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.
DOCUMENT	**REPLY BRIEF OF ARGUMENT OF THE *AD HOC* COMMITTEE OF DEBENTURE HOLDERS, IN RESPONSE TO THE BRIEFS OF THE RECEIVER, ARGO PARTNERS, AND HUSKY OIL OPERATIONS LIMITED**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	**BENNETT JONES LLP** Barristers and Solicitors 4500, 855 – 2nd Street S.W. Calgary, Alberta T2P 4K7 Attention: Chris Simard and Alexis Teasdale Tel No.: 403-298-4485/3067 Fax No.: 403-265-7219 Client File No. 76739.1

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I. INTRODUCTION

1. This Reply Brief sets out the reply submissions of the *Ad Hoc* Committee of Debenture holders to the Brief of Argument submitted by FTI Consulting Inc. (the "**Receiver**"), in its capacity as Court-Appointed Receiver of Twin Butte, on June 20, 2017 (the "**Receiver's Brief**") and the Brief of Argument (the "**Argo/Husky Brief**") submitted by Argo Partners ("**Argo**") and Husky Oil Operations Limited ("**Husky**"), on June 23, 2017.

2. Capitalized terms used in this Reply Brief and not defined herein bear their meanings as defined in the Brief of Argument of the *Ad Hoc* Committee filed on June 7, 2017 (the "**Original Brief**").

II. ARGUMENT

A. The Role of the Receiver in this Application

1. Deliberately Changing the Rights of Competing Creditors is an Impermissible Exercise of the Receiver's Powers

3. The Receiver says its involvement in this Application is proper for three reasons:[1] first, it asserts it has an obligation to assess claims on their merits under the Claims Procedure Order (as defined herein); second, it references its duty to maximize distributions in an impartial and fair manner; and third, it asserts it is empowered and possibly obligated to enforce the Subordination Provisions of the Indenture.

4. The second reason can be quickly and easily dismissed. Intervening in this intercreditor dispute will not maximize distributions. It is an attempt to reduce one group's recoveries, and to increase another group's recoveries. The final reason is addressed in part 2 of this section. The *Ad Hoc* Committee will now address the first reason.

5. While the Receiver may have a duty to assess claims and maximize distributions, the Receiver's actions in this case run contrary to its obligation to discharge those duties in a fair and impartial manner on behalf of all creditors, and constitute conduct that changes the rights of

[1] See paragraphs 8-13 of the Receiver's Brief

competing creditors. This is impermissible. As the Court in Saskatchewan Court of Appeal in *Canadian Commercial Bank v Simmons Drilling* emphasized (at para 22):

> The receiver's action is the action of the court and the court will not permit or approve any action on the part of its officer which has the effect of changing the rights of competing creditors, whether deliberately or by default.[2]

6. On June 21, 2017, the Receiver sent a Notice of Revision (the "**NOR**") to Computershare, revising the claim submitted by Computershare on behalf of all Debenture holders. The Receiver also provided a copy to the Ad Hoc Committee. The NOR states:

> **Classification of the claim is revised from "unsecured" to "subordinate unsecured"** pursuant to the Subordination Provisions in the Convertible Debenture Indenture between Twin Butte Energy Ltd. and Valiant Trust Company dated as of December 13, 2013.[3]

7. The Proof of Claim form approved under the Order (Claims Procedure) granted on April 27, 2017 (the "**Claims Procedure Order**") listed only three options for the classification of the creditor's claim – unsecured, secured, or trust. That was entirely proper and appropriate since the definition of "Claim" approved by this Court in paragraph 4(e) of the Claims Procedure Order defined the types of Claims that could be proven in the Claims Procedure by reference to claims that "would be a debt provable in bankruptcy had Twin Butte become bankrupt…" The BIA allows the proof of unsecured claims, secured claims and trust claims.[4] As noted in paragraphs 45 – 49 of the Original Brief, the BIA does not contain any provisions regarding "subordinated unsecured" claims and does not create a class of "subordinated unsecured" claims.

8. Thus, the Receiver has purported to create a new category of claim for a single group of creditors, **contrary to the Claims Procedure Order and the BIA**, to deliberately alter the rights of the Debenture holders for the benefit of other creditors. The Receiver's purported creation of a new unauthorized class of claim cannot be allowed to justify its intervention against one group of creditors for the benefit of another group of creditors. A court officer cannot be allowed to change

[2] 1989 CarswellSask 48 (CA) at para 22 **[TAB 1]**
[3] Notice of Revision dated June 21, 2017, to Computershare Trust Company of Canada **[TAB 2]**
[4] *Bankruptcy and Insolvency Act, RSC 1985* c C B-3 **[TAB 3]**. Proofs of secured claims are addressed in sections 127 – 135 unsecured claims are addressed in sections 121 and trust claims are addressed in sections 67 and 81.

the rules of the game and then rely on those changed (and unauthorized) rules to choose sides in an inter-creditor dispute.

9. The Courts have specifically prohibited this. The Receiver's duty is to determine claims as against Twin Butte, not as against other creditors. The Receiver's revised classification of the Debenture holders' claim is not a determination of the Debenture holders' rights against Twin Butte, but their rights against other unsecured creditors. As observed by the Court in *Re Rico* (at para 26), citing *Re Orzy*:[5]

> It is my view, however, that the distribution by the Trustee should only be affected by agreements between the Bankrupt and its creditors, and by agreements between creditors that are conceded. There would be no point in having the Trustee distribute monies to one creditor when it is admitted by that creditor that the monies should be paid to another creditor. In support of my view, I refer to the decision of the First Appellate Division of the Ontario Supreme Court in *Re Orzy* where Ferguson J.A. said the following:
>
> > ... **the practice in bankruptcy does not permit of the adjustment of the rights and privileges of creditors *inter se* but only the rights, privileges and preferences of creditors as against the insolvent and his estate** ... the reason or principle governing being that bankruptcy proceedings are designed to administer the rights of creditors of the estate as against the debtor and his estate, and therefore the Court may not in that administration be delayed or hindered by being called upon to determine questions between creditors or between a creditor and another person such as assignee of a creditor, or as here a question as to whether or not one creditor is estopped from taking a dividend from the insolvent estate to the prejudice of another.[6] [**emphasis added**]

10. The Receiver is attempting to adjust the rights and privileges of unsecured creditors as between them, rather than assessing their rights and privileges as against Twin Butte. This conduct falls outside the scope of the Receiver's legitimate duties, and constitutes "picking sides" as between groups of creditors, which runs afoul of the Receiver's duty to "…represent impartially the interests of **all** creditors, [and] the obligation to act even-handedly…".[7]

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[5] *Orzy, Re*, [1924] 1 DLR 250 at para 19 **[TAB 4]**
[6] *Rico Enterprises Ltd, Re*, 1994 CarswellBC 608 (BCSC) at para 26 **[Receiver's Brief, TAB 3; Argo/Husky Brief, TAB 6]**
[7] *YBM Magnex International Inc, Re*, 2000 CarswellAlta 1068 at para 34 [**TAB 5**]

2. The Receiver is not Entitled to Enforce the Indenture

11. The Receiver asserts that its involvement in this Application is proper and required because Twin Butte is a party to the Indenture, and the Receiver is empowered by the Receivership Order to enforce the Indenture.

12. The Receiver is not expressly empowered by the Receivership Order to enforce the Indenture, nor any other executory contract to which Twin Butte was party. Neither paragraph 3(c) nor 3(u) of the Receivership Order provide the Receiver with authority to enforce executory contracts between Twin Butte and third parties.[8] Paragraph 3(c) empowers the Receiver to manage, operate and carry on the business of Twin Butte, including **entering into** any agreements, incurring obligations in the normal course, ceasing to carry on Twin Butte's business, or **ceasing to perform** any contracts. The only powers expressly granted to the Receiver are to enter into agreements or cease to perform agreements. Enforcing a pre-filing contract between the debtor and a third party does not constitute "entering into" an agreement. Paragraph 3(u) does not provide additional powers to the Receiver, it merely enables the exercise of those powers granted elsewhere in paragraph 3.

13. It is well-established that, upon its appointment, a Receiver has two choices with respect to executory contracts such as the Indenture: the Receiver can positively affirm a contract, or disclaim a contract.[9] While receivers are not automatically bound by pre-receivership contracts,[10] once a receiver affirms a contract, it thereby personally assumes **both the benefits and the obligations** thereunder and is bound and fully liable under that contract.[11] It cannot call for the completion of part of a contract without full performance of all of the debtor's duties thereunder.[12] When performing contracts, as court officers, receivers have an obligation to enforce contractual provisions in a manner that is fair to all parties with an interest in the estate.[13]

14. Consequently, if the Receiver had intended to take Twin Butte's place under the Indenture in order to be able to enforce the Subordination Provisions, it would have had to affirm the contract

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[8] Receivership Order of the Honourable Madam Justice B.E.C. Romaine, granted September 1, 2016, paras 3(c), 3(u) [**Receivership Order**]
[9] Frank Bennett, *Bennett on Receiverships*, 3d Ed (Toronto: Carswell, 2011) at page 433 [*Bennett*] **[TAB 6]**
[10] *Bank of Montreal v Scaffold Connection Corporation*, 2002 ABQB 706, [2002] AJ No 959 at para 11**[TAB 7]**
[11] *Bennett, supra*, at page 435 citing *General Motors Corporation v Peco, Inc*, 15 BLR (4th) 282, 19 CBR (5th) 224 **[TAB 6]**
[12] *Thompson Knitting Co, Re*, [1925] 2 DLR 1007, 56 OLR 625 at para 6 **[TAB 8]**
[13] *Textron Financial Canada Limited . Beta Limitee*, 36 CBR (5th) 296, 2007 CanLII 37461 (ON SC) at para 22 **[TAB 9]**

and thereby become personally liable to perform all of Twin Butte's obligations thereunder, including the obligation to buy back the Debentures pursuant to the change of control provisions under Article 2.4(j) of the Indenture. In other words, FTI Consulting Canada Inc. would have made itself personally liable to purchase the Debentures upon the change of control occurring. The Receiver did not positively affirm the Indenture, and it cannot enforce the Indenture. If the Receiver had affirmed the Indenture, its failure to carry out Twin Butte's obligations under the Indenture would have constituted a breach of the contract, which would preclude the Receiver from enforcing the Indenture.[14]

3. There is no Right Granted to Twin Butte in the Indenture to Enforce the Subordination Provisions

15. There is an even more fundamental reason why the Receiver cannot purport to enforce the Subordination Provisions. Upon a full reading of Article 5 of the Indenture, it is apparent that Twin Butte never had any right to enforce the Subordination Provisions against the Debenture holders. Thus, the Receiver is purporting to exercise a contractual right that is non-existent. This point is made expressly in Article 5.3:

> … it being understood that the provisions of this Article 5 are and are intended **solely for the purpose of defining the relative rights of the holders of the Debentures, on the one hand, and the holders Senior Indebtedness, on the other hand**.

and in Article 5.4:

> **Nothing contained in this Article 5 or elsewhere in this Indenture or in the Debentures is intended to or shall impair, as between the Corporation, its creditors other than the holders of Senior Indebtedness, and the holders of the Debentures, the obligation of the Corporation, which is absolute and unconditional, to pay to the holders of the Debentures the principal of, premium, if any, on and interest on the Debentures, as and when the same shall become due and payable in accordance with their terms**, or affect the relative rights of the holders of the Debentures and creditors of the Corporation other than the holders of the Senior Indebtedness, nor shall anything herein or therein prevent the Debenture Trustee or the holder of any Debenture from exercising all remedies otherwise permitted by applicable law upon default under

[14] GHL Fridman, *The Law of Contract in Canada*, 6th Ed, (Toronto: Carswell, 2011) at pages 523-524 and 530 **[TAB 10]**

> this Indenture, subject to the rights, if any, under this Article 5 of the holders of Senior Indebtedness.
>
> [**emphasis added**]

16. Thus, Twin Butte agreed that the sole purpose of Article 5 was to define the rights as between creditor groups: Debenture holders and Senior Creditors. The only role that Twin Butte had to play in that inter-creditor relationship was to provide the Officer's Certificate and enter into the agreement with a Senior Creditor and Computershare, as part of the Priority Mechanism in Article 5.7.

17. The complete lack of any right of Twin Butte in Article 5 of the Indenture to enforce the Subordination Provisions serves to further highlight just how inappropriate is the Receiver's intervention in this case. That intervention is also completely unnecessary. All creditors who filed proofs of claim were given over three weeks' notice of the June 30 application and had ample opportunity to take part in the hearing if they wished to seek to enforce the Subordination Provisions. Argo and Husky have chosen to do so.

B. The Receiver's, Argo's and Husky's Interpretation of The Indenture Fails to Follow Certain Fundamental Principles of Contractual Interpretation

1. The Principles of Interpretation

18. In the Receiver's Brief and the Argo/Husky Brief, the Receiver, Argo and Husky recite, but do not faithfully apply, the fundamental principle that a contract must be read as a whole, giving the words used their ordinary and grammatical meaning, and giving meaning to all the words used. The Receiver makes no attempt to construe the entire Indenture at all, let alone arguing how its interpretation gives effect to the whole contract. Rather, it sets out a series of partial excerpts from a number of provisions in the Indenture at paragraphs 18 through 30 of the Receiver's Brief, and then in a single paragraph, states:

> As detailed above, the Subordinated Debentures are expressly subordinated to the Senior Indebtedness of Twin Butte. This expressly includes with respect to "any distribution of the assets" of Twin Butte, including in a receivership proceeding, and the subordination is effective whether or not the Senior Indebtedness is secured.[15]

[15] Receiver's Brief at para 36

19. It is not enough for the Receiver to simply paste together a number of excerpts from the Indenture that support its interpretation of the instrument, and suggest that this is the meaning of the contract. The Court must consider the meaning of all the words used and the specific meanings of specific provisions. They all have to be fit together as an entire coherent document, to provide the objective meaning intended by the drafters.

20. Another, related principle, is that contracts should be interpreted in such a way as to give meaning to all clauses. As explained in *Canadian Contractual Interpretation Law*:

> […] "The key principle of contractual interpretation here is that the words of one provision must not be read in isolation but should be considered in harmony with the rest of the contract and in light of its purposes and commercial context." The rule is so basic that it has aptly been described as a "well-known" principle of contractual interpretation.
>
> The corollary of this principle is the precept that meaning must be given to all of the words in a contract: **To the extent that it is possible to do so, [a contract] should be construed as a whole and effect should be given to all of its provisions**. The provisions should be read, not as standing alone, but in light of the agreement as a whole and the other provisions thereof: [citations omitted] [**emphasis added**] [16]

21. This Honourable Court recently affirmed this principle in *BA Energy Inc, Re*, where Justice Romaine stated (at para 15):

> Thus, individual provisions of a contract, such as the surplus return provision at issue, are not to be read in isolation, but instead must be read in harmony with the whole of the contract. Whenever possible, meaning should be given to all provisions. No term in a contract should be found to be meaningless or redundant: *National Trust Co. v. Mead*, [1990] 2 S.C.R. 410 at para. 31.[17]

22. Flowing from these principles is the rule that each part of a contract is taken to have been deliberately inserted, having regard to all the other parts of the document, resulting in a presumption against redundant words.[18]

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[16] Geoff R. Hall, *Canadian Contractual Interpretation Law* 3 ed (Lexis Nexis: Toronto, 2016) at page 16 **[TAB 11]**
[17] *BA Energy Inc, Re*, 2011 ABQB 142 at paras 14-15 **[TAB 12]**
[18] Sir Kim Lewison, *The Interpretation of Contracts*, 6 ed (London: Thompson Reuters, 2011) at page 371 **[TAB 13]**

2. The Receiver's, Argo's and Husky's Incorrect Interpretations

23. It is respectfully submitted that there are a number of glaring errors in the Receiver's, Argo's and Husky's interpretation of the Indenture that flow from their failure to apply the principles set out immediately above.

24. At paragraphs 49 – 55 of the Receiver's Brief, the Receiver suggests that the Priority Mechanism under Article 5.7 of the Indenture is merely **optional**, and that the subordination provided for in Article 5 is operative notwithstanding the Priority Mechanism. This is contrary to the opening words of Article 5.7, which provide that each holder of Debentures authorizes and directs the Debenture Trustee on its behalf to take such action as may be necessary or appropriate **to effect** the subordination as provided in this Article 5. The interpretation of those words was explained at paragraphs 68 – 74 of the Original Brief. Neither the Receiver, Argo nor Husky has contested that interpretation. Rather, they simply ignore the fact that the clear meaning of "to effect the subordination" is "to **make** the subordination **become effective**."

25. Instead, the Receiver, Argo and Husky all point to the concluding words of Article 5.7, "However, nothing herein shall impair the rights of any Senior Creditor who has not entered into such an agreement." They all simply argue that Senior Creditors have the right to enforce the Subordination Provisions as a starting point, and that "impair" therefore refers to removing such enforcement rights. That interpretation completely ignores the words "to effect" in the same article, giving those words no meaning at all and making them completely redundant.

26. There is an interpretation that gives full effect to all the words used in Article 5.7, both "give effect" and "impair." It can be explained by first interpreting "impair." The plain and ordinary meaning of the word "impair", as defined, in part, in *The New Shorter Oxford English Dictionary*, is "make less effective or weaker; devalue, damage, injure" and "become less effective or weaker; deteriorate; suffer injury or loss."[19]

27. The interpretation of Article 5.7 that gives full effect to "to effect" and "impair" is this. The starting point for all those parties who fall in the definition of "Senior Creditor" in the Indenture is that they rank *pari passu* with the Debenture holders – this is their "baseline" status.

[19] *New Shorter Oxford English Dictionary* (Oxford University Press: Oxford, 1993) at 1317 **[TAB 14]**

A Senior Creditor, however, had the ability to elevate its position above that of Debenture holders, by utilizing the Priority Mechanism to put into **effect** the Subordination Provisions. However, if the Senior Creditor chose not to use the Priority Mechanism, its position as an unsecured creditor ranking *pari passu* with Debenture holders would not deteriorate from its baseline status. It would remain *pari passu*. Its baseline position would not be **impaired**. It is submitted that this is the only interpretation of all the words used in Article 5.7 that gives full effect to "effect" and "impair".

28. It should also be noted that, contrary to the statement in paragraph 52 of the Receiver's Brief, Senior Creditors **cannot** now try to invoke the Priority Mechanism. That is the case for a number of reasons:

(a) such a step is prevented by the stay of proceedings in the Receivership Order, as it would change the *status quo*;

(b) for the reasons stated above, the Receiver has not affirmed the Indenture and become personally liable for all obligations thereunder, including the obligation of Twin Butte to issue Officer's Certificates and enter into agreements under Article 5.7; and

(c) Twin Butte no longer has officers who could issue the required Officer's Certificate.

29. A further error by Argo and Husky is to suggest that Article 5.5 of the Indenture gives rise to a trust in the present circumstances of Twin Butte's insolvency, because it "provides for any amounts paid by Twin Butte to the Trustee after circumstances arise that constitute a "default" permitting a Senior Creditor to demand payment of Senior Debt to be held in trust and paid over to the Senior Creditors." With respect, this ignores fundamental principles of contractual interpretation.

30. Article 5.5 does not apply in an insolvency scenario, as Argo and Husky suggest. Article 5.2 is the article that is expressly stated to apply in the event of a distribution in insolvency or restructuring proceedings, including bankruptcy or receivership. Article 5.5 does not include any references to insolvency proceedings, other than the permission given to the Debenture Trustee to file a proof of claim in such proceedings. If Article 5.5 was intended to alter the Article 5.2 provisions regarding distribution in insolvency proceedings, it would have expressly said so. It

does not. Argo and Husky concede that the trust provisions in *Stelco* were located within the insolvency distribution provisions of the indenture at issue in that case (the equivalent of Article 5.2 here) – that is a critical difference and is fatal to Argo and Husky's interpretation. Argo and Husky suggest that because Article 5.5 permits the Debenture Trustee to file a proof of claim in insolvency proceedings, notwithstanding the remainder of the Article, this proves it was intended to apply in insolvency proceedings.

31. To the contrary, the article applies in entirely different circumstances – it applies "Upon the maturity of any Senior Indebtedness by lapse of time, acceleration or otherwise, or any enforcement of any Senior Indebtedness". To find that Article 5.5 applied in the present insolvency scenario would make Article 5.2 redundant.

32. Further, the circumstances contemplated in Article 5.5 no longer exist. The only enforcement of Senior Indebtedness against Twin Butte was the Lending Syndicate's application to appoint the Receiver. Once that occurred, all enforcement was stayed. The Lending Syndicate has been repaid in full and all defaults of Twin Butte under the loan agreements have been cured. The Claims Procedure and the distributions to be made in the future thereunder are occurring in the absence of any enforcement of any Senior Indebtedness.

