly from the company to the law firm which represented the receiver in its unsuccessful efforts to resist the company's appeal. No disclosure was made to the court of the receiver's intention to make these withdrawals, nor was any direction or guidance sought from the court with respect to the taking of advances. They were taken at a time when it was known to the receiver that the *Companies' Creditors Arrangement Act* proceedings might soon be reinstated, and after this had happened. They were taken with knowledge that the result would necessarily be to reduce significantly any possibility that those proceedings could prove fruitful.

15 At the time the advances were taken there had for almost two months been in place the order of Mr. Justice Lambert of January 29, 1992, which stayed the effect of the order of Mr. Justice Scarth pending disposition of the appeal

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and reduced the role of the receiver to that of a "caretaker" until the appeal had been decided. The order of Mr. Justice Lambert, if it did not suspend the order of Mr. Justice Josephson, significantly modified its effect by limiting the receiver's function.

16 In giving reasons for the decision now under appeal, Mr. Justice Macdonald dealt first with the company's contention that no funds at all could be retained by the receiver in view of the reversal of the order of Mr. Justice Scarth, which he rejected. That matter has yet to be argued in this court. The judge then continued with the following three paragraphs which relate to the issues raised on these appeals [p. 171 B.C.L.R.]:

> 3. The right to make advances contained in the December 13, 1991 order is limited to 'reasonable amounts.' In my view, the final two groups of advances totalling $146,204.86 made during argument on the appeal and after the decision thereon were unreasonable and cannot be retained.
>
> 4. In the circumstances, it was incumbent on the receiver-manager to seek directions before taking those final advances. My view is that permission to do so would have been denied, considering the amount involved in relation to the time period and the existence of the January 29, 1992 partial stay.
>
> 5. I have little confidence, considering the investigative work done by the receiver-manager, which was more properly a function of the trustee in bankruptcy, and several other factors which I have only glimpsed, that neither the receiver-manager nor its legal advisor will be able to retain, in the long term, the total of the advances now in issue. Thus it is fair in the interim that the bank, by virtue of its indemnity of the receiver-manager, should bear half of the load.

The central issue before us is whether in so deciding the judge erred in principle or in his understanding of the facts.

17 It is necessary, in my view, in disposing of these appeals, to look to certain fundamental principles governing the office of a court-appointed receiver-manager in the light of which the order of Mr. Justice Josephson is to be interpreted and applied. They are as follows:

> 1. A receiver-manager appointed by the court in a debenture-holder's action is an officer of the court responsible to the court and not to the holder of the debenture at whose instance the appointment is made: *Parsons v. Sovereign Bank of Canada*, [1913] A.C. 160 (P.C.); *Royal Trust Co. v. Montex Apparel Industries Ltd.*, [1972] 3 O.R. 132, 27 D.L.R. (3d) 551, 17 C.B.R. (N.S.). 45 (C.A.).
>
> 2. A receiver-manager so appointed owes fiduciary duties to all parties, including the debtor: see *Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.*, [1991] 5 W.W.R. 577, 81 Alta. L.R. (2d) 45, 8 C.B.R. (3d) 31, 81 D.L.R. (4th) 280, 7 C.E.L.R. (N.S.) 66, 117 A.R. 44, 2 W.A.C. 44 (C.A.) , and cases there referred to.
>
> 3. Such a receiver-manager is at all times subject to the supervision of the court and entitled to the court's directions: see above authorities, also *Canada Deposit Insurance Corp. v. Greymac Mortgage Corp.* (1991), 2 O.R. (3d) 446 (Gen. Div.), and cases there cited.

An examination of the relevant parts of the order of Mr. Justice Josephson in the light of these basic principles leads, in my view, to the following conclusions.

18 The authority given by that order to the receiver to make discretionary advances to itself is not in the nature of a right but, as counsel properly conceded before us, a special privilege. The receiver-manager must therefore exercise this privilege fairly, as an officer of the court, and with regard to its fiduciary duties, especially those owed to the debtor and the creditors as a whole. The exercise of the privilege is necessarily subject to supervision by the court. The authority to take advances is not given as security for the payment of the receiver's fees and disbursements when approved by the court; these are, by the terms of the order, secured on the assets of the company. The authority to take advances serves

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rather as a convenience to the receiver, so that it would not need to have frequent takings of accounts in order to avoid accumulating its charges.

19 A receiver-manager has therefore no right to advance to itself the debtor's money because it fears that the order appointing it may be terminated or stayed, or may turn out to be invalid, and any advance made for purposes of that sort would not be within the scope of the order of Mr. Justice Josephson. It is, of course, to the debenture holder, not to the debtor, that the receiver must look for any assurance it requires that its fees and disbursements will be paid even though its appointment is set aside or suspended, or the assets on which they are secured prove inadequate to discharge them when fixed and approved. The receiver in this case, as would be expected, obtained an indemnity from the bank in respect of its charges.

20 The matter before Mr. Justice Macdonald was obviously an urgent one, because the company's survival was at stake. An onus in my view lay on the receiver to give a prompt account to the court of its reasons for taking the advances, and to satisfy the court that they fell within the contemplation of the order of Mr. Justice Josephson in that they were both reasonable in amount and reasonable also in the sense that they were taken fairly and in accordance with the receiver's duties to the parties and the court. As an officer of the court subject to its supervision the receiver had not only to act fairly in exercising this privilege, but had also to be seen to be acting fairly.

21 The timing of the advances suggested, of course, that they had been taken without concern for the financial position in which the company would find itself upon the creditors' arrangements proceedings being reinstated.

22 The receiver adduced no evidence showing that the advances were taken for any reason other than a desire to see its position secured before the legal basis on which its appointment rested was removed by this court. This would, of course, enable it to enter into the inevitable dispute over its entitlement to fees and disbursements with the advantage of having the debtor's funds in its hands, and the assurance that these funds would not be available for use during the reorganization effort under the creditors' arrangement statute. In order to be seen to have acted reasonably the receiver had an obligation, in my view, to satisfy the court that it was not so motivated.

23 The position taken before us on behalf of the receiver and the bank is that the propriety and reasonableness of the advances can only be determined after the fixing of remuneration and taking of accounts is completed. That position, in the circumstances of this case, is inconsistent, in my view, with the principles to which I have referred. It would mean that the privilege of taking advances could be exercised in the absolute discretion of the receiver, without supervision by the court, and this cannot, in my view, be so. The receiver's position that the matter could only be dealt with in the bank's debenture holder's action — which had, of course, by then been stayed — and could not properly be dealt with in these proceedings, was not taken below and cannot, in my view, now be acceded to.

24 It seems to me that on the basis of the evidence before him, Mr. Justice Macdonald was entitled to find that the funds taken by the receiver had not been shown to be reasonable advances fairly taken for the purposes for which the privilege was granted, and was right, in the exercise of the court's supervisory jurisdiction, to order that the funds be returned.

25 These appeals have been concerned solely with the advances taken by the receiver on the eve of its removal from control of the company's affairs. We are told that a cross-appeal is pending in which the right of the receiver to be remunerated at all will be in issue, and the validity of earlier advances will be challenged. In those proceedings issues will arise which were not the subject of argument before us, and on which I would therefore not wish to be thought to express an opinion.

26 I would dismiss these appeals.

Appeals dismissed.

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TAB 3

2005 CarswellOnt 9058
Ontario Court of Appeal

Ravelston Corp., Re

2005 CarswellOnt 9058, [2005] O.J. No. 5351, 24 C.B.R. (5th) 256

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

In the Matter of a Plan of Compromise or Arrangement of
Ravelston Corporation Limited and Ravelston Management Inc.

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c.B-3, as Amended, and the Courts of Justice Act, R.S.O. 1990, c. C.43, as Amended

Doherty, S. Borins, H.S. LaForme JJ.A.

Heard: October 18, 2005
Judgment: November 10, 2005
Docket: CA M33075, CA M33076, CA M33049, CA C44249

Proceedings: refusing leave to appeal *Ravelston Corp., Re* (2005), 2005 CarswellOnt 4907 (Ont. S.C.J. [Commercial List])

Counsel: Alan H. Mark, Edward Greenspan for Conrad Black
Robert Staley for Hollinger International Inc.
Derek Bell for Hollinger Inc.
Alex MacFarlane for R.S.M. Richter Inc.

Subject: Civil Practice and Procedure; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency

- XVII Practice and procedure in courts
  - XVII.7 Appeals
    - XVII.7.b To Court of Appeal
      - XVII.7.b.ii Availability
        - XVII.7.b.ii.A Future rights

Bankruptcy and insolvency

- XVII Practice and procedure in courts
  - XVII.7 Appeals
    - XVII.7.b To Court of Appeal
      - XVII.7.b.ii Availability
        - XVII.7.b.ii.C Leave by judge

Headnote

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — To Court of Appeal — Availability — Future rights

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Application by receiver of company RCL applied for order authorizing and directing it to voluntarily accept service, on behalf of RCL, of summons to indictment returned on August 18, 2005, by federal grand jury in Chicago was granted — B, another stakeholder, vigorously opposed attornment — Trial judge found receiver indicated that it had completed thorough analysis of issues arising from U.S. criminal proceedings as they related to RCL, receivership of RCL and stakeholders of RCL — Trial judge found two major stakeholders, H International Inc. and H Inc., advised that their view was that it was appropriate for receiver to have RCL attorn to U.S. criminal proceedings — Trial judge found receiver reached conclusion that it was appropriate to so attorn and to enter not guilty plea — Trial judge found appointment of receiver in April 2005 was on basis that old guard, B, and his colleague, R, were out as to control of RCL, and receiver, as new guard, was completely in control — Trial judge found receiver must zealously safeguard interests of legitimate stakeholders, including U.S. Department of Justice and those for whom it was responsible for protecting — B appealed — Receiver brought application to quash appeal — Application granted; appeal quashed and leave to appeal refused — No leave to appeal as of right existed, as no future rights were at issue as contemplated by s. 193 of Bankruptcy and Insolvency Act — No future rights of U.S. Attorney affected — Merely advancing claim does not create future right — No realistic possibility of success on appeal — Receiver has broad discretion to direct actions of business subject to its authority.

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — To Court of Appeal — Availability — Leave by judge

Application by receiver of company RCL applied for order authorizing and directing it to voluntarily accept service, on behalf of RCL, of summons to indictment returned on August 18, 2005, by federal grand jury in Chicago was granted — B, another stakeholder, vigorously opposed attornment — Trial judge found receiver indicated that it had completed thorough analysis of issues arising from U.S. criminal proceedings as they related to RCL, receivership of RCL and stakeholders of RCL — Trial judge found two major stakeholders, H International Inc. and H Inc., advised that their view was that it was appropriate for receiver to have RCL attorn to U.S. criminal proceedings — Trial judge found receiver reached conclusion that it was appropriate to so attorn and to enter not guilty plea — Trial judge found appointment of receiver in April 2005 was on basis that old guard, B, and his colleague, R, were out as to control of RCL, and receiver, as new guard, was completely in control — Trial judge found receiver must zealously safeguard interests of legitimate stakeholders, including U.S. Department of Justice and those for whom it was responsible for protecting — B appealed — Receiver brought application to quash appeal — Application granted; appeal quashed and leave to appeal refused — No leave to appeal as of right existed, as no future rights were at issue as contemplated by s. 193 of Bankruptcy and Insolvency Act — No future rights of U.S. Attorney affected — Merely advancing claim does not create future right — No realistic possibility of success on appeal — Receiver has broad discretion to direct actions of business subject to its authority.

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Generally — referred to

s. 193 — considered

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s. 193(a) — considered

s. 193(b) — referred to

s. 193(c) — referred to

s. 193(d) — referred to

s. 193(e) — considered

s. 195 — referred to

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

APPLICATION by receiver to quash appeal of shareholder from judgment reported at *Ravelston Corp., Re* (2005), 2005 CarswellOnt 4907 (Ont. S.C.J. [Commercial List]), granting receiver's application for authorization of direction to accept service of indictment.

***Doherty J.A.*:**

I

1 The receiver, R.S.M. Richter Inc. ("Richter") seeks an order quashing an appeal brought by Lord Conrad Black ("Black") as of right from the order of Farley J. Black resists the motion to quash and, by way of alternative, seeks leave to appeal the order of Farley J. Black's application for leave to appeal need be considered only if Richter successfully quashes Black's appeal.

2 I would hold that Black does not have a right of appeal and would quash his appeal. I would refuse leave to appeal.

II

3 In April 2005, Ravelston Corporation Limited ("RCL") was placed into receivership in proceedings taken under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") and the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). Richter was appointed receiver/monitor with wide powers to manage the affairs of the company. In making the order, Farley J. indicated that Black and others had resigned as officers and directors of RCL and that the objective of the proceedings was to place RCL (and associated entities) under the control of a court appointed officer:

> The draft orders are to be adjusted to make it absolutely clear that the old guard (Black and Radler — and any other officer and director including Messrs. White and Boultbee) are "out" — out in the sense of not being able to, directly or indirectly, pull any of the strings and that Richters as an officer of the court, responsible to the court and the stakeholders of the applicants, is "in" — in in the sense of being able to pull all the strings and thereby direct the fortunes, business and affairs of the applicants.

4 Richter has filed a series of reports with the Superior Court summarizing its activities since April 2005. Various stakeholders have raised issues before Farley J. and he has made several orders in the course of his ongoing supervision of the insolvency proceedings.

5 On August 18, 2005, a federal grand jury in Chicago, Illinois indicted RCL and others on fraud charges. RCL has no assets or place of business in the United States. It is currently engaged in civil litigation in Illinois. In its Ninth Report filed on September 16, 2005, Richter outlined the issues raised by the criminal proceedings against RCL in federal court

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in the United States and advised Farley J. that it needed more time to formulate recommendations as to what steps, if any, RCL should take in response to the indictment.

6 On September 28, 2005, Richter filed its Tenth Report with Farley J. That report contains a detailed examination of the legal, practical and "special" considerations that Richter had evaluated in formulating RCL's proposed response to the criminal charges in the United States federal court. Richter concluded that it should accept service of the summons in the criminal proceedings on RCL's behalf, voluntarily appear in those proceedings and plead not guilty to the charges. Richter set out several reasons for its recommendation. It then moved before Farley J. for an order allowing it to accept service of the summons, appear in the U.S. federal court, and enter a not guilty plea on behalf of RCL. Richter was supported on the motion by various stakeholders, including Hollinger International Inc. and Hollinger Inc. Black, whose control over RCL had been terminated by the receivership, but who remained a shareholder and creditor, opposed the receiver's motion. His was the only opposition.

7 On the motion, counsel for Black argued that under the terms of the relevant American "long arm" statute, RCL could not be served with a criminal summons because RCL had no place of business in the United States. Counsel further contended that absent proper service of the summons on RCL, the U.S. federal court had no jurisdiction to proceed against RCL. Counsel urged Farley J. to find that it could not be in the best interests of any of the RCL stakeholders for RCL to attorn to the federal court's jurisdiction, thereby opening itself to potential additional criminal charges and massive penalties, when under the applicable American statute, the American criminal court could not exercise jurisdiction over RCL absent attornment.

8 The Tenth Report prepared by Richter was the only material before Farley J. on the motion. As I understand the submissions before Farley J., no objection was taken to the facts outlined in the report or the relevance of the various factors identified by Richter in reaching its conclusion as to the appropriate response by RCL to the American indictment.

9 Farley J. made the order sought by Richter. In doing so, he said:

> The Receiver has had the opportunity of a thorough analysis, assisted by its Canadian counsel, but importantly by its U.S. counsel, and it has concluded that on balance it would be appropriate to attorn and plead not guilty; and further that that would be the right and proper thing to do and that it would likely be to the advantage of the estate. I see no reason to quarrel with or second guess that considered analysis ...

10 Black appealed the order of Farley J. He relied on s. 193(a) of the *BIA*, which provides a right of appeal from an order "if the point at issue involves future rights". Alternatively, if s. 193(a) was inapplicable, Black applied for leave to appeal under s. 193(e) of the *BIA*.

11 Pursuant to s. 195 of the *BIA*, the filing of the Notice of Appeal stayed the order under appeal. If Black is found not to have a right of appeal, but is granted leave to appeal, the granting of leave also stays the order. RCL has not yet attorned to the jurisdiction of the U.S. federal criminal court.

III

The motion to quash

12 Richter, supported by Hollinger Inc. and Hollinger International Inc., argues that the order of Farley J. does not involve future rights and therefore does not provide an automatic right of appeal pursuant to s. 193 (a). If Richter's submission is correct, the appeal must be quashed for want of jurisdiction.

13 In addition to a right of appeal where the issue "involves future rights" under s. 193(a), ss. 193(b), (c) and (d) provide a right of appeal in a variety of other circumstances. Black does not rely on any of these provisions and I need

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not set them out here. There does not appear to be any unifying principle underlying the situations in which an appeal lies as of right via s. 193 of the *BIA*.

14 The specific rights of appeal granted under s. 193 of the *BIA* are combined with s. 193(e), which provides for appeals where leave is granted by a judge of the Court of Appeal. Leave may be granted from any order made under the *BIA* on any ground.

15 By combining limited specific rights of appeal with a broad power to appeal with leave, s. 193 of the *BIA* both allows access to the appeal court on meritorious appeals and limits the availability of multiple appeals in ongoing insolvency proceedings where those appeals would inevitably delay and fracture the proceedings.

16 The *BIA* does not provide any definition of the phrase "future rights". As with any exercise in statutory interpretation, the words must be read in their entire context, in their grammatical and ordinary sense, and in keeping with the scheme and object of the Act: *Rizzo & Rizzo Shoes Ltd., Re* (1998), 154 D.L.R. (4th) 193 (S.C.C.) at para. 21; *Bell ExpressVu Ltd. Partnership v. Rex* (2002), 212 D.L.R. (4th) 1 (S.C.C.) at para. 26.

17 Earlier cases such as *Amalgamated Rare Earth Mines Ltd. (No. 2), Re* (1958), 37 C.B.R. 228 (Ont. C.A.) that would give the phrase "future rights" a "wide and liberal interpretation" are inconsistent with the contemporary approach to statutory interpretation. These cases also take the interpretation of "future rights" from earlier insolvency cases. Those earlier cases were, however, interpreting insolvency legislation that did not grant any right of appeal from orders made in insolvency proceedings, but only provided for appeal with leave from specific orders, including orders "involving future rights". It was within the context of statutory provisions that provided only a limited right of appeal with leave that the courts gave a wide and generous reading to the phrase "future rights". Any other reading could have closed the appeal court door on many meritorious appeals. Under the scheme of appeals set out in the present *BIA*, there is no need to give the phrase "future rights" a broad meaning to ensure that meritorious appeals can be heard. [1]

18 The meaning of the phrase "future rights" is not obvious. Caselaw holds that it refers to future legal rights and not to procedural rights or commercial advantages or disadvantages that may accrue from the order challenged on appeal: *Ditchburn Boats & Aircraft (1936) Ltd., Re* (1938), 19 C.B.R. 240 (Ont. C.A.), at 242; *Dominion Foundry Co., Re* (1965), 52 D.L.R. (2d) 79 (Man. C.A.), at 84. Rights that presently exist, but may be exercised in the future or altered by the order under appeal are present rights and not future rights: *Simonelli v. Mackin* (2003), 320 A.R. 330 (Alta. C.A. [In Chambers]) at paras. 9-11 (C.A., Wittmann J.A. in chambers); *Fiber Connections Inc. v. SVCM Capital Ltd.* (2005), 10 C.B.R. (5th) 201 (Ont. C.A. [In Chambers]) at paras. 11-12 (Ont. C.A., Armstrong J.A. in chambers); *Devcor Investment Corp., Re* (2001), 277 A.R. 93 (Alta. C.A.) at para. 7 (C.A., Picard J.A. in chambers).

19 A definition of the phrase "future rights" appears in the judgment of McGillivray C.J.A. in *Elias v. Hutchison* (1981), 121 D.L.R. (3d) 95 (Alta. C.A.), at 100-101:

> A right in a legal sense exists when one is entitled to enforce a claim against another or to resist the enforcement of a claim advanced by another. A present right exists presently; a future right is inchoate in that while it does not now exist, it may arise in the future. For the adjective "future" to have any meaning, it cannot refer to that which presently exists. ...
>
> To give "future" the meaning that includes that which a litigant may obtain by success in litigation in the future is to say that a right of appeal exists in all cases. Any claim advanced is, in that sense, a future right to a judgment which does not yet exist. It would seem to me for para, (a) of s. 163 [now 193] to have any meaning that it must refer to rights which could not at the present time be asserted but which will come into existence at a future time
>
> [emphasis added].

Elias has been repeatedly cited with approval in various appellate courts: see e.g. *TFP Investments Inc. (Trustee of) v. Singhal* (1991), 44 O.A.C. 234 (Ont. C.A.), at 236 (Catzman J.A. in chambers).

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20 Black does not argue that the order of Farley J. involves the future rights of RCL. That order directs RCL to attorn to the jurisdiction of the American court and to plead not guilty to the outstanding indictment. RCL clearly had the right to appear in answer to the criminal allegations and enter a plea after the grand jury had returned the indictment against RCL. The order of Farley J. does not affect RCL's future rights, but rather tells RCL how it should exercise its present rights.

21 Counsel for Black also does not argue that his future rights are affected by the order.

22 Counsel does argue that the future rights of the American prosecutor (the U.S. Attorney) who Farley J. has held to be a stakeholder in the insolvency proceedings, are affected by the order. Counsel contends that the U.S. Attorney presently has no right to proceed against RCL in the U.S. criminal proceedings, but that an order directing RCL to attorn would give the U.S. Attorney the right to proceed against RCL in the future.

23 The order of Farley J. may impact on the right of the U.S. Attorney to proceed against RCL, but it does not involve any future right of the U.S. Attorney. The U.S. Attorney's rights against RCL, including its right to proceed if RCL attorns to the jurisdiction, existed when Farley J. made his order. His order may remove an impediment to the U.S. Attorney's proceeding against RCL, but that does not make the U.S. Attorney's right to proceed a future right. I would analogize this to a situation where a litigant needs leave to pursue a civil proceeding in the insolvency context. An order granting leave does not create the right to sue which existed all along, but merely removes an impediment to the exercise of that right: see *Simonelli*, *supra*, at paras. 9-11.

24 As I have rejected the submission that the order of Farley J. involves the future rights of the U.S. Attorney, I need not decide whether Black can rely on the future rights of another stakeholder to gain a right of appeal. I leave that question for another day.

25 The order of Farley J. does not involve future rights. The appeal must be quashed.

IV

The leave to appeal application

26 Having concluded that Black has no right of appeal, I turn to his application for leave to appeal. In seeking leave, Black argues that Farley J.'s exercise of his discretion directing RCL to attorn to the jurisdiction of the American court was based on a misinterpretation of the relevant American statute. He contends that the proper interpretation of that statute raises a significant legal question upon which leave to appeal should be granted under s. 193(e) of the *BIA*.

27 As indicated above, s. 193(e) permits leave to appeal from any order on any issue that the court determines warrants leave to appeal. There are no statutory criteria governing the granting of leave. Appellate courts, using different formulations, have identified various factors that should be addressed when deciding whether to grant leave under s. 193(e) of the *BIA*. The cases recognize, however, that the granting of leave to appeal is an exercise in judicial discretion that must be case-specific, and cannot be completely captured in any single formulation of the relevant criteria: see e.g. *Baker, Re* (1995), 22 O.R. (3d) 376 (Ont. C.A. [In Chambers]), at 381 (C.A., Osborne J.A. in chambers); *Fiber Connections Inc. v. SVCM Capital Ltd.*, *supra*, at para. 19; *GMAC Commercial Credit Corp. - Canada v. T.C.T. Logistics Inc.*, [2003] O.J. No. 5761 (Ont. C.A. [In Chambers]) (C.A., Feldman J.A. in chambers).

28 The inquiry into whether leave to appeal should be granted must, however, begin with some consideration of the merits of the proposed appeal. If the appeal cannot possibly succeed, there is no point in granting leave to appeal regardless of how many other factors might support the granting of leave to appeal.

29 A leave to appeal application is not the time to assess, much less decide, the ultimate merits of a proposed appeal. However, the applicant must be able to convince the court that there are legitimately arguable points raised so as to

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create a realistic possibility of success on the appeal. Granting leave to appeal if the merits fall short of even that relatively low bar would be a waste of court resources and would needlessly delay and complicate insolvency proceedings.

30 In *Canadian Airlines Corp., Re* (2000), 261 A.R. 120 (Alta. C.A. [In Chambers]) at para. 35, Wittmann J.A. (in chambers) was faced with an application for leave under the *CCAA*. He referred to earlier cases which had listed four criteria for the granting of leave, one of which was that "the appeal is *prima facie* meritorious". He described the necessary merits inquiry in this way:

> ... There must appear to be an error in principle of law or a palpable and overriding error of fact. Exercise of discretion by a supervising judge, so long as it is exercised judicially, is not a matter for interference by an appellate court, even if the appellate court were inclined to decide the matter another way. It is precisely this kind of a factor which breathes life into the modifier "*prima facie*" meritorious.

31 I think the same level of merits inquiry is warranted on an application for leave to appeal under the *BIA*. I would describe an appeal which raises an apparent error in law or apparent palpable and overriding factual error as an appeal that has a realistic possibility of success.

32 The court need address the other matters relevant to the exercise of its discretion on a leave to appeal application only if the applicant demonstrates that the appeal has *prima facie* merit. I do not reach those other considerations on this motion.

33 Black's proposed appeal focuses on two aspects of the reasons of Farley J. He submits that Farley J. erred in holding that the applicable U.S. federal legislation contemplated service of a summons in a criminal matter on RCL even though RCL had no assets or a place of business in the United States. Black also contends that at most, Farley J. should have directed Richter to enter an appearance in the federal court in the United States solely for the purpose of contesting the jurisdiction of that court. An appearance limited to the jurisdictional issue would have permitted RCL to determine whether in fact the American court had jurisdiction without attorning to that jurisdiction.

34 The federal prosecutor's right to effect service of a summons on RCL in Canada was canvassed in Richter's Tenth Report:

> The Receiver has been unable to determine the existence of any U.S. judicial decision that confirms the effectiveness of service of a summons outside the United States. Given the language of the Federal Rules of Criminal Procedure 4(c) (Fed. R. Crim. P. 4(c)), the uncertainty of the language of the MLAT [Mutual Legal Assistance in Criminal Matters Treaty], the absence of any apparent practice of serving an originating process for criminal prosecution under the MLAT, and the lack of any U.S. caselaw to support effective service *ex juris* of an originating criminal process, it appears to the Receiver that the U.S. Attorney's Office would have significant difficulty effecting service, in Canada, on the Receiver or RCL
>
> [emphasis added]. ...

35 Richter did not put forward a definitive interpretation of the relevant U.S. legislation. Nor did it rest its advice that RCL should attorn to the U.S. federal jurisdiction on its interpretation of any American legislation. Richter referred to the possibility of service under the legislation, and to several other possible ways that a U.S. federal court might find that it had jurisdiction over RCL. Richter concluded that the question of the court's criminal jurisdiction over RCL raised several difficult legal issues that would have to be litigated to be resolved. Richter believed that the litigation would be lengthy and expensive and the outcome uncertain.

36 Richter did not limit its analysis to the possible bases upon which the U.S. prosecutor might successfully assert that the U.S. federal court had jurisdiction over RCL. Richter considered practical factors including the benefits that might inure to RCL through cooperation with the U.S. authorities. Richter also addressed what it called "special circumstances"

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that arose because of Richter's status as a court appointed receiver. When referring to these "special considerations", Richter observed:

> A receiver has a further duty to consider and respect the interests of comity between this Honourable Court and the U.S. Court, and the public's interest in the administration of justice generally.

37 Black argues that Farley J. misconstrued the American legislation that provides for the service of a summons on a corporation in a criminal matter. Black contends that on a plain reading of the statute and its accompanying commentary, it is crystal clear that since RCL had no place of business in the United States, it could not be served with a summons requiring it to appear in a criminal proceeding in federal court in the United States. Black maintains that Farley J. found that RCL could be served under the relevant statute and that this led him to accept Richter's recommendation that RCL should attorn to the American jurisdiction.

38 Farley J. did not decide whether RCL could be served with a summons under the relevant American legislation. He referred to counsel for Black's interpretation of the legislation and identified what he considered to be weaknesses in the argument advanced by counsel. He did not ultimately accept or reject counsel's contention.

39 It was unnecessary for Farley J. to come to any conclusion as to the proper meaning of the American legislation. He based the exercise of his discretion on the absence of any reason to "quarrel with or second guess" Richter's analysis. That analysis included, but was not limited to, Richter's assessment of the U.S. Attorney's ability to effectively summons RCL in answer to the charges. Farley J. did not make the order he did because he was satisfied that RCL could be properly summonsed under the American legislation, but because he was satisfied that Richter had done its job as the court appointed receiver and there was no reason for the court to interfere with Richter's judgment as to RCL's best course of conduct.

40 Receivers do not often have to decide whether to attorn to the criminal jurisdiction of a foreign court on behalf of those in receivership. While the specific decision Richter had to make was an unusual one, it was not essentially different from many decisions that receivers must make. Receivers will often have to make difficult business choices that require a careful cost/benefit analysis and the weighing of competing, if not irreconcilable, interests. Those decisions will often involve choosing from among several possible courses of action, none of which may be clearly preferable to the others. Usually, there will be many factors to be identified and weighed by the receiver. Viable arguments will be available in support of different options. The receiver must consider all of the available information, the interests of all legitimate stakeholders, and proceed in an evenhanded manner. That, of course, does not mean that all stakeholders must be equally satisfied with the course of conduct chosen by the receiver. If the receiver's decision is within the broad bounds of reasonableness, and if it proceeds fairly, having considered the interests of all stakeholders, the court will support the receiver's decision. Richter's Tenth Report demonstrates that it fully analyzed the situation at hand before arriving at its decision as to RCL's best course of conduct.

41 The second argument made by Black that Farley J. should have at least limited RCL's appearance to a challenge of the American federal court's jurisdiction fails for the same reason as his first argument. Richter was aware of this option. The determination that RCL should attorn and plead not guilty reflected its considered opinion that RCL had much to lose should it engage in and ultimately lose a jurisdictional fight with the U.S. Attorney. Richter also properly took into account its court appointed status in deciding against a jurisdictional battle with the U.S. Attorney. Finally, Richter weighed the views expressed by other stakeholders, particularly Hollinger Inc. and Hollinger International, the principal stakeholders. All stakeholders save Black wanted RCL to attorn to the American jurisdiction.

42 I see no viable argument that Farley J. erred in principle in the exercise of his discretion. There is no realistic possibility that Black could succeed on appeal were leave to appeal granted. I would refuse leave to appeal.

V

Conclusion

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43 I would quash the appeal brought by Black and refuse leave to appeal.

44 The successful parties, Richter, Hollinger Inc., and Hollinger International, are entitled to their costs on a partial indemnity basis. As the two motions were closely related, one order of costs is appropriate. Counsel for the successful parties will have five days from the release of these reasons to provide written submissions of no more than five pages. Black will have five days from receipt of those submissions to respond with written submissions of no more than five pages.

***S. Borins J.A.*:**

I agree

***H.S. LaForme J.A.*:**

I agree

Application granted.

Footnotes

1 The earlier insolvency legislation which provided for leave to appeal from orders involving future rights was in issue in *Clarke v. Union Fire Insurance Co.* (1886), 13 O.A.R. 268 (Ont. C.A.), at 294 -95; *J. McCarthy & Sons Co., Re* (1916), 32 D.L.R. 441 (Ont. C.A.), at 442 -43. Those cases were in turn cited with approval in cases such as *Amalgamated Rare Earth Mines Ltd. (No. 2), Re*, *supra*, without reference to the important difference in the rights of appeal created by the relevant legislation.

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TAB 4

Most Negative Treatment: Distinguished
Most Recent Distinguished: Pan Canadian Mortgage Group Inc. v. 679972 B.C. Ltd. | 2014 BCCA 113, 2014 CarswellBC 753, [2014] B.C.W.L.D. 2201, [2014] B.C.W.L.D. 2298, 42 R.P.R. (5th) 25, [2014] 6 W.W.R. 264, 59 B.C.L.R. (5th) 290, 371 D.L.R. (4th) 430, 10 C.B.R. (6th) 54, 239 A.C.W.S. (3d) 795, 353 B.C.A.C. 83, 603 W.A.C. 83 | (B.C. C.A., Mar 24, 2014)

2008 BCSC 897
British Columbia Supreme Court [In Chambers]

bcIMC Construction Fund Corp. v. Chandler Homer Street Ventures Ltd.

2008 CarswellBC 1421, 2008 BCSC 897, [2008] B.C.W.L.D. 5281, [2008] B.C.W.L.D. 5336, [2008] B.C.W.L.D. 5337, [2008] B.C.W.L.D. 5338, [2008] B.C.W.L.D. 5414, [2008] B.C.J. No. 1297, 169 A.C.W.S. (3d) 102, 44 C.B.R. (5th) 171, 72 R.P.R. (4th) 68, 86 B.C.L.R. (4th) 114

bcIMC Construction Fund Corporation (Petitioner) and Chandler Homer Street Ventures Ltd., Chandler Development Group Inc., Mark Chandler, Cooper Pacific II Mortgage Investment Corporation, P3 Holdings Inc., 636455 B.C. Ltd., Lower Mainland Steel (1998) Ltd., Susan Richards Investments Ltd., Susan Freeman, and Theodore Freeman a.k.a. Ted Freeman (Respondents)

bcIMC Speciality Fund Corporation (Petitioner) and Cook and Katsura Homes Inc., Chandler Katsura Developments Inc., Mark Chandler, Chandler Development Group Inc., 636455 B.C. Ltd., BCMP Mortgage Investment Corporation, Susan Richards Investments Ltd., Theodore Freeman a.k.a. Ted Freeman, and Susan Freeman (Respondents)

Burnyeat J.

Heard: March 27, 2008; April 14, 2008; May 29, 2008; June 9, 2008
Judgment: July 9, 2008 *
Docket: Vancouver H070700, H070699

Counsel: D.D. Nugent for Petitioner
H.M.B. Ferris for Bowra Group Inc., Receiver & Manager of Chandler Homer Street Ventures Ltd., Cook & Katsura Homes Inc.
S.R. Andersen for Farouk Ratansi, Salim Jiwa, Sui Chun Chao-Dietrich
G.J. Gehlen for 636455 B.C. Ltd.
A.H. Brown for Crestmark Holdings Corp.

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

Related Abridgment Classifications
Bankruptcy and insolvency

V Bankruptcy and receiving orders
V.2 Effect of order

Contracts

XIV Remedies for breach
XIV.4 Specific performance

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XIV.4.c Availability in particular contracts
XIV.4.c.x Sale of land

Debtors and creditors

VII Receivers
VII.3 Appointment
VII.3.c Validity of appointment

Debtors and creditors

VII Receivers
VII.6 Conduct and liability of receiver
VII.6.b Rights

Debtors and creditors

VII Receivers
VII.7 Actions involving receiver
VII.7.b Actions against receiver
VII.7.b.iii Miscellaneous

Remedies

III Specific performance
III.3 Availability in particular contracts
III.3.j Sale of land

Headnote

Debtors and creditors --- Receivers — Conduct and liability of receiver — Rights

In two foreclosure actions, receiver and manager was appointed of assets, undertakings and properties of developers, Chandler and Cook — Receiver was authorized, where "necessary and desirable," to enter into or cease to perform any of debtor's contracts, and to sell or otherwise dispose of debtor's property in ordinary course of business — After review of pre-sales that had been arranged by Chandler and Cook, receiver determined that certain contracts should be disclaimed as pre-sales, for many units were significantly below current market value — Receiver applied for directions to disclaim these contracts, or to allow it to sell strata lots involved at current market value free and clear of any obligation of Chandler or Cook that might arise under contracts on bases that discount contained in contracts constituted payment of pre-receivership unsecured claim, or that purchase price did not represent fair market value — Receiver had power to disclaim contracts — Court-appointed receiver and manager has ability to disclaim contracts, even though effect of doing so is that contract holder will have claim for damages — Receiver is not bound by existing contracts made by debtor unless it decides to be bound by them, and is not personally liable for performance of contracts entered into before receivership — Receiver should seek leave of court before disclaiming contracts — Duty to preserve goodwill of debtor is owed to that entity and not to its creditors — Ability to disclaim contracts applies even if party contracting with debtor has equitable interest as result of contract — Refusal to complete contracts was included within power given to receiver to cease part of business of Chandler and Cook — Contract holders did not have equitable interest in strata lots such that receiver should not be able to disclaim their contracts — Receiver was at liberty to disclaim contract in respect of which one contract holder had filed certificate of pending litigation — Specific performance was not available to contract holders — Receiver was directed to disclaim contracts or alternatively, to offer strata lots for sale at current market value free and clear of any obligation of Chandler and/or Cook that might arise under contracts with contract holders.

Bankruptcy and insolvency --- Receiving order — Effect of receiving order

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In two foreclosure actions, receiver and manager was appointed of assets, undertakings and properties of developers, Chandler and Cook — Receiver was authorized, where "necessary and desirable," to enter into or cease to perform any of debtor's contracts, and to sell or otherwise dispose of debtor's property in ordinary course of business — After review of pre-sales that had been arranged by Chandler and Cook, receiver determined that certain contracts should be disclaimed as pre-sales, for many units were significantly below current market value — Receiver applied for directions to disclaim these contracts, or to allow it to sell strata lots involved at current market value free and clear of any obligation of Chandler or Cook that might arise under contracts on bases that discount contained in contracts constituted payment of pre-receivership unsecured claim, or that purchase price did not represent fair market value — Receiver had power to disclaim contracts — Court-appointed receiver and manager has ability to disclaim contracts, even though effect of doing so is that contract holder will have claim for damages — Receiver is not bound by existing contracts made by debtor unless it decides to be bound by them, and is not personally liable for performance of contracts entered into before receivership — Receiver should seek leave of court before disclaiming contracts — Duty to preserve goodwill of debtor is owed to that entity and not to its creditors — Ability to disclaim contracts applies even if party contracting with debtor has equitable interest as result of contract — Refusal to complete contracts was included within power given to receiver to cease part of business of Chandler and Cook — Contract holders did not have equitable interest in strata lots such that receiver should not be able to disclaim their contracts — Receiver was at liberty to disclaim contract in respect of which one contract holder had filed certificate of pending litigation — Specific performance was not available to contract holders — Receiver was directed to disclaim contracts or alternatively, to offer strata lots for sale at current market value free and clear of any obligation of Chandler and/or Cook that might arise under contracts with contract holders.

Debtors and creditors --- Receivers — Actions by and against receiver — Actions against receiver

In two foreclosure actions, receiver and manager was appointed of assets, undertakings and properties of developers, Chandler and Cook — Receiver was authorized, where "necessary and desirable," to enter into or cease to perform any of debtor's contracts, and to sell or otherwise dispose of debtor's property in ordinary course of business — After review of pre-sales that had been arranged by Chandler and Cook, receiver determined that certain contracts should be disclaimed as pre-sales, for many units were significantly below current market value — Contract holder, Crestmark, applied for order that it be at liberty to commence action against Chandler, Cook, and receiver so that it could seek order for specific performance, certificate of pending litigation, and other relief in relation to contracts for units in Cook's project which it had agreed to purchase — Application dismissed — Contracts specified that any agreement resulting from acceptance of offer by Chandler and/or Cook created contractual rights only and not interest in land — Specific performance was not available to Crestmark — There was nothing which would allow court to conclude that receiver had adopted contract and agreed to perform pursuant to it — Accordingly, there could be no action against receiver for specific performance — Crestmark was at liberty to commence action against Chandler or Cook for damages, but not for specific performance — Crestmark had not met onus of establishing reasonable cause of action.

Remedies --- Specific performance — Availability in particular contracts — Sale of land

In two foreclosure actions, receiver and manager was appointed of assets, undertakings and properties of developers, Chandler and Cook — Receiver was authorized, where "necessary and desirable," to enter into or cease to perform any of debtor's contracts, and to sell or otherwise dispose of debtor's property in ordinary course of business — After review of pre-sales that had been arranged by Chandler and Cook, receiver determined that certain contracts should be disclaimed as pre-sales, for many units were significantly below current market value — Contract holder Crestmark applied for order that it be at liberty to commence action against Chandler, Cook, and receiver so that it could seek order for specific performance, certificate of pending litigation, and other relief in relation to contracts for units in Cook's project which it had agreed to purchase — Application dismissed — Contracts specified that any agreement resulting from acceptance of offer by Chandler and/or Cook created contractual rights only and not interest in land — Specific performance was not available to Crestmark — There was nothing which would allow court to conclude that receiver had adopted contract and agreed to perform pursuant to it — Accordingly, there

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could be no action against receiver for specific performance — Crestmark was at liberty to commence action against Chandler or Cook for damages, but not for specific performance — Crestmark had not met onus of establishing reasonable cause of action.

Debtors and creditors --- Receivers — Appointment — Validity of appointment

No notice to contract holders to appoint receiver and manager.

Table of Authorities

Cases considered by *Burnyeat J.*:

Abramowich v. Azima Developments Ltd. (1993), 34 R.P.R. (2d) 174, 86 B.C.L.R. (2d) 129, [1994] 2 W.W.R. 525, 35 B.C.A.C. 193, 57 W.A.C. 193, 1993 CarswellBC 348 (B.C. C.A.) — referred to

Ambassador Industries Ltd. v. Kastens (2001), 2001 BCSC 484, 2001 CarswellBC 927 (B.C. S.C. [In Chambers]) — referred to

Bayhold Financial Corp. v. Clarkson Co. (1991), 10 C.B.R. (3d) 159, 108 N.S.R. (2d) 198, 294 A.P.R. 198, (sub nom. *Bayhold Financial Corp. v. Community Hotel Co. (Receiver of)*) 86 D.L.R. (4th) 127, 1991 CarswellNS 33 (N.S. C.A.) — referred to

Behnke v. Bede Shipping Co. (1927), [1927] All E.R. Rep. 689, 96 L.J.K.B. 325, 136 L.T. 667, 43 T.L.R. 170, 71 Sol. Jo. 105, 17 Asp. Mar. Law Cas. 222, 32 Com. Cas. 134, [1927] 1 K.B. 649 (Eng. K.B.) — referred to

Buchanan v. Oliver Plumbing & Heating Ltd. (1959), [1959] O.R. 238, 18 D.L.R. (2d) 575, 1959 CarswellOnt 167 (Ont. C.A.) — referred to

CareVest Capital Inc. v. CB Development 2000 Ltd. (2007), 2007 BCSC 1146, 2007 CarswellBC 1771 (B.C. S.C. [In Chambers]) — considered

Central Trust & Safe Deposit Co. v. Snider (1915), [1916] 1 A.C. 266, 35 O.L.R. 246, 25 D.L.R. 410 (Ontario P.C.) — referred to

Cheema v. Chan (2004), 2004 BCSC 1342, 2004 CarswellBC 2476 (B.C. S.C. [In Chambers]) — referred to

Cornwall v. Henson (1899), [1899] 2 Ch. 710 (Eng. Ch. Div.) — referred to

DiGuilo v. Boland (1958), [1958] O.R. 384, (sub nom. *Di Guilo v. Boland*) 13 D.L.R. (2d) 510, 1958 CarswellOnt 102 (Ont. C.A.) — referred to

Enigma Investments Corp. v. Henderson Land Holdings (Canada) Ltd. (2007), [2008] 5 W.W.R. 763, 2007 BCSC 1379, 2007 CarswellBC 2132, 61 R.P.R. (4th) 277, 78 B.C.L.R. (4th) 120 (B.C. S.C.) — considered

Freevale Ltd. v. Metrostore (Holdings) Ltd. (1983), 47 P & CR 481, [1984] Ch. 199, [1984] 1 All E.R. 495, 81 L.S.G. 516, 128 S.J. 116, [1984] 2 W.L.R. 496 (Eng. Ch. Div.) — referred to

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International Paper Industries Ltd. v. Top Line Industries Inc. (1996), 20 B.C.L.R. (3d) 41, 2 R.P.R. (3d) 1, [1996] 7 W.W.R. 179, 135 D.L.R. (4th) 423, 76 B.C.A.C. 114, 125 W.A.C. 114, 1996 CarswellBC 1108 (B.C. C.A.) — considered

Kimniak v. Anderson (1929), 63 O.L.R. 428, [1929] 2 D.L.R. 904 (Ont. C.A.) — referred to

Lochson Holdings Ltd. v. Eaton Mechanical Inc. (1984), 55 B.C.L.R. 54, 33 R.P.R. 100, 52 C.B.R. (N.S.) 271, 10 D.L.R. (4th) 630, 1984 CarswellBC 572, 53 C.B.R. (N.S.) 177 (B.C. C.A.) — considered

Miller v. Howard (1914), 7 W.W.R. 627, [1915] A.C. 318, 20 B.C.R. 230, 22 D.L.R. 75, 1914 CarswellBC 309, 30 W.L.R. 112 (British Columbia P.C.) — referred to

Nesrallah v. Pagonis (1982), 1982 CarswellBC 172, [1982] 5 W.W.R. 175, 24 R.P.R. 200, 38 B.C.L.R. 112, 136 D.L.R. (3d) 762 (B.C. S.C.) — considered

New Skeena Forest Products Inc., Re (2005), 2005 BCCA 154, 2005 CarswellBC 578, (sub nom. *New Skeena Forest Products Inc. v. Hull (Don) & Sons Contracting Ltd.*) 210 B.C.A.C. 185, (sub nom. *New Skeena Forest Products Inc. v. Hull (Don) & Sons Contracting Ltd.*) 348 W.A.C. 185, (sub nom. *New Skeena Forest Products Inc. v. Don Hull & Sons Contracting Ltd.*) 251 D.L.R. (4th) 328, 9 C.B.R. (5th) 267, 39 B.C.L.R. (4th) 327 (B.C. C.A.) — considered

Newdigate Colliery Ltd., Re (1912), [1912] 1 Ch. 468 (Eng. Ch. Div.) — referred to

Norfolk v. Aikens (1989), 7 R.P.R. (2d) 235, 41 B.C.L.R. (2d) 145, 64 D.L.R. (4th) 1, [1990] 2 W.W.R. 401, 1989 CarswellBC 221 (B.C. C.A.) — referred to

Pope & Talbot Ltd., Re (May 29, 2008), Doc. Vancouver Registry No. S077839 (B.C. S.C. [In Chambers]) — considered

Romfo v. 1216393 Ontario Inc. (2006), 2006 CarswellBC 2731, 2006 BCSC 1648 (B.C. S.C.) — considered

Semelhago v. Paramadevan (1996), 1996 CarswellOnt 2737, 1996 CarswellOnt 2738, 197 N.R. 379, 3 R.P.R. (3d) 1, 28 O.R. (3d) 639 (note), 136 D.L.R. (4th) 1, 91 O.A.C. 379, [1996] 2 S.C.R. 415 (S.C.C.) — considered

St. James (Rural Municipality) v. Bailey (1956), 64 Man. R. 365, 7 D.L.R. (2d) 179, 1957 CarswellMan 6, 21 W.W.R. 1 (Man. C.A.) — considered

Strata Plan VIS2968 v. K.R.C. Enterprises Inc. (2007), 74 B.C.L.R. (4th) 89, 59 R.P.R. (4th) 183, 2007 CarswellBC 1243, 2007 BCSC 774 (B.C. S.C.) — referred to

Terra Nova Management Ltd. v. Halcyon Health Spa Ltd. (2006), 25 C.B.R. (5th) 199, 2006 CarswellBC 2565, 2006 BCCA 458, 58 B.C.L.R. (4th) 64 (B.C. C.A.) — considered

Rules considered:

Rules of Court, 1990, B.C. Reg. 221/90
R. 18A — referred to

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R. 47 — referred to

R. 50 — referred to

APPLICATION by receiver in two foreclosure actions for directions; APPLICATION by contract holder for liberty to commence action against receiver and developers for specific performance.

***Burnyeat J.*:**

1 These are foreclosure Actions. To date, no Orders Nisi have been granted. In both Actions, an order was made on November 28, 2007 appointing The Bowra Group Inc. as Receiver and Manager without security ("Receiver and Manager"), of all of the assets, undertakings and properties of Chandler Homer Street Ventures Ltd. ("Chandler") and Cook and Katsura Homes Inc. ("Cook"). As part of that Order, the Receiver and Manager was granted a number of powers including the ability to: "... manage, operate and carry on the business of the Debtor, including the powers to enter into any agreements, incur any obligations in the ordinary course of business, cease to carry on all or any part of other business, or cease to perform any contracts of the Debtor".

2 It was further provided in each of the Orders that:

> ... no proceeding or enforcement process in any Court or tribunal (each, a "Proceeding"), shall be commenced or continued against the Receiver except with the written consent of the Receiver or with leave of this Court.
>
> ... no Proceeding against or in respect of the Debtor or the Property shall be commenced or continued except with the written consent of the Receiver or with leave of this Court and any and all Proceedings currently under way against or in respect of the Debtor or the Property are hereby stayed and suspended pending further Order of this Court, provided, however, that nothing in this Order shall prevent any Person from commencing a Proceeding regarding a claim that might otherwise become barred by statute or an existing agreement if such Proceeding is not commenced before the expiration of the stay provided by this paragraph.

3 Each of the Orders also provided the Receiver and Manager was empowered and authorized but not obligated to do any of the following where the Receiver considered it "necessary or desirable":

> (2)(c) manage, operate and carry on the business of the Debtor, including the powers to enter into any agreements, incur any obligations in the ordinary course of business, cease to carry on all or any part other business, or cease to perform any contracts of the Debtor; ...
>
> (k) market any or all the Property, including advertising and soliciting offers in respect of the Property or any part or parts thereof and negotiating such terms and conditions of sale as the Receiver in its discretion may deem appropriate;
>
> (l) sell, convey, transfer, lease, assign or otherwise dispose of the Property or any part or parts thereof out of the ordinary course of business . . .
>
>> (ii) with the approval of this Court in respect of any transaction in which the purchase price [exceeds $10,000.00] or the aggregate purchase price exceeds [$10,000.00] ...
>
> (m) apply for any vesting order or other orders necessary to convey the Property or any part or parts thereof to a purchaser or purchasers thereof, free and clear of any liens or encumbrances affecting such Property; ...
>
> (s) take any steps reasonably incidental to the exercise of these powers.

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4 In both Actions, the Receiver and Manager now applies for "Directions" concerning either to disclaim certain contracts of purchase and sale ("Contracts") or to allow it to sell the strata lots involved at current market value free and clear of any obligation of Chandler or Cook that may arise under the Contracts on the bases that the discount contained in the Contracts constitutes payment of a pre-receivership unsecured claim or that the purchase price set out under the Contracts does not represent fair market value as at the date of those Contracts.

Background

5 Action H070699 relates to a 192 unit project in Yaletown ("Vancouver Project"). Action H070700 relates to two residential towers in Richmond ("Richmond Project"), being 9188 Cook Road ("Tower I") and 633 Katsura Road ("Tower II").

6 The Receiver and Manager has provided the following estimates of the present secured debt owing: (a) *Vancouver Project*: $59,800,000.00 (Petitioner); $1,000,000.00 (New Home Warranty provision); $1,000,000.00 (borrowings of the Receiver and Manager); $3,500,000.00 (second charge holder); $6,300,000.00 (third charge holder); $20,300,000.00 (fourth charge holder having a charge for this amount against both the Vancouver Project and the Richmond Project; (b) *Richmond Project*: $25,400,000.00 (Petitioner); $1,000,000.00 (New Home Warranty provision); $1,000,000.00 (borrowings of the Receiver and Manager); and $20,300,000.00 (second charge holder having a charge for this amount against both the Richmond Project and the Vancouver Project). The Receiver and Manager also estimates that the unsecured creditors claim $30,100,000.00 against the Vancouver Project and $32,300,000.00 against the Richmond Project. Approximately $30,000,000.00 of those amounts are said to be owing to the Respondent, Theodore Freeman a.k.a. Ted Freeman.

7 The Receiver and Manager estimates that the equity that will be available on Tower I of the Richmond Project will be $3,700,000.00 prior to the application of the debt owing under collateral security. The Receiver and Manager estimates that the equity that may be available on the Vancouver Project is $3,746,000.00 prior to the application of the debt owing under collateral security. Overall, the estimated shortfall to Gibrailt Capital under its *inter alia* charge after applying all equities available would be in the neighbourhood of $3,764,000.00.

8 There were a number of pre-sales on both the Vancouver Project and on the Richmond Project with those pre-sales occurring prior to the construction of the Projects. Because of escalating construction costs, it became apparent that the total purchase prices on the pre-sales were insufficient to allow the completion of the two Projects.

9 After a review of the pre-sales that had been arranged by Chandler and Cook, it was the opinion of the Receiver and Manager that certain Contracts should be disclaimed as the pre-sales for many of the Units were significantly below the current market value at the time of the Contracts, at the time of the appointment of the Receiver and Manager, and presently.

10 In agreements in place between the Petitioner and Chandler and between the Petitioner and Cook, the Petitioner required that there be a number of firm and binding pre-sale agreements in place and that these agreements achieve a certain minimum price determined by the Petitioner prior to providing construction financing being made available to Chandler and to Cook. Regarding the Vancouver Project, the Petitioner advised that it was prepared to advance funds and to give partial discharges of its security if the sales proposed by Chandler for units met the criteria set out in the charge of the Petitioner. The Mortgages of the Petitioner in place as against the Vancouver Project and the Richmond Project include the following provisions:

> **3.3 Prepayment**
>
> (a) When not in default, the Mortgagor may prepay the Principal Amount, in whole or in part, prior to the Balance Due Date.

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(b) Provided that:

(i) The Mortgagor is not in default in the payment of any amount owing to the Mortgagee hereunder;

(ii) The Lands have been subdivided by a strata plan approved by the Mortgagee and filed in the appropriate Land Title Office and separate titles have been issued for each lot or strata lot ("Strata Lot") created by the said strata plan;

(iii) The Mortgagor has entered into an unconditional bona fide agreement of purchase and sale for a Strata Lot created on the Lands with a purchaser or purchasers who are at arm's length to the Mortgagor and has provided the Mortgagee with a true copy of the agreement of purchase and sale; and

(iv) The Mortgagor has paid to the Mortgagee a partial discharge fee of $75.00 for each Strata Lot discharged from the charge of this Mortgage;

the Mortgagee will grant a partial discharge of this Mortgage from title to the Strata Lots so created upon payment of all interest due and payable to the date of payment and upon payment of 100% of the Net Sale Proceeds (hereinafter defined) for each of the Strata Lots, less Extra Costs (hereinafter defined) paid for by the Purchaser over and above the gross sale price of each of the Strata Lots. "Net Sale Proceeds" means the gross arm's length sale price of an individual Strata Lot less the aggregate of the following:

A. Any net GST included within the gross sale price (i.e., GST payable less rebate to be received by the Mortgagor or a purchaser);

B. Real estate commissions;

C. Reasonable legal fees and disbursements and GST and PST applicable thereto of the Mortgagor's solicitor for acting for the Mortgagor on sales of Strata Lots;

D. Normal closing adjustments between a vendor and a purchase[r] of real estate;

together with the holdback which a purchaser of a strata lot is permitted to retain pursuant to the provisions of the ***Strata Property Act*** provided that this holdback is maintained in trust by the solicitor or notary public acting for the Purchaser or the Mortgagor on his or her undertaking to forward the holdback to the Mortgagor's solicitor once the purchaser authorizes its release, and the Mortgagor irrevocably authorizes and directs its solicitors to forward and remit such holdback(s) when received to the Mortgagee.

"Extra Costs" refers to items specifically requested and paid for by the purchaser and not included in the gross sale price of a Strata Lot.

(c) The Mortgagor shall not enter into an agreement of purchase and sale at prices less than the pro forma price list approved by the Mortgagee, without the prior approval of the Mortgagee, and the Mortgagee's obligation to provide a partial discharge of the Mortgage is conditional upon the sale prices for Strata Lots being not less than the prices listed in the price list (the "Price List") submitted by the Mortgagor to and approved by the Mortgagee or at such sale prices that the Mortgagee has approved in writing, provided that the sale price of each Strata Lot shall not be less than 95% of the listed price for such Strata Lot shown on the Price List.

11 The Petitioner takes the position that it is not prepared to grant partial discharges of its Mortgage relating to a number of the Contracts as they do not comply with that Mortgage provision. Partial discharges would be available where provisions of the Mortgage have been met.

12 The Contracts relating to these pre-sales all contained the same provisions. Those provisions include the following:

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8. Completion

The completion of the purchase and sale of the Strata Lot shall take place on a date (the "**Completion Date**") to be specified by the Vendor which is not less than ten business days after the Vendor or the Vendor's Solicitors notifies the Purchaser or the Purchaser's solicitor that:

(a) the City of Vancouver [or the City of Richmond] has given permission to occupy the Strata Lot; and;

(b) the Strata Plan in respect of the Development has been or is expected to be fully registered in the New Westminster/Vancouver Land Title Office prior to the Completion Date.

10. Delay

If the Vendor is delayed from completing the Strata Lot, depositing the Strata Plan for the Development in the Land Title Office or in doing anything hereunder as a result of fire, explosion or accident, howsoever caused, act of any governmental authority, strike, lockout, inability to obtain or delay in obtaining labour materials or equipment, flood, act of God, delay or failure by carriers or contractors, unavailability of supplies or materials, breakage or other casualty, unforeseen geotechnical conditions, climatic conditions, acts or omissions of third parties, interference of the Purchaser, or any other event beyond the control of the Vendor, then the time within which the Vendor must do anything hereunder, and the Purchaser's Termination Option Date will be extended for a period equivalent to such period of delay.

16. Risk

The Strata Lot is to be at the risk of the Vendor to and including the day preceding the Completion Date, and thereafter al the risk of the Purchaser and, in the event of loss or damage to the Strata Lot deemed material by the Vendor and occurring before such time by reason of fire, tempest, lightning, earthquake, flood, act of God or explosion, either party may, at its option, by written notice to the other party cancel this Agreement and thereupon the Purchaser will be entitled to repayment of the Deposit together with all interest accrued thereon and neither the Vendor nor the Purchaser shall have any further obligation hereunder. If neither party elects to cancel this Agreement, the Purchaser shall be entitled to an assignment of insurance proceeds in respect of the material loss or damage to the Strata Lot, if any. All other remedies and claims of the Purchaser in the event of such damage are hereby waived.

25. Assignment by Purchaser

The Purchaser may not assign or list for sale on MLS (Multiple Listing Service) the Purchaser's interest in this Agreement until all Deposits contemplated under this Agreement have been paid in full and thereafter may not list without the prior written consent of the Vendor,. No assignment by the Purchaser shall release the Purchaser from his/her obligations hereunder. This Agreement creates contractual rights only between the Vendor and the Purchaser and does not create an interest in the Strata Lot The Purchaser shall pay the Vendor an administration fee of $2,000 plus GST for any assignment of this Agreement or conveyance of the Strata Lot other than to the Purchaser named herein provided that the Vendor shall waive such fee for an assignment to a Spouse, child or parent of the Purchaser on receipt of evidence of such relationship satisfactory to the Vendor.

26. Liability of Purchaser

In the event of an assignment in accordance with section 25, the Purchaser will remain fully liable under the Agreement and such assignment will not in any way relieve the Purchaser of its obligations under this Agreement.

28. Contractual Rights Only

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This offer and the agreement which results from its acceptance creates contractual rights only and not any interest in land.

MPC Intelligence Inc. Report

13 The Receiver and Manager obtained a February 27, 2008 "Analysis" from MPC Intelligence Inc. ("MPC") relating to both Projects. The "Analysis" for the Vancouver Project and the "Analysis" for the Richmond Project contain the following "Forward":

The information provided in this pricing summary is intended for use by Bowra Group in the historical market analysis of the H&H development in Vancouver, BC and Garden City development in Richmond. This is not an appraisal. This report was prepared as an opinion of competitive conditions and is a past assessment of the market and the demand for such product. This is not an opinion of the market from a sales and marketing strategy perspective but a narrative of the previous climate and demand for the developments at time of launch.

All information and detail within the report is compiled through public sources or through the developers and property owners associated with each project. The data is deemed to be accurate at the time of assembly and delivery of the report. Every reasonable effort will be made to compile accurate and reliable information and the data contained within the report is deemed to be that. MPC Intelligence assumes no responsibility for inaccuracies provided by the developer, agents or other reporting parties.

14 The "Analysis" of MPC for the Vancouver Project was as follows:

... it is obvious that there are a selection of units that have been sold for well below the market value at the time. Determining the market value for a period of time starting almost two years ago is a difficult challenge because prices in the Downtown condo market have risen so quickly. It is also important to acknowledge the way that sales campaigns work. It is considered standard for prices on units to increase by anywhere from $15,000 to over $50,000 at the grand opening depending on the demand being shown by buyers. Any good sales & marketing company would also try to aggressively raise the prices during the weeks and months after the launch to try to earn more money for the developer. This does not mean that the units that were sold initially were under priced, as the overall market can shift quite quickly as was experienced when the Woodward's project sold out at $600/sq ft and instantly increased what all other projects could achieve.

From looking at the sales prices for units in the building we believe that overall, the building sold for fair market value. This backs up our initial perception from when it launched in 2006 and was considered to be achieving good pricing levels in that market. Since we have assumed that the majority of units in the building were sold at fair market value, the best way to determine which units were under priced is to compare them to similar units in the building that sold at roughly the same time. We have excluded any of the units that look like they were under priced by less than $20,000 because of the difficulty in reaching consensus on the value of these units.

15 The "Analysis" of MPC for the Richmond Project was as follows:

When analyzing the sale prices of the units at Garden City there does not appear to be many units that were sold below market values. Determining the market value for a period of time starting over two years ago is a difficult challenge because prices in the Richmond condo market have rose very quickly from 2005 to 2007. It is also important to acknowledge the way that sales campaigns work. It is considered standard for prices on units to increase by anywhere from $15,000 to over $50,000 at the grand opening depending on the demand being shown by buyers. Any good sales & marketing company would also try to aggressively raise the prices during the weeks and months after the launch to try to earn more money for the developer. The Richmond market is also unlike most of the other markets in the Lower Mainland when it comes to purchaser incentives. The Chinese buyer in this market almost always expects for there to be some sort of incentive or negotiation process to save money. This was seen

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in the second phase of Garden City with the first 20 buyers at the public grand opening receiving $5,000 off the purchase price along with no GST (4.48% value). This resulted in many of the units having credits of approximately $20,000 to $25,000. This is very typical in the Richmond market and is considered a cost of doing business.

From looking at the sales prices for units in the building we believe that overall, the building sold for fair market value. This backs up our initial perception from when it launched in 2005 and was considered to be achieving good pricing levels in that market. Since we have assumed that the majority of units in the building were sold at fair market value, the best way to determine which units were under priced is to compare them to similar units in the building that sold at roughly the same time. We have excluded any of the units that look like they were under priced by less than $20,000 because of the difficulty in reaching consensus on the value of these units.

16 It is clear that the two reports are not appraisals. It is the position taken on behalf of counsel for the pre-sale Contract holders that the reports are inadmissible. While I find that the reports are inadmissible for the truth of their contents, I admit them into evidence for the purpose of ascertaining the grounds upon which the Receiver and Manager is of the belief that the market value at the time of the Contracts or the current market value is such that the Receiver and Manager should be in a position to either disclaim the Contracts or to allow the sale of the strata lots involved free and clear of any obligation of Chandler and Cook that may arise under the Contracts.

Applications of the Receiver and Manager

17 Originally, the Receiver and Manager sought directions to disclaim 17 Contracts relating to the Vancouver Project and 10 Contracts relating to the Richmond Project. The Motion of the Receiver and Manager is now restricted to Strata Lots 12 and 85 of the Vancouver Project and Strata Lots 12, 46, 85, 92 and 95 of the Richmond Project. The Petitioner supports most of the applications of the Receiver and Manager. However, the Petitioner does not support the application of the Receiver and Manager to disclaim the Contract relating to Strata Lot 12 in the Vancouver Project as it is satisfied that the proposed purchase price met the minimum pre-sale criteria set in the agreement reached with Chandler.

(a) Contracts of Siu Chun Chao-Dietrich

18 Ms. Chao-Dietrich had Contracts relating to Strata Lot 46 in the Richmond Project and Strata Lot 85 in the Vancouver Project. Strata Lot 46 has been complete and ready for occupancy since late 2007. Strata Lot 85 in the Vancouver Project will not be completed until the Fall of 2008.

19 Ms. Chao-Dietrich is a former employee of Chandler and is a licensed realtor. Ms. Chao-Dietrich states that she was instrumental in arranging for the purchase by Cook of the land that later would be the site of the Richmond Project. By reason of her efforts, Ms. Chao-Dietrich claims to be entitled to a fee of $200,000.00 and that this fee remains unpaid. In a September 20, 2006 agreement with Chandler, Ms. Chao-Dietrich was to receive a further $100,000.00 "... for deferring paying the commission which you earned on July 16, 2007. The owed commission and compensate [sic] payment in total of $300,000.00 shall be discounted from the purchase price." In her March 25, 2008 Affidavit, Ms. Chao-Dietrich states that the purchase price for Strata Lot 46 of the Richmond Project was to be further reduced in order to reflect $34,800.00 in commissions on previous sales in that Project and $6,000.00 to reflect late closing expenses relating to the "...original unit of that she was to have obtained in satisfaction of the amount owing in respect of the commission".

20 Ms. Chao-Dietrich states that Chandler verbally agreed in March of 2006 that the net purchase price of $349,000.00 for Strata Lot 85 would be made available to her. In this regard, a $100,000.00 "decorating allowance" was provided to Ms. Chao-Dietrich so that the original offer of $449,000.00 with a $5,000.00 deposit became a net offer of $349,000.00. Though Ms. Chao-Dietrich states that the price was agreed to in March of 2006, the Contract was not signed until July 6, 2007.

21 It is the position of Ms. Chao-Dietrich that the discount was not a discount for "unpaid services" but, rather, was a price equal to a similar unit on a per square foot basis of a unit in the Vancouver Project sold to "Darren", another employee of Chandler. It is said that the units sold to "Darren" and to her reflected "employer's discount" given

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to employees. In this regard, Ms. Chao-Dietrich notes that the Receiver and Manager has not sought to disclaim the contract relating to that other unit even though that unit is of a comparable size. In a March 3, 2008 letter to the Receiver and Manager, Ms. Chao-Dietrich states: "in order to maintain the value of the Project, giving a decorating allowance instead of discounting off the purchase price seemed to be appropriate at the time".

22 It is the position of the Receiver and Manager that the market value for Strata Lot 85 at the time of the Contract was either $399,000.00 (based on the "Contract Analysis" prepared by MPC), or $424,000.00 (based on the comments relating to that unit prepared by a realtor advising the Receiver and Manager).

23 MPC gave the following "Analysis" relating to the market value of Strata Lot 85 at the time of the Contract:

Gross Selling Price $449,900	Net Selling Price $349,900	Incentives: $100,000

This unit was under priced because the identical unit one floor above (614) sold for $50,000 more when it sold six months previously. The market would have escalated in this time and there should only be a $5,000 discount for being located one floor below.

Estimated Market Value at time of Pre Sale	$429,900
Estimated Selling Discount	$80,000

24 Regarding Strata Lot 46 in the Richmond Project, Ms. Chao-Dietrich states that the purchase price was in the aggregate of $500,800.00 but that "Much of that consideration, however, was paid by way of set off of various commissions and interest stated to be owed by the vendor to the purchaser". After deductions, the remaining amount owing is stated to be $160,000.00. It is this amount which is shown as the sale price in the Contract. A deposit of $40,000.00 was paid in two instalments: $32,000.00 on September 20, 2006 and $8,000.00 on April 30, 2007. The Richmond Project is now complete. On August 21, 2007, Ms. Chao-Dietrich received a Notice of completion.

25 While it has not been accepted by the Receiver and Manager, the Receiver and Manager states that it has received an offer on Strata Lot 46 in the amount of $469,200.00.

26 MPC gave the following "Analysis" relating to the market value of Strata Lot 46 at the time of the Contract:

Gross Selling Price $160,000	Net Selling Price $160,000	Incentives: $0

This unit was severely under priced. An example why would be the unit below (801) selling for $283,620 more 10 months later. Another example is the unit beside it (908) which is the same plan but with a SE instead of SW exposure sold for $378,259 more than it sixteen months previous. It is assumed that unit 901 could have sold for somewhere near what 908 sold for with the increase in the market over the four months being balanced by the fact that the 08 units were more popular and commanded a higher value.

Estimated Market Value at time of Pre Sale	$417,900
Estimated Selling Discount	$257,900

27 An action for specific performance of the Contract and for damages in the alternative relating to Strata Lot 46 in the Richmond Project was commenced and Certificate of Pending Litigation No. BB0207241 was filed against the Richmond Project by Ms. Chao-Dietrich on March 7, 2008. Ms. Chao-Dietrich states that those steps were taken on the basis that: "The Receiver has indicated that he will not be completing the Contract." That action was commenced

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without the "written consent of the Receiver or with leave of this Court". There is no Motion before the Court that Ms. Chao-Dietrich be at liberty to commence or to continue that action.

(b) Contract of Wayne Nikitiuk Assigned to Salim Jiwa and Farouk Ratansi

28 This Contract relates to Strata Lot 12 in the Vancouver Project. This unit is presently unfinished and is not scheduled to be finished until the Fall of 2008. Originally, Wayne Nikitiuk made an offer of $649,000.00 (excluding GST) and provided a deposit of $64,900.00. Mr. Nikitiuk was given a $32,450.00 "decorating allowance" so that the "net" purchase price reflected in the Contract was $616,550.00 (excluding GST).

29 By a July 29, 2007 assignment of the Contract between Mr. Nikitiuk and Messrs. Ratansi and Jiwa and with the consent of Chandler, the Contract was assigned to Messrs. Ratansi and Jiwa. The price paid by Messrs. Ratansi and Jiwa for that assignment was $150,900.00 and that sum has been disbursed to Mr. Nikitiuk. It was a term of the consent of Chandler that $2,000.00 of the assignment price was paid by Mr. Nikitiuk to Chandler.

30 MPC gave the following "analysis" relating to the market value of Strata Lot 12 at the time of the Contract:

Gross Selling Price $649,000	Net Selling Price $616,500	Incentives: $32,450

This unit was under priced as it sold for $12,550 more than TH2 which was the same plan type but was located in the alley which should have been less desirable.

Estimated Market Value at time of Pre Sale	$649,000
Estimated Selling Discount	$32,450

31 The Petitioner does not support the application to disclaim the Contract as the Contract would net $616,550.00 and this price met the minimum pre-sale criteria set by the Petitioner. In seeking to disclaim the Contract, the Receiver and Manager is of the view that the current market value of Strata Lot 12 is $730,000.00.

(c) Contracts of Crestmark Holdings Corp.

32 Applying pursuant to Rules 47 and 50 of the *Rules of Court* and the inherent jurisdiction of the Court, Crestmark Holdings Corp. ("Crestmark") seeks an order that it be at liberty to commence an action against Chandler, Cook, and the Receiver and Manager so that it may seek an order for specific performance, a Certificate of Pending Litigation and related relief in relation to August 10, 2007 Contracts relating to Strata Lots 12, 85, 92, and 95 in the Richmond Project.

33 In July of 2007, Chandler contacted Edward Wong & Associates Realty Inc. ("Wong") requesting that Wong submit a marketing proposal for the unsold units in Tower I and Tower II in the Richmond Project. On July 18, 2007, Wong signed an Exclusive Listing Agreement relating to the Richmond Project ("Listing Agreement"). 37 units in Tower I and 50 units in Tower II were unsold at the time of the Listing Agreement. The term of the Listing Agreement was to end on November 30, 2008 but Chandler had the right to terminate the Listing Agreement after December 15, 2007 if Wong had not sold 20 units by that time.

34 In accordance with the agreement in place, the Petitioner advised Chandler that it was prepared to give partial discharges of its security providing sales of the Units met the criteria set out in the Mortgage including that the gross sale price of any units was not less than 95% of the list sale price approved by the Petitioner for each phase of the construction of each phase of the Richmond Project. The list prices relating to the Strata Lots in issue were as follows: (a) Strata Lot 12 ($534,900.00); (b) Strata Lot 85 ($379,900.00); (c) Strata Lot 92 ($384,900.00); and (d) Strata Lot 95 ($498,900.00).

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35 Chandler and Wong agreed to an amendment of the Listing Agreement which saw potential purchasers being offered a price discount of up to 10% off the then list price and a bonus of up to $250,000.00 to Wong. As at August 8, 2007, offers on 28 units had been received at prices discounted from between 6% to 10% and six units remained unsold. It is stated by Wong that all sales contracts showed the full list price with reductions recorded in the form of payment of cash or credit towards the purchase price on closing so that there would be no jeopardy to the pricing on the remaining unsold units.

36 In August, 2007, Chandler is stated to have requested that Wong purchase some units so that the goal of meeting the financial commitments set by the Petitioner could be met. It is stated that, as an additional incentive for Wong to purchase. A Mr. Aguirre on behalf of Chandler offered a 50% interest in his entitlement to purchase a unit in Tower II.

37 On August 10, 2007, Wong agreed through his company (Crestmark) to purchase four units with a 15% discount from the list price. Contracts were executed to reflect the following:

(a) Strata Lot 12 — gross sale price of $498,800.00 with a "decoration allowance" of $74,820.00 ($423,980.00 net) with a deposit of $5,000.00;

(b) Strata Lot 85 — gross sale price of $418,800.00 with a "decoration allowance" of $62,820.00 ($356,180.00 net) with a deposit of $5,000.00;

(c) Strata Lot 92 — gross sale price of $421,800.00 with a "decoration allowance" of $63,270.00 ($358,530.00 net) with a deposit of $5,000.00; and

(d) Strata Lot 95 — gross sale price of $513,800.00 with a "decoration allowance" of $77,070.00 ($436,730.00 net) with a deposit of $5,000.00.