33. The purpose of Article 5.5 is to prevent payments of interest on the Debentures while there is a default in Senior Indebtedness, where notice of the default has been given to Twin Butte or Twin Butte is aware of the default. The prohibition on payments lasts until the default is cured. The only Senior Indebtedness of Twin Butte in default was the indebtedness due to the Syndicate. That indebtedness has been repaid in full; the provisions of Article 5.5 no longer apply.

34. It is significant that Article 5.6 provides that regular payments of interest or principal on the Debentures are permitted, subject **independently** to Articles 5.2 and 5.5 – this is telling, as it strongly supports the interpretation that the provisions of each of those Articles deal with separate and distinct prohibitions on the obligation of Twin Butte to make payments on the Debentures, in two distinct circumstances.

C. The Onus on Senior Creditors

35. As noted above, the only creditors who have sought to discharge the onus of establishing that they are "Senior Creditors" and have the right to enforce the Subordination Provisions, are Argo and Husky. The *Ad Hoc* Committee, through its consultation rights in the Claims Procedure, has become aware of other creditor claims and makes the following comments on some of those claims.

1. The Interpretation of "Senior Indebtedness"

36. The Receiver, without providing any rationale, simply submits that the Debentures are subordinated to "the general class of unsecured creditors of Twin Butte".[20] The Receiver also simply asserts that the defined term "Senior Indebtedness" in the Indenture is "expansive",[21] although it admits that "the Indenture contains an unequivocal subordination of the priority of the Subordinated Debentures to **virtually** all other unsecured debt of Twin Butte…", **not** all unsecured debt.[22] Argo and Husky simply assert that they are "Senior Creditors" as defined in the Indenture.[23] The Receiver does not attempt to delineate which unsecured creditors, in its view, should have the benefit of the subordination and which should not.

37. None of them actually make any attempt to construe the incredibly lengthy and convoluted definition of "Senior Indebtedness".[24] They simply seem to construe it as if it simply said "all claims against Twin Butte other than claims related to the Debentures." If that was the drafters' intent, it could have been achieved using very few words. Instead, 265 words were used to define the term, and meaning must be given to all of them. At paragraphs 92 – 104 of the Original Brief, the *Ad Hoc* Committee provided a detailed analysis of that definition. It has been the *Ad Hoc* Committee's consistent position that Twin Butte creditors have the onus of establishing not only that they are "Senior Creditors" under the Indenture, but also that they have the right to enforce the Subordination Provisions. The only creditors who have made an attempt to do so are Argo and Husky.

[20] Receiver's Brief at para 75
[21] Receiver's Brief at para 30
[22] Receiver's Brief at para 37
[23] Argo/Husky Brief at para 3
[24] Indenture, Article 1.1

38. It is apparent from the proofs of claim submitted in the Claims Procedure, that there are a number of significant creditors whose claims do not comprise "Senior Indebtedness" and who therefore could never even have had access to the Priority Mechanism to gain the right to enforce the Subordination Provisions.

2. Claims Generated by Disclaimers or Terminations in a Receivership, Are Not Obligations, Liabilities, or Indebtedness that can be, or are, Classified on a Balance Sheet

39. The opening language of the definition of Senior Indebtedness is "all obligations, liabilities and indebtedness of the Corporation which would, in accordance with GAAP, be classified upon a consolidated balance sheet of the Corporation as liabilities of the Corporation…".

40. Claims that arose as a result of the Receiver disclaiming contracts can by definition never be classified on Twin Butte's balance sheet. Such claims arise purely as incidents to the Receivership. They are claims generated in and provable in the Receivership, but are not classified on Twin Butte's balance sheet. The last financial statements available on SEDAR were posted on August 11, 2016. After the Receiver was appointed on September 1, 2016, as is always the case, no further financial statements for Twin Butte were posted on SEDAR. Any claim for damages arising from the Receiver's repudiation or disclaimer of contracts is not "Senior Indebtedness" within the meaning of the Debenture.

3. Taxes are not "Senior Indebtedness"

41. The *Ad Hoc* Committee has received, pursuant to its consultation rights in the Claims Procedure, a copy of a proof of claim from the Canada Revenue Agency for Federal income tax totaling over $6 million (inclusive of interest and penalties) relating to certain Notices of Reassessment issued to Twin Butte in 2015. Alberta Tax and Revenue Administration also issued Notices of Reassessment, based on the notices issued by CRA. These claims, even though they have been disallowed by the Receiver,[25] are not "Senior Indebtedness" within the meaning of the Indenture.

42. First, the liability to CRA is not an obligation, liability, or indebtedness of Twin Butte which would, in accordance with GAAP, be classified on Twin Butte's consolidated balance sheet

[25] The Ad Hoc Committee understands the Receiver is in the process of determining a trust claim asserted by CRA.

as a liability. In fact, Twin Butte's interim financial statements for Q2 of 2016 state that while notices of reassessment had been received, resulting in $5.9 million of taxes payable for 2015, Twin Butte had not recorded a liability for the reassessments, and management would vigorously defend the Company's tax filing position.[26] CRA's claim does not fall within the opening language of the definition of "Senior Indebtedness". The *Ad Hoc* Committee understands from the Receiver that Twin Butte indeed had sufficient non-capital tax losses in 2016 to carry back and fully reduce to zero the tax liability for the 2014 and 2015 tax years claimed in the Notices of Reassessment.

4. Accounts Payable to Trade Creditors do not Include Claims for Damages Associated with Cessation or Termination of Services Resulting in a Breach

43. One category of claims under the definition of Senior Indebtedness is "accounts payable to trade creditors." It is therefore important to consider the definition of "trade creditor". *Black's Law Dictionary* defines "trade" as "[t]he business of buying and selling or bartering goods or services".[27] Accordingly, a trade creditor is a creditor who provides credit in connection with the sale of goods and services to the debtor.

44. This Honourable Court considered what constitutes a "trade creditor" in the CCAA proceedings of Smoky River Coal Ltd.[28] In that case, the Initial Order provided that "Post-Petition Trade Creditors", would benefit from a first charge against the assets of the company; however, the term "Post-Petition Trade Creditors" (or "**PPTC**") was not defined in the Initial Order. Justice LoVecchio was asked to determine whether certain claims amounted to PPTC claims.

45. His Lordship held that, to be considered a PPTC claim, the debt in question had to have been incurred in connection with the daily operating activities of the company – the debt could **not** arise from the cessation or termination of services, as penalties or obligations associated with a breach were not expenses associated with continued obligations.[29] On appeal, the Court of Appeal accepted the requirements enunciated by Justice LoVecchio and added the caveat that they had to be interpreted according to commercially reasonable terms.[30]

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[26] 2016 Second Quarter Report of Twin Butte Energy Ltd., Management's Discussion and Analysis, page 13 **[TAB 15]**
[27] *Black's Law Dictionary* 10 ed (Thomson Reuters: St Paul, 2009) at p 1720 **[TAB 16]**
[28] *Smoky River Coal Ltd, Re*, 2000 ABQB 621 **[TAB 17]**
[29] *Ibid*, at para 40 **[TAB 17]**
[30] *Smoky River Coal Ltd, Re*, 2001 ABCA 209 at para 19 **[TAB 18]**

46. Based on these principles, claims arising out of the Receiver's repudiation or disclaimer of contracts are not "accounts payable to trade creditors", do not constitute Senior Indebtedness, and therefore, rank *pari passu* with the Debenture holders regardless of whether the Subordination Provisions are enforceable. Claims in this category include former employee claims for severance, and landlord claims for terminated leases.

(a) Employees are not Trade Creditors in Respect of Severance

47. Any claims of Twin Butte's former employees for severance are not trade creditor claims, because they arise solely from the Receiver's repudiation of their contracts with Twin Butte or their resignations – they are obligations associated with the cessation of services, not expenses associated with continued obligations of Twin Butte to its employees. An employee's claim for severance does not arise from the employee's provision of services to the debtor – only unpaid wages fit that description.

48. The question of whether employee claims for severance should be treated as trade creditor claims was considered in *Mirant Canada Energy Marketing Ltd, Re*,[31] where an employee brought an application shortly after the Initial CCAA Order was granted seeking payment of severance.

49. The employee relied on Justice LoVecchio's decision in *Smoky River*, and his classification of an equipment lessor's claim for rental and repair charges as PPTC claims, on the basis that both types of charges arose from the same contract. The employee in *Mirant* argued that his monthly salary and severance were analogous to the rental payments and repair costs, respectively, and that his severance entitlement was an obligation that arose during the CCAA period and therefore should be paid in full. Justice Kent dismissed the employee's claim for severance, finding that it was an obligation that arose on the termination of services, rather than a contractual obligation essential for the continued supply of services.[32] Justice Kent's reasoning is consistent with the view that severance pay, as an obligation that arises from termination of a contract, is not a trade creditor claim.

50. Further, in the context of directors' liability for unpaid wages, various Courts across Canada have held that the definition of "all debts … for service performed" under corporate legislation

[31] *Mirant Canada Energy Marketing Ltd, Re*, 2004 ABQB 218 **[TAB 19]**
[32] *Ibid* at para 28 **[TAB 19]**

includes salary and accrued vacation pay, but does not include termination pay and severance pay, as the latter two categories do not flow from services performed for the employer, but rather from the damage arising from non-performance of a contractual obligation to give sufficient notice.[33]

(b) Landlords are not Trade Creditors

51. As with employee severance claims arising from the termination of a contract of employment, a landlord's claim for damages arising from the repudiation of a lease is not a trade creditor claim. Landlords do not extend credit for goods or services – quite the opposite, a landlord is paid in advance for the use of its premises in any given month of the tenancy. The claims of landlords in the within proceedings are for damages for lost rent to the end of the term of their leases – i.e. obligations associated with a breach of those leases, and not expenses associated with continued obligations. Therefore, a landlord's claim for damages is not a trade creditor claim and is not "Senior Indebtedness" to which the Debenture holders' claims could ever be subordinated.

(c) CRA and Alberta Treasury are not Trade Creditors

52. Tax authorities are not trade creditors. In *Re Norris*, the Alberta Court of Queen's Bench stated that CRA "did not constitute a trade creditor of the bankrupt" for the purposes of determining whether it had received a payment in the ordinary course of business in the context of a fraudulent preference.[34] Similarly, in *Smoky River*, supra, the Court of Queen's Bench ruled that the municipality claiming property tax was not a trade creditor.[35]

5. No Creditors other than the Lending Syndicate Utilized the Priority Mechanism

53. As reported in the Receiver's Ninth Report,[36] the only creditor who utilized the Priority Mechanism in Article 5.7 of the Indenture was National Bank of Canada, as agent to the lending syndicate. The lending syndicate was repaid in full earlier in these Receivership proceedings. Other Senior Creditors could obviously have done the same, but did not.

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[33] *Crabtree (Succession de) c Barrette*, [1993] SCR 1027 at para 45 **[TAB 20]**; *Brown v Shearer*, 1995 CarswellMan 173 (CA) at para 10 **[TAB 21]**

[34] *Norris Re*, 1994 CarswellAlta 353 (Alta QB); on appeal (CarswellAlta 884) [**TAB 22**], the Court considered the Trustee's failure to disclose that certain unsecured creditors claiming against the estate were related to the bankrupt. The Court of Appeal found that the new evidence could be capable of rebutting the presumption of preference, and ordered a new hearing

[35] *Smoky River*, *supra* at paras 29-33 **[TAB 17]**

[36] Receiver's Ninth Report at paras. 20 - 22

6. The Subordination Provisions do not Apply to Claims of Debt Traders

54. A number of Twin Butte's trade creditors sold their debt to Argo and CRG Financial LLC (the "**Debt Traders**"), entities who purchase claims against insolvent entities for profit. Neither the Debt Traders nor the creditors who sold claims to them, utilized the Priority Mechanism. Further, these are not the types of parties who would be entitled to the relaxation of the privity doctrine under *London Drugs* and *Fraser River*.[37] The Debt Traders are complete strangers to the claims they purchased, and to the Indenture. There are no policy reasons to support the relaxation of the doctrine of privity with respect to debt traders. As this Court has observed, "…appellate courts in our country are reluctant to disregard the doctrine of privity and they have made it clear that the exception should only be applied to avoid injustice."[38] There will be no injustice worked against traders who bargain for the opportunity to try to make a profit by purchasing debt claims.

55. The doctrine of "collateral contract"[39] does not apply to allow the Debt Traders to enforce the Subordination Provisions. Argo refers to Article 5.16 of the Indenture to suggest that a collateral contract was expressly created by Computershare and Twin Butte, for the benefit of the Debt Traders. Article 5.16 (b) makes it clear that the acceptance of the benefit of the Subordination Provisions contemplated therein was expressly "on the terms **and conditions** set forth in this Article 5…" As has been explained in this Reply Brief and the Original Brief, the condition that had to be satisfied for a Senior Creditor to be able to enforce the Subordination Provisions was the utilization of the Priority Mechanism. That was the only way to effect the subordination.

56. At paragraph 21 of the Argo/Husky Brief, citing paragraph 17 of the Receiver's Brief, Argo and Husky suggest Senior Creditors should be paid "first and in full, **including costs and interest**…". The Receiver has taken the position, based on the "interest stops" rule, that interest ceased to run at September 1, 2016 with respect to the Debentures, and all other unsecured claims in which interest was claimed. As the Receiver must act impartially and even-handedly, that position must apply equally to all of Twin Butte's unsecured creditors, including any Senior Creditors.

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[37] *Fraser River Pile Dredge Ltd v Can-Dive Services Ltd*, 1999 CarswellBC 1927 at paras 28 – 29 **[TAB 23]**
[38] *Liu v Calgary Chinatown Development Foundation*, 2017 ABQB 149, at para. 28 – 32 citing *London Drugs Ltd v Kuehne and Wagel International Ltd*, 1992 CarswellBC 315 at 446 **[TAB 24]**
[39] Argo/Husky Brief at paras 39 - 42

D. The *Ad Hoc* Committee is not Seeking to "Double-Dip"

57. The Receiver erroneously suggests that the Debenture holders are seeking to "double-dip" and be paid on both the Debenture Debt Claim and the Debenture Damages Claim. It is obvious from the face of Computershare's Amended Proof of Claim that the Debenture holders are asserting alternative claims, and not seeking to be paid for both. The Amended Proof of Claim filed by Computershare clearly states that it includes an alternative claim in debt or damages, and a "Subsequent Claim" (arising after the date of the Claims Procedure Order) for damages.

58. As noted, the Receiver has revised Computershare's claim, in part because "it [was] considered to be duplicative of the Debenture Debt Claim." The *Ad Hoc* Committee, pursuant to its consultation rights in the Claims Procedure, intends to object to the Receiver's determination of Computershare's claim, including on the basis that the Receiver appears to have misunderstood the concept of alternative claims, and reserves all of its rights in that regard.

E. Bankruptcy

59. Argo and Husky incorrectly assert[40] that the *Ad Hoc* Committee is applying to bankrupt Twin Butte. That is not the case. The application is merely to seek leave to do so in the future.

III. RELIEF SOUGHT

60. The relief sought by the *Ad Hoc* Committee is set out in the Original Brief.

ALL OF WHICH IS RESPECTFULLY SUBMITTED at Calgary, Alberta this 26th day of June, 2017.

BENNETT JONES LLP

Estimated Time for Argument:
45 minutes

Per: _____
fav Chris Simard and Alexis Teasdale
Counsel for the *Ad Hoc* Committee

[40] At paras. 80 -82 of the Argo/Husky Brief

TABLE OF AUTHORITIES

22. *Norris Re*, 1994 CarswellAlta 353 (Alta QB); on appeal (CarswellAlta 884)

23. *Fraser River Pile Dredge Ltd v Can-Dive Services Ltd*, 1999 CarswellBC 1927

24. *Liu v Calgary Chinatown Development Foundation*, 2017 ABQB 149

TAB 1

Most Negative Treatment: Distinguished
Most Recent Distinguished: Arthur Andersen Inc. v. Merit Energy Ltd. | 2002 SKCA 105, 2002 CarswellSask 593, [2003] 2 W.W.R. 303, 220 D.L.R. (4th) 351, 117 A.C.W.S. (3d) 376, 227 Sask. R. 44, 287 W.A.C. 44, [2002] S.J. No. 535 | (Sask. C.A., Sep 18, 2002)

1989 CarswellSask 48
Saskatchewan Court of Appeal

Canadian Commercial Bank v. Simmons Drilling Ltd.

1989 CarswellSask 48, [1989] C.L.D. 1276, [1989] S.J. No. 481, 17 A.C.W.S. (3d) 493, 62 D.L.R. (4th) 243, 76 C.B.R. (N.S.) 241, 78 Sask. R. 87

CANADIAN COMMERCIAL BANK v. SIMMONS DRILLING LTD.

Vancise and Sherstobitoff JJ.A. and Osborn J. (ad hoc)

Heard: June 5, 1989
Judgment: September 14, 1989
Docket: No. 115

Counsel: *L. Andrychuk*, for appellant.
J. Ehmann, for Deloitte, Haskins and Sells.
T. Stodalka, for Oil Patch.
M. Sawatsky, for Shell Products.

Subject: Corporate and Commercial; Insolvency; Contracts

Related Abridgment Classifications

Construction law

IV Construction and builders' liens
IV.6 Holdback
IV.6.f When payable

Construction law

IV Construction and builders' liens
IV.6 Holdback
IV.6.g Miscellaneous

Construction law

IV Construction and builders' liens
IV.7 Trust fund
IV.7.f Distribution of fund

Headnote

Construction Law --- Construction and builders' liens — Holdback — When payable

Construction Law --- Construction and builders' liens — Holdback

Construction Law --- Construction and builders' liens — Trust fund — Distribution of fund

Secured creditors — Mechanics' liens — Receiver-manager appointed by court at instance of debenture holder — Receiver-manager having funds remaining after payment of subcontractors with registered liens out of receivables from contracts — Receiver-manager failing to discover unpaid subcontractors without registered liens until expiration of one-year limitation period for claims against lien trust fund — Receiver-manager actions constituting default of positive obligations under Business Corporations Act and Builders' Lien Act, and of responsibility to court — Receiver-manager and debenture holder not to benefit from default — Court directing payment of unpaid subcontractors out of funds received on account of contracts.

The plaintiff held a debenture secured by the assets of the defendant. In March 1987, at the instance of the plaintiff, the court appointed a receiver-manager of the defendant under the provisions of the Saskatchewan Business Corporations Act. The order permitted distribution of moneys held by the receiver only by direction of the court. By 31st March 1987 the defendant had completed various drilling contracts. The receiver-manager paid those subcontractors with registered builders' liens from the moneys received under the contracts and had funds remaining in hand. Upon completion of a review of the defendant's records in March 1988, the receiver-manager discovered that certain subcontractors who had not registered liens were unpaid. In June 1988 the receiver-manager applied for directions as to its obligation to pay these subcontractors in light of the expiration of the one-year limitation period for claims against the lien trust fund under s. 19 of the Builders' Lien Act. The judge declined to answer the question before him but found that the subcontractors had valid unregistered liens, enforceable against the funds received by the receiver-manager. The plaintiff appealed.

Held:

Appeal dismissed.

The trial judgment could not stand because under ss. 70 and 71 of the Act, the bank, holding security that arose prior to the lien, had priority in any event over the unregistered liens.

Pursuant to s. 7 of the Builders' Lien Act, when the receiver-manager was appointed, all of the receivables which eventually were converted into cash came into his possession and under his control impressed with the trust. As the defendant was prohibited from dealing with the receivables by s. 91 of the Business Corporations Act, the receiver-manager was de facto trustee of the trust fund. In addition, the receiver-manager was responsible to the court under s. 92 of the Business Corporation Act and the terms of the order appointing it for the receivables and moneys paid on that account. Section 89 of the Business Corporations Act, together with s. 7 of the Builders' Lien Act, imposed a positive obligation upon the receiver-manager to pay the subcontractors from the trust fund within a reasonable time. The receiver-manager's failure to act with sufficient promptness and diligence to discover and pay the claims against the trust before expiration of the limitation period was in default of those statutory obligations. The receiver-manager's actions were the actions of the court and the court will not permit or approve any action on the part of its officer which has the effect of changing the rights of competing creditors, whether deliberately or by default. The receiver-manager, and through it the plaintiff, must bear responsibility for the consequences of the unpaid subcontractors being deprived of the right to realize their claims from the trust fund. Accordingly, the receiver-manager should pay the claims of the subcontractors from the funds received on account of the appropriate contracts.

Table of Authorities

Cases considered:

Cornish, Re; Ex parte Bd. of Trade, [1896] 1 Q.B. 99 (C.A.) — *distinguished*

Gen. Rolling Stock Co., Re (1872), 7 Ch. 646 — *distinguished*

Harrisson v. Duignan (1842), 2 Dr. & War. 295 — *distinguished*

Parsons v. Sovereign Bank of Can., [1913] A.C. 160 (P.C.) — *considered*

Plisson v. Duncan (1905), 36 S.C.R. 647 [N.W.T.] — *referred to*

Wrixon v. Vize (1842), 3 Dr. & War. 104 — *distinguished*

Statutes considered:

Builders' Lien Act, S.S. 1984-85-86, c. B-7.1

s. 7

s. 15

s. 16

s. 19

s. 27

s. 33

s. 34

s. 40 [am. 1986, c. 8, s. 3]

s. 49(5)

s. 70

s. 71

Business Corporations Act, R.S.S. 1978, c. B-10

s. 89

s. 91

s. 92

s. 95(d)

Authorities considered:

Bennett on Receiverships (1985), pp. 15-16.

39 Hals. (4th), para. 877.

Kerr on Receivers, 15th ed. (1978), pp. 130, 142, 159.

Appeal from order of Geatros J., 73 C.B.R. (N.S.) 73, 33 C.L.R. 238, 73 Sask. R. 140, enforcing payment of unregistered liens from funds held by receiver-manager.

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

1 The determinative issue in this appeal [from 73 C.B.R. (N.S.) 73, 33 C.L.R. 238, 73 Sask. R. 140] is whether a court-appointed receiver-manager, and the secured creditor at whose instance the receiver-manager was appointed, are entitled to rely upon the time limitation in s. 19(1) of the Builders' Lien Act, S.S. 1984-85-86, c. B-7.1, to obtain priority for the secured creditor over a debt to a stranger to the action, secured by a statutory trust fund, when the time limitation did not elapse until after the appointment of the receiver-manager.

2 These are the relevant provisions of the Builders' Lien Act:

> 7(1) All amounts:
>
> (*a*) owing to a contractor, whether or not due or payable; or
>
> (*b*) received by a contractor;
>
> on account of the contract price of an improvement constitute a trust fund for the benefit of:
>
> (*c*) subcontractors who have subcontracted with the contractor and other persons who have provided materials or services to the contractor for the purpose of performing a contract; and
>
> (*d*) labourers who have been employed by the contractor for the purpose of performing the contract.
>
> (2) The contractor is the trustee of the trust fund created by subsection (1) and he shall not appropriate or convert any part of the trust fund to his own use or to any use inconsistent with the trust until all persons for whose benefit the trust is constituted are paid all amounts related to the improvement owed to them by the contractor ...
>
> 15 In addition to any other priority which a beneficiary of a trust constituted by this Part may have at law, a beneficiary has priority over all general or special assignments, security interests, judgments, attachments, garnishments and receiving orders, whenever received, granted, issued or made, of or in respect of the contract or subcontract price or any portion of the contract or subcontract price ...
>
> 19(1) On the expiry of one year after the contract is completed or abandoned:
>
> (*a*) a person who is a trustee under this Part is discharged from his obligations as trustee; and
>
> (*b*) no action to enforce the trust may be commenced.
>
> (2) Subsection (1) does not affect the ability to commence and maintain a prosecution.

3 In 1980 the appellant Canadian Commercial Bank obtained a debenture, including a fixed and floating charge, over the present and future assets of Simmons Drilling Limited. Validity of the debenture and default thereunder were not disputed.

4 Deloitte, Haskins & Sells Ltd. was appointed receiver-manager of the business and property of Simmons at the instance of the bank by the Court of Queen's Bench of Alberta on 20th February 1987 and by the Court of Queen's Bench of Saskatchewan on 3rd March 1987. The orders contain no unusual provisions. They prohibit any action against Simmons or the receiver without the leave of the court. They also permit distribution of any moneys in the hands of the receiver, after payment of expenses, only by the direction of the court.

5 Simmons had drilling contracts with several oil and gas operators in Saskatchewan and had completed various wells between 5th December 1986 and 31st March 1987. The receiver, between 15th May 1987 and 5th February 1988, received moneys due under the contracts and paid therefrom those subcontractors who had registered builders' liens. There remained, in the receiver's hands, about $141,000. During a review of Simmons' records by the receiver conducted between December 1987 and March 1988, it was discovered that there were some subcontractors, including the respondents Oil Patch Group Ltd., J-& L Supply Co. Ltd. and Shell Canada Products Limited, who had supplied services and materials in connection with the drilling of the wells, who were unpaid, and had not registered liens. The receiver applied, on 30th June 1988, to the Queen's Bench for the following relief:

> ... advice and directions as to its obligation, if any, with respect to the possible claims of certain subcontractors of SDL in relation to the proceeds of certain drilling contracts received by the receiver, in light of the provisions of s. 19 of *The Builders' Lien Act*, S.S. 1984-85, c. B-7.1, which proceeds are claimed by the plaintiff Canadian Commercial Bank ("CCB") pursuant to its security interests.

6 Geatros J. declined to answer the question put to him, but found, by application of ss. 27, 33, 34, 40 and 49(5) of the Act, that the respondents had valid unregistered liens, enforceable against the funds received by the receiver under the contracts which constituted holdbacks required by the Act. His judgment cannot stand because, even if the liens were valid (and we pass no judgment on that issue), he misconstrued ss. 70 and 71 of the Act, which gave priority to a secured creditor over a lienholder where the security was given before the lien arose. Thus, the bank had priority in any event over the unregistered liens. We are therefore left to determine the original question which was unanswered below.

7 The issue to be decided is the effect of s. 19 of the Act on priority between the bank as secured creditor and the respondents as beneficiaries of the trust created by s. 7 and given priority by s. 15. That raises the following questions. At what date are priorities determined: the date of appointment of the receiver, the date of receipt of the moneys, the date of application to the court, or the date of distribution? Is a court-appointed receiver entitled to affect priorities between competing creditors by permitting limitation periods to expire even if done inadvertently? Even assuming that s. 19 does not apply to prevent any claim against the trust fund, what moneys are affected: all moneys received on account of the contracts, or only moneys actually received within a year of completion of the contracts?

8 As to the last question, s. 7 makes all amounts owing to a contractor under a contract, whether due and payable or not, a part of the trust fund. Thus, when the receiver was appointed, all of the receivables which eventually were converted into cash came into his possession and under his control impressed with the trust. The date of actual receipt of moneys is therefore irrelevant since the payment simply converted the assets in the trust from receivables to cash to the extent of the payments. There were, at all relevant times, assets in some form in the trust fund sufficient to meet the claims of the respondents.

9 The first two questions must be answered together.

10 The respondents argued that time did not run against them under s. 19 from the date of appointment of the receiver. They relied principally on two cases. *Re Cornish; Ex parte Bd. of Trade*, [1896] 1 Q.B. 99 (C.A.), was a case concerning the application of s. 8 of the Trustee Act, 1888, to a trustee in bankruptcy.

11 The court said at p. 104:

> The other point taken was that s. 8 of the Trustee Act, 1888, applies to the case. In my opinion s. 8, which limits the time for making claims upon trustees, has nothing to do with an officer of the Court who is required by the Court to account. If it had, it would equally apply to a receiver and to other officers of the Court who have been put by the Court in possession of property, and are required to account to the Court. I have never yet heard it suggested that s. 8 of the Trustee Act applied to such cases as that. Moreover, if it did apply, it would not apply to the present case, because if upon taking the account it should appear that the trustee has money in his hands which he has not properly applied, he would come within the exception in s. 8 of the Act, and the limitation of the liability of a trustee would not apply to him at all.

12 In *Re Gen. Rolling Stock Co.* (1872), 7 Ch. 646, the court said this concerning a compulsory winding-up order [pp. 649-50]:

> That being so, I think we must consider that the Legislature intended us to follow the analogy of other cases where the assets of a debtor are to be divided amongst his creditors, whether in bankruptcy or insolvency, or under a trust for creditors, or under a decree of the Court of Chancery, in an administration suit. In these cases the rule is that everybody who had a subsisting claim at the time of the adjudication, the insolvency, the creation of the trust for creditors, or the administration decree, as the case may be, is entitled to participate in the assets, and that the *Statute of Limitations* does not run against this claim, but, as long as assets remain unadministered he is at liberty to come in and prove his claim, not disturbing any former dividend.

13 These cases do not apply. They dealt with fact situations and with statutes unrelated to those before us. While *Cornish* mentioned receivers, the reference was obiter dictum. *Rolling Stock*, and the cases upon which it relied, as well as those which followed it, did not deal with receivers.

14 The appellant relied on the common law with respect to receivers and reasoned as follows. A receiver appointed by the court becomes a principal and is answerable to the court which appointed him. As a principal, he is not the agent of the security holder, the debtor or of any particular creditor. He has a duty to exercise such reasonable care, supervision and control of the debtor's property as an ordinary man would give to his own and if he fails to provide this standard of care he may be liable for his negligence: Bennett on Receiverships (1985), pp. 15-16; *Plisson v. Duncan* (1905), 36 S.C.R. 647 [N.W.T.]. The powers and duties of a court-appointed receiver are summarized in *Parsons v. Sovereign Bank of Can.*, [1913] A.C. 160 at 167 (P.C.), by Viscount Haldane:

> A receiver and manager appointed ... is the agent neither of the debenture-holders whose credit he cannot pledge, nor of the company, which cannot control him. He is an officer of the Court put in to discharge certain duties prescribed by the order appointing him; duties which in the present case extended to the continuation and management of the business. The company remains in existence, but it has lost its title to control its assets and affairs ...

15 Unlike a trustee in bankruptcy, a receiver does not become vested with title to the debtor's property. He only has possession and custody of them. As stated in Kerr on Receivers, 15th ed. (1978), at p. 130:

> The appointment of a receiver does not in any way affect the right to the property over which he is appointed. The court takes possession by its receiver, and his possession is that of all parties to the action according to their titles ... [*Re Butler* (1863) 13 L.R. Ir. 456; *Bertrand v. Davies* (1862) 31 Beav. 436.]

The appellant argued that the key portion of this passage was the statement that the possession of the court was the possession only of the parties to the action, and not the possession of all persons who might be interested in the property of the debtor. He cited two cases in support of that proposition: *Harrisson v. Duignan* (1842), 2 Dr. & War. 295, and *Wrixon v. Vize* (1842), 3 Dr. & War. 104. Both cases dealt with receivers appointed by the court to protect the interest of minors in land. The first case held that the appointment of a receiver did not affect the operation of a Statute of Limitations against a stranger to the action. The second case held that the appointment of a receiver did prevent a Statute of Limitations from operating in favour of a stranger to the action. The appellant concluded, relying as well on the

interpretation of the same cases in Kerr at pp. 142 and 159, and 39 Halsbury's Laws of England, 4th ed., para. 877, that the application of limitation periods to the recovery of property or the enforcement of encumbrances against an estate in receivership depended entirely upon who was a party to the action. If the person claiming a paramount right was a party to the action, the possession of the receiver was his possession and therefore the appointment of the receiver would prevent the running of the limitation period. If he was a stranger to the action and was out of possession, time would continue to run against him as the possession of the receiver was not his possession. Thus the appellant said, in this case, the respondents being strangers to the action, time ran against them under s. 19, the trust terminated, and the bank had priority.

16 While the foregoing is, in our opinion, an accurate statement of the common law as it existed at the dates of the cases decided, we do not agree that the venerable cases cited by the appellant apply to this case. They were concerned with use of receiverships to protect the property of minors, a procedure long since fallen into desuetude, and were concerned with adverse possessory claims to land where actual possession was always a crucial factor in determining whether and when limitation periods ran. Furthermore, we are dealing in this case with receivables and cash where actual possession has no bearing on right to claims of entitlement to it. Most importantly, Saskatchewan legislation now governs the appointment and delineates some of the duties of the receiver, and in this case, the receiver has additional obligations superimposed by the Builders' Lien Act.

17 The receiver was appointed under the provisions of the Business Corporations Act, R.S.S. 1978, c. B-10. The relevant provisions of the Act are as follows:

> 89. A receiver of any property of a corporation may, subject to the rights of secured creditors, receive the income from the property and pay the liabilities connected with the property and realize the security interest of those on behalf of whom he is appointed, but, except to the extent permitted by a court, he may not carry on the business of the corporation.
>
> 91. If a receiver-manager is appointed by a court or under an instrument, the powers of the directors of the corporation that the receiver-manager is authorized to exercise may not be exercised by the directors until the receiver-manager is discharged.
>
> 92. A receiver or receiver-manager appointed by a court shall act in accordance with the directions of the court.
>
> 95. Upon an application by a receiver or receiver-manager, whether appointed by a court or under an instrument, or upon an application by any interested person, a court may make any order it thinks fit including, without limiting the generality of the foregoing:
>
> (*d*) an order requiring the receiver or receiver-manager, or a person by or on behalf of whom he is appointed, to make good any default in connection with the receiver's or receiver-manager's custody or management of the property and business of the corporation, or to relieve any such person from any default on such terms as the court thinks fit, and to confirm any act of the receiver or receiver-manager.

18 Thus the receiver held the receivables and moneys paid on account thereof in two representative capacities — as receiver-manager responsible to the court (s. 92 of the Business Corporations Act, and the terms of the order appointing the receiver) and as trustee under s. 7 of the Builders' Lien Act. We reject the argument of the bank that the latter statute made Simmons only the trustee, and that the appointment of the receiver, which gave only the right to possession and not ownership of the receivables, could not substitute the receiver as trustee in the place of Simmons. The receiver received the receivables impressed with the trust. Section 16 of the Builders' Lien Act made anyone who had effective control of a corporation or its relevant activities liable for any breach of trust by the corporation, if assented to or acquiesced in. Simmons was prohibited from dealing with the receivables by s. 91 of the Business Corporations Act. Thus, the receiver became the de facto trustee.

19 The intent of the Builders Lien Act was that the trust fund be used to pay unpaid subcontractors. That did not happen because the directors of Simmons could not do so by reason of s. 91 of the Business Corporations Act and the receiver, for unexplained reasons, did not discover the existence of the unpaid subcontractors until after the time limitation in s. 19 had expired.

20 The material before us discloses that nine or ten months elapsed between the date of appointment of the receiver and the commencement of the review of accounts that disclosed the trust claims of the subcontractors. Another two or three months elapsed before the review was completed, and another three months elapsed before the receiver applied to the court for directions with respect to the claims. No explanation was given for the delays, nor was there any suggestion or evidence of any improper motive on the part of the receiver, and in particular, no suggestion that the receiver deliberately sought to affect priorities between the subcontractors and the bank. Nevertheless, the failure to discover the claims and to apply to the court for directions until about 16 months after the date of the appointment must be considered a breach of the receiver's obligation to the court to act with diligence and within a reasonable time. The receiver, and through it the bank, must bear responsibility for the consequences of the failure to act with sufficient diligence to discover the claims within a reasonable time, thereby permitting lapse of the limitation period.

21 What is clear is that, when the receiver was appointed, the subcontractors were entitled to payment from the trust fund. The failure to make payment to the subcontractors within a reasonable time thereafter, an obligation imposed by s. 89 of the Business Corporations Act and s. 7 of the Builders' Lien Act taken together, was in default of those statutory obligations. If the receiver had applied to the court for directions for payment out of the moneys on that date or within a reasonable time thereafter, the money would have been ordered paid to the subcontractors. The result is that the default of the receiver in failing to act with sufficient promptness and diligence to discover and pay the claims against the trust before expiration of the limitation period has deprived the subcontractors of the right to realize their claims from the trust fund.

22 The bank now seeks to benefit from that default and the receiver supports its position. That position is untenable. While it may not be improper for a private debtor to withhold payment of a debt due and owing, whether deliberately or by neglect or oversight, and thereby benefit from an intervening limitation period, the same is not true of a receiver, for he is an officer of the court. The receiver's action is the action of the court and the court will not permit or approve any action on the part of its officer which has the effect of changing the rights of competing creditors, whether deliberately or by default.

23 The receiver and the bank argued that the onus was on the subcontractors to assert their claims, rather than on the receiver to discover and pay them. That might be so in other claims against a receiver or the person at whose instance he was appointed. However, in this case, as noted above, we view s. 89 of the Business Corporations Act and s. 7 of the Builders' Lien Act, taken together, as imposing a positive obligation on the receiver to pay the subcontractors from the trust fund within a reasonable time.

24 The court has the power to direct payment to the subcontractors by virtue of s. 92 of the Business Corporations Act and by virtue of the terms of the order appointing the receiver, both of which make distribution by the receiver subject to the direction of the court. The bank, at whose instance the order was obtained, is bound by those provisions.

25 If there is any doubt about the right of the court to act under s. 92 or the order, we would invoke the provisions of s. 95(*d*) of the Business Corporations Act, which permits the court to require the receiver and the bank to make good any default in respect of the receivership. The failure of the receiver to discover and pay the claims of the subcontractors within a reasonable time is such a default and is deserving of remedy by requiring payment by the receiver to the subcontractors from the moneys which would have constituted the trust fund created by the Builders' Lien Act.

26 The court did not consider whether the receiver was in a fiduciary relationship to all interested persons, whether parties to the action or not, either at common law, or by reason of the relevant provisions of the Business Corporations

Act, or the Builders' Lien Act, and if so, the effect of that relationship. That question is left open. However, reference must be made to the position of the receiver on an application such as this. The receiver, in its factum, strongly supported the position of the bank. At the opening of the hearing of the appeal, counsel for the receiver was asked why, since the receiver was not the agent of the bank, but an officer of the court, it was taking a position favouring one party against the other. Counsel indicated that he would take no position in argument. Nevertheless, he spoke, when the time came, in favour of the position of the bank. The court took exception to this for two reasons. First, it gave the appearance that the receiver felt itself to be agent of the bank and acted accordingly, which would not be a proper position for an officer of the court. Secondly, since the receiver's failure to act promptly gave rise to the bank's claim to priority, the position taken again gave the appearance of favouring its own interest and that of the bank against another party. We do not suggest any improper motives or lack of good faith on the part of either the receiver or counsel, but take the opportunity to re-emphasize that a court-appointed receiver is not an agent of the secured creditor or anyone else, but is an officer of the court. He must act accordingly.

27 The appeal must therefore fail. The order below is now inappropriate. The application was for advice and directions. It is declared that the receiver shall pay the claims of the respondent subcontractors from the funds received on account of the appropriate contract or contracts. The respondents will have their costs under double col. V.

Appeal dismissed.

End of Document

TAB 2

Notice of Revision

To: Computershare Trust Company of Canada (the "**Claimant**")

Date: June 21, 2017

Proof of Claim No. 134

IN THE MATTER OF THE RECEIVERSHIP OF TWIN BUTTE ENERGY LTD. ("TWIN BUTTE")

Take notice that FTI Consulting Canada Inc., in its capacity as court-appointed receiver of Twin Butte (the "**Receiver**") has reviewed the Proof of Claim in respect of the above-named Claimant, and has assessed the Proof of Claim in accordance with the order of the Alberta Court of Queen's Bench issued on April 27, 2017 (the "**Claims Procedure Order**").

All capitalized terms not defined herein have the meaning given to such terms in the Claims Procedure Order.

The Receiver has reviewed your (*Proof of Claim*) in accordance with the Claims Procedure Order, and has revised your Claim, for the following reason(s):

_____The Proof of Claim submitted has been revised to reflect the following adjustments:

1) Classification of the claim is revised from "unsecured" to "subordinate unsecured" pursuant to the Subordination Provisions in the Convertible Debenture Indenture between Twin Butte Energy Ltd. and Valiant Trust Company dated as of December 13, 2013 (the **Indenture**);
2) The "Subsequent Claim" for damages of **$451,198.63** is rejected in full as it is considered to be duplicative of the debt claim, barred by the terms of the Indenture including clause 5.2(c) thereof, are not provable, and are otherwise contrary to law; and
3) Post-receivership interest in the amount of **$3,664,168.28** has been disallowed from the claim by application of the "interest stop" rule.

Based on the above reasons, the total amount disallowed from the claim is **$4,115,366.91**, reducing the revised, accepted claim amount to **$88,584,758.15** and the revised classification to a subordinate unsecured claim.