38 In a February 12, 2008 letter to counsel for the Receiver and Manager, counsel for Crestmark stated:

> When construction of the Development was completed and our client received notice to close the purchase of the Units, [the] ... developer agreed to extend the closing date to November 30, 2007 "or within 5 business days after the Vendor has paid the commission bonus to Edward Wong & Associates Realty Inc. in an amount of $250,000.00 plus G.S.T. whichever occurs later". The bonus has not been paid, however our client is ready, willing and able to complete the purchase of the Units forthwith.

39 On August 22, 2007, Notices of Completion relating to Strata Lots 12, 85, 92 and 95 were issued. At that time, Wong asked for payment of his bonus under the amended Listing Agreement but was advised that, due to cash flow problems, the bonus could only be paid after the sale of all units in Tower I had been completed.

40 On October 11, 2007, a further addendum to the Listing Agreement was signed providing the following:

(a) "The Completion Date is to be extended to Nov 30, 2007 or within 5 business days after the vendor has paid the commission bonus to Edward Wong & Ass. Realty in an amount of $250,000.00 + GST whichever occurs later."

(b) "Upon closing, the Purchaser may elect to apply $62,500 + GST, being part commission ... due to Edward Wong & Asso. Realty Inc. ('EWA') towards the purchase price provided EWA authorizes to do so."

41 Crestmark states that it has now agreed to waive as a condition of closing its entitlement to apply the amount of the unpaid $250,000.00 bonus against the purchase price of the four Strata Lots and that it is ready, willing and able to complete the purchase of Strata Lots 12, 85, 92 and 95. In this regard, Edward Wong in his April 29, 2008 Affidavit states:

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> I agree to cause both of those companies [Wong and Crestmark] to sign any documentation that might be required to satisfy the Receiver and the Court that I am bound by that waiver and will pay the full purchase prices payable under the 4 agreements without the deduction of the bonus contemplated in the October [11, 2007] Addendum. .... While my preferred completion date is June 30, 2008, Crestmark is ready, willing and able to complete the purchase of Strata Lots 12, 85, 92 and 95 at any time. In my opinion, taking into account the value to ... [Cook] of the services I have already caused ... [Wong] to perform, it would be extremely unfair to allow the receiver to disclaim or refuse to close on the sales of Crestmark's 4 units.

42 In the circumstances, Crestmark requests that the Court lift the stay contained in paragraphs 6 and 7 of the November 28, 2007 Order to allow it to commence an action for specific performance relating to Strata Lots 12, 85, 92 and 95.

43 The Petitioner supports the application of the Receiver and Manager to disclaim the proposed sale of Strata Lots 12, 85, 92 and 95 to Crestmark as those sales are said not to meet the minimum pre-sale requirements set by the Petitioner. The Petitioner also states that: "Even if the sales are not disclaimed, ... [the Petitioner] will not be issuing partial discharges for them."

44 The MPC "Analysis" relating to the market value of Strata Lots 12, 85, 92 and 95 at the time of the Contracts was as follows:

Strata Lot 12	Gross Selling Price $649,000	Net Selling Price $616,500	Incentives: $32,450

This unit was under priced as it sold for $12,550 more than TH2 which was the same plan type but was located in the alley which should have been less desirable.

Estimated Market Value at time of Pre Sale	$649,000
Estimated Selling Discount	$32,450

Strata Lot 85	Gross Selling Price $418,800	Net Selling Price $355,980	Incentives: $62,820

This unit was under priced because the unit below it (1506) sold for only $5,875 less 27 months before. Another comparable is a 808sqft resale unit in the Seasons high-rise project a short distance away; #1606 — 5088 Kwantlen St that sold for $402,300 ($480/sqft) on Sept 5, 2007.

Estimated Market Value at time of Pre Sale	$419,900
Estimated Selling Discount	$63,920

Strata Lot 95	Gross Selling Price $513,800	Net Selling Price $436,730	Incentives: $77,070

This unit was under priced because the unit below it (1601) sold for $72,070 more than it four months before. It is assumed that 1701 should have been able to sell at a premium to 1601.

Estimated Market Value at time of Pre Sale	$519,900

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Estimated Selling Discount	$83,170

Strata Lot 92	Gross Selling Price $421,800	Net Selling Price $358,530	Incentives: $63,270

This unit was under priced because the unit two levels below it (1506) sold for only $8,426 less 27 months before. Another comparable is a 808sqft resale unit in the Seasons high-rise project a short distance away; #1606 — 5088 Kwantlen St that sold for $402,300 ($480/sqft) on Sept 5, 2007.

Estimated Market Value at time of Pre Sale	$425,900
Estimated Selling Discount	$67,370

45 While these offers have not been accepted by the Receiver and Manager as yet, the Receiver and Manager has now received offers as follows: (a) Strata Lot 12 ($519,200.00); and (b) Strata Lot 95 ($504,200.00).

Should Contract Holders Have Been Given Notice of the Application to Appoint the Receiver and Manager?

46 It is the submission of Crestmark that, because the proposed purchasers under the Contracts were not parties to this action and were not served or given notice of the application by the Petitioner to appoint the Receiver and Manager, the November 28, 2007 Order is not binding on them and does not affect any interest in the Property held by them. In this regard, Crestmark relies on the decisions in *Lochson Holdings Ltd. v. Eaton Mechanical Inc.* (1984), 55 B.C.L.R. 54 (B.C. C.A.) and *Terra Nova Management Ltd. v. Halcyon Health Spa Ltd.* (2006), 25 C.B.R. (5th) 199 (B.C. C.A.).

47 In *Lochson*, *supra*, the issue was whether Lochson as the holder of the first and second mortgages against property should be bound by an order allowing the borrowing powers of a receiver to have priority over the interest of Lochson when that order was granted to a subsequent charge holder. The Court concluded that, subject to three exceptions not applicable here, a prior charge holder must have notice of or consent to any application purporting to grant priority to the borrowing powers of a Receiver. Of similar effect Is the decision in *Terra Nova*, *supra*, where the Court dealt with the priority of the proposed remuneration of a receiver and concluded that, because a prior charge holder had no notice of the application to appoint a receiver and manager with borrowing powers of $5,000.00, it was not bound by the priority given in that order (at para. 14).

48 I am satisfied that the decisions in *Lochson* and *Terra Nova*, both *supra*, have no application to the position of Crestmark. First, Crestmark is not a secured creditor. Second, Crestmark only takes whatever interest it may have from Chandler.

49 Assuming Crestmark is an unsecured creditor, there was no obligation to join unsecured creditors as parties or to provide them with notice of an application to appoint a receiver and manager. Once appointed, one of the duties of a receiver and manager is to ascertain what creditors have claims, the amount of those claims, and the priority of those claims. That duty is fulfilled after and not before the appointment. The secured creditor applying to appoint a receiver and manager will not have knowledge of the identity of all unsecured creditors or of the amounts owing. It would be impossible for all unsecured creditors to be given notice of an application for the appointment of a receiver and manager.

50 Assuming Crestmark has an equitable interest, that interest is by way of an assignment of the equity of redemption that was retained by Chandler or Cook when those entities mortgaged their interest in the two Projects in favour of the Petitioner. The foreclosure proceedings seek declarations that, if a certain amount is not paid to redeem the charges against the two Projects, the interest of Chandler or Cook will be foreclosed as will the interest of any parties claiming under them. As potential purchasers of an interest that Chandler and/or Cook might have in the two Projects, Crestmark

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would be in a position to apply to approve the sale of a particular part of the property if it could be shown that their offer represented fair market value at the time their application was made. Alternatively, Crestmark could request that the Receiver and Manager apply to Court to have their offer approved or could place its offer before the Court if the Receiver and Manager applied to Court to approve an offer which, in the view of the Receiver and Manager, represented fair market value at the time the application was made.

51 Whether Crestmark is an unsecured creditor or is a creditor claiming an interest in land, it was only after the appointment of the Receiver and Manager that the Receiver and Manager would know for certain what Contracts were in place. There was no obligation on the Petitioner, on Chandler, or on Cook to notify Crestmark or any other holders of Contracts that an application was being made to appoint a Receiver and Manager. It was not necessary to join Crestmark or any other holders of Contracts as parties to these proceedings. The preliminary position taken by Crestmark is rejected.

52 Quite properly, the Receiver and Manager has notified the holders of the Contract that applications would be made to either disclaim the Contracts or allow the Receiver and Manager to sell the Strata Lots at the current market value free of any obligation of Chandler and Cook that might arise under the Contracts so that the holders of the Contracts would be bound by any Order made. Holders of Contracts were entitled to no other notice.

Can the Receiver and Manager Disclaim Contracts?

53 I have concluded that the Receiver and Manager has the power to disclaim these Contracts. In this regard, the learned author of *Bennett on Receiverships*, 2nd Ed. (Toronto — Carswell) states:

> In a court-appointed receivership, the receiver is not bound by existing contracts made by the debtor nor is the receiver personally liable for the performance of those contracts entered into before receivership. However, that does not mean the receiver can arbitrarily break a contract. The receiver must exercise proper discretion in doing so since ultimately the receiver may face the allegation that it could have realized more by performing the contract rather than terminating it or that the receiver breached the duty by dissipating the debtor's assets. Thus, if the receiver chooses to break a material contract, the receiver should seek leave of the court. The debtor remains liable for any damages as a result of the breach. (at p. 341)
>
> In the proper case, the receiver may move before the court for an order to breach or vary an onerous contract including a lease of premises or equipment. If the receiver is permitted to disclaim such a contract between the debtor and a third party, the third party has a claim for damages and can claim set-off against any moneys that it owes to the debtor. If the court-appointed receiver can demonstrate that the breach of existing contracts does not adversely affect the debtor's goodwill, the court may order the receiver not to perform the contract even if the breach would render the debtor liable in damages. If the assets of the debtor are likely to be sufficient to meet the debt to the security holder, the court may not permit the receiver to break a contract since, by doing so, the debtor would be exposed to a claim for damages. (at p. 342)

54 There are numerous decisions which establish the principle that a Court appointed receiver and manager has the ability to disclaim contracts even though the effect of doing so is that the contract holder will have a claim for damages against the company. In *New Skeena Forest Products Inc., Re* (2005), 39 B.C.L.R. (4th) 327 (B.C. C.A.), the issue was whether the receiver and manager was entitled to disclaim "executory contracts" and apply to approve a better offer. Braidwood J.A. with Oppal J.A. concurring stated:

> In a recent decision of the Alberta Court of Queen's Bench *Bank of Montreal v. Scaffold Connection Corp.*, [2002] A.J. No. 959, 2002 ABQB 706, Wachowich C.J.Q.B., in considering whether to grant a declaration to a receiver-manager that certain seating equipment would vest in the receiver free and clear of claims by a secured creditor, observed at para. 11:

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> > The law is clear to the effect that in a court-appointed receivership, the receiver is not bound by existing contracts made by the debtor: *Re Bayhold Financial v. Clarkson* (1991), 10 C.B.R. (3d) 159 (N.S.C.A.), *Bennett on Receivership*, 2d ed. (Toronto: Carswell, 1999) at 169, 341.
>
> (at para. 16)
>
> In another leading case, *Bayhold Financial Corp. v. Clarkson* (1991), 108 N.S.R. (2d) 198, 10 C.B.R. (3d) 159 (N.S.C.A.), the Nova Scotia Court of Appeal considered the content of the order appointing the receiver determinative of the receiver's powers, and rejected the proposition that a court cannot approve the repudiation of contracts entered into by a debtor prior to the receiver's appointment.
>
> The powers of the Receiver in this case are set out in the appointment order of 20 September 2004, in which Brenner C.J.S.C. included in clause 14, *inter alia*:
>
> > The Receiver be and it is hereby authorized and empowered, if in its opinion it is necessary or desirable for the purpose of receiving, preserving, protecting or realizing upon the Assets or any part or parts thereof, to do all or any of the following acts and things with respect to the assets, forthwith and from time to time, until further or other order of this Court:
> >
> > . . . . .
> >
> > > (c) *apply for any vesting Order* or Orders which may be necessary or desirable in the opinion of the Receiver in Order *to convey the Assets or any part or parts thereof to a purchaser or purchasers thereof free and clear of any security, liens or encumbrances* affecting the Assets ....
> >
> > [Emphasis added.]
>
> In my view, this clause is the end of the matter. The court's order contemplates a power in the Receiver to apply to court for a vesting order to convey the assets to a purchaser free and clear of the interests of other parties. That is what happened in this case, and no serious challenge was mounted to the equitable considerations Chief Justice Brenner took into account when deciding whether to grant the vesting order.
>
> (at paras. 19-21)

55 In the *Bayhold Financial Corp. v. Clarkson Co.* [1991 CarswellNS 33 (N.S. C.A.)] decision referred to, the Court dealt with a court appointed receiver and manager and the question of whether there was personal liability for breaching contracts entered into by the company prior to receivership. On behalf of the Court, Hallett J.A. referred to the decision in *Newdigate Colliery Ltd., Re*, [1912] 1 Ch. 468 (Eng. Ch. Div.) and stated:

> ... The *Newdigate* case is authority for the following valid proposition (p. 468):
>
> > It is the duty of the receiver and manager of the property and undertaking of a company to preserve the goodwill as well as the assets of the business, and it would be inconsistent with that duty for him to disregard contracts entered into by the company before his appointment.
>
> In that case, the receiver-manager of the undertaking and property of a colliery company wished to repudiate certain unfavourable forward contracts for the supply of coal. The court declined to approve of the repudiation as it would be inconsistent with the duty of the receiver-manager to preserve the goodwill of the business. However, the case is not authority for the proposition that the court cannot approve of the repudiation of such contracts and certainly not authority for the proposition that a failure to obtain authorization to close down a business results in personal liability of the receiver-manager to existing creditors who remain unpaid as a result of the assets of the debtors being insufficient to pay their claims. (at paras. 27-8)

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56 On the question of whether there was an obligation on the receiver and manager to honour contracts which were in existence prior to the receivership, Hallett J.A. stated:

> There is no doubt that the law requires a receiver-manager to preserve the goodwill of the business but that does not require that he perform all existing contracts. This is clear from the following passage from *Parsons v. Sovereign Bank of Canada* at pp. 170-171 [A.C.]:
>
> > The construction which their Lordships place on the correspondence is that the receivers and managers had intended to carry on the existing arrangements as long as possible without break in continuity, *but to make it clear that they reserved intact the power, which they undoubtedly possessed, later on to refuse to fulfil the contracts which existed between the company and the appellants*. That such a breach would give rise to claims for damages against the company which might lead to its winding up, or to counter-claims, although the claimants could not get at the assets in the hands of the receivers, was sufficient reason for the receivers and managers not desiring to put their powers in force. The inference is that as between the company and the appellants the contracts continued to subsist.
> >
> > [Emphasis added.]
>
> The duty to preserve "the goodwill" is primarily owed to the company in receivership rather than the creditors. The risk the receiver-manager runs in terminating pre-existing contracts is that to do so could diminish the goodwill and without obtaining approval the debtor might sue the receiver-manager for damages or the court might censure the receiver-manager for the manner in which the receivership was conducted, but a party who had contracted with the company in receivership prior to the receivership order being granted does not have a cause of action against the receiver-manager if the latter chooses not to honour pre-existing contracts.
>
> (at paras. 55-6)

57 In *The Matter of the Receivership of Pope & Talbot Ltd.* [*Pope & Talbot Ltd., Re* (May 29, 2008), Doc. Vancouver Registry No. S077839 (B.C. S.C. [In Chambers])] (Vancouver Registry: S077839), Brenner C.J.S.C. in oral reasons for judgment in chambers on May 29, 2008 stated:

> The power of a receiver to disclaim contracts is set out in Bennett on *Receiverships*, (2d) Toronto, Carswell 1999, at page 341, which was referred to by both sides in their submissions on this application. That extract states:
>
> > In a court-appointed receivership, the receiver is not bound by existing contracts made by the debtor, nor is the receiver personally liable for the performance of those contracts entered into before receivership.
>
> The paragraph goes on to outline the consequences of the steps that a receiver may choose to take.
>
> This extract was recently the subject of judicial consideration in the Court of Appeal decision, *New Skeena Forest Products Inc. v. Don Hill & Sons Contracting Ltd.*, 2005, BCCA 154. That judgment reaffirms the foreseeability of disclaimed contracts, even where the party contracting with the debtor has an equitable interest in a contract. In that case, apart from noting the authorities supporting the principle, Braidwood J. noted that the order appointing the receiver included a term granting the receiver the following power:
>
> > Apply for any vesting order or orders which may be necessary or desirable in the opinion of the Receiver in order to convey the assets or any part or parts thereof by a purchaser or purchasers thereof free and clear of any security, liens or encumbrances affecting the assets.
>
> In Braidwood J.A.'s opinion the foregoing clause determined the issue. (at paras. 17-8)

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58 I am satisfied that the decisions referred to establish the following propositions: (a) the Receiver and Manager is not bound by the Contracts of either Chandler or Cook entered into before the receivership unless it decides to be bound by them; (b) the Receiver and Manager should and did seek leave of the Court before disclaiming the Contracts; (c) Chandler and Cook will remain liable for any damages if the Contracts are disclaimed by the Receiver and Manager; (d) any duty to preserve the goodwill of Chandler and/or Cook is owed to those entities and not to the creditors of Chandler and Cook; (e) the ability to disclaim contracts applies even if the party contracting with the debtor has an equitable interest as a result of the contract; and (f) if a receiver and manager decides in its discretion to be bound by the contracts of a company entered into before the receivership, then the receiver and manager be liable for the performance of those contracts.

59 Ms. Chao-Dietrich and Messrs. Ratansi and Jiwa submit that the content of the Order appointing the Receiver is determinative of the powers available to the Receiver and Manager and that paragraph 2(c) of the Order only granted the Receiver and Manager the power to "... cease to perform any contracts of the Debtor". They submit that no performance was required under their Contracts until completion dates came into effect and that the completion dates for the purchase of Strata Lot 85 by Ms. Chao-Dietrich and the purchase of Strata Lot 12 by Mr. Jiwa and Mr. Ratansi in the Vancouver Project has not been set because the units remain unfinished. Regarding the completion date for Strata Lot 46 in the Richmond Project, Ms. Chao-Dietrich submits that the completion date was September 14, 2007, that she was ready willing and able at that time to complete the purchase, a caveat was filed when Chandler did not complete the sale, and an action seeking specific performance was commenced. In the absence of a power given to disclaim, it is the submission that the remedy that will be available for anticipatory breach of contract is both a specific performance and/or a mandatory injunction and only in the alternative, for damages.

60 While I am satisfied that the power available to the Receiver and Manager to cease to perform any Contracts is sufficient to allow the Receiver and Manager to apply to the Court to be at liberty to disclaim the Contracts, I also note that the submissions of Ms. Chao-Dietrich and Mr. Ratansi and Mr. Jiwa ignore a number of powers given to this Receiver and Manager including the power to "... cease to carry on all or any part other [sic — of the] business" of Chandler or Cook. The business of these two companies was to create, enter into contracts to sell, and to sell condominium units. The refusal to proceed to complete Contracts is included within the power given to the Receiver and Manager to cease part of the business of Chandler and Cook. The power to "cease to perform any contracts" includes the ability to advise Contract holders that the Receiver and Manager will not proceed to complete the sales contemplated by the Contracts. The ability to "market any or all of the Property", the ability to "sell, convey, transfer, lease, assign or otherwise dispose of the Property or any part or parts thereof" and the ability to "apply for any vesting order or other orders necessary to convey the Property or any part or parts thereof" must be taken to allow the Receiver and Manager to disclaim a Contract providing the Receiver and Manager seeks court approval to do so and providing the holders of the Contracts are notified of such an application.

61 I also note that paragraph 2(m) of the Orders appointing this Receiver and Manager is identical to the paragraph referred by the Chief Justice in *Pope & Talbot Ltd.*, *supra* and that it was this paragraph which was relied upon by the Chief Justice to conclude that the receiver there was in a position to disclaim an existing contract and proceed with an application to approve a different sale. In the circumstances, I am satisfied that the powers granted to this Receiver and Manager are sufficient to allow the Receiver and Manager to disclaim the Contracts.

62 The holders of the Contract also submit that the Receiver and Manager must maintain the goodwill of Chandler and Cook for their benefit. That submission cannot be maintained in view of the decision in *Bayhold Financial Corp.*, supra. Additionally, there is no goodwill to maintain here. First, it is clear that there will be a massive shortfall to one of the secured creditors even after both Projects have been completed and sold. Second, the unsecured debt is in excess of $30,000,000.00. Third, I anticipate that these companies were incorporated solely for the purpose of developing these two Projects so that the corporate entities will be abandoned by the shareholders once the Projects have been completed and the Units within the Projects sold.

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Do the Contract Holders Have an Equitable Interest?

63 Paragraph 28 of the Contracts is specific. Any offer made and the agreement which results from the acceptance of the offer by Chandler and/or Cook creates: "... contractual rights only and not any interest in land." A similar provision was considered by Myers J. in *Romfo v. 1216393 Ontario Inc.*, [2006] B.C.J. No. 2897 (B.C. S.C.) where the clause in issue stated that the purchaser "... acknowledges and agrees that the Purchaser: (a) will not have any claim or interest in the Strata Lot, the Development or the Property until the Purchaser becomes the registered owner of the Strata Lot, and (b) the Purchaser does not now have and will not have at any time hereafter notwithstanding any default of the Vendor, any right to register this Offer or the Agreement, or any part of or right contained in this Offer to the Agreement against the Strata Lot, the Development or the Property in the Land Title Office." The effect of this provision was not determined because the plaintiffs had argued that the developer was estopped from reliance on the clause and Myers J. was of the view that estoppel issues should not be dealt with on a Rule 18A application.

64 The contract in *Enigma Investments Corp. v. Henderson Land Holdings (Canada) Ltd.* (2007), 61 R.P.R. (4th) 277 (B.C. S.C.) contained this provision: "This offer and the agreement which results from its acceptance create contractual rights only and not any interest in land." In deciding that the certificates of pending litigation should not be discharged, Goepel J. made reference to that provision and concluded:

> The defendants submit that paragraph 2.1 of the Contracts that states the Contracts do not create "any interest in land" precludes such a claim. With respect, I disagree. At this stage the issue is not whether the plaintiffs can prove an interest in land; the issue is whether they are claiming such an interest. The Statement of Claim makes such a claim. That is all that is required to file a CPL.

65 While it would have been preferable for the clause used in *Romfo*, *supra*, to have been incorporated into these Contracts to more fully set out when and only when an equitable interest is created, I see no reason not to enforce paragraph 18 of these Contracts wherein the holders of the Contract forego any interest in land. If the Contract holders claim an equitable interest, should I ignore this clear provision in their Contracts? I have concluded that I should give effect to paragraph 28 in the Contract. The provision is clear and the Contract holders agreed to that provision when they signed the Contract. It is not submitted that Chandler or Cook is estopped from reliance on that paragraph.

66 On the assumption that I am incorrect in arriving at the conclusion that paragraph 28 determines the issue of whether they have any equitable interest, I will now consider the submissions made by the Contract holders. It is submitted on behalf of the holders of the Contracts that they have an equitable interest in the Property and the Strata Lots so that the Receiver and Manager should not be in a position to disclaim the Contracts. On this question, the Contract holders rely on the decision in *CareVest Capital Inc. v. CB Development 2000 Ltd.*, [2007] B.C.J. No. 1698 (B.C. S.C. [In Chambers]).

67 *CareVest* dealt with the fact that the prices available on 32 pre-sold units would not be sufficient to discharge the mortgages against the property. The holders of the pre-sale contracts took the position that the contracts created an equitable charge which was entitled to priority over the registered mortgage. While dismissing the application for a direction that the receiver and manager be permitted to disclaim the contracts, Pitfield J. ordered that the receiver and manager could sell each of the units but then hold in trust for CareVest and any purchasers under pre-sale contracts the excess of the sale price payable pending determination of: "... priority and/or entitlement thereto as between the pre-sale contract buyer and CareVest".

68 On the issue of whether the pre-sale buyers had an unregistered equitable charge, Pitfield J. stated:

> I do not think it is appropriate to attempt to resolve, on a summary application of this kind, the question of whether the presale buyers have an unregistered equitable charge which will entitle them to recover their damages out of the sale proceeds of the strata lot which they were to be the purchaser in priority to the registered second charge in favour of CareVest. That claim warrants more detailed consideration in the circumstances surrounding the financing of this development.

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(at para. 16)

69 The Contract holders also submit that the following statement of the learned author in *The Law of Vendor and Purchaser*, 3rd Ed. (Toronto: Thomson Canada Limited, 2007) applies:

> Ranking high on the list of venerable doctrines postulated by high authority is the equitable landmark decreeing that *instanter* a valid contract for the sale of land comes into existence the vendor becomes in equity a constructive trustee for the purchaser and (1) the beneficial ownership passes to the purchaser, the vendor retaining a reciprocal right to the purchase money carrying with it and for its security a lien on the premises; (2) the vendor, in the absence of an agreement to the contrary, is entitled to retain possession and is entitled to the rents and profits up to the date fixed for completion. But it is then said that although the vendor becomes a constructive trustee, he does so *sub modo* only: (1) he is not a mere dormant trustee; (2) he is a trustee having a personal and substantial interest in the property: he has a right to protect and an active right to assert that interest if anything is done in derogation of it; (3) his right to protect his own interest is paramount and overriding, and until he is bound to convey he retains for certain purposes his old dominion over the estate.
>
> Further, the purchaser's status as equitable owner is contingent upon the contract being specifically enforceable.
>
> It is clear, then, that the precise position in which the parties stand with respect to each other is *in fieri*, until certainty as to the consummation of the contract by conveyance or transfer is established, at which point the respective characters of the parties as trustee and *cestui que trust* relate back to the date of the contract and confirm that throughout the contract the legal estate was in the vendor and the equitable interest in the purchaser. (at pp. 1-12 and 1-13) (footnotes omitted)

70 However, the status of a potential purchaser as having an equitable interest is contingent upon the contract being specifically enforceable: *Buchanan v. Oliver Plumbing & Heating Ltd.*, [1959] O.R. 238 (Ont. C.A.); *Cornwall v. Henson*, [1899] 2 Ch. 710 (Eng. Ch. Div.) at p. 714; *Miller v. Howard* (1914), 7 W.W.R. 627 (British Columbia P.C.) at p. 631; and *Central Trust & Safe Deposit Co. v. Snider* (1915), [1916] 1 A.C. 266 (Ontario P.C.) at p. 272. A purchaser has an equitable interest in land only as long as he or she would be entitled to specific performance of the agreement: *DiGuilo v. Boland* (1958), 13 D.L.R. (2d) 510 (Ont. C.A.); *Howard*, *supra*, at pp. 79-80; *Kimniak v. Anderson*, [1929] 2 D.L.R. 904 (Ont. C.A.); *Freevale Ltd. v. Metrostore (Holdings) Ltd.* (1983), [1984] 1 All E.R. 495 (Eng. Ch. Div.); and *St. James (Rural Municipality) v. Bailey* (1956), 21 W.W.R. 1 (Man. C.A.).

71 In *St. James*, the Court dealt with a request for a declaration that the defendants had no right, title or interest in property so that the plaintiff was entitled to a declaration that the defendants were trespassing upon the property. Regarding the question of whether a sale of property produced an equitable interest in the proposed purchaser, Adamson C.J.M. stated:

> When a binding agreement for sale of lands is entered into, the immediate effect of the contract is that the purchaser acquires an equitable estate in the land": *Remedies of Vendors & Purchasers, McCaul*, 2nd ed., p. 1; *Rose v. Watson* (1864) 10 HL Cas 672, 33 LJ Ch 385; *McKillop v. Alexander* (1912) 1 W.W.R. 871, 45 S.C.R. 551; *Thorn's Canadian Torrens System*, p. 129. (at para. 18)

72 A similar statement was made by Montague J.A.:

> I am of the opinion that in the light of all the circumstances in the instant case the defendants have acquired an equitable interest in the lands of such a nature that an action for trespass by the plaintiffs cannot succeed. The appeal therefore should be allowed and the action of the plaintiff dismissed with costs to the defendant Bailey.. (at para. 71)

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73 The holders of the Contract must be entitled to specific performance and I am satisfied that specific performance is only available in relation to contracts that require no further work or services to be performed or provided by a receiver and manager. In *CareVest*, *supra*, Pitfield J. stated in this regard:

> It will be apparent from the terms of the order as I have recited them that I have concluded that the presale purchasers' agreements are not capable of specific performance. My conclusion results from the fact that the property which is the subject of purchase and sale in the presale contracts does not yet exist. It cannot be created without creating new rights and obligations in relation to the property, particularly insofar as procuring funds for completion, and securing the repayment thereof, are concerned. Were I to attempt to require the receiver to pick up where the developer left off, I would be granting the equivalent of a mandatory injunction which I construe to extend far beyond the scope of an order for specific performance of the conveyance of the property.
>
> As a general rule, specific performance is not a remedy that is available in relation to a contract that requires work and services to be performed or provided, or in circumstances where the ongoing supervision of the court through a court-appointed receiver/manager will be required. Nor is the remedy available in respect of matters over which the court does not have complete control such as the modification of financing arrangements in order to obtain the funds required to complete construction.
>
> (at paras. 13-4)

74 The question which then arises is whether the holders of the Contracts have an equitable interest and, if so, whether the Receiver and Manager should still be provided with the Direction sought that it can disclaim the Contracts.

Disclaiming Contracts Relating to the Vancouver Project

75 Regarding the Contracts of Ms. Chao-Dietrich (Strata Lot 46) and Salim Jiwa and Farouk Ratansi (Strata Lot 12) relating to the Vancouver Project, construction is not complete and stratification has not occurred. A purchaser is not entitled to specific performance until the time for the completion of the contract has arrived and all conditions precedent have been met. For the Vancouver Project, this would include a filing in the Land Title Office to subdivide the existing property into the Strata Lots which will constitute the Strata Plan.

76 Until a proper subdivision plan is registered, no interest in land is created: *Nesrallah v. Pagonis* (1982), 38 B.C.L.R. 112 (B.C. S.C.) where Taylor J. concluded that the right to create a leasehold interest arose only when a duly approved subdivision plan had been registered and that no interest in land was created prior to such a registration (at para. 14). Similarly, a contingent option granted prior to a strata corporation coming into existence was found to be unenforceable: *Strata Plan VIS2968 v. K.R.C. Enterprises Inc.* (2007), 74 B.C.L.R. (4th) 89 (B.C. S.C.).

77 As well, I am satisfied that it is not possible to imply a covenant or obligation on the part of Chandler to seek and obtain subdivision approval for the Vancouver Project: *International Paper Industries Ltd. v. Top Line Industries Inc.* (1996), 20 B.C.L.R. (3d) 41 (B.C. C.A.), being a decision involving whether a lease granted prior to subdivision approval was enforceable or not.

78 Because construction is not complete and because stratification has not taken place, Ms. Chao-Dietrich (Strata Lot 46) and Messrs. Jiwa and Ratansi (Strata Lot 12) have no equitable interest in the Vancouver Project. There is considerable construction to be undertaken by the Receiver and Manager to complete the Vancouver Project even before the preparation and filing of the documents which will be required before the subdivision plan and the Strata Plan can be registered in the Land Title Office. The property which is the subject matter of the Contracts does not yet exist. In order for it to exist, further funds must be borrowed by the Receiver and Manager, and those funds must be expended. The Receiver and Manager must "pick up" where Chandler left off. I am bound by the decisions in *New Skeena* and *Pope & Talbot*, both *supra*, so that the Receiver and Manager is in a position to disclaim the Contracts even if I could

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conclude that the holders of these Contracts had an equitable interest in the Contract or in the interest in land created by the Contract.

79 Even if I could conclude that Ms. Chao-Dietrich and Messrs. Jiwa and Ratansi had an equitable interest in the Vancouver Project and the Strata Lots which will eventually be created, I could not conclude that the Receiver and Manager should not be given the power to disclaim the Contracts relating to Strata Lots 85 and 12 in the Vancouver Project.

80 In coming to this conclusion, I rely on the following related to Strata Lot 85: (a) the $100,000.00 discount made available to Ms. Chao-Dietrich would amount to now preferring Ms. Chao-Dietrich in priority to other unsecured creditors of Chandler as she would be entitled to a fee for services rendered by a reduction of the purchase price agreed to on July 6, 2007; (b) there appears to be at least some evidence that the net selling price at July 6, 2007 was significantly less than the net selling price of $349,900.00 that was to be made available to Ms. Chao-Dietrich as the net selling price acceptable to the Petitioner was significantly higher than the price made available to Ms. Chao-Dietrich; and (c) I can find no obligation on the Petitioner to provide a partial discharge of its security in order to accommodate the contemplated sale to Ms. Chao-Dietrich.

81 For Ms. Chao-Dietrich and all other holders of Contracts, the notice set out in the Disclosure Statement was clear:

> The Developer will cause and each Lender will agree to provide the partial discharge of the Construction Security in respect of any Strata Lot and its undivided interest in the Common Property sold hereunder within a reasonable period after completion of the purchase and sale thereof provided a certain minimum purchase price is obtained and upon receipt of the net purchase price (after deduction of real estate commission and usual closing costs).

82 As well, holders of Contracts signed after the security of the Petitioner was registered had notice that partial discharges would only be provided in accordance with the net sale prices established in accordance with the provisions of the security. Additionally, now that the security of the Petitioner is in default, I am satisfied that there is no obligation on the Petitioner to provide partial discharges even if the net sale prices agreed to between Chandler and/or Cook and the Petitioner were being met.

83 I provide the Direction to the Receiver and Manager that it can disclaim the Contract relating to Strata Lot 85 or, alternatively, to offer for sale that Strata Lot at current market value free and clear of any obligation of Chandler that might arise under the Contract with Ms. Chao-Dietrich.

84 Regarding the Contract relating to Strata Lot 12, I cannot be satisfied that the price at the time of the Contract was so much lower than the then current market value so that the Receiver and Manager is correct in concluding that this is a Contract which should be disclaimed. However, I am satisfied that the current market value of Strata Lot 12 is such that the Receiver and Manager should be at liberty to offer that Strata Lot for sale free and clear of any obligation of Chandler that might arise under the Contract as I am satisfied that the purchase price set out under the Contract does not reflect the current market value of Strata Lot 12.

85 In this regard, I take into account not only the view of the Receiver and Manager that the current market value is $730,000.00 but also the view of Messrs. Jiwa and Ratansi that the current market value or, at least the market value as at July 29, 2007, is far in excess of the original Contract amount of $649,000.00. In the July 29, 2007 assignment of the Contract, it was the view of Messrs. Ratansi and Jiwa that the value was $767,450.00 made up of the original offer of $649,000.00 plus the $150,900.00 that they paid to Mr. Nikitiuk for the assignment. In view of the current market value, I am satisfied that the Receiver and Manager would be subject to criticism from the creditors having security against the Vancouver Project if it proceeded to complete the sale at $649,000.00.

86 Whether or not I am correct in coming to the conclusion that Messrs. Jiwa and Ratansi do not have an equitable interest because an action for specific performance is not available to them, I provide the Direction that the Receiver and Manager will be permitted to sell Strata Lot 12 at current market value free and clear of any obligation of Chandler

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or Cook that might arise under the Contract originally with Mr. Nikitiuk. However, any offer on Strata Lot 12 which is accepted by the Receiver and Manager shall only be accepted subject to Court approval. Notice of any application to approve a sale shall be provided to Messrs. Jiwa and Ratansi.

Disclaiming Contracts Relating to the Richmond Project

87 The question which then arises is whether the Receiver and Manager should be allowed to disclaim the Contracts relating to the Richmond Project. Regarding the Contract of Ms. Chao-Dietrich relating to Strata Lot 46, I am satisfied that it is in order for the Receiver and Manager to disclaim the Contract. First, the considerable discount of $340,800.00 that was made available to Ms. Chao-Dietrich for what was described as payments: "... by way of set off of various commissions and interest stated to be owed by the vendor to the purchaser" would create a significant preference to Ms. Chao-Dietrich if the Contract was allowed to stand. Second, the "analysis" of MPC even though flawed allows me to conclude that a similar unit in the floor below Strata Lot 46 sold for $283,620.00. Third, the proposed price to Ms. Chao-Dietrich is well below the net sale price agreed to between the Petitioner and Chandler which I take to be an indication of the market value at the time. Fourth, the inability to provide a discharge of the security against Strata Lot 46. All of those factors allow me to conclude that the Receiver and Manager is not acting arbitrarily in the exercise of its discretion to request a Direction that it be at liberty to disclaim this Contract. I provide that Direction to the Receiver and Manager. If Ms. Chao-Dietrich does not volunteer to remove the Certificate of Pending Litigation filed against Strata Lot 46 in the Richmond Project, then I will hear any application on behalf of the Receiver and Manager that the Certificate of Pending Litigation be discharged from title.

88 Regarding the Contracts of Crestmark relating to Strata Lots 12, 85, 92, and 95, I am satisfied that Crestmark does not have an equitable interest in those Strata Lots as the Contracts are not specifically enforceable. Even if I could be satisfied that Crestmark had an equitable interest, I would be satisfied that the Direction should be given to the Receiver and Manager that those Contracts be disclaimed.

89 The doctrine of specific performance continues to apply where a deadline has passed even in the presence of a "time is of the essence clause" where the conduct of the parties has waived the requirement to close by the given deadline and a closing date has been extended. In this regard, see *Cheema v. Chan*, [2004] B.C.J. No. 2222 (B.C. S.C. [In Chambers]).

90 Once a deadline for closing has been extended by the conduct of the parties even in the presence of a "time is of the essence" clause, the deadline must be reset with reasonable notice of the new deadline before a party can rely upon the failure to close by that date as a ground for treating the contract as being at an end or for permitting an action for specific performance. For time to be of the essence again, the person wanting a new date must specify a reasonable new completion date in such a manner that the other person would realize that he or she is now bound by the new date: *Ambassador Industries Ltd. v. Kastens* (B.C. S.C. [In Chambers]); *Norfolk v. Aikens* (1989), 41 B.C.L.R. (2d) 145 (B.C. C.A.); and *Abramowich v. Azima Developments Ltd.* (1993), 86 B.C.L.R. (2d) 129 (B.C. C.A.).

91 Under the Crestmark Contracts, the original completion dates were to be not less than ten business days after Crestmark had been notified that the City of Richmond had given permission to occupy the Strata Lot and the Strata Plan was fully registered in the Land Title Office. That date would have been sometime in August or September of 2007. While the dates for completion set out in the Contracts may well have already expired, Crestmark and Chandler agreed in the October 11, 2007 Addendum that the completion date was to be extended to: "... Nov 30, 2007 or within 5 business days after the vendor has paid the commission bonus to Edward Wong & Ass. Realty in an amount of $250,000.00 + G.S.T. whichever occurs later." November 30, 2007 has passed and the sale of Strata Lots 12, 85, 92 and 95 were not completed. To date, the amount of $250,000.00 has not been paid. It is more than probable that the $250,000.00 will never be paid.

92 While Mr. Wong states that he has agreed to "sign any documentation that might be required to satisfy the Receiver and the Court that I am bound by that waiver [a waiver of the condition to apply the amount of the unpaid $250,000.00 bonus against the purchase price of the four Strata Lots] and will pay the full purchase prices payable under

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the 4 agreements without the deduction of the bonus contemplated in the October [11, 2007] Addendum ....", there was nothing in evidence which would allow me to conclude that there has been an addendum executed by Crestmark amending the completion date agreed upon, there is nothing executed by Crestmark making time of the essence again, and there is nothing in evidence executed on behalf of Chandler which either changes the completion date to make time of the essence again or accepts an addendum to the Contract to provide for a completion date other than in accordance with the October 11, 2007 Addendum.

93 While I recognize that it would not be necessary for the Receiver and Manager to sign a further addendum accepting reasonable notice from Crestmark of the new date for completion, I am satisfied that it would be necessary for the Receiver and Manager to sign a further addendum relating to these Strata Lots to amend the purchase price so that the "decoration" allowances of $74,820.00 (Strata Lot 12), $62,820.00 (Strata Lot 85), $63,270.00 (Strata Lot 92), and $77,070.00 (Strata Lot 95) are removed so that the price to be paid does not reflect decoration allowances totalling $277,980.00 which were added to provide Crestmark with its "bonus". If these decoration allowances are not removed, then the unsecured amount said to be payable to either Wong or Crestmark would be available as a preference if the four sales were to complete.

94 I can find no contractual obligation requiring the Receiver and Manager to execute a further Addendum. Specific performance is not available to Crestmark. Accordingly, it is clear that an equitable interest is not available because there are further steps to be taken before it could be said that an equitable interest exists.

95 There is another reason why specific performance would not be available. There is nothing about these Strata Lots which would allow me to conclude that they are of a unique character and of particular value to Crestmark: *Behnke v. Bede Shipping Co.*, [1927] 1 K.B. 649 (Eng. K.B.). It is clear that specific performance will only be generally available in the context of an agreement for the sale of land where the land is unique to the extent that a substitute would not be readily available: *Semelhago v. Paramadevan*, [1996] 2 S.C.R. 415 (S.C.C.) where Sopinka J. on behalf of the majority stated:

> Specific performance should, therefore, not be granted as a matter of course absent evidence that the property is unique to the extent that its substitute would not be readily available. The guideline proposed by Estey J. in *Asamera Oil Corp. v. Seal Oil & General Corp.*, [1979] 1 S.C.R. 633, with respect to contracts involving chattels is equally applicable to real property. At p. 668, Estey J. stated:
>
>> Before a plaintiff can rely on a claim to specific performance so as to insulate himself from the consequences of failing to procure alternate property in mitigation of his losses, some fair, real and substantial justification for his claim to performance must be found.

96 I cannot conclude that the Strata Lots are of an unique character and of particular value to Crestmark. Even if I could conclude that Crestmark had an equitable interest, I would also conclude that it was appropriate for the Receiver and Manager to disclaim the Contracts relating to these four Strata Lots. The four August 10, 2007 Contracts provide for "decoration" allowances totalling $277,980.00. Unless Crestmark and the Receiver and Manager are prepared to execute a further Addendum removing those decoration allowances, the significant reductions from the "gross sale price" agreed to and the significant reduction from the "minimum pre-sale requirements set by the Petitioner" allows me to conclude that, if the Contracts are not disclaimed, Crestmark and Wong will receive significant preferences not otherwise available to other unsecured creditors of Chandler or Cook. Assuming that Crestmark has an equitable interest in the four Strata Lots, equity would require that I not approve any sales which would incorporate such significant preferences. The "analysis" performed by MPC and the minimum pre-sale requirement set by the Petitioner allow me to conclude that the Contracts were at prices not in accordance with fair market value at the time of the Contracts.

97 Accordingly, I provide the Direction to the Receiver and Manager that it can disclaim the Contracts of Crestmark relating to Strata Lots 12, 85, 92, and 95 of the Richmond Project or alternatively, offer for sale those Strata Lots at current market value free and clear of any obligation of Chandler that might arise under the Contracts with Crestmark.

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The Application of Crestmark

98 The application is that Crestmark be at liberty to commence an action against Chandler, Cook and the Receiver Manager for specific performance. The application of Crestmark pursuant to Rules 47 and 50 of the Rules of Court and the inherent jurisdiction of the Court is dismissed to the extent that the order sought relates to an action claiming specific performance. Regarding the proposed action against the Receiver and Manager, there is nothing before me which will allow me to conclude that the Receiver and Manager has adopted the Contract and has agreed to perform pursuant to it. Accordingly, there can be no action against the Receiver and Manager for specific performance. Regarding the proposed action against Chandler or Cook, Crestmark will be at liberty to commence an action claiming damages against either or both of those companies. However, Crestmark will not be at liberty to commence an action against either Chandler or Cook for specific performance. Crestmark has not met the onus of establishing a reasonable cause of action is disclosed.

Costs

99 The Receiver and Manager will be at liberty to speak to the question of costs against Crestmark Holdings Corp., Farouk Ratansi, Salim Jiwa, and Sui Chun Chao-Dietrich.

Order accordingly.

Footnotes

* A corrigendum issued by the court on October 16, 2008 has been incorporated herein.

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TAB 5

1974 CarswellOnt 82
Ontario Supreme Court, In Bankruptcy

Pont v. Brown

1974 CarswellOnt 82, 21 C.B.R. (N.S.) 272

Pont v. Brown et al.

Dunn, Master

Judgment: March 12, 1974

Counsel: *M. B. Page, Q.C.*, for plaintiff.
C. H. Morawetz, Q.C., for receiver.
D. W. Scott, for defendant.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications
Debtors and creditors

VII Receivers
VII.6 Conduct and liability of receiver
VII.6.c Duties
VII.6.c.vii Miscellaneous

Headnote
Receivers --- Conduct and liability of receiver — Duties

Receivership — Claims against estate — Burden of proof.

In the course of delivering reasons for judgment on 12th March 1974, Dunn, Master, said: "It is my view that, when the receiver has made a ruling in respect of claims against the estate, the onus is on any claimant who disputes the receiver's position to establish adequate grounds for his claim ... A finding by the receiver as to a claim should not lightly be disturbed, for to do so would invite the court to step into the shoes of the receiver and to deal with matters that really are the duties of a receiver".

***Dunn, Master*:**

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TAB 6

Most Negative Treatment: Distinguished
Most Recent Distinguished: Dempsey v. Bagley | 2016 ABQB 124, 2016 CarswellAlta 394, [2016] A.W.L.D. 1614, [2016] A.W.L.D. 1650, 29 C.C.E.L. (4th) 213, 30 Alta. L.R. (6th) 237, [2016] 8 W.W.R. 344, 264 A.C.W.S. (3d) 825 | (Alta. Q.B., Mar 4, 2016)

1992 CarswellBC 315
Supreme Court of Canada

London Drugs Ltd. v. Kuehne & Nagel International Ltd.

1992 CarswellBC 315, 1992 CarswellBC 913, [1992] 3 S.C.R. 299, [1992] S.C.J. No. 84, [1993] 1 W.W.R. 1, [1993] B.C.W.L.D. 037, 13 C.C.L.T. (2d) 1, 143 N.R. 1, 18 B.C.A.C. 1, 31 W.A.C. 1, 36 A.C.W.S. (3d) 669, 43 C.C.E.L. 1, 73 B.C.L.R. (2d) 1, 97 D.L.R. (4th) 261, J.E. 92-1650, EYB 1992-67042

LONDON DRUGS LIMITED v. DENNIS GERRARD BRASSART and HANK VANWINKEL; KUEHNE & NAGEL INTERNATIONAL LTD. and FEDERAL PIONEER LIMITED (Third Parties); GENERAL TRUCK DRIVERS AND HELPERS LOCAL UNION NO. 31 (Intervenor)

La Forest, L'Heureux-Dubé, Sopinka, Cory, McLachlin, Stevenson [*] and Iacobucci JJ.

Heard: October 29, 1991
Judgment: October 29, 1992
Docket: Doc. 21980

Counsel: Richard B. Lindsay, Michael J. Jackson, for Appellant
Bryan G. Baynham, William S. Clark, for Respondents

Subject: Employment; Torts; Property; Contracts; Public

Related Abridgment Classifications

Contracts

II Parties to contract
 II.4 Privity
  II.4.b Third party beneficiary
   II.4.b.i General principles

Contracts

VII Construction and interpretation
 VII.9 Disclaimer clauses

Labour and employment law

II Employment law
 II.4 Relationship to third parties
  II.4.c Liability of employee to third parties

Personal property

II Bailment and warehousing

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II.7 Hire of custody
II.7.a Bailee's liability to bailor for loss or damage
II.7.a.i Warehousing and storage
II.7.a.i.B Contractual limitation of liability

Headnote

Bailment and Warehousing --- Hire of custody — Bailee's liability to bailor for loss or damage — Warehousing and storage — Contractual limitation of liability

Contracts --- Parties to contract — Privity — Third party beneficiary — General

Employment Law --- Relationship to third parties — Liability of employee to third parties

Contracts — Parties — Privity — Warehouse employees in course of their duties negligently damaging transformer of warehouse customer — Employees owing duty of care to customer — Storage contract limiting "warehouseman's" liability — Customer bringing negligence action against employees for total damage — Supreme Court of Canada stating requirements for employees to benefit from limitation of liability clause in employer-customer contract — Warehouse employees meeting requirements.

Employment — Duties and liability of employee — Negligence — Warehouse employees in course of their duties negligently damaging transformer of warehouse customer — Employees owing duty of care to customer — Storage contract limiting "warehouseman's" liability — Customer bringing negligence action against employees for total damage — Supreme Court of Canada stating requirements for employees to benefit from limitation of liability clause in employer-customer contract — Warehouse employees meeting requirements.

Negligence — Defences — Releases and exclusion clauses — Warehouse employees in course of their duties negligently damaging transformer of warehouse customer — Employees owing duty of care to customer — Storage contract limiting "warehouseman's" liability — Customer bringing negligence action against employees for total damage — Supreme Court of Canada stating requirements for employees to benefit from limitation of liability clause in employer-customer contract — Warehouse employees meeting requirements.

Negligence — Duty and standard of care — Warehouse employees in course of their duties negligently damaging transformer of warehouse customer — Employees owing duty of care to customer — Storage contract limiting "warehouseman's" liability — Customer bringing negligence action against employees for total damage — Supreme Court of Canada stating requirements for employees to benefit from limitation of liability clause in employer-customer contract — Warehouse employees meeting requirements.

Negligence — Defences — Voluntary assumption of risk — Warehouse employees in course of their duties negligently damaging transformer of warehouse customer — Employees owing duty of care to customer — Storage contract limiting "warehouseman's" liability — Customer bringing negligence action against employees for total damage — Supreme Court of Canada stating requirements for employees to benefit from limitation of liability clause in employer-customer contract — Warehouse employees meeting requirements.

A customer entered into a written contract with a warehouse owner for the storage of its transformer. Clause 11(*a*) of the contract provided that the responsibility of a "warehouseman" was the reasonable care and diligence required by law. Clause 11(*b*) limited the liability of a "warehouseman" to $40. Clause 10(*e*) of the contract used the term "warehouse employee." When the contract was signed, the customer knew of the clause limiting liability. The customer chose not to obtain additional insurance from the warehouse owner and instead obtained its own

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coverage. Two warehouse employees damaged the transformer while moving it. At the time, they were acting in the course of their employment and were performing services directly related to the contract. The customer brought action against the warehouse owner and its employees for breach of contract and negligence. The trial judge found the employees negligent in their handling of the transformer and found them personally liable for the full amount of damages. He limited the warehouse owner's liability to $40. The majority of the Court of Appeal allowed the employees' appeal and reduced their liability to $40. The customer was granted leave to appeal to the Supreme Court of Canada. The employees argued on cross-appeal that they should be completely free of liability.

Held:

Appeal and cross-appeal dismissed.

Per Iacobucci J. (L'HEUREUX-DUBÉ, SOPINKA AND CORY JJ. concurring): The employees owed a duty of care to the customer when handling the transformer. It was reasonably foreseeable to them that their negligence in handling the transformer would result in its damage. There was such a close relationship between the parties as to place a duty to exercise reasonable care on the employees. Reliance, as used here, goes to the existence of a duty of care owed and *not* to liability for breach of a duty of care. There is no general rule in Canada that an employee acting in the course of his or her employment and performing the "very essence" of the employer's contractual relations with a customer, does not owe a duty of care to the employer's customer. The question of whether a duty of care arises will depend on the circumstances. As the employees owed a duty of care to the customer in their handling of the transformer, the cross-appeal should be dismissed.

The doctrine of privity of contract has two distinct aspects. It precludes parties to a contract from imposing liabilities on third parties. It also prevents third parties from enforcing rights or benefits under a contract, even where the contract attempts to confer third party benefits. The doctrine of privity should be relaxed in the circumstances of this case, where a third party beneficiary was relying on a contractual provision as a defence in an action brought by one of the contracting parties. There would be no concerns about double recovery or floodgates of litigation brought by third party beneficiaries. The doctrine of privity fails to appreciate the special considerations which arise from the relationships of employer-employee and employer-customer. There is an identity of interest between the employer and its employees in performing the employer's contractual obligations. When an employer and its customer contract for services and include a clause limiting the liability of the employer for damages arising from conduct normally performed by the employer's employees, and in fact so performed, there is no valid reason to deny the benefit of the clause to those employees. The nature and scope of the limitation of liability clause would coincide essentially with the nature and scope of the contractual obligations performed by the employees. Upholding a strict application of the doctrine of privity here would also have the effect of allowing the customer to circumvent the limitation of liability clause to which it had expressly consented. It could not obtain more than $40 from the warehouse owner, in contract or in tort, because of the clause. However, resorting to exactly the same grounds, it attempted to obtain the full amount from the individual "warehousemen." Finally, there are sound policy reasons why the doctrine of privity should be refused here. A limitation of liability clause enables the contracting parties to allocate the risk of damage and to procure insurance accordingly. A prudent customer would not omit to obtain insurance because it was looking to employees for recovery. In addition, in this case the employees did not reasonably expect to be subject to unlimited liability for damages that occurred in performing a contract which limited the liability of the "warehouseman" to a fixed amount. It did not make commercial sense to hold that the term "warehouseman" was not intended to cover the employees. The doctrine of privity should not stand in the way of commercial reality and justice.

Employees should be entitled to benefit from a limitation of liability clause between their employer and its plaintiff customer if the following requirements are satisfied: 1) The limitation of liability clause must, either expressly or impliedly, extend the benefit to the employees seeking to rely on it; and 2) the employees seeking the benefit

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of the clause must have been acting in the course of their employment *and* must have been performing the very services provided for in the contract between their employer and its plaintiff customer when the loss occurred. These requirements represent only an incremental change to the common law relating to privity of contract, and do not affect any recognized exceptions to privity of contract such as trust and agency. Here the only question was whether the employees were third party beneficiaries with respect to the limitation of liability clause so as to come within the first requirement of the test. The employees were *implied* third party beneficiaries. The use of the term "warehouse employee" in cl. 10(*e*) of the contract did not by itself preclude interpreting "warehouseman" in cl. 11(*b*) to implicitly include employees. When all the circumstances were taken into account, including the nature of the relationship between the employees and their employer, the identity of interest respecting contractual obligations, the fact that the customer knew that the employees would be involved in performing the contractual obligations, and the absence of a clear indication in the contract to the contrary, the term "warehouseman" in cl. 11(*b*) should be interpreted as meaning "warehousemen."

Per MCLACHLIN J.: Tort and contract constitute separate legal regimes. The customer's action against the employees was necessarily in tort, since there was no contract between it and the employees. The theory of voluntary assumption of risk permits an employee sued in tort to rely on a term of limitation in the employer's contract. On this theory, a plaintiff, having agreed to the limitation of liability vis-à-vis the employer, must be taken to have done so respecting the employer's employees. It has been characterized in two different ways: first as a negation or limitation of the duty of care; and second, as a waiver of an existing cause of action. The negation or limitation of duty of care approach looks at all the circumstances, including the contract, to determine what the common law duty between the parties was. The waiver approach assumes a standard duty of care, but assumes that the plaintiff's right to sue for that breach has been removed. Here the problem with the waiver approach was that the term "warehouseman" in the contract did not include the employees and it would be difficult to determine whether the court should imply a term including them. But voluntary assumption of risk can be grounded on a broader basis than waiver based on the contract's exclusion clause. Quite apart from the particular contract term, it could be argued that the circumstances giving rise to the tort duty, including the contract with its exemption of liability, were such that they limited the duty of care the employees owed the customer to damage under $40.

Per LA FOREST J. (dissenting in part): Two questions must be asked to determine whether a duty of care exists: 1) is there a sufficiently close relationship between the parties so that, in the reasonable contemplation of the defendant, carelessness on its part might cause damage to the plaintiff? If so, 2) are there any considerations which ought to negative or limit a) the scope of the duty, and b) the class of persons to whom it is owed or c) the damages to which a breach of it may give rise? As the damage here was reasonably foreseeable, the first branch of the test was satisfied. Regarding the second branch, policy considerations may negate the existence of the duty. Courts must be sensitive to the impact that an imposition of tort liability would have on the contractual allocation of risk, whether the damage incurred is economic loss or property damage. Tort liability may be less likely to disrupt contractual arrangements in property damage cases than in economic loss cases. Where parties are not in contractual privity, such parties may be linked by a chain of contracts or not. The mere fact that this case involved property damage rather than economic loss could not eliminate inquiry into whether the recognition of a duty of care in these circumstances was justified on policy grounds. Although in the vast majority of property damage cases application of the foreseeability test suffices to found a duty of care, policy considerations should not be precluded.

Neither the *Warehouse Receipt Act* nor cl. 11(*b*) of the contract confirms or negates the existence of a duty owed by the warehouseman's employees; nor do they create such a duty. The Act does not apply to employees; it is limited to a "warehouseman." Accordingly, the scope of any duty a warehouseman's employees may have to the warehouseman or its customers must be determined under the common law principles of tort. The vicarious liability regime, which considers the employer to be vicariously liable for the acts of its employee, is best seen as a response to a number of policy concerns. The vicarious liability regime not only ensures that the employer guarantees the employee's primary liability, it has the broader function of transferring to the business itself the risks created by the activity of its agents.

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Elimination of the employee's liability is practically compelled by the developing logic of the vicarious liability regime. In our modern economy, an employee's capacity to cause loss does not bear any relation to his or her salary. Moreover, the employer will almost always be insured against the risk of being held liable to third parties through vicarious liability: the cost of such liability is thus internalized to the profitable activity that gives rise to it. Imposing tort liability on the employee in these circumstances cannot be justified by the need to deter careless behaviour. Employees subject themselves to discipline by refusal to perform work as instructed. The critical policy concern here that would be raised by the elimination of the employees' liability is that of compensation. In the vast majority of cases eliminating the employee's liability will have no impact on the plaintiff's compensation. Nonetheless, the employer may not be available as a source of compensation. In cases where there are no "contractual overtones" concerning the plaintiff, as between the plaintiff and the negligent employee the employee must be held liable for property damage and personal injury caused to the plaintiff. As between the employee and the employer, the employer should still bear the risk even in this kind of case. Such cases can be distinguished from the present case. When a planned transaction is involved, there are foreseeable risks and thus the possibility of allocating those risks in advance. This circumstance must be taken into account, even if the plaintiff's action is in tort. Where the plaintiff has suffered injury to his or her property pursuant to contractual relations with a company, he or she can be considered to have chosen to deal *with a company*. Here the customer relied upon performance by the corporate warehouse owner, and upon the liability of that body if the services were negligently performed. It could not be regarded as relying on the employees' liability, nor could the employees be taken here to appreciate that the customer was relying on them for compensation. A plaintiff who chooses to deal with a limited company can be held to have voluntarily assumed the risk that the company will be unable to satisfy a judgment. A plaintiff should not be able to shift that risk to an employee by claiming in tort concurrently with contract. The customer and the warehouse owner allocated the risk between themselves. However, the employees had no real opportunity to decline the risk. It would be ill-advised to place the onus on employees to contract out of their tort liability, even in a collective bargaining context. Policy reasons strongly supported a finding of no duty on the employees on the facts of this case. Because of the proximity created by contract, the employer owed a duty of care to the customer and was vicariously liable for its employees' negligent acts.

For employees to be liable, specific and reasonable reliance on such employees is necessary where the law provides for the possibility of compensation through recourse to the employer. It is also necessary where the employees have no real opportunity to decline the risk. Reliance on an ordinary employee will rarely if ever be reasonable in the absence of an express or implied undertaking of responsibility by the employee to the plaintiff. Mere performance of the contract by the employee, without more, is not evidence of such an undertaking. Reliance by the customer on the employees was not reasonable here.

The employee remains liable to the plaintiff for independent torts. The liability of the employer to the plaintiff is determined under the ordinary vicarious liability rules. If the tort is related to the contract, one must resolve whether any reliance by the plaintiff on the employee was reasonable. Here the tort was related to the contract and any reliance by the customer on the employees was not reasonable.

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Toronto-Dominion Bank v. Guest (1979), 16 B.C.L.R. 174, 10 C.C.L.T. 256, 105 D.L.R. (3d) 347 (S.C.) — *distinguished*

Winterbottom v. Wright (1842), 10 M. & W. 109, 152 E.R. 402 — *not followed*

Statutes considered:

Civil Code of Lower Canada

art. 1023*considered*

art. 1029*considered*

Civil Code of Quebec, S.Q. 1991, c. 64

arts. 1444-50*considered*

Company Act, R.S.B.C. 1979, c. 59

s. 16*referred to*

s. 130*referred to*

Contracts (Privity) Act 1982, Stat. N.Z. 1982, No. 132

s. 2*considered*

s. 4*considered*

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Engineers Act, R.S.B.C. 1979, c. 109

s. 10(5)*referred to*

Ministry of Correctional Services Act, R.S.O. 1990, c. M.22

s. 12*referred to*

Negligence Act, R.S.B.C. 1979, c. 298

s. 4*referred to*

Proceedings Against the Crown Act, R.S.O. 1990, c. P.27

s. 5*considered*

Property Law Act 1969, W. Aust. Acts 1969, No. 32

s. 11*referred to*

Property Law Act 1974, Queensl. Stat. 1974, No. 76

s. 55*referred to*

Warehouse Receipt Act, R.S.B.C. 1979, c. 428

s. 1 "warehouseman"*considered*

s. 2(4)*considered*

s. 13*considered*

Water Carriage of Goods Act, R.S.C. 1952, c. 291

Sched., art. IV(5)*referred to*

Words and phrases considered:

independent tort

planned transaction

warehouseman

Appeal and Cross-appeal from judgment of British Columbia Court of Appeal, [1990] 4 W.W.R. 289, 45 B.C.L.R. (2d) 1, 31 C.C.E.L. 67, 2 C.C.L.T. (2d) 161, 70 D.L.R. (4th) 51, reversing judgment of Trainor J., [1986] 4 W.W.R. 183, 2 B.C.L.R. (2d) 181, allowing customer's negligence action against warehouse employees.

***La Forest J.*, (dissenting on the cross-appeal):**

[Publisher's Note: The full-text reasons have been modified to reflect editorial revisions published in the Supreme Court Reports.]

Introduction

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1 In this case, the appellant seeks to recover damages against the respondent employees for their negligence in the performance of a duty their employer undertook by contract to do. The issues are whether the employees have a duty in tort towards the appellant and, if so, whether a clause in the contract limiting the employer's liability in the performance of the duty will serve to protect the employees as well.

2 My colleague Justice lacobucci has set out the facts and judicial history of the appeal, but for convenience I shall briefly reiterate the facts. The appellant London Drugs Limited purchased a transformer for its new warehouse facility and arranged for storage of the transformer with Kuehne & Nagel International Ltd. (KNI). London Drugs knew or can be taken to have known that KNI was a limited liability company and that KNI's employees would be responsible for carrying out the contract. The terms of storage were set forth in a standard form contract, which included a limitation of liability clause limiting the warehouseman's liability to $40. This clause having been brought to its attention, London Drugs declined to purchase extra insurance through KNI and chose instead to arrange for its own all-risk coverage. The defendant employees, Dennis Gerrard Brassart and Hank Vanwinkel, having received orders to load the transformer onto a truck which would deliver it to London Drugs' new warehouse, negligently damaged the transformer and caused damages in the amount of $33,955.41. The trial judge allowed the action against Vanwinkel and Brassart for the full amount of the damage but limited judgment against KNI to $40 in accordance with the terms of the contract. The Court of Appeal of British Columbia, sitting as a panel of five, limited judgment against both the employees and KNI to $40.

3 I have had the benefit of reading the reasons of my colleagues McLachlin and Iacobucci JJ. Both would decide this case by applying the clause in the contract limiting the liability of the employer (KNI) to the employees, McLachlin J. on the basis of a tort analysis, Iacobucci J. in terms of a contractual analysis. For reasons that will appear, however, I think the best solution would be to hold that the respondent employees did not, in the circumstances of this case, owe any duty to the appellant. Although my colleagues have given this possibility short shrift, I think it deserves more extensive examination.

4 In my view, before turning to the examination of any specific provision of the contract between the employer and the customer, it is necessary to consider the difficult issue of whether the employees had any duty of care to the appellant. Such an approach has the advantage of being more comprehensive, since it is not dependent on the specific terms of the employer's contract with the customer. The issue, was raised by the parties before all the courts that have heard the case and is the object of conflicting jurisprudence. At all events, the question of the duty of care determines whether Vanwinkel and Brassart are jointly liable with KNI for the $40 or whether KNI alone will be liable for that amount.

5 The latter point was what impelled me to write. My colleagues have ably advanced views that seem to me to be tenable and I was particularly attracted to Iacobucci J.'s view, which would go a long way towards ridding us of many of the consequences of that pestilential nuisance, privity. However, the difficulty with accepting their positions in the present context is that it would have the effect, given the manner in which the case has come to us, of barring us from subsequently dealing with the underlying issues in a comprehensive way. For what their approaches do is to focus on an incidental aspect of the matter — the fact that London Drugs and KNI inserted a clause in their contract allocating liability as between themselves. But the real issue is no different from what it would be if no such clause appeared in the contract. Ultimately what we are concerned with is whether it is appropriate to impose a duty on employees to compensate their employers or those who contract with them for the employees' negligence in carrying out an activity the contracting parties have set in motion. Reading the limiting clause as applying by implication to the employees or as restricting their tort liability is simply to reach out for a convenient device that partially solves the problem, but which depends on underlying policies applicable to the whole problem — whether the employees should be subject to a duty of care for ordinary, and so foreseeable negligence, in performing work arising out of the contract.

6 My colleagues justify their unwillingness to enter into the matter on the basis of what they perceive as the proper institutional role of the courts in modifying law and suggest that it should be left to the legislature. I do not agree. The relevant law, the doctrine of vicarious liability, is a judicial creation devised in Holmes' phrase, in response to "the felt necessities of the time". In my view, like the judges who created the doctrine, it is incumbent on present day judges to

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adapt the law to new and evolving social and organizational realities. The present situation, it seems to me, is ideally suited to a principled case by case approach, subject to legislative intervention if need be to meet special situations not easily resolvable by doctrinal development. Compared to other areas, economic loss for example, into which courts have ventured without any prompting by the legislature, employee liability does not appear to raise that formidable a doctrinal task. On the other hand, a general legislative response seems inappropriate to a task that requires great sensitivity to the specific context in which a claim arises. The courts created the law; it is up to them to adapt it to meet modern needs.

7 As I mentioned, my colleagues say very little about this duty of care issue. Nor can much help be derived from the reasons in the courts below, possibly because it has so little practical importance in the present case. It means a variation of $40 in the amount granted by the Court of Appeal. Its importance in other situations, however, is far from negligible, and the manner in which my colleagues have dealt with the case precludes our taking what appears to me the proper approach to the problem in different fact situations.

8 Of the judges in the Court of Appeal, only Lambert J.A. clearly addressed the question of the employees' duty of care in the absence of a contractual limitation clause. He found that "if there were no express contract governing the storage", he would have had no hesitation in saying that the two employees were directly liable to the customer London Drugs ((1990), 45 B.C.L.R. (2d) 1, at p. 40).

9 McEachern C.J. expressly declined to address the question. He stated, at p. 28:

> **(3) Do employees owe any duty of care except to their employer?**
>
> While Mr. Baynham did not stress this argument, he cited cases such as *Sealand* and *Summitville* where the contract did not limit the employer's liability. It is unnecessary to deal with this question and I prefer to leave it to be decided, if necessary, when it arises squarely for decision.
>
> [Italics in original, emphasis added.]

Earlier in his judgment, McEachern C.J.B.C. had already expressly declined to consider the general question of the duty of care because of the existence of the limitation clause in this case (at p. 23). He did, however, apparently jump to the conclusion that the employees owed a duty of care for the purposes of his disposition of the case, but in light of his express refusal to consider the issue of the duty of care in the relevant part of his judgment and his failure to consider at any length the cases cited by counsel or the policy issues, I do not place great significance on this conclusion.

10 Wallace J.A. examined the recent English cases applying the "just and reasonable" test at length. He noted that in the absence of special circumstances that would negate or qualify their duty of care, the employees would be liable for the damage to the transformer: citing *Donoghue v. Stevenson*, [1932] A.C. 562 (H.L.). Accordingly, the question that fell to be decided was (at p. 69): what are the circumstances that would qualify or negate the *prima facie* duty of care required of employees of the warehouse? He concurred with the finding of Purchas L.J. in *Pacific Associates Inc. v. Baxter*, [1990] 1 Q.B. 993, [1989] 2 All E.R. 159 (C.A.), at p. 1011, that "this question can only be answered in the context of the factual matrix including especially the contractual structure against which such duty is said to arise". He considered that "[t]he principle that, where the relationship between the parties arises from a contract, the contractual structure may well qualify or negate any liability in tort, is well recognized" (at p. 78), and referred notably to *Central Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147, (sub nom. *Central & Eastern Trust Co. v. Rafuse)* 37 C.C.L.T. 117, 42 R.P.R. 161, 34 B.L.R. 187, 31 D.L.R. (4th) 481, 75 N.S.R. (2d) 109, 186 A.P.R. 109, 69 N.R. 321, in this regard. However, Wallace J.A. limited his consideration of the impact of the contractual structure to the single question of the impact of the limitation of liability clause. He did not consider any of the cases cited by counsel to which I shall later refer where the issue of the duty of care of an employee in the absence of such a clause was specifically considered.

11 Two judges in the Court of Appeal did not find a duty of care to exist. Hinkson J.A. concluded that the employees did not owe any duty of care, although he based that conclusion on the contractual limitation of liability clause. Southin J.A. found that the duty of care issue was irrelevant since she considered that the case sounded in trespass.

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12 The trial judge decided that "there is no general rule that an employee cannot be sued for tort committed in the course of carrying out the very services for which the plaintiff had contracted with his employer" ((1986), 2 B.C.L.R. (2d) 181, at p. 189).

The Duty of Care Since Anns

General

13 The duty of care issue was reviewed by this Court in *Nielsen v. Kamloops (City)*, [1984] 2 S.C.R. 2, [1984] 5 W.W.R. 1, 29 C.C.L.T. 97, 26 M.P.L.R. 81, 8 C.L.R. 1, 10 D.L.R. (4th) 641, 54 N.R. 1. In that case Wilson J., speaking for the majority, adopted the criteria for determining the question set forth by Lord Wilberforce in *Anns v. Merton London Borough Council*, [1978] A.C. 728, (sub nom. *Anns v. London Borough Council of Merton)* [1977] 2 All E.R. 492 (H.L.). She restated in the following way the two questions that must be asked in order to determine whether a duty of care exists (at pp. 10-11):

> (1) is there a sufficiently close relationship between the parties ... so that, in the reasonable contemplation of the authority, carelessness on its part might cause damage to that person? If so,
>
> (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?

14 I agree with McLachlin J. that *Anns*, as adopted by this Court in *Kamloops* and *Rothfield v. Manolakos*, [1989] 2 S.C.R. 1259, [1990] 1 W.W.R. 408, 41 B.C.L.R. (2d) 374, (sub nom. *Manolakos v. Gohmann)* 46 M.P.L.R. 217, 1 C.C.L.T. (2d) 233, 63 D.L.R. (4th) 449, (sub nom. *Manolakos v. Vernon (City))* 102 N.R. 249, governs this case. I agree with both my colleagues that the damage in question in this case was reasonably foreseeable and that as a result, the first branch of the *Anns* test is satisfied. In my view, the second branch of the *Anns* test is broad enough to allow for the consideration, where relevant, of the factors the English courts have considered in the context of their just and reasonable test. It is now well established that policy considerations may in fact negate the existence of the duty; see *Central Trust Co. v. Rafuse*, *supra*; *Leigh & Sillavan Ltd. v. Aliakmon Shipping Co.*, [1986] A.C. 785, [1986] 2 All E.R. 145 (H.L.) ; *Norwich City Council v. Harvey*, [1989] 1 W.L.R. 828, [1989] 1 All E.R. 1180 (C.A.); *Pacific Associates v. Baxter*, *supra*.

The Application of the Second Branch of Anns: Property Damage and Economic Loss

15 In my view, in applying *Anns* and *Rafuse*, the courts must be vigilant to guide the development of concurrent liability in such a manner as to avoid unacceptable results. In *New Brunswick Telephone Co. v. John Maryon International Ltd.* (1982), 43 N.B.R. (2d) 469, 113 A.P.R. 469, 141 D.L.R. (3d) 193, 24 C.C.L.T. 146 (C.A.), I surveyed a number of the potential difficulties and juridical solutions in the context of concurrent liability between two parties. I stated, at p. 512:

> The question may also arise regarding the application of this general approach [the concurrent application of tort and contract] to certain fact situations; for example sales of real estate by the owner as occurred in *McGrath v. Maclean et al*. [(1979), 95 D.L.R. (3d) 144, 22 O.R. (2d) 784 (C.A.)]. But if it is felt the principle advanced here should not be applied to such cases, it could be distinguished either on general policy or the particular facts of a situation on the basis of an implied term (for example caveat emptor) read into the contract having regard to the relation of the parties or on the ground that there is no duty of care under such circumstances. Such an approach has the advantage that it is based on policy or factual grounds rather than mere formalism.

16 The problems posed by the concurrent application of contract and tort in a two-party context pale in comparison with the difficulties raised by the extensive overlapping of tort and contract claims in multi-party contexts. Rules and approaches that were acceptable or at least tolerable in the relatively narrow field of tort liability that existed before the full development of the concurrent application of the two regimes of liability may need to be re-examined. The extent of overlap is obviously most acute in cases of economic loss, and the court must take due account, neither more nor less,

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of the contractual context in which the alleged tort duty is said to exist; see my reasons in *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*, [1992] 1 S.C.R. 1021, 11 C.C.L.T. (2d) 1, 137 N.R. 241, 91 D.L.R. (4th) 289. But the critical new interaction of tort and contract is not limited to cases involving economic loss. In the vast new areas in which tort applies in conjunction with contract, *Rafuse*, or in contexts with contractual overtones, *Norsk* and the case at bar, sensitive approaches will be required. The relaxation of privity by Iacobucci J. in this case is an example of that adaptation. So too is the application by McLachlin J. of the theory of voluntary assumption of risk.