Note: *The Receiver noted a discrepancy between the total claim value per page one of the Amended Proof of Claim ($92,671,961.15, representative of $92,220,726.52 for debt and damages, plus $451,198.63 for subsequent damages) and Schedule B – Appendix 1, which calculated the total claim value as $92,700,125.07. The above revisions were calculated based on the figures provided in Schedule B – Appendix 1. The Receiver's revised calculation (based off of Schedule B – Appendix 1) is attached.*

_____

_____

Subject to further dispute by you in accordance with the Claims Procedure, your Claim will be allowed as follows:

Name of Claimant	Claim Amount per Proof of Claim	Classification of Claim per Proof of Claim	Amount of Revised Claim	Classification of Claim revised
Computershare Trust Company of Canada	$92,671,925.15	Unsecured	**$88,584,758.15**	**Subordinate Unsecured**

IF YOU WISH TO DISPUTE THE REVISION OR DISALLOWANCE OF YOUR CLAIM AS SET FORTH HEREIN YOU MUST TAKE THE STEPS OUTLINED BELOW

The Claims Procedure Order provides that if you disagree with the revision or disallowance of your claim as set forth herein, you must:

1. before 5:00 P.M. on the fifteenth (15th) Calendar Day after your receipt of this Notice of Revision or Disallowance, whichever is earlier, deliver to the Receiver a completed Notice of Dispute; and

2. file an application with the Court, with copies to be sent to the Receiver immediately after filing, with such application to be:

    i. supported by an affidavit setting out the basis for disputing this Notice of Revision or Disallowance; and

    ii. returnable within ten (10) Calendar Days of the date on which the Receiver receives your completed Notice of Dispute.

If you do not dispute the revision or disallowance of your Claim in accordance with the above instructions and the Claims Procedure Order, the amount and classification of your Claim will deemed to be accepted, and the Claim shall be a Proven Claim in the amount, and classification, set forth herein.

If you have any questions or concerns regarding the Claims Procedure, or the attached materials, please contact the Receiver directly.

DATED the _21st _ day of __June__, 2017

FTI Consulting Canada Inc., in its capacity as Receiver of Twin Butte Energy Ltd.

Per: 

Schedule A - Re-calculation of revised claim for Computershare Trust Company of Canada
June 21, 2017

			FTI Revisions	
			Accepted Claim	Rejected
POC - Per Schedule B, Appendix 1	**$ 92,700,125.07**	**Notes:**	**$ 88,584,758.15**	**$ 4,115,366.91**
Principal	**85,000,000.00**	**ok**	85,000,000.00	-
June 30, 2016 Interest Payment	**2,656,250.00**	**ok**	2,656,250.00	-
Interest on overdue June 30 payment	**151,230.93**	**Note 1**	28,576.46	122,654.47
December 31, 2016 Interest Payment	**2,656,250.00**	**Note 2**	899,931.69	1,756,318.31
Interest on overdue Dec payment	**67,769.52**	**Note 1**	-	67,769.52
Dec 31/16 - Jan 1/17 int	**14,515.03**	**Note 3**	-	14,515.03
jan 1 - apr 28 2017 interest	**1,702,910.96**	**Note 3**	-	1,702,910.96
Apr 28 - May 29 interest	**451,198.63**	**Note 3**	-	451,198.63

Notes:

Note 1 **INTEREST ON OVERDUE INTEREST**

Interest Payment - per POC Schedule B, Appendix 1							
30-Jun-16	2,656,250	30-Jun-16	1-Jan-17	185	366	$	83,915.00
		1-Jan-17	29-May-17	148	365	$	67,315.92
						$	**151,230.93**
31-Dec-16	2,656,250	31-Dec-16	1-Jan-17	1	366	$	453.59
		1-Jan-17	29-May-17	148	365	$	67,315.92
						$	**67,769.52**

Interest Payment - Accepted (FTI Re-calc)							
30-Jun-16	2,656,250	30-Jun-16	**1-Sep-16**	63	366	$	28,576.46
						$	**28,576.46**
31-Dec-16	2,656,250	n/a as full period for overdue calc is post receivership					
						$	**-**
rate			**6.25%**				

Note 2

			Period		# of Days		Interest/Day	
December 31, 2016 Interest Payment	2,656,250	**A**	1-Jul-16	31-Dec-16	183	**B**	14,515.03	**C = A/B**
Interest Payment for Pre-Receivership Period			1-Jul-16	**1-Sep-16**	62	**D**	**899,931.69**	**E = C*D**

Note 3 Amounts calculated and included in claim for interest Post-Receivership (post-September 1, 2016) are disallowed in their entirety per interest stop rules.

TAB 3

CANADA

CONSOLIDATION

CODIFICATION

Bankruptcy and Insolvency Act

Loi sur la faillite et l'insolvabilité

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

L.R.C. (1985), ch. B-3

Current to June 5, 2017

Last amended on February 26, 2015

À jour au 5 juin 2017

Dernière modification le 26 février 2015

Published by the Minister of Justice at the following address:
http://laws-lois.justice.gc.ca

Publié par le ministre de la Justice à l'adresse suivante :
http://lois-laws.justice.gc.ca

OFFICIAL STATUS OF CONSOLIDATIONS

Subsections 31(1) and (2) of the *Legislation Revision and Consolidation Act*, in force on June 1, 2009, provide as follows:

Published consolidation is evidence
31 (1) Every copy of a consolidated statute or consolidated regulation published by the Minister under this Act in either print or electronic form is evidence of that statute or regulation and of its contents and every copy purporting to be published by the Minister is deemed to be so published, unless the contrary is shown.

Inconsistencies in Acts
(2) In the event of an inconsistency between a consolidated statute published by the Minister under this Act and the original statute or a subsequent amendment as certified by the Clerk of the Parliaments under the *Publication of Statutes Act*, the original statute or amendment prevails to the extent of the inconsistency.

NOTE

This consolidation is current to June 5, 2017. The last amendments came into force on February 26, 2015. Any amendments that were not in force as of June 5, 2017 are set out at the end of this document under the heading "Amendments Not in Force".

CARACTÈRE OFFICIEL DES CODIFICATIONS

Les paragraphes 31(1) et (2) de la *Loi sur la révision et la codification des textes législatifs*, en vigueur le 1er juin 2009, prévoient ce qui suit :

Codifications comme élément de preuve
31 (1) Tout exemplaire d'une loi codifiée ou d'un règlement codifié, publié par le ministre en vertu de la présente loi sur support papier ou sur support électronique, fait foi de cette loi ou de ce règlement et de son contenu. Tout exemplaire donné comme publié par le ministre est réputé avoir été ainsi publié, sauf preuve contraire.

Incompatibilité — lois
(2) Les dispositions de la loi d'origine avec ses modifications subséquentes par le greffier des Parlements en vertu de la *Loi sur la publication des lois* l'emportent sur les dispositions incompatibles de la loi codifiée publiée par le ministre en vertu de la présente loi.

NOTE

Cette codification est à jour au 5 juin 2017. Les dernières modifications sont entrées en vigueur le 26 février 2015. Toutes modifications qui n'étaient pas en vigueur au 5 juin 2017 sont énoncées à la fin de ce document sous le titre « Modifications non en vigueur ».

PART IV

Property of the Bankrupt

Property of bankrupt

67 (1) The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person;

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides;

(b.1) goods and services tax credit payments that are made in prescribed circumstances to the bankrupt and that are not property referred to in paragraph (a) or (b);

(b.2) prescribed payments relating to the essential needs of an individual that are made in prescribed circumstances to the bankrupt and that are not property referred to in paragraph (a) or (b); or

(b.3) without restricting the generality of paragraph (b), property in a registered retirement savings plan or a registered retirement income fund, as those expressions are defined in the *Income Tax Act*, or in any prescribed plan, other than property contributed to any such plan or fund in the 12 months before the date of bankruptcy,

but it shall comprise

(c) all property wherever situated of the bankrupt at the date of the bankruptcy or that may be acquired by or devolve on the bankrupt before their discharge, including any refund owing to the bankrupt under the *Income Tax Act* in respect of the calendar year — or the fiscal year of the bankrupt if it is different from the calendar year — in which the bankrupt became a bankrupt, except the portion that

(i) is not subject to the operation of this Act, or

(ii) in the case of a bankrupt who is the judgment debtor named in a garnishee summons served on Her Majesty under the *Family Orders and Agreements Enforcement Assistance Act*, is garnishable money that is payable to the bankrupt and is to be paid under the garnishee summons, and

(d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

PARTIE IV

Biens du failli

Biens du failli

67 (1) Les biens d'un failli, constituant le patrimoine attribué à ses créanciers, ne comprennent pas les biens suivants :

a) les biens détenus par le failli en fiducie pour toute autre personne;

b) les biens qui, selon le droit applicable dans la province dans laquelle ils sont situés et où réside le failli, ne peuvent faire l'objet d'une mesure d'exécution ou de saisie contre celui-ci;

b.1) dans les circonstances prescrites, les paiements qui sont faits au failli au titre de crédits de taxe sur les produits et services et qui ne sont pas des biens visés aux alinéas a) ou b);

b.2) dans les circonstances prescrites, les paiements prescrits qui sont faits au failli relativement aux besoins essentiels de personnes physiques et qui ne sont pas des biens visés aux alinéas a) ou b);

b.3) sans restreindre la portée générale de l'alinéa b), les biens détenus dans un régime enregistré d'épargne-retraite ou un fonds enregistré de revenu de retraite, au sens de la *Loi de l'impôt sur le revenu*, ou dans tout régime prescrit, à l'exception des cotisations au régime ou au fonds effectuées au cours des douze mois précédant la date de la faillite,

mais ils comprennent :

c) tous les biens, où qu'ils soient situés, qui appartiennent au failli à la date de la faillite, ou qu'il peut acquérir ou qui peuvent lui être dévolus avant sa libération, y compris les remboursements qui lui sont dus au titre de la *Loi de l'impôt sur le revenu* relativement à l'année civile — ou à l'exercice lorsque celui-ci diffère de l'année civile — au cours de laquelle il a fait faillite, mais à l'exclusion de la partie de ces remboursements qui :

(i) soit sont des sommes soustraites à l'application de la présente loi,

(ii) soit sont des sommes qui lui sont dues et qui sont saisissables en vertu d'un bref de saisie-arrêt signifié à Sa Majesté en application de la *Loi d'aide à l'exécution des ordonnances et des ententes familiales* dans lequel il est nommé comme débiteur;

d) les pouvoirs sur des biens ou à leur égard, qui auraient pu être exercés par le failli pour son propre bénéfice.

Deemed trusts

(2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(a) unless it would be so regarded in the absence of that statutory provision.

Fiducies présumées

(2) Sous réserve du paragraphe (3) et par dérogation à toute disposition législative fédérale ou provinciale ayant pour effet d'assimiler certains biens à des biens détenus en fiducie pour Sa Majesté, aucun des biens du failli ne peut, pour l'application de l'alinéa (1)a), être considéré comme détenu en fiducie pour Sa Majesté si, en l'absence de la disposition législative en question, il ne le serait pas.

Exceptions

(3) Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a ***province providing a comprehensive pension plan*** as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a ***provincial pension plan*** as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

R.S., 1985, c. B-3, s. 67; 1992, c. 27, s. 33; 1996, c. 23, s. 168; 1997, c. 12, s. 59; 1998, c. 19, s. 250; 2005, c. 47, s. 57; 2007, c. 36, s. 32.

Exceptions

(3) Le paragraphe (2) ne s'applique pas à l'égard des montants réputés détenus en fiducie aux termes des paragraphes 227(4) ou (4.1) de la *Loi de l'impôt sur le revenu*, des paragraphes 23(3) ou (4) du *Régime de pensions du Canada* ou des paragraphes 86(2) ou (2.1) de la *Loi sur l'assurance-emploi* (chacun étant appelé « disposition fédérale » au présent paragraphe) ou à l'égard des montants réputés détenus en fiducie aux termes de toute loi d'une province créant une fiducie présumée dans le seul but d'assurer à Sa Majesté du chef de cette province la remise de sommes déduites ou retenues aux termes d'une loi de cette province, dans la mesure où, dans ce dernier cas, se réalise l'une des conditions suivantes :

a) la loi de cette province prévoit un impôt semblable, de par sa nature, à celui prévu par la *Loi de l'impôt sur le revenu*, et les sommes déduites ou retenues aux termes de la loi de cette province sont de même nature que celles visées aux paragraphes 227(4) ou (4.1) de la *Loi de l'impôt sur le revenu*;

b) cette province est ***une province instituant un régime général de pensions*** au sens du paragraphe 3(1) du *Régime de pensions du Canada*, la loi de cette province institue un ***régime provincial de pensions*** au sens de ce paragraphe, et les sommes déduites ou retenues aux termes de la loi de cette province sont de même nature que celles visées aux paragraphes 23(3) ou (4) du *Régime de pensions du Canada*.

Pour l'application du présent paragraphe, toute disposition de la loi provinciale qui crée une fiducie présumée est réputée avoir, à l'encontre de tout créancier du failli et malgré tout texte législatif fédéral ou provincial et toute règle de droit, la même portée et le même effet que la disposition fédérale correspondante, quelle que soit la garantie dont bénéficie le créancier.

L.R. (1985), ch. B-3, art. 67; 1992, ch. 27, art. 33; 1996, ch. 23, art. 168; 1997, ch. 12, art. 59; 1998, ch. 19, art. 250; 2005, ch. 47, art. 57; 2007, ch. 36, art. 32.

Protection of trustee

80 If the trustee has seized or disposed of property in the possession or on the premises of a bankrupt without notice of any claim in respect of the property and after the seizure or disposal it is made to appear that the property, at the date of the bankruptcy, was not the property of the bankrupt or was subject to an unregistered security or charge, the trustee is not personally liable for any loss or damage arising from the seizure or disposal sustained by any person claiming the property, interest in property or, in the Province of Quebec, a right in property, or for the costs of proceedings taken to establish a claim to that property, interest or right, unless the court is of opinion that the trustee has been negligent with respect to the trustee's duties in relation to the property.

R.S., 1985, c. B-3, s. 80; 1997, c. 12, s. 71; 2004, c. 25, s. 48.

Persons claiming property in possession of bankrupt

81 (1) Where a person claims any property, or interest therein, in the possession of a bankrupt at the time of the bankruptcy, he shall file with the trustee a proof of claim verified by affidavit giving the grounds on which the claim is based and sufficient particulars to enable the property to be identified.

How claim disposed of

(2) The trustee with whom a proof of claim is filed under subsection (1) shall within 15 days after the filing of the claim or within 15 days after the first meeting of creditors, whichever is the later, either admit the claim and deliver possession of the property to the claimant or send notice in the prescribed manner to the claimant that the claim is disputed, with the trustee's reasons for disputing it, and, unless the claimant appeals the trustee' decision to the court within 15 days after the sending of the notice of dispute, the claimant is deemed to have abandoned or relinquished all his or her right to or interest in the property to the trustee who may then sell or dispose of the property free of any right, title or interest of the claimant.

Onus on claimant

(3) The onus of establishing a claim to or in property under this section is on the claimant.

Require proof of claim

(4) The trustee may send notice in the prescribed manner to any person to prove his or her claim to or in property under this section, and, unless that person files with the trustee a proof of claim, in the prescribed form, within 15 days after the sending of the notice, the trustee may then, with the leave of the court, sell or dispose of the property free of any right, title or interest of that person.

Protection du syndic

80 Lorsque le syndic a saisi des biens en la possession ou dans le local d'un failli, ou en a disposé, sans qu'ait été donné avis de réclamation relativement aux biens, et lorsqu'il est démontré que, à la date de la faillite, les biens n'étaient pas la propriété du failli ou étaient grevés d'une sûreté ou d'une charge non enregistrée, le syndic ne peut être tenu personnellement responsable du préjudice résultant de cette saisie ou disposition et subi par une personne réclamant ces biens, un intérêt ou, dans la province de Québec, un droit sur ces biens, ni des frais de procédures intentées pour établir une réclamation à cet égard, à moins que le tribunal ne soit d'avis que le syndic a été négligent en ce qui concerne ses obligations à l'égard des biens.

L.R. (1985), ch. B-3, art. 80; 1997, ch. 12, art. 71; 2004, ch. 25, art. 48.

Personnes réclamant des biens en possession d'un failli

81 (1) Lorsqu'une personne réclame des biens, ou un intérêt dans des biens, en la possession du failli au moment de la faillite, elle doit produire au syndic une preuve de réclamation attestée par affidavit indiquant les motifs à l'appui de la réclamation et des détails suffisants pour permettre l'identification des biens.

Comment disposer de la réclamation produite

(2) Lorsqu'il reçoit une preuve de réclamation produite en vertu du paragraphe (1), le syndic doit, dans les quinze jours qui suivent la réception ou, si elle est postérieure, la première assemblée de créanciers, soit admettre la réclamation et mettre le réclamant en possession des biens, soit informer ce dernier, par avis envoyé de la manière prescrite, qu'il conteste la réclamation, moyens à l'appui; à moins que le réclamant n'en appelle au tribunal dans les quinze jours qui suivent l'envoi de l'avis de contestation, il est censé avoir délaissé ou abandonné tout droit ou intérêt sur ces biens en faveur du syndic, qui peut dès lors les vendre ou les aliéner sans que le réclamant retienne quelque droit, titre ou intérêt en l'espèce.

Fardeau de la preuve

(3) La charge d'établir une réclamation sur des biens, sous l'autorité du présent article, incombe au réclamant.

Production de la preuve

(4) Le syndic peut, par avis envoyé de la manière prescrite, demander à toute personne de prouver sa réclamation sur des biens en vertu du présent article; à moins que cette personne ne produise au syndic une preuve de réclamation en la forme prescrite, dans les quinze jours qui suivent l'envoi de l'avis, le syndic peut dès lors, avec l'autorisation du tribunal, vendre ce bien ou l'aliéner sans

No other proceeding to be instituted

(5) No proceedings shall be instituted to establish a claim to, or to recover any right or interest in, any property in the possession of a bankrupt at the time of the bankruptcy, except as provided in this section.

Rights of others not extended

(6) Nothing in this section shall be construed as extending the rights of any person other than the trustee.

R.S., 1985, c. B-3, s. 81; 2005, c. 47, s. 65.

Right of unpaid supplier to repossess goods

81.1 (1) Subject to this section, if a person (in this section referred to as the "supplier") has sold to another person (in this section referred to as the "purchaser") goods for use in relation to the purchaser's business and delivered the goods to the purchaser or to the purchaser's agent or mandatary, and the purchaser has not fully paid for the goods, the supplier may have access to and repossess the goods at the supplier's own expense, and the purchaser, trustee or receiver, or the purchaser's agent or mandatary, as the case may be, shall release the goods, if

(a) the supplier presents a written demand for repossession to the purchaser, trustee or receiver, in the prescribed form and containing the details of the transaction, within a period of 15 days after the day on which the purchaser became bankrupt or became a person who is subject to a receivership;

(b) the goods were delivered within 30 days before the day on which the purchaser became bankrupt or became a person who is subject to a receivership;

(c) at the time when the demand referred to in paragraph (a) is presented, the goods

(i) are in the possession of the purchaser, trustee or receiver,

(ii) are identifiable as the goods delivered by the supplier and not fully paid for,

(iii) are in the same state as they were on delivery,

(iv) have not been resold at arms' length, and

(v) are not subject to any agreement for sale at arms' length; and

(d) the purchaser, trustee or receiver does not, forthwith after the demand referred to in paragraph (a) is

que cette personne retienne quelque droit, titre ou intérêt en l'espèce.

Nulle autre procédure

(5) Nulle procédure ne peut être intentée pour établir une réclamation ou pour recouvrer un droit ou un intérêt à l'égard d'un bien en la possession d'un failli au moment de la faillite, sauf disposition contraire du présent article.

Les droits d'autres personnes ne sont pas étendus

(6) Le présent article n'a pas pour effet d'étendre les droits de personnes autres que le syndic.

L.R. (1985), ch. B-3, art. 81; 2005, ch. 47, art. 65.