17 This case involves a claim for property damage. Undoubtedly, if the case involved economic loss, the court would undertake a searching inquiry into policy concerns under the second branch of *Anns* before concluding as to the existence of a duty of care; see *B.D.C. Ltd. v. Hofstrand Farms Ltd.*, [1986] 1 S.C.R. 228, [1986] 3 W.W.R. 216, 1 B.C.L.R. (2d) 324, (sub nom. *Hofstrand Farms Ltd. v. British Columbia)* 36 C.C.L.T. 87, 33 B.L.R. 293, 26 D.L.R. (4th) 1, 65 N.R. 261; *Norsk*, *supra*. Since this case concerns property damage, however, the venerable authority of *Donoghue* is invoked in support of the simple and straightforward application of the fore-seeability test established in that great case. This approach harkens back to an era in which tort law divided most losses into three broad categories: personal injury, property damage and economic loss. In the first two areas, a duty of care was established based on mere foreseeability on the authority of *Donoghue*. In the third area, economic loss, an expansive reading of early cases such as *Cattle v. Stockton Waterworks Co*. (1875), L.R. 10 Q.B. 453, led to a broad exclusionary rule for pure economic loss.

18 Whatever the benefits of such a rigid approach, it has now been clearly rejected in the case of economic loss; see *Kamloops* and *Norsk*. One of the principal reasons behind the softening of the broad rule prohibiting recovery for pure economic loss is the by now oft repeated statement that the differences between property damage and economic loss have been vastly exaggerated. This view has accompanied the development of jurisprudence on economic loss since *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.).

19 It is important to note that comparisons between economic loss and property damage in tort cases operate on at least two planes. On one plane there is the question of the *relative social importance* of the two types of loss. In *Norsk*, Stevenson J. considered that there was no distinction to be made on this plane. At page 1173, he states:

> Some argue that there is a fundamental distinction between physical damage (personal and property damage) and pure economic loss and that the latter is less worthy of protection. Professor Feldthusen has attempted to make this argument in *Economic Negligence*, *supra*, at pp. 8-14, but I am left unconvinced. Although I am prepared to recognize that a human being is more important than property and lost expectations of profit, I fail to see how property and economic losses can be distinguished.

McLachlin J. adopted a much less trenchant position, noting only that even if pure economic loss were to be considered less deserving, as Professor Feldthusen suggests, that should not preclude recovery of such loss where justice so requires (at p. 1138). In my reasons, I did not find it necessary to comment explicitly on this question. I did find that property damage, since it is in some sense there first, was sufficient to establish deterrence in cases of contractual relational economic loss. In my view, it is unlikely that any broad comparison is possible. Property damage is more likely to occur in contexts that raise concerns other than compensation, such as safety and the desire to deter dangerous activity.

20 However, where the loss is suffered by a corporation, as in this case, I can see little reason to distinguish in social importance between the two types of loss from the perspective of *compensation*. Thus, for London Drugs, it is of little consequence that their loss of $33,000 occurred as a result of damage to a transformer rather than through, say, the late delivery of an envelope, as in *Hofstrand*. Of course, other concerns may arise that justify distinctions.

21 The second plane on which economic loss and property damage are compared in tort law is with respect to the *policy concerns they raise in the context of allowing recovery for them in courts of law based on tort principles*. The institutional limitations of courts are such that even those who adopt the position that there is no difference in social importance between the two types of damage recognize that many if not all economic loss cases pose policy problems, such as the

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problem of indeterminacy, not present with the same acuity in the vast majority of property damage cases; see the reasons of Stevenson J. in *Norsk*.

22 Until now, the insight that there may be less difference between economic loss and property damage than was formerly thought has been principally used to justify limited extensions of liability in the field of economic loss, for example in cases of negligent misrepresentation, e.g., *Hedley Byrne*, or in cases involving the liability of public authorities, e.g., *Kamloops* and *Rothfield*. As we examine the different types of economic loss cases with more care, however, we are discovering additional policy concerns. What is important for present purposes is that certain of the policy concerns most evidenced in some economic loss cases *may not really have much to do with the specific nature of economic loss*; it may just be that the concern is present with particular force in such cases and less often in cases involving physical damage to property. As Professor Blom has noted, the present case requires us to apply what we have learnt from our confrontation with economic loss in property damage cases that arise in contractual contexts; see "Case Comment on *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*" (1991), 70 *Can. Bar Rev*. 156.

23 In my view, it is now clearly recognized that courts must be sensitive to the impact that an imposition of tort liability would have on the contractual allocation of risk, whether the damage incurred is economic loss or property damage. Tort liability, however, may be less likely to disrupt contractual arrangements in property damage cases. As Professor Blom notes, one reason why property damage cases are generally unproblematic from a policy perspective is that they are much less likely than economic loss cases to be associated with *planned transactions* and *contractual expectations*; see Blom, "Fictions and Frictions on the Interface Between Tort and Contract" in *Donoghue v. Stevenson and the Modern Law of Negligence* (1991), at p. 181 (hereinafter cited as "Fictions and Frictions"). As he notes, physical damage to person or property can result from being run down in the street, from fire destroying your house or from a street-cleaning machine bumping your car. Economic loss, on the other hand, very often occurs in a contractual context.

24 This has now been most clearly recognized in cases of concurrent liability. However, it has also been recognized, and for good reason, in cases involving parties who are not in contractual privity; such parties may be linked by a chain of contracts or not. I shall examine these different situations in turn.

Concurrent Application of Tort and Contract

25 The most obvious case of this interaction is undoubtedly *where tort and contract apply concurrently between two parties*. This issue arose on the facts in *J. Nunes Diamonds Ltd. v. Dominion Electric Production Co.*, [1972] S.C.R. 769, 26 D.L.R. (3d) 699, and was also considered in *Rafuse*, *supra*. In *Nunes Diamonds*, Pigeon J. used the independent tort requirement to take account of the contractual bargain between the parties. He stated, at pp. 777-78:

> Furthermore, the basis of tort liability considered in *Hedley Byrne* is inapplicable to any case where the relationship between the parties is governed by a contract, unless the negligence relied on can properly be considered as "an independent tort" unconnected with the performance of that contract .... This is specially important in the present case on account of the provisions of the contract with respect to the nature of the obligations assumed and the practical exclusion of responsibility for failure to perform them.

26 Arguably, in light of the decision of this Court in *Rafuse*, the same result would be achieved today by first finding concurrent liability to exist in tort and contract and then finding that the contractual exclusion applied to tort liability arising from the same circumstances. It would appear that Nunes Diamonds, in drafting their exclusion of liability, relied on the inapplicability of tort in contractual situations. As Le Dain J. noted in *Rafuse*, *supra*, at p. 163, it appears to have been assumed by Pigeon J. as by the trial judge in *Nunes Diamonds* that the clause in the contract limiting liability in the cases of loss to $50 did not cover negligence. Nonetheless, I think today it is apparent that the case turned on the interaction of tort and contract. As Hinkson J.A. noted in delivering the unanimous judgment of the British Columbia Court of Appeal in *Surrey (District) v. Carroll-Hatch & Associates Ltd.*, [1979] 6 W.W.R. 289, 14 B.C.L.R. 156, 10 C.C.L.T. 226, 101 D.L.R. (3d) 218, at p. 236:

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> In the *Nunes* case, the parties had by their contract agreed on the extent of the liability of the defendant in the event a breach of contract occurred. In those circumstances, it was held that it was not appropriate to rewrite the terms of the agreement between the parties to impose a greater liability than that agreed upon between the parties.

In *Dominion Chain Co. v. Eastern Construction Co.* (1976), 12 O.R. (2d) 201, 1 C.P.C. 13, 68 D.L.R. (3d) 385, Jessup J.A., writing for the majority (at p. 215), wrote that *Nunes Diamonds* was a case that stood for the proposition that a plaintiff cannot escape a contractual exclusion of liability, whether express or implied, by reliance on a concurrent liability in tort. In *Maryon*, *supra*, I noted that the point made in *Dominion Chain* and *Carroll-Hatch* was that *Nunes Diamonds* stands for the proposition that "the law of negligence will not be used to give a remedy to a person for a breach of contract for which he is absolved under the contract" (at p. 506). The reasons of Jessup J.A. were cited in *Rafuse* as being "of particular significance for subsequent consideration of the principle for which those cases [*Nunes Diamonds* and other cases which have applied *Elder, Dempster & Co. v. Paterson, Zachonis & Co.*, [1924] A.C. 522 (H.L.)] stand" (at p. 185). Both my reasons in *Maryon* and those of Hinkson J.A. in *Carroll-Hatch* were also cited with apparent approval by Le Dain J. in *Rafuse*.

27 Today, courts are perhaps readier to extend a limitation of liability for contractual breach to a tort claim arising out of the same circumstances if it is necessary to do so to prevent tort being unjustifiably used to avoid obligations and limitations freely accepted in contract. The need to impose an independent tort requirement to achieve the basic policy aim is accordingly reduced. Parties should by now be well aware of the need to include exclusions of both contractual and tort liability in most cases, however, and concurrent liability cases in which it is necessary to interpret a clause, limited on its face to contractual liability, to cover tort liability should become increasingly rare.

Parties Linked by a Chain of Contracts

28 Similar considerations arose in *Rivtow Marine Ltd. v. Washington Iron Works*, [1974] S.C.R. 1189, [1973] 6 W.W.R. 692, 40 D.L.R. (3d) 530, a case in which *there was no direct contractual relationship between the plaintiff and the defendants*. Rather, there was a *chain of contracts* linking the two parties, as in the present case. Despite the lack of contractual privity, Ritchie J., as I noted in *Norsk*, at p. 1066, expressly considered whether the tort duty he imposed would have the effect of disrupting contractual relations. He stated, at p. 1214:

> In the present case, however, I am of opinion that the failure to warn was "an independent tort" unconnected with the performance of any contract either express or implied.
>
> [Emphasis added.]

In *Kamloops*, *supra*, at p. 34, Wilson J. noted that the contractual aspects of *Rivtow* played a "major role" in the restrictive approach taken by the majority.

29 *Rivtow* was not a true concurrent liability case because of the lack of privity between Rivtow and the defendants: Rivtow had no contractual claim against the defendants. Nonetheless, it was concurrent in the broader sense that I prefer to refer to as tort liability in a contractual context or matrix; see the reasons of Purchas L.J. in *Pacific Associates*, which as I noted were concurred in by Wallace J.A. in the Court of Appeal. Many issues raised in concurrent cases like *Nunes Diamonds* and *Rafuse* must also be considered where there is no privity of contract between the plaintiff and defendant. The mere lack of privity does not justify the complete disregard of contractual concerns. In fact, since in such circumstances it is more difficult for the parties to contract out of tort liability, tort law may need to be *more* attuned to the contractual allocation of risk than in cases of concurrent liability.

30 On the other hand, it is apparent that the values protected by tort may predominate in a given context, and the nature of the damage may be a relevant consideration. This is revealed by an examination of cases involving products liability. Since *Donoghue*, it is well established that manufacturers are liable for negligence causing property damage to end users of their products: the safety concerns are obvious. When the question of recovery for economic loss in a products liability

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case arises, however, the case becomes more difficult. For example, in *Rivtow*, the crux of the disagreement between the majority and the dissent turned on whether the safety concerns underlying the law on products liability for physical damage justified allowing recovery for economic loss. Laskin J. felt that safety concerns should take precedence on the facts of that case. At pages 1218-19, he stated:

> It seems to me that the rationale of manufacturers' liability for negligence should equally support such recovery in the case where, as here, there is a threat of physical harm and the plaintiff is in the class of those who are foreseeably so threatened: see Fleming, *Law of Torts*, 4th ed., 1971, pp 164-5, 444-5.
>
> The present case is concerned ... (and here I repeat myself) with economic loss resulting directly from avoidance of threatened physical harm to property of the appellant if not also personal injury to persons in its employ.

Ritchie J. gave precedence in that context to contractual concerns. He based his rejection of recovery on the fact that (at p. 1207) "liability for the cost of repairing damage to the defective article itself and for the economic loss flowing directly from the negligence, is akin to liability under the terms of an express or implied warranty of fitness and as it is contractual in origin cannot be enforced against the manufacturer by a stranger to the contract".

31 In my view, Ritchie J.'s reference to the contractual "origin" of the manufacturer's liability must be read as a conclusion that, in his opinion, the contractual aspects of that case outweighed the safety concerns. For it is clear that the manufacturer's undoubted liability for *physical* damage is also akin to liability under the terms of an express or implied warranty of fitness and is no less contractual in "origin" than liability for economic loss. Nonetheless, liability in tort undoubtedly exists in those circumstances essentially because of the safety concerns. Thus, to be precise, it is not the contractual origin but rather the concern with upsetting the contractual *bargain* struck that lies behind the majority decision in *Rivtow*. Where the concern with safety becomes more tenuous, as in a products liability economic loss case, the contractual aspects begin to predominate. The decision of the majority may also have been prompted by concerns about the difficulty of applying the minority's criteria. It would appear that an unjustified extension of recovery in a number of English cases of the *Rivtow* variety beyond those cases which truly raise safety concerns may have been a key factor in the recent overruling of *Anns* (which relied on the dissent in *Rivtow*) by the House of Lords in *Murphy v. Brentwood District Council*, [1991] 1 A.C. 398, [1990] 2 All E.R. 908 (H.L.); see I. N. Duncan Wallace, "Anns Beyond Repair" (1991), 107 *L.Q. Rev*. 228, at pp. 230-31.

32 Laskin J. was of the opinion that the safety concerns, although they might perhaps be attenuated, should still prevail. As I noted in *Norsk* (at p. 1065), however, he was most careful to exclude recovery in tort for "safe but shoddy" products and to exclude recovery in cases "where a manufactured product proves to be merely defective (in short, where it has not met promised expectations)". In such cases, tort has no role since the contractual aspects take precedence. The plaintiff should not be able to use tort law merely to improve its contractual bargain.

33 *Nunes Diamonds* was concerned with loss of property, *Rivtow* with economic loss. The fact that a particular case concerns property damage rather than economic loss, while undoubtedly relevant and important to the resolution of the case, does not preclude the consideration of the issue of the interaction of tort and contract. This is most obvious in concurrent liability cases. No one suggests that the ability of one party to exclude its tort liability by contract should be limited to its tort liability for economic loss. As the reasons of Iacobucci and McLachlin JJ. in this case indicate, it is also apparent in third party beneficiary cases. I note that Iacobucci J. in his reasons does not for a moment consider that the benefit of exclusion clauses should be limited to cases of economic loss, even though some earlier cases had drawn such a distinction, perhaps because they felt constrained by the House of Lords decision in *Scruttons Ltd. v. Midland Silicones Ltd.*, [1962] A.C. 446; see *Johnson Matthey & Co. v. Constantine Terminals Ltd.*, [1976] 2 Lloyd's Rep. 215 (Q.B. (Com. Ct.)), at p. 222; F. M. B. Reynolds, "Tort Actions in Contractual Situations" (1984-85), 11 *N.Z.U.L.R. 215*, at p. 222. Similarly, McLachlin J. does not limit the operation of the doctrine of voluntary assumption of risk to economic loss. What these holdings recognize is that there is no reason to limit the effect of the limitation of privity or of voluntary assumption of risk to economic loss because the policy reasons lying behind their application are linked, not to the nature of the loss, but to the contractual allocation of risk between the parties and the general context of the case.

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Parties in a Contractual Context

34 *Norsk* raised the issue of the interaction between tort liability and contract in a different context. In *Norsk* the principal relevant contract was between the plaintiff and the property owner. (Other contracts, such as the plaintiff's contracts with its customers and suppliers, were also peripherally relevant.) Not only was there no privity of contract between the plaintiff and the defendant but the defendant's contractual arrangements were largely irrelevant (except for the potential effect of imposing liability on the defendant's insurance contracts). Despite the lack of privity and the lack of a chain of contracts linking the plaintiff and the defendant, six of the judges hearing that case agreed that the contractual allocation of risk was a relevant consideration in the imposition of tort liability in that case (see my reasons, at pp. 1125-27, and those of McLachlin J., at p. 1164). There was a three-three split as to its application on the facts of that case. Stevenson J. was the lone judge to find (implicitly) that the contractual allocation of risk was not a relevant consideration and that only the problem of indeterminacy needed to be considered in that context.

35 Policy concerns about contractual allocation of risk in cases in which tort and contract claims coexist arise regardless of whether the damage incurred is property damage or economic loss. As Professor Blom notes in his article "Slow Courier in the Supreme Court: A Comment on B.D.C. Ltd. v. Hofstrand Farms Ltd." (1986-87), 12 *Can. Bus. L.J*. 43, at p. 64:

> These problems of the relationship between the obligations undertaken by the defendant by contract, the risks assumed by the plaintiff by contract (which may be a different contract), and the tort duties and rights that may be superimposed on these contractual duties and rights, exist irrespective of whether the damage in question is physical or economic loss.
>
> [Emphasis added.]

Taylor J.A. referred to a similar idea in writing for the British Columbia Court of Appeal in *Kamahap Enterprises Ltd. v. Chu's Central Market Ltd.* (1989), [1990] 1 W.W.R. 632, 40 B.C.L.R. (2d) 288, 1 C.C.L.T. (2d) 55, 64 D.L.R. (4th) 167, at p. 170:

> Reliance on the carefulness of another is reasonably to be expected as a general rule when it is foreseeable that a person may suffer personal injury or physical property damage as a result of the carelessness of another, subject, no doubt, to exception where such reliance would not be reasonable or expected, by reason, for instance, of the existence of some special knowledge, contractual arrangements, or legal relationship.
>
> [Emphasis added.]

36 I re-emphasize that the recognition that contractual concerns must be considered in tort cases like the present is not to be interpreted as a return to the now discredited reasoning in *Winterbottom v. Wright* (1842), 10 M. & W. 109, 152 E.R. 402. It is now recognized that it would be anomalous if a person who has assumed responsibility gratuitously is subject to the legal consequences of tortious liability but a person who had assumed such responsibility under contract is not; see my reasons in *Maryon*, and *Rafuse*, at pp. 506 and 204-5. *Rafuse* establishes that tort liability cannot be excluded by the mere *presence* or *existence* of a contract in a particular situation. Undoubtedly in past cases, once a particular situation had been analyzed and a conclusion reached that contractual concerns should predominate, this conclusion was often expressed in terms of the "contractual origin" of particular duties, or in terms of the existence of a contract barring liability in tort. In my view, such phrases must be interpreted as shorthand for the conclusion reached as a result of the balancing of tort and contract concerns in a particular situation.

37 I conclude that the mere fact that this case involves property damage rather than economic loss cannot be sufficient to eliminate inquiry into whether the recognition of a duty of care in these circumstances is justified on policy grounds. Before leaving the issue of the application of *Anns* in this case, I note that my colleague McLachlin J., at p. 460, states that *Anns* permits and indeed requires the court to take account of all relevant circumstances in assessing the duty of care

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which a particular defendant owes a particular plaintiff and makes no reference to the type of loss involved in the case. While I agree generally with that statement, I would underline the policy interest in stability of the law expressed notably by Lord Brandon in *Leigh and Sillavan Ltd. v. Aliakmon Shipping Co.*, *supra*, at pp. 815-16. As noted by Taylor J.A. in *Kamahap*, *supra*, in the vast majority of property damage cases, the straightforward application of the foreseeability test is sufficient to found a duty of care. Accordingly, it should only rarely be necessary to examine such cases under the second branch of *Anns*.

38 Many property damage cases occur outside of a contractual context, and as I noted, a duty of care is justified in those cases based on foreseeability. Even in property damage cases with contractual overtones, it undoubtedly makes sense in almost all cases to allow the risk of damage to accompany the property in the absence of some express contractual stipulation. In most contractual contexts, all parties are able to plan for potential tort liability for property damage based on foreseeability. For the reasons set out below, I am of the opinion that in general employees are not realistically in a position to so plan.

39 Property damage is also a criterion that has the significant advantage of being relatively easy for courts to apply. It responds to the strong policy interest in having workable rules. Even in those cases that do have contractual overtones, parties benefit greatly from clear rules attributing liability. In sum, a return to first principles will rarely be necessary in property damage cases. I shall set out below the reasons why I am of the opinion that an exception to the general rule of foreseeability should apply here.

40 I conclude that the considerations put forward in support of an application of the simple foreseeability test, while undoubtedly important, are not sufficient to preclude policy analysis in this case under the second branch of *Anns*. In today's world, in which the gradual extension of tort liability means that many losses incurred as a result of breaches of contract will give rise to a concurrent or associated claims in tort, the question of the employee's liability in cases that trigger the operation of vicarious liability needs to be examined more closely. Accordingly, I turn to an examination of the operation of vicarious liability in this case.

Vicarious Liability

41 This case raises the question of the employee's personal liability within the context of the vicarious liability regime. Under that regime, the law holds the employer liable for the misconduct of another person, his employee. Although the regime has traditionally also held the employee to be liable, the respondents and the intervener point to the arguments put forward by leading tort scholars such as John Fleming and to a number of cases which suggest that that rule should be reconsidered. They also suggest that to apply the traditional rules of vicarious liability to tort claims arising in contractual situations as a result of the recent development of concurrent liability in tort and contract would be inappropriate. The appellant, on the other hand, contends that the employees owed a duty of care to London Drugs at common law as well as by virtue of the *Warehouse Receipt Act*, R.S.B.C. 1979, c. 428.

42 I agree with Wallace J.A. (at p. 79) that neither ss. 2(4)(b) and 13 of the *Warehouse Receipt Act* nor s. 11(b) of the contract of storage confirms or negates the existence of a duty owed by the employees of the warehouseman; nor do they create a duty on the part of such employees. In my view, that statute does not apply to employees. It is limited to a "warehouseman". Accordingly, I agree with Wallace J.A. that the scope of the duty the employees of a warehouseman may, or may not, have to the warehouseman or its customers must be determined by the application of the common law principles of tort.

43 Before I examine the common law authorities on the question of employee liability, I shall explain why I think that the law, if settled as counsel for the appellant says it is, would be defective.

44 Vicarious liability is generally considered to rest on one of two logical bases; see Fridman, *The Law of Torts in Canada* (1990), vol. 2, at pp. 314-15; Atiyah, *Vicarious Liability in the Law of Torts* (1967), at pp. 6-7. The first, encapsulated by the Latin maxim *qui facit per alium facit per se*, considers the employer to be vicariously liable for the

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acts of his employee because the acts are regarded as being authorized by him so that in law the acts of the employee are the acts of the employer. This first basis was termed the "master's tort theory" by Glanville Williams, "Vicarious Liability. Tort of the Master or of the Servant?" (1956), 72 *L.Q. Rev*. 522. The second approach, which is described by the maxim *respondeat superior*, attributes liability to the employer simply because the employer was the employee's superior and in consequence in charge or command of the employee. In Williams' terminology, this basis is termed the "servant's tort theory".

45 Fridman has noted how neither of the logical bases for vicarious liability succeeds completely in explaining the operation of the doctrine. As he notes, "[b]oth these maxims express not so much the true rationale of vicarious liability but an attempt by the law to give some formal, technical explanation of why the law imposes vicarious liability" (at p. 315). Lord Reid was hardly more respectful of the doctrine's supposed logical foundations; in *Staveley Iron & Chemical Co. v. Jones*, [1956] A.C. 627, [1956] 1 All E.R. 403, at p. 643, he said: "[t]he former [*respondeat superior*] merely states the rule baldly in two words, and the latter merely gives a fictional explanation of it". Even concerted attempts to establish theoretical distinctions, such as that by Professor Williams, end up by concluding that recourse to at least two theories is necessary to obtain satisfactory results in the various scenarios in which vicarious liability comes into play; see Williams, *supra*; Atiyah, *supra*, at p. 7.

46 In my opinion, the vicarious liability regime is best seen as a response to a number of policy concerns. In its traditional domain, these are primarily linked to compensation, deterrence and loss internalization. In addition, in a case like the one at bar, which involves a planned transaction or a contractual matrix, the issue of tort liability in the context of contractual relations involves a wider range of policy concerns. Alongside those respecting compensation, deterrence and loss internalization, there are important concerns regarding planning and agreed risk allocation.

47 Before I examine the policy concerns raised by the operation of vicarious liability in this case, I wish to underline that I am considering here a case in which the regime clearly operates. This case involves a situation in which no difficulties arise as to the scope of employee behaviour covered or the range of agents for whom the employer is responsible or other similar concerns. Nothing I say here should be taken as having any relevance to the question of whether the employer's liability should be extended or restricted in other types of cases.

48 The most important policy considerations lying behind the doctrine of vicarious liability are based on the perception that the employer is *better* placed to incur liability, both in terms of fairness and effectiveness, than the employee. Fleming admirably summarizes the policy concerns in the following passage from *The Law of Torts* (7th ed. 1987), at p. 340:

> Despite the frequent invocation of such tired tags as Respondeat superior or Qui facit per alium, facit per se, the modern doctrine of vicarious liability cannot parade as a deduction from legalistic premises, but should be frankly recognised as having its basis in a combination of policy considerations. Most important of these is the belief that a person who employs others to advance his own economic interest should in fairness be placed under a corresponding liability for losses incurred in the course of the enterprise; that the master is a more promising source for recompense than his servant who is apt to be a man of straw; and that the rule promotes wide distribution of tort losses, the employer being a most suitable channel for passing them on through liability insurance and higher prices. The principle gains additional support for its admonitory value in accident prevention. In the first place, deterrent pressures are most effectively brought to bear on larger units like employers who are in a strategic position to reduce accidents by efficient organisation and supervision of their staff. Secondly, the fact that employees are, as a rule, not worth suing because they are rarely financially responsible, removes from them the spectre of tort liability as a discouragement of wrongful conduct. By holding the master liable, the law furnishes an incentive to discipline servants guilty of wrongdoing, if necessary by insisting on an indemnity or contribution.

It is useful to separate out the various policy concerns identified by Fleming.

49 First, the vicarious liability regime allows the plaintiff to obtain compensation from someone who is financially capable of satisfying a judgment. As Lord Wilberforce noted in *Kooragang Investments Pty. v. Richardson & Wrench*

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Ltd., [1982] A.C. 462, [1981] 3 All E.R. 65 (P.C.), at p. 68, the manner in which the common law has dealt with the liability of employers for acts of employees (masters for servants, principals for agents) has been progressive: the tendency has been toward more liberal protection of innocent third parties; see also Fridman, at pp. 315-16. The plaintiff benefits greatly from the doctrine of vicarious liability, which allows access to the deep pocket of the company, even where the company is blameless in any ordinary sense.

50 Second, a person, typically a corporation, who employs others to advance its own economic interest should in fairness be placed under a corresponding liability for losses incurred in the course of the enterprise. As Lord Denning noted in *Morris v. Ford Motor Co.*, [1973] 1 Q.B. 792, [1973] 2 All E.R. 1084 (C.A.), at p. 798, the courts "would not find negligence so readily — or award sums of such increasing magnitude — except on the footing that the damages are to be borne, not by the man himself, but by an insurance company" through coverage purchased by the employer.

51 Third, the regime promotes a wide distribution of tort losses since the employer is a most suitable channel for passing them on through liability insurance and higher prices. In *Hamilton v. Farmers' Ltd.*, 31 M.P.R. 343, [1953] 3 D.L.R. 382 (N.S.S.C.), Mac-Donald J. noted, at p. 393, that the principle of vicarious liability "probably reflects a conclusion of public policy that the master should be held liable for the incidental results of the conduct of his business by means of his servants as a means of distributing the social loss arising from the conduct of his enterprises".

52 Fourth, vicarious liability is also a coherent doctrine from the perspective of deterrence. KNI is in a much better situation than Vanwinkel and Brassait to adopt policies with respect to the use of cranes, the inspection of stickers and so on in order to prevent accidents of this type. Given that it will either be held liable or its customers' insurance costs will reflect its carefulness, KNI has every incentive to encourage its employees to perform well on the job and to discipline those who are guilty of wrongdoing.

53 It is apparent that the vicarious liability regime is not merely a mechanism by which the employer guarantees the employee's primary liability. The regime responds to wider policy concerns than simply the desire to protect the plaintiff from the consequences of the possible and indeed likely incapacity of the employee to afford sufficient compensation, although obviously that concern remains of primary importance. Vicarious liability has the broader function of transferring to the enterprise itself the risks created by the activity performed by its agents.

54 The question in this case is whether the elimination of the employee's liability would significantly impact on the policies advanced by vicarious liability. In my view, it would impact favourably on the second and third considerations set out above and have negligible impact on the fourth. Again, Fleming, *supra*, at pp. 340-41, sets out the reasons why the elimination of the employee's liability is generally desirable:

55 As already noted, the master's vicarious liability does not displace the servant's personal liability to the tort victim. But this conclusion is neither self-evident nor beyond all objection. For one thing, *ordinarily it is positively desirable that the master absorb the cost as a matter of sound resource allocation rather than that he be considered merely as guaranteeing the servant's primary responsibility to pay for the damage*. For another, to hold the servant liable will either tend to overtax his financial resources (especially under modern conditions when these have become increasingly unequal to his capacity for causing great loss) or require double insurance, covering both him and his employer against the same risk. For these reasons, there is now a growing momentum in many countries for "channelling" liability to the employer alone; the employee being freed altogether from claims by third parties and liable at most to his employer for a limited contribution when this is justified on disciplinary grounds. This mostly corresponds with our own *practices* — damages are rarely collected from employees by their tort victims or indemnity sought by their employers — but except in South Australia and the Northern Territory, the popular notion that the primary responsibility should be the employer's rather than the employee's is as yet hardly reflected by the law in books. [Emphasis added.]

56 In my view, not only is the elimination of the possibility of the employee bearing the loss logically compatible with the vicarious liability regime, it is practically compelled by the developing logic of that regime. In our modern economy, an employee's capacity to cause loss does not bear any relation to his salary. As was stated by a Committee set up in

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England to inquire into the implications of the case of *Lister v. Romford Ice & Cold Storage Co.*, [1957] A.C. 555, [1957] 1 All E.R. 125 (H.L.) (Atiyah, *supra*, at p. 426):

> There can ... be no doubt that if there were any real possibility of employees regularly being called upon to pay out of their own pockets damages resulting from acts of carelessness or inattention occurring in the course of their employment, a situation would be created for which some remedy would have to be provided.

The employer will almost always be insured against the risk of being held liable to third parties by reason of his vicarious liability: the cost of such liability is thus internalized to the profitable activity that gives rise to it. There is no requirement for double insurance, covering both the employee and his employer against the same risk. Shifting the loss to the employee, either by permitting a customer to act against the employee or by permitting the employer to claim an indemnity against the employee, upsets the policy foundation of vicarious liability.

57 As for deterrence, imposing tort liability on the employee in these circumstances cannot be justified by the need to deter careless behaviour. An employee subjects himself to discipline or dismissal by a refusal to perform work as instructed by the employer. These are the real external pressures felt by an employee to perform well; the odds of an employee being held personally liable remain slight. With the onus clearly on the employer to act to reduce accident costs, the employer is free to establish contractual schemes of contribution from negligent employees as an element in the employer's campaign to reduce accidents. The amounts could be better calibrated on the extent of the employee's fault and the real deterrent effect would be greater. Given the notorious reluctance of employers to sue their employees for obvious reasons, the employer is probably likely to prefer other techniques for improving job performance.

58 I conclude that for three of the four policy concerns identified, the elimination of employee liability in the context of this case would either lead to the concern being better met or would have negligible impact. The critical policy concern that would be raised by the elimination of the employee's liability in this case is related to compensation. Obviously, removing a potential defendant from the equation will reduce to some degree the plaintiff's chances of being compensated for its loss.

59 In this regard, it should first be noted that in the vast majority of cases, eliminating the possibility of shifting the loss to the employee will have no impact on the plaintiff's compensation. The plaintiff will naturally prefer to sue the employer whenever possible. Under current law, the plaintiff may wish to join one or more employees as parties to the action in order to obtain the possibility of additional discovery (provided it does not constitute an abuse of process), but in the ordinary case, the plaintiff will not look to the employee for recovery. The principal defensive weapon of employees is, of course, their impecuniousness. Second, in this case, as I outlined above, I see no reason why London Drugs' interest in compensation is any stronger than it would be if it were seeking compensation for economic loss in similar circumstances.

60 Furthermore, the decision of this Court today with respect to the application of contractual clauses excluding or limiting liability will remove one of the principal reasons to sue employees, since such an approach will no longer offer a convenient way around such a contractual clause. In light of the Court's decision today on the applicability of the contractual clause, the issue of an employee's liability will arise principally when the employer is unable to satisfy a judgment, most often because it is bankrupt.

61 Nonetheless, for one reason or another, the employer may not be available as a source of compensation. In my view, in what may be termed a "classic" or non-contractual vicarious liability case, in which there are no "contractual overtones" concerning the plaintiff, the concern over compensation for loss caused by the fault of another requires that *as between the plaintiff and the negligent employee*, the employee must be held liable for property damage and personal injury caused to the plaintiff. An example of such a case is a plaintiff who is injured by an employee while the employee, acting in the course of employment, is driving on the road. In this context, the plaintiff obviously never chose to deal with a limited liability company. I do not find it necessary here to consider the vexing question of the possible impact of clauses in the defendant's contract with a third party, i.e., in this example, a clause in the contract between the employee

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and the employer, on liability to a plaintiff; see Atiyah, *An Introduction to the Law of Contract* (4th ed. 1989), at pp. 394-95; B. J. Reiter, "Contracts, Torts, Relations and Reliance" in B. J. Reiter and J. Swan, eds., *Studies in Contract Law* (1980), 235, at p. 301. *As between the plaintiff and the employee*, there is no reason to excuse the employee in such a case. Even if a contractual clause as described above could in some circumstances act to modify the tort duty, a question I expressly reserve, it could obviously never do so with respect to the duty to drive carefully.

62 However, the policy arguments set out above strongly support the idea that, *as between the employee and employer*, the employer should still bear the risk even in this kind of case. The best solution to such "classic", non-contractual, cases would probably be an indemnity regime operating between employer and employee along the lines of that which exists, as a result of judicial innovation, in Germany. Markesinis describes the regime as follows (*A Comparative Introduction to the German Law of Torts* (2nd ed. 1990), at pp. 502-3):

> The injured party's right to proceed against the tortfeasor employee can be neutralized as far as the *latter* is concerned in so far as he can rely on a principle developed by the case-law known as the 'employee's claim for exception'. This in principle places the employer under an obligation to indemnify his employee whenever the latter has been sued by the victim. The danger of disturbing manager-labour relationships, by allowing the employer to seek an indemnity from his employee is thus not only avoided, but on the contrary, the issue is resolved by placing liability squarely on the shoulders which can best carry it (see the decisions of the Supreme Court for Labour Matters in 1957 and 1959, BAG 5, 1 and BAG 7, 290).
>
> [Emphasis added.]

A more recent German case which extended the scope of the employee's immunity vis-à-vis his employer for torts against the employer thus sets forth in forceful terms the economic trends that make this evolution desirable (Bundesarbeitsgericht (Seventh Senate), judgment of 23 March 1983, BAG 42, 130, translated and reproduced in Markesinis, *supra*, at pp. 574-75):

> Following the decision of the Great Senate of the *Bundesarbeitsgericht* of 25 September 1957 (BAG 5, 1, 18) this Senate now holds that in a case where the employee's fault is 'less than grave', his liability is excluded by the employer's business risk concept, applying § 254 BGB by analogy. For this purpose normal or medium carelessness, as well as slight fault, should count as 'less than grave', as the words suggest. In view of the increased liability brought about by technological developments, to attribute business risk on a case-by-case basis as the *Bundesarbeitsgericht* has hitherto done is not an appropriate way of dealing with its liability in cases where the employee has been guilty of normal fault. Thus, damage done by an employee without intention or gross negligence while engaged on a dangerous job is one of the employer's business risks and must be borne by him alone. To allot damage done by the employee to the risks of the business, in the absence of gross negligence, is justified by the fact that it is the division of labour within the business which exposes the employee to the risks specific to his work. Division of labour and organizational structure are matters for the employer whose ownership and power of management enable him to determine how the work of the business is to be organized. The employee, on the other hand, given his subordinate position, has little or no influence on these factors which are relevant to the damage caused. Since the employer is better able to deploy technical and organizational measures to reduce the special risks of the business and to take out any necessary insurance, it is right to treat damage as a risk of the business to be borne by him alone unless it is due to the intentional or grossly negligent conduct of the employee. Another consideration is that without such division of labour the employer himself would have to perform the dangerous job and would then have to bear the cost of damage due to the negligence which is occasionally bound to occur; an instance would be the small haulier who himself takes the wheel of a truck, perhaps his only truck, and so causes damage. Division of labour within a business should not enable the business to put such risk of liability on the employee. Furthermore the extent of harm is greatly dependent on the way the business is equipped and run. In almost all sectors of the economy technological development involves the replacement of personnel by expensive machinery and other technical equipment which increases the risk of liability. As such rationalization also reduces the employer's expenditure on wages, it is right

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> that he should bear the risk of the increased harm which is due to the conduct of an employee which is neither intentional nor grossly negligent.
>
> [Emphasis added.]

By finding that the employee was not liable in such a context, the court was not required to consider the question of whether the employer's duty to look after his employees required him to take out insurance.

63 The trends identified by the German court are long-term trends common to all advanced industrial economies and I find these arguments very persuasive. Establishing such an indemnity regime is probably the next logical step in the development of the theory of vicarious liability. This would essentially involve bringing legal doctrine into line with the reality of modern industrial relations. In England, the House of Lords rejected such an indemnity regime as an implied term in a contract of employment in a 3-2 decision in *Lister v. Romford Ice and Cold Storage Co.*, *supra*. The majority allowed the employer's liability insurer to recover an indemnity against the uninsured truck driver whose negligence had caused the injury and involved the employer in vicarious liability. The effect of the *Lister* decision was promptly substantially nullified by a whole series of formal and informal agreements; see Atiyah, *Vicarious Liability in the Law of Torts*, *supra*, at pp. 426-27. Although the terms of the agreements between insurers appeared to be confined to cases in which a fellow employee is injured or killed, an attempt by a plaintiff to hold the employee personally liable as a result of being subrogated to the employer's rights was rejected in *Morris v. Ford Motor Co.*, *supra*. Lord Denning M.R. underlined the injustice in finding the employee liable, at p. 798:

> If the cleaners are right in this contention — if they can thus force Roberts to pay the damages personally — it would imperil good industrial relations. When a man such as Roberts makes a mistake — like not keeping a good lookout — and someone is injured, no one expects the man himself to have to pay the damages, personally. It is rather like the driver of a car on the road. The damages are expected to be borne by the insurers. The courts themselves recognise this every day. They would not find negligence so readily — or award sums of such increasing magnitude — except on the footing that the damages are to be borne, not by the man himself, but by an insurance company. If the man himself is made to pay, he will feel much aggrieved. He will say to his employers: "Surely this liability is covered by insurance." He is employed to do his master's work, to drive his master's trucks, and to cope with situations presented to him by his master. The risks attendant on that work — including liability for negligence — should be borne by the master. The master takes the benefit and should bear the burden. The wages are fixed on that basis. If the servant is to bear the risk, his wages ought to be increased to cover it.

In *Morris*, the court was bound by the decision of the House of Lords in *Lister* with respect to the prior issue of the employee's liability to Ford. This Court has never had occasion to consider the *Lister* case on this point.

64 I do not, however, need to consider the *Lister* case for the purposes of resolving this case: the employees did not bring a claim for indemnification against their employer. I propose to rest my decision on narrower grounds, linked to the con-tactual context in which this case occurs. In the particular type of vicarious liability situation we are concerned with here, the general arguments put forward by Fleming and others to the effect that employees should not bear the loss in most cases are reinforced by a second consideration.

65 I referred earlier to classic, non-contractual, vicarious liability cases. These cases can be distinguished from those like the case at bar, that involve a planned transaction. Such cases may perhaps best be described as commercial vicarious liability claims. Professor Blom sets forth a simple definition of a planned transaction as one in which someone acquires or disposes of property of any kind or services of any kind; see "Fictions and Frictions", *supra*. As Blom notes, whenever a planned transaction is involved, there are foreseeable risks — to someone's person, land, goods, or financial interests — and thus the possibility of allocating or otherwise dealing with those risks in advance. This circumstance must be taken into account, even if the plaintiff s action is in tort. He states, at p. 159:

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> Wherever there is a planned transaction there are foreseeable risks — to someone's person, land, goods, or financial interests — and thus the possibility of allocating or otherwise dealing with those risks in advance. Where the risk materializes, and there is a tort claim for the loss that results, it is relevant to ask what expectations it was reasonable to have about that risk, and what planning the victim and the negligent party could have done with regard to their respective exposures to loss or liability. In short, the proper approach to the tort claim may need to be coordinated with these contractual or contract-like features of the situation.

This Court has increasingly recognized the importance of such considerations in recent tort cases; see my reasons (at pp. 1125-27), and those of McLachlin J. (at p. 1164) in *Norsk* which hold that contractual concerns were a relevant consideration. The opinions of both my colleagues in the present case also attest to the importance of this type of consideration.

66 In my view, where the plaintiff has suffered injury to his property pursuant to contractual relations with the company, he can be considered to have chosen to deal *with a company*. Company legislation typically provides for notice and publicity of the fact that a company is under a limited liability regime; customers and creditors are thereby put on notice that in ordinary circumstances they can only look to the company for the satisfaction of their claims. In British Columbia, corporations are also required to set out their name in all contracts, invoices, negotiable instruments and orders for goods and services; see British Columbia *Company Act*, R.S.B.C. 1979, c. 59, ss. 16 and 130.

67 In my view, in contracting for services to be provided by a business corporation like KNI in the circumstances of the present case, London Drugs can fairly be regarded as relying upon performance by the corporation, and upon the liability of that body if the services are negligently performed. As Reiter, *supra*, suggests, at p. 290:

> The plaintiff did not rely, or cannot be regarded as having relied reasonably, upon the liability of any individual where the individual is acting in furtherance of a contract between plaintiff and a principal or employer of the individual: the individual defendant cannot reasonably be regarded as appreciating that he is being looked to (personally) to satisfy the expectations of the plaintiff.

Nor can Vanwinkel and Brassart be taken on the facts of this case to appreciate that the plaintiff is relying on *them* for compensation at all. As Reiter underlines, the intention to transfer the responsibility to the corporation or association is a most explicit risk allocation by contract in the three-party enterprise.

68 The distinction between voluntary and involuntary creditors is also useful in this area. As commentators have pointed out (Halpern, Trebilcock and Turnbull, "An Economic Analysis of Limited Liability in Corporation Law" (1980), 30 *U.T.L.J.* 117), different types of claimants against the corporation have differing abilities to benefit from being put on notice with respect to the impact of the limited liability regime. At one end, creditors like bond holders and banks are generally well situated to evaluate the risks of default and to contract accordingly. These "voluntary" creditors can be considered to be capable of protecting themselves from the consequences of a limited liability regime and the practically systematic recourse by banks to personal guarantees by the principals of small companies attests to that fact.

69 At the other end of the spectrum are classic involuntary tort creditors exemplified by a plaintiff who is injured when run down by an employee driving a motorcar. These involuntary creditors are those who never chose to enter into a course of dealing with the company and correspond to what I have termed as the classic vicarious liability claimant.

70 The type of situation in this case is intermediate. Clearly, London Drugs is not a voluntary creditor in the sense that it voluntarily supplied money or goods to the company. However, London Drugs is not a wholly involuntary creditor either since, as I noted, it voluntarily entered into a course of dealing with the employer company. The type of claim present here obviously involves a planned transaction and, significantly, that is true regardless of whether or not the service contract contains a limitation of liability clause. That fact merely goes to the extent of the planning.

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71 The policy reason that lies behind the argument founded on limited liability is an admittedly weaker version of the rationale for the result obtained by McLachlin J. through the doctrine of voluntary assumption of risk. She points to the voluntary assumption of risk by the plaintiff in the particular contract; see McLachlin J., at p. 460; Fleming, at p. 265. I applied a not dissimilar analysis in *Norsk*, although in a very different context.

72 In similar terms, a plaintiff who chooses to enter into a course of dealing with a limited liability company can, in most cases, be held to have voluntarily assumed the risk of the company being unable to satisfy a judgment in contract or for vicarious liability. That the customer takes this risk in matters of contract has been accepted since *Salomon v. Salomon & Co.*, [1897] A.C. 22 (H.L.). Now that many contractual claims are brought concurrently as tort claims, the customer should not be able to shift this risk to the employee by claiming in tort. This is merely another application of the general principle I enunciated in *Maryon*, referred to with apparent approval in *Rafuse*, that the court must not let tort be used to unjustly and unjustifiably avoid obligations and limitations accepted in contract.

73 In addition, in the context of a commercial vicarious liability claim, placing liability exclusively on the employer places liability on a party that is easily able to modify its liability by contractual stipulations. In many cases of this type, this may well be an advantageous approach. As I noted in *Norsk*, at p. 1126:

> In many cases, contracting parties are not willing to insure performance; the contractual allocation of risk in this case is probably typical in that risk is allocated to the potential victim of interrupted service, who benefits from a lower price and who is best placed to take other measures to deal with accidental interruption of contractual benefits.

KNI *and London Drugs* took advantage of that possibility in this case. They used the by now well accepted application of contractual clauses to strictly limit KNI's tort and contract liability for property damage. As a result, London Drugs had the option of purchasing its own insurance or purchasing extra insurance from KNI. London Drugs found it advantageous not to require KNI to insure performance. So long as there are no concerns about unconscionability and no overriding social interest protected by tort is involved, this ability of the parties to modify their possible tort and contract liability is an unquestionable advantage. The customer *benefits* from the ability of the future defendant to contract out of its tort liability.

74 In a different case it might, for a variety of reasons, be cheaper for KNI and thus for its customers for KNI to insure directly. Even where it is not cheaper, KNI might have other reasons to insure directly. Rather than limit its liability and require its customers to purchase insurance, it could purchase liability insurance itself and add the cost onto the cost of storage. Surely, the extent of the employees' liability should not depend on whether KNI limits its liability to $40 and then offers insurance to its customers separately, or does not limit its liability to the customer and insures itself.

75 Unlike KNI, Vanwinkel and Brassait had no real opportunity to decline the risk. The intervener stressed that in the usual case, the employee will have no knowledge of how or upon what conditions the work was acquired; they only know that once it is acquired, they are required to perform it if they are directed to do so by their employer.

76 Even in those cases, such as negligent misstatement cases, that bring the employee into contact with the plaintiff and thus at least theoretically allow the employee some way to decline to accept the risk, employees are poorly situated to do so. In *Northwestern Mutual Insurance Co. v. J.T. O'Bryan & Co.*, [1974] 5 W.W.R. 322, [1974] I.L.R. 1-639, 51 D.L.R. (3d) 693 (B.C.C.A.), the court found that the employee who proffered faulty information concerning the state of the plaintiff's insurance "could have kept silent and declined to give the information" or "could have given the information with a reservation that he accepted no liability for its accuracy or otherwise (p. 701)". The court in that case thus applied to employees the same criteria as were applied to the liability of a company in *Hedley Byrne*. With respect, one imagines a rather short career for an employee hired to serve the public who kept silent and declined to give out information for fear of engaging personal liability in tort. As Reiter underlines, the court's alternative suggestion implies that the employee should preface all his remarks to clients about their insurance by saying that he was accepting no *personal* responsibility for the information while underlining that he was saying nothing about his *employer's* responsibility; see Reiter, *supra*,

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at p. 291. It is unrealistic to oblige the employee to act in such an artificial manner. In most cases other than negligent misstatement, and in particular in the case at bar, the employee has no opportunity to decline the risk at all.

77 Counsel for the appellant suggested that liability should lie against the employees because they remain free to contract out of such liability. In cases where the employees are represented by a union, the onus should lie on the union to contract out of liability for its members. In other words, he argued that the employees do have an opportunity to contract out of or to decline the risk, when they negotiate their terms of employment with their employer.

78 Undoubtedly, in the vast majority of cases involving property damage, counsel's argument is compelling. However, I do not find it convincing here. I would note first that the same argument could be made with respect to the application of the contractual limitation clause to the employees, i.e., that they could have taken advantage of exceptions to privity recognized in *ITO — International Terminal Operators Ltd. v. Miida Electronics Inc.*, [1986] 1 S.C.R. 752, (sub nom. *Miida Electronics Inc. v. Mitsui O.S.K. Lines Ltd.*) 68 N.R. 241, 28 D.L.R. (4th) 641, 34 B.L.R. 251, and that since they did not, liability should follow. Both my colleagues have implicitly or explicitly rejected that contention and I agree with them.

79 For similar reasons, I think it ill advised to place the onus on employees to contract out of their tort liability. Despite suggestions going back as far as the aftermath of the *Lister* case that unions should bargain about this issue (see Atiyah, *Vicarious Liability in the Law of Torts*, *supra*, at p. 426, n. 3), it is apparent that unions and employers have more pressing concerns. It is hardly necessary to refer to any elaborate theory regarding negotiating agendas to recognize that actual employee liability occurs infrequently enough that it is unlikely to get on the collective bargaining agenda. In the interim, serious injustice to individual employees can occur.

80 Furthermore, such a rule would create an untenable situation for the majority of private sector employees who are not unionized. As counsel recognized, the idea of contracting out for these employees is highly artificial, and their only hope would be legislative action in each province. Iacobucci J. described the context in which such employees contract with their employers in the recent case of *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986, 40 C.C.E.L. 1, 92 C.L.L.C. 14,022, 91 D.L.R. (4th) 491, (sub nom. *Lefebvre v. HOJ Industries Ltd.*) 136 N.R. 40, 53 O.A.C. 200, at p. 1003:

> The harm which the Act [the *Employment Standards Act*] seeks to remedy is that individual employees, and in particular non-unionized employees, are often in an unequal bargaining position in relation to their employers. As stated by Swinton, *supra*, at p. 363:
>
>> ... the terms of the employment contract rarely result from an exercise of free bargaining power in the way that the paradigm commercial exchange between two traders does. Individual employees on the whole lack both the bargaining power and the information necessary to achieve more favourable contract provisions than those offered by the employer, particularly with regard to tenure.

Iacobucci J. went on to note, at p. 1003, that "the fact that many individual employees may be unaware of their statutory and common law rights in the employment context is of fundamental importance". At page 1004, he again refers to the fact that "most individual employees are unaware of their legal rights, or unwilling or unable to go to the trouble and expense of having them vindicated". In light of this context, I think it highly unrealistic to expect employees to employ sophisticated contractual techniques to eliminate a potential liability about which they are very likely to be entirely unaware. Furthermore, in light of the general public policy interest in collective bargaining, I can see no justification for placing unionized employees in a more onerous situation than unorganized employees with respect to the same behaviour. Placing the onus to contract out of their tort liability on the employees is unjustified in this context.

81 I conclude that policy reasons strongly support a finding of no duty for an employee on the facts of this case. It is perhaps worth noting here that many statutes contain immunity clauses that relieve Crown servants from liability in tort for acts done in good faith in the intended execution of their duties. Hogg, *Liability of the Crown* (2nd ed. 1989), at pp. 145-46, describes the situation as follows:

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> ... many jurisdictions do in fact grant immunity from personal liability to many or all of their Crown servants. The common practice is to include a privative clause in a statute establishing a department or agency of government; the clause immunizes the employees within that department or agency from liability for damages for acts done in good faith in the intended execution of their duties.

Hogg's systematic survey of one jurisdiction, Ontario, revealed a total of 80 statutory immunity clauses (at p. 91, n. 55). Crown employees are also protected by what Hogg refers to as the "universality of the Crown practice of 'standing behind' Crown servants who incur tortious liability" (at p. 97). Furthermore, the risk of bankruptcy does not exist for all intents and purposes in the public sector context.

82 Iacobucci J. considers that the acceptance of the general rule advocated by the respondents would be at odds with the common law notion of vicarious liability. It has been suggested that to eliminate the employee's personal liability would eliminate the employer's tort liability, leaving only his liability in contract; see Blom, Case Comment, *supra*, at p. 174. While it is possible to find the employer negligent while exempting the employee in cases of negligent misstatement because of the special requirement of reliance, where the damage suffered is to the plaintiff's property, there is no means of imposing a duty of care exclusively on the employer. Blom concludes that the "duty of care has to be on the person who does the damage, because the employer's liability ... is only vicarious" (at p. 174).

83 It is first of all important to note that the employer's liability in contract would very likely still exist. As I noted, it is this aspect that distinguishes this type of vicarious liability case from the ordinary case, in which the employer's contractual responsibility is not engaged. In the ordinary case, the employee's tort does not lead to a breach of a contract between his employer and a customer.

84 However, for some purposes, it may be important that the employer also be vicariously liable in tort. In my view, the argument of Professor Blom gives too much weight to the word "vicarious"; it implies that that word connotes a particular set of logical consequences. As I outlined earlier, the doctrine is not primarily a logical construction. In any case, there is no logical necessity that the employer's liability in tort depend on the personal liability of the servant. The vicarious liability regime has shown great flexibility; see Atiyah, *Vicarious Liability in the Law of Torts*, *supra*. In earlier times, vicarious liability was based on an untraversable fiction that the master was sued for his own negligence in selecting and employing careless servants. That fiction has been discarded without significant loss of effectiveness. Employers have been held vicariously liable even where no individual servant could be held liable. In *Co-Operators Insurance Association v. Kearney*, [1965] S.C.R. 106, 48 D.L.R. (2d) 1, this Court found that an employer could be vicariously liable for the negligence of its employee despite the fact that the liability of the employee was eliminated by statute. In a similar manner, I think the supposed logical requirement of the employee's personal liability can also be eliminated where appropriate.

85 Furthermore, the experience in the public sector is strong evidence that the alleged logical necessity of employee liability for the operation of the vicarious liability regime is neither logical nor necessary. The general rule in Canadian Crown liability statutes which adopt the English model is that the liability of the servant is a precondition of the liability of the Crown; see, for example, *Proceedings Against the Crown Act*, R.S.O. 1990, c. P.27, s. 5. This approach may be a result of the fact that Crown liability developed initially through the liability of its agents. As a result, to achieve the desired end result of employer (Crown) liability and employee immunity, the immunity statutes typically expressly preserve the vicarious liability of the Crown itself. Hogg, *supra*, observes, at p. 146:

> If the clause does not expressly preserve the vicarious liability of the Crown itself, the clause will immunize the Crown as well; the general rule is that the liability of the servant is a precondition of the vicarious liability of the master. But such clauses can be drafted so as to preserve the vicarious liability of the Crown, and this practice, which is common, is the only defensible one, because it leaves the injured victim with recourse against the Crown.

As Hogg notes (at p. 91, n. 55), most of the immunity clauses in statutes establishing ministries expressly preserved the Crown's vicarious liability; see, for example, *Ministry of Correctional Services Act*, R.S.O. 1990, c. M.22, s. 12.

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86 In my view, the negligent act of the employee can be attributed to the company for the purposes of applying the vicarious liability regime in this context. Because of the proximity created by contract, the company owes a duty of care to the customer and is vicariously liable for the negligent acts of its employees. As Atiyah notes, *Vicarious Liability in the Law of Torts*, *supra*, at pp. 381-83, from the practical point of view, it is generally quite immaterial in tort law whether a corporation is treated as liable because it has itself committed a tort, or whether it is liable because its employees, acting in the course of their employment, have done so.

87 It should be noted, however, that for the purposes of the problem that arose in *Lenard's Carrying Co. v. Asiatic Petroleum Co.*, [1915] A.C. 705 (H.L.), the fault in this case is not that of the comparty nor is the tort that of the company. In that case, the question was whether the appellant shipping company was entitled to limit its liability under the provisions of the Merchant Shipping Acts which afforded a defence where the loss occurred without its "fault or privity". The Lord Chancellor, Viscount Haldane, set down the general principle of direct corporate liability to the effect that such fault or privity can be established against the corporation where the fault is that of "somebody who is not merely a servant or agent for whom the company is liable upon the footing respondeat superior, but somebody for whom the company is liable because his action is the very action of the company itself (at pp. 713-14). In order to prove actual fault or privity of the corporation, it remains necessary to prove that a directing mind and will of the corporation acted or committed a fault.

Canadian Cases

88 As I turn to the authorities, which the appellant contends clearly support a finding of a duty on the facts of this case, it is appropriate to recall the words of Lord Atkin in *Donoghue v. Stevenson*, *supra*, at p. 582:

> ... I should consider the result a grave defect in the law, and so contrary to principle that I should hesitate long before following any decision to that effect which had not the authority of this House.

Far from finding that the cases uniformly support the appellant's argument, I am comforted by the fact there has also been considerable support for the approach I am suggesting in Canadian cases and academic writing. My colleague lacobucci J. refers briefly to a number of Canadian cases. With respect, I do not find that they support his conclusion that a duty is unquestionably owed in this context or a conclusion that a simple foreseeability test is sufficient to ground liability.

89 I begin by noting that it is perhaps the lack of cases that is most striking. Seen by today's light, it is apparent that a straightforward application of the foreseeability test established by *Donoghue* would lead to employee liability in virtually all cases of property damage in this type of context. That this situation was the logical outcome of *Donoghue*, however, was not realized until much later because of an earlier avatar of the privity rule. Prior to *Donoghue*, it was generally considered that the case of *Winterbottom v. Wright*, *supra*, established a rule of privity to the effect that if A owed a contractual duty to B, C could not sue A in tort for conduct constituting a breach of the contract; see Fleming, *supra*, at p. 465. As noted by Reynolds, *supra*, it was not until the famous "Himalaya" case of *Adler v. Dickson*, [1955] 1 Q.B. 158, [1954] 3 All E.R. 397 (C.A.), soon to be reinforced by *Scruttons Ltd. v. Midland Silicones Ltd.*, supra, that it became apparent that the result of *Donoghue v. Stevenson* was that employees, agents or sub-contractors, *who had previously been protected by the privity of contract rule*, would now be liable to the other contracting party in cases of damage to person or property. It is perhaps worth noting that as recently as the *Nunes Diamonds* case, the plaintiff apparently did not even attempt to bring an action against the employee personally. With the recent confirmation of the fact that many breaches of contract will also constitute negligence in tort and the extension of tort recovery into the area of economic loss at least in some cases, the scope of *prima facie* tort liability in contractual contexts has greatly increased. As a result, the number of cases involving employee liability has increased in recent years.

90 On the cross-appeal, Vanwinkel and Brassait relied on the authority of *Sealand of the Pacific Ltd. v. Robert C. McHaffie Ltd.*, [1974] 6 W.W.R. 724, 51 D.L.R. (3d) 702 (B.C.C.A.). There the plaintiff engaged McHaffie Ltd., a firm of naval architects, to carry out the design work for improvements to an oceanarium. Robert McHaffie, the principal of the

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company, recommended that the plaintiff use a product called zonolite which was to be supplied by another company. Zonolite proved to be totally unsuitable and extensive repairs were required. The plaintiff brought a number of actions, including actions against the company for breach of contract and in tort for negligent misstatement and against Robert McHaffie personally in tort for negligent misstatement. The company's liability in contract was clear. In tort, it was held not liable on the basis of *Nunes Diamonds*: since the negligent misstatement occurred in the course of carrying out its contract with the plaintiff, the negligence could not be seen as an independent tort unconnected with the performance of that contract as required by Pigeon J.'s test in *Nunes Diamonds*.

91 On the issue of McHaffie's personal liability in tort as an employee, Seaton J.A. concluded as follows, at p. 706:

> An employee's act or omission that constitutes his employer's breach of contract may also impose a liability on the employee in tort. However, this will only be so if there is breach of a duty owed (independently of the contract) by the employee to the other party. Mr. McHaffie did not owe the duty to Seal and to make inquiries. That was a company responsibility. It is the failure to carry out the corporate duty imposed by contract that can attract liability to the company. The duty in negligence and the duty in contract may stand side by side but the duty in contract is not imposed upon the employee as a duty in tort.

The *Sealand* court noted that Robert McHaffie did not undertake to apply his skill for the assistance of Sealand. Rather, Robert McHaffie did exercise, or rather fail to exercise, his skill as an employee of the company. It was with McHaffie Ltd. that Sealand contracted and it was upon the skill of McHaffie Ltd. that it relied. The court held that it would not hold an individual employee liable personally unless there is a breach of duty owed independently of the contract by the employee to the other party.

92 Two questions, which it is convenient to deal with immediately, arise in light of the subsequent history of *Sealand*: first, whether the case was overruled by this Court in *Rafuse*; second, whether the holding in the case should be limited to the area of negligent misstatement.

93 The question whether *Sealand* still stands in light of the decision of this Court in *Rafuse* has arisen in a number of cases. Its continuing applicability to employees has been doubted in light of *Rafuse*; see *Rainbow Industrial Caterers Ltd. v. Canadian National Railway Co.* (1988), [1989] 1 W.W.R. 673, 30 B.C.L.R. (2d) 273, 46 C.C.L.T. 112, 54 D.L.R. (4th) 43 (C.A.), at p. 297, or rejected (*Ataya v. Mutual of Omaha Insurance Co.*, [1988] I.L.R. 1-2316, 34 C.C.L.I. 307 (B.C.S.C.)). In my opinion, while the rejection of McHaffie *Ltd.'s* tort liability would fall to be reconsidered in the light of *Rafuse, Rafuse* was not concerned with the questions raised by employee torts. The question whether a customer can bring a claim in tort against an *employee* is a very different question from whether there exists concurrent liability in tort and contract *between contracting parties*, i.e., in this case, between customer and employer. The independent tort requirement established by Pigeon J. in *Nunes Diamonds* has been criticized for its application to the question of the concurrent application of tort and contract in relations between two parties and the *Rafuse* case reconsidered this point. *Rafuse*, however, has no bearing on the question of the liability of employees; see Stieber, Annotation to *East Kootenay Community College v. Nixon & Browning* (1988), 28 C.L.R. 189, at p. 190.

94 In *Summitville Consolidated Mining Co. v. Klohn Leonoff Ltd.* (July 6, 1989), Doc. Vancouver C880756 (B.C.S.C.), a case in which the plaintiff sued three employees, none of whom was a director or officer of the employer company, for negligence in the performance of duties undertaken by their employer in a contract with the plaintiff, Gibbs J. held as follows, at pp. 4-5:

> The *Rafuse* case is of doubtful relevance or application to the issues on this application. It addresses the right to pursue concurrent remedies in tort and in contract as between the parties to the contract. It does not deal with the right, or the absence of such right, in one party to the contract to sue the employees of the other party to the contract in tort, while, at the same time pursuing the employer in both contract and tort. It is difficult to understand how *Rafuse* came to be regarded as somehow being determinative, or persuasive, in the application of the *London Drugs* principle.

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I agree with this statement. The application of the independent tort theory to employees was not overruled by *Rafuse*, which dealt exclusively with situations involving two parties.

95 On the second question, the case of *Toronto-Dominion Bank v. Guest* (1979), 16 B.C.L.R. 174, 10 C.C.L.T. 256, 105 D.L.R. (3d) 347 (S.C.), can be read for the proposition that *Sealand* is limited to cases of negligent misstatement. In my view, however, that case is weak authority for that proposition. The case is distinguishable on its facts from the present case, as it concerned a bank manager with whom the plaintiffs by counterclaim had extensive personal dealings. More importantly, however, the case must be interpreted in light of the arguments made by the parties.

96 Mr. and Mrs. Guest had given a mortgage to the Toronto-Dominion Bank as security for advances to a company of which Mr. Guest was a principal. The Toronto-Dominion Bank initiated an action for foreclosure against the company. The Guests counterclaimed and in their counterclaim, the Guests apparently made allegations of negligence and fraud against the manager and the bank and against the manager alone. The trial judge referred a single question of law to be determined on a motion, namely, whether a bank manager could be held personally liable to a customer in damages *for tortious acts or omissions* falling within the scope of the manager's employment. The motions judge noted that difficulties arose because the cause of action alleged in the counterclaim was "by no means clear" (at p. 259). However, he noted statements in the pleadings alleging fraudulent, improper and malicious behaviour by the manager.

97 Against such an apparently broad pleading by the Guests, the bank apparently argued that the employee's immunity would extend to all claims in tort, including, for example, cases of theft or conversion (see p. 259). The bank thus argued that the *Sealand* principle should extend to ah torts, including intentional torts (see p. 262). This argument was reflected in the question set forth by the order of the trial judge, which the motions judge rephrased as the question whether *any alleged act or omission* of the manager within the scope of her employment could render her liable personally in damages to the bank's customers.

98 Not surprisingly, the judge rejected the bank's rather extraordinary argument. Unfortunately, he did not consider the intermediate possibility that a duty of care should be excluded in all cases of ordinary *negligence*, while tortious liability for *intentional* torts would remain. Faced with the bank's very broad argument, he chose to severely limit the scope of the *Sealand* case to negligent misrepresentation. He did not give separate consideration to whether *Sealand* should merely be limited to cases of negligence. In my view, the apparently narrow scope given to the *Sealand* case by the judge in *Guest* should not be taken as a considered rejection of its application to other cases of negligence; he was principally concerned to reject the very broad contention of the bank in that case. He did not attempt to logically justify his narrow reading of *Sealand*; he countered the bank's argument that limiting *Sealand* to negligent misstatement was illogical by referring to "venerable authority on both sides of the Atlantic against the contention that logic alone directs the path of the law" (at p. 264). In my view, there is no lack of logical justification for holding employees liable for intentional torts and gross negligence, while finding no duty of care for ordinary negligence. On the other hand, as Irvine appears to suggest, there is little reason to limit the application of *Sealand* to negligent misrepresentation; see Irvine, Case Comment: *Surrey v. Carroll-Hatch & Associates and Toronto-Dominion Bank v. Guest* (1979), 10 *C.C.L.T.* 266, at p. 273.

99 The argument for limiting the principle to negligent misstatement is founded essentially on the special requirement of reliance which exists in cases of negligent misrepresentation. In such cases, the duty of care is not imposed on every person who can foresee the risk that his negligent words may cause harm to another. It is argued that, although the employee would be liable if foreseeability were the only criterion, the employee does not meet the other criteria set forth in *Hedley Byrne*. In my view, there is no reason, in cases raising the issue of employee liability for negligence, to limit the requirement of reliance to cases involving negligent misrepresentation. The reasons why the imposition of liability does not make sense are a result of the analysis of the situation of the employee and the policies underlying vicarious liability. While it may be doctrinally easier to justify an exemption of liability for negligent misstatement, there are no policy reasons why the exemption should be so limited. Reliance has been found to be relevant by this Court in cases not involving negligent misrepresentations; see *B.D.C. Ltd. v. Hofstrand Farms Ltd.*, *supra*.

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100 *Sealand* has been generally well received by academic commentators: Blom, "The Evolving Relationship Between Contract and Tort" (1985), 10 *Can. Bus. L.J*. 257, at pp. 273-74; Blom, "Fictions and Frictions", *supra*, at pp. 185-86n; Blom, Case Comment, *supra*, at p. 173; Reiter, *supra*. The evolution of Professor Blom's thinking in this area is particularly revealing. He began by making a sharp distinction between negligent misrepresentation cases and those involving physical damage to person or property which he considered to be "radically different": while the absence of a duty could be justified in the former type of case owing to the requirement that the defendant undertake the responsibility, in the latter case, liability was clear: "The Evolving Relationship Between Contract and Tort", *supra*, at pp. 273-74. In his later writing, however, Professor Blom has noted that, while it may be doctrinally easier to justify the absence of a duty in *Hedley Byrne* type cases because of the clearly established requirement of reliance and the fact that the customer's reliance can arguably be said to be on the employer but not on the employee as an individual, policy reasons do not support any such limitation of the principle; see "Fictions and Frictions", at pp. 185-86n. In his case comment on the Court of Appeal decision in the present case, he concludes that even if there were no contractual clause limiting liability, a finding that the employees should have no duty makes sense for reasons similar to those I set out above. He states, at pp. 173-74:

> Suppose that the warehousing contract had left Kuehne & Nagel's liability unlimited. Even then, would it have been light to impose the same unlimited liability on the employees? They would never have been handling $40,000 transformers if it had not been part of their job. The employer is being paid to assume the risk of damage to the transformer, but except in the most theoretical sense the employees are not. They are selling their labour, not a form of insurance. The risk of doing $40,000 worth of damage is imposed on them, but as employees (and here their position would be different from independent contractors) they are badly placed to arrange things financially to cope with that risk. They can get their employer to include them as insureds under its liability policy, but then suing them is indistinguishable from suing the employer; it is the same insurance.

101 Reiter, *supra*, considers that the result in *Sealand* is justified by the principle of limited liability. In contracting for services to be provided by a business corporation or association, a plaintiff can fairly be regarded as relying upon performance by the corporation or association, and upon the liability of that body if the services are purveyed negligently. He says, at p. 290:

> It is true that the contract between Sealand and McHaffie Ltd. did not provide explicitly for the exculpation of McHaffie in respect of personal liability: but the very object of taking the contract in the corporate name is as cogent an explanation of the intended limitation on risk exposure as any express clause could be. There should be no need for any such express provision excluding liability in third parties acting in furtherance of one contractor's obligations under the contract: the matter is less one of contractual exclusion of liability than of the existence of contractual relations negativing the legal preconditions of tort liability.

This limited liability principle applies equally to all cases of negligence and not just to cases of negligent misrepresentation.

102 In *Moss v. Richardson Greenshields of Canada Ltd.*, [1989] 3 W.W.R. 50, 56 Man. R. (2d) 230 (C.A.), the court achieved a result similar to *Sealand*, even though the cases involved alleged negligent acts rather than negligent misrepresentation. The plaintiff Moss was an investor. The defendants were a brokerage firm and an employee stockbroker of the firm. The contract between Moss and the firm limited the firm's liability to cases of gross negligence. The plaintiff sued the employee Davies to recover the amount of a trading loss incurred allegedly through Davies' negligent act.

103 Huband J.A., writing for himself and Philp J.A., did not find it necessary to consider whether the employee could claim the benefit of the limitation provision in the contract between the plaintiff and his employer. He said, at p. 56:

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> In my view, there is no separate cause of action that would enable Moss to successfully sue Davies. The contract was with Richardson. The essence of the complaint is a breach of that contract. Moss' cause of action, if any, is against Richardson, and there is no independent cause of action in negligence against the defendant Davies.
>
> [Emphasis added.]

Huband J.A. also noted that in that case, the employee's acts or omissions related solely to the work he was doing as an employee of Richardson, for Moss. No one else was or could be affected (at p. 57). In his concurring reasons, Twaddle J.A. concluded that although the law imposes a duty of care on a stockbroker in some circumstances, it did not do so in the circumstances of that case. Any duty of care that existed was contractual, whether the employer's duty to the plaintiff or Davies' duty to his employer. He explicitly noted that "[w]hat this case is all about is the contractual obligation of care owed by the defendant Richardson" (at p. 62).

104 I think that the language in the *Moss* decision to the effect that tort liability is excluded because of the contractual *nature* or *essence* of the claim should be read as shorthand for a conclusion that contractual aspects dominate in that context and that it does not make sense, in the context of that case, to allow the contractual aspects to be circumvented by an action in tort against an employee. In my view, *Rafuse* establishes that Moss's complaint against *Richardson Greenshields* (the employer) could presumably be brought in either tort or contract, so its "essence" cannot be said to be contractual unless the plaintiff chooses to argue the case in contract only. If Moss is alleging breach of the contract by Richardson Greenshields, the action is contractual; if Moss is alleging that Richardson Greenshields fell below the standard of care of the reasonable stockbroker, the claim is in tort. Of course, it may be very difficult for the plaintiff to win in tort against a defendant like Richardson Greenshields since the case will typically involve economic loss: various policy issues will be raised including the possibility that tort liability would unduly interfere with the contractual bargain and allocation of risk. Nonetheless, a tort action is not excluded by virtue of the mere existence of a contract. Accordingly, to the extent that the court relied on *Charlesworth and Percy on Negligence* for the finding that a stockbroker's duty is "primarily in contract" (at p. 55), I think it must be doubted in the light of *Rafuse*. However, the fact that concurrent liability may exist with respect to Richardson Greenshields does not invalidate the finding that the employee is not liable.

105 The conclusion that no cause of action in tort lies against Davies, although expressed in terms of the action being of a contractual *nature*, is undoubtedly the product of balancing of the importance of the values protected by tort and those protected by contract in the particular context of the case. It can be justified as an application of the principle of limited liability. Rather than finding the essence of a particular complaint to be contractual, it might be more appropriate to find that the alleged tort liability exists in a contractual context, and that contractual concerns predominate.

106 In the early eighties a number of claims in negligence against employees were struck out on motions in Ontario. In *Durham Condominium Corp. No. 34 v. Shoreham Apartments Ltd.*, Ont. H.C., April 23, 1982, 14 A.C.W.S. (2d) 155, unreported, the judge held that the claimant was limited to a contractual claim against the company; see also *O'Keefe v. Ontario Hydro* (1980), 29 Chitty's L.J. 232 (Ont. H.C.). The *Durham* case was followed by Hughes J. in *Constellation Hotel Corp. v. Orlando Corp.* (July 6, 1983), Doc. 717/83 (Ont. H.C.), 20 A.C.W.S. (2d) 482. The action in that case arose from an allegation of faulty construction of a parking garage annexed to the premises of the plaintiff. Bradstock Reicher & Partners Ltd. was an engineering company employed by the plaintiff under a written contract and Hans Reicher, a professional engineer, was its employee and represented it during the work. The pleadings contained allegations of breach of contract and negligence in the performance of the contract against both the company and Reicher personally. The motion judge considered notably the cases of *Nunes Diamonds* and *Sealand*. He considered himself bound by the holding in *Durham*.

107 On appeal, the Court of Appeal of Ontario specifically found that the issue was whether an action could be brought against a limited company with which the plaintiff has a contract and also against the *principal officer* of the company who is alleged to have acted negligently in the course of performing the contract and in breach of his duty to the plaintiff; see *Constellation Hotel Corp. v. Orlando Corp.*, Houlden, Goodman and Cory JJ.A., January 12, 1984,

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unreported, endorsement reproduced at 2 C.P.C. (2d) 24. The court noted that there was no allegation of an independent tort. On the narrow issue of the liability of a principal officer, the court set aside the order of the motion judge and allowed the issue to go to trial on the ground that the "law on this point is far from clear".