Droit du fournisseur impayé

81.1 (1) Sous réserve des autres dispositions du présent article, le fournisseur qui a vendu à un acheteur, qui ne les lui a pas payées au complet, des marchandises destinées à être utilisées dans le cadre des affaires de celui-ci et qui les a livrées à celui-ci ou à son mandataire peut avoir accès à ces marchandises — l'acheteur, le syndic, le séquestre ou le mandataire étant tenu d'accorder mainlevée à cet égard — et en reprendre possession à ses propres frais, lorsque les conditions suivantes sont réunies :

a) dans les quinze jours suivant la date à laquelle l'acheteur fait faillite ou fait l'objet d'une mise sous séquestre, il présente à l'acheteur, au syndic ou au séquestre, en la forme prescrite, une demande écrite à cet effet contenant les détails de la transaction;

b) les marchandises ont été livrées dans les trente jours précédant cette date;

c) au moment de la présentation de la demande, les marchandises sont en la possession de l'acheteur, du syndic ou du séquestre, peuvent être identifiées comme celles qui ont été livrées par le fournisseur et ne lui ont pas été payées au complet, sont dans le même état qu'au moment de leur livraison, n'ont pas été revendues à une personne sans lien de dépendance et ne font pas l'objet d'une promesse de vente à une personne sans lien de dépendance;

d) ni l'acheteur, ni le syndic, ni le séquestre n'ont, dès la présentation de la demande, acquitté le solde impayé.

time verify the bank balance of the estate, examine the trustee's accounts and inquire into the adequacy of the security filed by the trustee and, subject to subsection (4), shall approve the trustee's final statement of receipts and disbursements, dividend sheet and disposition of unrealized property.

de l'actif, examinent ses comptes, s'enquièrent de la suffisance de la garantie fournie par le syndic et, sous réserve du paragraphe (4), approuvent l'état définitif des recettes et des débours préparé par le syndic, le bordereau de dividende et la disposition des biens non réalisés.

Approval of trustee's final statement by inspectors

(4) Before approving the final statement of receipts and disbursements of the trustee, the inspectors shall satisfy themselves that all the property has been accounted for and that the administration of the estate has been completed as far as can reasonably be done and shall determine whether or not the disbursements and expenses incurred are proper and have been duly authorized, and the fees and remuneration just and reasonable in the circumstances.

Approbation par les inspecteurs de l'état définitif préparé par le syndic

(4) Avant d'approuver l'état définitif des recettes et des débours du syndic, les inspecteurs doivent s'assurer eux-mêmes qu'il a été rendu compte de tous les biens et que l'administration de l'actif a été complétée, dans la mesure où il est raisonnablement possible de le faire, et doivent établir si les débours et dépenses subis sont appropriés ou non et ont été dûment autorisés et si les honoraires et la rémunération sont justes et raisonnables en l'occurrence.

inspector's expenses and fees

(5) Each inspector

(a) may be repaid actual and necessary travel expenses incurred in relation to the performance of the inspector's duties; and

(b) may be paid such fees per meeting as are prescribed.

Frais et honoraires

(5) Chaque inspecteur peut être remboursé des frais de déplacement réels et nécessaires engagés dans le cadre de ses fonctions et il peut aussi recevoir les honoraires prescrits pour chaque assemblée.

Special services

(6) An inspector duly authorized by the creditors or by the other inspectors to perform special services for the estate may be allowed a special fee for those services, subject to approval of the court, which may vary that fee as it deems proper having regard to the nature of the services rendered in relation to the obligations of the inspector to the estate to act in good faith for the general interests of the administration of the estate.

R.S., 1985, c. B-3, s. 120; 1992, c. 27, s. 49; 2001, c. 4, s. 30; 2004, c. 25, s. 65(F); 2005, c. 47, s. 85.

Services spéciaux

(6) Un inspecteur régulièrement autorisé par les créanciers ou par les autres inspecteurs à exécuter des services spéciaux pour le compte de l'actif peut avoir droit à des honoraires spéciaux pour ces services, sous réserve de l'approbation du tribunal qui peut modifier ces honoraires comme il le juge à propos eu égard à la nature des services rendus par rapport à l'obligation qu'a l'inspecteur d'agir de bonne foi en vue de l'intérêt général de l'administration de l'actif.

L.R. (1985), ch. B-3, art. 120; 1992, ch. 27, art. 49; 2001, ch. 4, art. 30; 2004, ch. 25, art. 65(F); 2005, ch. 47, art. 85.

Claims Provable

Réclamations prouvables

Claims provable

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

Réclamations prouvables

121 (1) Toutes créances et tous engagements, présents ou futurs, auxquels le failli est assujetti à la date à laquelle il devient failli, ou auxquels il peut devenir assujetti avant sa libération, en raison d'une obligation contractée antérieurement à cette date, sont réputés des réclamations prouvables dans des procédures entamées en vertu de la présente loi.

Contingent and unliquidated claims

(2) The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such a claim shall be made in accordance with section 135.

Debts payable at a future time

(3) A creditor may prove a debt not payable at the date of the bankruptcy and may receive dividends equally with the other creditors, deducting only thereout a rebate of interest at the rate of five per cent per annum computed from the declaration of a dividend to the time when the debt would have become payable according to the terms on which it was contracted.

Family support claims

(4) A claim in respect of a debt or liability referred to in paragraph 178(1)(b) or (c) payable under an order or agreement made before the date of the initial bankruptcy event in respect of the bankrupt and at a time when the spouse, former spouse, former common-law partner or child was living apart from the bankrupt, whether the order or agreement provides for periodic amounts or lump sum amounts, is a claim provable under this Act.

R.S., 1985, c. B-3, s. 121; 1992, c. 27, s. 50; 1997, c. 12, s. 87; 2000, c. 12, s. 14.

Claims provable in bankruptcy following proposal

122 (1) The claims of creditors under a proposal are, in the event of the debtor subsequently becoming bankrupt, provable in the bankruptcy for the full amount of the claims less any dividends paid thereon pursuant to the proposal.

Interest

(2) If interest on any debt or sum certain is provable under this Act but the rate of interest has not been agreed on, the creditor may prove interest at a rate not exceeding five per cent per annum to the date of the bankruptcy from the time the debt or sum was payable, if evidenced by a written document, or, if not so evidenced, from the time notice has been given the debtor of the interest claimed.

R.S., 1985, c. B-3, s. 122; 2004, c. 25, s. 66(E).

Proof in respect of distinct contracts

123 Where a bankrupt was, at the date of the bankruptcy, liable in respect of distinct contracts as a member of two or more distinct firms, or as a sole contractor and also as member of a firm, the circumstance that the firms are in whole or in part composed of the same individuals,

Décision

(2) La question de savoir si une réclamation éventuelle ou non liquidée constitue une réclamation prouvable et, le cas échéant, son évaluation sont décidées en application de l'article 135.

Créances payables à une date future

(3) Un créancier peut établir la preuve d'une créance qui n'est pas échue à la date de la faillite, et recevoir des dividendes tout comme les autres créanciers, en en déduisant seulement un rabais d'intérêt au taux de cinq pour cent par an calculé à compter de la déclaration d'un dividende jusqu'à la date où la créance devait échoir selon les conditions auxquelles elle a été contractée.

Réclamations alimentaires

(4) Constitue une réclamation prouvable la réclamation pour une dette ou une obligation mentionnée aux alinéas 178(1)b) ou c) découlant d'une ordonnance judiciaire rendue ou d'une entente conclue avant l'ouverture de la faillite et à un moment où l'époux, l'ex-époux ou ancien conjoint de fait ou l'enfant ne vivait pas avec le failli, que l'ordonnance ou l'entente prévoie une somme forfaitaire ou payable périodiquement.

L.R. (1985), ch. B-3, art. 121; 1992, ch. 27, art. 50; 1997, ch. 12, art. 87; 2000, ch. 12, art. 14.

Réclamations prouvables en faillite à la suite d'une proposition

122 (1) Les réclamations des créanciers aux termes d'une proposition sont, dans le cas où le débiteur deviendrait subséquemment en faillite, prouvables dans la faillite pour le plein montant des réclamations moins tout dividende payé à cet égard en conformité avec la proposition.

Intérêts

(2) Lorsque l'intérêt sur toute créance ou somme déterminée est prouvable sous le régime de la présente loi, mais qu'il n'a pas été convenu du taux d'intérêt, le créancier peut établir la preuve d'un intérêt à un taux maximal de cinq pour cent par an jusqu'à la date de la faillite à compter de la date où la créance ou somme était exigible, si elle est attestée par un document écrit, ou, si elle n'est pas ainsi attestée, à compter de la date où il a été donné au débiteur avis de la réclamation d'intérêt.

L.R. (1985), ch. B-3, art. 122; 2004, ch. 25, art. 66(A).

Preuve à l'égard de contrats distincts

123 Lorsqu'un failli était, à la date de la faillite, responsable à l'égard de contrats distincts, en qualité de membre de plusieurs firmes distinctes, ou en qualité de signataire individuel des contrats et aussi à titre de membre d'une firme, le fait que les firmes sont

Worker's wage claims

(2) Proofs of claims for wages of workers and others employed by the bankrupt may be made in one proof by the bankrupt, by someone on the bankrupt's behalf, by a representative of a federal or provincial ministry responsible for labour matters, by a representative of a union representing workers and others employed by the bankrupt or by a court-appointed representative, and that proof is to be made by attaching to it a schedule setting out the names and addresses of the workers and others and the amounts severally due to them, but that proof does not disentitle any worker or other wage earner to file a separate proof on his or her own behalf.

R.S., 1985, c. B-3, s. 126; 1997, c. 12, s. 88; 2005, c. 47, s. 87.

Réclamations d'ouvriers pour gages

(2) Les preuves de réclamations pour gages d'ouvriers et d'autres personnes employés par le failli peuvent être établies en une seule preuve par celui-ci ou pour son compte, par le représentant soit d'un ministère fédéral ou provincial responsable des questions liées au travail, soit d'un syndicat représentant les ouvriers et autres employés, ou par le représentant nommé par le tribunal; la preuve est accompagnée d'une annexe énumérant les noms et adresses des ouvriers et des autres personnes, ainsi que les sommes qui leur sont respectivement dues. Une telle preuve n'enlève pas à l'ouvrier ou à tout autre salarié le droit de produire pour son propre compte une preuve distincte.

L.R. (1985), ch. B-3, art. 126; 1997, ch. 12, art. 88; 2005, ch. 47, art. 87.

Proof by Secured Creditors

Proof by secured creditor

127 (1) Where a secured creditor realizes his security, he may prove the balance due to him after deducting the net amount realized.

May prove whole claim on surrender

(2) Where a secured creditor surrenders his security to the trustee for the general benefit of the creditors, he may prove his whole claim.

R.S., 1985, c. B-3, s. 127; 2004, c. 25, s. 67(F).

Proof may be requested

128 (1) Where the trustee has knowledge of property that may be subject to a security, the trustee may, by serving notice in the prescribed form and manner, require any person to file, in the prescribed form and manner, a proof of the security that gives full particulars of the security, including the date on which the security was given and the value at which that person assesses it.

Where reply not received

(1.1) Where the trustee serves a notice pursuant to subsection (1), and the person on whom the notice is served does not file a proof of security within thirty days after the day of service of the notice, the trustee may thereupon, with leave of the court, sell or dispose of any property that was subject to the security, free of that security.

Dividend on balance

(2) A creditor is entitled to receive a dividend in respect only of the balance due to him after deducting the assessed value of his security.

Preuve des créanciers garantis

Preuve du créancier garanti

127 (1) Lorsqu'un créancier garanti réalise sa garantie, il peut prouver le reliquat qui lui est dû, après avoir déduit la somme nette réalisée.

Peut prouver sa réclamation entière sur renonciation

(2) Lorsqu'un créancier garanti renonce à sa garantie en faveur du syndic au profit des créanciers en général, il peut établir la preuve de sa réclamation entière.

L.R. (1985), ch. B-3, art. 127; 2004, ch. 25, art. 67(F).

Preuve de garantie

128 (1) S'il a connaissance de biens qui peuvent être assujettis à une garantie, le syndic peut, par signification d'un avis en la forme et de la manière prescrites, enjoindre à quiconque de produire, en la forme et de la manière prescrites, une preuve de la garantie énonçant la date à laquelle elle a été donnée, la valeur que cette personne lui attribue et tous autres renseignements à son égard.

Défaut de réponse

(1.1) Faute par la personne à laquelle le syndic a fait signifier l'avis d'avoir produit une preuve de sa garantie dans les trente jours suivant cette signification, le syndic peut, sur permission du tribunal, aliéner les biens visés, ceux-ci étant dès lors libres de toute garantie.

Dividende sur le reliquat

(2) Un créancier n'est admis à recevoir un dividende que relativement au reliquat qui lui est dû après déduction de la valeur attribuée à sa garantie.

Trustee may redeem security

(3) The trustee may redeem a security on payment to the secured creditor of the debt or the value of the security as assessed, in the proof of security, by the secured creditor.

R.S., 1985, c. B-3, s. 128; 1992, c. 27, s. 51; 1999, c. 31, s. 25; 2004, c. 25, s. 68(F).

Rachat par le syndic

(3) Le syndic peut racheter une garantie sur paiement au créancier garanti de la créance ou de la valeur de la garantie telle qu'elle est fixée par le créancier garanti dans la preuve de garantie.

L.R. (1985), ch. B-3, art. 128; 1992, ch. 27, art. 51; 1999, ch. 31, art. 25; 2004, ch. 25, art. 68(F).

May order security to be sold

129 (1) Where the trustee is dissatisfied with the value at which a security is assessed, the trustee may require that the property the security comprises be offered for sale at such time and on such terms and conditions as may be agreed on between the creditor and the trustee or, in default of such an agreement, as the court may direct.

Peut ordonner la vente de la garantie

129 (1) S'il n'est pas satisfait de la valeur attribuée à une garantie, le syndic peut exiger que le bien visé par la garantie soit mis en vente à la date et selon les modalités pouvant être convenues entre le créancier et lui, ou que le tribunal peut ordonner à défaut de pareille convention.

Sale by public auction

(2) Where a sale under subsection (1) is by public auction the creditor or the trustee on behalf of the estate may bid or purchase.

(3) [Repealed, 1992, c. 27, s. 52]

Vente à l'enchère publique

(2) Lorsque la vente s'opère par enchère publique, le créancier, ou le syndic agissant au nom de l'actif, peut enchérir ou se porter acquéreur.

(3) [Abrogé, 1992, ch. 27, art. 52]

Costs of sale

(4) The costs and expenses of a sale made under this section are in the discretion of the court.

R.S., 1985, c. B-3, s. 129; 1992, c. 27, s. 52; 2004, c. 25, s. 69(F).

Frais de vente

(4) Les frais occasionnés par une vente faite sous l'autorité du présent article sont à la discrétion du tribunal.

L.R. (1985), ch. B-3, art. 129; 1992, ch. 27, art. 52; 2004, ch. 25, art. 69(F).

Creditor may require trustee to elect to exercise power

130 Notwithstanding subsection 128(3) and section 129, the creditor may, by notice in writing, require the trustee to elect whether he will exercise the power of redeeming the security or requiring it to be realized, and if the trustee does not, within one month after receiving the notice or such further time or times as the court may allow, signify in writing to the creditor his election to exercise the power, he is not entitled to exercise it, and the equity of redemption or any other interest in the property comprised in the security that is vested in the trustee shall vest in the creditor, and the amount of his claim shall be reduced by the amount at which the security has been valued.

R.S., c. B-3, s. 101.

Un créancier peut exiger du syndic qu'il choisisse d'exercer son pouvoir

130 Nonobstant le paragraphe 128(3) et l'article 129, le créancier peut, au moyen d'un avis écrit, exiger du syndic qu'il choisisse s'il exercera son pouvoir de racheter la garantie ou de la faire réaliser; si, au cours du mois suivant la réception de l'avis ou dans le ou les délais supplémentaires que le tribunal peut accorder, le syndic ne signifie pas, par écrit au créancier, son choix d'exercer ce pouvoir, il n'a pas le droit de l'exercer; la faculté de réméré ou autre intérêt dans les biens compris dans la garantie qui est dévolue au syndic sont attribués au créancier, et le montant de sa réclamation est diminué du montant auquel la garantie a été évaluée.

S.R., ch. B-3, art. 101.

Amended valuation by creditor

131 Where a creditor after having valued his security subsequently realizes it, or it is realized under section 129, the net amount realized shall be substituted for the amount of any valuation previously made by the creditor and shall be treated in all respects as an amended valuation made by the creditor.

R.S., c. B-3, s. 102.

Évaluation modifiée par le créancier

131 Lorsqu'un créancier, après avoir évalué sa garantie, la réalise subséquemment, ou qu'elle est réalisée sous le régime de l'article 129, le montant net réalisé est substitué au montant de toute évaluation antérieurement faite par le créancier et il est traité à tous égards comme une évaluation modifiée faite par le créancier.

S.R., ch. B-3, art. 102.

Secured creditor may amend

132 (1) Where the trustee has not elected to acquire the security as provided in this Act, a creditor may at any time amend the valuation and proof on showing to the satisfaction of the trustee or the court that the valuation and proof were made in good faith on a mistaken estimate or that the security has diminished or increased in value since its previous valuation.

Amendment at cost of creditor

(2) An amendment pursuant to subsection (1) shall be made at the cost of the creditor and on such terms as the court orders, unless the trustee allows the amendment without application to the court.

Rights and liabilities of creditor where valuation amended

(3) Where a valuation has been amended pursuant to this section, the creditor

(a) shall forthwith repay any surplus dividend that he may have received in excess of that to which he would have been entitled on the amended valuation; or

(b) is entitled to be paid out of any money for the time being available for dividend any dividend or share of dividend that he may have failed to receive by reason of the amount of the original valuation before that money is made applicable to the payment of any future dividend, but he is not entitled to disturb the distribution of any dividend declared before the amendment is filed with the trustee.

R.S., c. B-3, s. 103.

Exclusion for non-compliance

133 Where a secured creditor does not comply with sections 127 to 132, he shall be excluded from any dividend.

R.S., c. B-3, s. 104.

No creditor to receive more than 100 cents in dollar

134 Subject to section 130, a creditor shall in no case receive more than one hundred cents on the dollar and interest as provided by this Act.

R.S., c. B-3, s. 105.

Admission and Disallowance of Proofs of Claim and Proofs of Security

Trustee shall examine proof

135 (1) The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.

Le créancier garanti peut modifier l'évaluation

132 (1) Lorsque le syndic n'a pas choisi d'acquérir la garantie dans les conditions prévues à la présente loi, un créancier peut modifier l'évaluation et la preuve en démontrant, à la satisfaction du syndic ou du tribunal, que l'évaluation et la preuve ont été faites de bonne foi sur une estimation erronée, ou que la garantie a diminué ou augmenté en valeur depuis son évaluation précédente.

Modification aux frais du créancier

(2) Une modification conforme au paragraphe (1) est faite aux frais du créancier et selon les modalités que le tribunal prescrit, à moins que le syndic ne permette la modification sans requête au tribunal.

Droits et obligations du créancier lorsque l'évaluation est modifiée

(3) Lorsqu'une évaluation a été modifiée conformément au présent article, le créancier, selon le cas :

a) doit rembourser sans retard tout surplus de dividende qu'il peut avoir reçu en sus du montant auquel il aurait eu droit sur l'évaluation modifiée;

b) a droit de recevoir, sur les deniers alors applicables à des dividendes, tout dividende ou part de dividende qu'il peut ne pas avoir reçu à cause du montant de l'évaluation primitive, avant que ces montants soient attribués au paiement d'un dividende futur; il n'a toutefois pas le droit de déranger la distribution d'un dividende déclaré avant que la modification soit déposée chez le syndic.

S.R., ch. B-3, art. 103.

Exclusion pour défaut de se conformer

133 Lorsqu'un créancier garanti ne se conforme pas aux articles 127 à 132, il est exclu de tout dividende.

S.R., ch. B-3, art. 104.

Aucun créancier ne peut recevoir plus de cent cents par dollar

134 Sous réserve de l'article 130, un créancier ne peut dans aucun cas recevoir plus de cent cents par dollar avec l'intérêt prévu par la présente loi.

S.R., ch. B-3, art. 105.

Admission et rejet des preuves de réclamation et de garantie

Examen de la preuve

135 (1) Le syndic examine chaque preuve de réclamation ou de garantie produite, ainsi que leurs motifs, et il peut exiger de nouveaux témoignages à l'appui.

Determination of provable claims

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

Disallowance by trustee

(2) The trustee may disallow, in whole or in part,

(a) any claim;

(b) any right to a priority under the applicable order of priority set out in this Act; or

(c) any security.

Notice of determination or disallowance

(3) Where the trustee makes a determination under subsection (1.1) or, pursuant to subsection (2), disallows, in whole or in part, any claim, any right to a priority or any security, the trustee shall forthwith provide, in the prescribed manner, to the person whose claim was subject to a determination under subsection (1.1) or whose claim, right to a priority or security was disallowed under subsection (2), a notice in the prescribed form setting out the reasons for the determination or disallowance.