108 A more recent Ontario case, *Leon Kentridge Associates v. Save Toronto's Official Plan Inc.*, Ont. Dist. Ct., Conant Dist. Ct. J., No. 301678/87, March 27, 1990, rejected the personal liability of corporate officers for their negligent misrepresentations. The case concerned a non-profit corporation (STOP) formed to oppose the construction of a domed stadium in downtown Toronto in an area locally known as "the railway lands". The individual defendants Bossons and Martini were officers and directors of STOP. The plaintiff Kentridge was retained by STOP as a planning consultant in 1986 in connection with hearings before the Ontario Municipal Board. Kentridge dealt only with the individual defendants Bossons and Martini on behalf of STOP.

109 Kentridge worked for STOP for a period, then was told to stop work. When the corporation received a $50,000 anonymous donation, Kentridge recommenced work only after receiving assurances from the two defendants that he would be treated in the same manner as the corporation's law firm. Kentridge later learned that the whole of the $50,000 was paid to the law firm as part payment of its account. He took the position that he was "short changed" because he received less fair treatment than the lawyers. At the time of the lawsuit, STOP had been dissolved. Kentridge claimed from the individual defendants his "fair share" of the $50,000 because of the representations upon which he relied and resumed his work.

110 The court had no difficulty in finding that the elements of negligent misrepresentation existed. Accordingly, the judge turned to consider whether the defendants could be held to be personally liable for misstatements made in exercising their duties as directors and officers of STOP. The court explicitly referred to the limited liability principle precluding the personal liability of the defendant directors. The judge considered that the defendant directors acted as officers and directors of STOP and not in their personal capacity:

> As a result, in my view the plaintiff herein is entitled to sue in either contract or in tort. However, on the facts, I find the defendant directors acted as <u>officers</u> and directors of STOP and not in their personal capacity.
>
> [Emphasis added.]

In my view, it would be unjust for *officers* to benefit from an exclusion of liability for torts committed by them, while ordinary warehouse employees are held personally liable for torts committed by them.

111 In *Summitville*, *supra*, Gibbs J., after finding that *Sealand* had not been overruled in *Rafuse* as I outlined above, went on to consider the question of the liability of the three employees. He underlined that they were not, like the individual defendant in *Sealand*, a sole proprietor. Nor was there a personal relationship and special reliance on the skill of a particular employee. He considered that the plaintiff's alleged reliance on the particular employees was insufficient; the mere fact that the employees had come into contact with the plaintiff as a result of being designated by their employer to do on-site work was insufficient. At page 9, he stated:

> Klohn Leonoff [the employer] is not an "incorporated pocketbook" kind of sole proprietorship. It is a large organization in the engineering services field. Persons who contract with it must do so in the reliance that competent personnel will be assigned from a large staff. There is not that close personal relationship approaching dependence which is evident in cases where the employees have been held personally liable in tort.

In my view, Gibbs J. was correct in finding that it is in this type of context that a finding of no duty is most easily justified.

112 Despite the academic approval of *Sealand*, the courts, particularly in B.C., have not always followed the approach taken in that case. A case to which I referred earlier and which was decided at practically the same time as *Sealand, Northwestern Mutual Insurance Co. v. J. T. O'Bryan & Co.*, reveals the confusion that reigns in this area. In *Northwestern*, the plaintiff was a partial insurer of a warehouse; O'Bryan Ltd. was an insurance broker in charge of placing shares of

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the pooled insurance coverage and Thibeau was an employee of O'Bryan. Northwestern had repeatedly asked O'Bryan to be removed from the risk on a particular building. After numerous efforts by Northwestern to have itself removed from the risk, Thibeau informed Northwestern that it was off the risk. The information was wrong because Thibeau had mistakenly looked at the wrong file. After a fire broke out and damaged the building, Northwestern was required to pay its proportionate share. It sued O'Bryan in contract and Thibeau in tort and succeeded in both actions.

113 On the issue of Thibeau's liability, the argument in the case appears to have turned largely on whether Thibeau could be brought within the well-known principle set out by Lord Reid in *Hedley Byrne*, at p. 486:

> A reasonable man, knowing that he was being trusted or that his skill and judgment were being relied on, would, I think, have three courses open to him. He could keep silent or decline to give the information or advice sought: or he could give an answer with a clear qualification that he accepted no responsibility for it or that it was given without that reflection or inquiry which a careful answer would require: or he could simply answer without any such qualification. If he chooses to adopt the last course he must, I think, be held to have accepted some responsibility for his answer being given carefully, or to have accepted a relationship with the inquirer which requires him to exercise such care as the circumstances require.

Hedley Byrne was a case involving the liability of companies. The defendants were merchant bankers. Despite the general reference to a "reasonable man", great care must be taken in extending its principles to employees without due regard for the differences in context. The court in *Northwestern* simply concluded that Thibeau "could have kept silent and declined to give the information" or "could have given the information with a reservation that he accepted no liability for its accuracy or otherwise". Furthermore and unsurprisingly, the court concluded that the relationship was not casual but rather commercial: an employee, when acting as such, will rarely be outside of a commercial context. Little or no consideration was given to the fact that Thibeau was an employee. Unlike a company or Lord Reid's reasonable man, however, an employee is under a pre-existing contractual obligation to perform his work obligation to his employer. In many cases, that work obligation will involve making representations of various kinds to the public. In that context, as I noted earlier, it is not realistic to consider that the ordinary employee is in a similar situation to the defendant in a *Hedley Byrne* situation, i.e., entirely free to decline to make any representation at all or, alternatively, free to decline any tort liability.

114 The other lower court cases cited by the appellant are not compelling. In *British Columbia Automobile Assn. v. Manufacturers Life Insurance Co.* (1979), 14 B.C.L.R. 237 (S.C.), an actuary employed by Manulife was held personally liable for careless advice given to a Manulife client. Manulife had made an admission to the effect that, to the extent that the actuary was found to be responsible for any loss suffered by the plaintiff, Manulife was liable as principal and the issue of the employee's duty of care was not addressed at length. In my view, the intervener rightly distinguished that case as one in which the result turned upon evidence of actual reliance on a particular designated person and upon the professional relationship between the client and the professional actuary. In *Herrington v. Kenco Mortgage & Investments Ltd.* (1981), 29 B.C.L.R. 54, 125 D.L.R. (3d) 377 (S.C.), a principal of a mortgage brokerage firm, who carelessly misrepresented the value of a mortgage in which the plaintiff subsequently invested, was held personally liable for injury resulting from that advice.

115 *East Kootenay Community College v. Nixon & Browning*, *supra*, was another case involving a professional engineer (Loh) who was the principal of Loh Associates. The defendant Loh Associates negligently prepared certain plans that were used by the defendant architects (Nixon & Browning). As a result, certain corrective work had to be carried out, resulting in a delay in completion of the plaintiff's college campus facility. At trial judgment was given against the architects and Loh Associates with the architects being held entitled to indemnity in the third party proceedings against the engineers. On an application to settle formal judgment, the question was raised whether the individual third party C.Y. Loh was personally liable to indemnify certain defendants.

116 The case is easily distinguished from the case at bar. It concerns an employee who was both a professional and a principal of a company. Furthermore, in finding liability to exist, the court relied on the statutory regime applicable

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to engineers in British Columbia; see *Engineers Act*, R.S.B.C. 1979, c. 109. That regime required that an engineer stamp or seal plans that he, in his capacity as professional engineer, prepared or had prepared under his direct supervision, restricted engineering work to companies with professional engineers on staff, and provided, in s. 10(5), that professional engineers who are employed by corporations "individually shall assume the functions of and be held responsible as professional engineers". The court explicitly noted that Loh's seal was affixed to the plans.

117 In *Ataya v. Mutual of Omaha Insurance Co.*, *supra*, the judge relied on the decision of the trial judge in the present case. Again, the case is clearly distinguishable on its facts, since the defendant employee was both a principal and owner of the defendant company. The judge referred to "numerous cases" finding employees liable in negligence for faults committed by them in carrying out their employer's contractual duty to a plaintiff, but cited only the decision at trial in the present case as authority for that proposition. In light of what the judge apparently considered to be an established principle of employee liability, the judge confined his inquiry to the question of whether an employee who is also the proprietor of the incorporated business should be treated any differently than an ordinary employee. Concluding that he should not be treated differently, he accordingly found the individual plaintiff liable. The authority of the *Sealand* case was questioned in light of *Rafuse*; as I stated earlier, *Rafuse* did not specifically consider the issue of employee torts.

118 It remains for me to consider the two cases involving employees decided by this Court and cited by the appellant.

119 The first case, *Greenwood Shopping Plaza Ltd. v. Beattie*, [1980] 2 S.C.R. 228, 10 B.L.R. 234, 111 D.L.R. (3d) 257, 39 N.S.R. (2d) 119, 71 A.P.R. 119, [1980] I.L.R. 1-1243, 32 N.R. 163, arose as a result of the destruction of a substantial proportion of the Greenwood Shopping Plaza by a fire originating shortly after certain welding operations in the service bay building of the Canadian Tire associate store in the shopping centre. I have adapted the following summary of the relevant parts of the case from the judgment of Hart J.A. on a related appeal (1979), 31 N.S.R. (2d) 135, aff'g (1978), 31 N.S.R. (2d) 1 (S.C.T.D.).

120 The Greenwood Shopping Plaza was owned by Greenwood Shopping Plaza Ltd. (hereinafter "Greenwood"). Neil J. Buchanan Ltd. (hereinafter "Buchanan Ltd.") was the operator of a franchised associate store of Canadian Tire Corporation Ltd. (and this store was co-managed by Neil J. Buchanan and Robert Walker Beattie). Roy Vincent Pettipas was a welder by trade. On the night of the fire, he had been welding some tire storage racks under the general direction of Beattie in the service bay area of the associate store shortly before the fire broke out. Blair Douglas MacMurtery was an employee of Buchanan Ltd. who was assisting Pettipas in the welding operation.

121 Several of the tenants of the shopping centre whose premises were destroyed by the fire, namely, Eatons, Simpsons-Sears, Metropolitan Stores, Greenwood Pharmacy and Wade's Groceteria, were the initial plaintiffs. They brought action against Buchanan Ltd., Canadian Tire, Beat-tie, Pettipas and MacMurtery for the damages they suffered as a result of the fire, claiming negligence by the defendants, their servants and agents. The defendants denied liability and joined Greenwood as a third party claiming that the fire was caused by Greenwood, its servants, agents and contractors as a result of the negligent installation and maintenance of the electrical system provided to the premises leased by Buchanan Ltd. from Greenwood.

122 Greenwood then brought action against Neil J. Buchanan, Buchanan Ltd., Canadian Tire, Beattie, Pettipas and MacMurtery claiming that the defendants caused the fire by negligence and seeking damages for the loss of the shopping centre buildings and rentals during the period of reconstruction. The defendants denied liability and claimed indemnity against any liability incurred as a result of the fire, since they alleged that the fire was caused by faulty electrical installations by Greenwood. They also pointed to clauses 14 and 15 of their lease with Greenwood which required the owner to insure the buildings against fire without right of subrogation, and claimed that Greenwood's actions were therefore barred.

123 The issue of whether the employees owed a duty of care was not considered by this Court and I do not consider that the decision of this Court is authority with respect to the duty of care question. Leave was granted on the narrow issue of whether the employees who were not parties to the lease and insuring agreement in clauses 14 and 15 of the lease,

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could claim the benefit of those provisions; see *Greenwood*, *supra*, at pp. 235-36. The branch of the *Greenwood* case that involved the question of the duty of care never reached this Court. In fact, none of the courts hearing the *Greenwood* case found, simultaneously, that the employees owed a duty and that they were liable.

124 The initial plaintiffs, who were tenants of the shopping plaza, had not entered into a course of dealing with Buchanan Ltd. Accordingly, unlike Greenwood, they could be assimilated to "classic", or "non-contractual", plaintiffs. Finding the employees liable towards such plaintiffs is defensible on policy grounds, as I noted above. The employees in *Greenwood* did not claim an indemnity from their employer, nor did they bring a claim in negligence against their employer with respect to its failure to contract adequately to protect them from ultimate liability. Accordingly, the Court did not have occasion to consider the issues raised in *Lister*.

125 It should be underlined that Greenwood, the sole plaintiff that did have a contractual link (the lease) with Buchanan Ltd., was prevented from recovering against the employees in both the trial court and the Court of Appeal by the application of the lease term to protect the employees. Accordingly, the issue of the duty of care to a co-contractant of the employer did not need to be squarely faced by those courts since recovery was in any case not allowed on a contractual analysis. It was only in this Court, by which time the duty of care question was no longer at issue, that the lower courts were considered to have erred on the application of the clause.

126 This analysis is reinforced by the cursory examination of the issue of an employee's duty of care in both the trial court ((sub nom. *Greenwood Shopping Plaza v. Neil J. Buchanan Ltd.*) (1978), 31 N.S.R. (2d) 1, 59 A.P.R. 1), and the Court of Appeal ((1979), 31 N.S.R. (2d) 135, 52 A.P.R. 135). In both sets of reasons, consideration of the employee's situation occurs *after* the company's liability has been established. Thus, in the Court of Appeal, the passage immediately preceding the consideration of whether the employees were negligent reads as follows, at p. 159:

> In my opinion the trial judge did not err in reaching the conclusion that the fire was caused by the escape of effluent from the welding operation and that Buchanan Limited was liable for the damages resulting from the fire by virtue of the negligence of its employees.

It is not clear from the reasons of the Court of Appeal whether the duty of care issue was even argued. The second and third grounds of appeal were to the effect that the trial judge had erred in finding that the two employees were "guilty of negligence" and the main thrust of the argument, in so far as it is possible to determine from the very brief reasons, appears to have been related to either the standard of care or to whether the employee occupied a position of responsibility with respect to the carrying out of the welding operations (at p. 159). The critical question of whether even an admittedly negligent employee with undeniable responsibility for carrying out a particular operation should bear *personal* liability for damage is not clearly addressed.

127 The trial judge (at p. 40) found that two of the three employees involved were liable, after having determined that the employer was liable. As I noted, he applied the contractual clause to the employees, thereby precluding liability. Given this solution, it was not necessary for the judge to consider any of the policy factors bearing on the question of employee liability and I can only assume they were not drawn to his attention.

128 As a result of the peculiar structure of the *Greenwood* case, I do not find it to be strong authority on the issue of an employee's duty of care. In any case, in my view, it can be distinguished from the present case. It involved an intrinsically dangerous activity. As a result, the case raised serious concerns about the safety of the plaintiffs and the general public, concerns that are largely absent from the present case. Those concerns arguably justified a special duty on employees to all plaintiffs, with an indemnity regime as a corrective. In the case at bar, safety concerns are in my view sufficiently looked after through the imposition of liability on the employer, through the employer's power to discipline and dismiss, through the operation of statutory schemes of occupational health and safety and through the employee's self-interest in his personal safety. The imposition of liability cannot be justified here by concern over safety.

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129 In *Cominco Ltd. v. Bilton*, [1971] S.C.R. 413, the plaintiff brought an action for damages against the defendant tug boat master, alleging that he was negligent in his performance of a contract whereby his employer had agreed to transport the plaintiff's goods by water from Vancouver to Port McNeill, B.C. The scows in which the goods were carried sank at their mooring at Port McNeill booming ground with the result that the plaintiff's goods were lost or damaged. The trial judge dismissed the action. He took the view that when the contract for carrying is between the carrier and the owner of the goods, the master employed by the carrier is not liable to the owner of the goods for the negligent carrying as he is under no duty of care to the owner of the goods. The plaintiff appealed to this Court. The appeal was dismissed.

130 Admittedly, this Court did not adopt the trial judge's reasons. Rather, it found another route to deny the tug boat master's liability. Although it found that liability theoretically existed under *Donoghue*, the majority apparently applied a stricter than usual causality test, requiring that the plaintiff prove that the tug boat master's negligence was a "probable cause" of the loss, and held that the plaintiff had not discharged this burden.

131 *Cominco* predates *Anns* and the adoption of *Anns* by this Court in *Kamloops*, It has been followed only once in over twenty years; the case in question did not even involve the question of employee liability; see *Great West Steel Industries v. Arrow Transfer Co.* (1977), 75 D.L.R. (3d) 424 (B.C.S.C.). Today suit is rarely taken against the master or crew because they are amply protected by modern Himalaya clauses; see Tetley, *Marine Cargo Claims* (3rd ed. 1988), at p. 261. Policy considerations, which are now an explicit part of the tort analysis, were not considered in *Cominco* with respect to the question of the tug boat master's duty of care; the duty of care is founded purely on *Donoghue* foreseeability. Like some other cases that predate *Anns* (see Wilson J.'s reference to *Rivtow* in *Kamloops*, at pp. 32-33), it may well be that *Cominco* will need to be reconsidered by a full panel of this Court.

132 In any case, I do not find the case to be controlling here. For one thing, the case did not involve the vicarious liability regime. The owner of the tug boat was in no way concerned by the litigation, apparently as a result of an "arrangement" between the plaintiff and that company; see *Cominco*, *supra*, at p. 416. As Ritchie J. noted, if the action had been brought against the employer, other considerations might have applied (at p. 430).

133 I would limit the application of the *Cominco* case to the context of maritime cases. Maritime law has long provided that a ship master is a very special type of employee, with a far wider range of autonomy and responsibilities than the employees in this case. In earliest times, as noted by Tetley, the master was usually owner or part owner of the ship and was a proper defendant whenever cargo was lost or damaged; see Tetley, *supra*, at p. 261. As the reasons of Spence J. (dissenting on the issue of causality) make clear, ship masters are subject to specific rules, inapplicable to other employees. He stated, at p. 434:

> Although the mate and the deckhand were not the defendant Bilton's employees and therefore he cannot become liable for their acts on the basis of the maxim *respondeat superior*, nevertheless, they were under his direct orders and were acting on his direct orders. I am of the opinion that the physical acts of the mate and the deckhand were as much the acts of the defendant Bilton as if he had done them himself.

Furthermore, the widespread recourse to Himalaya clauses as a matter of course means that the problem has been largely resolved in the maritime context.

134 In light of the specific characteristics of a ship master, I think that even if the case is considered to have some relevance outside the area of maritime law, I would assimilate a ship master to a professional employee for the purposes of employee liability. The majority judgment of Ritchie J. justified the application of *Donoghue* on the grounds that the tug boat master was "temporarily in control of the appellant's cargo"; I would interpret that language as being limited to circumstances in which the employee has a level of autonomy in his activities equal to that of a ship master. I note that even in such circumstances, Ritchie J. apparently applied a stricter than usual causality test, requiring the plaintiff to prove that the master's negligence was a "probable cause" of the loss (at p. 430). As I noted, he rejected the master's liability on causality grounds.

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The Test: Reliance, Undertakings and Insurance

135 In my view, a requirement of specific and reasonable reliance on the defendant employees is justified in this type of case. I find it to be a necessary condition for recovery in cases of employee negligence where the law provides for the possibility of compensation through recourse to the employer and where, accordingly, the plaintiff's interest in compensation for its loss caused by the fault of another is substantially looked after. I also find it to be necessary in cases in which the defendant has no real opportunity to decline the risk.

136 In my view, there is no reason to limit the requirement of reasonable reliance to employee torts involving negligent misrepresentation. In the case of negligent misrepresentations, the requirement of reasonable reliance exists in part to respond to policy concerns about potentially indeterminate liability in the context of negligent words and economic loss. Here, the policy concerns are different, but a requirement of reasonable reliance is equally justified in light of my analysis of the situation of the employees in this case and the policies underlying vicarious liability. Reliance has been found to be relevant to findings of proximity by this Court in cases not involving negligent misrepresentations; see *Hofstrand*, *supra*.

137 Reliance on an ordinary employee will rarely if ever be reasonable. In most if not all situations, reliance on an employee will not be reasonable in the absence of an express or implied undertaking of responsibility by the employee to the plaintiff. Mere performance of the contract by the employee, without more, is not evidence of the existence of such an undertaking since such performance is required under the terms of the employee's contract with his employer. It may well be, as Blom argues, "Fictions and Frictions", at p. 179, that the further one moves away from a wholly commercial type of case, the more scope there is for asserting reasonable reliance on something less than promises. This case, at any rate, is wholly commercial. With respect for those of a contrary opinion, I find any reliance by London Drugs on Vanwinkel and Brassart was certainly not reasonable in this case.

138 Iacobucci J. declines to decide whether reliance is relevant in cases like the present. However, he finds that even if it were relevant, it is necessary to distinguish between reliance on careful behaviour and reliance on the defendant's pocketbook. With respect, I do not find Iacobucci J.'s distinction between reliance on conduct and reliance on the pocketbook persuasive. The obvious truth that customers naturally hope that the employees of their co-contractant will do the job right is insufficient to constitute reasonable reliance. The very purpose of a corporation is to separate out conduct and pocketbook, to allow some to contribute capital and share in profit, and to allow others to contribute work, generally for a fixed return. Vicarious liability is a recognition of that fact. The cases cited generally by Iacobucci J. in support of the distinction, *Hedley Byrne, Junior Books Ltd. v. Veitchi Co.*, [1983] 1 A.C. 520, [1982] 3 All E.R. 201 (H.L.), and *Hofstrand*, deal with the issue of reliance only with respect to a defendant limited company; the issue of the separation between conduct and pocketbook, between corporation and employee, simply does not arise in those contexts.

139 The distinction also does not explain the decided cases. In cases involving employee torts, the conduct is clearly the employee's; nonetheless, in cases such as *Sealand*, only the company was found liable. That conclusion was based on the fact that reliance was only justified on the company. To limit the consideration of reliance to reliance on conduct would require a finding that an employee owed a duty as a precondition to company liability in tort in every case of employee torts where reliance is relevant. Far from abstaining from commeriting on cases such as *Sealand, Moss* and *Summitville*, Iacobucci J. adopts a distinction that, as I understand it, rejects the very basis of those decisions.

140 Furthermore, Iacobucci J. merely uses the conduct/pocketbook distinction to find that "reliance, as it may be used here, goes to the existence of a duty of care owed and not to liability for breach of a duty of care" (at p. 407). He approves a passage in which Professor Blom rejects the approach of Hinkson J.A., in which a *contractual limitation clause* has the effect of eliminating proximity in tort. With respect, I agree that Hinkson J.A.'s approach is not convincing. While a limitation clause may be a factor in evaluating the expectations of the parties, it is not sufficient, in and of itself, to *eliminate* a duty of care. My approach, however, does not rely on the contractual clause.

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141 Iacobucci J. rejects a "blanket rule" that would eliminate the employees' duty of care for acts committed in the course of employment and in the course of contract performance by the employer. I do not take issue with that finding. Unlike my colleague, however, I do not consider that it suffices to justify a duty of care here. In effect, Iacobucci J. contends that the mere fact that employees are sometimes held liable suffices to justify liability in this case. With respect, I disagree. To find that employees are not always exempt from liability does not lead logically to the conclusion that they must be liable in this case.

142 While the respondents' argument was indeed at times cast in broader terms than it perhaps needed to be, the intervener contended at times for a rule limited to employees in situations characterized by "relational contracts" and a number of its arguments were addressed to employees who are primarily labourers and subject to a collective agreement. For example, it emphasized in its factum that this is not a case of reliance upon the specialized skills of a particular employee. In my view, to reject the respondents' blanket rule is insufficient to resolve the duty of care issue in this case.

143 I note first that the question of employee liability in the context of the specific facts of the *Sealand* case does not arise for decision here. *Sealand* involved the question of the liability of a principal of a one-person company. Such cases raise problems, such as the potential confusion in the mind of the plaintiff as to the identity of his or her co-contractant, which do not exist in the present case. Unlike the case here, the employee in that case may well be responsible for the taking on of the contract and for the organization of the work. As I noted, in *Constellation*, the Ontario Court of Appeal found the precise issue in *Sealand* to be "far from clear". Small companies and particularly one-person companies are increasingly available to professionals. It may be legitimate in such cases to require the principal employee to at least draw the attention of the client to the fact that he desires to take advantage of the corporate vehicle to limit his personal liability as an employee. On the other hand, it may make sense to establish the limited liability principle as a general principle and allow for individual exceptions to the rule as policy judgments in particular sorts of situations. I would thus decline to express an opinion on the *Sealand* case as one of general application to such situations.

144 A related issue is the status of professional employees, or alternatively, skilled employees. It raises many of the same concerns as the one-person company so a number of the considerations I outlined in the previous paragraph are relevant here. As the intervener correctly noted, this case does not raise the question of employee duties of care in the context of a unique professional relationship. In some cases, such as *British Columbia Automobile Association*, professional employees have been found personally liable; in others, such as *Moss*, they have not. Academic commentators have disagreed about the desirability of limiting any rule to nonprofessional employees; see McCamus and Maddaugh, "Some Problems in the Borderland of Tort, Contract and Restitution", in *Special Lectures of the Law Society of Upper Canada: Torts in the 80s* (1983), at p. 290; Caplan and Schein, "Caught in a Cross-Fire: The Erring Employee in the Borderland of Contract and Tort" (1987), 8 *Advocates' Q*. 243, at p. 255. Like the specific problem raised in *Sealand*, the problem is one of great practical importance, since such employees are much more likely to have sufficient assets to make proceedings against them attractive to plaintiffs. In fact, most of the reported cases concern employees who are principals, as in *Sealand*, or professionals, as in *Moss*. The question of reliance on a particular individual in such cases may give rise to difficulties because it may be the reputation of one person that attracts work to a firm while others may end up doing the work. It is particularly important in cases involving professionals to distinguish between mere reliance in fact and *reasonable* reliance on the employee's pocket-book. Unlike this case, in which it clearly makes no sense to impose upon the employee an obligation to insure against property loss, such cases raise with particular acuity the question of whether in effect requiring double insurance by both the firm and the employee makes sense in that context. Ultimately, the question of the reasonableness of the plaintiff's reliance may depend essentially on the answer to that question. Such an approach would avoid difficult definitional questions concerning whether a particular employee is "skilled" or a "professional". Without the benefit of argument on that problem and others that may be raised in the context of professional or skilled employees, I do not find it necessary or appropriate to decide that issue here. I note that leave to appeal has been granted ([1992] 2 S.C.R. vi) in *Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd.*, [1991] 4 W.W.R. 251, 53 B.C.L.R. (2d) 180, 44 C.L.R. 88, 7 C.C.L.T. (2d) 177, 1 B.L.R. (2d) 188 (C.A.), where these issues may well arise.

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145 Subject to consideration by this Court of the arguments put forward by Fleming and others with respect to employee liability generally under the vicarious liability regime, the employee also remains liable to the plaintiff for his independent torts. The employer may also be vicariously liable for some independent torts in accordance with the general rules for establishing the employer's liability. The term "independent tort" has been used with different meanings in different contexts. I should make clear that by independent tort in this context I mean a tort that is unrelated to the performance of the contract. It is not necessary in this case to consider the question of the definition of independent tort at length, since the tort in question was obviously not unrelated to the performance of the contract between London Drugs and KNI. Furthermore, since it is very likely that the only time a plaintiff will need to allege an independent tort is when the company is unable to satisfy a judgment, it can be expected that the issue will not arise with great frequency. The following remarks may, however, help guide the application of this concept.

146 It is first of all necessary to distinguish the use of the term independent tort here from other meanings that have been given to the term. The term has also been used in the context of the development of concurrent liability to refer to a tort that exists in the context of a contractual relationship between two parties; see *Rafuse*, *supra*, at p. 205. If I agree by contract to wash a motorcar and also agree that I will be liable for any damage to the car while it is in my possession, the car owner has a claim in contract for such damage however caused. He also has an "independent" claim intort in the sense referred to in *Rafuse*: if the damage results from my not taking reasonable care (in this case, a different standard than the contractual standard agreed to, although that is not a necessary condition for tort liability), he can claim in tort. In this sense, characterizing a tort as an "independent tort" is simply an affirmation that the mere existence of a contract does not preclude tort liability; it also refers to the fact that the tort action must rely on a duty of care in tort and not, for example, on a higher standard of care created by a particular contract.

147 The car owner's claim in tort in this car example would not be, however, independent in the sense set forth in *Sealand* or in the sense I am referring to here. In cases of employee torts, as I stated, an independent tort is one that is unrelated to the performance of the contract. What the independent tort requirement recognizes in the context of employee torts is that the risks assumed by the plaintiff as a result of contracting with a limited liability company need not extend to the whole range of negligent acts or omissions of the employee. A plaintiff may be considered to have assumed one risk and not another; see Fleming, at p. 273. The independent tort test recognizes the limits of the plaintiff's voluntary assumption of risk by recognizing that the employee's tortious behaviour must be linked to the contract.

148 The existence of limits to the plaintiff's voluntary assumption of risk also applies to the nature of the employee's conduct. Where the employee is guilty of serious and wilful misconduct (such as an intentional tort or gross negligence), liability is justified on policy grounds. The plaintiff cannot be held to have voluntarily accepted the risk of such behaviour by employees by virtue of contracting with a limited liability company. Although the plaintiffs interest in compensation and the employer's residual ability to deter even intentional torts may justify imposing liability on the employer under the vicarious liability regime for some torts of this nature, there is no reason to excuse the employee. The employer is not better situated than the employee to deter intentional torts. It is not fair to attribute losses caused by an employee's intentional tort to the employer merely because he employs the employee to advance his own interest. There is no reason to distribute losses that occur as a result of intentional torts; on the contrary, the loss should be concentrated as much as possible on the guilty party.

149 Where the employee is guilty of only ordinary negligence, however, the courts should not strain to apply a highly technical definition to the limits of the notion of performance of the contract. The test of tort liability being "unrelated to the contract" should be applied with due regard to the policy concerns involved in the operation of the vicarious liability regime.

150 The plaintiff's voluntary assumption of risk may also be circumscribed with respect to the type of interest at stake. This Court has rejected rigid analysis based on the nature of the injury suffered by the plaintiff. Obviously, however, the type of injury incurred is of the first importance. Where the plaintiff s interest is more compelling than the one put forward in the present case, it may be appropriate to find that a duty does exist under the second branch of *Anns*. In

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cases of personal injury, for example, the mere fact of contracting with a limited liability company may not be construed as an acceptance of risk of personal injury being satisfied by the company only. Of course, if the plaintiff accepts a limitation of liability-against the company, a suit against an employee will not be allowed as a method of circumventing that limitation; if the limitation is unconscionable, it should be struck down on that ground rather than avoided through use of the doctrine of privity; see Waddams, *The Law of Contracts* (2nd ed. 1984), at p. 213. Where there is no such express limitation clause, however, the employee would likely be liable to the plaintiff. As I noted earlier, there are strong arguments that as between the employee and the employer, the latter should bear sole responsibility in such a case through the operation of an indemnity regime; however, the plaintiff's claim to compensation and the safety concerns would obviously be paramount in such a context and the employee would, it seems to me, very likely be under a duty of care.

151 An independent tort may fall within or outside the range of the employer's liability under the vicarious liability regime. An employee's tort may be independent of the performance of the plaintiff's contract, while still occurring in the course of the employee's duty as interpreted in the cases. Such an act would therefore attract the operation of the vicarious liability regime. Alternatively, if the employee injures the plaintiff while driving on the weekend to his or her cottage, the tort is both independent and would not attract the operation of the vicarious liability regime, since it occurred outside the scope of the employee's course of employment.

152 It may be helpful to set out an appropriate approach to cases of this kind. The first question to be resolved is whether the tort alleged against the employee is an independent tort or a tort related to a contract between the employer and the plaintiff. In answering this question, it is legitimate to consider the scope of the contract, the nature of the employee's conduct and the nature of the plaintiff's interest. If the alleged tort is independent, the employee is liable to the plaintiff if the elements of the tort action are proved. The liability of the company to the plaintiff is determined under the ordinary rules applicable to cases of vicarious liability. If the tort is related to the contract, the next question to be resolved is whether any reliance by the plaintiff on the employee was reasonable. The question here is whether the plaintiff reasonably relied on the eventual legal responsibility of the defendants under the circumstances.

153 In this case, as I noted, the tort was related to the contract and any reliance by the plaintiff on Vanwinkel and Brassart was not reasonable.

Disposition

154 I would dismiss the appeal, allow the cross-appeal and dismiss the action against the employees, with costs throughout.

***Iacobucci J.*:**

155 This appeal and cross-appeal [from [1990] 4 W.W.R. 289, 45 B.C.L.R. (2d) 1, 31 C.C.E.L. 67, 2 C.C.L.T. (2d) 161, 70 D.L.R. (4th) 51, reversing [1986] 4 W.W.R. 183, 2 B.C.L.R. (2d) 181] raise two principal issues: (1) the duty of care owed by employees to their employer's customers, and (2) the extent to which employees can claim the benefit of their employer's contractual limitation of liability clause.

I. Facts

156 The facts are not complicated. On August 31, 1981, London Drugs Limited (hereinafter "appellant") delivered a transformer weighing some 7,500 pounds to Kuehne and Nagel International Ltd. (hereinafter "Kuehne & Nagel") for storage pursuant to the terms and conditions of a standard form contract of storage. The transformer had been purchased from its manufacturer, Federal Pioneer Limited, and was to be installed in the new warehouse facility being built by the appellant. The contract of storage included the following limitation of liability clause:

> LIABILITY - Sec. 11(*a*) The responsibility of a warehouseman in the absence of written provisions is the reasonable care and diligence required by the law.

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(*b*) The warehouseman's liability on any one package is limited to $40 unless the holder has declared in writing a valuation in excess of $40 and paid the additional charge specified to cover warehouse liability.

157 With full knowledge and understanding of this clause, the appellant chose not to obtain additional insurance from Kuehne & Nagel and instead arranged for its own all-risk coverage. At the time of entering into the contract, the appellant knew, or can be assumed to have known, that Kuehne & Nagel's employees would be responsible for moving and upkeeping the transformer.

158 On September 22, 1981, Dennis Gerrard Brassait and Hank Vanwinkel (hereinafter "respondents"), both employees of Kuehne & Nagel, received orders to load the transformer onto a truck which would deliver it to the appellant's new warehouse. The respondents attempted to move the transformer by lifting it with two forklift vehicles when safe practice required it to be lifted from above using brackets which were attached to the transformer and which were clearly marked for that purpose. While being lifted, the transformer toppled over and fell causing damages in the amount of $33,955.41.

159 Alleging breach of contract and negligence, the appellant brought an action for damages against Kuehne & Nagel, Federal Pioneer Limited, and the respondents. In a judgment rendered on April 14, 1986, Trainor J. of the Supreme Court of British Columbia held that the respondents were personally liable for the full amount of damages, limiting Kuehne & Nagel's liability to $40 and dismissing the claim against Federal Pioneer Limited. On March 30, 1990, the majority of the Court of Appeal allowed the respondents' appeal and reduced their liability to $40. The appellant was granted leave to appeal to this Court on December 7, 1990, [1990] 2 S.C.R. viii. The respondents have cross-appealed in order to argue that they should be completely free of liability. A written intervention was made by the General Truck Drivers & Helpers Local Union No. 31, the union authorized to negotiate the collective agreement with Kuehne & Nagel which, at all material times, governed the respondents' employment relationship.

II. Judgments in the Courts Below

A. Supreme Court of British Columbia (1986), 2 B.C.L.R. (2d) 181

160 Trainor J. held that Federal Pioneer Limited was not negligent in its manufacturing and packaging of the transformer. On the other hand, he found the respondent employees negligent in their handling of the transformer, but limited Kuehne & Nagel's vicarious liability to $40 in accordance with the limitation of liability clause found in the contract of storage. According to the trial judge, the main issue was whether this clause also limited the respondents' liability to $40.

161 After a review of the relevant jurisprudence, the trial judge held that there is no general rule in British Columbia barring an employee from being sued for a tort committed in the course of carrying out the very services for which the plaintiff had contracted with his or her employer. This was said in answer to the respondents' argument that they should be given the protection of the limitation of liability clause since their negligence was not an "independent tort" in itself, but rather negligence in the very course of performing the contract between their employer and the appellant.

162 An alternative submission at trial was that the respondents could benefit from the clause in question since the appellant, in the circumstances of this case, had impliedly consented to the limitation of liability extending to the conduct of Kuehne & Nagel's employees. The circumstances relied on were the appellant's knowledge that employees would be handling its transformer, its knowledge and acceptance of the limitation of liability clause, and its decision to purchase its own insurance. In essence, the argument was that the appellant had voluntarily accepted the risk of damage flowing from the respondents' negligence and should accordingly bear the cost of the damages. While the trial judge expressed sympathy for this submission, he felt that accepting it would require rewriting the contract; a course "not open to me".

163 Accordingly, Trainor J. held that the limitation of liability clause in the contract was not available to the respondents who were thus liable for the full amount of damages caused to the transformer.

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B. Court of Appeal of British Columbia (1990), 45 B.C.L.R. (2d) 1

164 The Court of Appeal, sitting exceptionally as a panel of five, reversed the judgment against the respondents by a four-to-one majority. With the exception of Hinkson J.A. (who was silent on the issue), all justices acknowledged that privity of contract was a major obstacle to the respondents' claim to the benefit of the limitation of liability clause. However, using different approaches, the majority concluded that the respondents' liability was nonetheless limited to $40. McEachern C.J.B.C. and Wallace J.A. adopted what has been referred to as a "tort analysis". Writing separate reasons, they were of the opinion that the duty of care owed by the respondents to the appellant was, in all the circumstances, qualified so as to limit the amount of recovery to $40. Preferring a "contract analysis", Lambert J.A. implied a term in s. 11(b) of the contract of storage which extended the limitation of liability to the respondents and then apparently applied the agency/unilateral contract exception to the doctrine of privity. For his part, Hinkson J.A. concluded that the respondents did not owe any duty of care towards the appellant and he would have imposed no liability whatsoever on them. Finally, Southin J.A., in dissent, said the present action was in trespass to goods, not in negligence, and accordingly the appellant could recover against the respondents for the cost of repair to its transformer.

165 Because of the importance of the issues involved in this case and the variety of approaches taken by the members of the Court below, a fuller discussion of the reasons of the Court of Appeal is warranted.

(1) Reasons of McEachern C.J.B.C.

166 McEachern C.J.B.C. began his reasons with an analysis of the doctrine of privity of contract as it applies in this area of law. He reviewed the authorities, in particular *Scruttons Ltd. v. Midland Silicones Ltd.*, [1962] A.C. 446, [1962] 1 All E.R. 1 (H.L.), *New Zealand Shipping Co. v. A.M. Satterthwaite & Co.;* "*Eurymedon*" *(The)*, [1975] A.C. 154, [1974] 1 All E.R. 1015, [1974] 1 N.Z.L.R. 505 (P.C.), and the decisions of this court in *Greenwood Shopping Plaza Ltd. v. Beattie*, [1980] 2 S.C.R. 228, 10 B.L.R. 234, 111 D.L.R. (3d) 257, 39 N.S.R. (2d) 119, 71 A.P.R. 119, [1980] I.L.R. 1-1243, 32 N.R. 163, and *ITO-International Terminal Operators Ltd. v. Miida Electronics Inc.*, [1986] 1 S.C.R. 752, (sub nom. *Miida Electronics Inc. v. Mitsui O.S.K. Lines Ltd.)* 68 N.R. 241, 28 D.L.R. (4th) 641, 34 B.L.R. 251. He distinguished the case at bar from *The Eurymedon* and from *ITO — International Terminal Operators* on the basis that the bills of lading in those cases clearly defined the "commercial intention" of the parties and the courts therein were simply giving effect to this intention by permitting non-party stevedores to rely on limitation of liability clauses. In the case at bar, however, McEachern C.J.B.C. felt there was no ascertainable commercial intention with respect to s. 11 of the contract of storage. Moreover, there was no evidence to support a finding of trust or agency. McEachern C.J.B.C. disagreed with the approach of Lambert J.A. who implied a term into the contract extending the benefit of the clause to the respondents. According to him, there were no pleadings or evidence in support of such an interpretation. Accordingly, he felt bound by the decision of this Court in *Greenwood Shopping Plaza*, *supra*, to hold that the respondents were without the protection of the contract.

167 Having said this, McEachern C.J.B.C. embarked upon a tort analysis. At the outset, he stated that the respondents were "clearly under a duty to take reasonable care of the [appellant's] transformer under the law as it existed both before and after *Donoghue*" (p. 22). The real question was whether this duty, or the consequences of its breach, should be modified in this case. The Chief Justice held that *Anns v. Merton London Borough Council*, [1978] A.C. 728, (sub nom. *Anns v. London Borough Council of Merton)* [1977] 2 All E.R. 492 (H.L.), applied by this court in *Nielsen v. Kamloops (City)*, [1984] 2 S.C.R. 2, [1984] 5 W.W.R. 1, 29 C.C.L.T. 97, 26 M.P.L.R. 81, 8 C.L.R. 1, 10 D.L.R. (4th) 641, 54 N.R. 1, is sufficient authority to conclude that it is necessary to look at all the circumstances before deciding the nature and consequences of a breach of the duty of care, if any, which an employee owes to his or her employer's contractual partner. The "most significant fact" in this case, according to McEachern C.J.B.C, was that the respondents were acting in a contractual setting in which the appellant had voluntarily agreed with their employer that the latter would exercise reasonable care and diligence and that the right of recovery for a breach would be limited to $40. In his words, the parties established their "own law for this transaction". In the Chief Justice's opinion, a contract between two parties may be relevant in determining tort rights and duties arising within the contractual matrix. He stated it would be unreasonable

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to conclude that the appellant relied on Kuehne & Nagel's obligation under the contract for the first $40 of any damage, looking to the respondents for the balance. Further, it would be unreasonable to expect the respondents to be aware that they might be relied upon beyond the extent to which their employer's liability was limited. Finally, it is reasonable that the appellant's remedy for the respondents' tort should be no greater than that which the appellant agreed would be imposed upon their employer. In view of these circumstances, McEachern C.J.B.C. would limit the respondents' liability to $40.

(2) Reasons of Hinkson J.A.

168 The reasons of Hinkson J.A. are limited to the issue of whether the respondents owed a duty of care to the appellant. Hinkson J.A. reviewed the jurisprudence starting with *Donoghue v. Stevenson*, [1932] A.C. 562 (H.L.), and *Anns*, *supra*, placing considerable attention on recent English decisions which, in his words, have given "fresh consideration" to what is involved in the "concept of proximity". In particular, he relied on *Junior Books Ltd. v. Veitchi Co.*, [1983] 1 A.C. 520, [1982] 3 All E.R. 201 (H.L.), where Lord Roskill said this concept "must always involve, at least in most cases, some degree of reliance" (p. 546), and on two Court of Appeal decisions in which a factor of "just and reasonable" has been, apparently, added to the analysis: *Norwich City Council v. Harvey*, [1989] 1 W.L.R. 828, [1989] 1 All E.R. 1180 (C.A.), and *Pacific Associates Inc. v. Baxter*, [1990] 1 Q.B. 993, [1989] 2 All E.R. 159 (C.A.).

169 Hinkson J.A. conceded that, in most cases, employees such as the respondents would owe a duty of care to their employer's contractual partners. However, he added that there was no element of reliance in the case at bar. The appellant voluntarily accepted the risk of damage to its transformer and took steps to protect itself through its own policy of insurance. Hinkson J.A. concluded that the circumstances of the case did not disclose that there existed "such a close and direct relationship of proximity" between the appellant and the respondents as to give rise to a duty of care by the latter to the former. He added that in all the circumstances, it would not be "just and reasonable" to hold that the respondent employees owed a duty of care to the appellant. Accordingly, he would have imposed no liability on the respondents for the damages to the transformer.

(3) Reasons of Lambert J.A.

170 Lambert J.A. agreed with McEachern C.J.B.C. and Wallace J.A. that the respondents' liability should be limited to $40; however, he refused to undertake an "adventurous and perilous tort analysis" in order to reach this conclusion. He began by stating that Kuehne & Nagel and the respondents owed a duty of care to the appellant. In his opinion, an express or implied contract for services brings the customer, on the one hand, and the employer and employees, on the other, into a relationship of "sufficient proximity" to lay the foundation for a duty of care on the part of both the employer and the employee to the customer. Besides mere proximity, many factors will determine whether a duty of care arises in the end; in particular, reliance by the customer on the employer and/or employees. According to Lambert J.A., reliance can be assumed in most cases involving direct physical damage to persons or property.

171 Lambert J.A. held that the respondents' duty of care is unaffected by the presence of the limitation of liability clause in the contract of storage. According to him, ss. 2(4)(b) and 13 of the *Warehouse Receipt Act*, R.S.B.C. 1979, c. 428, support the view that the clause was intended only to limit the extent of liability consequent upon a breach of duty of care, rather than to limit or negate the scope of that duty. This clause should not be used as evidence that the appellant assumed the risk of damage and released the respondents from their duty of care. In addition, Lambert J.A. reviewed and criticized what he calls the "just and reasonable test", sometimes used by English courts to deny the existence of a duty of care which proximity and foreseeability of damage would otherwise bring into effect. He does not think that this test should be applied in Canada because it would "introduce into tort law a subjective factor which is unnecessary and which ... would produce haphazard, idiosyncratic and unpredictable results" (p. 54). In any event, this test cannot operate to remove a duty of care that has long been recognized, such as the duty in the case at bar. Finally, Lambert J.A. claims that the second part of the *Anns* approach, which asks whether there are circumstances which ought "to negative, or to reduce or limit ... the damages to which a breach of it [the *prima facie* duty] may give rise", refers to heads of damage

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and does not suggest that it is possible to modify the normal rules for the assessment of damages by putting a monetary limit on damages for negligence. In his opinion, the concept of a $40 duty of care is unknown to the law.

172 Having said this, Lambert J.A. held that the respondents were entitled to benefit from the limitation of liability clause according to well established principles of contract law. He reviewed the jurisprudence dealing with the doctrine of privity of contract and with the implication of contracual terms. In his view, it was necessary to imply a term in the contract in order to avoid the "commercial absurdity" brought about by the rights of contribution of the respondent employees against their employer, Kuehne & Nagel, pursuant to s. 4 of the *Negligence Act*, R.S.B.C. 1979, c. 298. According to him, if the respondents are found fully liable it is conceivable that they could then commence an action against Kuehne & Nagel for contribution of half the damages awarded to the appellant (i.e. $16,977.70). Such a result would render the limitation of liability clause in the contract of storage wholly ineffective; a result neither party intended. Accordingly, Lambert J.A. implied a term in s. 11(b) of the contract of storage to the effect that the liability of Kuehne & Nagel's employees would also be limited to $40. Having implied such a term, he concluded that the agency exception to the doctrine of privity, developed in *The Eurymedon*, *supra*, and applied in *ITO — International Terminal Operators*, *supra*, applied so as to prevent the appellant from recovering more than $40 from the respondents (at p. 65).

(4) Reasons of Wallace J.A.

173 Like McEachern C.J.B.C, Wallace J.A. disposed of this case largely on the basis of tort law principles. After a review of English jurisprudence, Wallace J.A. stated that in order to determine whether a duty of care exists in a particular case, two approaches may be taken: (1) the *Anns*, *supra*, approach where, once you find there to be a *prima facie* duty of care, based on proximity and foreseeability, the surrounding circumstances must be examined to determine if the duty is negated or qualified in its nature or scope; or (2) the approach followed in *Pacific Associates Inc. v. Baxter*, *supra*, and *Norwich City Council v. Harvey*, *supra*, of considering three essential criteria to the existence of a duty of care: proximity, reliance and whether it is "just and reasonable" to impose such a duty. According to Wallace J.A., the end result is the same regardless of the approach taken: "a consideration of all the circumstances to determine whether a duty of care should fairly be imposed upon the alleged wrongdoer, and if so, its scope and its consequences" (at p. 77). He asserts that when the parties have come into a relationship of proximity because of a contract, the terms of that contract are among the circumstances that determine the existence and scope of the duties of care to be discharged by the parties.

174 In the case at bar, Wallace J.A. noted that by expressly agreeing to limit its claim to $40, the appellant assumed the risk of any damage in excess of that sum. In his opinion, it could not be inferred that the appellant intended to retain a right to claim in tort against the respondents for the full amount of any loss, particularly since they were performing the very services which their employer, Kuehne & Nagel, was bound to provide under the contract. These circumstances were said to limit the scope of the respondents' duty of care to the same extent as the duty their employer owed, namely, to $40. Wallace J.A. did not find privity of contract to be a bar to his finding. He notes that while third parties, such as the respondents, cannot benefit from a contract unless they fall within one of the established exceptions, the existence and nature of a contract nevertheless "provides the matrix or structural background which creates the common law duties, privileges, rights and obligations of a third party whose conduct is affected by such a contractual arrangement" (p. 81).

(5) Dissenting Reasons of Southin J.A.

175 Southin J.A. agreed with McEachern C.J.B.C.'s reasons on the issue of privity of contract. She added that the limitation of liability clause in question is not a "landlubber's version of a Himalaya clause" so as to permit the respondents to rely on this Court's decision in *ITO — International Terminal Operators*, *supra*. Southin J.A. also expressed the view that there is no doctrine of "vicarious immunity" in the common law.

176 Differing from her colleagues, she took the view that the notion of duty of care was irrelevant in the case at bar since the appellant's action was founded on trespass to goods. In her opinion, "the modern tort of negligence, all-devouring monster though it is, has not swallowed up the tort of trespass" (p. 92). She held that the tort of trespass does not require any consideration of modern notions of duty of care. Southin J.A. thus concluded that the respondents

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were liable for trespass to goods by dropping the transformer and that the appellant may recover the cost of repair. In closing, Southin J.A. added: "I regret to have had to come to this conclusion because the result is, to my mind, in a moral sense, unjust" (p. 92).

III. Issues

177 The cross-appeal raises the following question:

> (1) Did the respondents, acting in the course of their employment and performing the very essence of their employer's contractual obligations with the appellant, owe a duty of care to the appellant?

If so, it is not disputed before this Court that the respondents were negligent in their handling of the appellant's transformer. In other words, the finding of the trial judge that the respondents breached their duty of care is not contested. Moreover, it is not disputed that it is the respondents' negligence which was the cause of the damages to the transformer and that these damages amount to $33,955.41. The next question which is raised by the appeal would thus become one of the appropriate liability for this breach, namely:

> (2) Can the respondents obtain the benefit of the limitation of liability clause contained in the contract of storage between their employer and the appellant so as to limit their liability to $40?

For reasons that follow, I am of the opinion that both questions should be answered in the affirmative. By so concluding, both the cross-appeal and the appeal should therefore be dismissed.

IV. Analysis

A. Duty of Care

178 The trial judge impliedly held that the respondents owed a duty of care to the appellant in the handling of the transformer, adding that in British Columbia there is no general rule that an employee cannot be sued for a tort committed in the course of carrying out the very services for which the plaintiff had contracted with his or her employer. McEachern C.J.B.C. stated without qualification that the respondents were "clearly under a duty to take reasonable care of the [appellant's] transformer under the law as it existed both before and after *Donoghue*" (p. 22). Lambert J.A., while embarking on a more in-depth analysis of the question, came to the same conclusion again without much difficulty. Wallace J.A., for his part, held that the respondents owed a "*prima facie* duty of care" to the appellant based on the *Donoghue v, Stevenson*, *supra*, principle. Southin J.A. did not address the issue directly as she felt the appellant's cause of action was in trespass, rather than in negligence.

179 As noted earlier, Hinkson J.A. was alone in concluding that the respondents owed no duty of care to the appellant. He came to this conclusion by referring to a number of English authorities which, in his view, qualify the two-stage approach of Lord Wilberforce in *Anns*, *supra*, by importing notions of reliance, justness and reasonability (as well as the established requirement of foreseeability) in the determination of whether or not a duty of care arises in a particular situation. In his view, there was no duty of care mainly because of an absence of reliance on the part of the appellant and also because it would not be "just and reasonable" to hold otherwise.

180 In arguing that they did not owe any duty of care to the appellant, the respondents rely in part on the approach suggested by Hinkson J.A. They argue that the concept of "neighbourhood (or proximity)" cannot be reduced to the simple principle that factual foreseeability of damage creates, without more, a duty of care. The respondents offer a list of English decisions showing some discontent with the approach set out in *Anns* and suggesting alternative interpretations of the proper "test" to be applied. It is submitted that many factors, besides foreseeability of damage, must be taken into account when determining the existence of a duty of care, namely, the reasonable expectations of the parties, reliance, the nature of the damage suffered and the existence of a pre-existing commercial agreement. Like Hinkson J.A., the respondents submit there is no reliance in the case at bar. But their argument does not end there. They submit that,

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as a general rule, an employee acting in the course of his or her employment and performing the essence of his or her employer's contractual obligations with a "third party" does not owe an "independent duty of care" to that "third party". In such a case, it is argued, the third party — or customer — should have no cause of action against the employee in negligence. The respondents offer some cases to support this principle and submit that it is sensible in light of what they call modern economic, employment and legal conditions. In particular, they claim the "central element" of reliance is almost always absent between individual employees and their employer's customers.

181 For its part, the appellant relies on the decision of *Anns*, *supra*, to support a finding that the respondents were under a duty of care. Moreover, the appellant claims that the conclusion of Hinkson J.A. is contrary to the terms of the contract of storage, the provisions of the *Warehouse Receipt Act*, s. 2(4), the common law of bailment and the decisions of this Court in *Greenwood Shopping Plaza*, *supra*, *Canadian General Electric Co. v. Pickford & Black Ltd.*, [1971] S.C.R. 41, 2 N.S.R. (2d) 497, 14 D.L.R. (3d) 372, and *Cominco Ltd. v. Bilton*, [1971] S.C.R. 413, 15 D.L.R. (3d) 60.

182 In my opinion, the respondents unquestionably owed a duty of care to the appellant when handling the transformer. I arrive at this conclusion with as little difficulty as the judges in the courts below. I do not base my conclusion on the terms of the contract of storage or on s. 2(4) of the *Warehouse Receipt Act* but on well established principles of tort law. In all the circumstances of this case, it was reasonably foreseeable to the respondent employees that negligence on their part in the handling of the transformer would result in damage to the appellant's property. In sum, there was such a close relationship between the parties as to give rise to a duty on the respondents to exercise reasonable care.

183 I find it unnecessary for the purposes of this appeal to consider the numerous English authorities which have, according to some, given "fresh consideration" to what is involved in determining whether a duty of care exists in a particular situation. I say this because, to borrow the words of McEachern C.J.B.C, the respondents were "clearly under a duty to take reasonable care of the [appellant's] transformer under the law as it existed both before and after *Donoghue*". We are not here dealing with the type of factual situation in which concerns about the breadth of traditional principles have arisen. A conclusion that the respondents owed no duty of care to the appellant would clearly be recognizing a new immunity where none existed before.

184 As already mentioned, absence of reliance on the part of the appellant is a crucial factor according to Hinkson J.A. and the respondents. Hinkson LA. made the following comments (at p. 35):

> Normally, the owner expects the warehouseman and its employees to use reasonable care in handling and storing its goods. The warehouseman and its employees know that if the goods are damaged the owner will suffer loss. Thus, the requirements of foreseeability and proximity can be said to have been met with the result that the warehouseman and its employees owe to the owner a duty of care.

However, he then goes on to find that because the appellant knew about the limitation of liability clause and chose to obtain its own insurance, it was "not relying on the warehouseman and its employees not to damage the transformer" (p. 36). Assuming, *arguendo*, that "reliance" is relevant in the case at bar, I am of the view that Hinkson J.A. misapplied this concept.

185 When reliance is used in cases such as *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.), *Junior Books*, supra, and *B.D.C. Ltd. v. Hofstrand Farms Ltd.*, [1986] 1 S.C.R. 228, [1986] 3 W.W.R. 216, 1 B.C.L.R. (2d) 324, (sub nom. *Hofstrand Farms Ltd. v. British Columbia*) 36 C.C.L.T. 87, 33 B.L.R. 293, 26 D.L.R. (4th) 1, 65 N.R. 261, in order to determine the existence of a duty of care, it is concerned with the relationship between the plaintiff's position and the tortfeasor's conduct, not with the relationship between the plaintiff's position and the tortfeasor's pocketbook. In other words, reliance, as it may be used here, goes to the existence of a duty of care owed and not to liability for breach of a duty of care. In this respect, I agree with the following passage taken from Professor Joost Blom's commentary in (1991), 70 *Can. Bar Rev*. 156, at p. 168:

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> Probably the line taken by Hinkson J.A. presents the most serious problems. It seems unrealistic to say, as he did, that by agreeing to a virtual exclusion of liability in a case like this, you remove potential wrongdoers from "proximity" with yourself because you give up reliance on their taking reasonable care. As McEachern C.J.B.C. pointed out, the nuisance of having your goods damaged, and the cost of making an insurance claim and paying the deductible, are strong reasons for saying that you do rely. Saying, "I will not look to you for damages if there is an accident" is not the same thing as saying, "Go ahead and be as careless as you want with my property."
>
> [Emphasis added.]

186 Having said this, I wish simply to add what has already become evident by my conclusion. There is no general rule in Canada to the effect that an employee acting in the course of his or her employment and performing the "very essence" of his or her employer's contractual obligations with a customer does not owe a duty of care, whether one labels it "independent" or otherwise, to the employer's customer. Our law of negligence has long since moved away from a category approach when dealing with duties of care. It is now well established that the question of whether a duty of care arises will depend on the circumstances of each particular case, not on pre-determined categories and blanket rules as to who is, and who is not, under a duty to exercise reasonable care. There may well be cases where, having regard to the particular circumstances involved, an employee will not owe a duty of care to his or her employer's customer. Indeed, the respondents have provided this Court with a series of decisions where this conclusion appears to have been reached: see *Sealand of the Pacific Ltd. v. Robert C. McHaffie Ltd.*, [1974] 6 W.W.R. 724, 51 D.L.R. (3d) 702 (B.C.C.A.); *Moss v. Richardson Greenshields of Canada Ltd.*, [1989] 3 W.W.R. 50, 56 Man. R. (2d) 230 (C.A.); *Summitville Consolidated Mining Co. v. Klohn Leonoff Ltd.* (July 6, 1989), Doc. Vancouver C880756 (B.C.S.C.); and *R.M. & R. Log Ltd. v. Texada Towing Co.* (1967), 62 D.L.R. (2d) 744, [1968] 1 Ex. C.R. 84.

187 However, this does not mean that this is the necessary result in all factual situations. Abstaining from commenting on the conclusions reached in the cases cited, I find nothing in any of them, nor have I found anything else, which supports the type of blanket rule advocated by the respondents. At best, these decisions simply confirm that the question of whether a duty of care arises between an employee and his or her employer's customer depends on the circumstances of each particular case. The mere fact that the employee is performing the "very essence" of a contract between the plaintiff and his or her employer does not, in itself, necessarily preclude a conclusion that a duty of care was present.

188 As conceded by the respondents, there are many decisions in which a duty of care was found to exist: see, for example, *Northwestern Mutual Insurance Co. v. J.T. O'Bryan & Co.*, [1974] 5 W.W.R. 322, [1974] I.L.R. 1-639, 51 D.L.R. (3d) 693 (B.C.C.A.); *Toronto-Dominion Bank v. Guest* (1979), 10 C.C.L.T. 256, 16 B.C.L.R. 174, 105 D.L.R. (3d) 347 (S.C.); *East Kootenay Community College v. Nixon & Browning* (1988), 28 C.L.R. 189 (B.C.S.C.); and *Ataya v. Mutual of Omaha Insurance Co.*, [1988] I.L.R. 1-2316, 34 C.C.L.I. 307 (B.C.S.C.). In concluding discussion of this issue, I would add that the acceptance of the general rule advocated by the respondents would be at odds with the common law notion of vicarious liability. This principle, which has been well developed through years of jurisprudence, has as part of its very core the recognition that in many cases employees *do* owe duties of care to third parties, such as their employer's customers.

189 As the respondents owed a duty of care to the appellant in their handling of the transformer, I would accordingly dismiss the cross-appeal.

B. Limitation of Liability Clause

190 Accepting the finding of the trial judge that the respondents breached their duty of care thereby causing damages fixed at $33,955.41 to the appellant, I must now consider whether they are allowed to benefit from the limitation of liability clause found in the contract of storage between their employer, Kuehne & Nagel, and the appellant. The majority of the Court of Appeal reached a conclusion favourable to the respondents on this issue by using two different approaches (1) by implying a term in the contract extending the protection of s. 11(b) of the contract of storage to the respondents

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and by applying the exception to the doctrine of privity set out in *The Eurymedon* and *ITO — International Terminal Operators* (Lambert J.A.'s contract analysis); and (2) by taking into account the "contractual matrix" between Kuehne & Nagel and the appellant, including the limitation of liability clause, so as to qualify the respondents' duty of care and their ensuing liability to $40 (McEachern C.J.B.C. and Wallace J.A.'s tort analysis).

(1) Arguments of the Parties

191 The appellant argues that the respondents should not benefit, in any way, from a limitation of liability clause contained in a contract to which they are not parties. In its submissions, the appellant strongly, if not exclusively, relies upon the doctrine of privity of contract and upon its application by this Court in *Canadian General Electric*, *supra*, *Greenwood Shopping Plaza*, *supra*, and *ITO-International Terminal Operators*, *supra*. It is submitted that these decisions have unequivocally established the legal principles to be applied in determining whether a tortfeasor may rely upon a limitation of liability clause in a contract to which the tortfeasor is not a party. The appellant submits that, in so doing, this Court has repeatedly rejected attempts to abrogate or weaken the doctrine of privity of contract. In particular, it is argued that contractual protection can be extended to non-contracting parties only in limited circumstances where the facts support a finding of agency or trust. In the present case, the appellant states that there exists no evidence which would allow this Court to make such a finding. Accordingly, it is submitted that the majority of the Court of Appeal has abandoned "longstanding, established and fundamental principles of law" in affording contractual protection to the respondents.

192 More specifically, the appellant argues that, while Lambert J.A. was correct in adopting a contractual analysis, he erred in implying into the contract a term which included the respondents. On the other hand, the appellant claims that McEachern C.J.B.C. and Wallace J.A. erred in their emphasis upon the contractual relationship between the appellant and Kuehne & Nagel when considering the nature and extent of the duty of care owed by the respondents. It is submitted that such reasoning is unfounded in Canadian law and is bound to create uncertainty. Furthermore, it represents an unwarranted and unnecessary intrusion in the area of tort law. The appellant submits that to use a duty of care (tort) analysis to import contractual limitations into tort law is another attempt to circumvent the rigidity of the doctrine of privity. According to the appellant, any departure from this doctrine should be brought upon by the legislature and not by the courts. In any event, it is submitted that the application of the duty of care analysis is inappropriate in the case at bar as the foundation of liability against the respondents is the tort of trespass to goods, as advanced by Southin J.A. in dissent. In conclusion, the appellant challenges the "starting point" of the judges in the courts below to the effect that it is unjust to hold the respondent employees personally liable in the case at bar. In particular, it notes that the respondents were negligent, that more substantive injustice has been done in this case and others by a departure from orthodox and fundamental principles, and that adequate protection for employees exists within the current framework of the common law.

193 For their part, the respondents submit that they are entitled to benefit from the limitation of liability clause and suggest three alternative ways to arrive at such a result. First, they argue for a judicial reconsideration, or a relaxation of, the doctrine of privity of contract as it applies to the case at bar. It is submitted that this doctrine, in the facts of the present case, is radically out of step with commercial reality, with the expectations of the parties and with the way in which the parties allocated the risk of loss or damage. The respondents argue that employees can, without consideration and without invoking traditional exceptions such as trust or agency, claim the benefit of their employer's contractual limitation of liability when: (1) there is a contractual limitation of liability between their employer and another party; (2) a loss occurs during the employer's performance of its contractual obligations to that third party; and (3) the employees are acting in the course of their employment when the loss occurs. Second, the respondents submit that they can benefit from the clause in question by implying a term into the contract and by relying on the decisions in *The Eurymedon*, *supra*, and *ITO — International Terminal Operators*, *supra*, in the manner suggested by Lambert J.A. And third, the respondents adopt similar arguments to those advanced in the reasons of McEachern C.J.B.C. and Wallace J.A. and submit that the contractual setting between Kuehne & Nagel and the appellant, including the limitation of liability clause, has the effect of limiting the respondents' liability to the appellant. In this sense, it is suggested that the respondents should be

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allowed to benefit from the clause, albeit indirectly, via a duty of care (tort) analysis. They argue that such an analysis is not irrelevant as suggested by Southin J.A. in dissent and by the appellant. Rather, the respondents submit it is the principles of trespass, not negligence, that are inapplicable to the facts of this case.

(2) Approach to be Taken Herein

194 In my opinion, it is unnecessary to embark upon the type of tort analysis suggested by the respondents in order to arrive at the result that justice mandates in the case at bar. I do not say this because I disagree in principle with the reasoning of McEachern C.J.B.C. and Wallace J.A., and of my colleague Justice McLachlin, on which I refrain from expressing any opinion, but rather because I believe that a more direct approach is both available and preferable. The respondents are seeking the benefit of s. 11(b) of the contract of storage between their employer and the appellant in order to limit the liability that would otherwise attach to their breach of duty; in other words, in order to downwardly modify the assessment of damages currently fixed at $33,955.41. The appellant has never argued, understandably in the circumstances of this case, that s. 11(b) of the contract of storage was not wide enough to cover the respondents' negligence, that it had not been brought to the appellant's attention prior to the execution of the contract, or that it would be unconscionable to permit the respondents to rely on the limitation clause. The main obstacle to the respondents' claim, as pointed out by the appellant, is the doctrine of privity of contract. The judges below were well aware of the difficulty presented by this doctrine and chose different routes to deal with it: the trial judge and Southin J.A., in dissent, simply applied the doctrine; Lambert J.A. applied a recognized exception to privity; and McEachern C.J.B.C. and Wallace J.A. circumvented the doctrine by resorting to a tort analysis.

195 For my part, I prefer to deal head-on with the doctrine of privity and to relax its ambit in the circumstances of this case. Some may argue that the same result can (and should) be reached by using a number of approaches which are seemingly less drastic and/or allegedly more theoretically sound, such as the one advanced in the Court of Appeal by McEachern C.J.B.C. and Wallace J.A., or the "no duty" approach advocated by my colleague, Justice La Forest, and authors such as B. J. Reiter, "Contracts, Torts, Relations and Reliance", in B. J. Reiter and J. Swan, eds., *Studies in Contract Law* (1980), 235, or the doctrine of "vicarious immunity" allegedly adopted by the House of Lords in *Elder, Dempster & Co. v. Paterson, Zochonis & Co.*, [1924] A.C. 522.

196 In this respect, I have had the opportunity to read the reasons of my colleague McLachlin J. in the case at bar but, with respect, cannot agree with her characterization of my reasons or with her approach to the questions raised herein. Except for a rigid adherence to the doctrine of privity of contract, I do not see any compelling reason based on principle, authority or policy demonstrating that this Court, or any other, must embark upon a complex and somewhat uncertain "tort analysis" in order to allow third parties such as the respondents to obtain the benefit of a contractual limitation of liability clause, once it has been established that they breached a recognized duty of care. In my view, apart from privity of contract, it is contrary to neither principle nor authority to allow such a party, in appropriate circumstances, to obtain the benefit *directly* from the contract (i.e. in the same manner as would the contracting party) by resorting to what may be referred to as a "contract analysis". The main obstacle to such an approach resides in the fact that the party relying on the limitation of liability clause is not a party to the contract, not in the alleged principle that if one starts in tort, one must end in tort.

197 I accept the respondents' submission that this is both the time and the case for a judicial reconsideration of the rule regarding privity of contract as applied to employers' contractual limitation of liability clauses. Furthermore, I find wide support for the contract approach I adopt, including my view as to how a contractual limitation of liability clause may become relevant in a tort case such as the present one (i.e. as a juridical reason affecting the consequences — *liability* — of the breach of a duty of care), both in the jurisprudence and in a number of commentaries dealing specifically with the case at bar: see *Dyck v. Manitoba Snowmobile Assn. Inc.*, [1985] 1 S.C.R. 589, [1985] 4 W.W.R. 319, 32 C.C.L.T. 153, 32 M.V.R. 192, 35 Man. R. (2d) 22, 18 D.L.R. (4th) 635 ; *Crocker v. Sundance Northwest Resorts Ltd.*, [1988] 1 S.C.R. 1186, 44 C.C.L.T. 225, 86 N.R. 241, 29 O.A.C. 1, 51 D.L.R. (4th) 321, [1988] R.R.A. 444; *ITO-International Terminal Operators*, *supra*; W. J. Swadling, "Privity, Tort and Contract: Exempting the Careless Employee" (1991), 4

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Journal of Contract Law 208, at p. 229; and J. Swan, "Privity of Contract and Third Party Beneficiaries: the Selective Use of Precedent" (1991), 4 *Journal of Contract Law* 129, at pp. 133-34.

198 In my view, the respondents were third party beneficiaries to the limitation of liability clause found in the contract of storage between their employer and the appellant and, in view of the circumstances involved, may benefit directly from this clause notwithstanding that they are not a signing party to the contract. I recognize that such a conclusion collides with privity of contract in its strictest sense; however, for reasons that follow, I believe that this Court is presented with an appropriate factual opportunity in which to reconsider the scope of this doctrine and decide whether its application in cases such as the one at bar should be limited or modified. It is my opinion that commercial reality and common sense require that it should.

199 Before proceeding with my analysis I wish to state that, in view of the approach I adopt, it will be unnecessary for me to determine whether or not the respondents' liability is, as argued by Southin J.A. in dissent, governed by the law of trespass and not the law of negligence. Indeed, as I am of the opinion that the respondents owed a duty of care and that they may benefit from the limitation of liability clause without resorting to a tort analysis, a conclusion that they are liable in trespass rather than in negligence would change nothing in the disposition of this appeal. I must add, however, that I have some doubts as to the correctness of the conclusions of law made by Southin J.A. on this matter. In this respect, I would adopt the comments made by Professor Swadling, *supra*, at pp. 221-23 of his commentary.

200 I will now turn to the heart of the present appeal, namely, privity of contract and third party beneficiaries. In dealing with this issue, I would like briefly to review what is understood by the doctrine of privity of contract, the decisions that support it, the reasons behind the doctrine, criticisms of the doctrine, and its treatment in other jurisdictions. I shall then go on to discuss previous decisions of this Court on the matter before turning to the doctrine in the circumstances of this appeal.

(3) The Doctrine of Privity of Contract and Third Party Beneficiaries

(a) Introduction

201 The doctrine of privity of contract has been stated by many different authorities sometimes with varying effect. Broadly speaking, it stands for the proposition that a contract cannot, as a general rule, confer rights or impose obligations arising under it on any person except the parties to it: see, for example, *Anson's Law of Contract* (25th ed. 1979), at p. 411, cited by McIntyre J. for this Court in *Greenwood Shopping Plaza Ltd.*, *supra*, at p. 236; G. H. Treitel, *The Law of Contract* (8th ed. 1991), at pp. 523-75; *Cheshire, Fifoot and Furmston's Law of Contract* (12th ed. 1991), at pp. 450-68; and *Chitty on Contracts* (25th ed. 1983), vol. I, at pp. 662-91. It is now widely recognized that this doctrine has two very distinct components or aspects. On the one hand, it precludes parties to a contract from imposing liabilities or obligations on third parties. On the other, it prevents third parties from obtaining rights or benefits under a contract; it refuses to recognize a *jus quaesitum tertio* or a *jus tertii*. This latter aspect has not only applied to deny complete strangers from enforcing contractual provisions but has also applied in cases where the contract attempts, either expressly or impliedly, to confer benefits on a third party. In other words, it has equally applied in cases involving third party beneficiaries. This appeal is concerned only with the second aspect of privity, and particularly with its application to third party beneficiaries. Nothing in these reasons should be taken as affecting in any way the law as it relates to the imposition of obligations on third parties.

202 The decisions most often cited in Canadian courts in support of the doctrine of privity are: *Tweddle v. Atkinson* (1861), 1 B. & S. 393, 121 E.R. 762; *Dunlop Pneumatic Tyre Co. v. Selfridge & Co.*, [1915] A.C. 847 (H.L.); *Scrutions Ltd. v. Midland Silicones Ltd.*, *supra*; *Canadian General Electric*, *supra*; and *Greenwood Shopping Plaza*, *supra*. As confirmed by these and other decisions, privity of contract is an established principle of contract law. It is not, however, an ancient principle. As noted by this Court in *Greenwood Shopping Plaza*, at p. 237, the doctrine "has not always been applied with the rigor which has developed during modern times". Indeed, many have noted earlier decisions in the English common law which have allowed third party beneficiaries to enforce contracts made for their benefit: see, for example, the review

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of the history by Windeyer J. in *Coulls v. Bagot's Executor & Trustee Co.*, [1967] A.L.R. 385 (H.C.), at pp. 407-9; R. Flannigan, "Privity — The End of an Era (Error)" (1987), 103 *L.Q. Rev*. 564, at pp. 565-68; and *Carver's Carriage by Sea* (13th ed. 1982), at pp. 241-47. It is generally recognized that the law in this respect was not "settled" until the mid-nineteenth century. It is also accepted that there are certain exceptions to the doctrine of privity such as trust and agency: see *Greenwood Shopping Plaza*, *supra*, at pp. 238-41 and *JTO — International Terminal Operators*, *supra*, at pp. 784-94.

203 Closely related to the doctrine of privity, but conceptually distinct, is the rule that consideration for a promise must move from the person entitled to sue or rely on that promise. Both rules have been used in the past, sometimes in an interchangeable manner, in order to deny third parties the right to enforce contractual provisions made for their benefit. There is some debate in academic circles, supported by *obiter dicta*, as to whether or not privity and consideration are really distinct concepts. For our purposes, however, I find it unnecessary to consider this question. I proceed on the basis that the major obstacle to the respondents' claim, as stated by the appellant, is that they are not a party to the contract from which they seek to obtain a benefit.

204 The reasons behind the doctrine of privity have received very little judicial attention. Professor Treitel offers perhaps the most often cited (and debated) justifications for this doctrine in his treatise *The Law of Contract*, *supra*, at pp. 527-28. Maintaining a certain distance, he claims that the denial of third party rights under a contract may be justified for four reasons: (1) a contract is a very personal affair, affecting only the parties to it; (2) it would be unjust to allow a person to sue on a contract on which he or she could not be sued; (3) if third parties could enforce contracts made for their benefit, the rights of contracting parties to rescind or vary such contracts would be unduly hampered; and (4) the third party is often merely a donee and a "system of law which does not give a gratuitous promisee a right to enforce the promise is not likely to give this right to a gratuitous beneficiary who is not even a promisee".

205 Professor Atiyah in *The Rise and Fall of Freedom of Contract* (1979) offers an economic explanation for the doctrine (at p. 414):

> There is a sense in which the new doctrine of privity was an important development in the law at a time of increasing complexity in multilateral commercial relationships. The appearance of middlemen in all sorts of commercial situations served to separate the parties at either end of the transaction, and it was generally accepted that no privity existed between them. Economically, this may have served a useful purpose, in that it encouraged the development of a more market-based concept of enterprise liability. But on some occasions the results were not only economically dubious but socially disastrous.

Other possible justifications include preventing the promisor from being subject to double recovery and avoiding a floodgate of litigation brought about by third party beneficiaries.

(b) Criticisms of the Doctrine

206 Few would argue that complete strangers to a contract should have the right to enforce its provisions. When it comes to third party beneficiaries, however, the doctrine of privity of contract has received much criticism in this century by law reformers, commentators, and judges. To date, three major law reform bodies in the Common-wealth have examined the doctrine; each has recommended its abolition.

207 In 1937, the Law Revision Committee of the United Kingdom in its *Sixth Interim Report*, noting the difficulties created by privity of contract, recommended that it be abolished subject to three provisos: (1) no third party right can be acquired unless given by the express terms of the contract; (2) the promisor should be entitled to raise against the third party any defence that would have been valid against the promisee; and (3) the parties to the contract should retain the right to cancel it at any time, unless the third party has received notice of the agreement and has adopted it. The English Parliament has yet to legislate in this area and the whole matter is once again before the law reformers of that country: Law Commission, *Twenty-fifth Annual Report: 1990* (Law Comm. No. 195), para. 2.14. The Commission recently published a Consultation Paper in which it makes the provisional recommendation that a reform to the law

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of privity should be made in order to allow third parties to enforce contractual provisions made in their favour: Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Consultation Paper No. 121 (1991).

208 In New Zealand, a similar recommendation was made in the 1981 *Report on Privity of Contract* of the New Zealand Contracts and Commercial Law Reform Committee following a review of the problems created by a strict adherence to privity of contract and of the legal techniques sometimes used to avoid unjust results. The many recommendations of the Committee, including a reference to limitation of liability clauses and third parties, were implemented in the *Contracts (Privity) Act 1982*, Stat. N.Z., No. 132.

209 In Canada, the Ontario Law Reform Commission in its 1987 *Report on Amendment of the Law of Contract* recommended, persuasively in my view, the enactment of a general legislative provision to the effect that "contracts for the benefit of third parties should not be unenforceable for lack of consideration or want of privity" (at p. 71). The Commission, in the chapter of its *Report* entitled "Third Party Beneficiaries and Privity of Contract", offered the following general reasons for its recommendation: (1) the present state of the law is very complex and uncertain; (2) the traditional justifications for the doctrine of privity (only those in privity should be allowed to sue; consideration gives the right to sue; and preventing double recovery) are largely unfounded; (3) the doctrine impairs the enforcement of sensible commercial and personal arrangements made on a daily basis; (4) exceptions to the doctrine have developed with no rational basis except to avoid the application of the doctrine; (5) it is difficult, if not impossible, to reconcile the exceptions with the doctrine; (6) the exceptions are of limited use in many situations; (7) the possibility remains that meritorious claims will be defeated by the application of the doctrine; (8) the doctrine has been subject to legislative inroads as well as academic and judicial criticism; (9) many jurisdictions around the world (United States, New Zealand, Western Australia, Queensland and Quebec) have recognized third party rights by abolishing or modifying the doctrine of privity. The Commission concluded its canvass of the reasons for reform with the following comments (at pp. 67-68):

> Abolishing the present third party beneficiary rule would, we believe, render the law more consistent internally, and more understandable by lay persons. As was pointed out previously, the courts have been able to circumvent the doctrine of privity by one legal device or another when the desired result was the enforcement of the promise by the third party beneficiary. The present state of the law, with its anomalies and unjustified distinctions, cannot and should not continue.
>
> We note the clear trend in other jurisdictions permitting third parties to enforce contracts made for their benefit. From the discussion of the law in other jurisdictions, it should be apparent that there is almost universal agreement among those who have considered the question that the existing privity of contract rule must be abandoned. In the United States, through common law developments and legislative reform, the privity of contract rule has been rendered virtually obsolete. In Ontario, there are significant areas of the law where this rule no longer holds sway. We believe that the time has come for Ontario to recognize that the doctrine of privity of contract is no longer appropriate as a general principle of contract law.
>
> It is the firmly held view of the Commission that the privity of contract rule should be abolished.

210 The Commission opted for a reform based on the enactment of a general provision abolishing the doctrine, rather than detailed legislation. This approach was considered to be more flexible, permitting courts to fashion principles on a case by case basis in order to enforce third party rights where justice required such a result. Moreover, it would avoid the many difficulties facing the drafter of specific legislation. It is apparent throughout the *Report* that the reform was also directed towards third parties seeking to enforce limitation of liability clauses made for their benefit.

211 While noting that legislative reform along the lines mentioned above would be most welcome in this area of the law, many commentators have noted that uniform reform is unlikely in Canada owing to our present constitutional framework: see, for example, S. M. Waddams, "Contracts — Carriage of Goods — Exemptions for the Benefit of Third Parties" (1977), 55 *Can. Bar Rev*. 327, at p. 333; S. M. Waddams, "Third Party Beneficiaries in the Supreme Court of Canada" (1981), 59 *Can. Bar Rev*. 549, at p. 556; and L. C. Reif, "A Comment on *ITO Ltd. v. Miida Electronics Inc*. —

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The Supreme Court of Canada, Privity of Contract and the Himalaya Clause" (1988), 26 *Alta. L. Rev*. 372, at p. 382. Despite the difficulty in the way of uniform legislative reform, Professor Reif is of the opinion that "the legislatures are still the most appropriate sites for any substantial amendment to the principle" since courts are limited in their response to "sporadic and factually limited opportunities" (p. 382). While this may be true, it does not mean that this Court should refuse to assist in the evolution of the common law when faced with appropriate circumstances.

212 Most of the specific criticisms of the doctrine of privity and its application to third party beneficiaries have come from commentators. Some have questioned the application of the doctrine in general terms, that is, in its application to cases where a third party is attempting to enforce a contractual provision either by suit or by a defence to a suit, while others have dealt exclusively with the question of third party beneficiaries and limitation of liability (or exemption or exclusion) clauses. See, for example, A. L. Corbin, "Contracts for the Benefit of Third Persons" (1930), 46 *L.Q. Rev*. 12; S. M. Waddams, "Contracts — Carriage of Goods — Exemptions for the Benefit of Third Parties", *supra*; S. M. Waddams, "Third Party Beneficiaries in the Supreme Court of Canada", *supra*; S. M. Waddams, *The Law of Contracts* (2nd ed. 1984), at pp. 200-16; *Carver's Carriage by Sea*, *supra*, at pp. 241-64; M. Tedeschi, "Consideration, Privity and Exemption Clauses; Port Jackson Stevedoring Pty. Ltd. v. Salmond and Spraggon (Australia) Pty. Ltd." (1981), 55 *Aust. L.J*. 876; J. Swan and B. J. Reiter, "Developments in Contract Law: The 1979-80 Term" (1981), 2 *Sup. Ct. L. Rev*. 125; W. J. Swadling, "Privity, Tort and Contract: Exempting the Careless Employee", *supra*; J. Swan, "Privity of Contract and Third Party Beneficiaries: the Selective Use of Precedent", *supra*; R. Flannigan, "Privity — The End of an Era (Error)", *supra*; J. N. Adams and R. Brownsword, "Privity and the Concept of a Network Contract" (1990), 10 *Legal Studies* 12; G. Battersby, "Exemption Clauses and Third Parties" (1975), 25 *U.T.L.J*. 371; G. Battersby, "Exemption Clauses and Third Parties: Recent Decisions" (1978), 28 *U.T.L.J*. 75; B. Coote, *Exception Clauses* (1964), at pp. 117-36; J. Livermore, *Exemption Clauses and Implied Obligations in Contracts* (1986), at pp. 175-207. See also the articles cited by McIntyre J. in *ITO — International Terminal Operators*, *supra*, at p. 783 dealing specifically with the application of the rule to "*Himalaya* clauses".

213 These comments and others reveal many concerns about the doctrine of privity as it relates to third party beneficiaries. For our purposes, I think it sufficient to make the following observations. Many have noted that an application of the doctrine so as to prevent a third party from relying on a limitation of liability clause which was intended to benefit him or her frustrates sound commercial practice and justice. It does not respect allocations and assumptions of risk made by the parties to the contract and it ignores the practical realities of insurance coverage. In essence, it permits one party to make a unilateral modification to the contract by circumventing its provisions and the express or implied intention of the parties. In addition, it is inconsistent with the reasonable expectations of all the parties to the transaction, including the third party beneficiary who is made to support the entire burden of liability. The doctrine has also been criticized for creating uncertainty in the law. While most commentators welcome, at least in principle, the various judicial exceptions to privity of contract, concerns about the predictability of their use have been raised. Moreover, it is said, in cases where the recognized exceptions do not appear to apply, the underlying concerns of commercial reality and justice still militate for the recognition of a third party beneficiary right.

214 There have been numerous calls from the judiciary for a reconsideration of the doctrine of privity and its refusal to allow third party beneficiaries to enforce provisions made for their benefit. Lord Denning has probably been the most outspoken, if not the least subtle, in this respect. In cases such as *Smith & Snipes Hall Farm Ltd. v. River Douglas Catchment Board*, [1949] 2 K.B. 500, [1949] 2 All E.R. 179 (C.A.), at p. 514 [K.B.], *Drive Yourself Hire Co. (London) v. Strutt*, [1954] 1 Q.B. 250, [1953] 2 All E.R. 1475 (C.A.), at pp. 272-75 [Q.B.], *Adler v. Dickson*, [1955] 1 Q.B. 158, [1954] 3 All E.R. 397 (C.A.), at p. 183 (a case involving an exemption of liability clause and an action against employees), *Midland Silicones*, *supra*, at pp. 483-89 (a case involving a limitation of liability clause and stevedores) and in his Court of Appeal judgment in *Beswick v. Beswick*, [1966] Ch. 538, Lord Denning questioned the accuracy and necessity of the "fundamental principle" that no one who is not a party to a contract can sue or be sued on it or take advantage of the stipulations or conditions that it contains, He has been quick to note that the principle is far from being an ancient one and that there are judicial ways to avoid its application when desired. However, his efforts have been largely ignored, and sometimes criticized, by the English judiciary.

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215 But often judges have expressed similar discontent and have called for a reconsideration of the doctrine prohibiting a third party from enforcing contractual provisions made for his or her benefit: *Beswick v. Beswick*, [1968] A.C. 58, [1967] 2 All E.R. 1197 (H.L.), at p. 1201 per Lord Reid; *Olsson v. Dyson*, 120 C.L.R. 365, [1969] A.L.R. 443 (H.C.), at pp. 392-93 per Windeyer J.; *Woodar Investment Development Ltd. v. Wimpey Construction U.K. Ltd.*, [1980] 1 W.L.R. 277, [1980] 1 All E.R. 571 (H.L.), at pp. 588-89 per Lord Keith and at p. 591 per Lord Scarman; *Swain v. Law Society*, [1983] A.C. 598, [1982] 2 All E.R. 827 (H.L.), at p. 611 *per* Lord Diplock. Lord Scarman's comments are particularly forceful:

> I respectfully agree with Lord Reid that the denial by English law of a jus quaesitum tertio calls for reconsideration. In *Beswick v Beswick*, Lord Reid, after referring to the Law Revision Committee's recommendation that the third party should be able to enforce a contractual promise taken by another for his benefit, observed: "If one had to contemplate a further long period of Parliamentary procrastination, this House might find it necessary to deal with this matter." The committee reported in 1937; *Beswick v Beswick* was decided in 1967. It is now 1979; but nothing has been done. If the opportunity arises, I hope the House will reconsider *Tweddle v Atkinson* and the other cases which stand guard over this unjust rule.

216 More recently, the High Court of Australia was faced with an opportunity in which to reconsider the doctrine of privity. The majority of the Court accepted the invitation made by those calling for reform. It strongly criticized the doctrine and permitted a third party beneficiary to enforce a provision in an insurance contract notwithstanding that it was not a party to the contract and had provided no consideration, and that neither agency nor trust (nor any other exception) was applicable: *Trident General Insurance Co. v. McNiece Brothers Pty.* (1988), 80 A.L.R. 574.

217 Trident General Insurance Co. had entered into a contract of insurance with Blue Circle Southern Cement Ltd., a limestone crushing plant, with respect to its operation. The contract, among other things, attempted to extend certain benefits of coverage to third parties such as contractors and subcontractors. Following an accident in which a third party was held liable (McNiece Bros. Pty. Ltd.), Trident refused coverage on the ground that said party was not privy to the contract of insurance and had given no consideration. Notwithstanding that the facts could not support an agency argument and that trust had not been pleaded, the lower courts allowed McNiece's claim under the insurance policy thus creating, in effect, a new exception to the doctrine of privity. Trident appealed to the High Court of Australia making arguments very similar to ones made by the appellant in the case at bar; namely, that the High Court should confirm and apply "fundamental", "settled" and "established" contract principles relating to privity of contract and consideration, and asking that courts reject any judicial developments outside the scope of existing exceptions to the doctrine. These submissions were, in essence, accepted by three members of the High Court: Brennan, Deane and Dawson JJ. Each wrote individual dissenting reasons in which they defended the orthodox doctrine of privity and rejected attempts at judicial reform. However, a majority of the High Court (Mason C.J. and Wilson, Toohey and Gaudron JJ.) decided to examine the propriety of the rule denying third party beneficiary rights and held that this was an appropriate case in which to relax the rule. In the end, Trident's appeal was dismissed and McNiece was permitted to obtain the benefit of a contract to which it was not a party without resorting to notions of agency or trust.

(c) Treatment in Other Jurisdictions

218 As long ago as 1937, the English Law Revision Committee observed in its *Sixth Interim Report* that "the common law of England stands alone among modern systems of law in its rigid adherence to the view that a contract should not confer any rights on a stranger to the contract, even if the sole object may be to benefit him" (para. 48). This observation is still appropriate today, although it may be said that the common law of England has, for better or worse, found allegiance in Canada.

219 I need not engage in a thorough review of how third party beneficiary questions are dealt with in other jurisdictions or systems of law; that has been done on a number of occasions: see, for example, M. A. Millner, "*Ius Quaesitum Tertio*: Comparison and Synthesis" (1967), 16 *Int'l & Comp. L. Rev*. 446; A. J. Waters, "The Property in the Promise: A Study of the Third Party Beneficiary Rule" (1985), 98 *Harv. L. Rev*. 1109; S. P. de Cruz, "Privity in America: A Study in Judicial

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and Statutory Innovation" (1985), 14 *Anglo-American L. Rev*. 265; D. M. Walker, *The Law of Contracts and Related Obligations in Scotland* (2nd ed. 1985), at pp. 454-60; A. L. Corbin, *Corbin on Contracts*, 1 vol. ed. (1952), at pp. 723-82; and Ontario Law Reform Commission, *Report on Amendment of the Law of Contract*, *supra*, at pp. 55-65. I will simply take this opportunity to note what is obvious to anyone considering the issue, that is, that many jurisdictions have recognized, in varying degrees, that third party beneficiaries to a contract are entitled to enforce contractual provisions made for their benefit without necessarily resorting to notions such as agency or trust.

220 For example, in Quebec, the general principle of privity of contract (*relativité des contrats*) endorsed in art. 1023 of the *Civil Code of Lower Canada* is qualified by art. 1029 so as to permit contracting parties to stipulate in favour of third parties. Courts have interpreted this latter provision as giving to the third party a right, under certain circumstances, to enforce a contract made for his or her benefit. Such an interpretation is now codified in arts. 1444 to 1450 of the amendments to the Quebec *Civil Code*, S.Q. 1991, c. 64, which were recently passed by the National Assembly.

221 In a similar vein, while Scottish law adheres to the general rule that persons who are not parties to a contract cannot sue upon it, it nevertheless recognizes an exception when a *jus quaesitum tertio* has been created; that is, a right vested in and secured to a third party in and by a contract between two other parties. If an intention to confer a benefit on a third party can be gathered from the terms of the contract and the conduct of the parties, a *jus quaesitum tertio* will arise and the third party will have a right to enforce the contractual provision.

222 As stated above, in New Zealand, the *Contracts (Privity) Act 1982* abolishes to a very large extent the doctrine of privity of contract. Section 4 of the Act states that when a promise contained in a contract confers, or purports to confer, a benefit on a third party, the promisor shall be under an obligation, enforceable at the suit of the third party, to perform the promise. Section 2 of the Act defines "benefit" as including, *inter alia*, any immunity and any limitation or qualification of an obligation to which a person (other than a party to the contract) is or may be subject. Similar statutory inroads on privity include Western Australia's *Property Law Act, 1969*, W. Austl. Acts 1969, No. 32, s. 11, and Queensland's *Property Law Act 1974*, Queensl. Stat. 1974, No. 76, s. 55.

223 Finally, in the United States, third party rights are now recognized in every State, to a varying degree, by common law, uniform statutory legislation and/or specific state legislation. See, for example, §§ 302-315 of the *Restatement of Law (Second): Contracts 2d*. Ever since the cornerstone decision of the New York Court of Appeal in *Lawrence v. Fox*, 20 N.Y. 268 (1859), there has emerged what Professor Corbin refers to as a "trend" in the law, both judge-made and statutory, recognizing that third party beneficiaries are entitled, as a general rule, to enforce contractual provisions made for their benefit. The decision of the Massachussetts State Supreme Court in *Choate, Hall & Stewart v. SCA Services, Inc.*, 392 N.E.2d 1045 (1979), demonstrates that this trend has apparently now swept the entire country.

(d) Previous Decisions of This Court

224 As mentioned above, the appellant in its argument places considerable if not exclusive reliance on the decisions of this Court in *Canadian General Electric*, *supra*, *Greenwood Shopping Plaza*, *supra*, and *ITO — International Terminal Operators*, *supra*. From these decisions it is submitted that a tortfeasor's liability cannot be excluded, limited or modified by the terms of a contract to which he or she is not a party absent facts that can support a finding of trust or agency.

225 In *Canadian General Electric*, *supra*, an owner of goods brought an action against a firm of stevedores for negligence in the stowing of certain heavy electrical equipment belonging to the plaintiff on board a steamship destined for the Republic of Ghana. Writing reasons for the Court, Ritchie J. began by finding that the stevedoring company owed a duty of care to the owner of the goods, because in carrying out the work which it had undertaken for the shipowners, the stevedores should have had the owner of the goods in contemplation as a person affected by their acts. One argument raised by the firm of stevedores was that, even if they were in breach of this duty, their liability would be nonetheless limited in accordance with the provisions of the *Water Carriage of Goods Act*, R.S.C. 1952, c. 291, Schedule, Article IV(5), which were incorporated in the contracts of carriage between the owner of the goods and other parties, as evidenced by certain bills of lading. In response to this argument, Ritchie J. made the following observations (at pp. 43-44):

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> ... as the stevedoring company is a complete stranger to the contract of carriage it would not be affected by any provisions for limitation of liability or otherwise contained in the bills of lading and if the respondent was in breach of its duty to take reasonable care of the goods which it was stowing in the ship, it must accept the normal consequences of its tort. The law in this regard is, in my opinion, correctly stated in the reasons for judgment of the majority of the House of Lords in *Midland Silicones v. Scruttons Limited*, where the relevant cases are fully discussed.
>
> [Emphasis added.]

226 It is important to note that the provisions of the *Water Carriage of Goods Act* relied on by the stevedoring company only made the "carrier" and the "ship" beneficiaries of a limited liability. There was no "*Himalaya* clause" involved as this expression is commonly understood. In other words, the limitation of liability clause contained in the contracts of carriage (i.e. the provisions of the *Water Carriage of Goods Act* incorporated by reference) did not confer, nor did it attempt to confer, any benefits whatsoever on the stevedoring company. There was no specific reference to stevedores and the terms "carrier" and "ship" could not be interpreted as including stevedores according to jurisprudence: see *Midland Silicones*, *supra*, and *Robert C. Herd & Co. v. Krawill Machinery Corp.*, 359 U.S. 297 (1959). In sum, nothing in the contracts expressly or impliedly limited the liability of *the stevedoring company*. The firm of stevedores was not a third party beneficiary under the contracts but rather a "complete stranger" who was attempting to acquire a benefit (i.e. a limitation of liability) from contracts which did not even acknowledge its existence. Accordingly, while *Canadian General Electric* confirms the doctrine of privity to the extent that a stranger cannot obtain a benefit from a contract to which he or she is not a party, it says nothing about the aspect of the doctrine which refuses to recognize a third party beneficiary right.

227 Much of the same can be said about *Greenwood Shopping Plaza*, *supra*. In that case, employees of a company which was leasing premises in a shopping centre, while acting in the course of their employment, negligently caused a fire which destroyed part of the shopping centre. The lease between the owner of the centre and the company included in paragraphs 14 and 15 the provisions which dealt with the insurance of the demised premises. Although neither party to the contract took any steps towards the performance of the insurance undertakings, both were partially insured. Following the fire, an action was brought against the company and its employees on behalf of the owner of the shopping centre for the recovery of its uninsured loss and on behalf of its fire insurers by way of subrogation for moneys paid. The company, even though it was vicariously liable for the negligence of its employees, was held to be protected from liability through the provisions of the lease. The sole question before this Court, as stated by McIntyre J., was the following (at pp. 235-36):

> ... whether the respondents, held to have been guilty of negligence which caused the loss, but not parties to the lease and the insuring agreement in paras. 14 and 15, may claim the benefit of those provisions and thereby receive the same protection as that afforded to the company, their employer, who was otherwise equally liable with them for their negligence.

228 McIntyre J. answered the question in the negative by resorting to the doctrine of privity of contract. He noted that while certain exceptions to this doctrine had developed, such as agency and trust, on the limited evidence before this Court none was available to permit the employees to claim the benefit from the provisions of the lease.

229 I should like to make four observations concerning this decision. First, the contract involved in *Greenwood Shopping Plaza* was a lease of premises rather than a contract for services such as a contract of storage. The contract was between a lessor (the owner of the shopping centre) and the lessee (the company) and the intervention of the lessee's employees was not at all necessary for the execution of this agreement. It was irrelevant to any aspect of this agreement, especially to paragraphs 14 and 15, whether the lessee had any employees and whether they would be present on the leased premises. Second, the provisions of the contract which the employees were seeking to obtain a benefit from in *Greenwood Shopping Plaza* were not general limitation of liability clauses. Rather they were stipulations containing mutual undertakings by the lessor and the lessee with respect to insurance of the premises and the granting of subrogation rights. Third, it was inferentially observed that there was little, if any, evidence to support a finding that the parties to

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the contract intended to confer a benefit on the employees by the provisions of the lease relied on. This appears from the comments made by McIntyre J. in the context of his analysis of both the agency exception (at pp. 238-39) and the trust exception (at p. 240) and, more clearly, in the following closing observations (at pp. 240-41):

> It must also be observed that the clear and precise words of paras. 14 and 15 limit the application of the insurance provisions to the parties to the lease, the appellant and the company. Courts must, in cases of this sort, be wary against drawing inferences upon vague and scanty evidence, where the result would be to contradict the clear words of a written agreement and where rectification is not sought or may not be had.
>
> [Emphasis added.]

Finally, and closely related to the preceding comment, there is the fact that, as in *Canadian General Electric*, *supra*, the parties seeking to obtain benefits from the contract in *Greenwood Shopping Plaza* were viewed as complete strangers and not third party beneficiaries. This appears clearly from the wording of the provisions in question as noted by McIntyre J. in the underlined passage reproduced above.

230 In sum, the decision of this Court in *Greenwood Shopping Plaza*, while containing certain general statements relating to privity of contract, involved a contract and provisions which are different from the contract and provision in the case at bar. More importantly, however, is the fact that that case was not decided with reference to third party beneficiaries and with the aspect of privity denying a *jus tertii*, but rather with reference to complete strangers to a contract. Accordingly, *Greenwood Shopping Plaza*, like *Canadian General Electric*, is of limited use in a determination of whether third party beneficiary rights should be recognized in certain limited circumstances.

231 I now come to *ITO — International Terminal Operators*, *supra*. In that case, Mitsui O.S.K. Lines Ltd., a carrier, entered into a contract of carriage with Miida Electronics Inc. to carry some of the latter's electronic calculators from Japan to Montreal. The bill of lading contained what has become known as a "*Himalaya* clause" by which the carrier Mitsui sought to extend expressly the benefit of a limitation of liability to those it employed in connection with the shipment and unloading of the cargo, including stevedores. The carrier arranged for the goods to be picked up on arrival and stored at the port on a short-term basis by ITO-International Terminal Operators, a stevedoring and cargo-handling company. The contract between Mitsui and ITO stated that the stevedoring company was to be an express beneficiary of all limitation of liability provisions in its bills of lading. Many cartons of calculators were stolen from ITO's shed and Miida brought an action against both the carrier and the stevedoring company. The action was dismissed at trial. The Federal Court of Appeal dismissed the owner's appeal against the carrier but allowed its appeal against ITO. Both ITO and the owner appealed to this Court.

232 One of the issues raised was the effect of the "*Himalaya* clause" in the bill of lading, particularly, whether such clauses are to be recognized as a feature of Canadian maritime law. McIntyre J., writing for the majority, began by noting that the major obstacle to the recognition of the "*Himalaya* clause" was the common law doctrine of privity of contract. However, observing that academic writers had revealed a gap between contractual theory and commercial reality in refusing to recognize such clauses, that exceptions to the doctrine had been inferentially recognized in *Greenwood Shopping Plaza*, *supra*, and that the "route" left open by Lord Reid in *Midland Silicones* (i.e. the four-part "agency test") had been applied by Lord Wilberforce, speaking for the majority of the Privy Council, in *The Eurymedon*, *supra*, a case later affirmed in the Privy Council in *Port Jackson Stevedoring Pty. v. Salmond & Spraggon (Australia) Pty.;* "*New York Star*" *(The)*, [1981] 1 W.L.R. 138, [1980] 3 All E.R. 257, McIntyre J. held that "*Himalaya* clauses" could be effective in Canadian maritime law. His conclusion was largely based on the reasoning of Lord Wilberforce in *The Eurymedon* and the latter's application of Lord Reid's agency "four-step" exception to the doctrine of privity, especially the fourth step which involves the use of the concept of a unilateral contract in order to show consideration moving from the stevedores to the owner of goods. McIntyre J. stressed that he was not resorting to a general third party right (or *jus tertii*) in order to dispose of the matter; however, he did not foreclose the possibility that such a right might one day be recognized. His comments in this respect merit citation (at pp. 787-88):

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Of interest on this point is the thirteenth edition of Carver, *Carriage by Sea* (1982), in which is found a different approach to the question of liability of stevedores and other agents of the carrier. The learned author rejects the proposition that the concept of the *jus tertii* is unknown to the common law and refers to early authorities which support its application. In essence, the view is expressed that there is nothing wrong in principle or authority with the clear application of the principle of *jus tertii*. There is nothing offensive, it is argued, in a contract of affreightment in giving effect to that which was intended by the parties. The essence of the proposition advanced by the learned author may be found at vol. 1, p. 262, where he says, at paragraph 410:

Importance of the Himalaya Clause

It will be a happy day when the *Himalaya Clause* and *The Eurymedon* have run their full course. The *Himalaya Clause* has proved to have been a most effective dyke to stem the tide threatening to overwhelm the barrier against incursion on shipowners' pockets of perils of the sea. But exceptions of perils of the sea can be preserved more thoroughly by simpler and more rational means once it was generally apparent that the fundamental principle of *jus tertii* covers all. It is clearly the available protective principle to apply now to ensure that the will of the parties to a contract of affreightment can simply be secured by saying in the bill of lading what that will is.

An omnibus clause, of *Himalaya* vintage, could be devised, but it need no longer go into awkward concepts, which vary as between one country and another such as those of undisclosed agency and deemed (which means non-existent *de facto*) trusts.

England does not stand alone in this matter; the real need to preserve, and possibly improve, the clause at this time stems also from the views already expressed by courts in Australia, Canada and the United States.

It may be that this approach offers a more rational solution to the problem than that outlined by Lord Wilber-force, which compresses the facts into a contractual mould in order to preserve the common law principle of privity in a situation in which it would appear that it is being rejected. Be that as it may, 1 leave open for another day consideration of the Carver proposal, and I would follow the approach of Lord Wilberforce expressed in the case of The "*Euryinedon*".

[Emphasis added.]

McIntyre J. went on to find that the clause in question applied to the stevedoring company and that they were protected from liability.

233 Several points about *ITO — International Terminal Operators*, *supra*, warrant mention. First, unlike *Canadian General Electric*, *supra*, and *Greenwood Shopping Plaza*, *supra*, this case involved third party beneficiaries. The bill of lading expressly extended the benefit of a limitation of liability on third parties such as stevedores, which is the essence of a "*Himalaya* clause". In this sense, the stevedoring company was not a complete stranger to the contract of carriage but rather a third party beneficiary. While this fact was insufficient in itself to allow the third party to rely on the clause as a means of defence, it demonstrates that *ITO — International Terminal Operators* was concerned with a different aspect of the doctrine of privity from the two earlier decisions; the aspect which is involved in the case at bar.

234 Second, the majority of this Court in *ITO — International Terminal Operators* in recognizing the "*Himalaya* clause" took into consideration factors such as: commercial reality, the need for a definite establishment of risks in order to secure the respective needs for insurance, the situation in other jurisdictions, the need to promote uniformity and certainty in this area of law, and the true intention of the parties.

235 Third, and perhaps most importantly, while McIntyre J. opted for a recognition of the "*Himalaya* clause" within the current framework of the doctrine of privity and the traditional exception of agency, he nonetheless left open "for another day" the consideration of whether an approach simply recognizing a *jus tertii* would be a more rational solution to the problem faced by third party beneficiaries. Although his comments in this respect were made in a context different from

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that in the case at bar, I see nothing in the "Carver proposal" nor in the reasons of the majority in *ITO — International Terminal Operators* which would prevent this Court from accepting McIntyre J.'s invitation, albeit in a different factual setting.

236 It appears from the foregoing that the three decisions of this Court relied upon by the appellant do not completely and clearly dispose of the issue under consideration. Put another way, there is nothing in any of them which precludes this Court from adopting the approach I shall set out in the following part of these reasons.

(4) The Doctrine of Privity and the Present Appeal

237 None of the traditional exceptions to privity is applicable in the case at bar. As noted by the appellant, there is no evidence to support a finding of agency or trust, and these matters were not fully argued before the courts below. While the respondents rely to a certain extent on the approach taken by Lambert J.A. in the Court of Appeal, I must say that I have much difficulty in supporting a conclusion that the approach described in *The Eurymedon*, *supra*, and *ITO — International Terminal Operators*, *supra*, is applicable to the facts of this case. Rather than artificially extending recognized exceptions beyond their accepted limits, I prefer approaching this matter on the basis that privity of contract would otherwise apply so as to preclude the respondents from obtaining the benefit of the limitation of liability clause. The questions I now need to address are whether this doctrine should be relaxed in the circumstances of this case and, if so, on what basis.

(a) Should the Doctrine of Privity be Relaxed?

238 Without doubt, major reforms to the rale denying third parties the right to enforce contractual provisions made for their benefit must come from the legislature. Although I have strong reservations about the rigid retention of a doctrine that has undergone systematic and substantial attack, privity of contract is an established principle in the law of contracts and should not be discarded lightly. Simply to abolish the doctrine of privity or to ignore it, without more, would represent a major change to the common law involving complex and uncertain ramifications. This Court has in the past indicated an unwillingness to sanction judge-made changes of this magnitude: see, for two recent examples, *Watkins v. Olafson*, [1989] 2 S.C.R. 750, [1989] 6 W.W.R. 481, 39 B.C.L.R. (2d) 294, 50 C.C.L.T. 101, 100 N.R. 161, 61 D.L.R. (4th) 577, 61 Man. R. (2d) 81, at pp. 760-61 [S.C.R.], and *R. v. Salituro*, [1991] 3 S.C.R. 654, 9 C.R. (4th) 324, 68 C.C.C. (3d) 289, 131 N.R. 161, 50 O.A.C. 125, 8 C.R.R. (2d) 173, at pp. 665-70 [S.C.R.].

239 McLachlin J.'s comments in *Watkins v. Olafson*, at pp. 760-61, speaking for the Court, are worth repeating:

> This branch of the case, viewed thus, raises starkly the question of the limits on the power of the judiciary to change the law. Generally speaking, the judiciary is bound to apply the rules of law found in the legislation and in the precedents. Over time, the law in any given area may change; but the process of change is a slow and incremental one, based largely on the mechanism of extending an existing principle to new circumstances. While it may be that some judges are more activist than others, the courts have generally declined to introduce major and far-reaching changes in the rules hitherto accepted as governing the situation before them.
>
> There are sound reasons supporting this judicial reluctance to dramatically recast established rules of law. The court may not be in the best position to assess the deficiencies of the existing law, much less problems which may be associated with the changes it might make. The court has before it a single case; major changes in the law should be predicated on a wider view of how the rule will operate in the broad generality of cases. Moreover, the court may not be in a position to appreciate fully the economic and policy issues underlying the choice it is asked to make. Major changes to the law often involve devising subsidiary rules and procedures relevant to their implementation, a task which is better accomplished through consultation between courts and practitioners than by judicial decree. Finally, and perhaps most importantly, there is the long-established principle that in a constitutional democracy it is the legislature, as the elected branch of government, which should assume the major responsibility for law reform.

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> Considerations such as these suggest that major revisions of the law are best left to the legislature. Where the matter is one of a small extension of existing rules to meet the exigencies of a new case and the consequences of the change are readily assessable, judges can and should vary existing principles. But where the revision is major and its ramifications complex, the courts must proceed with great caution.

240 This Court has also recognized, however, that in appropriate circumstances courts have not only the power but the duty to make incremental changes to the common law to see that it reflects the emerging needs and values of our society: *R. v. Salituro*, at pp. 669-70. It is my view that the present appeal is an appropriate situation for making such an incremental change to the doctrine of privity of contract in order to allow the respondents to benefit from the limitation of liability clause.

241 As we have seen earlier, the doctrine of privity has come under serious attack for its refusal to recognize the right of a third party beneficiary to enforce contractual provisions made for his or her benefit. Law reformers, commentators and judges have pointed out the gaps that sometimes exist between contract theory on the one hand, and commercial reality and justice on the other. We have also seen that many jurisdictions around the world, including Quebec and the United States, have chosen from an early point (as early as the doctrine became "settled" in the English common law) to recognize third party beneficiary rights in certain circumstances. As noted by the appellant, the common law recognizes certain exceptions to the doctrine, such as agency and trust, which enable courts, in appropriate circumstances, to arrive at results which conform with the true intentions of the contracting parties and commercial reality. However, as many have observed, the availability of these exceptions does not always correspond with their need. Accordingly, this Court should not be precluded from developing the common law so as to recognize a further exception to privity of contract merely on the ground that some exceptions already exist.

242 While these comments may not, in themselves, justify doing away with the doctrine of privity, they nonetheless give a certain context to the principles that this Court is now dealing with. This context clearly supports in my view some type of reform or relaxation to the law relating to third party beneficiaries. Again, I reiterate that any substantial amendment to the doctrine of privity is a matter properly left with the legislature. But this does not mean that courts should shut their eyes to criticisms when faced with an opportunity, as in the case at bar, to make a very specific incremental change to the common law.

243 At this point, it is useful to recall briefly the salient facts with which this Court is seized. The appellant entered into a contract with Kuehne & Nagel for certain services, namely, the storing of its transformer. When the contract was signed, the appellant knew that it contained a clause limiting the liability of the "warehouseman" to $40. It also knew, or can be assumed to have known, that Kuehne & Nagel employed many individuals and that these employees would be directly involved in the storing of the transformer. The appellant chose not to obtain additional insurance from Kuehne & Nagel and instead arranged for its own all-risk coverage. When the damages to the transformer occurred, the respondents, two of Kuehne & Nagel's employees, were acting in the course of their employment and were performing services directly related to the contract of storage. The appellant is now seeking to recover the full amount of damages from these employees since it can only obtain $40 from the employer. As a defence to such a claim, the respondents are attempting to obtain the benefit of the limitation of liability clause.

244 There are few principled reasons for upholding the doctrine of privity in the circumstances of this case. Maintaining the alleged *status quo* by itself is an unhelpful consideration since I am considering whether or not a relaxation, or change, to the law should be made. Similarly, most of the traditional reasons or justifications behind the doctrine are of little application in cases such as this one, when a third party beneficiary is relying on a contractual provision as a defence in an action brought by one of the contracting parties. There are no concerns about double recovery or floodgates of litigation brought by third party beneficiaries. The fact that a contract is a very personal affair, affecting only the parties to it, is simply a restatement of the doctrine of privity rather than a reason for its maintenance. Nor is there any concern about "reciprocity", that is, there is no concern that it would be unjust to allow a party to sue on a contract when he or she cannot be sued on it.

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245 Moreover, recognizing a right for a third party beneficiary to rely on a limitation of liability clause should have relatively little impact on the rights of contracting parties to rescind or vary their contracts, in comparison with the recognition of a third party right to sue on a contract. In the end, the most that can be said against the extension of exceptions to the doctrine of privity in this case is that the respondent employees are mere donees and have provided no consideration for the contractual limitation of liability.

246 The doctrine of privity fails to appreciate the special considerations which arise from the relationships of employer-employee and employer-customer. There is clearly an identity of interest between the employer and his or her employees as far as the performance of the employer's contractual obligations is concerned. When a person contracts with an employer for certain services, there can be little doubt in most cases that employees will have the prime responsibilities related to the performance of the obligations which arise under the contract. This was the case in the present appeal, clearly to the knowledge of the appellant. While such a similarity or closeness might not be present when an employer performs his or her obligations through someone who is not an employee, it is virtually always present when employees are involved. Of course, I am in no way suggesting that employees are a party to their employer's contracts in the traditional sense so that they can bring an action on the contract or be sued for breach of contract. However, when an employer and a customer enter into a contract for services and include a clause limiting the liability of the employer for damages arising from what will normally be conduct contemplated by the contracting parties to be performed by the employer's employees, and in fact so performed, there is simply no valid reason for denying the benefit of the clause to employees who perform the contractual obligations. The nature and scope of the limitation of liability clause in such a case coincides essentially with the nature and scope of the contractual obligations performed by the third party beneficiaries (employees).

247 Upholding a strict application of the doctrine of privity in the circumstances of this case would also have the effect of allowing the appellant to circumvent or escape the limitation of liability clause to which it had expressly consented. This Court warned against such a practice in *Central Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147, *(*sub nom. *Central & Eastern Trust Co. v. Rafuse)* 37 C.C.L.T. 117, 42 R.P.R. 161, 34 B.L.R. 187, 31 D.L.R. (4th) 481, 75 N.S.R. (2d) 109, 186 A.P.R. 109, 69 N.R. 321. There, Le Dain J. in speaking for the Court made the following statement of principle (at p. 206):

> A concurrent or alternative liability in tort will not be admitted if its effect would be to permit the plaintiff to circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort. Subject to this qualification, where concurrent liability in tort and contract exists the plaintiff has the right to assert the cause of action that appears to be most advantageous to him in respect of any particular legal consequence.

248 I appreciate that this Court was dealing with a somewhat different factual situation in *Central Trust* since it was addressing the general question of concurrent or alternative liabilities in tort and contract as between two parties to a contract. It was not concerned specifically with the right of a contracting party to bring an action in tort against the employees of the other party, at the same time as suing that other party in contract and tort. However, the concern expressed by Le Dain J., that is, the fundamental unilateral alteration of one's contract, remains entirely applicable to the case at bar. Let me explain.

249 In making the above "qualification" to concurrent or alternative liability, Le Dain J. was largely influenced by the majority judgment of Pigeon J. in *J. Nunes Diamonds Ltd. v. Dominion Electric Protection Co.*, [1972] S.C.R. 769, 26 D.L.R. (3d) 699. In this respect, I think it would be useful to reproduce the passages from *Central Trust*, *supra*, which reveal what Le Dain J. had in mind when he spoke of circumventing or escaping one's contractual limitation of liability. He reviewed *Nunes Diamonds* in the following manner (at pp. 162-63):

> The trial court and the Court of Appeal were of the opinion that there had not been misrepresentation for which D.E.P. was liable. The majority of this Court appear also to have been of this view but, assuming that there had been a misrepresentation, they held that there could not be liability in tort for it because of the existence of the contract. Pigeon J., with whom Martland and Judson JJ. concurred, said the following at pp. 777-78:

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> Furthermore, the basis of tort liability considered in *Hedley Byrne* is inapplicable to any case where the relationship between the parties is governed by a contract, unless the negligence relied on can properly be considered as "an independent tort" unconnected with the performance of that contract, as expressed in *Elder, Dempster & Co. Ltd. v. Peterson, Zochonis & Co., Ltd.*, [[1924] A.C. 522], at p. 548. This is specially important in the present case on account of the provisions of the contract with respect to the nature of the obligations assumed and the practical exclusion of responsibility for failure to perform them.

It appears to have been assumed by the majority, as had been held by the trial judge, that the clause in the contract limiting liability in the case of loss to $50 did not cover negligence and also that the clause respecting representations did not apply to representations made after the contract was entered into. Pigeon J. said that if D.E.P. were to be liable in tort, despite the limitation of liability in the contract, it would effect a fundamental alteration of the contract.

250 Le Dain J. went on to examine the House of Lords decision of *Elder, Dempster*, *supra*, in order to elucidate what Pigeon J. meant by an "independent tort unconnected with the performance of [the] contract". This decision is of particular interest in the case at bar because of the similarity of legal issues involved therein, namely, the reliance by a third party on a contractual limitation of liability. Of course, I recognize that *Elder, Dempster* may be interpreted in many different ways and that the House of Lords has later expressed disapproval with at least one of these interpretations (i.e. vicarious immunity): *Midland Silicones*, *supra*. However, in clarifying the comments made by Pigeon J. in *Nunes Diamonds*, this Court chose to adopt one particular meaning of *Elder, Dempster* in *Central Trust* (at p. 164) which is very helpful in understanding the concern expressed by Le Dain J.:

> What [*Elder, Dempster*] decided in essence was that the contractual exclusion of liability for bad stowage in the bill of lading could not be circumvented by reliance on a liability in tort where the act or omission complained of was one connected with the performance of the contract. This appears from the speech of Viscount Finlay, cited by Pigeon J. in *Nunes Diamonds*, where, referring to the contention that the shipowners had a liability in tort that was unaffected by the exclusion of liability in the bill of lading [because they were not privy to the contract], he said at p. 548:
>
> > This contention seems to me to overlook the fact that the act complained of was done in the course of the stowage under the bill of lading, and that the bill of lading provided that the owners are not to be liable for bad stowage. If the act complained of had been an independent tort unconnected with the performance of the contract evidenced by the bill of lading, the case would have been different. But when the act is done in the course of rendering the very services provided for in the bill of lading, the limitation on liability therein contained must attach, whatever the form of the action and whether owner or charterer be sued. It would be absurd that the owner of the goods could get rid of the protective clauses of the bill of lading, in respect of all stowage, by suing the owner of the ship in tort.

251 In a similar fashion, it would be absurd in the circumstances of this case to let the appellant go around the limitation of liability clause by suing the respondent employees in tort. The appellant consented to limit the "warehouseman's" liability to $40 for anything that would happen during the performance of the contract. When the loss occurred, the respondents were acting in the course of their employment and performing the very services, albeit negligently, for which the appellant had contracted with Kuehne & Nagel. The appellant cannot obtain more than $40 from Kuehne & Nagel, whether the action is based in contract or in tort, because of the limitation of liability clause. However, resorting to exactly the same actions, it is trying to obtain the full amount from the individuals ("warehousemen") who were directly responsible for the storing of its goods in accordance with the contract. As stated earlier, there is an identity of interest between the respondents and Kuehne & Nagel as far as performance of the latter's contractual obligations is concerned. When these facts are taken into account, and it is recalled that the appellant knew the role to be played by employees pursuant to the contract, it is clear to me that this Court is witnessing an attempt in effect to "circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort". In my view, we should not sanction such an endeavour in the name of privity of contract.

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252 Finally, there are sound policy reasons why the doctrine of privity should be relaxed in the circumstances of this case. A clause such as one in a contract of storage limiting the liability of a "warehouseman" to $40 in the absence of a declaration by the owner of the goods of their value and the payment of an additional insurance fee makes perfect commercial sense. It enables the contracting parties to allocate the risk of damage to the goods and to procure insurance accordingly. If the owner declares the value of the goods, which he or she alone knows, and pays the additional premium, the bargain will have placed the entire risk on the shoulders of the "warehouseman". On the other hand, if the owner refuses the offer of additional coverage, the bargain will have placed only a limited risk on the "warehouseman" and the owner will be left with the burden of procuring private insurance if he or she decides to diminish its own risk. In either scenario, the parties to the contract agree to a certain allocation and then proceed, based on this agreement, to make additional insurance arrangements if required. It stretches commercial credulity to suggest that a customer, acting prudently, will not obtain insurance because he or she is looking to the employees for recovery when generally little or nothing is known about the financial capacity and professional skills of the employees involved. That does not make sense in the modern world.

253 In addition, employees such as the respondents do not reasonably expect to be subject to unlimited liability for damages that occur in the performance of the contract when said contract specifically limits the liability of the "warehouseman" to a fixed amount. According to modern commercial practice, an employer such as Kuehne & Nagel performs its contractual obligations with a party such as the appellant *through* its employees. As far as the contractual obligations are concerned, there is an identity of interest between the employer and the employees. It simply does not make commercial sense to hold that the term "warehouseman" was not intended to cover the respondent employees and as a result to deny them the benefit of the limitation of liability clause for a loss which occurred during the performance of the very services contracted for. Holding the employees liable in these circumstances could lead to serious injustice especially when one considers that the financial position of the affected employees could vary considerable such that, for example, more well off employees would be sued and left to look for contribution from their less well off colleagues. Such a result also creates uncertainty and requires excessive expenditures on insurance in that it defeats the allocations of risk specifically made by the contracting parties and the reasonable expectations of everyone involved, including the employees. When parties enter into commercial agreements and decide that one of them and its employees will benefit from limited liability, or when these parties choose language such as "warehouseman" which implies that employees will also benefit from a protection, the doctrine of privity should not stand in the way of commercial reality and justice.

254 For all the above reasons, I conclude that it is entirely appropriate in the circumstances of this case to call for a relaxation of the doctrine of privity.

(b) How Should the Doctrine of Privity be Relaxed?

255 Regardless of the desirability of making a particular change to the law, I have already noted that complex changes with uncertain ramifications should be left to the legislature. Our power and duty as a court to adapt and develop the common law must only be exercised generally in an incremental fashion. This is particularly important when, as here, changes to substantive law are concerned, as opposed to changes to procedural law. The respondents submit that this Court should relax the doctrine of privity so as to permit non-contracting employees to take the benefit of any immunities or limitations of liability granted to their employer. They offer three requirements for the application of this new exception, namely: (1) there is a contractual limitation of liability between an employer and another party; (2) the loss occurs during the employer's performance of its contractual obligations to that party; and (3) the employees are acting in the course of their employment when the loss occurs.

256 In my opinion, not only does the respondents' submission go beyond what is required to dispose of the present appeal, but it also does not represent an incremental change to the law. The main problem I have is with their first requirement. As we have seen earlier, the criticisms and statutory inroads into the doctrine of privity of contract have mostly, if not exclusively, occurred with respect to third party beneficiaries. That is, with respect to third parties to whom contracting parties have extended, either expressly or impliedly, some form of benefit arising under the contract.

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However, this is not the thrust of the respondents' submission. In essence, what they are requesting is the recognition of a third party right, or *jus tertii*, for complete strangers to their employer's contracts, without any regard whatsoever to the intention of the contracting parties. While this may be an appropriate step for the legislature, it is not the type of incremental change that this Court should endorse.

257 In my opinion, a threshold requirement for employees to obtain the benefit of their employer's contractual limitation of liability clause is the express or implied stipulation by the contracting parties that the benefit of the clause will also be shared by said employees. Without such a stipulation, it is my view that the employees are in a no better situation than this Court held those employees involved in *Greenwood Shopping Plaza*, *supra*, to be in, and should not therefore be able to rely on the clause as a means of defence. This Court found that the employees were strangers to the contract, as I discussed above. As for the other requirements proposed by the respondents, I agree with their substance although I would express them in a different manner.

258 In the end, the narrow question before this Court is: in what circumstances should employees be entitled to benefit from a limitation of liability clause found in a contract between their employer and the plaintiff (customer)? Keeping in mind the comments made earlier and the circumstances of this appeal, I am of the view that employees may obtain such a benefit if the following requirements are satisfied:

> 1) The limitation of liability clause must, either expressly or impliedly, extend its benefit to the employees (or employee) seeking to rely on it; and
>
> 2) the employees (or employee) seeking the benefit of the limitation of liability clause must have been acting in the course of their employment *and* must have been performing the very services provided for in the contract between their employer and the plaintiff (customer) when the loss occurred.

Although these requirements, if satisfied, permit a departure from the strict application of the doctrine of privity of contract, they represent an incremental change to the common law. I say "incremental change" for a number of reasons.

259 First and foremost, this new exception to privity is dependent on the intention of the contracting parties. An employer and his or her customer may choose the appropriate language when drafting their contacts so as to extend, expressly or impliedly, the benefit of any limitation of liability to employees. It is their intention as stipulated in the contract which will determine whether the first requirement is met. In this connection, I agree with the view that the intention to extend the benefit of a limitation of liability clause to employees may be express or *implied* in all the circumstances: see e.g. *Mayfair Fabrics v. Henley*, 244 A.2d 344 (N.J. 1968); *Employers Casualty Co. v. Wainwright*, 473 P.2d 181 (Colo. Ct. App. 1970) (*cert*, denied).

260 Second, taken as a whole, this new exception involves very similar benchmarks to the recognized agency exception, applied in *The Eurymedon* and by this Court in *ITO — International Terminal Operators*, *supra*. As discussed in the latter decision, the four requirements for the agency exception were inspired from the following passage of Lord Reid's judgment in *Midland Silicones*, *supra* (at p. 474):

> I can see a possibility of success of the agency argument if (first) the bill of lading makes it clear that the stevedore is intended to be protected by the provisions in it which limit liability, (secondly) the bill of lading makes it clear that the carrier, in addition to contracting for these provisions on his own behalf, is also contracting as agent for the stevedore that these provisions should apply to the stevedore, (thirdly) the carrier has authority from the stevedore to do that, or perhaps later ratification by the stevedore would suffice, and (fourthly) that any difficulties about consideration moving from the stevedore were overcome.

The first requirement of both exceptions is virtually identical. The second and third requirements of the agency exception are supplied by the identity of interest between an employer and his or her employees as far as the performance of contractual obligations is concerned; this is implicit in the recognition of this new exception. As for the fourth requirement of agency, while this new exception makes no specific mention of consideration moving from the employees to the

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customer, the second requirement of the new exception embraces the same elements which were adopted by courts to recognize consideration moving from stevedores in cases involving "*Himalaya* clauses".

261 Third, it must be remembered that I am proposing a very specific and limited exception to privity in the case at bar; viz. permitting employees who qualify as third party beneficiaries to use their employer's limitation of liability clauses as "shields" in actions brought against them, when the damage they have caused was done in the course of their employment and while they were carrying out the very services for which the plaintiff (customer) had contracted with their employer. In sum, I am recognizing a limited *jus tertii*.

262 In closing on this point, I wish to add the obvious comment that nothing in the above reasons should be taken as affecting in any way recognized exceptions to privity of contract such as trust and agency. In other words, even if the above requirements are not satisfied, an employee may still establish the existence of a trust or agency so as to obtain a benefit which the contracting parties intended him or her to have, notwithstanding lack of privity.

(c) Application of the New Exception

263 The only question in the case at bar is whether the respondents are third party beneficiaries with respect to the limitation of liability clause so as to come within the first requirement of the test I set forth above. Based on uncontested findings of fact, the respondents were acting in the course of their employment when they caused the transformer to topple over. Moreover, at that time they were performing the very services provided for in the contract between Kuehne & Nagel and the appellant, namely, the storage and upkeep of the transformer.

264 For convenience, I reproduce again the limitation of liability clause:

> LIABILITY - Sec. 11(*a*) The responsibility of a warehouseman in the absence of written provisions is the reasonable care and diligence required by the law.
>
> (*b*) The warehouseman's liability on any one package is limited to $40 unless the holder has declared in writing a valuation in excess of $40 and paid the additional charge specified to cover warehouse liability.

265 Does the language chosen indicate that the benefit of the clause is specifically restricted to Kuehne & Nagel? I think not. On the contrary, when all of the relevant circumstances are considered, it is my view that the parties must be taken as having intended that the benefit of this clause would also extend to Kuehne & Nagel's employees.

266 It is clear that the parties did not choose express language in order to extend the benefit of the clause to employees. For example, there is no mention of words such as "servants" or "employees" in s. 11(b) of the contract. As such, it cannot be said that the respondents are express third party beneficiaries with respect to the limitation of liability clause. However, this does not preclude a finding that they are *implied* third party beneficiaries. In view of the identity of interest between an employer and his or her employees with respect to the performance of the former's contractual obligations and the policy considerations discussed above, it is surely open to a court, in appropriate circumstances, to conclude that a limitation of liability clause in a commercial contract between an employer and his or her customer impliedly extends its benefit to employees.

267 In the case at bar, the parties have not chosen language which inevitably leads to the conclusion that the respondents were not to benefit from s. 11(*b*) of the contract of storage. The term "warehouseman" as used in s. 11(b) is not defined in the contract and the definition provided in the *Warehouse Receipt Act*, s. 1, is of no use in determining whether it includes employees for the purpose of the contractual limitation of liability. While it is true that s. 10(e) of the contract uses the term "warehouse employee", this by itself does not preclude an interpretation of "warehouseman" in s. 11(b) of the same contract as implicitly including employees for the purposes of the limitation of liability clause. Such a conclusion does not offend the words chosen by the parties.

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268 When all the circumstances of this case are taken into account, including the nature of the relationship between employees and their employer, the identity of interest with respect to contractual obligations, the fact that the appellant knew that employees would be involved in performing the contractual obligations, and the absence of a clear indication in the contract to the contrary, the term "warehouseman" in s. 11(b) of the contract must be interpreted as meaning "warehousemen". As such, the respondents are not complete strangers to the limitation of liability clause. Rather, they are unexpressed or implicit third party beneficiaries with respect to this clause. Accordingly, the first requirement of this new exception to the doctrine of privity is also met.

C. Conclusion

269 The respondents owed a duty of care to the appellant in their handling of its transformer. According to the uncontested findings of the trial judge, they breached this duty causing damages in the amount of $33,955.41. While neither trust nor agency is applicable, the respondents are entitled to benefit directly from the limitation of liability clause in the contract between their employer and the appellant. This is so because they are third party beneficiaries with respect to that clause and because they were acting in the course of their employment and performing the very services contracted for by the appellant when the damages occurred. I acknowledge that this, in effect, relaxes the doctrine of privity and creates a limited *jus tertii*. However, when viewed in its proper context, it merely represents an incremental change to the law, necessary to see that the common law develops in a manner that is consistent with modern notions of commercial reality and justice.

V. Disposition

270 For the foregoing reasons, I would dismiss the appeal and cross-appeal, both with costs.

***McLachlin J.*:**

271 I agree with Justice Iacobucci that the appeal should be dismissed. However, I arrive at the conclusion that the liability of the defendant employees is limited to the $40 maximum stipulated in their employer's contract by somewhat different reasoning.

272 Iacobucci J., as I understand his reasons, founds the liability of the defendants in tort. He concludes that the defendant employees owed the plaintiff a duty of care and that they breached that duty in dropping the plaintiff's transformer. He then finds that the limitation in the contract between the plaintiff and a third party (the employer) is a bar to full recovery in tort. He simply asserts this, without much discussion of how, as a matter of doctrine, defendants in a tort action can raise, as a defence to a tort claim, a contract to which they are not parties. I believe the question of how, in terms of legal principle, a term of a contract can serve as a defence to a claim in tort is important for this and future cases. Hence these reasons.

273 I have also had the advantage of reading my colleague Justice La Forest's reasons. While 1 confess to great admiration for the scholarship and good sense they display, my concerns about the magnitude of the change they would introduce to the Canadian law of tort and the difficult questions they raise prevent me from agreeing with them. Later in these reasons, I will briefly address some of these concerns.

274 In the court below, Lambert J.A conducted an analysis in contract, and found an independent contract between the plaintiff and the employees. A limitation of liability clause was seen by Lambert J.A. to be a logically necessary term to that contract. Meanwhile, Southin J.A. found the employees liable in trespass. With respect, Lambert J.A.'s approach suffers from many difficulties, chief among which is that of uncertainty as to the terms that a court will find to be applied between the employees and the plaintiff in any given case. I am also in respectful disagreement with Southin J.A.'s approach, as an action in trespass is most likely inappropriate in law where a bailor who came into possession of goods with the consent of the plaintiff damages the goods negligently (and not intentionally).

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275 The analysis in this case, as I see it, must start from the self-evident proposition that tort and contract constitute separate legal regimes. The plaintiff's action against the employees in this case is necessarily in tort, since there was no contract between it and the employees. The defendants, however, seek to rely on the terms of the contract between the plaintiff and their employer as a defence. The question is whether they can do this, and if so, on what basis.

276 Several theories for permitting an employee sued in tort to rely on a term of limitation in his employer's contract have been suggested. The most salient is the assertion that the plaintiff voluntarily accepted the risk of damage over the amount specified in the limitation clause. On this theory, the plaintiff, having agreed to the limitation of liability vis-à-vis the employer, must be taken to have done so with respect to the employer's employees.

277 The concept of voluntary assumption of the risk is known in tort law by the maxim *volenti non fit injuria*. Scholars have characterized it in two different ways: first, as a negation or limitation of the duty of care, and second, as a waiver of an existing cause of action (i.e. a bar to recovery): *Clerk & Lindsell on Torts* (16th ed. 1989), at pp. 112-13; J. G. Fleming, *The Law of Torts* (7th ed. 1987), at p. 265; *Salmond and Heuston on the Law of Torts* (19th ed. 1987), at pp. 557-58; A. M. Linden, *Canadian Tort Law* (4th ed. 1988), at pp. 448-49. The negation or limitation of duty of care approach looks at all the circumstances, including the contract, to determine what was the common law duty between the parties. The waiver approach assumes a standard duty of care, but says that the plaintiff's right to sue for breach of that duty has been removed.

278 In the court below, McEachern C.J.B.C., Wallace J.A. and Hinkson J.A. took the first approach. My colleague Iacobucci J., as I understand his reasons, takes the second. He says it is unnecessary to take the "tort" approach. He determines breach on the usual standard of care without consideration of the particular circumstances or the contract. He then proceeds to consider whether the limitation of liability in the plaintiff-employer contract provides a defence, and finds it does.

279 The first problem in Iacobucci J.'s approach is whether the defendants, who were not parties to the contract, can rely on the contract at all. In the past, the doctrine of privity of contract has said no. Iacobucci J. says this should no longer be a bar; I agree.

280 But there is a second problem. This arises from the fact that the contract term, even if it can be raised as a defence by the employees, does not by *its content* provide the employees with a defence. The contract exempts only the "warehouseman". The term "warehouseman" is not defined in the contract. But in my respectful view, upon a reading of the contract as a whole, the only reasonable interpretation is that the term "warehouseman" refers to the employer and does not include the employees.

281 One way of overcoming this difficulty would be through the doctrine of implied terms. It might be argued that where a customer and employer contract for a limitation of liability in circumstances where they know that the work will be done by the employer's employees, it is an implied term of that contract that the plaintiff accepts the risk of the employees' negligence as well, with the consequence that the employees may raise the defence of *volenti* against the plaintiff.

282 The supposition of an implied term to exempt the employees from liability on this case runs up against the problem that there is nothing to suggest that the parties intended the word "warehouseman", which defines whose liability is exempted, to include the employees. With all respect to Iacobucci J.'s apparent finding to the contrary, the conclusion that the parties intended "warehouseman" to include employees is of doubtful validity, given the absence of evidence on the matter and the fact that elsewhere in the contract "warehouseman" can only be read as not extending to employees.

283 However, presumed intention of the parties is only one of the grounds on which an implied term may be founded. As G. H. Treitel states in *The Law of Contract* (8th ed. 1991) at p. 185:

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> Implied terms may be divided into three groups. The first consists of terms implied in fact, that is, terms which were not expressly set out in the contract, but which the parties must have intended to include. The second consists of terms implied in law, that is, terms imported by operation of law, although the parties may not have intended to include them. The third consists of terms implied by custom.

See also Le Dain J. in *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711, 41 C.C.L.T. 1, 77 N.R. 161, 21 O.A.C. 321, 40 D.L.R. (4th) 385, and my concurring reasons in *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986, 40 C.C.E.L. 1, 92 C.L.L.C. 14,022, 91 D.L.R. (4th) 491, (sub nom. *Lefebvre v. HOJ Industries Ltd.*) 136 N.R. 40, 53 O.A.C. 200. In short, the court, where appropriate, may as a matter of policy imply a term in a particular type of contract, even where it is clear the parties did not intend it.

284 This would seem to me to afford a sufficient foundation for Iacobucci J.'s conclusion that the contract exemption should afford a defence to the employees. It might be argued that *as a matter of policy* the courts should imply a term in warehousing contracts that "warehouseman" includes the employees of the warehouse for purposes of contractual limitations of liability. This in turn would permit the conclusion that the plaintiff, by entering into such a contract, waived its right to sue the employees for damage beyond $40. This approach does, however, raise the difficult question of whether the court should, as a matter of policy, imply the term contended for.

285 But voluntary assumption of the risk can be grounded on a broader basis than waiver based on the contract's exclusion clause, as the three judges of the court below who dealt with the matter in tort concluded. Quite apart from the particular contract term, it can be argued that the concatenation of circumstances giving rise to the tort duty, of which the contract with its exemption of liability is one, are such that they limit the duty of care the employees owed to the plaintiff. As Wallace J.A. put it (quoting Purchas L.J. in *Pacific Associates Inc. v. Baxter*, [1990] 1 Q.B. 993, [1989] 2 All E.R. 159 (C.A.), at p. 1011), the question of whether there are circumstances qualifying or negating the duty of care "can only be answered in the context of the factual matrix including especially the contractual structure against which such duty is said to arise."

286 The law of tort has long recognized that circumstances may negate or limit the duty of care in tort. Indeed, as noted earlier in these reasons, this is one of the fundamental theories by which scholars have explained the defence of voluntary assumption of the risk. Waivers and exemption clauses, whether contractual or not, have long been accepted as having this effect on the duty in tort. As Fleming, *supra*, at p. 265 (dealing with the complete negation of any duty of care), puts it:

> The basic idea is that the plaintiff, by agreeing to assume the risk himself, absolves the defendant from all responsibility for it. The latter's duty of care is thus suspended.

287 Canadian courts, including this one, have applied this principle in determining liability and damages in tort. In *Car & General Insurance Corp. v. Seymour*, [1956] S.C.R. 322, 2 D.L.R. (2d) 369, Kellock J., after discussing the duty of care that is ordinarily owed by the operator of an automobile to a passenger, stated (at p. 331):

> A finding of *volenti* involves the consequence that no such duty existed, the onus of establishing which lay upon the defendant.

See also *Crocker v. Sundance Northwest Resorts Ltd.*, [1988] 1 S.C.R. 1186, 44 C.C.L.T. 225, 86 N.R. 241, 29 O.A.C. 1, 51 D.L.R. (4th) 321, [1988] R.R.A. 444, at p. 1203.

288 McEachern C.J.B.C., Hinkson J.A. and Wallace J.A. in the Court of Appeal below, after a careful review of the circumstances giving rise to the duty of care owed by the employees to the plaintiff in this case, concluded that it was limited to damage under $40. It would serve no purpose to repeat the considerations that led them to this conclusion, which have been ably summarized by Iacobucci J. Suffice it to say that I think they were right. (I add only the caveat that unlike one commentator (W. J. Swadling, "Privity, Tort and Contract: Exempting the Careless Employee" (1991),

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4 *Journal of Contract Law* 208, at pp. 218-19), I do not read Hinkson J.A. as holding that reliance by the plaintiff is essentia] to recovery in all such cases, nor Wallace J.A. as saying that the only requirement for liability is what is "just and reasonable.")

289 In England, the courts have rejected the doctrine of "vicarious immunity" which holds as a matter of principle that "an employee who performs acts under a contract made between his employer and a third party is entitled to the same immunities that the contract confers on his employer" (Swadling, *supra*, at p. 223). However, more recent decisions have opened the door to an analysis based on modification of the duty of care similar to that adopted in the Court of Appeal below. In *Junior Books Ltd. v. Veitchi Co.*, [1983] 1 A.C. 520, [1982] 3 All E.R. 201 (H.L.), Lord Roskill, in addressing the question as to "what the position would be in a case where there was a relevant exclusion clause in the main contract", stated (at p. 546):

> ... that question does not arise for decision in the instant appeal, but in principle I would venture the view that such a clause according to the manner in which it was worded might in some circumstances limit the duty of care just as in the *Hedley Byrne* case the plaintiffs were ultimately defeated by the defendants' disclaimer of responsibility.
>
> [Emphasis added.]

290 The principles of tort set out in *Anns v. Merton London Borough Council*, [1978] A.C. 728, (sub nom. *Anns v. London Borough Council of Merton)* [1977] 2 All E.R. 492 (H.L.), and repeatedly applied by this Court permit, and indeed require, the court to take into account all relevant circumstances in assessing the duty of care which a particular defendant owes to a particular plaintiff. The existence of a limitation on liability, whether contractual or otherwise, may affect the ambit of that duty of care. In this case, the majority of the Court of Appeal, applying these principles, concluded that the duty of care of the defendants was limited to damage under $40, the plaintiff having accepted all risk of damage over that amount. I would affirm that conclusion.

291 I have outlined how the notion of voluntary assumption of the risk, whether on the basis of a contractual waiver via the doctrine of implied terms, or on an analysis based on the scope of the duty of care, permits the conclusion that the defendant employees are not liable to the plaintiff. It remains to consider briefly the conclusion of my colleague La Forest J. that on the matrix of facts relevant to this case, no duty of care whatsoever lies on the employees, that duty lying exclusively on the employer. My concern is whether it is appropriate for this Court to take such a step at this time.

292 The rale proposed by my colleague La Forest J. would introduce a change in the common law of tort of major significance. It has always been accepted that a plaintiff has the right to sue the person who was negligent, regardless of whether the employee was working for someone else or not. The employer becomes liable only by the doctrine of vicarious liability, absent independent negligence on its part. The reasons of my colleague would reverse the scheme; the employer, regardless of whether it was itself negligent, would be primarily liable for the negligence of its employees. Only in exceptional cases, as where there is specific reliance on the employee or special "safety concerns", would there be a right to sue the employee directly.

293 Such a change would have great impact on the substantive and procedural rights of plaintiffs. On the substantive front, elimination of the current right to recover against a negligent employee would deprive a plaintiff of the possibility of alternative recovery in cases where, for example, the employer has insufficient insurance and no realizable assets (frequently the case with smaller corporate employers). On the procedural front, the rights to discovery and use in evidence of the testimony of the person who was actually negligent might be lost. These are but two important consequences that come to mind.

294 Not only is the proposed change in the law one of great significance; it would introduce collateral questions the answers to which are not immediately apparent, at least to me. How does one define specific reliance on employees or special safety concerns? Once established, do they justify holding employees liable for property damage and economic loss as well as for personal injury damages? Should an employer sued in such a case have a right over against the employee?

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My concern is not that questions such as these cannot be satisfactorily resolved, but that their resolution would involve the courts in a long and difficult process of law-making in an area where the legislative process might be better suited than the courts to setting the rules. In the meantime employees, employers and the insurance industry would find it difficult to accurately assess and provide for the risk of liability. These considerations suggest to me that however attractive the idea posited by my colleague may seem, the better course is to leave it to the legislatures of Canada to consider the full implications of the proposed change, decide whether on balance it is desirable, and if they think it is, impose appropriate exceptions, terms and conditions.

295 As I stated in *Watkins v. Olafson*, [1989] 2 S.C.R. 750, [1989] 6 W.W.R. 481, 39 B.C.L.R. (2d) 294, 50 C.C.L.T. 101, 100 N.R. 161, 61 D.L.R. (4th) 577, 61 Man. R. (2d) 81, at p. 761 [S.C.R.]:

> ... major revisions of the law are best left to the legislature. Where the matter is one of a small extension of existing rules to meet the exigencies of a new case and the consequences of the change are readily assessable, judges can and should vary existing principles. But where the revision is major and its ramifications complex, the courts must proceed with great caution.

Conclusion

296 I would dismiss the appeal and cross-appeal with costs.

Appeal and cross-appeal dismissed.

Footnotes

* Stevenson J. took no part in the judgment.

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TAB 7

Most Negative Treatment: Distinguished
Most Recent Distinguished: Williams-Sonoma Inc. v. Oxford Properties Group Inc. | 2013 ONCA 441, 2013 CarswellOnt 8646, 22 C.L.R. (4th) 199, 307 O.A.C. 314, 229 A.C.W.S. (3d) 865 | (Ont. C.A., Jun 26, 2013)

1999 CarswellBC 1927
Supreme Court of Canada

Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.

1999 A.M.C. 2840, 1999 CarswellBC 1927, 1999 CarswellBC 1928, [1999] 3 S.C.R. 108, [1999] 9 W.W.R. 380, [1999] I.L.R. I-3717, [1999] S.C.J. No. 48, [2000] 1 Lloyd's Rep. 199, 11 C.C.L.I. (3d) 1, 127 B.C.A.C. 287, 176 D.L.R. (4th) 257, 207 W.A.C. 287, 245 N.R. 88, 47 C.C.L.T. (2d) 1, 50 B.L.R. (2d) 169, 67 B.C.L.R. (3d) 213

Fraser River Pile & Dredge Ltd., Appellant v. Can-Dive Services Ltd., Respondent

Gonthier, Cory, McLachlin, Iacobucci, Major, Bastarache, Binnie JJ.

Heard: February 25, 1999
Judgment: September 10, 1999
Docket: 26415

Proceedings: affirming (1997), 39 B.C.L.R. (3d) 187 (C.A.); reversing (1995), 9 B.C.L.R. (3d) 260 (S.C.); additional reasons at (1995), 33 C.C.L.I (2d) 71 (B.C. S.C.)

Counsel: *David F. McEwen*, for the appellant.
D. Barry Kirkham, Q.C., and *Gregory J. Tucker*, for the respondent.

Subject: Contracts; Insurance

Related Abridgment Classifications

Civil practice and procedure

XXIV Costs
XXIV.8 Scale and quantum of costs
XXIV.8.d Quantum of costs
XXIV.8.d.ii Allowance of increased costs

Commercial law

I Agency
I.4 Ratification
I.4.c Necessity for full knowledge by principal

Contracts

II Parties to contract
II.4 Privity
II.4.b Third party beneficiary
II.4.b.i General principles

Contracts

VII Construction and interpretation

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VII.8 Implied terms
VII.8.c Warranty
VII.8.c.iii Fitness

Insurance

VI Contract of indemnity
VI.2 Subrogation
VI.2.f Defences to subrogated action
VI.2.f.i Waiver of subrogation rights

Insurance

VI Contract of indemnity
VI.2 Subrogation
VI.2.f Defences to subrogated action
VI.2.f.iv Miscellaneous

Torts

XVI Negligence
XVI.2 Duty and standard of care
XVI.2.b Standard of care

Headnote

Insurance --- Contract of indemnity — Subrogation — Defences to subrogated action — Waiver of subrogation rights

Insurance policy covered owner for loss of vessels — Policy contained waiver of subrogation clause stating that insurer waived right of subrogation against charterers — Owner lost vessel as result of charterer's negligence — Owner received payment under insurance policy and then brought successful action against charterer for damages — Appeal by charterer was allowed — Court of Appeal held that waiver of subrogation clause was established exception to doctrine of privity of contract and that charterer could rely on clause as defence to action — Appeal by owner dismissed — Two requirements for relaxing doctrine of privity of contract were clearly met in circumstances.

Contracts --- Parties to contract — Privity — Third party beneficiary — General

Insurance policy covered owner for loss of vessels — Policy contained waiver of subrogation clause stating that insurer waived right of subrogation against charterers — Owner lost vessel as result of charterer's negligence — Owner received payment under insurance policy and then brought successful action against charterer for damages — Appeal by charterer was allowed — Court of Appeal held that waiver of subrogation clause was established exception to doctrine of privity of contract and that charterer could rely on clause as defence to action — Appeal by owner dismissed — Two requirements for relaxing doctrine of privity of contract were clearly met in circumstances.

Assurance --- Contrat d'indemnisation — Subrogation — Moyens de défense à une action subrogatoire — Renonciation au droit à la subrogation

Police d'assurance couvrant le propriétaire contre la perte de navires — Police comprenait une clause de renonciation à la subrogation énonçant que l'assureur renonce à son droit à la subrogation à l'encontre des affréteurs — Propriétaire a perdu un navire en raison de la négligence de l'affréteur — Propriétaire a obtenu un paiement en vertu de sa police d'assurance et a ensuite obtenu gain de cause contre l'affréteur dans une action en dommages et intérêts — Pourvoi de l'affréteur a été accueilli — Cour d'appel a conclu que la clause de renonciation à la subrogation constituait une exception fondée sur des principes à la règle du lien contractuel et que l'affréteur pouvait invoquer cette clause pour se défendre contre l'action — Pourvoi du propriétaire a été rejeté — Deux exigences permettant l'assouplissement de la règle du lien contractuel ont été clairement satisfaites dans les circonstances.