Determination or disallowance final and conclusive

(4) A determination under subsection (1.1) or a disallowance referred to in subsection (2) is final and conclusive unless, within a thirty day period after the service of the notice referred to in subsection (3) or such further time as the court may on application made within that period allow, the person to whom the notice was provided appeals from the trustee's decision to the court in accordance with the General Rules.

Expunge or reduce a proof

(5) The court may expunge or reduce a proof of claim or a proof of security on the application of a creditor or of the debtor if the trustee declines to interfere in the matter.

R.S., 1985, c. B-3, s. 135; 1992, c. 1, s. 20, c. 27, s. 53; 1997, c. 12, s. 89.

Scheme of Distribution

Priority of claims

136 (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:

(a) in the case of a deceased bankrupt, the reasonable funeral and testamentary expenses incurred by the

Réclamations éventuelles et non liquidées

(1.1) Le syndic décide si une réclamation éventuelle ou non liquidée est une réclamation prouvable et, le cas échéant, il l'évalue; sous réserve des autres dispositions du présent article, la réclamation est dès lors réputée prouvée pour le montant de l'évaluation.

Rejet par le syndic

(2) Le syndic peut rejeter, en tout ou en partie, toute réclamation, tout droit à un rang prioritaire dans l'ordre de collocation applicable prévu par la présente loi ou toute garantie.

Avis de la décision

(3) S'il décide qu'une réclamation est prouvable ou s'il rejette, en tout ou en partie, une réclamation, un droit à un rang prioritaire ou une garantie, le syndic en donne sans délai, de la manière prescrite, un avis motivé, en la forme prescrite, à l'intéressé.

Effet de la décision

(4) La décision et le rejet sont définitifs et péremptoires, à moins que, dans les trente jours suivant la signification de l'avis, ou dans tel autre délai que le tribunal peut accorder, sur demande présentée dans les mêmes trente jours, le destinataire de l'avis n'interjette appel devant le tribunal, conformément aux Règles générales, de la décision du syndic.

Rejet total ou partiel d'une preuve

(5) Le tribunal peut rayer ou réduire une preuve de réclamation ou de garantie à la demande d'un créancier ou du débiteur, si le syndic refuse d'intervenir dans l'affaire.

L.R. (1985), ch. B-3, art. 135; 1992, ch. 1, art. 20, ch. 27, art. 53; 1997, ch. 12, art. 89.

Plan de répartition

Priorité des créances

136 (1) Sous réserve des droits des créanciers garantis, les montants réalisés provenant des biens d'un failli sont distribués d'après l'ordre de priorité de paiement suivant :

TAB 4

1923 CarswellOnt 17
Ontario Supreme Court, First Appellate Division, In Bankruptcy

Orzy, Re

1923 CarswellOnt 17, [1924] 1 D.L.R. 250, 3 C.B.R. 737, 53 O.L.R. 323 at 327

In re Orzy (Canadian Garment Company)

Ex parte Orchikofsky

Maclaren, Magee, Hodgins and Ferguson, JJ.A.

Judgment: January 12, 1923

Counsel: *F. Erichsen Brown*, for creditor, appellant.
L. M. Singer, for the authorized trustee.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications
Bankruptcy and insolvency

XIII Dividends
XIII.2 Distribution of dividends

Headnote
Bankruptcy --- Dividends — Distribution of dividends — General

Proof of Claim — Contestation — Rights of Creditors Inter Se — Alleged Conspiracy between Debtor and One Creditor to Misrepresent the Latter's Debt as Paid — Estoppel — Parties Prejudiced — Procedure by Separate Action — Interference with Course of Administration of Assets — Payment of Proved Debts Pari Passu — Bankruptcy Act, Sec. 25, 1 C.B.R. 32 — Act, Sec. 45, 1 C.B.R. 51 — Act, Sec. 51(4), 1 C.B.R. 56.

The bankruptcy Court will not impound a dividend to a creditor whose claim against the estate is duly proved, for the purpose of adjudicating upon the rights of individual creditors or of a class of creditors claiming to have been deceived by the creditor whose proof of claim is attacked as against the latter, based upon an alleged estoppel upon equitable grounds not affecting the right of claim against the bankrupt but affecting only the rights of creditors *inter se*. Whatever equitable remedy the complaining creditor may have against the other for knowingly allowing the bankrupt to obtain credit from the one creditor by pretending that the other's claim had in fact been paid off, when in fact a promissory note had been substituted on the discharge of a chattel mortgage, such cannot properly be adjudicated in the trustee's allowance or disallowance of the proof of claim made upon the promissory note, nor upon an appeal in bankruptcy from the trustee's decision upon the proof of claim.

[*In re Orzy (Canadian Garment Co.); Ex parte Orchikofsky* (1922) 3 C.B.R. 44, reversed.]

Appeal by Orchikofsky, a creditor, from that part of the judgment of Fisher, J. (3 C.B.R. 44) which directed the postponement of the ranking of the creditor's claim. The appeal was allowed.

***Hodgins, J.A.*:**

1 Appeal by claimant from Fisher, J. [3 C.B.R. 44] who, while allowing him to prove for his whole debt, directed that

> no dividends are payable to him in respect thereof until all the creditors' claims incurred after February 20, 1922, and before the assignment, have been paid in full. [3 C.B.R. 47.]

2 This postponement is directed by the learned Judge upon a finding that the claimant had knowingly allowed his son, the bankrupt, to obtain credit by representing to his creditors that he owed $6,446 less than he actually did or, in other words, by suppressing the fact that the bankrupt owed his father this sum.

3 The claimant accepts this finding *quantum valeat*, but says that his dividend cannot be deferred in this way, but that if it can, there was no proof to support the finding, except possibly in one instance, and that no other creditor can benefit thereby nor can he enforce his individual right here.

4 Sec. 51, subsec. 4 of *The Bankruptcy Act*, is as follows:

> Subject to the provisions of this Act, all debts proved in the bankruptcy or under an assignment shall be paid *pari passu*. [1 C.B.R. 56.]

5 The rule adopted by the learned Judge may be applicable where a fund is being distributed and the Court is at liberty to apply equitable principles or to enforce an estoppel. But in bankruptcy the rule of equality is absolute except where the Act itself gives priority to some debts over others. The claims of these creditors, even if misled, are not within the favoured class so specified, nor is the claimant's debt less a provable debt because he knew that others were becoming creditors under an erroneous impression as to himself or his debt.

6 The rule is clearly laid down in *Ex parte Pottinger; In re Stewart* (1878) 8 Ch. D. 621, 47 L.J. Bk. 43, and *In re Whitaker; Whitaker v. Palmer*, [1901] 1 Ch. 9, 70 L.J. Ch. 6. In the first case, dealing with a section identical on this point with out own statute, Thesiger, L.J., says:

> The words of sec. 32 [of the Act of 1869] are very clear and distinct, and in their natural construction mean that where there is a right of proof there shall be a right to dividend.

7 In the last-mentioned case, Rigby, L.J. is equally emphatic, at p. 12 ([1901] 1 Ch.):

> Now undoubtedly in bankruptcy (it does not matter how it came about) the rule as to debts and liabilities provable is that all those debts and liabilities, whether contracted for value or not, shall rank *pari passu*.

8 and Vaughan Williams, L.J., adds, at p. 13:

> In bankruptcy, once given a provable debt, all the debts proved were entitled to payment of dividend *pari passu*.

9 Reference may also be had to *Williams on Bankruptcy*, 12th ed., 1921, p. 194, and to *In re Coates; Ex parte Scott*, 9 Morrell 87.

10 I have not been able, after a thorough search for precedents in this matter, to find any departure from this rigid attitude. The reason is probably what is suggested by Mr. Justice Wright in *In re Frost*, [1899] 2 Q.B. 50, at p. 52, 6 Manson 194, where, in dealing with an application of an assignee of a debt which had been proved in bankruptcy for payment to her of the dividend, he says:

> It is obvious that if the trustee is to be required to recognize the rights of assignees the administration of bankrupts' estates might be incumbered with inquiries of a most embarrassing character, which it can never have been intended by the Legislature should be undertaken.

11 Other instances are *Prout v. Gregory* (1889) 24 Q.B.D. 281, 59 L.J.Q.B. 118, holding that a dividend is not a debt liable to be attached, and *In re Cook; Ex parte Cripps*, [1899] 1 Q.B. 863, 68 L.J.Q.B. 597, solicitor refused charging order on dividend.

12 What would have been an undoubted equity under any other jurisdiction was denied by the Court of Appeal in *In re Wigzell*, 2 C.B.R. 72, [1921] 2 K.B. 835, 90 L.J.K.B. 897, where the provisions of *The Bankruptcy Act* were enforced against Barclay's Bank. That bank had no notice of a receiving order against its customer nor of the fact that it had been stayed pending an appeal. During the stay the bank received from their customer £165, and he drew out £199. The trustee claimed that the bank should hand over to him the £165 without regard to the fact that they had paid out the £199. The Court held that *The Bankruptcy Act* made the £165 the property of the trustee in bankruptcy, and that the bank not being protected by the statute as to the £199 could not resist the trustee's claim. It was urged that the case of *Ex parte James; In re Condon* (1874) L.R. 9 Ch. 609, 43 L.J. Bk. 107, as well as other decisions cited in the argument, indicated that where the action of a trustee in bankruptcy was contrary to natural justice or unconscionable on his part, the Court would intervene and require what was right and just to be done, and that this was such a case. The contention was rejected and the cases reviewed with the result I have stated. It may be pointed out that the jurisdiction there exercised is that of the Court over its officer and that they declined to apply it in a case where the statute was clear and dealt with the point at issue. This is further emphasized in the later cases of *In re Gunsbourg*, [1920] 2 K.B. 426, [1920] B. & C.R. 50, and *Scranton's Trustee v. Pearse*, [1922] 2 Ch. 87, [1922] B. & C.R. 52. It may be of interest to quote the words of Davey, L.J., in *In re Clark; Ex parte Beardmore*, [1894] 2 Q.B. 393, at p. 411, 63 L.J.Q.B. 806, as applying in principle to this case:

> I am inclined to think that it would be very reasonable to hold, in accordance with a well-known principle of equity in similar cases, that the trustee should not take the fruits of the bankrupt's trading without discharging the liabilities by means of which those fruits had been created. But *** the words of sec. 44 vest this property in the trustee to be distributed by him amongst the creditors under the first bankruptcy. The Act contains no words from which I can judicially infer that the trustee is at liberty to divert that property from the statutory purposes to which it is made applicable.

13 The case which presents the closest analogy to the present one is *Ex parte Sheen; In re Wright*, (1877) 6 Ch. D. 235, 37 L.T. 451. A proof was there tendered by one C. for money lent. It was rejected by the trustee on the ground that C. was a partner of Wright. The County Judge held he was a partner and affirmed the rejection of his proof. On appeal to Bacon, C.J., this was reversed and C. was adjudged not to be a partner. On appeal to the Court of Appeal, his judgment was affirmed and C. allowed to prove. It was alleged by the creditors who had appealed that Wright had represented to them that C. was a partner in the presence and with the silent acquiescence of C. James, L.J., said (6 Ch. D. 235, at p. 237):

> I am of opinion that the order of the Chief Judge must be affirmed. It is to my mind perfectly clear from the evidence that there never was any actual partnership between these two gentlemen, and in my opinion also there was no ostensible partnership, no holding out to the world, that is, to the creditors generally, that there was a partnership. If there had been, we should have heard more about it. There was no holding out to the world that there was a partnership, or that the stock-in-trade was that of a partnership, so as to make it joint estate. There was nothing to make it joint estate, and the creditors generally never heard that any such partnership existed.
>
> It is said, however, that there were three individuals to whom some representations were made by Wright in the presence and with the acquiescent silence of Crabtree, to the effect that the latter was a partner. I am of opinion that those representations, if they were made, and that silence on the part of Crabtree, if it really existed, whatever effect they might have upon Crabtree's personal liability to those three creditors, cannot have the effect of creating a partnership for any purpose whatever of administration in bankruptcy. Those creditors, if they had any rights against Crabtree, have those rights against him still. It cannot be said that he is seeking to prove in competition with them. If he is their co-debtor they ought not to have proved in the liquidation at all; they ought to have enforced their rights against him as the solvent co-debtor. The solvent co-debtor is not precluded from proving his debt against the real debtor, for as there never was any joint estate, and it appears that there can be no surplus of the separate estate,

> he would not be taking away that which would otherwise go to pay the joint creditors. And that is the principle, as is clearly laid down by Lord Westbury in *Ex parte Topping*, 4 DeG.J. & S. 551, 34 L.J. Bk. 44, upon which one partner is held to be not entitled to prove against the estate of his co-partner.
>
> Upon the whole case, therefore, I am of opinion that there was no actual partnership and no ostensible partnership, and, even if there was any liability in the nature of a joint liability created by conduct, there is nothing in that to interfere with the right of Crabtree to prove against the estate of Wright.

14 Baggallay and Cotton, L.JJ., concurred. The judgment in that case exactly fits this case notwithstanding that the repre sentation in it was different from what is claimed here. The divisible assets are $2,302.59 and the claims proved outside that of the appellant would only receive thirty per cent on the dollar.

15 On this branch of the case the appeal must be allowed, and the order varied to comply with the foregoing decision.

16 On the other branch, the appeal also succeeds. The right of the individual creditor who alleges that he has been misled is to claim damages against the person misleading him to his prejudice in an independent action. No creditor who does not prove that he personally was induced to give credit by a similar misrepresentation, can take advantage of what misled another. See *Trusts and Guarantee Co. v. Grand Valley Ry. Co.* (1918) 44 O.L.R. 398, at p. 423, 15 O.W.N. 247.

17 I do not see, notwithstanding a desire to satisfy what the learned Judge thought was the justice of the case, that the Court can impound or defer payment to the claimant of his dividends till the creditors have an opportunity to establish their case against him if they so desire. To do this would be in effect to interfere with the statutory direction as to payment and as it were, to give execution before a judgment based on a tort has been pronounced.

18 The respondent should pay the costs of the appeal.

***Ferguson, J.A.*:**

19 I agree in the result suggested by my brother Hodgins, but rest my judgment on the ground that the practice in bankruptcy does not permit of the adjustment of the rights and privileges of creditors *inter se* but only the rights, privileges and preferences of creditors as against the insolvent and his estate. That, I think, is the effect and meaning of subsec. 4 of sec. 51 of *The Bankruptcy Act*, and of such cases as *Ex parte Pottinger; In re Stewart* (1878) 8 Ch. D. 621, 47 L.J. Bk. 43, and in *In re Frost*, [1899] 2 Q.B. 50, at p. 52, 6 Manson 194, the reason or principle governing being that bankruptcy proceedings are designed to administer the rights of creditors of the estate as against the debtor and his estate, and therefore the Court may not in that administration be delayed or hindered by being called upon to determine questions between creditors or between a creditor and another person such as assignee of a creditor, or as here a question as to whether or not one creditor is estopped from taking a dividend from the insolvent estate to the prejudice of another.

20 MACLAREN, J.A. concurred in allowing the appeal.

***Magee, J.A.* (dissenting in part):**

21 In this bankruptcy matter David Orchikofsky claimed to rank as a creditor of Louis Orzy who had made an assignment to H. H. Goodman an authorized assignee. The assignee disallowed the claim and on appeal therefrom [3 C.B.R. 44] Fisher, J. held that Orchikofsky was a creditor for $6,975 but directed that he should not receive any dividends till claims of other creditors incurred after February 20, 1922, had been paid in full. From this restriction Orchikofsky appeals.

22 Though bearing a different name Orzy is the appellant's son. He carried on business as the Canadian Garment Company. His father had advanced moneys to him and had taken a chattel mortgage on his stock and chattels which had been duly registered. The son found his credit hampered thereby and so informed his father. Thereupon in February, 1922, the father signed a discharge of the mortgage in the ordinary form, certifying that the mortgagor had satisfied all moneys owing on the mortgage, and he took instead his son's promissory note on which he now claims. The continued

existence of any debt to the father was not made known to creditors, and upon the evidence Fisher, J., was satisfied that it was the intention of both father and son to represent to creditors that the mortgage debt had been paid off and no debt existed and that the father agreed with the son that the latter might and should so represent to any one in order to obtain credit. Therefore he directed in effect that subsequent creditors should be paid in priority to the father's claim.

23 On the whole I think the evidence warranted the conclusion that the father did intend that the existence of any debt to him should be concealed and that the son should be at liberty to represent to any persons that no debt existed, and I would agree with Fisher, J. therein.

24 But it does not appear as yet that misrepresentation to that effect was made to any creditor except the Dominion Dress Company whose claim of $327 arose after February 20 and who appear to have acted upon the misrepresentation.

25 As against them Orchikofsky should be estopped by the misstatement which he authorized from depleting the trust fund in which he and they claim to share. Assuming that the total claims including the appellant's would be $14,000 it is obvious that if the misstatement were true, the total claims would be reduced one-half and the Dominion Dress Company would receive twice as great a dividend as they would if the appellant were allowed to share to the full extent of his claim now put forward against them. If the amount for distribution would be $2,100 they would only receive about $50 if the appellant is allowed to share equally with them, whereas they would receive about $100 if he is compelled to live up to his statements. The difference — $50 — they should be entitled to receive out of the estate as against him, but not as against other creditors; in other words, it should be paid to them out of his dividend and they should not be driven to collecting it from him after he has received it from the trustee but they should be entitled to prevent him from handling it.

26 The proper result therefore would be that the trustee should pay to the Dominion Dress Company out of each dividend otherwise payable to the appellant so much as the Dress Company's dividend is reduced by reason of the appellant's claim having been allocated for the distribution.

27 But it is objected for the appellant that there is no jurisdiction to grant such relief either to the Dress Company or to the general body of other creditors or to those who became creditors after February, 1922, and we are referred to sec. 51(4) of *The Bankruptcy Act* [1 C.B.R. 56] which directs that subject to the provisions of the Act all debts proved in the bankruptcy or under an assignment shall be paid *pari passu*.

28 The result which I have indicated as the proper one for the Dominion Dress Company would not in any way interfere with that section. All claims would be dealt with *pari passu* but that would not prevent individual creditors dealing *inter se* in any way they please as to the amounts they would receive on that basis.

29 If this appellant had in writing agreed that as between him and the Dress Company the trust estate should be shared as if he had no claim what would that amount to but an agreement that the company would be entitled to so much out of his share of the trust estate as would be necessary to effect that result? What again would that amount to in equity but an assignment of so much of his dividend? It, of course, makes no difference that he disputes having done anything having that result. The moment it is proved against him his denials go for nothing and the situation is the same as if he had admitted it — as if he were now coming to the Court and saying, "It is true I did so, but there is no relief against me."

30 If he is estopped from receiving so much of his dividend and from preventing the Dress Company from receiving that much, it is the same as if he had executed an assignment of so much of his dividends and were here admitting the assignment.

31 It is not merely a promise by him to pay them after he receives the dividends; it is a dealing with the dividends them selves whch gives them a right to so much of them. If he had assigned so much of his dividends could it be said the estate was not being distributed *pari passu*?

32 The case of *Ex parte Pottinger; In re Stewart* (1878) 8 Ch. D. 621, 47 L.J. Bk. 43, under the English *Bankruptcy Act*, was referred to, where a voluntary covenant in a settlement to pay to the trustees £4,000 was held entitled to rank

with other creditors, contrary to the old rule in bankruptcy, which, like the rule in administration of estates, postponed voluntary obligations to the onerous ones to creditors for value. But that only decided that the direction to pay claims *pari passu* did away with that old distinction, but it in no way decided that creditors could not deal between themselves. The same was held in *In re Coates; Ex parte Scott*, 9 Morrell 87, as the effect of the statute of 1883. The case of *In re Whitaker; Whitaker v. Palmer*, [1901] 1 Ch. 9, 70 L.J. Ch. 6, applied the same change to the administration of an estate, holding that a similar claim for £5,000 was entitled to rank equally with debts contracted for value because *The Judicature Act* has in effect put both on a level. Here again was no pretence of saying that the parties could not by dealings between themselves affect their several rights so long as other creditors were not affected.

33 These cases are referred to in *Williams on Bankruptcy*, 1921, ed. at pp. 149 and 194, but not as having any greater effect than to change these old rules in bankruptcy and administration as to the rights upon voluntary obligations.

34 *In re Cook; Ex parte Cripps*, [1899] 1 Q.B. 863, 68 L.J. Q.B. 597, was an appeal from the refusal of an application by a solicitor for an order for payment to him on account of his costs of the dividend on the judgment proved as a claim by his client, who had disappeared. Wright, J., after holding that the application could not succeed under the common-law jurisdiction or *The Solicitors Act*, said he could not agree that there was power under sec. 102 of *The Bankruptcy Act* (whereby the Court was given full power to decide all questions which it might deem expedient or necessary to decide for the purpose of doing complete justice) but the reason he gave was:

> I do not think we have any right to jeopardize property which in the event of F. [who had disappeared] being insolvent would belong to the general body of his creditors, or in certain other events would belong to the Crown as unclaimed dividend.