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Contrats --- Parties au contrat — Lien contractuel — Tiers partie bénéficiaire — En général

Police d'assurance couvrant le propriétaire contre la perte de navires — Police comprenait une clause de renonciation à la subrogation énonçant que l'assureur renonce à son droit à la subrogation à l'encontre des affréteurs — Propriétaire a perdu un navire en raison de la négligence de l'affréteur — Propriétaire a obtenu un paiement en vertu de sa police d'assurance et a ensuite obtenu gain de cause contre l'affréteur dans une action en dommages et intérêts — Pourvoi de l'affréteur a été accueilli — Cour d'appel a conclu que la clause de renonciation à la subrogation constituait une exception fondée sur des principes à la règle du lien contractuel et que l'affréteur pouvait invoquer cette clause pour se défendre contre l'action — Pourvoi du propriétaire a été rejeté — Deux exigences permettant l'assouplissement de la règle du lien contractuel ont été clairement satisfaites dans les circonstances.

The owner carried on business as a provider of dredging, pile-driving and related services. Occasionally the owner chartered vessels to third parties. The charterer chartered a derrick barge to carry out work on a natural gas pipeline. The barge was insured by the owner under a Hull Subscription Policy. The policy contained a waiver of subrogation clause which stated that the insurers waived any right of subrogation against any charterer. The charterer contracted with the owner for the owner's personnel to operate the crane and winches on board the barge. The charterer assumed full responsibility for towing the barge to and from the work site and for maintaining the safety and condition of the barge. The barge sunk at the work site in stormy weather, two weeks after being towed to the site. The owner recovered the sum of $1,128,365.57 from the insurers, and entered into an agreement with the insurers to pursue a legal action against the charterer in negligence.

The owner brought an action for damages against the charterer, and was awarded judgment in the amount of $949,503. The trial judge held that the loss was owing to the charterer's negligence. The trial judge concluded that there was insufficient clear and cogent evidence to enable him to conclude that the owner agreed to extend its own insurance to cover any risk of loss by the charterer during the charter period. The trial judge further concluded that the insurers were not precluded from bringing a subrogated action against the charterer on the basis that the charterer was an "additional insured" under the policy. The trial judge held that the charterer could not rely on a contractual term in the policy, as it was not a party to the policy. The trial judge held that for the same reason, the charterer could not rely on the waiver of subrogation clause in the policy, as no sufficient reason existed to relax the doctrine of privity of contract in the circumstances. The trial judge awarded the owner costs, and held that the owner was entitled to increased costs. The charterer's appeal to the Court of Appeal was allowed. The Court of Appeal agreed that the claim was wholly subrogated, and held that the charterer could rely on the waiver of subrogation clause in the policy in the circumstances. The Court of Appeal held that "waiver of subrogation" clauses in contracts of insurance constituted an exception to the doctrine of privity of contract in circumstances where the third-party beneficiary is not a party to the policy, but nonetheless falls within the contractual definition of those to whom coverage is extended. The Court of Appeal awarded the charterer its costs there and at the court below. The owner brought an appeal.

Held: The appeal was dismissed.

Generally, the doctrine of privity provides that a contract can neither confer rights nor impose obligations on third parties. The charterer was a third-party beneficiary who normally would be precluded from enforcing or relying on the terms of the policy in effect between the owner and its insurers. A principled exception to the common law doctrine of privity of contract has been introduced by recent caselaw. The threshold requirement for the exception is that the parties to the contract must have intended the relevant provision to confer a benefit on the third party. Secondly, the activities performed by the third party seeking to rely on the contractual provision must be the very activities contemplated as coming within the scope of the contract in general, or the provision in particular. There was no question that the parties intended to extend the benefit under the waiver of subrogation clause to a class of third-party beneficiaries whose membership included the charterer. A plain reading of the provision did not support

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the owner's claim that the provision could only be enforced by the owner on the charterer's behalf and not by the charterer acting independently. The owner and the insurers could not unilaterally revoke the charterer's rights under the provision once they had developed into an actual benefit. The charterer became for all intents and purposes a party to the initial contract for the limited purpose of relying on the waiver of subrogation clause, at the point at which its rights crystallized. The activities of the charterer in issue arose in the context of the relationship of the charterer to the owner as a charterer, the very activity anticipated in the insurance policy pursuant to the waiver of subrogation clause. The two requirements for relaxing the doctrine of privity were clearly met in the circumstances. In addition, there were also sound policy reasons for relaxing the doctrine in the circumstances. No commercial reason existed for failing to enforce a bargain entered into by sophisticated commercial actors. Relaxing the doctrine of privity in the circumstances most closely corresponded to commercial reality.

Le propriétaire exploitait une entreprise de services de dragage et de battage de pieux, et de services connexes. Il frétait occasionnellement des navires nolisés à des tiers. L'affréteur a loué une barge-grue pour effectuer des travaux sur un gazoduc. Le propriétaire était titulaire d'une police de coassurance sur corps de navire, laquelle police couvrait la barge. La police d'assurance contenait une clause de renonciation à la subrogation qui stipulait que les assureurs renonçaient à tous droits de subrogation à l'égard des fréteurs. L'affréteur a convenu avec le propriétaire que les employés de ce dernier feraient fonctionner la grue et les treuils qui se trouvaient sur la barge. L'affréteur a assumé l'entière responsabilité du remorquage de la barge pour l'amener au chantier et pour l'en ramener, ainsi que de la sécurité et du maintien en bon état de celle-ci. Deux semaines après avoir été remorquée jusqu'au chantier, la barge y a fait naufrage lors d'une tempête. Les assureurs ont versé la somme de 1 128 365,57 $ au propriétaire et ce dernier a conclu une entente avec les assureurs dans laquelle ils ont convenu d'intenter une action fondée sur la négligence contre l'affréteur.

Le propriétaire a intenté une action en dommages-intérêts contre l'affréteur et a obtenu un jugement pour la somme de 949 503 $. Le juge de première instance a estimé que la perte avait été causée par la négligence de l'affréteur et a conclu qu'il n'existait pas suffisamment d'éléments de preuve clairs et convaincants pour qu'il puisse conclure que le propriétaire avait accepté d'étendre sa propre assurance à tout risque de perte par l'affréteur au cours de la période d'affrètement. Le juge de première instance a par ailleurs conclu que les assureurs avaient le droit d'intenter une action subrogatoire contre l'affréteur au motif que ce dernier était un « assuré additionnel » aux termes de la police. Il a par ailleurs estimé que l'affréteur ne pouvait invoquer la clause de renonciation à la subrogation prévue dans la police puisqu'il n'était pas partie à celle-ci. Il a conclu, pour les mêmes motifs, que l'affréteur ne pouvait invoquer la clause de renonciation à la subrogation parce qu'il n'avait pas de raisons suffisante pour justifier l'assouplissement de la règle du lien contractuel dans les circonstances. Le juge de première instance a accordé les dépens au propriétaire et jugé que ce dernier avait le droit à des dépens majorés. La Cour d'appel a accueilli le pourvoi de l'affréteur. Elle a estimé que l'action était entièrement subrogatoire et que l'affréteur pouvait, dans les circonstances, invoquer la clause de renonciation à la subrogation stipulée dans la police. La Cour d'appel était d'avis que les clauses de « renonciation à la subrogation » stipulées dans les contrats d'assurance constituaient une exception à la règle du lien contractuel dans le cas où le tiers bénéficiaire n'est pas partie à la police, mais est néanmoins visé par la définition contractuelle des personnes à l'égard desquelles la protection est accordée. Elle a accordé à l'affréteur les dépens relatif à l'appel et au tribunal de première instance. Le propriétaire a formé un pourvoi.

Arrêt: Le pourvoi a été rejeté.

De façon générale, la règle du lien contractuel veut qu'un contrat ne puisse conférer de droits, ni imposer d'obligations à un tiers. L'affréteur était un tiers bénéficiaire à qui il n'aurait normalement pas été permis de faire exécuter ou d'invoquer les conditions de la police en vigueur entre le propriétaire et ses assureurs. Une exception fondée sur des principes à la règle du lien contractuel de common law a toutefois été reconnue par la jurisprudence récente. Pour donner ouverture à l'exception, la condition préliminaire selon laquelle les parties au contrat doivent avoir voulu que la disposition pertinente confère un avantage au tiers doit être satisfaite. Deuxièmement, les activités

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auxquelles se livrait le tiers qui entend invoquer la clause du contrat doivent correspondre aux activités mêmes qui sont censées être visées par le contrat en général ou par la disposition particulière. Il n'y avait aucun doute que les parties avaient l'intention d'accorder le bénéfice de la clause de renonciation à la subrogation à une catégorie de tiers bénéficiaires comprenant l'affréteur. Le sens clair de la disposition n'étayait pas la prétention du propriétaire selon laquelle seul le propriétaire pouvait faire exécuter la disposition pour le bénéfice de l'affréteur, et non ce dernier de façon indépendante. Le propriétaire et les assureurs ne pouvaient pas supprimer de façon unilatérale les droits de l'affréteur une fois qu'ils s'étaient cristallisés sous la forme d'un avantage réel. Au moment où les droits de l'affréteur se sont cristallisés, ce dernier était devenu à toutes fins pratiques une partie au contrat initial en ce qui concernait uniquement le droit d'invoquer la clause de renonciation à la subrogation. Les activités pertinentes de l'affréteur s'inscrivaient dans le contexte de sa relation avec le propriétaire, soit l'activité même qui était prévue par la police aux termes de la clause de renonciation à la subrogation. Il était manifeste que les deux conditions requises pour l'assouplissement de la règle du lien contractuel avaient été satisfaites. Il existait également des raisons de principe valables en faveur de l'assouplissement de cette règle dans les circonstances. Il n'y avait aucune raison commerciale de ne pas faire exécuter un marché conclu par des acteurs commerciaux avertis. L'assouplissement de la règle du lien contractuel dans ces circonstances correspondait très étroitement à la réalité commerciale.

Table of Authorities

Cases considered by/Jurisprudence citée par *Iacobucci J.*:

Commonwealth Construction Co. v. Imperial Oil Ltd. (1976), [1978] 1 S.C.R. 317, [1976] 6 W.W.R. 219, 1 A.R. 161, [1976] I.L.R. 1-804, 69 D.L.R. (3d) 558, (sub nom. *Imperial Oil Ltd. v. Commonwealth Construction Co.)* 12 N.R. 113 (S.C.C.) — considered

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

R. v. Salituro, 9 C.R. (4th) 324, 8 C.R.R. (2d) 173, 50 O.A.C. 125, [1991] 3 S.C.R. 654, 131 N.R. 161, 68 C.C.C. (3d) 289 (S.C.C.) — referred to

Scott v. Wawanesa Mutual Insurance Co., [1989] 4 W.W.R. 728, 9 C.C.L.I. (2d) 268, [1989] 1 S.C.R. 1445, [1989] I.L.R. 1-2462, 59 D.L.R. (4th) 660, 94 N.R. 261, 37 B.C.L.R. (2d) 273, [1989] R.R.A. 722 (S.C.C.) — considered

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Watkins v. Olafson, 50 C.C.L.T. 101, [1989] 2 S.C.R. 750, [1989] 6 W.W.R. 481, 61 D.L.R. (4th) 577, 100 N.R. 161, 39 B.C.L.R. (2d) 294, 61 Man. R. (2d) 81 (S.C.C.) — referred to

APPEAL by owner from judgment reported at (1997), 39 B.C.L.R. (3d) 187, [1998] 3 W.W.R. 177, 98 B.C.A.C. 138, 161 W.A.C. 138, 47 C.C.L.I. (2d) 111 (B.C. C.A.) allowing charterer's appeal from judgment reported at [1995] 9 W.W.R. 376, 33 C.C.L.I. (2d) 9, 9 B.C.L.R. (3d) 260 (B.C. S.C.) allowing owner's action for damages arising from negligence.

POURVOI formé par le propriétaire à l'encontre de l'arrêt publié à (1997), 39 B.C.L.R. (3d) 187, [1998] 3 W.W.R. 177, 98 B.C.A.C. 138, 161 W.A.C. 138, 47 C.C.L.I. (2d) 111 (C.A. C.-B.) accueillant le pourvoi de l'affréteur contre le jugement

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publié à [1995] 9 W.W.R. 376, 33 C.C.L.I. (2d) 9, 9 B.C.L.R. (3d) 260 (C.S. C.-B.) accueillant l'action du propriétaire en dommages-intérêts résultant de la négligence.

The judgment of the court was delivered by *Iacobucci J.*:

1 This appeal concerns the application of the doctrine of privity of contract to a waiver of subrogation clause in a contract of insurance.

I. Facts

2 This action arose subsequent to the sinking of the derrick barge "Sceptre Squamish," owned by the appellant, Fraser River Pile & Dredge Ltd. ("Fraser River") and, at the time of loss, under charter to the respondent, Can-Dive Services Ltd. ("Can-Dive"). Can-Dive was held liable at trial for damages in the amount of $949,503. In appealing the trial decision, Can-Dive does not dispute that the loss resulted from its negligence, but contends that it cannot be held liable in what is in effect a subrogated action by the underwriters of Fraser River's insurance policy.

3 Fraser River carries on business as a provider of dredging, pile-driving and related services. It owns approximately 50 vessels which it uses for these purposes. Occasionally, Fraser River charters vessels for which it has no immediate use to others. In 1990, Can-Dive undertook work as a sub-contractor on a natural gas pipeline under construction between Vancouver Island and the mainland of British Columbia. In order to carry out the work required, Can-Dive contracted with Fraser River to charter the "Sceptre Squamish," and arranged for Fraser River's personnel to operate the crane and winches on board. The charter contract also included a flat scow. Can- Dive assumed full responsibility for towing the barge to and from the work site, and for maintaining the safety and condition of the barge. The "Sceptre Squamish" was towed to the work site on October 30, 1990, where it remained until sinking in stormy weather on the night of November 16, 1990.

4 At all material times during the charter of the "Sceptre Squamish" and its subsequent loss, Fraser River was insured under a Hull Subscription Policy (the "policy"), dated June 28, 1990. Following the loss of the vessel and its equipment, Fraser River recovered from the insurers the sum of $1,128,365.57, being the fixed amount stipulated in the policy to cover such loss. On June 4, 1991, Fraser River and the insurers entered into a further agreement, setting out their joint intention to pursue a legal action against Can-Dive in negligence for the sinking of the "Sceptre Squamish." The preamble of the agreement included the following terms:

> C) The Underwriters have agreed to pay the claims (the claims) of F.R.P.D. for the loss of the barge and crane and the Underwriters wish to proceed with legal action against Can-Dive Services Ltd. and possibly others to recover part or all of their payments;
>
> D) F.R.P.D. has agreed to waive any right it may have pursuant to the waiver of subrogation clause in the aforesaid policy with respect to Can-Dive Services Ltd. ...

5 Fraser River subsequently commenced this action in June, 1991 to recover damages for its losses arising from the sinking of the derrick barge. Can-Dive not only denied that it was negligent, but argued as well that the action was a subrogated action conducted by and for the sole benefit of the insurers, i.e., that as Fraser River had received payment from the insurers in the amount specified in the policy (which exceeded the actual value of the loss by a little over $300,000), the claim was wholly subrogated, notwithstanding that it was initiated by Fraser River. Accordingly, the insurers were precluded from proceeding against Can-Dive on the basis that the company was included within the category of "Additional Insureds" as defined in the terms of the policy as follows:

> **General Conditions**
>
> ***1. Additional Insureds Clause***

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> It is agreed that this policy also covers the Insured, associated and affiliated companies of the Insured, be they owners, subsidiaries or interrelated companies and as bareboat charterers and/or charterers and/or sub-charterers and/or operators and/or in whatever capacity and shall so continue to cover notwithstanding any provisions of this policy with respect to change of ownership or management. Provided, however, that in the event of any claim being made by associated, affiliated, subsidiary or interrelated companies under this clause, it shall not be entitled to recover in respect of any liability to which it would be subject if it were the owner, nor to a greater extent than an owner would be entitled in such event to recover.
>
> . . . . .
>
> Notwithstanding anything contained in the Additional Insureds Clause above, it is hereby understood and agreed that permission is hereby granted for these vessels to be chartered and the charterer to be considered an Additional Insured hereunder.
>
> . . . . .
>
> *Trustee Clause*
>
> It is understood and agree that the Named Insured who obtained this Policy did so on his own behalf and as agent for the others insured hereby including those referred to by general description.

6 In the alternative, Can-Dive claimed that, assuming it was not included in the policy under the category of "Additional Insureds," the insurers had nonetheless expressly waived any right of subrogation it may have held against the defendant, pursuant to the waiver of subrogation clause which read as follows:

> **17. Subrogation and Waiver of Subrogation Clause**
>
> In the event of any payment under this Policy, the Insurers shall be subrogated to all of the Insured's rights of recovery therefor, and the Insured shall execute all papers required and shall do everything that may be necessary to secure such rights, but it is agreed that the Insurers waive any right of subrogation against:
>
> . . . . .
>
> (b) any charterer(s) and/or operator(s) and/or lessee(s) and/or mortgagee(s).

II. Judgments Below

A. Supreme Court of British Columbia (1995), 9 B.C.L.R. (3d) 260 (B.C. S.C.)

Warren J.

7 Having found that Fraser River's loss was owing to Can-Dive's negligence, Warren J. nonetheless agreed with Can-Dive that the action amounted to a subrogated claim, and went on to consider Can-Dive's defences based on the provisions of the policy. Can-Dive raised three defences: (a) that in agreeing to charter the "Sceptre Squamish" to Can-Dive, Fraser River agreed as well to extend its own insurance coverage under the policy to cover Can-Dive for the duration of the charter agreement; (b) that it came within the class of "Additional Insureds" as specified in the terms of the policy, thereby precluding the insurers from proceeding in a subrogated action against their own insured; and (c) that the insurers expressly waived a right of subrogation against Can-Dive as a "charterer" pursuant to a waiver of subrogation clause contained in the policy.

8 As to Can-Dive's claim that insurance coverage under Fraser River's policy was a term of the charter agreement, Warren J. held that there was insufficient clear and cogent evidence to enable him to conclude on a balance of probabilities that Fraser River agreed to extend its own insurance to cover any risk of loss by Can-Dive during the charter period. Warren J. also rejected Can-Dive's claim that the insurers were precluded from bringing a subrogated action against the company on the basis that Can-Dive, as a "charterer," came within the contractual definition of "Additional

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Insureds." Warren J. noted that, for this argument to succeed, Can-Dive would have to rely on a contractual term in the policy, and therefore must first overcome the doctrine of privity of contract which generally provides that a stranger to a contract may neither enforce nor rely on its terms.

9 Warren J. next considered Can-Dive's submission that, notwithstanding its status as a third party to the contract, the insurers were bound by the waiver of subrogation clause contained therein as the doctrine of privity of contract does not apply in circumstances where a third-party beneficiary relies on the waiver to defend against an action initiated by the insurers. Having reviewed the existing jurisprudence purporting to deal with privity of contract in this context, and relying in particular on the decision of the Privy Council in *Vandepitte v. Preferred Accident Insurance Co. of New York* (1932), [1933] A.C. 70 (British Columbia P.C.), Warren J. concluded that the doctrine was still applicable except to the extent it was incrementally abrogated through the creation of specific judicial exceptions, or more substantively, through legislative reform, as has generally been the case with automobile insurance legislation. He held that the Court's decision in *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299 (S.C.C.), was controlling on this issue; a waiver of subrogation clause, as with any other contractual provision, is subject to the doctrine of privity unless a traditional exception applies, or sufficient reason exists to relax the doctrine in the given circumstances. Warren J. held that relaxing the doctrine of privity of contract in the present circumstances would alter the doctrine in excess of the incremental changes contemplated by the reasoning in *London Drugs*.

10 Finally, Warren J. considered whether Can-Dive could avail itself of the principles of either trust or agency, established in the case law as potential exceptions to the doctrine of privity of contract. He quickly dismissed the application of trust principles, concluding that the policy did not reveal any intention that Fraser River was acting as trustee on Can-Dive's behalf in contracting for insurance coverage. As to the agency exception, Warren J. first noted that Fraser River, as the purported agent for Can-Dive, must have intended to act on behalf of Can-Dive as the principal or as a member of an ascertainable class of principals. As he was of the opinion that the case could be decided on other grounds, Warren J. was prepared to assume for the purposes of argument that the requisite intention was present.

11 The more significant obstacle in applying principles of agency, however, was the requirement of ratification. Warren J. held that to gain the benefit of the policy, Can-Dive as principal would have to ratify the actions taken by Fraser River in acting on its behalf to arrange for the policy to cover Can-Dive as within the class of "Additional Insureds." Subsequent ratification involves three initial requirements: (a) the purported agent must have represented to the third party that he or she was acting on behalf of the purported principal; (b) the purported principal must have been competent at the time the act was done; and (c) the purported principal must be legally capable of completing the act at the time of ratification. Warren J. concluded that the three initial requirements were met in these circumstances. The first criterion was satisfied by the inclusion of the "Trustee Clause," indicating to the insurers that Fraser River may be acting as agent on behalf of certain unnamed parties who might later ratify the act and become "Additional Insureds" under the policy. Both the second and third criteria were satisfied by the status of Fraser River and Can-Dive as capable, juridical persons at all material times.

12 Assuming that these initial hurdles were overcome, there still remained, however, as a final requirement an actual act of ratification, whether express or by implication. Warren J. concluded that Can-Dive's only act of ratification was amending its Statement of Defence upon learning of the existence of the policy and its potential scope of coverage. While Warren J. did not find that Can-Dive was precluded from ratifying its inclusion as an "Additional Insureds" under the terms of the policy subsequent to the time at which the loss occurred, he held that the opportunity for ratification was extinguished when Fraser River and the insurers entered into an agreement in June, 1991, to pursue a claim against Can-Dive for damages. The effect of this agreement was to change the terms of the policy, given that an action against Can-Dive would have been fundamentally incompatible with the existing scope of the "Additional Insureds" clause. Accordingly, no effective ratification of the policy could have occurred subsequent to this date.

13 Also fatal to Can-Dive's claim was Warren J.'s finding that, even assuming that the requirements of ratification had been met, no consideration flowed from Can-Dive to the insurers; the mere act of chartering Fraser River's vessel was insufficient to amount to consideration for the purposes of concluding that agency principles applied to deem Can-

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Dive a legal party to the contract between Fraser River and the insurers. In the result, Fraser River's action in negligence was allowed.

B. Court of Appeal for British Columbia (1996), 39 B.C.L.R. (3d) 187 (B.C. C.A.)

Esson, Huddart and Proudfoot JJ.A.

14 Esson J.A., writing for the court, agreed that the claim was wholly subrogated, noting that Fraser River had already received from the insurers the amount fixed in the policy, a sum which exceeded Fraser River's actual losses by over $300,000. He rejected Can-Dive's submission, however, that the trial judge was in error in finding that Fraser River did not covenant to insure Can-Dive as a term of the charter agreement. Instead, Esson J.A. chose to decide the appeal on the basis of the waiver of subrogation clause contained in the policy and the principles of the doctrine of privity of contract.

15 Esson J.A. first considered whether Can-Dive, as a stranger to the contract of insurance between Fraser River and the insurers, could rely on the waiver of subrogation clause to defend against the subrogated action. He disagreed with the trial judge's conclusion on this point, holding instead that *Vandepitte*, *supra*, had been impliedly overruled by the Supreme Court of Canada on the basis that the precedent had been ignored in cases where it might well have applied: see, for example, *Scott v. Wawanesa Mutual Insurance Co.*, [1989] 1 S.C.R. 1445 (S.C.C.), where the Court held, without any reference to the doctrine of privity of contract, that the named insured's son came within the class of "Insureds" as defined in the homeowner's policy. Esson J.A. also noted that soon after *Vandepitte* had been decided, its potential impact on contracts for automobile insurance was abrogated in every relevant jurisdiction. In his opinion, the decision was not good law, as it had either been overtaken by legislation, as in the case of automobile insurance, or largely ignored in favour of reasoning which better reflected commercial reality.

16 Apart from referring to the implicit overruling of *Vandepitte*, *supra*, Esson J.A. also concluded that judicial authority supported Can-Dive's submission that "waiver of subrogation" clauses in contracts of insurance constituted an exception to the doctrine of privity of contract in circumstances where the third-party beneficiary is not a party to the policy, but nonetheless falls within the contractual definition of those to whom coverage is extended. In *Commonwealth Construction Co. v. Imperial Oil Ltd.* (1976), [1978] 1 S.C.R. 317 (S.C.C.) , for example, subcontractors who were not partie to a builder's risk policy, but who met the definition of a "Contractor" for the purposes of coverage, were able to overcome the doctrine of privity of contract. In holding that subrogation was not available against the subcontractor, de Grandpré J. relied upon the nature of the relationship amongst the various contractors on a construction site, i.e, that the parties were involved in a joint effort towards a common goal. To give effect to the doctrine of privity of contract would be commercially unreasonable in these circumstances, in that any loss on the construction site caused by one of the parties would necessarily lead to litigation between the parties, contrary to the interest of the common enterprise. In addition to the builder's risk cases, Esson J.A. also identified an existing exception to the doctrine of privity of contract in insurance law more generally, originating in a line of authority dating back to a decision of Mathew J. in *Thomas & Co. v. Brown* (1899), 4 Com. Cas. 186.

17 Esson J.A. next considered whether this established exception, available in circumstances where a purported third-party beneficiary comes within the class of those to whom insurance coverage is extended, has nonetheless been overtaken by the Court's decision in *London Drugs*, *supra*. In other words, the exception in favour of waiver of subrogation clauses remains good law only to the extent that it does not contradict the legal principles or analytical framework set out in *London Drugs*. Esson J.A. held that an exception of this nature was entirely consistent on the basis that, if an insurer were to seek to avoid liability on the same grounds as were relied upon in *Vandepitte*, *supra*, under the more recent *London Drugs* analysis, it would fail. Many of the same considerations relevant to the disposition of *London Drugs* were applicable in the instant case, e.g., the third party or stranger to the contract was seeking to rely on a contractual provision to defend against an action, rather than seeking to enforce the terms of the contract on its own initiative against one of the original parties. Furthermore, it was expressly stated in *London Drugs* that nothing in the reasons should be taken as affecting in any way existing exceptions to the doctrine of privity of contract such as principles of trust or agency. Accordingly, as the jurisprudence in support of an exception to privity in favour of third-party beneficiaries falling within the contractual

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definition of the insured class for the purposes of the insurance policy had not been overtaken by the Court's decision in *London Drugs*, *supra*, Esson J.A. concluded that Can-Dive could rely on the waiver of subrogation clause in the policy.

18 Esson J.A. was also of the view that Can-Dive could succeed on the basis of the agency exception. He found that the trial judge erred in failing to find a clear act of ratification by Can-Dive. Specifically, he did not agree with the trial judge's conclusion that Can-Dive's amendment to the pleadings in February, 1994 could not amount to ratification on the basis that Fraser River and its insurers, by virtue of their agreement in June, 1991 to proceed against Can-Dive, had effectively revised the terms of the policy so as to delete the provision granting third-party rights to Can-Dive. Esson J.A. held that while parties to a contract may subsequently delete provisions in favour of third-party beneficiaries, contractual terms providing protection against loss to third parties cannot be varied to the detriment of the third party after the occurrence of the very loss contemplated in the policy.

19 Accordingly, Esson J.A. allowed the appeal and dismissed the action against Can-Dive.

III. Issues

20 As noted above, this appeal concerns the question of whether a third-party beneficiary can rely on a waiver of subrogation clause contained in a contract of insurance to defend against a subrogated action initiated by the insurer. In the context of this appeal, this question raises the following issues:

> a. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the agency exception to the doctrine of privity of contract?
>
> b. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the principled exception to the privity of contract doctrine established by the Court's decision in *London Drugs*?

IV. Analysis

A. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the agency exception to the doctrine of privity of contract?

21 The entirety of the dispute between the parties concerns the legal effect to be given to the waiver of subrogation contained in Clause 17 of the appellant Fraser River's contract of insurance, which reads as follows:

> **17. Subrogation and Waiver of Subrogation Clause**
>
> In the event of any payment under this Policy, the Insurers shall be subrogated to all of the Insured's rights of recovery therefor, and the Insured shall execute all papers required and shall do everything that may be necessary to secure such rights, but it is agreed that the Insurers waive any right of subrogation against:
>
> . . . . .
>
> (b) any charterer(s) and/or operator(s) and/or lessee(s) and/or mortgagee(s).

22 The respondent Can-Dive is seeking to rely on the waiver of subrogation clause contained in the policy to defend against this subrogated action in negligence. As a general rule, however, the doctrine of privity provides that a contract can neither confer rights nor impose obligations on third parties. This appeal is concerned only with the former situation, namely, circumstances in which a third party is seeking to obtain a benefit or right established in its favour pursuant to the terms of the contract. The Court is not called on to address the situation in which a contract imposes obligations on a third party, and I stress that nothing in these reasons should be taken as applicable to the law in this area.

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23 Although the doctrine of privity would normally be fatal to its case, Can-Dive submits that the principle of agency applies to deem Can-Dive a party to the contract in law, if not in fact, such that privity is no longer a concern. Because of the approach I intend to take to this case, I do not find it necessary to deal with the argument that Can-Dive may rely on the waiver of subrogation clause on this basis. In so stating, I do not wish to be taken as either agreeing or disagreeing with Esson J.A.'s conclusions on this issue. Instead, I prefer to adopt the approach set out in *London Drugs*, *supra*, and consider whether the doctrine of privity should be relaxed in these circumstances.

B. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the principled exception to the privity of contract doctrine established by the Court's decision in *London Drugs*?

1. London Drugs and a Principled Exception to the Doctrine of Privity of Contract

24 As stated above, Can-Dive's position is that of a third-party beneficiary who normally would be precluded from enforcing or relying on the terms of the policy in effect between Fraser River and its insurers. Accordingly, it is necessary to consider the legal status of the waiver of subrogation clause in light of the Court's decision in *London Drugs*, *supra*. In that case, the Court introduced what was intended as a principled exception to the common law doctrine of privity of contract.

25 At issue was the status of a limitation of liability clause in the standard form contract between the appellant and the respondent for storage of the appellant's transformer. The clause limited a "warehouseman's" liability on any one package to $40. While in storage, a transformer was damaged owing to negligence on the part of the respondent's employees. The appellant sued both the warehouse company and its employees, and the trial judge found the employees personally liable for the full amount of the damages. On appeal, the majority allowed the employees to rely on the limitation of liability clause in the employer's contract with the appellant, notwithstanding that the employees were not parties to this contract. The majority of the Court upheld the result on appeal, concluding that in circumstances where the traditional exceptions to privity of contract such as agency or trust do not apply, courts may nonetheless undertake the appropriate analysis, bounded by both common sense and commercial reality, in order to determine whether the doctrine of privity with respect to third-party beneficiaries should be relaxed in the given circumstances.

26 The Court devoted a great deal of attention to the judicial history and application of the doctrine of privity of contract as it relates to third-party beneficiaries, noting the extent of judicial discontent, legislative override, and a significant body of academic criticism. While acknowledging that privity of contract is an established doctrine of contract law, the Court concluded, at p. 423, that the concerns expressed regarding the application of the doctrine to third-party beneficiaries indicated that the time for judicial consideration in this particular context had arrived:

> These comments and others reveal many concerns about the doctrine of privity as it relates to third party beneficiaries. For our purposes, I think it sufficient to make the following observations. Many have noted that an application of the doctrine so as to prevent a third party from relying on a limitation of liability clause which was intended to benefit him or her frustrates sound commercial practice and justice. It does not respect allocations and assumptions of risk made by the parties to the contract and it ignores the practical realities of insurance coverage. In essence, it permits one party to make a unilateral modification to the contract by circumventing its provisions and the express or implied intention of the parties. In addition, it is inconsistent with the reasonable expectations of all the parties to the transaction, including the third party beneficiary who is made to support the entire burden of liability. The doctrine has also been criticized for creating uncertainty in the law. While most commentators welcome, at least in principle, the various judicial exceptions to privity of contract, concerns about the predictability of their use have been raised. Moreover, it is said, in cases where the recognized exceptions do not appear to apply, the underlying concerns of commercial reality and justice still militate for the recognition of a third party beneficiary right.

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27 The respondent employees in *London Drugs* were unable to rely on existing principles of trust or agency. Rather than adapting these established principles to accommodate yet another *ad hoc* exception to the doctrine of privity, it was decided to adopt a more direct approach as a matter of principle. The Court held that, in circumstances where the traditional exceptions do not apply, the relevant functional inquiry is whether the doctrine should be relaxed in the given circumstances.

28 In order to distinguish mere strangers to a contract from those in the position of third-party beneficiaries, the Court first established a threshold requirement whereby the parties to the contract must have intended the relevant provision to confer a benefit on the third party. In other words, an employer and its customer may agree to extend, either expressly or by implication, the benefit of any limitation of liability clause to the employees. In the circumstances of *London Drugs*, the customer had full knowledge that the storage services contemplated by the contract would be provided not only by the employer, but by the employees as well. In the absence of any clear indication to the contrary, the Court held that the necessary intention to include coverage for the employees was implied in the terms of the agreement. The employees, therefore, as third-party beneficiaries, could seek to rely on the limitation clause to avoid liability for the loss to the customer's property.

29 The Court further held, however, that the intention to extend the benefit of a contractual provision to the actions of a third-party beneficiary was irrelevant unless the actions in question came within the scope of agreement between the initial parties. Accordingly, the second aspect of the functional inquiry was whether the employees were acting in the course of their employment when the loss occurred, and whether in so acting they were performing the very services specified in the contract between their employer and its customer. Based on uncontested findings of fact, it was clear that the damage to the customer's transformer occurred when the employees were acting in the course of their employment to provide the very storage services specified in the contract.

30 Taking all of these circumstances into account, the Court interpreted the term "warehouseman" in the limitation of liability clause to include coverage for the employees, thereby absolving them of any liability in excess of $40 for the loss that occurred. The Court concluded that the departure from the traditional doctrine of privity was well within its jurisdiction representing, as it did, an incremental change to the common law rather than a wholesale abdication of existing principles. Given that the exception was dependent on the intention stipulated in the contract, relaxing the doctrine of privity in the given circumstances did not frustrate the expectations of the parties.

2. Application of the Principled Exception to the Circumstances of this Appeal

31 As a preliminary matter, I note that it was not our intention in *London Drugs*, *supra*, to limit application of the principled approach to situations involving only an employer-employee relationship. That the discussion focussed on the nature of this relationship simply reflects the prudent jurisprudential principle that a case should not be decided beyond the scope of its immediate facts.

32 In terms of extending the principled approach to establishing a new exception to the doctrine of privity of contract relevant to the circumstances of the appeal, regard must be had to the emphasis in *London Drugs* that a new exception first and foremost must be dependent upon the intention of the contracting parties. Accordingly, extrapolating from the specific requirements as set out in *London Drugs*, the determination in general terms is made on the basis of two critical and cumulative factors: (a) did the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision; and (b) are the activities performed by the third party seeking to rely on the contractual provision the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, again as determined by reference to the intentions of the parties?

Intentions of the Parties

33 As to the first inquiry, Can-Dive has a very compelling case in favour of relaxing the doctrine of privity in these circumstances, given the express reference in the waiver of subrogation clause to "charterer(s)," a class of intended third-

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party beneficiaries that, on a plain reading of the contract, includes Can-Dive within the scope of the term. Indeed, there is no dispute between the parties as to the meaning of the term within the waiver of subrogation clause; disagreement exists only as to whether the clause has legal effect. Accordingly, there can be no question that the parties intended to extend the benefit in question to a class of third-party beneficiaries whose membership includes Can-Dive. Given the lack of ambiguity on the face of the provision, there is no need to resort to extrinsic evidence for the purposes of determining otherwise. If the parties did not intend the waiver of subrogation clause to be extended to third-party beneficiaries, they need not have included such language in their agreement.

34 In essence, Fraser River's argument in terms of the intention of the parties is not that the scope of the waiver of subrogation clause does not extend to third parties such as Can-Dive, but that the provision can only be enforced by Fraser River on Can-Dive's behalf, and not by Can-Dive acting independently. A plain reading of the provision, however, does not support this conclusion. There is no language in the clause indicating that the waiver of subrogation is intended to be conditional upon Fraser River's initiative in favour of any particular third-party beneficiary. It appears to me that Fraser River has conflated arguments concerning the intentions of the parties in drafting the provision and the legal effect to be given to the provision. In no uncertain terms, the waiver of subrogation clause indicates that the insurers are precluded from proceeding with an action against third-party beneficiaries coming within the class of "charterer(s)," and the relevant inquiry is whether to give effect to these intentions by enforcing the contractual term, notwithstanding the doctrine of privity of contract.

35 In my opinion, the case in favour of relaxing the doctrine of privity is even stronger in the circumstances of this appeal than was the case in *London Drugs*, *supra*, wherein the parties did not expressly extend the benefit of a limitation of liability clause covering a "warehouseman" to employees. Instead, it was necessary to support an implicit extension of the benefit on the basis of the relationship between the employers and its employees, that is to say, the identity of interest between the employer and its employees in terms of performing the contractual obligations. In contrast, given the express reference to "charterer(s)" in the waiver of subrogation clause in the policy, there is no need to look for any additional factors to justify characterizing Can-Dive as a third-party beneficiary rather than a mere stranger to the contract.

36 Having concluded that the parties intended to extend the benefit of the waiver of subrogation clause to third parties such as Can-Dive, it is necessary to address Fraser River's argument that its agreement with the insurers to pursue legal action against Can-Dive nonetheless effectively deleted the third-party benefit from the contract. A significant concern with relaxing the doctrine of privity is the potential restrictions on freedom of contract which could result if the interests of a third-party beneficiary must be taken into account by the parties to the initial agreement before any adjustment to the contract could occur. It is important to note, however, that the agreement in question was concluded subsequent to the point at which what might be termed Can-Dive's inchoate right under the contract crystallized into an actual benefit in the form of a defence against an action in negligence by Fraser River's insurers. Having contracted in favour of Can-Dive as within the class of potential third-party beneficiaries, Fraser River and the insurers cannot revoke unilaterally Can-Dive's rights once they have developed into an actual benefit. At the point at which Can-Dive's rights crystallized, it became for all intents and purposes a party to the initial contract for the limited purposes of relying on the waiver of subrogation clause. Any subsequent alteration of the waiver provision is subject to further negotiation and agreement among all of the parties involved, including Can-Dive.

37 I am mindful, however, that the principle of freedom of contract must not be dismissed lightly. Accordingly, nothing in these reasons concerning the ability of the initial parties to amend contractual provisions subsequently should be taken as applying other than to the limited situation of a third-party's seeking to rely on a benefit conferred by the contract to defend against an action initiated by one of the parties, and only then in circumstances where the inchoate contractual right has crystallized prior to any purported amendment. Within this narrow exception, however, the doctrine of privity presents no obstacle to contractual rights conferred on third-party beneficiaries.

Third-Party Beneficiary is Performing the Activities Contemplated in the Contract

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38 As to the second requirement that the intended third-party beneficiary must rely on a contractual provision in connection with the very activities contemplated by the contract in general, or by the relevant clause in particular, Fraser River has argued that a significant distinction exists between the situation in *London Drugs*, *supra*, and the circumstances of the present appeal. In *London Drugs*, the relationship between the contracting parties and the third-party beneficiary involved a single contract for the provision of services, whereas in the present circumstances, such a "contractual nexus," to use Fraser River's phrase, does not exist. In other words, the waiver of subrogation clause upon which Can-Dive seeks to rely is contained in an unrelated contract that does not pertain to the charter contract in effect between Fraser River and Can-Dive.

39 With respect, I do not find this argument compelling, given that a similar contractual relationship could be said to exist in *London Drugs*, in terms of the service contract between the parties and a contract of employment which presumably existed between the employer and employees. At issue is whether the purported third-party beneficiary is involved in the very activity contemplated by the contract containing the provision upon which he or she seeks to rely. In this case, the relevant activities arose in the context of the relationship of Can-Dive to Fraser River as a charterer, the very activity anticipated in the policy pursuant to the waiver of subrogation clause. Accordingly, I conclude that the second requirement for relaxing the doctrine of privity has been met.

Policy Reasons in Favour of an Exception in these Circumstances

40 Having found that Can-Dive has satisfied both of the cumulative threshold requirements for the purposes of introducing a new, principled exception to the doctrine of privity of contract as it applies to third-party beneficiaries, I nonetheless wish to add that there are also sound policy reasons for relaxing the doctrine in these circumstances. In this respect, it is time to put to rest the unreasonable application of the doctrine of privity to contracts of insurance established by the Privy Council in *Vandepitte*, *supra*, a decision characterized since its inception by both legislatures and the judiciary as out of touch with commercial reality. As Esson J.A. noted, the decision in *Vandepitte* received little attention outside the field of automobile insurance, where it had been promptly overruled by legislative amendment in British Columbia and other provinces. In addition, Esson J.A. was correct in holding that *Vandepitte* has been impliedly overruled in the course of decisions by the Court, given that in cases where the rule of privity might have been applied, the decision was ignored: *Scott*, *supra*. Of particular interest is the Court's decision in *Commonwealth Construction Co.*, *supra*. The case concerned a general contractor's "builder's risk" policy that purported to extend coverage to sub-contractors who were not parties to the original contract. In holding that subrogation was not available against the sub-contractors, de Grandpré J., writing for the Court, made the following comments regarding the "Additional Insureds" and "Trustee" clauses, at p. 324:

> While these conditions may have been inserted to avoid the pitfalls that were the lot of the unnamed insured in *Vandepitte v. Preferred Accident Ins. Co.* [citations omitted] a precaution that in my view was not needed, they without doubt cover additional ground.

41 When considered in light of the Court's discussion of the necessary interdependence of various contractors involved in a common construction enterprise, the comment reflects the Court's acknowledgment that the rule of privity set out in *Vandepitte*, *supra*, was inconsistent with commercial reality. In a similar fashion, Fraser River in the course of this appeal has been unable to provide any commercial reason for failing to enforce a bargain entered into by sophisticated commercial actors. In the absence of any indication to the contrary, I must conclude that relaxing the doctrine of privity in these circumstances establishes a default rule that most closely corresponds to commercial reality as is evidenced by the inclusion of the waiver of subrogation clause within the contract itself.

42 A plain reading of the waiver of subrogation clause indicates that the benefit accruing in favour of third parties is not subject to any qualifying language or limiting conditions. When sophisticated commercial parties enter into a contract of insurance which expressly extends the benefit of a waiver of subrogation clause to an ascertainable class of third-party beneficiary, any conditions purporting to limit the extent of the benefit or the terms under which the

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benefit is to be available must be clearly expressed. The rationale for this requirement is that the obligation to contract for exceptional terms most logically rests with those parties whose intentions do not accord with what I assume to be standard commercial practice. Otherwise, notwithstanding the doctrine of privity of contract, courts will enforce the bargain agreed to by the parties and will not undertake to rewrite the terms of the agreement.

43 Fraser River has also argued that to relax the doctrine of privity of contract in the circumstances of this appeal would be to introduce a significant change to the law that is better left to the legislature. As was noted in *London Drugs*, *supra*, privity of contract is an established doctrine of contract law, and should not be lightly discarded through the process of judicial decree. Wholesale abolition of the doctrine would result in complex repercussions that exceed the ability of the courts to anticipate and address. It is by now a well-established principle that courts will not undertake judicial reform of this magnitude, recognizing instead that the legislature is better placed to appreciate and accommodate the economic and policy issues involved in introducing sweeping legal reforms.

44 That being said, the corollary principle is equally compelling, which is that in appropriate circumstances, courts must not abdicate their judicial duty to decide on incremental changes to the common law necessary to address emerging needs and values in society: *Watkins v. Olafson*, [1989] 2 S.C.R. 750 (S.C.C.) at pp. 760-61, and *R. v. Salituro*, [1991] 3 S.C.R. 654 (S.C.C.) at pp. 665-70. In this case, I do not accept Fraser River's submission that permitting third-party beneficiaries to rely on a waiver of subrogation clause represents other than an incremental development. To the contrary, the factors present in *London Drugs*, *supra*, in support of the incremental nature of the exception are present as well in the circumstances of this appeal. As in *London Drugs*, a third-party beneficiary is seeking to rely on a contractual provision in order to defend against an action initiated by one of the contracting parties. Fraser River's concerns regarding the potential for double recovery are unfounded, as relaxing the doctrine to the extent contemplated by these reasons does not permit Can-Dive to rely on any provision in the policy to establish a separate claim. In addition, the exception is dependent upon the express intentions of the parties, evident in the language of the waiver of subrogation clause, to extend the benefit of the provision to certain named classes of third-party beneficiaries.

V. Conclusion and Disposition

45 I conclude that the circumstances of this appeal nonetheless meet the requirements established in *London Drugs*, *supra*, for a third-party beneficiary to rely on the terms of a contract to defend against a claim initiated by one of the parties to the contract. As a third-party beneficiary to the policy, Can-Dive is entitled to rely on the waiver of subrogation clause whereby the insurers expressly waived any right of subrogation against Can-Dive as a "charterer" of a vessel included within the policy's coverage.

46 Accordingly, I would dismiss the appeal with costs.

Appeal dismissed.

Pourvoi rejeté.

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TAB 8

Most Negative Treatment: Check subsequent history and related treatments.

2006 CarswellOnt 4857
Ontario Superior Court of Justice

Stelco Inc., Re

2006 CarswellOnt 4857, [2006] O.J. No. 3219, 20 B.L.R. (4th) 286, 24 C.B.R. (5th) 59

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO STELCO INC. AND OTHER APPLICANTS

H.J.W. Siegel J.

Heard: July 17-21, 2006
Judgment: August 9, 2006
Docket: 04-CL-5306

Counsel: Robert W. Staley, Derek J. Bell, Alan Gardner for Debentureholders
Paul G. Macdonald, Andrew J.F. Kent, Brett Harrison for Subordinated Noteholders
Nancy Roberts, Tim Morgan for 2074600 Ontario Ltd.
Kyla Mahar for Monitor of the Applicants

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

Related Abridgment Classifications

Bankruptcy and insolvency

X Priorities of claims
  X.7 Unsecured claims
    X.7.c Priority with respect to other unsecured creditors

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
  XIX.3 Arrangements
    XIX.3.e Miscellaneous

Headnote

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

Effect on subordination agreement — Steel company entered protection under Companies' Creditors Arrangement Act, and plan was approved — Steel company had entered into contract for provision of computer management services, debt for which was held by numbered company — Creditors besides numbered company included noteholders and senior debenture holders — Subordination agreement stated that noteholder debt was subordinate to debt held by senior debt holders — Numbered company claimed that debt it held was also senior debt as contemplated by agreement — Senior debenture holders and numbered corporation brought motion for certain available funds — Senior debenture holders' claim allowed; claim by numbered company dismissed — Debt of noteholders subordinate to debt of senior debt holders, but not debt held by numbered company — Court had authority to determine issue of subordinate debt, regardless of any alleged deficiency in proof of ownership of

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debentures — Proposal did not invalidate subordination agreement — Subordination agreement statement of that subject to operation of law not meant to alter agreement.

Bankruptcy and insolvency --- Priorities of claims — Unsecured claims — Priority with respect to other unsecured creditors

Steel company entered protection under Companies' Creditors Arrangement Act, and plan was approved — Steel company had entered into contract for provision of computer management services, debt for which was held by numbered company — Creditors besides numbered company included noteholders and senior debenture holders — Subordination agreement stated that noteholder debt was subordinate to debt held by senior debt holders — Numbered company claimed that debt it held was also senior debt as contemplated by agreement — Senior debenture holders and numbered corporation brought motion for certain available funds — Senior debenture holders' claim allowed; claim by numbered company dismissed — Debt of noteholders subordinate to debt of senior debt holders, but not debt held by numbered company — Interest on debt continued to accumulate, despite filing under Act — "Interest stops" rule not applicable to proceedings under Act — Wording of debt agreement did not limit debenture holders' interest — Senior debenture holders were entitled to take advantage of third party beneficiary rule — Debenture holders were only group to benefit from subordination agreement — Actions of debenture holders were limited to enforcing contract — Senior debenture holders also held trust over turnover proceeds — No need to try deficiencies in claim individually, as aggregate deficiency claim of debenture holders determined by comparison of aggregate value of claims on plan implementation date with aggregate value of distributions received — Valuation of share interests in funds to be determined at date of volume weighted average prices at first week of trading — Securities generally valued at date of entitlement — Valuation would be close to market value as opposed to value in proposal — Debt owed to numbered company was not senior debt — Funds were spent for day-to-day operation of company.

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Cases considered by *H.J.W. Siegel J.*:

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

Guardian Trust Co. v. Gaglardi (1989), 64 D.L.R. (4th) 351, 1989 CarswellBC 615 (B.C. S.C.) — considered

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

Nav Canada c. Wilmington Trust Co. (2006), 2006 SCC 24, 2006 CarswellQue 4890, 2006 CarswellQue 4891, 20 C.B.R. (5th) 1, (sub nom. *Canada 3000 Inc., (Bankrupt), Re*) 349 N.R. 1 (S.C.C.) — considered

Pacific Mobile Corp., Re (1985), [1985] 1 S.C.R. 290, 55 C.B.R. (N.S.) 32, 16 D.L.R. (4th) 319, 57 N.R. 63, 1985 CarswellQue 30, 1985 CarswellQue 106 (S.C.C.) — considered

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RDA Film Distribution Inc. v. British Columbia Trade Development Corp. (2000), 2000 BCCA 674, 2000 CarswellBC 2627, 83 B.C.L.R. (3d) 302, [2001] 3 W.W.R. 88, 147 B.C.A.C. 15, 241 W.A.C. 15 (B.C. C.A.) — distinguished

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Stelco Inc., Re (2006), 2006 CarswellOnt 1505 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

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

s. 12 — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 57.01(6) — referred to

DETERMINATION regarding creditors' entitlement to funds.

***H.J.W. Siegel J.*:**

1 This proceeding is the final chapter of the financial restructuring of Stelco Inc. ("Stelco") under the *Companies' Creditors Arrangement Act* (the "CCAA"). It involves competing claims of entitlement to a pool of cash, notes, shares, and warrants of Stelco known as the "Turnover Proceeds". The dispute is principally between the holders of two series of Stelco debentures, on the one hand, and the holders of subordinated notes, on the other. The Turnover Proceeds were paid under the plan of arrangement of Stelco ("the Plan") to the holders of notes of Stelco. The holders of the debentures submit that the subordination provisions pertaining to the notes were preserved under the Plan. They seek an order requiring the noteholders to pay the Turnover Proceeds to them in accordance with these provisions on the basis that their claims against Stelco were not fully satisfied under the Plan. In addition, 2074600 Ontario Inc. ("2074600"), which is the assignee of a debt owed by Stelco to EDS Canada Inc. ("EDS") in the amount of $48,994,917 (the "EDS Claim"), seeks a declaration that it is also entitled to the benefit of the subordination provisions in respect of the EDS Claim and, therefore, is entitled to its *pro rata* share of the Turnover Proceeds.

Background

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2 Stelco is a corporation amalgamated under the laws of Canada with its head office located in Hamilton, Ontario. Stelco is one of Canada's largest producers and marketers of rolled and manufactured steel products.

Outstanding Debt of Stelco

3 Pursuant to a trust indenture between Stelco and Royal Trust Company dated as of November 30, 1989, as supplemented (the "10.4% Indenture"), Stelco issued debentures in the principal amount of $125,000,000 bearing interest at 10.4% per annum (the "10.4% Debentures"). Pursuant to a further trust indenture between Stelco and Montreal Trust Company of Canada dated February 15, 1999, as supplemented (the "8% Indenture" and collectively with the 10.4% Indenture the "Debenture Indentures"), Stelco issued debentures in the principal amount of $150,000,000 bearing interest at 8% per annum (the "8% Debentures"). The 10.4% Debentures and the 8% Debentures are herein collectively referred to as the "Debentures" and the holders thereof as the "Debentureholders".

4 The Debentures are registered in the name of CDS & Co. and are beneficially owned by institutional holders and individuals. The Debentureholders are represented in this proceeding by a steering committee of six Debentureholders (the "Claimants"). Collectively, the Claimants say they hold $92,030,000 in principal amount of 10.4% Debentures and $93,229,000 in principal amount of 8% Debentures.

5 Pursuant to a trust indenture between Stelco and CIBC Mellon Trust Company dated as of January 8, 2002, as supplemented by a first supplemental indenture dated as of January 21, 2002 (collectively the "Note Indenture"), Stelco issued convertible unsecured subordinated debentures in the principal amount of $90,000,000 bearing interest at 9.5% per annum (the "Notes"). The holders of the Notes are herein referred to as the "Noteholders".

6 Three corporations and one individual have identified themselves as Noteholders and are participating on their own behalf in this proceeding. They include Sunrise Partners Limited Partnership ("Sunrise") and Appaloosa Management L.P. ("Appaloosa"), both of which are also significant equity investors in Stelco under the Plan.

7 Under the terms of the Note Indenture (specifically in the first supplemental dated as of January 21, 2002), the Noteholders expressly agreed to subordinate their right of repayment to payment in full of "Senior Debt". Senior Debt is defined in the Note Indenture as follows:

> "Senior Debt" means the principal of, the premium (if any) and interest on: (i) indebtedness, other than indebtedness represented by the [Notes], for money borrowed by the Corporation or for money borrowed by others for the payment of which the Corporation is liable; (ii) indebtedness incurred, assumed or guaranteed by the Corporation in connection with the acquisition by it or by others of any business, property, services or other assets excluding indebtedness incurred in relation to any such acquisitions made in the ordinary course of business; and (iii) renewals, extensions and refundings of any such indebtedness, unless, in any of the cases specified above, it is provided by the terms of the instrument creating or evidencing such indebtedness that such indebtedness is not to be superior in right of payment to the [Noteholders].

8 It is agreed that the Debentures constitute "Senior Debt" as defined in the Note Indenture. In this proceeding, 2074600 seeks a declaration that the EDS Claim also constitutes Senior Debt. This issue is addressed below.

9 The provisions governing the subordination of the Notes are set out in Part VI of the first supplemental indenture dated as of January 21, 2002 (collectively the "Subordination Provisions"). The relevant sections of Part VI are set out in the Appendix. In particular the Debentureholders and 2074600 rely on section 6.1, which sets out the subordination covenant, and section 6.2, which addresses the operation of the subordination arrangements in the event of insolvency proceedings including a reorganization.

10 In particular, subsection 6.2(2) contains a provision requiring any payment or distribution of assets in these circumstances to be paid to the holders of Senior Debt (herein referred to as "Senior Debt Holders") to the

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extent necessary to result in payment in full of the principal and interest owing to the Senior Debt Holders. The Debentureholders and 2074600 seek to enforce this covenant as third party beneficiaries. In addition, subsection 6.2(3) provides that any payments or distributions not made in accordance with subsection 6.2(2) are to be held in trust by the Noteholders for the benefit of the Senior Debt Holders. The Debentureholders and 2074600 assert that they are beneficiaries of this trust.

The EDS Claim

11 2074600 is a company that was organized to acquire the EDS Claim. It is a wholly owned subsidiary of TriCap Management Limited ("TML"), which was a significant equity investor in Stelco under the Plan.

12 The EDS Claim related to an agreement between Stelco and EDS dated as of February 25, 2002 entitled the "Master Information Technologies Services Agreement" (the "MITSA"). The MITSA, and the nature of the EDS Claim, are described in greater detail below. EDS assigned its interest in the EDS Claim to 2074600 pursuant to an assignment agreement dated November 14, 2005.

Insolvency Proceedings of Stelco

13 On January 29, 2004 (the "Filing Date"), Stelco and certain of its subsidiaries filed for and obtained protection under the CCAA. Pursuant to an order of this Court dated January 29, 2004 (the "Initial Order"), Ernst & Young Inc. was appointed as a monitor (the "Monitor") over all of the applicant companies.

14 In the course of Stelco's lengthy CCAA process, the Monitor oversaw a CCAA claims process through which unsecured creditors proved their claims against Stelco for voting and distribution purposes. The Monitor accepted unsecured creditor claims totaling approximately $546 million. If post-filing interest related to these claims is included, the total of the accepted unsecured creditor claims was approximately $640 million. These claims included the Debentureholders' claims, which totaled $282,629,761 as of the Filing Date and $342,655,664 as of the Plan Implementation Date (defined below), and the EDS Claim, which Stelco and EDS agreed was $48,994,917 as of the Filing Date.

15 Throughout the latter part of 2004 and all of 2005, Stelco, the Monitor, and representatives of certain unsecured creditors, including representatives of the Debentureholders, were involved in various efforts to raise capital, sell assets, and negotiate a plan of arrangement or compromise. Ultimately, Stelco proposed its first plan of arrangement in October 2005 (the "Proposed Plan").

16 The Proposed Plan treated the Debentureholders and the Noteholders, together with other unsecured creditors whose claims were accepted by the Monitor, as members of the same class, referred to in the Plan as the "Affected Creditors". The Noteholders brought a motion to challenge this classification. They sought alternative relief either (1) directing Stelco to include provisions in the Proposed Plan, and disclosure in the related information circular, reflecting the extinguishment of the Subordination Provisions on implementation of the Proposed Plan, or (2) directing Stelco to extend separate class treatment to the Noteholders. The Noteholders' position was based on the absence of privity of contract — the fact that the Debentureholders were not parties to the Note Indenture.

17 The Noteholders' motion was heard on November 9, 2005 by Farley J. In his Endorsement of the same date, Farley J. denied both items of the requested relief and dismissed the motion: see *Stelco Inc., Re*, [2005] O.J. No. 4814 (Ont. S.C.J. [Commercial List]). A subsequent appeal to the Court of Appeal was also dismissed [2005 CarswellOnt 6510 (Ont. C.A.)]. The significance of these decisions for the issues in this proceeding is addressed below.

18 In response to a comment of Farley J. in his Endorsement of November 9, 2005, Stelco inserted a preliminary version of section 6.01(2) of the Plan in the draft plan to clarify its intentions with respect to the relationship between the Plan and the Subordination Provisions. This provision was subsequently revised in the course of negotiations that commenced in early December 2005 involving Sunrise and Appaloosa. These negotiations were prompted by an offer

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by these parties to subscribe for equity in Stelco under the Proposed Plan at $5.50 per common share, which was higher than the price contemplated under the Proposed Plan.

19 The negotiations in early December 2005 involved, among other parties, TML, Sunrise, Appaloosa, Stelco and the Claimants on behalf of the Debentureholders. They resulted in a revised plan of arrangement that was announced on December 5, 2005.

20 The final version of section 6.01(2) of the Plan is set out in the Appendix. The Debentureholders and 2074600 say that this provision preserves the rights of the Senior Debt Holders in respect of the Subordination Provisions. The Noteholders say it does not and that the Subordination Provisions were therefore extinguished on implementation of the Plan pursuant to its terms.

21 In late 2005, Stelco's directors and management obtained reports from UBS Securities Canada ("UBS") and BMO Nesbitt Burns Inc. ("BMO") regarding the estimated enterprise value of Stelco. In addition, the Monitor received a similar report from Ernst & Young Orenda Corporate Finance Inc. ("E&y"). The ranges of enterprise value in these reports was as follows : UBS — $550-$750 million using a discounted cash flow (" DCF") approach ; BMO — $580-$780 million using a public trading approach and $615-$785 using a DCF approach ; and E&Y- $635-$785 million. The existing holders of Stelco common shares obtained a report from Navigant Consulting ("Navigant"), which concluded that Stelco had an enterprise value in the range of $1.1-$1.3 billion.

22 The Affected Creditors approved the revised plan on December 9, 2005. The revised plan was then submitted to the Court for its approval pursuant to the CCAA at a hearing held on January 17 and 18, 2006 (the "Sanction Hearing") and was approved by the Court pursuant to an order dated January 20, 2006 (the "Sanction Order"). As approved, the Stelco plan of arrangement is referred to as the "Plan". The decision of Farley J. approving the Plan is set out in his Endorsement of the same date: see *Stelco Inc., Re*, [2006] O.J. No. 276 (Ont. S.C.J. [Commercial List]) No appeal was taken from that decision.

23 The Plan became effective on March 31, 2006 (the "Plan Implementation Date") at the "Effective Time", which was defined under the Plan as "the last moment on the Plan Implementation Date". On the Plan Implementation Date, articles of reorganization of Stelco were filed implementing the various steps in the Plan including the Distributions (as defined below) and the equity subscriptions of the equity sponsors of the Plan.

Treatment of the Parties Under the Plan

24 Under the Plan, on the Plan Implementation Date, each Affected Creditor received, in respect of its proven claims under the Plan, its *pro rata* share of each of:

> (a) the principal amount of the U.S. dollar equivalent (rounded up to the nearest US $1,000) of $275 million of secured fixed rate notes (the "FRNs");
>
> (b) a cash pool of a minimum of $108,548,000 and a maximum of $137,500,000, depending upon the number of Common Shares acquired pursuant to the Share Election (defined below) (the "Cash Pool"), funded by concurrent equity subscriptions of TML, Sunrise and Appaloosa;
>
> (c) 1.1 million new common shares of Stelco (the "Common Shares"); and
>
> (d) warrants to purchase 1,418,500 common shares of Stelco at $11 per share at any time prior to 2013 ("the Warrants").

Pursuant to section 2.07 of the Plan, each Affected Creditor could elect to receive all or any part of its entitlement to cash from the Cash Pool in Common Shares at a subscription price of $5.50 per share, subject to prorating in the event that more than 5,264,000 Common Shares were elected, which occurred. This right is referred to herein as the "Share

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Election". The securities actually distributed to the Affected Creditors, taking this election into account, are collectively referred to as the "Distributions".

25 The Distributions received by the Debentureholders under the Plan in satisfaction of their claims against Stelco were as follows:

(a) FRNs having an aggregate US$121,486,000. Assuming an exchange rate of 1.167 as of March 31, 2006, the aggregate face value of the FRNs was Cdn. $141,774,162;

(b) $52,189,293.52 and US$46,477.83 in cash. Assuming an exchange rate of 1.167 as of March 31, 2006, the aggregate cash received was $52,243,533.15;

(c) 4,004,829 of Common Shares; and

(d) 733,311 Warrants.

26 Valuing the FRNs at par, the Common Shares at $5.50, and the Warrants at $1.44, the Debentureholders value these Distributions at $216,044,254.65, resulting in a deficiency claim of $125,611,499.35 (including post-filing interest), which exceeds the value of the Turnover Proceeds. Using a valuation of the FRNs of $105.25, of the Common Shares of $20.50 and of the Warrants of $14.73, the Noteholders value these Distributions at $294,361,504, resulting in a deficiency claim on the same basis of $48,294,160, which represents 53.7% of the Turnover Proceeds.

27 The Distributions received by the Noteholders under the Plan in full satisfaction of their claims against Stelco were as follows:

(a) FRNs having an aggregate face value of US $40,522,000. Using the same exchange rate assumptions, the aggregate face value of the FRNs was Cdn. $47,289,174;

(b) $20,075,359 in cash;

(c) 849,325 Common Shares; and

(d) 244,528 Warrants.

These assets constitute the "Turnover Proceeds" and were delivered to the Monitor to be held in trust pending resolution of this litigation pursuant to the provisions of section 6.02(a) of the Plan.

Subsequent Events

28 Trading in the Common Shares, Warrants and FRNs on the Toronto Stock Exchange (the "TSE") began at the opening of business on Monday April 3, 2006, although there were no trades in the FRNs recorded until April 5, 2006. The FRNs also traded in the over-the counter market for which data was not made available to the Court.

29 On the first day of trading, 2,043,049 Common Shares were traded. The high and low prices for the Common Shares on that day were $19.49 and $15.00, respectively, with the closing price being $19.49. On the same day, 2,496 Warrants were traded. The high and low prices for the Warrants on that day were $12.00 and $10.00, respectively, with the closing price being $12.00.

30 The volume weighted average price (the "VWAP") of the Common Shares and the Warrants during the five-day period of April 3, 2006 to April 7, 2006 were $20.5049 and $14.7324, respectively. A total of 5,965,531 Common Shares and 91,579 Warrants were traded during that period. The Court was not provided with the VWAP calculation for the Common Shares and the Warrants for trading on April 3, 2006.

The MITSA

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31 The MITSA provided for the transfer from Stelco to EDS of responsibility for all of Stelco's IT needs. In this connection, 205 of Stelco's 212 IT employees were transferred to EDS. In addition Stelco sold to EDS the vast majority of the hardware, equipment, and other assets involved in the provision of Stelco's IT needs. The MITSA also contemplated a major overhaul of Stelco's legacy systems through the development and implementation of three new enterprise planning systems ("ERPs"). The ERPs contemplated three projects: (i) a synchronous manufacturing system (the "SMS"), that was completed but not implemented due to concerns for the implementation risk; (ii) an asset management system for Stelco's plants at Hilton Works and Lake Erie; and (iii) a human resources, payroll and financial management system.

32 The MITSA provided for payment of two types of fees. Operational fees, which were the significant majority of the fees, related to the operation and maintenance of the legacy systems and the transition to the applications and infrastructure implementing the ERPs. Project fees related specifically to the costs of developing and implementing the ERPs. Total costs over the 10-year term of the MITSA were expected to be approximately $320 million. As Stelco required flat annual payments to EDS, the MITSA was structured to provide that Stelco would incur indebtedness in the early years of the relationship, when the fees payable by Stelco would exceed the flat payments, and would retire that indebtedness over the remaining life of the contract, when the flat payments would exceed the fees payable to EDS. Interest was payable on most, but not all, of the outstanding indebtedness in order to make the debt assignable by EDS, although this became impossible due to Stelco's deteriorating credit rate.

33 The outstanding indebtedness at the time of Stelco's filing under the CCAA constitutes the EDS Claim. Stelco treated the EDC Claim as long-term indebtedness for financial reporting purposes. Substantially all of this indebtedness was treated as representing project fees for the ERPs. This resulted from Stelco's accounting practice of allocating the flat payments made by Stelco against the operational fees. EDS, however, appears to have treated a substantial portion of the indebtedness as operational fees.

This Proceeding

Procedural Matters

34 On March 7, 2006, Farley J. issued an order [2006 CarswellOnt 1505 (Ont. S.C.J. [Commercial List])] (the "Scheduling Order") setting out the procedure by which entitlement to the Turnover Proceeds would be resolved. The Scheduling Order, as supplemented, governs the current proceeding.

35 Pursuant to that Order, the Claimants, on behalf of the Debentureholders, and 2074600 filed claims in respect of the Turnover Proceeds on March 17, 2006. Subsequently, the Noteholders filed a defence to these claims and the Claimants and 2074600 filed replies to that defence. In addition, the Claimants filed a dispute to the claims of 2074600 to which 2074600 also filed a response.

Issues

36 There are eight separate issues in this proceeding as follows:

1. the Noteholders submit that the claims of the Debentureholders should be dismissed because the Debentureholders have failed to provide evidence that they held Debentures at the relevant times;

2. the Noteholders submit that the Subordination Provisions were cancelled on implementation of the Plan and, therefore, cannot be relied upon by the Senior Debt Holders;

3. the Noteholders submit that all debt, including the claims of the Debentureholders and 2074600, was extinguished on implementation of the Plan so there can be no Senior Debt for purposes of the Note Indenture;

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4. the Noteholders submit that any claims of the Debentureholders and 2074600 in respect of the Subordination Provisions are limited to their claims as of the date of Stelco's filing under the CCAA and do not include any post-filing interest;

5. the Noteholders submit that the Claimants are not parties to the Note Indenture and therefore cannot enforce its terms;

6. the Noteholders submit that there is no evidence that any of the Debentureholders or 2074600 suffered any deficiency on account of any Debentures held by them at the applicable time or the EDS Claim, as applicable, by virtue of the value of the Distributions received by each of them under the Plan:

7. 2074600 submits that the EDS Claim is Senior Debt; and

8. the Noteholders argue that, to the extent that 2074600 is otherwise entitled to the benefit of the Subordination Provisions as Senior Debt, it has failed to mitigate its damages.

The Debentureholders and 2074600 oppose the positions of the Noteholders in items 1 to 6 inclusive above. The Debentureholders and the Noteholders oppose the position of 2074600 in item 7.

I will discuss each of these issues in turn.

Analysis and Conclusions

Requirement for Proof of Holdings of Debentureholders

37 The Noteholders accept that the Claimants have been duly authorized to pursue the claims asserted by them in this proceeding on behalf of all Debentureholders. However, they argue that the claims of the Debentureholders should be dismissed because they have not introduced evidence regarding the holdings of individual Debentureholders on and after March 31, 2006 and the extent of their individual deficiency claims.

38 I do not accept this submission for two reasons.

39 First, as a procedural matter, I am satisfied that, by virtue of the inherent jurisdiction of the Court under the Plan and the CCAA as well as the specific procedural provisions of the Scheduling Order, the Court has the authority to convene a second hearing in this proceeding if it determines that further issues must be addressed to determine the quantum of the deficiency claims of any or all of the Debentureholders. In this connection, I note that the Court of Appeal upheld the Scheduling Order on the basis that the jurisdiction of this Court over the CCAA restructuring process extends at least to continued process-related matters concerning the rollout of the Plan in accordance with its provisions.

40 Pursuant to this authority, I indicated in my earlier Endorsement dated July 18, 2006 that the hearing this week is being treated as a motion for a declaration as to certain matters of law within the proceeding established by the Scheduling Order. If the Court's determination with respect to these issues does not constitute a final determination of the claims of the Debentureholders, the claims of the Debentureholders can be determined at a trial of the remaining factual issues.

41 Second, and more substantively, for the reasons addressed below under "Approach to the Determination of the Extent of the Deficiency Claims of the Senior Debt Holders", I have concluded that any deficiencies of the Debentureholders should be addressed on a collective rather than an individual basis. Accordingly, given the other determinations in these Reasons, there is no need for a further hearing by the Court to determine the deficiency claims of the Debentureholders except to the limited extent addressed below.

Survival of the Subordination Provisions

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42 The provisions of section 6.01(2) of the Plan are a complete answer to the Noteholders' submission that the Subordination Provisions were terminated on the Plan Implementation Date. Section 6.01(2) could have been drafted to express this purpose more directly. However, the only reasonable interpretation of section 6.01(2) is that the substantive rights and obligations of the Senior Debt Holders and the Noteholders in respect of the Subordination Provisions are not affected in any manner by the implementation of the Plan.

43 Conceptually, the result is that, while all of the provisions of the Note Indenture respecting the rights and obligations of Stelco and the Noteholders were extinguished on the Plan Implementation Date, the provisions of Part VI of the Note Indenture continue in full force insofar as they relate to the rights and obligations of the Senior Debt Holders vis-à-vis the Noteholders in respect of Distributions made on the Plan Implementation Date. This approach is consistent with both the provisions of the Plan and with the scope of the CCAA.

44 With respect to the Plan, the Noteholders argue that the proper interpretation of section 6.01(2) is that it preserves the right to assert claims and defences but, as a substantive matter, it does not preserve the Subordination Provisions to the extent that they would otherwise be extinguished by the terms of the Plan on the Plan Implementation Date. I do not accept this position. The Noteholders do not suggest that this provision is susceptible of any other interpretation other than one that renders it meaningless. I agree with the Senior Debt Holders that, as a matter of contract law, the Court should strive to give effect to every provision in an extensively negotiated commercial document. I therefore conclude that the more reasonable interpretation of section 6.01(2) is that it preserves the substantive rights of the parties in respect of the Subordination Provisions.

45 The Noteholders also rely on the clause "subject to the operation of law" in the last sentence of subsection 6.01(2) of the Plan. However, that clause is preceded by a statement that the last sentence is not intended to limit the generality of the rest of the provision. Absent an express indication that the clause was intended to render meaningless the rest of the provision, I conclude the reference to the operation of law was not intended to extend to the extinguishment of the rights and obligations of the parties in respect of the Subordination Provisions.

46 The Noteholders' position is essentially that it is not possible for Part VI of the Note Indenture to continue as an enforceable set of rights and obligations if the Note Indenture is otherwise extinguished. I do not think that this is necessarily so. To the extent that Part VI addresses rights and obligations of third parties that are enforceable by those parties, which is addressed below, there is no legal reason why these provisions cannot survive in full force and effect even if the remaining provisions of the Note Indenture are extinguished. Nor do I think that it is appropriate to characterize this result as rewriting the contract, as the Noteholders argue.

47 With respect to the CCAA, it is clear that the CCAA does not purport to affect rights as between creditors to the extent they do not directly involve the debtor. Farley J. confirmed this principle in his Endorsement dated November 9, 2005 at paragraph [7]. To succeed, the Noteholders must demonstrate clear and unambiguous language in the Plan evidencing an agreement to extinguish such rights. Subsection 6.01(2) of the Plan does not satisfy that requirement.

48 Based on the foregoing, I have therefore concluded that the Subordination Provisions were not extinguished on the implementation of the Plan.

49 The Senior Debt Holders go further and argue that the issue of the survival of the Subordination Provisions is *res judicata* in light of the above-mentioned Endorsement of Farley J. and the decision of the Court of Appeal dated November 14, 2005 upholding his decision. Given my determination of this issue it may be unnecessary to address this argument.

50 However, if it becomes relevant, I believe that the decision of Farley J. is limited to the principle set out above that, in the absence of any provision expressly extinguishing the Subordination Provisions in the Proposed Plan, neither the provisions of the CCAA nor the Proposed Plan would operate to extinguish the Subordination Provisions if the Proposed Plan were implemented. As there are no material differences between the Proposed Plan and the Plan that

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are relevant to this issue, apart from section 6.01(2), that principle also applies *prima facie* in the interpretation of the Plan in this proceeding. However, because the Proposed Plan did not include section 6.01(2) of the Plan, the decision of Farley J. did not address the legal effect of that provision with the result that the issue of the interpretation of section 6.01(2) is not technically *res judicata*.