35 That case therefore is no indication of want of power.

36 More to the present purpose is *In re Suffield & Watts; Ex parte Brown*, there cited (1888) 20 Q.B.D. 693, 58 L.T. 911, where Cave, J., had made an order giving a solicitor a charging order, not however upon a dividend, but upon a fund of the bankrupt estate, and had afterwards varied his order, and the Court of Appeal held he had no power to do so after it was once made, although entitled in bankruptcy as well. Lord Esher, M.R., said:

> The order was made by Cave, J., sitting in the Court in which he was exercising jurisdiction under *The Bankruptcy Act*, 1883, but he was a Judge of the Queen's Bench Division, and he was also entitled to exercise all the other powers which were vested in him as a judge of the High Court, among which was the jurisdiction given by *The Solicitors Act*.

37 A case of *Prout v. Gregory* (1889) 24 Q.B.D. 281, 59 L.J.Q.B. 118, held that a dividend in the administration of the estate of a deceased insolvent was not money which could be attached by a garnishee order; Mathew, J. said it was quite impossible to treat it as a debt or to say that the official receiver is a debtor.

38 *In re Wigzell*, 2 C.B.R. 72, [1921] 2 K.B. 835, 90 L.J.K.B. 897, was a decision upon a wholly different question, whether the Court would interfere with the trustee in bankruptcy enforcing his legal rights against a debtor to the estate because of the harshness of the circumstances.

39 *Ex parte Sheen; In re Wright* (1877) 6 Ch. D. 235, 37 L.T. 451, is, I think, if anything, an authority in favour of the respondent here, and certainly not for the appellant. C. claimed to rank on the bankrupt estate of Wright. Three other creditors claimed that C. had represented himself to them as a partner of Wright. The trustee rejected the claim on the ground that C. was a partner and not entitled to prove until all the joint creditors had been paid. The County Court Judge affirmed the rejection but on appeals to the Chief Judge in Bankruptcy and to the Court of Appeal it was held that there was no partnership and holding out was not proved and that he should rank. James, L.J., said the alleged representations and silence on C.'s part, whatever effect they might have on C.'s personal liability to the three creditors could not have the effect of creating a partnership for any purpose of administration in bankruptcy, and if they had any rights against him they had them still, and it could not be said that he was seeking to prove against them, there never was any joint estate. The implications there are surely all against this appellant.

40 Although it has no bearing upon the effect of the direction to distribute *pari passu*, the decision in *In re Frost*, [1899] 2 Q.B. 50 , 6 Manson 194, is really the only one to be seriously considered on this appeal. A dividend of about sixteen per cent had been paid in 1888, and the trustee had been released. In 1898 the official receiver, to whom the trusteeship fell, received some money which enabled him to declare a very small further dividend. Forty of the creditors had assigned to the wife their proved claims, and she applied for an order for payment of the dividend to her. The official receiver for some reason opposed it and even appealed. He set up that the forms required the creditors' signature to the receipt and that payments had to be made through the Board of Trade. The order was refused.

41 I confess I cannot give to the mountains of difficulties conjured up for not making the order the weighty consideration there accorded although it was admitted she was entitled to the money, and I would find difficulty here in coming to the same conclusion even if the same legislation existed. But we have in this case to deal with no such body as the Board of Trade and here we have the trustee willing to recognize the rights of parties — indeed insisting upon doing so.

42 A trust estate is being administered under the direction of the Court, and the persons entitled to the trust fund should be entitled to have it paid to them.

43 It may well be that any trustee of any fund confronted with rival claims may not be bound to take the risk of satisfying himself as to the merits and may say, "You must settle this between you elsewhere." But if the trustee does satisfy himself and is ready to pay the money to the person of right entitled I do not know of any authority for the person who is not entitled to the money interfering with such payment. *In re Iliff*, 51 W.R. 80, and *In re Hills; Ex parte Lang*, 107 L.T. 95, are in line with *In re Frost*.

44 Under sec. 18(*d*) (1921, ch. 17, sec. 18) [1 C.B.R. 567] the trustee is entitled to apply to the Court for directions as to any matter affecting the administration of the estate. He is in effect asking directions upon this appeal. Those directions should not be to pay money to this appellant which he has debarred himself from claiming.

45 If, as said in *In re Suffield & Watts, supra*, the Judge sitting in the Court in which he was exercising jurisdiction under *The Bankruptcy Act* was still a Judge of the Queen's Bench Division and entitled to exercise powers vested in him as such Judge, then this Court should make such order as will do that justice which the parties are and would ultimately be entitled to.

46 It would not savour of justice for this creditor to be told, "You must allow this appellant to receive this money which he told you he had no right to, and then you must bring an action to make him pay you or before he gets it you must apply for an injunction to restrain him from receiving that to which he has no equitable right."

47 Although I think the order of Fisher, J., should be varied it is not to be overlooked that *The Bankruptcy Act* itself in sec. 48 [1 C.B.R. 54] postpones in some cases the rights of husband, wife, children, parents, uncles and aunts to other creditors. The mere fact that the creditors' rights arise by way of estoppel is not of itself any bar to the trustee having to come to a proper conclusion. Many cases of rival claims arising in that way may arise; one very simple one would be the payee or endorsee of a promissory note or bill claiming upon it and asserting that a forged endorsement was not his while the transferee would also claim and allege estoppel from denying the signature, as in *Ewing v. Dominion Bank*, 35 S.C.R. 133, [1904] A.C. 806, 74 L.J.P.C. 21, and *McKenzie v. British Linen Co.*, 6 App. Cas. 82, 44 L.T. 431.

48 From the considerations I have mentioned, which appear to me to be reasons against wholly allowing this appeal, I would vary the order by directing what I have said is the proper result to be arrived at with regard to the Dominion Dress Company. If the trustee considers it proper I would also allow a period of three weeks within which any other creditor for a claim subsequent to February 20, 1922, alleging similar misrepresentation may make application for a similar order.

49 There should I think be no costs of the appeal.

Appeal allowed with costs.

End of Document

TAB 5

2000 CarswellAlta 1068
Alberta Court of Queen's Bench

YBM Magnex International Inc., Re

2000 CarswellAlta 1068, [2000] A.J. No. 1118, 275 A.R. 352, 99 A.C.W.S. (3d) 962, 9 B.L.R. (3d) 296

In the Matter of in Re s.234 of the Business Corporations Act, R.S.A. (1980) c. B-15 as Amended

In Re s.13(2) of the Judicature Act, R.S.A. (1980) c. J-1

In Re the Matter of YBM Magnex International, Inc.

Paperny J.

Heard: August 15, 2000
Judgment: September 15, 2000
Docket: Calgary 9801-16691

Counsel: *Alan D. MacLeod, Q.C.* and *Roger F. Smith*, for Applicant.
Peter F.C. Howard and *Glenn Zacher*, for Respondent.
Clint Docken and *Mark Freeman*, for Plaintiffs' Executive Committee.
Earl A. Cherniak, Q.C., for Royal Trust Corporation.
J.L. McDougall, Q.C., for Deloitte & Touche LLP.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications
Debtors and creditors

VII Receivers
VII.9 Discharge of receiver
VII.9.b Grounds for discharge

Headnote
Receivers --- Discharge of receiver — Grounds for discharge

Receiver was auditor of underwriters or predecessor of underwriters prior to being appointed receiver of company Y Inc., currently in receivership — Receiver was privy to Y Inc.'s confidential information, including litigation assets — Receiver acknowledged potential conflict of interest by drafting carefully considered receivership order — Receiver initially relied on its client confidentiality policy but later took additional security measures, including requiring staff to sign confidentiality agreement — Receiver's counsel had been retained by institutional shareholders on matters related to Y Inc. — Underwriters brought application to remove receiver and receiver's counsel for conflict of interest — Application dismissed — Receiver recognized and disclosed potential for conflict of interest at outset and adequately addressed it by creating receiver as separate entity and delegating certain tasks to receiver's counsel — Underwriters failed to prove receivers favoured other stakeholders to underwriters — Prejudice factors were significant and replacement receiver did not have background information to effectively take over Y Inc.'s extremely complicated and highly unusual estate — Underwriters' delay in bringing motion was significant factor as much money and time had been expended by receiver — Receiver's counsel's retainer for institutional shareholders ended prior to receiver's retainer — Institutional shareholders were not concerned about receiver's

counsel's involvement with Y Inc. — Receiver's counsel not tainted by either receiver's potential conflict or by involvement with institutional shareholders.

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Bolkiah v. KPMG (1998), [1999] 2 W.L.R. 215, [1999] 1 All E.R. 517, 45 B.L.R. (2d) 201 (U.K. H.L.) — considered

Canada Trustco Mortgage Co. v. York-Trillium Development Group Ltd. (1992), 12 C.B.R. (3d) 220 (Ont. Gen. Div.) — applied

Canadian Commercial Bank v. Pilum Investments Ltd. (February 10, 1987), Doc. 48/87 (Ont. C.A.) — referred to

Confederation Treasury Services Ltd., Re (1995), 37 C.B.R. (3d) 237 (Ont. Bktcy.) — considered

Drabinsky v. KPMG (1998), 41 O.R. (3d) 565, 45 B.L.R. (2d) 196 (Ont. Gen. Div.) — considered

Drabinsky v. KPMG (1999), 10 C.B.R. (4th) 130, 33 C.P.C. (4th) 318 (Ont. Div. Ct.) — referred to

Ernst & Young Inc. v. Royal Trust Corp. of Canada (1997), 208 A.R. 244 (Alta. Q.B.) — not followed

Hodgkinson v. Simms, [1994] 9 W.W.R. 609, 49 B.C.A.C. 1, 80 W.A.C. 1, 22 C.C.L.T. (2d) 1, 16 B.L.R. (2d) 1, 6 C.C.L.S. 1, 57 C.P.R. (3d) 1, 5 E.T.R. (2d) 1, [1994] 3 S.C.R. 377, 95 D.T.C. 5135, 97 B.C.L.R. (2d) 1, 117 D.L.R. (4th) 161, 171 N.R. 245 (S.C.C.) — referred to

MacDonald Estate v. Martin (1990), [1991] 1 W.W.R. 705, 77 D.L.R. (4th) 249, 121 N.R. 1, (sub nom. *Martin v. Gray*) [1990] 3 S.C.R. 1235, 48 C.P.C. (2d) 113, 70 Man. R. (2d) 241 (S.C.C.) — considered

Minister of National Revenue v. Burlingham Associates Inc., (sub nom. *R. v. Burlingham Associates Inc.*) 49 C.B.R. (3d) 69, (sub nom. *Koskie (Bankrupts), Re*) 159 Sask. R. 81, [1997] 10 W.W.R. 199 (Sask. Q.B.) — considered

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

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

R.J. Nicol Homes Ltd. (Trustee of) v. Nicol (1995), 30 C.B.R. (3d) 90, 77 O.A.C. 395 (Ont. C.A.) — considered

Scarth v. Northland Bank (Liquidator of) (1996), 43 C.B.R. (3d) 254, 114 Man. R. (2d) 314 (Man. Q.B.) — considered

Scarth v. Northland Bank (Liquidator of) (1997), (sub nom. *Northland Bank (Liquidation), Re)* 115 Man. R. (2d) 107, (sub nom. *Northland Bank (Liquidation), Re)* 139 W.A.C. 107 (Man. C.A.) — considered

Tannis Trading Inc. v. Camco Food Services Ltd. (Trustee of) (1988), (sub nom. *Camco Food Services Ltd., Re)* 67 C.B.R. (N.S.) 1, 63 O.R. (2d) 775, (sub nom. *Tannis Trading Inc. v. Thorne Ernst & Whinney Inc.)* 49 D.L.R. (4th) 128 (Ont. S.C.) — applied

United Fuel Investment Ltd. (No. 1), Re (1965), (sub nom. *United Fuel Investment (No. 2), Re)* [1966] 1 O.R. 165, 53 D.L.R. (2d) 12 (Ont. C.A.) — considered

APPLICATION by underwriters to remove receiver and receiver's counsel for conflict of interest.

***Paperny J*:**

Introduction

1 This is an application by Griffiths McBurney & Partners ("Griffiths") and National Bank Financial Inc. ("National Bank") (together, the "Underwriters"). The Underwriters seek removal of Ernst & Young YBM Inc. (the "Receiver"), and of Stikeman Elliott and Voorheis & Co. (the "Receiver's Counsel") on the grounds of conflict of interest. The removal sought is only for the limited purpose of dealing with the "Litigation Assets" (described below). The Underwriters are content for the Receiver and Receiver's Counsel to remain in place to supervise all other aspects of the receivership. The amended notice of motion seeks the following:

> 1. Ernst & Young YBM Inc. (the Receiver), or any other Ernst & Young LLP (Ernst & Young) affiliate, be prohibited from acting as the receiver and manager of YBM Magnex International, Inc. (YBM) in respect of the litigation assets (the Litigation Assets), being those assets of YBM described in subparagraphs 3(n) and 3(o) of the Order of this Honourable Court dated December 8, 1998 (the December 8 Order) and a new receiver and manager be appointed to administer the Litigation Assets.
>
> 2. Stikeman Elliott and Voorheis & Co. be prohibited from acting as counsel to the new receiver and manager which is given responsibility for the Litigation Assets.
>
> 3. The new receiver and manager shall only be entitled to use the report prepared in conjunction with paragraph 3(o) of the December 8 Order (the 3(o) Report) after the Applicants and their counsel have reviewed the 3(o) Report to ensure that it does not contain any confidential information which may have been disclosed as a consequence of Ernst & Young having been engaged as the auditors of Griffiths McBurney and First Marathon Securities Limited (FMSL).
>
> 4. The issue of the Applicants' claims shall be referred to the new receiver and manager, and any disputes arising on that issue shall be determined by the Ontario Court.

Facts

2 On June 7, 1999, YBM Magnex International Inc. ("YBM") pleaded guilty in the United States to a multi-object conspiracy to commit fraud. This fraud was perpetrated by YBM through certain officers and directors who, among other acts, caused YBM to disseminate materially false and misleading information to the investing public, securities regulators and other stakeholders.

3 The Receiver, appointed on December 8, 1998, is an affiliate of Ernst & Young LLP ("Ernst & Young"). Ernst & Young is currently the auditor of Griffiths, and was the auditor of First Marathon Securities Limited ("FMSL") from

May 1990 to August 1999. FMSL is National Bank's predecessor. As auditor, Ernst & Young is privy to certain material, including summaries of outstanding litigation issues, specifically those relating to YBM.

4 Concerns over the potential business conflicts inherent in the Receiver's relationship to Ernst & Young led to careful consideration and drafting of the Receivership Order. In particular, paragraph 3(o) was intended to ensure the independent pursuit of potential causes of action against certain parties, including the Underwriters. Paragraph 3(o) reads, in part:

> 3. Without limiting the powers set out in paragraph 1, the Receiver is hereby authorized and empowered to do all or any of the following acts or things if in its opinion it is necessary or desirable:
>
> . . . . .
>
> (o) to assess the existence and merits of any causes of action or other intangible proprietary rights which YBM Magnex may have, including without limitation, in respect of advice and/or assistance previously provided to YBM Magnex and in respect of all matters arising out of it historical financial statements and other public disclosure documents issued by YBM Magnex and, if it considers advisable, to seek the direction of this Honourable Court as to a mechanism and methodology for reporting the results of that assessment on a confidential basis to relevant stakeholders and to transfer any such causes of action or other intangible proprietary rights to one or more of the stakeholders as may wish to pursue such claims on such terms and conditions as this Honourable Court thinks fit provided that the Receiver is not itself obliged to initiate or maintain any such action or claim;

The granting of this Receivership Order was widely publicized.

5 The Receiver engaged the Receiver's Counsel, whose role is, of necessity, larger than one might expect in an "ordinary" receivership, due to the Receiver's potential business conflicts.

6 In a letter dated February 23, 1999 to the Receiver's Counsel, the Receiver states that business relationships of Ernst & Young "could give rise to perceived or real conflicts of interest if [the Receiver] were to become directly involved in the assessment and pursuit of such causes of action." Accordingly, and pursuant to paragraph 3(o) of the December 8, 1998 order the Receiver requested the Receiver's Counsel to perform certain tasks usually done it.

- Assess the existence and merits of any causes of action YBM may have, including all matters arising out of YBM's historical financial statements and other public disclosure documents, and relating to advice and/or assistance previously provided to YBM by others;
- Compile and organize any relevant YBM records and documents with respect to such causes of action;
- Interview third parties to facilitate the analysis; and
- Prepare a preliminary report concerning the potential causes of action, including recommendations on appropriate mechanisms to allow stakeholders to pursue these causes of action outside of the receivership proceedings.

7 The Receiver limited its own role in preparing the report to assisting its counsel in obtaining access to information and third parties. The report, with results and recommendations, was to be provided directly to this Court. The Receiver's Counsel was to submit its accounts weekly, along with a "very brief progress report".

8 At the beginning of the YBM receivership, no special confidentiality measures were taken, apart from Ernst & Young's already extant policies. Ernst & Young has a standard written policy relating to client confidentiality. All employees are required to sign annually an acknowledgement and undertaking regarding the policy. In cross-examination, Brian Denega, a senior vice president of the Receiver, states that Ernst & Young's unwritten policy is not to take assignments which would cause Ernst & Young to get into litigation with audit clients or with auditors. Regarding the fact that the Underwriters were audit clients, he stated that:

A. We decided that if the form and structure of the receivership could be set up appropriately to remove us from the role involving any litigation or contested actions for or against the company involving audit clients or auditors, then we were comfortable that we could act.

9 Two additional measures were implemented. In the spring of 1999, all of the YBM files were moved to a secure location within the office, with restricted access. This move was taken out of concern for security regarding the pending sale of certain YBM subsidiaries.

10 In October 1999, the Receiver initiated a policy where all members of the "YBM team" executed a specific confidentiality agreement. This restricted them from disseminating information regarding YBM and from seeking information regarding any Ernst & Young clients that may have been involved with YBM at any time. Denega states that this was not implemented earlier because the standard confidentiality policy and the provisions of paragraph 3(o) made it irrelevant.

11 Denega also deposes that he learned through inquiries that no Ernst & Young audit personnel have communicated any confidential information to Ernst & Young insolvency personnel assigned to YBM, nor to Stikeman Elliott or VC.

12 Adina Masson-Crocker, Chief Financial Officer of Griffiths, deposes that she was advised by an Ernst & Young employee who has worked on Griffiths' audit that he was moving to the insolvency group at Ernst & Young. Denega believes this is a reference to Jordan Sleeth, who has been specifically reminded of his confidentiality obligations.

13 The Underwriters were aware that Ernst & Young simultaneously acted as auditors for the Underwriters and some of the Underwriters' competitors. However, the Underwriters did not fear the release of confidential information among the audit clients, relying on Ernst & Young's professional obligations and policies. The Receiver submits that the confidentiality issue is no different in the context of Ernst & Young and its affiliate, the Receiver. In both situations, Ernst & Young is professionally and ethically obliged not to disclose confidential information.

14 The Underwriters filed two affidavits relating to certain initial discussions about the potential for a conflict of interest. Certain portions of Kym Anthony's July 6, 2000 affidavit were based on information he received from F. Michael Walsh. Those matters are also in Walsh's July 6, 2000 affidavit. I have taken this portion of the evidence from Walsh's affidavit, as it reflects the knowledge of a person directly involved. Anthony is the president and chief operating officer of National Bank; Walsh was a senior vice-president and director at FMSL until December 1999.

15 Walsh deposes that he became aware in 1998 that a group of institutional shareholders, led by Conner Clark and Lunn ("CCL") had appointed Wes Voorheis (of VC) and Steve Coxford to represent its interests. It became apparent later that Stikeman Elliott was also on CCL's retainer at that time. The group was seeking the resignation of certain directors and the creation of an Independent Committee to oversee YBM's activities. Walsh states that he learned of the Receiver's appointment in 1998.

16 Walsh deposes that he and Lawrence Bloomberg (FMSL's CEO) became concerned by a December 18, 1998 newspaper article which stated the Receiver was weighing whether to sue FMSL. Walsh states that he immediately raised this concern with Barry Rowland, the Ernst & Young audit partner for FMSL. Rowland sent Walsh a fax dated December 21, 1998, which states, in part: "The order of the court appointing EY receiver was specifically drawn in order that we would not be obliged to initiate or maintain any such action or claim [Article 3(o)]. As the order is a public document a copy has been attached at Lawrence's request." Therefore, FMSL was aware of the potential conflict of interest and of paragraph 3(o) of the December 8 order by late December 1998. There is no indication as to Griffiths' awareness at this time.