51 I should note that I also think it is clear that Farley J. did not determine the further issue of whether the Subordination Provisions were enforceable by the Senior Debt Holders. While he alludes to this issue in paragraphs [3] and [4] of his Endorsement, he does not express a conclusion as to whether the Subordination Provisions are enforceable in the particular circumstances of this CCAA proceeding.

Survival of the Senior Debt Holders' Claims

52 As a related matter, the Noteholders also argue that, because the Plan extinguished the Senior Debt on the Plan Implementation Date, there is no longer any Senior Debt to which the Subordination Provisions apply. I do not accept this interpretation of the operation of the Subordination Provisions in respect of the Plan for the following reasons.

53 First, this interpretation of the effect of the Plan robs section 6.2 of the Note Indenture of any meaning in the very circumstances in which it was intended to apply, as evidenced by the reference in the introductory clause to "insolvency or bankruptcy proceedings, or any in reorganization or similar proceedings relative to [Stelco]". For this reason alone, I would conclude that the parties to the Note Indenture cannot have intended the Subordination Provisions to operate in this manner.

54 Second, I do not think this position is correct based on the language of section 6.2 of the Note Indenture. Subsections 6.2(1) and (2) require that a determination of whether the Senior Debt Holders continue to have outstanding claims shall be made concurrently with any particular payment or distribution to the Noteholders. If the Senior Debt Holders have outstanding claims, the Subordination Provisions operate with respect to such payment or distribution. The extinguishment of the outstanding claims of the Senior Debt Holders cannot affect the operation of the Subordination Provisions in respect of the particular payment or distribution that may be subject to those Provisions.

55 Lastly, while I do not think it should be necessary to establish, as a technical matter, that the Senior Debt had not been extinguished at the precise moment at which the Distributions were received by the Noteholders, I think it is possible do so based on the sequencing of the transactions set out in section 5.04 of the Plan. Section 5.04 sets out an order in which the events described therein occur, including the separate distribution of each of the securities comprising the Distributions. Because the Senior Debt Holders' claims can only be extinguished after payment of all of the property comprising the Distributions in accordance with the Plan, I conclude that, notwithstanding the language of section 2.03 of the Plan, their claims were not extinguished until all of these transactions were completed and that the Distributions were completed immediately prior to such time.

Post-Filing Interest Claims

56 The claim of the Senior Debt Holders in respect of post-filing interest involves two issues:

1. whether interest continues to accrue in respect of the claims of the Senior Debt Holders against Stelco notwithstanding Stelco's filing under the CCAA?

2. whether the Subordination Provisions extend to post-filing interest?

I will address the position of the Debentureholders and of 2074600 separately.

Post-Filing Interest Claims of the Debentureholders

57 I am satisfied that interest continues to accrue on the Debentures after the Filing Date up to and including the Plan Implementation Date even though it was not payable by Stelco under the Initial Order. A filing by a debtor under the

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CCAA does not, as a matter of law, automatically terminate, or even suspend, the accrual of interest on its outstanding indebtedness. Suspension of the obligation of the debtor to pay interest is entirely based on the terms of any stay order issued by this Court in respect of the CCAA proceedings.

58 There is no authority to the contrary apart from the decision in *Air Canada (Re)*, Decision of Claims Officer Stockwood, dated August 4, 2004. I think that the decision is incorrect and, in any event, is not binding on this Court. On the other hand, there is authority in support of the position that post-filing interest continues to accrue after a CCAA filing in the statement of Binnie J. in *Nav Canada c. Wilmington Trust Co.*, [2006] S.C.J. No. 24 (S.C.C.) at para. 96.

59 The Noteholders argue that the "Interest Stops Rule", which applies in bankruptcy and winding-up proceedings, should also apply in respect of CCAA proceedings. I do not see why this should be the case. There may be circumstances, such as an increasing equity value of an entity in CCAA proceedings, that would justify inclusion of some or all post-filing interest in the claims of creditors in the plan of arrangement implemented at the end of the CCAA proceedings. There is no reason why creditors should be prevented from receiving satisfaction of such claims by imposition of the Interest Stops Rule.

60 The Noteholders also rely on the definition of "claim" in section 12 of the CCAA as "a debt provable in bankruptcy within the meaning of the [*Bankruptcy and Insolvency Act*]". They argue that, since a claim in bankruptcy includes interest only to the date of the assignment in bankruptcy, the Court should interpret the definition of "claim" in the CCAA analogously to limit interest claims to interest prior to the date of filing under the CCAA. I do not think this is a necessary implication of the definition of claim in the CCAA, which has meaning principally in the context of voting provisions.

61 The last argument of the Noteholders is that the Debenture Indentures are not sufficiently explicit that interest continues to accrue after the institution of insolvency proceedings. I do not agree. I am satisfied that the provisions of the Debenture Indentures that provide that interest is payable after default are sufficient to continue the accrual of interest after the commencement of insolvency proceedings and imposition of a stay. The Noteholders point to more explicit wording in certain securities referred to in the *Air Canada* decision at page 33. However, the language to which they refer does not relate to the payment of interest but rather to the operation of subordination provisions. In that context, such language is not essential if the subordination provisions do not otherwise exclude the accrual of interest, although it is helpful in confirming the fact that the parties directly addressed the issue.

62 With respect to the second question, the critical fact, as discussed above, is that the Subordination Provisions continue to operate independently of the Plan and are not affected by implementation of the Plan. Section 6.01(2) specifically preserves the rights of the Senior Debt Holders in respect of post-filing interest. While it also preserves any defences of the Noteholders, they assert none that are not based on the operation of the Plan. Accordingly, I conclude that the Subordination Provisions also extend to post-filing interest.

63 I agree with the Senior Debt Holders that the legal result is analogous to the treatment of guarantees of entities that have filed under the CCAA. As illustrated in *Guardian Trust Co. v. Gaglardi* (1989), 64 D.L.R. (4th) 351 (B.C. S.C.) at 361, interest continues to accrue post-filing in respect of the obligation of a guarantor even if a stay is imposed under the CCAA in respect of the obligation of the debtor. In that situation, as in the present circumstances, the result flows from the existence of an independent contract or document between parties other than the debtor and the absence of language that excludes the accrual of post-filing interest.

64 On the basis of the foregoing, I conclude that the holders of the Debentures are entitled to the benefit of the Subordination Provisions in respect of post-filing interest.

Post-Filing Interest Claims of 2074600

65 As a holder of Senior Debt, 2074600 would also be entitled to the benefit of the Subordination Provisions in respect of post-filing interest if it could establish that interest had continued to accrue, as between EDS and Stelco. The Debentureholders and the Noteholders argue that the claim of 2074600 for post-filing interest was, however, extinguished

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by the provisions of a term sheet dated November 14, 2005 between EDS and Stelco (the "Term Sheet") immediately prior to the assignment of the EDS Claim to 2074600.

66 In section 2(g) of the Term Sheet, EDS and Stelco agreed that the EDS claim in the CCAA proceeding would be $48,944,917 and specifically agreed that interest could not accrue after that date. 2074600 argues that the inference to be drawn from this provision is that nothing in the Term Sheet extinguished the accrual of interest prior to that date in respect of the EDS Claim. However, section 1 of the Term Sheet constitutes, among other things, an absolute release of all claims of EDS against Stelco as of November 14, 2005. There is nothing in section 2(g) that preserves any claim of EDS for interest accrued prior to that date.

67 Accordingly, I conclude that the effect of the Term Sheet is to extinguish the obligation of Stelco to pay post-filing interest on the EDS Claim.

Enforceability of the Subordination Provisions by the Senior Debt Holders

68 The Senior Debt Holders assert (1) that they are entitled to enforce the Subordination Provisions directly as third party beneficiaries and (2) that they are beneficiaries under a trust of the Turnover Proceeds established under subsection 6.2(3) of the Note Indenture. I will discuss each submission in turn.

Application of Third Party Beneficiary Rule

69 The Debentureholders (through the Claimants) and 2074600 seek to enforce the covenants of the Noteholders in favour of Stelco in section 6.1 and subsections 6.2(1) and (2) of the Note Indenture as third party beneficiaries by virtue of their status as Senior Debt Holders. The Noteholders submit that the Senior Debt Holders cannot enforce the Subordination Provisions on their own. I will address the two arguments of the Noteholders on this issue in turn.

70 First, the Noteholders say that the Senior Debt Holders cannot enforce the covenants of the Noteholders in favour of Stelco in section 6.1 and subsections 6.2(1) and (2) of the Note Indenture because they are not parties to the Note Indenture. The Debentureholders and 2074600 argue that they are entitled to enforce the covenants on the basis of the principles articulated in *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299 (S.C.C.) and *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108 (S.C.C.). The Noteholders say that the limited relaxation of the privity of contract rule permitted in these decisions does not extend to assertion of claims as a plaintiff but is limited to assertion of defences as a defendant in any action. In support of this position, they point to dicta in two recent British Columbia decisions: *Kitimat (District) v. Alcan Inc.*, [2005] B.C.J. No. 58 (B.C. S.C.) and *RDA Film Distribution Inc. v. British Columbia Trade Development Corp.*, [2000] B.C.J. No. 2550 (B.C. C.A.). On the basis of these decisions, they argue that the Senior Debt Holders can only enforce the covenants of the Note Indenture if Stelco had constituted itself a trustee of these covenants in favour of the Senior Debt Holders.

71 I do not agree with the Noteholders for the following reasons.

72 First, I am satisfied that the two-part test set out by Iacobucci J. at para. 32 in *Fraser River* is satisfied. There is no question that the benefit of the provisions extends to the Senior Debt Holders. Unlike the situations presented in *London Drugs* and *Fraser River*, the Senior Debt Holders are the only parties who benefit from these provisions. The second part of the test is satisfied insofar as the actions of the Debentureholders and 2074600 are limited to enforcing the covenants made in favour of Stelco that are intended to ensure that the Senior Debt Holders receive the benefit of the Subordination Provisions. In addition, because the policy concerns of multiplicity of actions and double recovery do not present themselves in the present action, there is no principled reason to refuse to extend the principle in *London Drugs* to the present action.

73 The Noteholders' second argument is that the limited relaxation of the doctrine of privity of contract in *London Drugs* and *Fraser River* is limited to use by a third party beneficiary as a shield to defend an action rather than as a sword to initiate one. They rely on dicta of Ehrcke J. in *Kitimat* at para. 65 and of Newbury J.A. in *RDA Film Distribution*

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at paras. 67 and 68 in support of this position. The Debentureholders argue that the Noteholders are the real plaintiffs in this proceeding.

74 I do not think it is possible, as the Debentureholders argue, to characterize their claims as a shield to prevent appropriation of assets by the Noteholders to which they are not entitled. While the circumstances of a debtor not enforcing subordination provisions directly may be novel, there is no question that the onus in this proceeding rests with the Debentureholders to establish that they are entitled to enforce the Subordination Provisions. However, there is a more fundamental reason why the decisions relied upon by the Noteholders are not applicable in the present circumstances.

75 The conclusion of Ehrcke J., which is the clearer of the two statements relied upon by the Noteholders, is a deduction from the more general statement of Iaccobucci J. in *Fraser River* at para. 44 that the exception should be applied in an "incremental" manner. It is clear from that decision that the fundamental consideration in the determination of whether, in any particular circumstance, relaxation of the doctrine of privity can be characterized as "incremental" is the potential for double recovery and multiplicity of actions. I would note that these concerns were present in both *Kitimat* and *RDA Film Distribution*. In the present proceeding where such concerns are not present, I believe the principle in *Fraser River* contemplates extension of the third party beneficiary principle regardless of whether it is being used as a shield or a sword.

76 Accordingly, I conclude that, in the absence of enforcement by Stelco, the Senior Debt Holders are entitled to enforce section 6.1 and subsections 6.2(1) and (2) of the Note Indenture directly as third party beneficiaries.

Alleged Existence of Trust

77 The Senior Debt Holders also submit that they are the beneficiaries of a trust of the Turnover Proceeds established in their favour in subsection 6.2(3) of the Note Indenture. The Noteholders make two arguments in denying that the holders of Senior Debt are entitled to rely on the trust language expressed in section 6.2(3).

78 First, they say that this provision is remedial and, as such, is only enforceable to the extent that the Senior Debt Holders can enforce the provisions of section 6.1 and subsections 6.2(1) and (2) as a third party beneficiaries. Given the decision above, this requirement is satisfied. I am of the opinion in any event that the two issues are not related. In particular, a trust could be validly created in respect of property received by or on behalf of the Noteholders irrespective of whether the Senior Debt Holders were entitled to enforce these covenants of the Note Indenture as third party beneficiaries.

79 In addition, the Noteholders argue that the pre-conditions to the establishment of a trust have not been satisfied. In particular they say that there has been no receipt of trust property by the Noteholders because the Distributions have been paid to the Monitor in accordance with the paragraph 6.01(2)(a) of the Plan. This is an argument of form over substance. The Monitor has no interest in the Distributions. For the purpose of this proceeding, payment to the Monitor satisfies the requirement of delivery of the corpus of the trust to the Noteholders. The only other possibility — that the Distributions were paid to the Senior Debt Holders — is, of course, denied by the Noteholders and would render consideration of this issue unnecessary.

80 In the course of oral argument, a third issue was raised — the revocability of the trust by the Noteholders, as trustees, without the consent of the Debentureholders, as beneficiaries. I conclude, however, that the possibility of revocation in these circumstances should not displace the existence of the trust for the following reasons. First, there is no question that the "three certainties" necessary to establish the existence of a trust have been demonstrated. Second, revocation of the trust was more a theoretical than a real possibility. The Noteholders could only revoke the trust with the consent of Stelco, as the other party to the Note Indenture. There was no realistic possibility that Stelco would have consented while Senior Debt was outstanding. In addition, if it had done so, there remains the possibility that the Debentureholders would have had a right to prevent the revocation based on principles of reliance or other applicable law.

81 Accordingly, I conclude that the Senior Debt Holders are also entitled to the benefit of a trust of the Turnover Proceeds established in their favour pursuant to section 6.2(3) of the Note Indenture.

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Approach to the Determination of the Extent of the Deficiency Claims of the Senior Debt Holders

82 The most difficult issue for this proceeding is the approach to valuing the Distributions for purposes of determining the extent, if any, of the entitlement of the Senior Debt Holders to the Turnover Proceeds pursuant to the Subordination Provisions.

83 The patires have suggested three different approaches. 2074600 argues that the Distributions should be valued as of the date of the Sanction Order. The Debentureholders argue that the Distributions should be valued as of the Plan Implementation Date. Both of these parties submit, however, that the Common Shares and the Warrants should be valued using the $5.50 subscription price for the Common Shares under the Plan, resulting in a modest value for the Warrants using the Black-Scholes model valuation. The Noteholders argue that the Court should use actual recoveries during the week of April 3, 2006, to the extent Senior Debt Holders sold any FRNs, Common Shares or Warrants during that period, and the volume weighted average sale price ("VWAP") for the week for any such securities held by the Debentureholders at the end of the week. The approach of the Debentureholders and 2074600 would calculate any deficiencies of the Senior Debt Holders on an aggregate basis. By contrast, the Noteholders argue that the deficiencies of the Senior Debt Holders must be calculated on an individual basis.

84 There are, therefore, four interrelated issues to be addressed in determining this issue:

1. whether any deficiencies of the Senior Debt Holders are to be claimed collectively or individually;

2. whether deficiencies of the Senior Debt Holders should be valued taking into account actual recoveries in respect of any securities sold by the Debentureholders after the Plan Implementation Date;

3. the appropriate date or dates for valuing the Distributions received by the Senior Debt Holders; and

4. the appropriate value of the Common Shares, Warrants and FRN's received by the Senior Debt Holders, to the extent that recoveries are not to be taken into account in such determination.

85 The point of commencement for these questions is the principle of subordination set out in subsection 6.2(1) of the Note Indenture, which provides that "the holders of all Senior Debt will first be entitled to receive payment in full of [their claims] before the [Noteholders] will be entitled to receive any payment or distribution of any kind or character, whether in cash, property or securities, which may be payable or deliverable in any such event in respect of any of the [Notes]". The resolution of each of the four issues must be consistent with the principles embodied in section 6.2(1). I will address each issue in turn.

Are Deficiencies to be Claimed Collectively or Individually?

86 The approach of the Noteholders requires the Court to approach the determination of the deficiency claims of the Debentureholders on an individual basis. As mentioned above, the Noteholders go further and submit that the failure of the Claimants to provide evidence of the actual deficiency claims of each of the Debentureholders is a fatal defect that should result in dismissal of their claims.

87 I do not accept either of these propositions.

88 The claims of the Debentureholders are based on the Subordination Provisions. While each claim for a deficiency is ultimately an individual claim, the Note Indenture generally, and section 6.2(1) thereof in particular, clearly contemplates treatment of these claims on a collective basis. In the ordinary course, the trustees under the Debenture Indentures (the "Trustees") would enforce the Subordination Provisions on behalf of all Debentureholders against Stelco in respect of all payments to Noteholders, whether cash or securities, in contravention of those Provisions. Any payments owing by the Noteholders would be paid to the Trustees for distribution *pro rata* among the Debentureholders. I do not believe

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that either the involvement of the Claimants or the disproportionate deficiency claims resulting from the exercise of the Share Election by Debentureholders changes the process for enforcement of the Subordination Provisions.

89 The Claimants are duly authorized by special resolutions of the holders of each of the 10.4% Debentures and 8% Debentures. The substitution of the Claimants for the Trustees as representatives of the Debentureholders does not affect the authority of the duly authorized representatives to enforce the claims of the Debentureholders collectively.

90 The fact that the claims of the individual Debentureholders will not be proportionate to their holdings of Debentures because of differing exercise of the Share Election by Debentureholders also does not affect the enforcement process in respect of their claims pursuant to the Subordination Provisions. The Noteholders have not argued that the differing exercise of the Share Election on its own requires, as a matter of law, that the Debentureholder claims that would otherwise be pursued collectively must now be pursued individually. In addition, I do not think that there are any practical difficulties in the determination of, or payment in respect of, the deficiency claims of individual Debentureholders that require that the claims be pursued individually.

91 The aggregate deficiency claims of the Debentureholders can be determined by a comparison of the aggregate value of their claims on the Plan Implementation Date with the aggregate value of the Distributions actually received by the Debentureholders, collectively, after the exercise of the Share Election. If there is a deficiency, the Noteholders are required to deliver Turnover Proceeds having an aggregate value equal to the aggregate amount of the deficiency claims of the Debentureholders, *pro rata* according to their holdings of Notes. The parties are agreed that this would proceed by payment of a percentage of each category of the Turnover Proceeds equal to the percentage that the aggregate deficiency claim of the Senior Debt Holders represents of the total value of the Turnover Proceeds. Such delivery will satisfy the Noteholders' obligations under the Subordination Provisions. Determination of the entitlement of individual Debentureholders to those Proceeds is entirely a mechanical exercise to be conducted outside of this proceeding by the Trustees, who have the responsibility of allocating the Turnover Proceeds, or the cash proceeds thereof if sold by the Trustees, to the Debentureholders *pro rata* in accordance with their respective deficiencies. As a practical matter, there is nothing in this process that requires that the individual deficiency claims of the Debentureholders be established in this proceeding if the aggregate deficiency claims of the Debentureholders are ascertainable.

92 I would note, as well, that the Noteholders' position on this issue is closely related to, but distinct from, their position that actual recoveries of the individual Debentureholders must be taken into consideration in the determination of the aggregate deficiency claims of the Debentureholders. This issue is addressed further below.

Are Recoveries to be Considered in the Determination of Debentureholder Deficiencies?

What is the Appropriate Date for Valuing the Distributions?

93 As these two issues are closely related, I propose to deal with them in the same section.

94 The Noteholders submit that the determination of the value of the Distributions received by the Senior Debt Holders should take into account the actual recoveries of individual Debentureholders who sold securities in the market after the Plan Implementation Date.

95 I do not think, however, that the "actual recoveries" approach of the Noteholders is consistent with the principles embodied in section 6.2(1) of the Note Indenture. The Note Indenture does not expressly provide any mechanism for valuing securities or other property received in payment of Senior Debt claims. In these circumstances, I think it necessarily follows that:

1. the valuation must be made as of the time the Noteholders became legally entitled to the Distributions, which was the Plan Implementation Date; and

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2. the valuation must be determined independently of any actual recoveries by Senior Debt Holders arising from subsequent sales transactions.

I will address each issue in turn.

96 First, I reach the conclusion that the valuation must be made as of the time the Noteholders became legally entitled to the Distributions for the following reasons. Most importantly, the language of section 6.2(1) specifically refers to deferral of the entitlement of the Noteholders to receive any distribution otherwise payable or deliverable to them until the Senior Debt Holders shall have received payment in full of their claims. The reference to "payment in full" requires a valuation of any payment, including property, made to the Senior Debt Holders at or before at the time of receipt of any payment made to the Noteholders. There is no authority in section 6.2(1) for deferring the date as of which the value of any such payment to the Senior Debt Holders shall be determined beyond the time of receipt of the particular payment to the Noteholders. In this proceeding, the time of receipt is also the time at which the Noteholders became legally entitled to the Distributions, being the Plan Implementation Date, and the concepts are used interchangeably except where expressly indicated to the contrary.

97 Second, the case law in this area, while dealing with a number of different circumstances, does exhibit a presumption that, absent special circumstances, securities will be valued as of the date on which a party becomes legally entitled to them. In the present circumstances, the Senior Debt Holders became entitled to the Distributions paid to them on the Plan Implementation Date. Accordingly, in order to succeed in their argument, the Noteholders must demonstrate an intention to displace this presumption in the provisions of the Note Indenture. They have failed to do so.

98 Third, in circumstances where the valuation exercise relates to a receipt of publicly-traded securities, rather than a compulsory sale, the valuation exercise should proceed as of the date of receipt, or as nearly as possible to the date of receipt, to reflect the fact that the recipients are in a position to realize the value of the securities in the market on that date if they so decide, subject, of course, to issues related to their ability to obtain the market price of the shares.

99 Fourthly, it must be presumed that the parties would not have intended to place any undue risk upon the Noteholders. In particular, I do not think that the parties to the Note Indenture would have intended at the date of its execution to provide for a deferral of the date as of which a valuation is to be made to provide greater certainty of the quantum of the claims of the Senior Debt Holders. Despite the actual trading experience, such an approach was at least as likely to increase the quantum of such deficiency claims and thereby increase the loss of the Noteholders.

100 Lastly, implementation of the approach of the Noteholders requires resolution of a number of issues for which there is no legal standard in the Note Indenture. For example, any determination of value based on actual recoveries requires a decision as to which sales will be considered and which will not. The Noteholders choose all sales during the first trading week after the Plan Implementation Date. There is, however, no principle based in the Note Indenture that justifies selection of this period rather than any shorter or longer period. There is also no presumption in the case law from which it can be inferred that the parties intended such an approach. Appeals to general considerations of fairness also fail. What the Noteholders regard as fair the Senior Debt Holders regard as unfair, given the fluctuations in market prices.

101 More fundamentally, the absence of any applicable legal standard in the Note Indenture is a strong indication that, in substance, the Court is being asked by the Noteholders to rewrite the Subordination Provisions rather than to interpret the intentions of the parties to the Note Indenture with respect to these Provisions. It is being asked to impose a regime that is not contemplated in any manner by the Note Indenture. In the absence of a clear indication that the parties to the Note Indenture intended such a regime, or provided broad authority to this Court to impose a valuation regime, I do not think the Court should engage in such an exercise.

102 A separate but related issue is the submission of 2074600 that the proper date for valuation should be the date of the Sanction Order on the basis that, in its view, the Senior Debt Holders became legally entitled to the Distributions

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to be paid to them as of that date. This argument is also rejected for the following reasons in addition to the reasons set out above.

103 First, as a matter of law, I do not think that the Senior Debt Holders were legally entitled to the Distributions as of the date of the Sanction Order. Implementation of the Plan was subject to satisfaction of a considerable number of conditions set out in section 5.03 of the Plan. There was no certainty that these conditions would be satisfied. There was therefore no legal entitlement to the Distributions until the Plan Implementation Date. Until that time, the Senior Debt Holders had only a conditional right to receive the securities.

104 Second, in any event, section 6.02(1) mandates a determination of the value of any payments received by the Senior Debt Holders as of the date of receipt of the Distributions by the Noteholders. As mentioned, this determination must be made as of the date that the Senior Debt Holders are in a position to sell any securities received by them. Otherwise, the Senior Debt Holders would bear the risk of a decline in value prior to the date of receipt of the securities. There is no evidence of any market for the securities included in the Distributions prior to the Plan Implementation Date. Accordingly, even if the Senior Debt Holders had become legally entitled to receive the Distributions as of the date of the Sanction Order, the determination of the amount or value of the payment could only be made as of the Plan Implementation Date because the payment of the Distributions did not occur until that date.

Valuation of the Distributions to the Senior Debt Holders

105 The issue for the Court can therefore be put simply: did the Senior Debt Holders receive Distributions on the Plan Implementation Date having a value that constituted "payment in full" of their claims and, if not, what is the extent of their deficiency? For this purpose, the Court must determine the value of the payments received by the Senior Debt Holders. For the reasons set out above, I have concluded that the payments were received by the Senior Debt Holders at the Effective Time on March 31, 2005 and must be valued as of that time. There is, however, no provision in either the Note Indenture or the Plan that specifically addresses the proper approach to the valuations of the property received in reorganization. Accordingly, the issue for the Court is the most appropriate evidence of the value of the Distributions received by the Senior Debt Holders on March 31, 2006.

106 The Court is not, of course, to conduct its own inquiry into the value of the securities. The Court must determine, instead, the best evidence of the value of the Distributions based on the evidence before it. For this purpose, I am of the opinion that "value" means the price for the securities that the Senior Debt Holders could have received if they had sold their securities in an open market at the Effective Time on March 31, 2006. This reflects the fact that, at that time, the Senior Debt Holders were in a position to realize the value of the securities paid to them by selling them in the market. Accordingly, the Court must determine the market price for the securities at the Effective Time. For this purpose, therefore, "value" does not mean the "fair market value", the "fair value" or the "intrinsic value", if those terms mean something other than the price of the securities in an open market. In particular, the issue is not whether the Senior Debt Holders received fair value, but rather what value should be ascribed to the Distributions received by the Senior Debt Holders. I would observe that this is not an exercise in the determination of the fair market value of securities pursuant to a statutory right provided to minority shareholders and, accordingly, the case law that has developed dealing with such valuations is not helpful in the present proceeding.

107 For the reasons set out above, I have rejected the approach proposed by the Noteholders that would use actual recoveries during the first week of trading and the VWAP for securities retained after the first week. The alternative argument of the Noteholders is that the securities should nevertheless be valued on the basis of market prices for the securities, disregarding recoveries. They propose using either the VWAP for the entire week or the VWAP for the first day of trading in each of the securities, although the Noteholders argued the latter with less enthusiasm. I will address the appropriateness of the use of VWAP data for the first trading week before considering the merits of the two approaches to value before the Court.

Appropriateness of Determination of Value Based on Trading Data for the First Week of Trading

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108 I do not think that the VWAP data for the first week of trading in the securities is an appropriate reflection of the value of the securities on March 31, 2005 for three reasons.

109 First, there is no principled basis for establishing a trading period exceeding the day closest to the date of receipt of the securities. I accept that, if there were market imperfections on the first day of trading that were eliminated in the course of the week, there could be a basis for such an approach. However, there is no evidence of any such imperfections. Nor are there any market considerations relating to trading in the following weeks, when apparently market prices fell, that would justify exclusion of such later period. In these circumstances, selection of trading for the week could legitimately be characterized as "averaging up" the market price even if that were not the intention.

110 Second, there are no legal precedents brought to the attention of the Court for the Noteholders' approach to the determination of the value of publicly traded securities. There is, instead, a marked preference in the case law for selection of a single date as the date for determination of the value of publicly traded securities.

111 Lastly, any such approach necessarily invites use of the actual recoveries of the Senior Debt Holders during the period, which has been rejected for the reasons set out above. The longer the period selected, the larger the amount of such recoveries and, correspondingly, the less the integrity of weighted average trading data for the period as the determinant of value of the securities received by the Senior Debt Holders.

112 Accordingly, I have rejected the VWAP data for the first week of trading of the Common Shares as the determinant of the value of those shares. I have, however, considered the volume weighted average price of trading in the securities on the first trading day after the Plan Implementation Date. In the case of the Common Shares and Warrants, the first trading day was April 3, 2006. In the case of the FRNs, the first trading day on the TSE was April 5, 2006 although, as addressed below, it may be that the FRNs traded in the over-the-counter market as early as April 3, 2006.

Preliminary Issues Regarding the Position of the Senior Debt Holders

113 I will deal next with two arguments of the Debentureholders and 2074600 that, if accepted, would dispose entirely of the issue of the determination of value.

114 First, the Debentureholders and 2074600 argue that, in his Endorsement dated January 20, 2006 approving the Plan, Farley J. approved the $5.50 value of the Common Shares as fair and reasonable for all purposes relating to the Plan, including the operation of the Subordination Provisions. I do not think that this is a correct reading of the decision of Farley J.

115 Reading the reasons of Farley J. in their entirety, it is clear that the issue before Farley J. relating to value was whether the Plan was unfair to the holders of equity in Stelco at that time because their common shares had value. This is clear from paragraph [37] of the Endorsement, which sets out his only finding relative to value:

> The end result is that given the above analysis, I have no hesitation in concluding that it would be preferable to rely upon the analysis of UBS, BMO Nesbitt Burns and Ernst & Young Orenda, both as to their direct views as to the enterprise value of existing Stelco and as to their criticism of the Navigant and MBR reports concerning Stelco. Therefore, I conclude that the existing shareholders cannot lay claim to there being any existing equity value....

On the basis of a number of factors including the valuations before the Court and the history of negotiations regarding the Plan, Farley J. found that the enterprise value of Stelco was not sufficient to attribute any value to the existing common shares. His conclusion in this paragraph does not, however, constitute a determination of the actual enterprise value of Stelco from which a finding as to the value of the Common Shares could be inferred, nor is there such a finding elsewhere in his Endorsement. He also made no separate finding regarding the fairness of the subscription price of $5.50 per Common Share. I would add that the Endorsement also does not address any issues relating to the Subordination Provisions.

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116 Second, the Debentureholders argue that the transactions effected on the Plan Implementation Date evidence a real market for the Common Shares on that date in which shares were effectively traded at $5.50 per Common Share. The transactions to which they refer are: (1) the equity subscriptions under the Plan by TML, Sunrise and Appaloosa; (2) the exercise of the Share Election by Affected Creditors; and (3) the issue and allotment of Common Shares and Warrants to purchase Common Shares to the new president of Stelco at a subscription price, and a strike price, of $5.50 per Common Share.

117 I also do not accept the submission that an open market for the Common Shares existed on the Plan Implementation Date from which the Court can conclude that the value of the Common Shares was $5.50. None of the transactions to which the Senior Debt Holders refer were entered into on the Plan Implementation Date. The equity subscriptions by TML, Sunrise and Appaloosa were agreed to prior to the meetings of the stakeholders to approve the Plan held on December 9, 2005. The subscription price for the Share Election had also been agreed by that time and the actual elections by individual Debentureholders were made well in advance of the Plan Implementation Date. Similarly, the issue price of the Common Shares, and the strike price of the warrants to purchase additional Common Shares that were issued to the new president of Stelco, were the result of negotiations that began in January and were completed well before the Plan Implementation Date. Completion of these transactions on the Plan Implementation Date is insufficient to establish the existence of a market for the Common Shares and Warrants of Stelco on that date. The Debentureholders must demonstrate sales of these securities or the FRNs, as applicable, by the recipients of these securities in these transactions, including the Affected Creditors, to establish the existence of a market on March 31, 2006. There is no such evidence.

Alternative Approaches to Determination of the Value of the Securities

118 There are therefore two alternatives before the Court proposed by the parties as the best evidence of the value of the securities received by the Senior Debt Holders on the Plan Implementation Date. The Debentureholders and 2074600 say that the most appropriate evidence of the value of the Common Shares and Warrants is the subscription price of $5.50 per Common Share used in respect of subscriptions for Common Shares under the Plan. They also suggest that the FRNs should be valued at their face value. The Noteholders argue that the market prices of these securities are the best indications of the actual value of the securities even though the trading took place after the Plan Implementation Date. As mentioned, I have limited consideration of this approach to a valuation of the securities based on the market prices on the first trading after the Plan Implementation Date for each of the securities.

119 Neither approach is entirely satisfactory. I will state my concerns with each before setting out my conclusions.

Approach of the Senior Debt Holders

120 Under the Plan, Common Shares were issued to the equity investors and Affected Creditors who exercised the Share Election at a subscription price of $5.50 per share. This implied an enterprise value of Stelco of $816.6 million. The Debentureholders and 2074600 argue that the Common Shares should be valued at $5.50 because this is the only value established for the Common Shares on and prior to March 31, 2006.

121 In support of this position, they submit that this price was the outcome of negotiations among the major stakeholders in Stelco. They also point to the fact that this subscription price was used in respect of the transactions with the incoming president of Stelco and was determined to represent the fair market value of the Common Shares by the incoming board of directors of Stelco on March 31, 2006 for purposes of all issues of Common Shares on that date.

122 In further support of their position, the Debentureholders and 2074600 rely upon the UBS, BMO and E&Y valuations, which Farley J. preferred to the Navigant valuation in approving the Plan. These valuations determined a range of enterprise values for Stelco based on a discounted cash flow approach using EBITDA projections for Stelco generated in late 2005. The BMO valuation included a second range based on a multiple of projected EBITDA reflecting BMO's estimate of appropriate multiples of EBITDA based on the market multiples of other publicly traded steel

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companies. As set out above, the ranges of enterprise value in these reports was as follows: UBS — $550-$750 million; BMO — $580-$780 million using a market multiple approach and $615-$785 using a DCF approach; and E&Y — $635-$785 million.

123 In addition, the Debentureholders obtained a further dated June 19, 2006 from Deloitte & Touche LLP (the "Deloitte Report") that calculated the enterprise value of Stelco at March 31, 2006 to be in the range of $910 to $956 million resulting in a value per Common Share of $5.93 to $7.70 after deduction of Stelco's post-reorganization debt at that date of $755 million. Deloitte was not asked to determine its best estimate of the value of the securities at that date. Instead, it was specifically mandated to assume that $5.50 represented the fair market value of the Common Shares at January 20, 2006 and to approximate the fair market value of the Common Shares on the Plan Implementation Date by "reflecting the impact of the changes in major value drivers" of that value, an exercise described as "rolling forward" the $5.50 value to March 31, 2006.

124 I have four principal difficulties with the approach of the Debentureholders and 2074600.

125 First, while the subscription price of $5.50 per Common Share was the result of protracted negotiations, I do not think the Court can rely on that fact alone as establishing the value that the Senior Debt Holders would have received on the Plan Implementation Date if they had been able to sell their shares in the open market on that date. Without an extensive analysis of the interests of each of the parties in the negotiations, as well as the history and dynamic of the negotiations, which is beyond the role and capability of the Court on the evidence before it in this proceeding, the Court cannot conclude that the outcome represented the value that the Common Shares would have obtained in the market at December 9, 2005, when the price was finalized, if it had been possible to sell the shares at that time. In any event, there is no way of establishing that the same negotiations conducted in March 2006 would have arrived at the same result. In fact, it is probable that developments since December 2005 would have resulted in a higher price, as indicated in the Deloitte Report, although it is not possible to say whether the difference would have been large or small.

126 Second, the four valuations upon which the Debentureholders and 2074600 rely are estimates of the enterprise value of Stelco as a whole rather than of the market values of the Common Shares, the Warrants or the FRNs. While the estimates of enterprise value in the UBS, BMO and E&Y reports play an important role in the determination of the relative contributions to value of the various creditor groups, there is no suggestion in these valuations that they also address the value of the Common Shares in an open market on the Plan Implementation Date. The utility of these reports is further diminished by developments in the market and otherwise since December 2005. For these reasons, there is no direct relationship between the estimates of the enterprise value of Stelco in late 2005 and the market values of the Common Shares, Warrants and FRNs on or about the Plan Implementation Date.

127 Third, there are also specific reservations identified by the Noteholders pertaining to each of the UBS, BMO and E&Y valuations. Among other things, each is based on information and projections that have been superceded. In addition, the BMO and UBS valuations are not based on the capital structure of the Plan as they pre-date it. More significantly, each is subject to limitations expressed in the valuations that limit their usefulness as an estimate of the value of the Common Shares.

128 Fourth, there are a number of qualifications expressed in the Deloitte Report that limit its usefulness as a valuation of the Common Shares as of the Plan Implementation date.

129 First, insofar as the Report does not review the validity of the $5.50 valuation as at January 20, 2006 but merely considers the extent to which developments since that date would impact value, it is difficult to assess the utility of its conclusions. In addition, the Report specifically states that it does not constitute a comprehensive valuation report as to the fair market value of the securities as of the Plan Implementation Date.

130 Second, the author of the Report did not have access to the new management team at Stelco or full access to the prior management team. In addition, the most recent forecast made available to Deloitte was dated November 18, 2005,

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even though Stelco management has prepared more current forecasts. The Report also indicates that it was not possible to fully assess the credit risk of Stelco and the debt facilities without a current cash flow forecast. This casts doubt on the conclusion in the Report that the FRNs should be valued at their face value.

131 Third, statements in the Deloitte Report suggest that it attempts to do more than is required or is appropriate for the issue before the Court in this proceeding. The Report uses a definition of fair market value that assumes, among other things, that the parties have full access to information about Stelco and its future prospects. It states that, in the view of its author, "it is doubtful that public market investors had sufficient knowledge of the new [Stelco] on which to make the kind of fully informed investment decision contemplated by the definition of fair market value". It also states that "the definition of fair market value contemplates a number of assumptions or valuation principles not applicable to actual market price."

132 In the present proceeding, however, it is irrelevant that the market price of the securities may not reflect full information or that the market price of the securities may have exceeded the fair market value of the securities as determined by Deloitte based on an estimation of the enterprise value of Stelco. The issue for the Court is the determination of the prices that the Senior Debt Holders could have obtained for their securities if it had been possible to trade the securities at the Effective Time on the Plan Implementation Date.

133 Lastly, while the Deloitte Report suggests that the valuation approach of the Noteholders based on the VWAP of the securities for the first trading week incorporates "elements of information, circumstances and future expectations that were not known or foreseeable at the [Plan Implementation Date]", the Report does not specify what these elements were. Nor is there any evidence before the Court of any such matters that should be considered in assessing the reliability of the market data. In addition, it does not reconcile its calculations of the fair market value of the Common Shares with the market prices of the Common Shares immediately after the Plan Implementation Date.

134 On the other hand, I have three concerns with the approach of the Noteholders based on the use of the trading data before the Court.

135 First, the data relates to a period after the Plan Implementation Date and is therefore being used with the benefit of hindsight. More significantly, the Court must be satisfied that there were no events between the Plan Implementation Date and the first day of trading in the securities that invalidates use of this data as evidence of value.

136 Second, the market prices for the securities can only be used if the evidence demonstrates that the market was sufficiently deep to have absorbed all of the securities of the Senior Debt Holders without a reduction in price if they had chosen to sell their securities on the first trading day. If, in fact, Senior Debt Holders would have incurred a significant discount if they had sold rather than retained their securities on that day, the Court cannot use the market prices as evidence of the value of the securities. The materials before the Court indicate that this was not considered by the expert engaged by the Noteholders whose report was provided to the Court. However, I think the onus of demonstrating that the market was not a reliable indication of value rests with the Senior Debt Holders.

137 Third, the evidence with respect to the Warrants and the FRNs is not as complete or persuasive as the evidence with respect to the Common Shares. Only a small number of Warrants, representing a very small percentage of the Warrants issued under the Plan, traded on August 3, 2006. None of the FRNs traded on the TSE until August 5, 2006, when a relatively small proportion of the FRNs traded. In an affidavit included in the materials before the Court, the financial advisor to Sunrise states that a larger number of trades took place in the over-the-counter market. However, no data is before the Court with respect to the prices or volumes of over-the-counter trading in the FRNs commencing April 3, 2006.

Conclusions

138 Although I have reservations regarding the issue of the market data before the Court, I have concluded that it represents better evidence of the value of the Common Shares, the Warrants and the FRNs than the $5.50 subscription

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price for the Common Shares used in respect of transactions in the Plan. I will set out my reasons dealing separately with each of the securities.

139 As mentioned, the principal issues relate to the Common Shares. I conclude that the VWAP for April 3, 2006 should be used to determine the value of the Common Shares for the following reasons.

140 First, and most importantly, it more closely reflects the conceptual approach of the Court to the valuation exercise before it than an approach based on an estimation of the enterprise value of Stelco. In the case of publicly traded securities, a recipient of securities is in a position to realize the value of the securities by selling them in the market. In such circumstances, and the securities should therefore be valued using the market prices as of the date of receipt. If the securities had been freely tradable on and prior to March 31, 2006, the securities would have been valued on such basis. In the absence of a market on that date, the Court must determine the best evidence for the market prices of the securities if such a market had existed. For this purpose, the VWAP for the first trading day of the securities is a more appropriate indication of the price at which the Senior Debt Holders could have sold their Common Shares on March 31, 2006 than the subscription price of $5.50 under the Plan. While the market for the Common Shares did not begin until two days after the Plan Implementation Date, there is no evidence that the market price levels would have been different if trading had commenced at the Effective Time or that the market prices did not reflect the possibility that all Senior Debt Holders could have sold their security positions on the first day of trading.

141 In particular, there were no events between the Effective Time and April 3, 2006 that cast doubt on the validity of the price on April 3, 2006. Nor is there any evidence of market imperfections that were eliminated later in the week that indicate that the trading on April 3, 2006 should be excluded. While there was bound to be uncertainty in the market, particularly at the opening of trading of a new security, I do not think that is relevant where the question of value reduces to the issue of the price that the Senior Debt Holders could have received for their Common Shares if they had sold them on April 3, 2006.

142 A more significant issue is the suggestion in the Deloitte Report that a sale of all of the Senior Debt Holders' Common Shares would have attracted a block discount. This opinion of the author of the Report is not, however, supported by any evidence. It assumes that trading in the Stelco shares during the first week was in relatively small blocks. While this may be true, I do not think there is any evidence to this effect. Second, it does not explain why trading on the first day would not have been influenced by the possibility that other Affected Creditors, including the Debentureholders, were free to sell at any time and, apart from Sunrise and Appaloosa, were not naturally long-term holders of the Common Shares.

143 Second, there is no conceptual basis on which it can be argued that the $5.50 subscription price of the Common Shares under the Plan represents reliable evidence as to the value of the Common Shares as of the Effective Time. There is no necessary relationship between the use of the $5.50 price in the Plan, representing the outcome of negotiations between the stakeholders in late 2005, and the market price for the Common Shares as of the Plan Implementation Date. As mentioned, there is also no necessary connection between the enterprise value of Stelco as a whole calculated in late 2005, from which a value of $5.50 can be derived as an arithmetic calculation, and the market price of the Common Shares as of the Plan Implementation Date. The issue is the value of the Common Shares, independently of the enterprise value of Stelco, except to the extent that it is possible to demonstrate a direct relationship based on the operation of the market. There are circumstances in which the market price for the equity of an entity is materially higher or lower than the price indicated by enterprise value calculations. This is clearly one of those situations. In the absence of an explanation of this divergence that casts doubt on the reliability of the market prices for the Common Shares and demonstrates the credibility of the $5.50 subscription price as the market price for the Common Shares of the Senior Debt Holders, I conclude that the VWAP of the Common Shares on April 3, 2006 is a more credible indication of the value received by the Senior Debt Holders.

144 With respect to the Warrants, the reasons for using the trading data for the Common Shares compel use of similar data to determine the price of the Warrants.

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145 The use of a value of $5.50 for the Common Shares results in a modest value for the Warrants using the Black-Scholes model. If, however, a substantially higher value is ascribed to the Common Shares, the Warrants necessarily have a substantially increased value. The only evidence of that increased value is the market trading data. While the volume of trading in the Warrants on April 3, 2006 is limited, the pricing information derived from those trades has reasonable credibility as the prices of the Warrants are closely related to the prices at which the Common Shares are trading at the time.

146 Accordingly, in the absence of evidence that the prices at which the Warrants traded were outside the expected range given the concurrent market prices of the Common Shares, I conclude that the VWAP of the Warrants for April 3, 2006 should be used to determine the value of the Warrants.

147 Valuation of the FRNs under either approach is more problematic. The Senior Debt Holders suggest there is no reason to use a value in excess of par but provide no support for this position. The Noteholders rely instead on market data, which their own advisor states is inadequate because much of the trading was conducted privately in the over-the-counter market and is therefore not available.

148 I am of the opinion that the prices at which the FRNs traded on the first trading day after the Plan Implementation Date should be the determinant of the value of these securities. In the absence of data for April 3 and April 4, 2006, the VWAP for trades on the TSE on April 5, 2006 is the best available evidence of the value of the FRNs on March 31, 2006. However, before making that determination, I think it appropriate to permit the parties to make representations on this issue based on any additional evidence of trading activity that may be available. I will convene a telephone conference with counsel shortly to establish a process for such representations unless the parties are able to agree among themselves on the value to be ascribed to the FRNs based on the principles set out above.

149 Finally, I wish to state that, in reaching the determinations set out above, I am not suggesting that the value ascribed to the Common Shares in the Plan and found to be the fair market value by the board of directors of Stelco is not valid in the context in which it was used by the stakeholders in the Stelco reorganization and by the board of directors. My conclusion is simply that the market price of the securities is the best evidence of the value of the securities for the purposes of determining the value received by the Senior Debt Holders on the Plan Implementation Date and the amount of their deficiency claim for the purposes of the Subordination Provisions on that date.

Is the Indebtedness in Respect of the MITSA Senior Debt?

150 The Supreme Court of Canada has held that there is no comprehensive definition of the term "ordinary course of business" and that the Court must consider the circumstances of each case in order to determine how to characterize any particular transaction: *Pacific Mobile Corp., Re*, [1985] 1 S.C.R. 290 (S.C.C.) at 291. In this proceeding, it is necessary to interpret this term in the context of the definition of "Senior Debt" in the Note Indenture, which includes indebtedness incurred in connection with the acquisition by Stelco of any "business, property, services or other assets *excluding indebtedness incurred in relation to any such acquisitions made in the ordinary course of business*" (italics added).

151 2074600 argues that the indebtedness incurred by Stelco pursuant to the deferred payment arrangements under the MITSA is Senior Debt because it was not incurred in connection with the acquisition of property and services made in the ordinary course of business. 2074600 points to a number of factors specific to Stelco that it submits demonstrate that the transaction was unusual for Stelco and therefore out of the ordinary course of business for it. These include the following: (1) the transaction was, in its view and in the view of Stelco representatives, complex, far-reaching in terms of its impact on Stelco's operations, and significant in terms of its day-to-day operations; (2) the Stelco board of directors approved the transaction; (3) the transaction was the subject of a Stelco press release; and (4) it was an isolated transaction arising out of special and particular circumstances related to the need to address replacement of Stelco's legacy systems to meet modern needs and a knowledge drain as employees knowledgeable in these legacy systems retired. 2074600 also argues that the transaction contemplated by the MITSA could not be characterized as being in the ordinary

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course of business within Stelco's industry as there were no similar agreements entered into by any of the other major Canadian steel producers. Similarly, it argued that the MITSA was not a typical outsourcing arrangement for EDS and was therefore out of the ordinary course of business for EDS.

152 The transaction envisaged by the MITSA was a unique outsourcing transaction. It is not disputed that the transaction contemplated by the MITSA was both comprehensive in terms of the scope of Stelco's IT requirements and was also significant to Stelco, because a failure by EDS to perform adequately would be costly. The issue for the Court, however, is whether the acquisition transaction contemplated by the MITSA was out of the ordinary course of business for Stelco.

153 The cases cited by 2074600 regarding the meaning of "ordinary course of business" deal with dispositions of assets, rather than acquisitions, in circumstances in which the applicable covenant or legislation is directed toward fair treatment of, or protection of, creditors: see for example *Pacific Mobile*, which deals with an alleged fraudulent preference; *Roynat Inc. v. Ron Clark Motors Ltd.* (1991), 1 P.P.S.A.C. (2d) 191 (Ont. Gen. Div.), which deals with a covenant in a floating charge; and *Rowbotham v. Nave* (1991), 1 P.P.S.A.C. (2d) 206 (Ont. Gen. Div.), which deals with bulk sales legislation. I do not find them to be helpful in the present circumstances. They do not deal with the concept of non-ordinary course transactions involving the purchase of assets or services by a solvent company. It is therefore necessary to start with a consideration of the purpose or intention of the definition of Senior Debt.

154 That definition has three parts — indebtedness for borrowed money; indebtedness incurred in connection with the acquisition of any business, property, services or other assets other than indebtedness incurred in relation to any such acquisitions made in the ordinary course of business; and renewals or refinancings of qualifying Senior Debt.

155 The first part of the definition contemplates new indebtedness, because refinancing of existing indebtedness is treated separately. The indebtedness permitted by this clause could be incurred to finance day-to-day operations, or more broadly ordinary course transactions, as well as acquisitions out of the ordinary course. There is no restriction on the source of such financing, which could include banking facilities as well as debt instruments placed in public or private financings. There is also no limit on the aggregate amount of any such indebtedness. As a result, this clause provides sufficient flexibility to Stelco to finance all of its activities, including all acquisitions, using Senior Debt.

156 The second part of the definition, which is operative in this proceeding, requires a consideration of whether the *indebtedness* in question was incurred in relation to an *acquisition* that was made in the ordinary course of business. The issue is therefore whether the acquisition transaction giving rise to the indebtedness was made in the ordinary course of business. It is not immediately obvious why this limitation was imposed on acquisition-related indebtedness when any direct borrowings for acquisition purposes are unrestricted. The type of indebtedness contemplated is clear however. The clause addresses indebtedness that is incurred on an acquisition, such as vendor take-back financing, or that is assumed or guaranteed in order to complete the transaction, in each case rather than raised separately to fund a particular acquisition. However, the intended breadth of this part of the definition depends on the scope of the concept of an acquisition made in the ordinary course of business of Stelco as an on-going business enterprise.

157 I am of the opinion that, for this purpose, the concept of an ordinary course acquisition should be interpreted broadly and, accordingly, a non-ordinary course acquisition should be given a narrow scope. The concept of an acquisition in the ordinary course of business goes beyond transactions with trade creditors. The reference to "*business, property*, services *or other assets*" (emphasis added) suggests that the principal focus of the clause is the acquisition of businesses or assets. The reference to the acquisition of services, while included in the list, is secondary and suggests that it was included to reflect the possibility that an acquisition could include a service component, rather than the possibility of a 'services only' transaction. This reading of the definition of an ordinary course transaction suggests that the intention was to narrow transactions that qualified as non-ordinary course transactions to those that are material to Stelco in terms of both the amount of the indebtedness incurred or assumed and in terms of their impact on Stelco' business and operations. Accordingly, I think the clause implicitly requires demonstration that the acquisition will have the effect of significantly changing the nature of the business conducted, being the goods and services produced and sold, the scale of

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operations, the manner of manufacturing or distributing the products sold by Stelco, or the anticipated financial results of Stelco.

158 While I do not think that the clause contemplates transactions in which services are the principal subject matter, I accept, however, that such acquisitions could qualify as Senior Debt if it can be demonstrated that the transaction will have an effect on Stelco that is described by the test set out above. In particular, if a service contract, for which the most obvious candidate would be an outsourcing contract such as the MITSA, materially changes the manner in which Stelco manufactures or distributes its products, or its financial prospects, the contract can be said to envisage a transaction that is analogous to a non-ordinary course acquisition of a business, property or assets.

159 I have concluded, however, that the transaction contemplated by the MITSA does not satisfy this test for the following three reasons.

160 First, considering all of the elements of the transaction contemplated by the MITSA collectively, the transaction contemplated by the agreement will not significantly change the nature of Stelco's business or the scale of its operations. Nor will it change either the products manufactured and sold by Stelco over this period or Stelco's manufacturing or distribution activities.

161 The principal result of the transaction contemplated by the MITSA is an increase in operating efficiencies in the conduct of Stelco's business. This is evidenced, for example, in the Stelco press release announcing the transaction, dated February 25, 2002. The press release focussed on the ERPs stating that implementation of the ERPs will "generate significant production and operational efficiencies for Stelco". This reflects the reality that, as an outsourcing contract, the day-to-day IT functions will be carried on largely as might have been anticipated if the contract had not been entered into with EDS.

162 Second, I think that it is necessary to separate the components of the MITSA into ordinary course elements and non-ordinary elements. EDS assumed two very separate functions under the MITSA. When these components of the MITSA are analysed separately in terms of the test, the characterization of the MITSA as a non-ordinary course transaction is much weaker.

163 The initial and principal agreement of the parties under the MITSA involved the transfer the IT division of Stelco, including its assets and employees, to EDS, and its commitment to carry on the business in the same manner as before, subject to performance standards. By itself, this does not meet the standard set out above for a non-ordinary course transaction.

164 Over the longer term, the transaction contemplates the development and implementation of new IT systems in three projects — the ERPs. However, while beyond Stelco's in-house capabilities and more extensive than any other projects undertaken by the other major Canadian steel producers, the ERPs do not significantly change any of the nature of Stelco's business, the scale of its business activities, or the nature of its manufacturing or distribution activities.

165 Based on the information before the Court, the SMS comes closest to satisfying this test. The other two ERPs deal with service functions. There is, however, insufficient evidence before the Court to demonstrate that the SMS, even if implemented, would so materially change the manner of Stelco's manufacturing and distribution activities that the contract for the SMS, by itself, could constitute an acquisition of services out of the ordinary course of business.

166 Finally, while the total fees anticipated over the ten-year term of the MITSA are undoubtedly significant, there is no evidence that the transaction contemplated by the MITSA was material to the projected annual financial performance of Stelco. While a press release was issued, it does not appear that the transaction was treated as constituting a material change under applicable securities legislation. The annual expenditures involved under the MITSA were not materially greater than under other outsourcing arrangements to which Stelco is a party. The Stelco press release indicated that Stelco believed that the transaction would be neutral in terms of its impact on costs, with realized cost savings financing the additional costs, particularly of the ERPs.

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167 In addition, the largest portion of the fees under the MITSA related to the operation and maintenance of the existing IT systems of Stelco. Stelco expensed the operational fees for these services as incurred rather than capitalizing them as would be appropriate for a non-ordinary course acquisition. On the other hand, it treated the indebtednesss relating to the project fees for the ERPs as long-term indebtedness under the deferred payment arrangements provided for under the MITSA. However, neither this indebtedess, and in particular the indebtedness relating specifically to the SMS, nor the total of project fees over the life of the MITSA, are sufficiently large to satisfy the test of materiality for a non-ordinary course transaction.

168 Based on the foregoing, I conclude that the EDS Claim does not constitute Senior Debt for purposes of the Subordination Provisions.

Alleged Failure of 2074600 to Mitigate

169 In light of the determination that the EDS Claim is not Senior Debt, it is unnecessary to address the following submission. I have set out my conclusion on this issue in case I have erred in reaching the prior conclusion.

170 The Noteholders allege that 2074600 failed to mitigate its damages. While acknowledging that there was a limit on the number of Common Shares for which TML was prepared to subscribe, or for which TML was allowed to subscribe by the other stakeholders, they argue that TML should have negotiated greater flexibility in its subscription arrangements. Specifically, they argue that TML should have required that 2074600 retain the right to elect Common Shares in lieu of cash from the Cash Pool, reducing the number of shares TML received as an equity sponsor correspondingly. The Noteholders argue that, had it done so, the recovery of 2074600 would have been increased, although the TML recovery as an equity sponsor would have been correspondingly reduced. This imaginative argument fails on at least two counts.

171 First, I doubt that TML was subject to any such duty to mitigate in the negotiations or otherwise. Even if there were such a duty, there cannot have been a breach in the absence of unequivocal evidence in advance of the election date that the Common Shares would have a market value in excess of $5.50. There is no such evidence before the Court. For this purpose, the subsequent trading history is totally irrelevant.

172 Second, the argument envisages a different plan of arrangement from what was agreed by the Stelco stakeholders. As was acknowledged by counsel for the Noteholders, the assumptions underlying this argument imply a plan with a smaller Cash Pool as a result of a reduced equity subscription by TML. There is no evidence that this plan of arrangement could have succeeded.

173 Third, and more technically, while the Noteholders assert that 2074600 failed to mitigate, their claim is actually asserted against TML, as the parent of 2074600.

174 In the absence of both a conceptual basis for this position in the Plan as negotiated and a legal basis for the duty of mitigation in the circumstances, this argument fails.

Conclusions

175 Based on the foregoing, I make the following determinations:

> **1.** the Distributions received by the Debentureholders are to be valued as of March 31, 2006;
>
> **2.** for such purpose, the Common Shares and Warrants shall be valued using the volume weighted average prices at which the Common Shares and Warrants traded on the Toronto Stock Exchange on April 3, 2006;
>
> **3.** in the absence of agreement, the Debentureholders and the Noteholders shall be entitled to make representations regarding the trading of FRNs on the first trading day in respect thereof, including any additional evidence of trading activity that may be available;

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4. after determination of the valuation of the FRNs, pursuant to the Subordination Provisions, the Noteholders shall pay to the Trustees on behalf of the Debentureholders Turnover Proceeds having a value equal to the amount of the aggregate Debentureholder deficiency claim as of March 31, 2006 against Stelco, including post-filing interest, pro rated against each of the four classes of property comprising the Turnover Proceeds in the manner agreed to and described above; and

5. the claims of 2074600 are denied.

Costs

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

Order accordingly.

APPENDIX A

Excerpts from Subordination Provisions of the Note Indenture

6.1 Agreement to Subordinate.

The Corporation covenants and agrees, and each Debentureholder, by his acceptance thereof, likewise agrees, that the payment of the principal of and of any interest on the Debentures is hereby expressly subordinated, to the extent and in the manner hereinafter set forth, in right of payment to the prior payment in full of all Senior Debt whether outstanding on the date of this First Supplemental Indenture or thereafter incurred.

6.2 Distribution on Insolvency or Winding-up.

In the event of any insolvency or bankruptcy proceedings, or any receivership, liquidation, reorganization or other similar proceedings relative to the Corporation, or to its property or assets, or in the event of any proceedings for voluntary liquidation, dissolution or other winding-up of the Corporation:

(1) the holders of all Senior Debt will first be entitled to receive payment in full of the principal thereof, premium (or any other amount payable under such Senior Debt), if any, and interest due thereon, before the Debentureholders will be entitled to receive any payment or distribution of any kind or character, whether in cash, property or securities, which may be payable or deliverable in any such event in respect of any of the Debentures;

(2) any payment by, or distribution of assets of, the Corporation of any kind or character, whether in cash, property or securities (other than securities of the Corporation or any other company provided for by a plan of reorganization or readjustment the payment of which is subordinate, at least to the extent provided in this Article 6 with respect to the Debentures, to the payment of all Senior Debt, provided that (i) the Senior Debt is assumed by the new company, if any, resulting from such reorganization or readjustment and (ii) without prejudice to the rights of such holders with respect to any such plan (including without limitation as to whether or not to approve same and on what conditions to do so), the rights of the holders of Senior Debt are not altered adversely by such reorganization or readjustment) to which the Debentureholders or the Trustee would be entitled, except for the provisions of this Article 6, will be paid or delivered by the Person making such payment or distribution, whether a trustee in bankruptcy, a receiver,

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a receiver-manager, a liquidator or otherwise, directly to the holders of Senior Debt or their representative or representatives or to the trustee or trustees under any indenture under which any instruments evidencing any of such Senior Debt may have been issued, rateably according to the aggregate amounts remaining unpaid on account of the Senior Debt held or represented by each, to the extent necessary to make payment in full of all Senior Debt remaining unpaid after giving effect to any concurrent payment or distribution (or provision therefor) to the holders of such Senior Debt; and

(3) subject to Section 6.6, if, notwithstanding the foregoing, any payment by, or distribution of assets of, the Corporation of any kind or character, whether in cash, property or securities (other than securities of the Corporation as reorganized or readjusted or securities of the Corporation or any other company provided for by a plan of reorganization or readjustment the payment of which is subordinate, at least to the extent provided in this Article 6 with respect to the Debentures, to the payment of all Senior Debt, provided that (i) the Senior Debt is assumed by the new company, if any, resulting from such reorganization or readjustment and (ii) without prejudice to the rights of such holders with respect to any such plan (including without limitation as to whether or not to approve same and on what conditions to do so), the rights of the holders of Senior Debt are not altered adversely by such reorganization or readjustment), is received by the Trustee or the Debentureholders before all Senior Debt is paid in full, such payment or distribution will be held in trust for the benefit of, and will be paid over to the holders of such Senior Debt or their representative or representatives or to the Trustee or trustees under any indenture under which any instruments evidencing any of such Senior Debt may have been issued, rateably as aforesaid, for application to the payment of all Senior Debt remaining unpaid until such Senior Debt has been paid in full, after giving effect to any concurrent payment or distribution (or provision therefor) to the holders of such Senior Debt.

Excerpts from the Plan of Arrangement

5.04 **Implementation**

(1) As soon as practicable after satisfaction (or waiver, if applicable) of each of the conditions to the implementation of the Plan as set out in Section 5.03, Stelco will cause to be posted to the Website a notice confirming that each of the conditions to the implementation of the Plan as set out in Section 5.03 has been satisfied (or waived, if applicable) and thereafter Stelco will file the Articles of Reorganization and seek to obtain the Certificate of Amendment. The Plan will become effective at the Effective Time. All the agreements and other instruments that have to be entered into or executed and all other actions that have to be taken in order for the transactions and agreements to be completed and occur or be effective at the Effective Time will be entered into, executed, taken and completed in escrow prior to the Effective Time. At the Effective Time, the transactions and agreements contemplated by the Plan set out below will be completed and be deemed to occur or be effective in the order set out below:

(a) the Articles of Reorganization will be effective and the New Redeemable Shares and New Common Shares to be issued under Section 2.03(c) will be validly issued;

(b) the New ABL Facility will be effective;

(c) the New Secured Revolving Term Loan Agreement will be effective;

(d) the New Platform Trust Indenture and the Supplemental Indenture will be effective and the New Secured FRNs to be issued in connection with this Plan will be validly issued;

(e) the New Inter-creditor Agreedment will be effective;

(f) the Pension Agreement will be effective;

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(g) the New Warrant Indenture will be effective and the New Province Note, the New Province Warrants and the New Warrants to be issued in connection with this Plan will be validly issued;

(h) the New Common Shares to be issued to the Equity Sponsors under the Plan Sponsor Agreement will be validly issued; and

(i) the New Common Shares to be issued to Electing Affected Creditors, and to the Standby Purchasers under the Plan Sponsor Agreement, will be validly issued.

(2) Upon receipt of the Certificate of Amendment, the Applicants will deliver to the Monitor, and file with the Court, a copy of a certificate stating that each of the conditions set out in Section 5.03 has been satisfied or waived, the Articles of Reorganization have been filed and have become effective as of the date set out in the Certificate of Amendment and the transactions set out in Section 5.04(1) have been completed and occurred.

6.01 **Effect of Plan Generally**

(1) At the Effective Time, the treatment of Affected Claims and the determination of Proven Claims will be final and binding on the Applicants, the Affected Creditors and the trustees under the trust indentures for the Bonds (and their respective heirs, executors, administrators and other legal representatives, successors and assigns), and this Plan will constitute: (a) full, final and absolute settlement of all rights of the Affected Creditors against Stelco; (b) an absolute release and discharge of all indebtedness, liabilities and obligations of or in respect of the Affected Claims against Stelco, including any interest and costs accruing thereon; (c) an absolute assignment to Stelco of all indebtedness, liabilities and obligations of or in respect of the Affected Claims against Subsidiary Applicants, including any interest and costs accruing thereon (whether before or after the Filing Date), and an absolute release and discharge of any rights of Affected Creditors in respect thereof (excluding, for greater certainty, any rights assigned to Stelco); and (d) a reorganization of the capital and change in the number of directors of Stelco in accordance with the provisions of Article 3 and the Articles of Reorganization.

(2) For greater certainty, notwithstanding any of the other provisions herein, nothing in the wording of Section 6.01(1) or any other language in this Plan will bar or prejudice or be deemed to bar or prejudice the ability of any holder of Senior Debt (as defined in the Subordinated 2007 Bond Indenture) or any trustee in respect of the Senior 2006 Bonds or Senior 2009 Bonds to maintain or pursue claims or other remedies, including any third party beneficiary claims or remedies they may have, against holders of Subordinated 2007 Bonds or their trustee under the Subordinated 2007 Bond Indenture (including claims against or to distributions under this Plan that otherwise would be made to the holders of Subordinated 2007 Bonds or their trustee) or bar or prejudice or be deemed to bar or prejudice the ability of any holders of Subordinated 2007 Bonds or their trustee to raise any defences in respect of such claims or other remedies. In that regard, without restricting the right of the holders of Subordinated 2007 Bonds to exercise the Share Option, and subject to any Order confirming the following process or providing for a different process:

(a) all New Secured FRNs, New Common Shares, New Warrants and cash from the Cash Pool (collectively, the "Turnover Proceeds") to be issued to the holders of the Subordinated 2007 Bonds or to their trustee will be delivered to the Monitor, to be held by the Monitor in trust; and

(b) the Monitor will, before or within 30 days after the Plan Implementation Date, bring a motion to the Court on no less than 10 days' notice to each of the Affected Creditors that has filed a Notice of Appearance in the CCAA Proceedings and each of the trustees in respect of the Senior 2006 Bonds, Senior 2007 Bonds and Subordinated 2007 Bonds, seeking directions in respect of a process to determine on a timely basis entitlements to the Turnover Proceeds.

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For greater certainty, and without limiting the generality of the foregoing, all rights of holders of Senior Debt to assert and require that the rights and claims of holders of Subordinated 2007 Bonds and their trustee are subordinated to the prior payment in full of the Senior Debt under the provisions of the Subordinated 2007 Bond Indenture or otherwise or the rights and claims of the holders of Subordinated 2007 Bonds or their trustee to raise any defences in respect of such claims and other remedies are not intended to be diminished, impaired or prejudiced by the wording of this Plan. Specifically, but without limiting the generality of the foregoing, but subject to the operation of applicable law, the fact that the Plan provides that the calculation of the quantum of Claims and Affected Claim [sic]is limited to principal, plus interest accrued to the Filing Date and that the Plan contains releases in favour of Stelco and other Persons, and provides for full satisfaction of Affected Claims against Stelco and other Persons, is not intended to bar or prejudice any entitlement of holders of Senior Debt (as defined in the Subordinated 2007 Bond Indenture) to make a claim for the full benefit of subordination against the holders of the Subordinated 2007 Bonds and their trustee in respect of *all* amounts owing to them or that would have been owing to them had the CCAA Proceedings and the Plan never been implemented, even amounts in excess of their Claims or Affected Claims for purposes of the Plan or the rights and claims of the holders of the Subordinated 2007 Bonds or their trustee to raise defences in respect of such claims and other remedies.

For greater certainty, nothing in this Section 6.01(2) is intended or shall be construed as derogating from any provision in this Plan that provides that all Proven Claims determined in accordance with the Claims Procedure Order are final and binding on Stelco, the Subsidiary Applicants and all Affected Creditors.

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TAB 9

Most Negative Treatment: Distinguished
Most Recent Distinguished: Nortel Networks Corp., Re | 2014 ONSC 5274, 2014 CarswellOnt 11369, 244 A.C.W.S. (3d) 10 | (Ont. S.C.J. [Commercial List], Sep 11, 2014)

2007 ONCA 483
Ontario Court of Appeal

Stelco Inc., Re

2007 CarswellOnt 4108, 2007 ONCA 483, [2007] O.J. No. 2533, 158 A.C.W.S. (3d) 877, 226 O.A.C. 72, 32 B.L.R. (4th) 77, 35 C.B.R. (5th) 174

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO STELCO INC. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A" APPLICATION UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

D. O'Connor A.C.J.O., S.T. Goudge, R.A. Blair JJ.A.

Heard: March 27, 2007; May 2, 2007
Judgment: June 28, 2007 *
Docket: CA C46248, C46258, C46266, C46916

Proceedings: reversing in part *Stelco Inc., Re* (2006), 24 C.B.R. (5th) 59, 2006 CarswellOnt 4857, 20 B.L.R. (4th) 286 (Ont. S.C.J. [Commercial List]); & affirming *Stelco Inc., Re* (2007), 30 C.B.R. (5th) 233, 2007 CarswellOnt 1256 (Ont. S.C.J.)

Counsel: Jeffrey Leon, Robert Staley, Derek Bell for Debenture Holders
Dan Macdonald, Erin Cowling for Sunrise Partners Limited Partnership, Appaloosa Management L.P., TD Securities, A Division of The Toronto Dominion Bank, Irving Wortsman
Joseph M. Steiner, Nancy Roberts for 2074600 Ontario Inc.
Kyla Mahar for Ernst & Young, in its capacity as Monitor
Sean Dunphy, Ellen Snow for Aurelius Capital Management, LP [representing the Cash-Elect Debentureholders]
Charles F. Scott, M. Paul Michell, Michael J. Sims for Catalyst Capital Group Inc., David Kempner Capital Management LLC [representing the Share-Elect Debentureholders]
Brendan Y.B. Wong for CIBC Mellon Trust Co.

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

Related Abridgment Classifications
Bankruptcy and insolvency

X Priorities of claims
X.7 Unsecured claims
X.7.c Priority with respect to other unsecured creditors

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.3 Arrangements

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XIX.3.e Miscellaneous

Headnote

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

Steel company entered protection under Companies' Creditors Arrangement Act, and plan was approved — Steel company had entered into contract for provision of computer management services, debt for which was held by numbered company — Creditors besides numbered company included noteholders and senior debenture holders — Subordination agreement stated that noteholder debt was subordinate to debt held by senior debt holders — Numbered company claimed that debt it held was also senior debt as contemplated by agreement — Motion by debenture holders and numbered corporation for entitlement to funds remaining after initial distribution of assets resulted in dismissal of debenture holders' claim and dismissal of claim by numbered company — Trial judge found debt of noteholders subordinate to debt of senior debt holders including debenture holders, but not debt held by numbered company — Trial judge found court had authority to determine issue of subordinate debt, regardless of any alleged deficiency in proof of ownership of debentures — Trial judge found proposal did not invalidate subordination agreement — Noteholders and numbered company appealed, certain debenture holders appealed regarding valuation of shares — Appeal by noteholders was dismissed, appeal by numbered company allowed, appeal by debenture holders dismissed — Proposal did not cancel terms of subordination agreement — Senior debtholders did not intend to forego rights of subordination when agreeing to plan — Senior debtholders were entitled to rely on trust principles to enforce turnover provisions — Monitor held funds in trust, and fact that funds were given to monitor not noteholders was irrelevant — Numbered company was senior debtholder and noteholders' debt was subordinate — In calculating deficiency, trial judge erred in attempting to ascertain proper value senior debtholders could have received had they been able to trade securities at effective date, instead of addressing manner in which payments made concurrent with noteholders were to be valued — Value of concurrent payments calculated using value under plan, not market value — Provisions of plan, negotiations which led to plan, and price actually paid per share on effective date favoured value of shares under plan — Using value of payments as set out in plan led to commercial certainty in reorganization — Amount of deficiency in amount paid to debenture holders calculated using dollar value of $5.50 per share — Appeal by debenture holders was moot.

Bankruptcy and insolvency --- Priorities of claims — Unsecured claims — Priority with respect to other unsecured creditors

Steel company entered protection under Companies' Creditors Arrangement Act, and plan was approved — Steel company had entered into contract for computer management services, debt for which was held by numbered company — Other creditors included noteholders and senior debenture holders — Subordination agreement stated that noteholder debt subordinate to senior debt holders — Numbered company claimed its debt also senior debt — Motion by debenture holders and numbered corporation for entitlement to funds remaining after initial distribution of assets resulted in dismissal of debenture holders' claim and dismissal of claim by numbered company — Trial judge found debt of noteholders subordinate to debt of senior debt holders, but not debt held by numbered company — Trial judge found interest on debt continued to accumulate — Trial judge found senior debenture holders were entitled to rely on third party beneficiary rule — Trial judge found no need to try deficiencies individually — Trial judge found valuation of share interests in funds determined at prices during first week of trading — Trial judge found valuation would be close to market value — Trial judge found debt owed to numbered company was not senior debt — Noteholders and numbered company appealed, certain debenture holders appealed regarding valuation of shares — Appeal by noteholders was dismissed, appeal by numbered company allowed, appeal by debenture holders dismissed — Proposal did not cancel terms of subordination agreement — Senior debtholders did not intend to forego rights of subordination — Monitor held funds on trust basis — Trial judge entitled to evaluate deficiency on group, not individual basis — Senior debtholders entitled to post-filing interest on claim — "Interest stops" rule is not applicable in proceedings under CCAA — Numbered company was senior debtholder — Contract was not made in course of business — Agreement was single transaction and was subject of public

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announcement — Trial judge made palpable and overriding error in determining nature of contract, and in defining ordinary course of business — Non-ordinary transactions should not be viewed narrowly in determining ordinary course of business — Plan was put in place to give priority to financiers rather than creditors — Purchase required approval of board of directors and was one time only transaction — Trial judge erred by attempting to ascertain proper value senior debtholders could have received had they been able to trade securities at effective date, instead of addressing manner in which payments made concurrent with noteholders' were to be valued in calculation of deficiency — Value of concurrent payments calculated using value under plan, not market value — Using value of payments as set out in plan led to commercial certainty in reorganization — Amount of deficiency in amount paid to debenture holders calculated using dollar value of $5.50 per share — Appeal by debenture holders was moot.

A steel company entered protection under the Companies' Creditors Arrangement Act. A proposed plan was approved. The steel company had entered into a contract for computer management services, the debt for which was held by a numbered company. Other creditors included noteholders and debenture holders. A subordination agreement stated that noteholder debt was subservient to the debt of the senior debt holders. The numbered company claimed its debt was senior debt as understood in the subordination agreement.

The motion by the senior debenture holders and numbered company for certain available funds after the initial distribution resulted in dismissal of the numbered company's claim and and granting of the claim by the senior debenture holders. The trial judge found that the debt of the noteholders was subordinate to the debt of the senior debt holders, but not the debt held by the numbered company. The trial judge found the court had the authority to try the issue of subordinate debt, regardless of any alleged shortcomings in proof of ownership of the debentures. The trial judge found the proposal did not invalidate the subordination agreement.

The trial judge found interest on the debt continued to accumulate, and that the "interest stops" rule is not applicable to proceedings under the Act. The wording of the debt agreement did not did not limit the debenture holders' interest.

The trial judge found the debenture holders were entitled to take advantage of the third party beneficiary rule to enforce the debt agreement. The trial judge found the funds owed to the numbered company were not senior debt. The numbered company was not entitled to recover at the expense of the noteholders.

The trial judge found no need to try deficiencies in the debenture holders claim individually. The aggregate deficiency claim of debenture holders was determined by a comparison of the aggregate value of claims on the plan's implementation date and the aggregate value of distributions received.

The trial judge found the valuation of share interest in the distributed funds should be determined by their value in the first week of trading, rather than their value as set out in the proposal. Securities are generally valued at their date of entitlement.

The noteholders and the numbered company appealed. Certain debenture holders appealed regarding valuation of the shares.

Held: The appeal by the numbered company was allowed and the appeal by the noteholders was dismissed. The appeal by the debenture holders was dismissed.

The trial judge properly found that the proposal did not cancel the subordination agreement. The debenture holders were senior debtholders and were entitled to rely on trust principles to enforce their entitlement to the funds. The funds at issue were held in trust, even though they had been given to the monitor rather than the noteholders. The senior debtholders did not intend to give up their subordination rights when agreeing to the plan.

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The senior debtholders were entitled to interest on their claim. The "interest stops" rule is not applicable to proceedings under the Act.

The numbered company was a senior debtholder entitled to priority over the noteholders. The trial judge erred in determining that the contract with the numbered company was made in the ordinary course of business. The contract was a large, single transaction which merited a public announcement and required approval from the board of directors. What constitutes an out of ordinary transaction should not be construed narrowly. The intent of the plan was to favour investors rather than creditors in ordinary course of business.

The trial judge erred in attempting to ascertain the proper value that shareholders could have obtained had the shares been traded on the effective date, instead of addressing the manner in which concurrent payments under the plan were valued when determining remaining deficiency after initial distribution. The deficiency in debt remaining to the senior debtholders should be determined by valuing the shares at the amount set out in the proposal. The terms of the plan, the negotiations which led to the plan, and the price paid per share on the effective date favoured valuing the shares as set out under the plan. This valuation method led to commercial certainty in the agreement. The share value in calculating the deficiency was $5.50 per share.

The appeal by the debenture holders was moot.

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

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Generally — referred to

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

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s. 12(1) "claim" — considered

APPEAL by corporation and creditors from judgment reported at *Stelco Inc., Re* (2006), 24 C.B.R. (5th) 59, 2006 CarswellOnt 4857, 20 B.L.R. (4th) 286 (Ont. S.C.J. [Commercial List]) and *Stelco Inc., Re* (2007), 30 C.B.R. (5th) 233, 2007 CarswellOnt 1256, 32 B.L.R. (4th) 53 (Ont. S.C.J.), regarding distribution of certain assets.

***The Court*:**

I. Overview

1 These reasons concern four appeals arising from proceedings involving Stelco Inc. under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*").

2 In January 2004, Stelco filed for protection under the *CCAA*. At the time, it owed almost $550 million to various creditors. (With post-filing interest, the amount increases to approximately $640 million.) In January 2006, after two years of efforts to raise capital, sell assets, and negotiate a compromise, a plan of arrangement and reorganization was sanctioned by Farley J. as fair and reasonable, thereby putting in motion the process by which Stelco would emerge from restructuring with its debt reorganized. In simple terms, the creditors agreed to release and discharge all claims against Stelco in exchange for a distribution of cash and new securities. These appeals concern how those assets are to be distributed amongst classes of the creditors, and include disputes over the ranking of priorities, the characterization of debt, and the value to be attributed to the new securities.

3 In these reasons, we summarize the facts most relevant to the appeals. The motion judge reviewed the facts in greater detail in his reasons for judgment released on August 9, 2006, and on March 6, 2007, which are reported at (2006), 20 B.L.R. (4th) 286 (Ont. S.C.J. [Commercial List]) and [2007] O.J. No. 808 (Ont. S.C.J.), respectively.

II. The Noteholders' Appeal (C46248)

(a) Facts

4 When Stelco filed for protection under the *CCAA* on January 29, 2004 (the "Filing Date"), it had two principal debt obligations:

(1) Debentures: There were two classes of senior debentures: 10.4% Debentures issued in 1989 in the principal amount of $125,000,000 and 8% Debentures issues in 1999 in the principal amount of $150,000,000.

(2) Notes: There was one class of unsecured subordinated debentures issued in 2002 in the principal amount of $90,000,000 and bearing an interest rate of 9.5% per annum.

In these reasons the parties representing the holders of the Debentures will be referred to as the "Debentureholders" and the parties representing the holders of the Notes will be referred to as the "Noteholders".

5 In the Note Indenture, the Noteholders agreed to subordinate their entitlement to repayment in full of the "Senior Debt" (the "Turnover Provisions"). It is agreed that the Debentures constitute Senior Debt as defined in the Note Indenture.

6 Article 6.2 of the Note Indenture specifically addresses the operation of the Turnover Provisions in the event of insolvency proceedings. Article 6.2(2) requires any payment or distribution of assets to the Noteholders in such circumstances be paid to the holders of Senior Debt to the extent necessary to result in payment in full of the principal and interest owing to them after giving effect to any concurrent payment or distribution to the holders of Senior Debt. Article 6.2(3) provides that if any payment or distribution is paid to the Noteholders it shall be held in trust for the Senior Debt Holders until the principal of and interest on the Senior Debt shall be paid in full.

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7 On January 20, 2006, Farley J. approved a plan of arrangement or compromise (the "Plan") to reorganize Stelco's debt obligations. The Plan became effective on March 31, 2006 (the "Effective Date") at 11:59 p.m. (the "Effective Time").

8 In accordance with the Plan, the Debentureholders filed proofs of claim totalling $342,655,664. On the Effective Date, they received an initial *pro rata* share of the Plan distribution in the form of cash, New Common Shares, New Warrants, and New Floating Rate Notes (the "New FRNs") (collectively, the "Distributed Assets"). The Distributed Assets were comprised of $52,243,533 in cash, US$121,486,000 in New FRNs, 4,004,829 New Common Shares, and 733,311 New Warrants. Pursuant to the terms of the Plan, the New Common Shares were issued at a price of $5.50 per share. Based on that price per share, the New Warrants would be worth $1.44 per warrant using the Black-Scholes Model.

9 The Plan also provided for a distribution of $20,075.359 in cash, US$40,522,000 in New FRNS, 849,325 New Common Shares and 244,528 New Warrants to the Noteholders (the "Turnover Proceeds"). The Plan required that the Turnover Proceeds be held in trust by the Monitor pending the determination of entitlement to the Turnover Proceeds pursuant to the Turnover Provisions.

10 The difference between what the Debentureholders claim to have received from the Distributed Assets and the resulting balance remaining from their claims, if any (the "Deficiency"), is payable to them out of the Turnover Proceeds.

11 On March 7, 2006, Farley J. issued an order as to how the litigation over the Turnover Proceeds was to be conducted. Pursuant to that order, the Debentureholders filed a claim stating that they were entitled to the Turnover Proceeds. 2074600 filed a claim stating that the debt owed to it was Senior Debt and had priority over the amount owing to the Noteholders. (This claim is the subject of a separate appeal and is discussed below.) The Noteholders responded with a counterclaim denying the existence of any Deficiency and insisting that they were entitled to the entire Turnover Proceeds. The hearing took place before the motion judge on July 17 through 21, 2006.

12 In a ruling released on August 9, 2006, and formally entered on October 31, 2006, the motion judge made the following findings that are relevant to the Noteholders' appeal: [1]

(1) The Senior Debt Holders are entitled to enforce the Turnover Provisions as third-party beneficiaries of the provision. They are also entitled to enforce the Provisions as the beneficiaries of the trust in which the Turnover Proceeds are currently held;

(2) The implementation of the Plan did not cancel the Turnover Provisions in the Note Indenture;

(3) It was not necessary for Senior Debt Holders to prove individually the actual amount of their deficiencies after receiving the Distributed Assets under the Plan; and

(4) The Senior Debt Holders were entitled to be paid post-CCAA-filing interest on their outstanding amounts.

13 The Noteholders appeal each of these findings.

(b) Enforcement of the Turnover Provisions

14 The Noteholders appeal the finding of the motion judge that the Debentureholders as holders of Senior Debt [2] are entitled to enforce the Turnover Provisions contained in the Note Indenture despite the fact that they are not parties to that Indenture.

15 The motion judge found that the Senior Debt Holders are entitled to do so both as third party beneficiaries and as the beneficiaries of the trust established in their favour by the Indenture.

16 For the reasons that follow, we agree with the motion judge that while they are not parties to the Note Indenture between Stelco and the Noteholders, the Senior Debt Holders can rely on trust principles to provide an exception to the

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privity of contract doctrine, entitling them to enforce the Turnover Provisions in the Note Indenture that constitutes the Noteholders trustees of the Turnover Proceeds for the Senior Debt Holders once the Noteholders receive those Proceeds. It is therefore unnecessary for us to decide whether the trial judge erred in allowing the Senior Debt Holders to enforce the Indenture as third party beneficiaries by extending to this case the principled exception to privity of contract found in *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108 (S.C.C.).

17 Needless to say, our approach to this issue is premised on our conclusion, explained below, that the Turnover Provisions of the Note Indenture survive the implementation of the Plan and are not extinguished by it.

18 It is helpful to begin by reproducing the Turnover Provisions in the Note Indenture, noting that they refer to the Indenture as the "Debenture" and the Noteholders as the "Debenture Holders". These are Article 6.1 and Article 6.2(1), (2) and (3), of which the last is the most important for the trust issue. They read as follows:

> **Article 6 — Subordination of Debentures**
>
> ***6.1 Agreement to Subordinate.***
>
> The Corporation covenants and agrees, and each Debentureholder, by his acceptance thereof, likewise agrees, that the payment of the principal of and of any interest on the Debentures is hereby expressly subordinated, to the extent and in the manner hereinafter set forth, in right of payment to the prior payment in full of all Senior Debt whether outstanding on the date of this First Supplemental Indenture or thereafter incurred.
>
> ***6.2 Distribution on Insolvency or Winding-up.***
>
> In the event of any insolvency or bankruptcy proceedings, or any receivership, liquidation, reorganization or other similar proceedings relative to the Corporation, or to its property or assets, or in the event of any proceedings for voluntary liquidation, dissolution or other winding-up of the Corporation:
>
>> (1) *the holders of all Senior Debt will first be entitled to receive payment in full of the principal* thereof, premium (or any other amount payable under such Senior Debt), if any, *and interest due thereon, before the Debentureholders will be entitled to receive any payment* or distribution of any kind or character, whether in cash, property or securities, which may be payable or deliverable in any such event in respect of any of the Debentures;
>>
>> (2) *any payment by, or distribution of assets of the Corporation* of any kind or character, whether in cash, property or securities (other than securities of the Corporation or any other company provided for by a plan of reorganization or readjustment the payment of which is subordinate, at least to the extent provided in this Article 6 with respect to the Debentures, to the payment of all Senior Debt, provided that (i) the Senior Debt is assumed by the new company, if any, resulting from such reorganization or readjustment, and (ii) without prejudice to the rights of such holders with respect to any such plan (including without limitation as to whether or not to approve same and on what conditions to do so), the rights of the holders of Senior Debt are not altered adversely by such reorganization or readjustment) *to which the Debentureholders or the Trustee would be entitled, except for the provisions of this Article 6, will be paid or delivered by the Person making such payment or distribution*, whether a trustee in bankruptcy, a receiver, a receiver-manager, a liquidator or otherwise, *directly to the holders of Senior Debt* or their representative or representatives or to the trustee or trustees under any indenture under which any instruments evidencing any of such Senior Debt may have been issued, rateably according to the aggregate amounts remaining unpaid on account of the Senior Debt held or represented by each, *to the extent necessary to make payment in full of all Senior Debt remaining unpaid* after giving effect to any concurrent payment or distribution (or provision therefore) to the holders of such Senior Debt; and
>>
>> (3) subject to Section 6.6, *if, notwithstanding the foregoing, any payment by*, or distribution of assets of, *the Corporation* of any kind or character whether in cash, property or securities (other than securities of the Corporation as reorganized or readjusted or securities of the Corporation or any other company provided

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> for by a plan of reorganization or readjustment the payment of which is subordinate, at least to the extent provided in this Article 6 with respect to the Debentures, to the payment of all Senior Debt, provided that (i) the Senior Debt is assumed by the new company, if any, resulting from such reorganization or readjustment and (ii) without prejudice to the rights of such holders with respect to any such plan (including without limitation as to whether or not to approve same and on what conditions to do so), the rights of the holders of Senior Debt are not altered adversely by such reorganization or readjustment), *is received by the Trustee or the Debentureholders before all Senior Debt is paid in full, such payment or distribution will be held in trust for the benefit of, and will be paid over the holders of such Senior Debt or their representative* or representatives or to the Trustee or trustees under any indenture under which any instruments evidencing any of such Senior Debt may have been issued, rateably as aforesaid, for application to the payment of all Senior Debt remaining unpaid *until such Senior Debt has been paid in full*, after giving effect to any concurrent payment or distribution (or provision therefore) to the holders of such Senior Debt.
>
> [Emphasis added.]

19 It is also helpful to review a number of the provisions of the Plan approved by the court on January 20, 2006, effective March 31, 2006.

20 Article 2.03 provides that once the Plan is effective, each Affected Creditor (including both the Senior Debt Holders and the Noteholders) will receive in full satisfaction of its claim against Stelco its *pro rata* share of the pool of assets provided by Stelco, consisting of cash, New FRNs, New Common Shares and New Warrants.

21 As noted above, Article 6.01(2) provides that the Turnover Proceeds will be delivered to the Monitor, who will hold the proceeds in trust pending the outcome of this litigation over the Proceeds. The Monitor was to seek directions of the court about the process to be used to determine that entitlement, so that this trust can be fully implemented.

22 The Senior Debt Holders claim that they are entitled to rely on the Turnover Provisions in Article 6.2(3) of the Note Indenture because of the trust exception to the privity of contract doctrine and that they are ultimately entitled to the Turnover Proceeds.

23 In response, the Noteholders assert that the Senior Debt Holders have no right to enforce those Provisions, and that therefore the Monitor holds the Turnover Proceeds in trust for the Noteholders and not for the Senior Debt Holders.

24 At first instance the Noteholders did not contest the trust exception to the privity of contract doctrine. Nor do they do so in this court. They accept the well-known proposition that parties to a contract can constitute one party a trustee for a third party of a right under the contract and thereby confer on the third party a right enforceable by it in equity. See *Greenwood Shopping Plaza Ltd. v. Neil J. Buchanan Ltd. (No. 1)*, [1980] 2 S.C.R. 228 (S.C.C.) at 239.

25 Rather, their principal argument below was that the Senior Debt Holders could not rely on Article 6.2(3) of the Note Indenture because the Turnover Proceeds have been paid to the Monitor under the Plan and have not therefore been "received" by the Noteholders for the purposes of the Article. Thus no trust has arisen and the Senior Debt Holders have no beneficial interest to enforce. The motion judge dismissed this argument as follows:

> This is an argument of form over substance. The Monitor has no interest in the Distributions. For the purpose of this proceeding, payment to the Monitor satisfies the requirement of delivery of the corpus of the trust to the Noteholders. The only other possibility — that the Distributions were paid to the Senior Debt Holders — is, of course, denied by the Noteholders and would render consideration of this issue unnecessary.

26 The Noteholders raise the same argument in this court. We would give the same response, with the following elaboration.

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27 The Plan, approved by court order, creates a trust in which the Monitor holds the Turnover Proceeds in trust pending determination by the court of whether the Senior Debt Holders or the Noteholders are ultimately entitled to them.

28 Subject to any right of subordination available to the Senior Debt Holders, the Noteholders are ultimately entitled to the Turnover Proceeds, pursuant to the terms of the Plan. In other words, the Noteholders hold the beneficial interest in the Turnover Proceeds but that interest is not unfettered. It is subject to the rights of the Senior Debt Holders if the court should so order. As a consequence, the Noteholders cannot be said to have the entire equitable interest in the Turnover Proceeds. The Senior Debt Holders' interest gives them the right to engage the assistance of the court to effect the full implementation of the trust created by the Plan.

29 In relying on Article 6.2(3) of the Note Indenture to accomplish this full implementation, the Senior Debt Holders effectively ask the court:

> (a) to order that the Turnover Proceeds be paid to the Noteholders who, on receipt, are obliged by Article 6.2(3) to hold the proceeds in trust for the Senior Debt Holders and to pay those proceeds over to them until they are paid in full, and
>
> (b) to enforce their right as beneficiaries of the arrangement set up by Article 6.2(3) to this payment.

30 We agree that the court below was correct to so order. The payment to the Noteholders is ordered simply as a step in the full implementation of the arrangement, and once these steps are taken, the Noteholders are to be held to the terms of the trust that results. The Senior Debt Holders are entitled to have the court ensure that the proper beneficial interests in both trusts are respected.

31 On appeal, the Noteholders raise two additional arguments.

32 First, they rely on *Greenwood Shopping Plaza*, *supra*, to argue that unless the Senior Debt Holders can establish that Stelco was contracting as trustee for them in entering into the Note Indenture, they cannot rely on the trust exception to privity of contract so as to enforce Article 6.2(3).

33 We do not agree. As we read *Greenwood Shopping Plaza*, the fundamental question is whether Article 6.2(3) can be shown to create a trust in favour of the Senior Debt Holders once property flows. While evidence that Stelco contracted with that intention would point to that conclusion, here the language of the Article itself is so explicit that it is more than enough to show the establishment of the trust contended for by the Senior Debt Holders.

34 Second, the Noteholders argue that the Indenture could have been amended without notice to or consent from the Senior Debt Holders and that this is inconsistent with Article 6.2(3) providing for the trust contended for by the Senior Debt Holders.

35 Again, we disagree. Not only has there been no such amendment, but Article 6.8 of the Note Indenture provides that Stelco cannot act to impair any subrogation rights of the Senior Debt Holders. Moreover, *Greenwood Shopping Plaza* makes clear that whether the parties can change the contractual terms creating the trust is but one test (although a common one) to determine whether a trust has been created. As we have said, in this case, the language of Article 6.2(3) is enough to make it crystal clear that that has happened.

36 In summary, on this issue we agree with the motion judge. The Senior Debt Holders are entitled to the benefit of the trust established in their favour pursuant to Article 6.2(3) of the Note Indenture.

(c) Cancellation of the Turnover Provisions

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37 The Noteholders argue that the motion judge erred in failing to conclude that because the Plan cancelled the Note Indenture on implementation, it necessarily cancelled the Turnover Provisions which were included in the Note Indenture. Thus, the Senior Debt Holders are no longer entitled to enforce their subordination rights that are embodied in the Turnover Provisions.

38 Article 4.01 of the Plan provides for the cancellation on implementation of Stelco debentures which include the Note Indenture. The relevant part of that Article reads:

> [A]ll debentures ... subject to Section 6.01(2) will be cancelled and null and void, and all debentures ... will not entitle any holder thereof ... to any compensation or participation other than as expressly provided for in this Plan[.]

39 The motion judge rejected the Noteholders' argument. He held that section 6.01(2) of the Plan was the complete answer. That section provides as follows:

> [N]othing in the wording of Section 6.01(1) or any other language in this Plan will bar or prejudice or be deemed to bar or prejudice the ability of any holder of Senior Debt (as defined in the Subordinated 2007 Bond Indenture) ... to maintain or pursue claims or other remedies, including any third party beneficiary claims or remedies they may have, against holders of the [Notes].

40 The Noteholders argue that s. 6.01(2) does not preserve the substantive rights of Senior Debt Holders contained in the Turnover Provisions. Rather, they say that the section provides only that the Plan would not preclude the Senior Debt Holders from advancing other claims not based on the Note Indenture or the Noteholders from raising defences to such claims.

41 We do not agree that s. 6.01(2) should be read in this manner. We agree with the motion judge that the most reasonable interpretation of s. 6.01(2) is that implementation of the Plan would not affect the substantive rights and obligations of the Senior Debt Holders and the Noteholders in respect of the Turnover Provisions. While the language of s. 6.01(2) does not explicitly refer to the Turnover Provisions, it does preserve "the ability of [Senior Debt Holders] to maintain or pursue claims or remedies, including any third party beneficiary claims or remedies, they may have against the [Noteholders]". The plain meaning of this language would protect all of the then-existing rights of the Senior Debt Holders against the Noteholders which unquestionably include the rights embodied in the Turnover Provisions.

42 Moreover, there is nothing in the language of s. 6.01(2) or elsewhere in the Plan to suggest that the Senior Debt Holders intended to forego their rights of subordination found in the Turnover Provisions. Indeed, there does not appear to be any commercial basis that would have led the Senior Debt Holders to vote in favour of a Plan that had the effect of removing the priority accorded to them by those provisions.

43 We read s. 6.01(2) as providing a method by which the parties could proceed with implementing the Plan without having to await the resolution of possible disputes between the Senior Debt Holders and the Noteholders with respect to the Turnover Provisions. The potential delay in awaiting such a resolution could be lengthy, as the present litigation has shown, and possibly fatal to the implementation of the Plan. From a commercial and practical standpoint, the approach adopted in s. 6.01(2) made a good deal of sense.

44 We note that this approach of delaying the resolution of inter-creditor disputes is not inconsistent with the scheme of the *CCAA*. In a ruling made on November 10, 2005, in the proceedings relating to Stelco reported at (2005), 15 C.B.R. (5th) 297 (Ont. S.C.J. [Commercial List]), Farley J. expressed this point (at para. 7) as follows:

> The *CCAA* is styled as "An Act to facilitate compromises and arrangements between companies and their creditors" and its short title is: *Companies' Creditors Arrangement Act*. Ss. 4, 5 and 6 talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors *vis-à-vis* the creditors themselves and not directly involving the company.

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45 Thus, we agree with the motion judge's interpretation of s. 6.01(2). The result of this interpretation is that the Plan extinguished the provisions of the Note Indenture respecting the rights and obligations as between Stelco and the Noteholders on the Effective Date. However, the Turnover Provisions, which relate only to the rights and obligations between the Senior Debt Holders and the Noteholders, were intended to continue to operate.

(d) Proof of Deficiencies

46 The Noteholders submit that the motion judge erred in failing to require each of the Senior Debt Holders to prove by evidence the amount of its actual Deficiency after receiving the distribution under the Plan.

47 The Note Indenture creates the Senior Debt Holders' subrogated rights against the Noteholders. Article 6.2, which is reproduced above, provides that in the event of insolvency or bankruptcy proceedings, the holders of all Senior Debt are entitled to be paid in full before the Noteholders are entitled to receive any payment or distribution. It further provides that any payment or distribution made to the Noteholders will be paid to or held in trust for the Senior Debt Holders to the extent necessary to make payment of all Senior Debt remaining after giving effect to any concurrent payment or distribution to the Senior Debt Holders. The Noteholders argue, therefore, that the motion judge should have required the Senior Debt Holders to prove the amount outstanding on their debts after receiving and disposing, if that is what occurred, of the Distributed Assets.

48 The thrust of the Noteholders' argument is that some Senior Debt Holders sold their securities in the new Stelco during the days or weeks immediately following the Effective Date at prices well in excess of the subscription price paid for those securities under the Plan. Others who did not sell at the higher prices could have done so. Thus the Noteholders argue the motion judge should have required each Senior Debt Holder to call evidence to prove its individual deficiency. In effect, the Noteholders ask for an accounting by each Senior Debt Holder at some point after receipt of their securities in the new Stelco.

49 The Noteholders argue that failure to call this type of evidence resulted in a failure to prove the individual claims of the Senior Debt Holders and for that reason the deficiency claims based on the subrogation right should have been dismissed.

50 The motion judge rejected this argument and proceeded by calculating the amount of the Deficiency on a collective rather than an individual basis. The amount owing to the Senior Debt Holders before implementation of the Plan was not in dispute. From this amount, the motion judge deducted the total amount of cash paid to the Senior Debt Holders together with the value he placed on the securities received by them as of the Effective Time. Below, we deal with the issue of whether or not the motion judge erred in the way that he valued the Distributed Assets. For present purposes, we need only concern ourselves with the general approach adopted by the motion judge, not the actual amounts resulting from that process.

51 In our view, the motion judge adopted the correct approach in calculating the Senior Debt Holders' Deficiency. It was not necessary for him to assess each claim on a collective, rather than an individual, basis. Both the Note Indenture and the Debenture Indentures contemplate claims being made on a collective basis.

52 The evidence about the amount owing to the Senior Debt Holders collectively was not in dispute, nor was the evidence about the distributions made to the Senior Debt Holders under the Plan. The only question was what value should be attributed to the securities being received by the Senior Debt Holders on implementation. The question was not: What did the Senior Debt Holders do with the securities after implementation or what could they have done?

53 Article 6.2(2) of the Note Indenture is clear that in the event of bankruptcy or insolvency proceedings, the Noteholders are required to make payment in full of the Senior Debt remaining unpaid after giving effect to any concurrent payment or distribution to the Senior Debt Holders. The exercise required under this provision is to look at the payment or distribution to the Senior Debt Holders in order to ascertain what remains unpaid. To complete this

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exercise it was not necessary for the Senior Debt Holders to call evidence to establish what they did with the securities they received after implementation.

54 The Senior Debt Holders assumed the market risks, benefits and burdens, after they received the securities. The Noteholders are not entitled to benefit in market increases realized by the Senior Debt Holders after the implementation of the Plan.

55 Thus, we agree that the motion judge correctly proceeded with the Senior Debt Holders deficiency claim on a collective rather than individual basis. We also agree that he did not err in not requiring the Senior Debt Holders to prove their individual claims by calling evidence about what securities were sold or at what prices securities could have been sold after implementation.

(e) Post-Filing Interest

56 The Noteholders submit that the trial judge erred in concluding that the Senior Debt Holders were entitled to post-CCAA-filing interest on their outstanding amounts. The Noteholders make two arguments.

57 First, the Noteholders say that under the Plan, interest is only payable to creditors up to and including the filing date. They base this argument on the definition of a claim in the Plan which is as follows:

> [A]ny right of any Person against one or more of the Applicants in connection with any indebtedness, liability or obligation of any kind of any one or more of the Applicants in existence on the Filing Date and any interest thereon and costs payable in respect thereof to and include the Filing Date[.]

58 The Noteholders submit that any claim the Senior Debt Holders have for interest must be based on a "claim" they have against Stelco for such interest. If the Senior Debt does not include post-filing interest, there can be no claim against the Noteholders for such amounts.

59 We do not accept the Noteholders' argument. We note that the Debentures were not cancelled until the implementation of the Plan on March 31, 2006. Section 6.01(2) of the Plan specifically contemplates that the Senior Debt Holders will be able to claim interest against the Noteholders up to the point at which they are paid in full. For convenience, we repeat the relevant language of s. 6.01(2) here:

> [T]he fact that the Plan provides that the calculation of the quantum of Claims and Affected Claim[s] is limited to principal, plus interest accrued to the Filing Date .... is not intended to bar or prejudice any entitlement of holders of Senior Debt (as defined in the Subordinated 2007 Bond Indenture) to make a claim for the full benefit for subordination against the holders of the Subordinated 2007 Bonds and their trustee in respect of *all* amounts owing to them or that would have been owing to them had the CCAA Proceedings and the Plan never been implement, even amounts in excess of their Claims or Affected Claims for purposes of the Plan[.] [Emphasis in original.]

60 In our view, a fair reading of the Plan as a whole indicates that the definition of "claim" in the Plan was not intended to limit the Senior Debt Holders' claims for interest on outstanding debt after the filing date. The definition of a claim relied upon by the Noteholders was intended only to form the basis upon which the amounts of claims against the company can be fixed for voting purposes in order to allow the company's affairs to be administered in the *CCAA* proceedings.

61 The question then becomes whether the Debentures provide that interest would accrue after the institution of the *CCAA* proceedings. We are satisfied that they do. The Debentures specify that Stelco would pay principal and interest accrued thereon, including in the case of default, interest on the amount of the default, so long as any Debentures remain outstanding. The Debentures remained outstanding after the filing in the *CCAA* proceedings until the Plan was implemented on March 31, 2006. Clearly, the Debentures contemplated that interest would continue to accrue post-filing.

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62 Moreover, nothing in the Note Indenture limits the Senior Debt Holders' entitlement to interest as of filing under a *CCAA* Plan. Parties to the Note Indenture expressly addressed the possibility of the insolvency of Stelco and established the Turnover Proceeds process. In doing so, the Note Indenture did not limit the Senior Debt Holders to pre-filing interest claims. On the contrary, the Noteholders agreed that they would not receive any payment from Stelco until after all Senior Debt had been paid in full. Senior Debt was defined as "the principal of the premium (if any) and interest ...".

63 Thus, we do not accept the Noteholders' argument that the Plan limited the Senior Debt Holders' claim to pre-filing interest.

64 The Noteholders' second argument is that the Senior Debt Holders are not entitled to post-filing interest because of an "Interest Stops Rule". According to this argument, interest would only be paid up to the filing date in all bankruptcy, winding up and related proceedings, including restructurings under the *CCAA*. The policy reasons for the rule are that one creditor's *pro rata* share of the debtor's filings should not increase faster than another's and also that claims in a *CCAA* proceeding should be fixed and not subject to continual recalculation for interest.

65 The Noteholders point out that the *CCAA* defines a claim as "any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy and Insolvency Act*." Post-filing interest cannot be claimed under the *BIA*.

66 The trial judge rejected these arguments, correctly in our view.

67 To start, there is no persuasive authority that supports an Interest Stops Rule in a *CCAA* proceeding. Indeed, the suggested rule is inconsistent with the comment of Justice Binnie in *NAV Canada c. Wilmington Trust Co.*, [2006] 1 S.C.R. 865 (S.C.C.) at para. 96, where he said:

> While a *CCAA* filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the *Bankruptcy and Insolvency Act*.

68 Justice Binnie's comment highlights the point that not all companies emerge from *CCAA* proceedings. Some are converted into *BIA* proceedings. When that happens, claims under the *BIA* include interest up to the date of the bankruptcy and, therefore, could include claims after a *CCAA* filing.

69 In our view, the definition of claim in the *CCAA* is not intended to limit payments to creditors. Indeed, the Noteholders accept that Plans can and sometimes do provide for payments in excess of claims filed in the *CCAA* proceeding. That fact argues against an interpretation of the definition of a claim in the *CCAA* that would limit payments to the creditors.

70 In our view, the definition of claim in the *CCAA* is intended to set a date in order to crystallize a point in time at which claims against the company can be fixed for voting purposes in order that the estate may be administered. It has nothing to do with the amount of payments to the creditors. As we set out above, s. 6.01(2) of the Stelco Plan contemplated the continuation of accrual of interest to the Senior Debt Holders after the *CCAA* filing date. We do not accept that there is a "Interest Stops Rule" that precludes such a result.

(f) Disposition

71 Accordingly, for the reasons set out above, the Noteholders' appeal is dismissed.

III. The 2074600 Ontario Inc. Appeal (C46258)

72 2074600 Ontario Inc. is the assignee of a claim against Stelco by EDS Canada Inc. ("EDS"). The EDS Claim arises out of a Master Information Technologies Services Agreement entered into between Stelco and EDS in February

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2002 (the "MITSA"). Under that Agreement, Stelco outsourced and transferred to EDS all of its information technology ("IT") services and needs. Stelco's anticipated costs for operational and project fees over the ten-year period contemplated by the MITSA were approximately $320 million. At the time of the CCAA filing Stelco's indebtedness to EDS was fixed at $48,994,917.

73 The issue before us is whether Stelco's indebtedness to EDS places 2074600, as assignee, amongst the class of Senior Debt Holders and therefore entitles 2074600 to its *pro rata* share of the Turnover Proceeds. The answer to this question depends upon whether the EDS indebtedness falls within the definition of "Senior Debt" in the Note Indenture.

74 "Senior Debt" is defined in the Indenture as follows:

> "Senior Debt" means the principal of, the premium (if any) and interest on: (i) indebtedness, other than indebtedness represented by the [Noteholders], for money borrowed by [Stelco] or for money borrowed by others for the payment of which [Stelco] is liable; (ii) indebtedness incurred, assumed or guaranteed by [Stelco] in connection with the acquisition by it or by others of any business, property, services or other assets *excluding indebtedness incurred in relation to any such acquisitions made in the ordinary course of business*; and (iii) renewals, extensions and refundings of any such indebtedness, unless, in any of the cases specified above, it is provided by the terms of the instrument creating or evidencing such indebtedness that such indebtedness is not to be superior in right of payment to the [Noteholders.]
>
> [Emphasis added.]

75 In short — as all counsel agreed the motion judge properly asked himself — the issue is whether the acquisition transaction contemplated by the MITSA was out of the ordinary course of business for Stelco. 2074600 says it was. The Debentureholders and the Noteholders (aligned in interest on this issue) say it was not. The motion judge agreed with the Debentureholders and the Noteholders. He held that the EDS Claim did not constitute "Senior Debt".

76 Respectfully, we disagree.

77 The motion judge began his consideration of the EDS Claim by observing that the Supreme Court of Canada has held that there is no comprehensive definition of the term "ordinary course of business" and that the Court must consider "the circumstances of each case in order to determine how to characterize any particular transaction": see *Pacific Mobile Corp., Re*, [1985] 1 S.C.R. 290 (S.C.C.), at 291. He therefore correctly determined that he must interpret the term in the context of the definition of "Senior Debt" and the circumstances of this case.

78 Having reviewed the three-part definition of "Senior Debt", the motion judge set out the substance of his decision as to the approach to be taken:

> I am of the opinion that, for this purpose, the concept of an ordinary course acquisition should be interpreted broadly and, accordingly, a non-ordinary course acquisition should be given a narrow scope. The concept of an acquisition in the ordinary course of business goes beyond transactions with trade creditors. The reference to "*business, property*, services *or other assets*" (emphasis added) suggests that the principal focus of the clause is the acquisition of businesses or assets. The reference to the acquisition of services, while included in the list, is secondary and suggests that it was included to reflect the possibility that an acquisition could include a service component, rather than the possibility of a 'services only' transaction. This reading of the definition of an ordinary course transaction suggests that the intention was to narrow transactions that qualified as non-ordinary course transactions to those that are material to Stelco in terms of both the amount of the indebtedness incurred or assumed and in terms of their impact on Stelco's business and operations. Accordingly, I think the clause implicitly requires demonstration that the acquisition will have the effect of significantly changing the nature of the business conducted, being the goods and services produced and sold, the scale of operations, the manner of manufacturing or distributing the products sold by Stelco, or the anticipated financial results of Stelco.

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> While I do not think that the clause contemplates transactions in which services are the principal subject matter, I accept, however, that such acquisitions could qualify as Senior Debt if it can be demonstrated that the transaction will have an effect on Stelco that is described by the test set out above. In particular, if a service contract, for which the most obvious candidate would be an outsourcing contract such as the MITSA, materially changes the manner in which Stelco manufactures or distributes its products, or its financial prospects, the contract can be said to envisage a transaction that is analogous to a non-ordinary course acquisition of a business, property or assets.

79 The motion judge then went on to find that the MITSA did not satisfy his test for essentially three reasons. First, he concluded that the transaction contemplated by the MITSA "will not significantly change the nature of Stelco's business or the scale of its operations. Nor will its change either the products manufactured and sold by Stelco over this period or Stelco's manufacturing or distribution activities". Secondly, he found it necessary to separate the components of the MITSA into its "ordinary course elements" and its "non-ordinary elements", and he decided that the former outweighed the latter. Finally, while the total fees anticipated over the ten-year term of the MITSA were "undoubtedly significant", the motion judge found that the annual expenditures involved were not materially greater than those under other outsourcing arrangements Stelco had entered into and that there was "no evidence that the transaction contemplated by the MITSA was material to the projected annual financial performance of Stelco".

80 The Debentureholders and Noteholders stress that this court has emphasized on a number of occasions that Commercial List judges, particularly those supervising a *CCAA* proceeding, are entitled to considerable deference: see *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.) at para. 63; *Stelco Inc., Re* (2006), 21 C.B.R. (5th) 157 (Ont. C.A.), at 160; and *BNY Capital Corp. v. Katotakis*, [2005] O.J. No. 623 (Ont. C.A. [In Chambers]) at para. 8. They also submit that a determination of whether a transaction falls within "the ordinary course of business" of an enterprise is an issue of fact: see *McDonic v. Hetherington (Litigation Guardian of)* (1997), 31 O.R. (3d) 577 (Ont. C.A.), at 583; and *Ontario (Public Trustee) v. Mortimer* (1985), 49 O.R. (2d) 741 (Ont. H.C.), at 750. Accordingly, they argue that we should not interfere with the findings of the motion judge — an experienced Commercial List judge interpreting a commercial contract — as he made no palpable and overriding error and is entitled to deference.

81 Determining whether a transaction occurs in the ordinary course of business entails more than simply the finding of facts and the drawing of inferences from those facts, although the fact finding exercise is clearly a central part of the process. "Ordinary course of business" is a legal notion and the decision as to whether a certain set of facts falls within that category, or does not, has generally been arrived at by courts through an examination of various factors associated with the notion — about which we will have more to say later. In this sense, we prefer the approach taken by the Alberta Court of Appeal in *369413 Alberta Ltd. v. Pocklington* (2000), 271 A.R. 280 (Alta. C.A.), namely that such a determination is a question of mixed fact and law. As Fruman J.A. noted at para. 23:

> While a reviewing court will defer to a trial judge's fact findings, a determination that a transaction was in the ordinary course of a company's business is a mixed question of fact and law. A failure to consider the appropriate factors constitutes reviewable error.

82 We do not read Justice Doherty's comments in *McDonic Estate*, *supra*, to mandate any different conclusion. There, the court was dealing with whether a law firm was vicariously liable for the actions of a partner who had invested funds deposited in the firm's trust account on behalf of the plaintiffs. The answer depended on whether the partner's actions fell within the scope of his implied authority, which they did if they fell within the ordinary course of business of the law firm. The meaning of the legal norm was not in issue. Doherty J.A. observed that the question was a factual one — without focusing on whether it was a question of fact alone or of mixed fact and law — and noted that the trial judge's finding that the partner's activities did not fall within the scope of the firm's ordinary course of business "must stand unless tainted by an error of law, a serious misapprehension of the evidence, or a failure to consider relevant evidence". This conclusion is not inconsistent with the approach taken by the Alberta Court of Appeal in *Gainers.*

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83 The Supreme Court of Canada recognized the importance of "the constant interplay between law and fact" in *Pacific Mobile*, *supra*, at 291, adopting the comments of Monet J.A. in the Quebec Court of Appeal in that case: (1983), 44 C.B.R. (N.S.) 190 (Que. C.A.) at 205. And in *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 (S.C.C.) at paras. 32-36, the Supreme Court of Canada also recognized that, although the findings of a judge of first instance on issues of mixed fact and law will generally be entitled to deference on the "palpable and overriding error" standard, where the judge has erred in applying a "readily extricable" legal principle in making those findings the review will be conducted in accordance with a less stringent standard. A failure to consider appropriate factors or an error in determining the factors to be applied will fall into this latter category.

84 In our view, the motion judge fell into such error here. We say this for a number of reasons.

85 First, his approach to the resolution of the ordinary course of business issue was grounded in his view that the concept of an "ordinary course" acquisition in the definition of Senior Debt in the Note Indenture should be interpreted broadly and that of a "non-ordinary course" acquisition, narrowly. This approach was driven by his view of the terms of the Note Indenture, particularly the definition of "Senior Debt" and his perception that the reference to the acquisition of "services" in the definition was secondary — included "to reflect the possibility that an acquisition could include a service component, rather than the possibility of a 'services only' transaction." We do not understand why, as the motion judge said (reasons, para. 157), "the reference to '*business, property*, services *or other assets*' [emphasis added by the motion judge] suggests that the principal focus of the clause is the acquisition of businesses [the first item mentioned] or assets [the last mentioned]" rather than on "services" (the third item mentioned). We can see no basis for singling out "services" from the list and assigning it a lower level of significance. These are not matters of fact; they are matters of contractual interpretation.

86 Secondly, while the motion judge acknowledged, and found, that the MITSA transaction "was a *unique* outsourcing transaction" and that it "was both *comprehensive* in terms of the scope of Stelco's IT requirements" and also "*significant* to Stelco, because a failure by EDS to perform adequately would be costly" [emphasis added], he gave these important factors little, if any, consideration in making his ordinary course of business determination.

87 Thirdly, in establishing the criteria that he did for resolving the issue, he set the bar so high that a non-ordinary course of business acquisition in relation to services is practically impossible. This stems, at least in part, from his conclusion that an acquisition in relation to "services" does not rank at the same level as other types of acquisitions. On our reading of the Note Indenture, this interpretation is inconsistent with the intention of the parties to it.

88 Finally, the motion judge erred, in our view, by entirely discarding the factors taken into account in the existing jurisprudence concerning what may constitute a transaction out of the ordinary course of business. He did so on the basis that the cases relied upon by 2074600 "dealt with the disposition of assets, rather than acquisitions, in circumstances in which the applicable covenant or legislation is directed toward fair treatment of, or protection of, creditors", and that "[t]hey do not deal with the concept of non-ordinary course transactions involving the purchase of assets or services by a solvent company". The cases referred to are *Pacific Mobile*, *supra* (a fraudulent preference case); *Roynat Inc. v. Ron Clark Motors Ltd.* (1991), 1 P.P.S.A.C. (2d) 191 (Ont. Gen. Div.) (covenant in a floating charge); and *Rowbotham v. Nave* (1991), 1 P.P.S.A.C. (2d) 206 (Ont. Gen. Div.) (bulk sales legislation). But see also, *Fairline Boats Ltd. v. Leger* (1980), 1 P.P.S.A.C. 218 (Ont. H.C.) (whether sale of a boat by a dealer was in the ordinary course of business); *369413 Alberta Ltd. v. Pocklington*, *supra* (sale of shares of a subsidiary company); *Canadian Broadcasting Corp. Pension Plan v. BF Realty Holdings Ltd.* (2002), 214 D.L.R. (4th) 121 (Ont. C.A.) (sale of all or substantially all of assets outside of the ordinary course of business in a dissenting shareholder rights context); and *Aubrett Holdings Ltd. v. R.*, [1998] G.S.T.C. 17 (T.C.C.).

89 Respectfully, we do not understand the significance of the distinction drawn by the motion judge between circumstances involving the disposition of assets and those involving acquisitions for these purposes. When the Supreme Court of Canada observed that it is unwise "to give a comprehensive definition of the term 'ordinary course of business'

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for all transactions" (*Pacific Mobile*, *supra* at 291), the court did not mean that there were no recognizable indicia or factors to be considered; it simply meant that no single criterion or set of criteria was suitable for all cases. While there may be different considerations in situations involving fraudulent preferences, bulk sales transactions, tax cases or dissenting shareholders' rights cases, the factors taken into account by the courts in such circumstances may nonetheless be of assistance here because they help shed light on what courts have looked to in various contexts in order to decide whether a transaction is one that is in the ordinary course of business.

90 In our view, the foregoing errors by the motion judge moderate the deference to which his decision on a question of mixed fact and law would otherwise be entitled and permit us to reconsider the ordinary course of business analysis afresh.

91 In that regard, we start with the observation that the intention of the Note Indenture is clear: the Noteholders' claims are to be subordinated to *all* Senior Debt, as defined in the Indenture. Article 2.9 (Rank and Subordination) provides that "payment of the principal of and interest on the Debentures is expressly subordinated to the prior payment in full of Senior Debt, as provided in Article 6." Article 6 (Subordination of Debentures) opens with the declaration in 6.1 that:

> [Stelco] covenants and agrees, and each [Noteholder], by his acceptance thereof, likewise agrees, that the payment of the principal of and of any interest on the Debentures is hereby *expressly subordinated*, to the extent and in the manner hereinafter set forth, in right of payment *to the prior payment in full of all Senior Debt whether outstanding on the date of this First Supplemental Indenture or thereafter incurred*. [Emphasis added.]

92 The definition of "Senior Debt" is cited above. In substance, it encompasses all borrowings of a general nature and all borrowings for purposes of acquisitions (except acquisitions in the ordinary course of business), together with the refinancing of such borrowings. In our opinion, this concept of Senior Debt is quite broad and is intended to be so.

93 Accordingly, we see no reason why ordinary course acquisitions should be viewed broadly and non-ordinary course acquisitions addressed narrowly. Having regard to the purpose of Article 6.1 of the Note Indenture and the definition of Senior Debt, we think the contrary is the case. The purpose and intent of the Indenture was to ensure that creditors providing financing to Stelco, other than ordinary course of business creditors, would have priority over the Noteholders, who accepted that they were taking subject to such "Senior Debt".

94 It does not advance the case to argue — as the Debentureholders do — that because of the impact on other creditors' rights (namely, those of the Noteholders) the concept of non-ordinary course transactions should be interpreted narrowly and ordinary course transactions broadly. The only issue here is what "creditors' rights" are to be affected? We can see no basis for interpreting the Note Indenture in favour of one group of creditors over another simply because of what group they fall into. A reading of the definition of Senior Debt supports the view that debtholders who were creditors for "moneys borrowed" by Stelco — whether it be free-standing borrowing or indebtedness incurred in connection with the acquisition of business, property, *services* or assets — were to have priority over the Noteholders. The only exceptions were ordinary course of business acquisitions. Given this scheme, it is the exception that ought to be construed narrowly, not the principal provision.

95 The motion judge's opinion that the factors considered by other courts to be pertinent to the determination of what constitutes a transaction in the ordinary course of business, together with his view that non-ordinary course transactions should be narrowly construed in the circumstances of this case, led him to postulate his own test. In doing so, he set the bar very high. To qualify as a transaction out of the ordinary course of business, he concluded that an acquisition must have the effect of *significantly changing* either (a) the nature of the business conducted by Stelco (the goods and services it produced or sold, the scale of its operations, the manner of manufacturing or distributing the products it sold) and/or (b) the financial results of Stelco.

96 The motion judge cited no authority for such a prohibitive test, and we are aware of none. Undoubtedly, an acquisition that met those criteria would be a non-ordinary course of business transaction, but we do not read anything

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in the Note Indenture or in the jurisprudence that requires a transaction that is out of the ordinary course of business to be of such a corporate landscape-changing nature.

97 In *Gainers*, *supra*, Fruman J.A. noted (at para. 21) that:

> The analysis is to be achieved through an objective examination of the usual type of activity in which the business is engaged, followed by a comparison of that general activity to the specific activity in question. *The transaction* "*must fall into place as part of the undistinguished common flow of business carried on, calling for no remark and arising out of no special or peculiar situation*": Aubrett Holdings Ltd. v. Canada [1998] G.S.T.C. 17 (T.C.C.). [Emphasis added.]

98 In *Roynat Inc. v. Ron Clark Motors Ltd.*, *supra*, at 197, Herold J. cited *Bradford Roofing Industries Proprietary Ltd., Re*, [1966] 1 N.S.W.R. 674 (New South Wales S.C.) — a decision of the New South Wales Supreme Court — to the same effect:

> The transaction must be one of the ordinary day to day business activities, having no unusual features, and being such as a manager of a business might reasonably be expected to be permitted to carry out on his own initiative without making prior reference back or subsequent report to his superior authorities such as, for example, to his board of directors.

99 These observations are consistent with dictionary explanations. *The Shorter Oxford English Dictionary*, 3rd ed., defines "ordinary" as being "of common occurrence, frequent, customary, usual" and "of the usual kind, not singular or exceptional". It defines "course" as meaning "habitual or ordinary manner of procedure; way, custom, or practice". *Black's Law Dictionary*, 6th ed., describes "ordinary course of business" in the following fashion:

> The transaction of business according to the common usages and customs of the commercial world generally or of the particular community or (in some cases) of the particular individual whose acts are under consideration. ... *In general, any matter which transpires as a matter of normal and incidental daily customs and practices in business*. [Emphasis added.]

100 Given these parameters, it is hard to appreciate why a transaction that is not in the ordinary course of business should be required to meet such a high threshold as that ascribed to it by the motion judge in the circumstances of this case — particularly keeping in mind the purposes and intent of the Turnover Provisions in the Note Indenture.

101 A number of helpful benchmarks may be gleaned from a review of the authorities and the citations referred to above for purposes of determining whether the MITSA transaction constitutes an acquisition of services in the ordinary course of Stelco's business. They include a consideration of whether the transaction:

a) is distinguishable from the normal course of the company's operations because of its particular complexity or its far-reaching or otherwise unusual nature;

b) arose out of some special or peculiar situation;

c) required approval from the company's shareholders or board of directors;

d) was given special notice by the company;

e) was an unusual or isolated undertaking as opposed to a routine one; or,

f) is reflective of standard practice in the relevant industry.

102 The motion judge was not unmindful of all of these factors. As we have indicated, however, he weighed those that he did consider against what we take to be an unsuitably high standard.

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103 In our view, the transaction envisaged in the MITSA was not a transaction in the ordinary course of Stelco's business. We say that having regard particularly to a number of factors and characteristics.

104 First, as the motion judge found, the MITSA was a uniquely comprehensive and significant transaction for Stelco. The evidence was that no outsourcing transaction in Stelco's history was comparable to it. It contemplated a total amount payable by Stelco over its ten-year term of more than $320 million.

105 The MITSA involved the total transition of Stelco's IT assets and virtually all business applications and IT employees from Stelco to EDS and the complete transfer from Stelco to EDS of all responsibility for Stelco's IT needs. As well as providing for the transfer of IT assets from Stelco to EDS and from EDS to Stelco, and for the provision of all services in relation to Stelco's IT needs, the MITSA provided for the integration, through a series of enterprise resource planning systems ("ERPs"), of all aspects of Stelco's business from procurement or materials to shipping of finished products. The ERPs consisted of three projects: (i) a synchronous manufacturing system, (ii) an asset management system, and (iii) human resources and financial management systems. The effect was to overhaul and change completely Stelco's manufacturing, asset management, human resource and financial management systems.

106 As Mr. Steiner put it in his factum and in oral argument on behalf of 2074600: "If this extraordinary contract for services ... is not out of the ordinary course of business for Stelco, what possible contract for services could be?" [3]

107 Second, the MITSA was a one-time transaction — isolated, unusual, and far from routine in the course of Stelco's business.

108 Third, the MITSA was the subject of a special public announcement by Stelco. The Debentureholders and the Noteholders argue that it is the content — or, rather, what is missing in the content — of the press release that is significant, not the public announcement itself. They say this because the press release made no specific mention of the fact that the MITSA indebtedness would constitute Senior Debt and therefore the market could not be expected to react on the basis that it did. In our view, however, the significant point is that Stelco felt the transaction was sufficiently important and unusual that public disclosure was necessary, a step the company rarely took when entering into a procurement contract. Stelco's indebtedness with regard to the MITSA was treated as long-term indebtedness, and was specifically mentioned on its financial statements. In short, the transaction — to adopt the language of *Aubrett Holdings*, *supra* — was not treated as one "calling for no remark". It received special notice.

109 Fourth, the MITSA entailed complex provisions relating to financing that were unusual to Stelco and to EDS. Because the material and evidence filed on this issue contains confidential information and has been ordered sealed, no more need be said about it.

110 Finally, the transaction was not one that could be carried out on management's own initiative. It required, and received, approval from Stelco's board of directors.

111 The fact that others in the steel industry may be outsourcing their IT needs as well, and the fact that Stelco engaged in other outsourcing transactions itself, are indicative of the increasing popularity of this particular practice, but they are not dispositive of whether the transaction envisaged in the MITSA is an ordinary course of business transaction for Stelco. In the end, the transaction provided for in the MITSA involved a fundamental change to the way in which Stelco carried on its integral IT operations — and through that, its manufacturing operations — at a cost and in a fashion that was considered sufficiently significant to call for public disclosure, and which required and received board of director approval. It was characterized by unusual and complex financial arrangements. Even if the motion judge were correct in his conclusion that the MITSA did not effect a significant change in the nature of the business Stelco conducted — it continued to manufacture and distribute steel products — the transaction was not "one of the ordinary day to day business activities, having no unusual features" (*Bradford Roofing Industries Proprietary Ltd., Re*), or "part of the

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undistinguished flow of business carried on, calling for no remark" (*Aubrett Holdings*, as adopted in *Gainers*). It did not transpire "as a matter of normal and incidental daily customs and practices in business" (*Black's Law Dictionary*).

112 The property, services and assets provided for in the MITSA were not acquisitions made in the ordinary course of Stelco's business. Accordingly, the indebtedness incurred by Stelco to EDS (and therefore to 2074600, as assignee of EDS) constitutes "Senior Debt" within the meaning of the Note Indenture.

113 2074600 Ontario Inc. is a Senior Debt Holder and is entitled to its *pro rata* share of the Turnover Proceeds in that capacity. Its appeal in this regard is allowed.

IV. The Debentureholders' Appeal (C46266)

(a) Overview

114 The Debentureholders and the Noteholders disagree on the value of the Distributed Assets. This has an effect on the value of the Deficiency (if any), which in turn determines how the Turnover Proceeds will be distributed amongst the parties. The Debentureholders assign a lower value to the Distributed Assets ($217,215,846) compared to the Noteholders' valuation ($294,497,863). This means that by the Debentureholders' calculation, the Deficiency is $125,439,818 whereas the Noteholders calculate the Deficiency to be much lower ($48,157,801).

(b) The Source of the Disagreement

115 The Debentureholders adduced evidence from different sources that supported a finding that the value of the New Common Shares on the Effective Date was $5.50 per share. They also argued that the New FRNs should be valued at par (face value) and that the New Warrants should be valued at $1.44 per warrant.

116 The Noteholders did not adduce conflicting evidence regarding the value of the shares on the Effective Date; instead, they adduced evidence by way of a report prepared by a derivatives expert who assigned a value to the Distributed Assets based on the volume weighted average price ("VWAP") of the securities during the first week of trading, beginning on April 3, 2006.

(c) The Motion Judge's Reasons

117 The motion judge used a third set of figures and his own methodology to arrive at a different set of valuations. He did not agree with either party's position on valuation. He held that "value" means "the price for the securities that the Senior Debt Holders could have received if they had sold their securities in an open market at the Effective Time on March 31, 2006." The motion judge also held that the definitions of "fair market value", "fair value", and "intrinsic value" were not helpful to determine the definition of "value" to the extent that those terms mean "something other than the price of the securities in an open market", because the issue was not whether the Debentureholders had received "fair" value, but rather what value should be ascribed to the assets.

118 The motion judge rejected the parties' positions on the grounds that neither method of valuation was an appropriate reflection of the value of the securities on the Effective Date. He then determined that the best evidence of the value of the Distributed Assets was the VWAP from the first trading day after the Effective Date. In the case of the New Common Shares and the New Warrants, the first day of trading was April 3, 2006; for the new FRNS, the first trading day was April 5, 2006. The motion judge did not take into account block discounts or a lack of liquidity in the marketplace to alter those values. He valued the Distributed Assets at a total of $276,487,090, leaving a Deficiency of $66,168,574.

119 Both the Debentureholders and 2074600 appeal the motion judge's reasons with respect to his valuation methodology.

(d) Analysis

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120 A central issue on this appeal relates to the price to be attributed to the securities distributed by Stelco — in particular, the price of its New Common Shares — as part of the compromise of its debt. The issue arises because of the Subordinated Noteholders' obligation under the Note Indenture to make the Senior Debt Holders whole out of any proceeds they (the Notheholders) receive in an insolvency or reorganization. Only after the Senior Debt Holders have been paid in full are the Noteholders entitled to recover on their own account.

121 Articles 2.9, 6.1 and 6.2 of the Note Indenture, which are cited in full elsewhere in these reasons, set out these obligations on the part of the Noteholders. For present purposes, the provisions that are most relevant are those set out in section 6.2(3)[4] which states that in the event of the insolvency or reorganization of Stelco, any payments received from Stelco by the Noteholders or the Trustee, whether in cash, property or securities, before the Senior Debt is paid in full, are to be held in trust,

> and will be paid over to the holders of such Senior Debt ... for application to the payment of all Senior Debt remaining *until such Senior Debt has been paid in full, after giving effect to any concurrent payment or distribution (or provision therefore) to the holders of such Senior Debt.* [Emphasis added.]

122 There is no dispute about the amount of the Senior Debt remaining unpaid as at the Effective Date ($342,655,664 plus the EDS Claim of $48,994,917). Thus, the central issue for determination is how to "[give] effect to any concurrent payment or distribution ... to the holders of [the] Senior Debt" in order to determine whether the Senior Debt Holders had been "paid in full" and, if not, the extent of the Deficiency to be made up through the Turnover Proceeds ("the Deficiency Claim").

123 That is not the question the motion judge posed for himself, however. Both the Debentureholders and 2074600 argued that the New Common Shares and the New Warrants should be valued using the $5.50 subscription price for the New Common Shares under the Plan. The motion judge rejected this approach. Instead, he focused on the public markets and sought to determine what the "market value" was of Stelco's New Common Shares received in the distribution, as closely as that value could be determined to the Effective Time under the Plan.

124 At paras. 105 and 106 of his Reasons he said:

> The issue before the Court can therefore be put simply: did the Senior Debt Holders receive Distributions on the Plan Implementation Date having a value that constituted "payment in full" of their claims and, if not, what is the extent of their deficiency? For this purpose, *the Court must determine the value of the payments received* by the Senior Debt Holders. For the reasons set out above, I have concluded that the payments were received by the Senior Debt Holders at the Effective Time on March 31, 2006 and must be valued as of that time. There is, however, *no provision in either the Note Indenture or the Plan that specifically addresses the proper approach to the valuations* of the property received in reorganization. Accordingly, the issue for the Court is the most appropriate evidence of the value of the Distributions received by the Senior Debt Holders on March 31, 2006.
>
> The Court is not, of course, to conduct its own inquiry into the value of the securities. The Court must determine, instead, the best evidence of the value of the Distributions based on the evidence before it. *For this purpose, I am of the opinion that "value" means the price for the securities that the Senior Debt Holders could have received if they had sold their securities in an open market at the Effective Time on March 31, 2006*. This reflects the fact that, at that time, the Senior Debt Holders were in a position to realize the values of the securities paid to them by selling them in the market. *Accordingly, the Court must determine the market price paid for the securities at the Effective Time*. [Emphasis added.]

Later, the motion judge concluded:

> The issue for the Court is the determination of the prices that the Senior Debt Holders could have obtained for their securities if it had been possible to trade the securities at the Effective Time on the Plan Implementation Date.

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125 Respectfully, however, the issue for the Court to determine was not the price the Senior Debt Holders could have obtained had they been able to trade their new securities at 11:59 p.m. on March 31, 2006 — their "market value" at that time. The issue was how to determine the "concurrent payment or distribution" received from Stelco by the Senior Debt Holders at the time of Stelco's emergence from *CCAA* protection at 11:59 p.m. on that date, and how to give effect to that concurrent payment or distribution for purposes of resolving whether the Senior Debt Holders had been paid in full, in the context of the Note Indenture and the Plan documents.

126 To interpret how to give effect to the payment received by the Senior Debt Holders "concurrently" — that is, concurrently with the payments received by, or on behalf of, the Noteholders in the *CCAA* insolvency proceedings — it is necessary to construe the provisions of the Note Indenture in the context of the language of the Plan itself and the negotiations leading up to its approval by the stakeholders and sanction by the Court. That is the factual matrix within which the meaning of this contract must be determined.

127 What, then, was the concurrent payment or distribution received by the Senior Debt Holders in exchange for the compromise of their claims on the emergence of Stelco from *CCAA* protection? The answer to that question is found in Article 2.03 of the Plan. What the Affected Creditors under the Plan — the Senior Debt Holders and the Noteholders included — received was their *pro rata* share of each of:

a) $275 million (U.S.) of the New Secured Floating Rate Notes ("FRNs");

b) the Cash Pool (subject to section 2.07 of the Plan);

c) 1.1 million New Common Shares; and

d) the New Warrants.

128 The argument on the appeal focused on the Senior Debt Holders' *pro rata* share of (b) and (c) above. The creditors were to receive a block of New Common Shares of Stelco as part of the compromise of their debt; they were prepared to invest and to take an equity position in the new Stelco to the extent of 1.1 million shares. They were also to receive a pool of cash which was to vary between $137.5 million and $108.5 million, depending upon the number of shares creditors elected to take up pursuant to Section 2.07 of the Plan, referenced in the caveat to (b) above.

129 Section 2.07 is the "Share Election" provision in the Plan. It does two things. First, it permits each Affected Creditor to "elect to receive all or any part of its distribution from the Cash Pool in New Common Shares at $5.50 per share", [5] thus providing an opportunity for electing Affected Creditors to take a further risk, in effect by engaging in a new transaction and investing part of their cash proceeds in the future of the new Stelco. Second — and significantly from the perspective of resolving what the concurrent payment or distribution received by the Senior Debt Holders was — Section 2.07 makes it clear that the size of the Cash Pool to be received on distribution is to be reduced by $5.50 for each New Common Share that is elected to be taken. Hence, the amount of cash that Stelco would be required to pay to exit from the *CCAA* process varied in the range referred to above, depending upon the number of New Common Shares the creditors elected to acquire.

130 All of this gives rise to the following questions. Viewed in the context of the Plan documentation and the negotiated compromise of the creditors' claims against Stelco, how should the words "give effect to any concurrent payment or distribution to the holders of such Senior Debt" in Articles 6.2(2) and (3) of the Note Indenture be interpreted? Leaving aside the FRNs and Warrants, was it the "concurrent payment or distribution" of cash and a bundle of $5.50 New Common Shares? Or was it the combination of cash and a bundle of shares distributed at the price they would fetch in the open market once trading commenced?

131 These are not questions of fact. They are questions of interpretation of the Note Indenture and the Plan documentation. Importantly, these questions focus on the proper approach to "giving effect to" the distribution of

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securities to the Senior Debt Holders as part of the reorganization. The motion judge's decision is therefore entitled to less deference on appeal than would be the case if what was at issue were simply a question of fact or of inferences drawn from the facts. See paragraph 83 above, and *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 (S.C.C.) at para. 33.

132 In our opinion — although the motion judge was correct in observing that marketable securities are normally valued on the basis of what they will bring in the open market — he erred in focusing on "market value" and rejecting the "plan value" approach urged upon him by the Debentureholders and 2074600 in the circumstances of this case. By doing so, he lost sight of the real issue for determination which, as mentioned above, is how to give effect to the concurrent payments or distribution received by the Senior Debt Holders in order to establish the extent of the Deficiency Claim. "Plan value" as opposed to "market value" is the touchstone for resolving that issue. Once this is recognized, much of the force in the motion judge's reasons for dismissing the criteria urged on him by the Debentureholders and 2074600 dissipates.

133 On a proper interpretation of Article 6 of the Note Indenture, in the context of the Plan documentation, what was paid or distributed by Stelco to the Senior Debt Holders and Noteholders pursuant to Section 2.03 of the Plan — leaving aside again the FRNs and the Warrants — was cash together with $5.50 New Common Shares (either as part of the Share Elect component or as part of the general New Common Share component of the payment or distribution to Affected Creditors). We say this for several reasons.

134 First, it makes sense that the "concurrent payment or distribution" to the Senior Debt Holders under the Note Indenture be determined by the Plan documents, since the Stelco reorganization is the source of the payment or distribution in question. The indicia of distribution price in the Plan documents point to $5.50 per share. [6]

135 Significantly, the Equity Sponsors under the Plan received 19,737,000 New Common Shares in exchange for their infusion of $108.5 million ($5.50 per share). Sunrise and Appaloosa — the two Noteholders leading this appeal — are two of the three Equity Sponsors. Each contributed approximately $27 million to acquire their roughly 4,950,000 shares at that price. Equally significantly, Senior Debt Holders and Noteholders who elected to take shares pursuant to Section 2.07 of the Plan (the "Share Elects") did so on the basis of accepting one New Common Share in lieu of $5.50 of their *pro rata* share of the Cash Pool.

136 Secondly, other indicia point in the same direction. For instance, Stelco itself publicly valued the New Common Shares issued at $5.50 per share "upon its emergence from *CCAA*": see Stelco's First Quarterly Report, March 2006, at p. 15. In addition, Stelco's board of directors approved a compensation package for its incoming CEO on the Effective Date. This package included a grant of 1 million New Common Shares at a price of $5.50 per share and a grant of options to acquire an additional 1,044,000 New Common Shares at a strike price of $5.50 per share. This transaction was consummated at the Effective Time as well and could not have taken place without the approval of the TSX, which was obtained. [7]

137 In the Amended Plan Sponsor Agreement, the Equity Sponsors (including Sunrise and Appaloosa) agreed (a) to inject new capital into Stelco in exchange for New Common Shares at a rate of $5.50 per share, and (b) to purchase any shares left over from the Share Election process at a price of $5.50. They also had a right to purchase any New Common Shares that a subscriber failed to purchase at the Effective Time for the same price.

138 Finally, it is apparent from the foregoing that the deal which was struck as a result of the negotiations leading up to the Plan and the acceptance and sanctioning of the Plan contemplated the distribution of $5.50 New Common Shares at the Effective Time. The Noteholders, as well as the Senior Debt Holders, were integrally involved in what Farley J. referred to at the Sanction Hearing as the "direct protracted negotiations" and "hard bargaining" of sophisticated parties, [8] and voted in favour of the Plan. In short, everyone knew, understood, and had agreed, that this was to be the case.

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139 The notion of the "Effective Time" (11:59 p.m. on the Effective Date) is important. The entitlement of the Senior Debt Holders and the Noteholders to the payment or distribution only arises at that moment, which is when their claims are compromised and their debentures (subject to the Turnover Proceeds dispute) are cancelled. All other transactions relating to the emergence of Stelco from its insolvent state occur at, or as close as possible to, that moment as well.

140 We note this because, in rejecting the "Plan value" approach, the motion judge placed considerable emphasis on the fact that the $5.50 price was negotiated at the time of the creditors' acceptance of the Plan in December 2005, and therefore was not necessarily an accurate benchmark of the value of the shares on March 31, 2006. Similarly, the share election under Section 2.07 had to be made by January 20, 2006. These factors are of little import in assessing the payment or distribution received by the Senior Debt Holders at the Effective Time, however. Those creditors who elected to exercise their option under Section 2.07 and take shares in lieu of $5.50 in cash ("the Share Elect Creditors"), were not entitled to receive and did not have the right to receive those shares prior to the Effective Time. Though these decisions were made prior to the Effective Time, they were made with a view to what everyone agreed was the price of the New Common Shares at the Effective Time. The same is true of others who acquired New Common Shares as part of the reorganization.

141 Stelco distributed its New Common Shares to the Equity Sponsors, the Share Elect Creditors (also including many Noteholders) and its new CEO at a price of $5.50 per share, effective 11:59 p.m. on March 31, 2006. The Equity Sponsors, Share Elect Creditors and the new CEO purchased the shares for that amount at the same time. It makes no sense to say that Share Elect Creditors received those shares — at the same time and for purposes of compromising their claims — at some different distribution price (the average market price three days later), all as part of the same reorganization process. Nor does it make any sense to differentiate between the distribution price of the Share Elect shares and that of the 1.1 million New Common Shares that were distributed generally as part of the payment to Affected Creditors. If all other New Common Shares that were being sold and acquired as part of the reorganization at the same Effective Time were being distributed at $5.50 per share, why would the New Common Share component of the payment to Senior Debt Holders and the other Affected Creditors be distributed at any other price?

142 All of these factors — the provisions of Section 2.03 of the Plan itself; the robust negotiations leading up to acceptance of the Plan; the $5.50 price paid at 11:59 p.m. on the Effective Date by the Senior Debt Holders, the Noteholders and the Equity Sponsors for their New Common Shares, and the price at which the New Common Shares and the options were issued to the new CEO at the same time — demonstrate clearly that the price which was accepted and agreed to by everyone involved in the reorganization for purposes of Stelco's payment or distribution upon emerging from the *CCAA* process was $5.50 per share.

143 This was the payment or distribution price for purposes of "[giving] effect to [the] concurrent payment or distribution to the holders of [the] Senior Debt" called for in section 6.2(3) of the Note Indenture.

144 Moreover, the foregoing interpretation makes commercial sense. Stelco and the Affected Creditors — including the Senior Debt Holders and the Noteholders — needed certainty in order to make the reorganization work. Stelco needed to know, with as much certainty as possible, how much it was going to have to pay to compromise its debt and emerge from the *CCAA* proceedings to start afresh. The Senior Debt Holders and Noteholders needed to know, again with as much accuracy as possible, how much they were going to be paid on account of their claims in order to decide whether to vote in favour of, or against, the Plan. These goals could not be achieved through an interpretation of the language in the Noteholders Indenture that would leave the quantum of the "concurrent payment or distribution" received by the Senior Debt Holders to the vagaries of the market after the distribution was completed.

145 While the Affected Creditors as a whole were prepared to assume the risk of a relatively minor equity investment in the new Stelco — 1.1 million New Common Shares — as part of the price of arriving at a resolution of their claims — the Share Election provisions of Section 2.07 of the Plan provided a different opportunity. They gave creditors who were prepared to take the risk of a successful Stelco recovery a further opening to invest in that recovery by purchasing

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additional New Common Shares in what was, in effect, a second transaction following the distribution. The fact that Section 5.04 of the Plan notionally treats the subscriptions for shares pursuant to the Share Election under Section 2.07 as having occurred *after* the distributions to the Affected Creditors, lends support to this "second transaction" concept. For purposes of establishing the extent of the Deficiency Claim, what is distributed to the Senior Debt Holders as the Cash Pool is either cash or the share equivalent of $5.50 in cash.

146 Although the foregoing analysis is limited to the Share Election shares, there is nothing in the Plan documentation or in the circumstances surrounding the reorganization — as we have mentioned above — to suggest that the New Common Shares as a whole should be treated on any different basis.

147 The appeal must therefore be allowed in this regard and the order of the motion judge dated October 31, 2006, varied to provide that the New Common Shares were paid or distributed by Stelco under the Plan at a price of $5.50 per share. Based on the price per share, the New Warrants should be valued at $1.44 per warrant. Given our conclusion that Plan value is to govern, the FRNs should be valued as stated in the Plan.

148 One further observation needs to be made. This decision should not be taken to have determined the value of the securities in the Turnover Proceeds to be used to provide "payment in full" of the Deficiency Claim. That issue was not before us.

V. The Share Elects' Appeal (C46916)

149 We have before us an appeal from the order of the motion judge dated March 6, 2007. This appeal involves a dispute between the Debentureholders who elected to take shares under Section 2.07 of the Plan and those who did not, as to the appropriate method of allocating the Turnover Proceeds amongst themselves.

150 The dispute had its genesis in the motion judge's earlier decision — the subject of the foregoing appeal — to apply a market value approach to the distributions under the Plan for purposes of quantifying the Senior Debt Holders' Deficiency Claim. Using the $17.72 per share market price per share fixed by the motion judge in his earlier decision for purposes of determining the allocation as between the Share Elect and the Cash Elect creditors had the effect of skewing the allocation of the Turnover Proceeds in favour of the Cash Elects and depriving the Share Elects of the benefit of their decision to invest in the new Stelco. The motion judge resolved this issue by concluding that the Turnover Proceeds should be allocated amongst the Senior Debt Holders based upon their respective claims under the Plan using a price of $5.50 per share. He said that this approach was consistent with what would have been the outcome of the earlier motion regarding the quantum of the Senior Debt Holders' Deficiency Claim if that issue had been resolved by determining the distribution price of the shares *before* giving effect to the Share Election, and hinted — none too subtly — that he may have erred in not doing so.

151 All counsel on the second appeal agreed, however, that if the first appeal were allowed with respect to the distribution price of the New Common Shares, and that price were fixed at $5.50 per share, this second appeal becomes moot. At a price of $5.50 per share, the Share Elects and the Cash Elects are treated equally on the allocation of the Turnover Proceeds. It is therefore unnecessary for us to decide the second appeal and it is dismissed as moot.

VI. Costs

152 As to costs, we ask counsel to discuss and resolve the issues if at all possible. If they are unable to do so, those parties seeking costs may make written submissions of no more than five pages each (in addition to their draft bills of costs) before July 31, 2007. Those opposing the requests may respond in writing, again no more than five pages, before August 15, 2007. Brief replies, if necessary, may be filed before August 20, 2007.

Order accordingly.

Footnotes

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* A corrigendum issued by the court on July 3, 2007 has been incorporated herein.

1 He made other findings that are addressed below in our reasons relating to the appeals by 2074600 Ontario Inc. and the Debentureholders.

2 The "Senior Debt Holders" include the Debentureholders and, given that we conclude below that the EDS claim constitutes Senior Debt, 2074600 Ontario Inc.

3 Factum of 2074600 Ontario Inc., para 72.

4 Article 6.2(2) contains the identical operative language.

5 Subject to an aggregate of 5,264,000 shares, at which point the Share Elects are entitled to receive a *pro rata* share of that total.

6 While there is provision in the Plan for market liquidation of the shares and distribution of the proceeds to the Affected Creditor, where the Affected Creditor is resident in a jurisdiction where there are restrictions on the distribution of the securities (Article 4.05(1)), we view this provision as simply creating a mechanism for dealing with a potential problem, rather than as an indication of the price of the securities for distribution purposes.

7 TSX approval is significant because TSX issuers may not grant options at less than the market price of the securities at the time the option was granted: see *TSX Company Manual*, s. 613(h)(i).

8 Endorsement of Farley J. at the Sanctioning Hearing, January 20, 2006.

End of Document

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