17 Walsh further deposes that Rowland and David Richardson (also of Ernst & Young) told him during a January 13, 1999 conversation that Ernst & Young had no requirement or intention to bring an action against FMSL or to

recommend that others do so. According to Walsh, they stated that they saw no reason for the company to bring such an action, and it was up to shareholders to do so if they wished.

18 On January 15, 1999, however, FMSL received a letter from the Receiver's Counsel stating that one of the Receiver's obligations:

> is to assess and make recommendations with respect to any causes of action YBM Magnex may have with respect to 'all matters arising out of its historical financial statements and other public disclosure documents issued by YBM Magnex'. As you will appreciate, this will include the services and advice rendered to YBM Magnex by your firm.

19 Walsh's affidavit attaches his notes from a conversation with Rowland on January 28, 1999 regarding the January 15 letter. According to those notes, Rowland told Walsh not to respond, that the Receiver's Counsel had not been instructed to send the letter, and that Denega and Richardson were not aware the letter had been sent out.

20 In conclusion, Walsh deposes:

> 14. We were led to believe that Ernst & Young recognized its obligation to FMSL, the nature of the conflict that it would put itself in were it to act for a party with interests contrary to those of FMSL and that it could not act in a manner which was contrary to the interests of FMSL.
>
> 15. With these assurances, we resolved to monitor the situation to ensure that the commitments made by Mr. Rowland and Mr. Richardson were adhered to.

21 Subsequently, the Receiver's Counsel sent letters to Griffiths and to FMSL's counsel (dated February 25, 1999), which contained additional wording, referring specifically to the conflict issue and its proposed resolution:

> In order to anticipate the possibility that there could be real or perceived conflicts in the receiver carrying out this responsibility, it has delegated the task to us as its counsel. The receiver will not be involved in the assessment other than through the use of the powers conferred in the Order. The report and recommended course of action will be delivered directly to the Court in Alberta. Further directions, if any, with respect to the mandate will come from the Alberta Court of Queen's Bench.

22 The Receiver and Receiver's Counsel clearly recognized the conflict or potential conflict inherent in the situation. The February 25, 1999 correspondence outlines that fact, as well as the steps being taken by the Receiver and Receiver's Counsel to deal effectively with the conflict. By that time, FMSL was represented by counsel. It chose not to pursue the matter further.

23 FMSL was aware of the Receiver's mandate in December 1998. Griffiths was certainly aware by February 25, 1999.

24 Anthony deposes that "Although National Bank Financial had initially determined that there was likely no conflict in E&Y YBM acting as the Receiver, the actions recently taken by the Receiver now indicate that it is acting in a manner which is adverse to the interests of National Bank Financial." He points to several actions by the Receiver, stating that they "raise the appearance that the interests of shareholders of YBM are being preferred to the interests of creditors" like National Bank. Such actions include not contesting claims advanced by innocent former shareholders, disallowing National Bank's claim for indemnity (to preserve the position until an Independent Litigation Supervisor, if and when appointed, can review the matter), and applying to court to enable the Receiver to provide the report prepared pursuant to paragraph 3(o) of the December 8, 1998 order (the "3(o) Report") to certain shareholders.

25 Anthony also notes that Stikeman Elliott and VC had formerly (in 1998) both been retained by CCL on matters relating to YBM. These events, where CCL led a group of institutional investors, culminated in an order by this court reconstituting YBM's board of directors.

26 Walsh states that FMSL remained uncomfortable with the Receiver's distancing mechanism, which was the reason FMSL continued discussions with the Receiver and with FMSL's own counsel on the point throughout January and February 1999. Walsh did not explain why the Underwriters seemed content after February 1999, particularly in light of the February 25 letter clarifying the Receiver's Counsel's enhanced responsibilities to deal with the conflict or potential conflict situation. The Underwriters' counsel, in argument, stated that the Underwriters were entitled to rely on the Receiver to put proper anti-conflict measures in place. He submitted that the Underwriters were under no obligation to monitor or review such measures.

Issue

27 Should the Receiver and Receiver's Counsel be removed for conflict of interest?

Analysis

1. Parties' Positions

28 The Underwriters raise several concerns regarding the Receiver: (1) the Underwriters' initial concerns regarding conflict of interest; (2) acting against the Underwriters' interests by treating shareholders with net losses as ordinary creditors and by sharing the 3(o) Report with certain shareholders for their own use; (3) using the same counsel as previously used by CCL on matters relating to YBM; and (4) the unavoidable interaction between the Receiver and Ernst & Young.

29 The Receiver submits that the Underwriters knew or had the means to know about certain matters from at least January 1999, such that they cannot now complain of a conflict and seek the Receiver's removal. These matters are: (1) the history of the Receiver's appointment; (2) the contacts with innocent shareholders; (3) the fact of and structure for assessing potential claims of YBM's estate; (4) large expenses incurred by YBM's estate in performing the assessment; and (5) the approximate completion date for the assessment, at which point the company would be in a position to initiate action, if warranted. The Receiver complains that the Underwriters waited until July 2000 to bring their motion, at which stage removing the Receiver and Receiver's Counsel would cause maximum expense, disruption and prejudice to the estate.

30 Regarding the Receiver's Counsel, the Underwriters are concerned that they were formerly engaged by CCL, which is still an interested party. The Underwriters submit that this former connection creates a perceived conflict when the Receiver's Counsel gives advice relating to CCL, as Receiver's Counsel owes a fiduciary duty to CCL and cannot act contrary to CCL's interests. As evidence of this, the Underwriters claim that various decisions have favoured CCL over the Underwriters, such as decisions relating to the 3(o) Report.

31 The Receiver's Counsel submits that the CCL retainer is over, so that it owes no continuing duty to CCL. Further, if any party has a right to complain about the Receiver's Counsel acting for the Receiver, it is CCL, the former client. The evidence is clear that CCL has no difficulty with Receiver's Counsel being involved, even if, at some point, the Receiver or Receiver's Counsel take a position adverse in interest to CCL.

2. Obligations of a Court-Appointed Receiver

32 *Canada Trustco Mortgage Co. v. York-Trillium Development Group Ltd.* (1992), 12 C.B.R. (3d) 220 (Ont. Gen. Div.) sets out the obligations of a court-appointed receiver (at 221):

> (a) it is a fiduciary as to all interests of concerned parties and as such it is to act as an appointee of the Court in good faith; with candour; disclosing all relevant material facts affecting the parties; avoiding any real or objectively perceived conflicts of interest; and
>
> (b) it has a general duty to exercise it obligations with prudence, diligence, due care and skill.

33 Other phrases used to describe a court-appointed receiver's obligations are "to act with utmost good faith, complete disclosure and scrupulous avoidance of conflict of interest toward all parties to a receivership or bankruptcy" (M.V. Ellis, *Fiduciary Duties in Canada* (Scarborough: Carswell, 2000) at 11-4.1); and "the standard required because of that status [as an officer of the court] is one of meticulous correctness" (*Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.* (1991), 117 A.R. 44 (Alta. C.A.) at 55 (leave to appeal refused [(1992), 127 A.R. 396 (S.C.C.)])).

34 As with a trustee in bankruptcy, a court-appointed receiver is an officer of the court and is expected and presumed to act as such. In *Confederation Treasury Services Ltd., Re* (1995), 37 C.B.R. (3d) 237 (Ont. Bktcy.), the court highlighted the differences between a privately appointed receiver, a trustee in bankruptcy and a court-appointed receiver. The latter two share many characteristics, such as the duty to represent impartially the interests of all creditors, the obligation to act even-handedly, and the need to avoid any real or perceived conflict between their interest and their duty (248-50).

35 In that case, certain parties were opposing a nominee for trustee, as the nominee had done extensive forensic investigation on behalf of a group of creditors. The court emphasized that it had discretion in determining whether a trustee would be unfit (at 247). The court allowed the nominee, finding that the former relationship with the creditors' group had ended. It stressed that the trustee must be indifferent among all creditors and demonstrate this neutrality throughout the trusteeship (at 258).

3. Test for Removing a Receiver for Conflict of Interest

36 In *Canada Trustco Mortgage Co.*, the defendants unsuccessfully applied to remove the receiver, alleging conflict of interest, lack of neutrality, and improper and imprudent management. The court noted that the onus to remove a receiver is heavier than the onus to oppose an appointment in the first place (at 222). The court also stated that a receiver's actions must be examined as they unfold, not in hindsight. For example, a receiver will be removed if it engages "in blatant intentional action contrary to the interests of one involved group" (at 222). The court acknowledged that the receiver there could have made certain disclosures to the defendants at the same time as it did to the lenders. However, the defendants suffered no disadvantage from receiving the information later. Moreover, the receiver did not attempt in any way to hide the issue from the defendants (at 224).

37 In *Tannis Trading Inc. v. Camco Food Services Ltd. (Trustee of)* (1988), 67 C.B.R. (N.S.) 1 (Ont. S.C.), the court removed a trustee because there was both the potential for and the appearance of conflict in the circumstances (at 7). Before reaching this conclusion, the court cautioned (at 6):

> In the complex context of insolvency, it is perhaps trite to say that each case will depend on its own facts. It is not, in my view, possible or necessary to attempt to define where the line should be drawn. No hard and fast rule can be laid down. It is a matter of degree. A firm that it the auditor of one or more of the creditors will not ordinarily be precluded from acting as a trustee. [emphasis added]

38 I agree with the above statement from *Tannis Trading Inc.*. Accordingly, I must examine the specific facts in order to reach a conclusion based on the entirety of the circumstances.

4. Factors Considered in Removing a Receiver for Conflict of Interest

39 The factors typically considered by courts as relevant to deciding whether to exercise their discretion to remove a receiver for conflict of interest are listed below. The court must balance the interests of the receivership as a whole with the factors favouring removal. They are:

(a) the gravity of the conflict or potential conflict;

(b) the receiver's qualifications, and the experience and familiarity already gained by the receiver;

(c) the prejudice to the estate in removing the receiver, in particular, the knowledge which would be lost and the time and costs which would be incurred in substituting a new receiver and bringing that person up to speed;

(d) the receiver's conduct, in particular, whether the receiver: (i) has disclosed the conflict or potential conflict from the outset; (ii) has established measures to reduce the dangers of conflicts or potential conflicts; and (iii) has in any way acted improperly;

(e) delay by the applicant in alleging conflict and bringing the motion for removal;

(f) tactical reasons for bringing the motion for removal; and

(g) the wishes of various stakeholders.

40 In submissions before me, counsel for the Underwriters agreed with this list of factors. He did caution that the wishes of stakeholders not be over-emphasized, as parties will often act in their own self-interest. I agree with that observation.

41 Obviously, there may be additional factors in other circumstances. Ultimately, of course, the decision is one of judicial discretion, based on all of the particular circumstances of a case. For cases discussing these factors, see, for example, *Tannis Trading Inc.*; *United Fuel Investment Ltd. (No. 1), Re* (1965), [1966] 1 O.R. 165 (Ont. C.A.); *Confederation Treasury Services Ltd.*; *Scarth v. Northland Bank (Liquidator of)* (1996), 114 Man. R. (2d) 314 (Man. Q.B.), leave to appeal denied (1997), 115 Man. R. (2d) 107 (Man. C.A.); *Minister of National Revenue v. Burlingham Associates Inc.*, [1997] 10 W.W.R. 199 (Sask. Q.B.); *Canada Trustco Mortgage Co.*; and *R.J. Nicol Homes Ltd. (Trustee of) v. Nicol* (1995), 30 C.B.R. (3d) 90 (Ont. C.A.).

5. Application of the Test and Factors

42 After balancing the factors listed above and discussed below, I am dismissing the Underwriters' application to remove the Receiver. While there was, at least, the potential for a conflict from the outset, the measures taken, in addition to the Underwriters' knowledge and delay, convince me that it is inappropriate to remove the Receiver in these circumstances.

(a) Nature of Conflict or Potential Conflict

(i) existence of conflict

43 The test for whether there is a conflict of interest is whether it is difficult for the trustee to act impartially, not whether the trustee has or will continue to act impartially (see *Tannis Trading Inc.* at 6; and *Confederation Treasury Services Ltd.* at 250).

44 It is clear from the evidence, the parties' submissions and the very structure of this receivership that there was, from the outset, a recognized conflict or potential for conflict in having the Underwriters' auditor (and former auditor) involved with the receivership. That was the reason for creating the Receiver as a separate entity and delegating certain tasks to Receiver's Counsel. Given that there are few firms capable of taking on such a large, complex receivership, it is not surprising that it was difficult to find candidates for receiver who were not in a potential conflict situation.

45 It is likewise obvious that the Receiver saw the potential conflict and recognized that it needed to be adequately addressed. This is clear from the measures taken at the start and throughout the course of the receivership (the adequacy of which is confirmed later in these Reasons), and from the planned future application for an Independent Litigation Supervisor.

(ii) alleged favouritism by the Receiver

46 The Underwriters state that they were satisfied at the outset with the apparent resolution of the conflict issue, only becoming concerned later when the Receiver, in their view, began to prefer the interests of other stakeholders to those of the Underwriters. For example, they claim that the Receiver is treating the shareholders as creditors and trying to release the 3(o) Report to shareholders. It was only then, in their submission, that they concluded the Receiver's conflict avoidance and confidentiality measures were inadequate from the outset.

47 There is nothing in the evidence to suggest that the Receiver has been acting contrary to the Underwriters' interests. On the contrary, it appears that the Receiver is taking its responsibilities seriously and trying to carry out its duties with integrity. Because a party does not like a receiver's decision does not mean that the receiver is being unfair or is "playing favourites". As stated elsewhere in these Reasons, the nature of insolvencies suggests that a receiver's decisions will not always be popular with all creditors or potential creditors. The decision taken must be objectively in the best interests of the estate a whole. A decision made in the best interests of YBM's estate cannot be equated with a decision made deliberately and for an improper purpose against one of the players. In any event, the Receiver sought court directions on matters such as the release of the 3(o) Report, as it is entitled to do.

(iii) nature of conflict for auditors affiliated with receivers

48 The Underwriters state that an auditor, as a fiduciary, owes a duty not to disclose confidential information, a duty of good faith and loyalty, and a duty not to act against the interests of the client, as found in *Drabinsky v. KPMG* (1998), 41 O.R. (3d) 565 (Ont. Gen. Div.) at 567, appeal dismissed (1999), 10 C.B.R. (4th) 130 (Ont. Div. Ct.). There, the Motions Judge granted Drabinsky an injunction preventing KPMG, the accounting firm of which Drabinsky was a client, from further participating in a forensic investigation into the accounts of Livent Inc. The investigation was undertaken on behalf of Livent Inc. to determine whether financial statement irregularities stemmed from fraudulent activity. Drabinsky was a senior officer of Livent Inc., whose suspension was announced along with the investigation.

49 On the injunction application, the court did not determine whether KPMG had breached its fiduciary duty to Drabinsky, but did find that there was a serious issue to be tried. While stating that the breach issue was up to a trial court, the court outlined its views on fiduciary relationships in this context (at 567):

> I am of the view that the fiduciary relationship between the client and the professional advisor, either a lawyer or an accountant, imposes duties on the fiduciary beyond the duty not to disclose confidential information. It includes a duty of loyalty and good faith and a duty not to act against the interests of the client. I am further of the view that the scope of these duties is not defined by the nature of the original retainer between the fiduciary and the client but, rather, by the nature of the activities in which the fiduciary proposes to engage in the face of such fiduciary duties.

50 According to the court, other issues for trial would include whether the Chinese Wall (information barrier) erected by KPMG absolved it of any breach, and whether KPMG should have disclosed the Livent Inc. retainer to Drabinsky, allowing Drabinsky to voice objections, consent, or reject the Livent Inc. retainer (at 568).

51 On appeal, the court held the Motions Judge correctly set out the broad scope of KPMG's fiduciary duty in the circumstances. The court also confirmed (at 131) that the scope of a fiduciary duty depends on the particular facts of a case, citing *Hodgkinson v. Simms* (1994), 117 D.L.R. (4th) 161 (S.C.C.).

52 It is interesting that both courts emphasized a distinction found in *Bolkiah v. KPMG* (1998), [1999] 1 All E.R. 517 (U.K. H.L.) between accountants' forensic and audit functions. The Divisional Court in *Drabinsky* noted (para.5) that the fiduciary duty owed to a client may be narrower (*i.e.*, limited to preserving confidentiality) where the accounting firm is engaged as auditors, rather than in conducting a forensic investigation.

53 In *Bolkiah*, the issue was whether, and in what circumstances, an accounting firm which possesses confidential information gleaned from providing litigation support services to a former client may undertake work for another client with an adverse interest. There, the appellant, Prince Jefri, was involved in personal litigation. He had KPMG's forensic

accounting department carry out litigation support, including investigating facts, interviewing witnesses, searching for documents, reviewing pleadings and preparing ideas for cross-examination. During the course of this investigation, KPMG learned confidential details of Prince Jefri's personal financial situation.

54 This investigation was terminated after the litigation settled. KPMG subsequently took on an assignment to discover and trace certain funds. It was apparent from July 1998 that this further assignment was at least in part adverse to Prince Jefri's interests. However, KPMG did not inform Prince Jefri of the new assignment, nor did it seek his consent to KPMG accepting the project. KPMG did erect Chinese Walls in an attempt to ensure that none of Prince Jefri's confidential information was released to those involved in the new assignment.

55 The court held that there was a need to preserve confidentiality, and that the Chinese Walls were inadequate in the circumstances. It granted Prince Jefri an injunction. I note that at 530, the court commented on the effectiveness of separating different functions in different situations:

> It is one thing, for example, to separate the insolvency, audit, taxation and forensic departments from one another and erect Chinese walls between them. Such departments often work from different offices and there may be relatively little movement of personnel between them. But it is quite another to attempt to place an information barrier between members all of whom are drawn from the same department and have been accustomed to work with each other. I would expect this to be particularly difficult where the department concerned is engaged in the provision of litigation support services, and there is evidence to confirm this. Forensic accountancy is said to be an area in which new and unusual problems frequently arise and partners and managers are accustomed to share information and expertise. [emphasis added]

56 Throughout *Bolkiah* is a recognition that the present financial world has several dominant accounting firms, who commonly provide services in a number of areas to a number of clients. It is inevitable that there will be some overlap of services and clients. This overlap is, to a large extent in many circumstances, adequately addressed by Chinese Walls.

57 The Underwriters also invite me to equate the conflict or potential conflict in the present situation with that of solicitor/client confidentiality in *MacDonald Estate v. Martin* (1990), 48 C.P.C. (2d) 113 (S.C.C.), as was done in *Ernst & Young Inc. v. Royal Trust Corp. of Canada* (1997), 208 A.R. 244 (Alta. Q.B.). At 252 of *Royal Trust Corp. of Canada*, the court found a conflict of interest:

> ...it is my view that the principles emanating from **McDonald** [sic], supra, have some play when an accounting firm acts as a litigation agent for parties it represents. In **McDonald** [sic], supra, the Court found that the use of confidential information is not usually susceptible to proof. It held that the appropriate test must be such that the public, represented by the reasonably informed person, would be satisfied that no use of confidential information would occur. In my view, there is always a risk where matters involving credibility are before the Court, and credibility almost invariably arises in any litigation, the risk being that information might be available to a party because of its special relationship with the opposing party. Secondly, there is no objectively verifiable method of determining that any such information would not be used for that purpose. This is especially the case where a large accounting firm has available electronic records and data which may be stored in many forms. It may well be that Ernst & Young has confidential, relevant information but is not even aware that it possesses such information. I accordingly conclude that an accounting firm which has been the auditor of a Defendant should not sue that Defendant where that accounting firm might have obtained information which might assist the accounting firm during the course of the audit. [emphasis added]

58 In *Royal Trust Corp. of Canada*, the receiver was Ernst & Young Inc.; no separate affiliate was established as in the present case. The company there provided extended warranties to automobile purchasers, which it funded through investment contracts held with Royal Trust, the applicant. The receiver sued Royal Trust to recover certain money allegedly improperly paid to the company by Royal Trust in breach of trust. One of the predecessor accounting firms which by then comprised Ernst & Young Inc. had been Royal Trust's auditor.

59 I would not apply the conclusion from *Royal Trust Corp. of Canada* in the present circumstances. The factual background there is distinguishable from the present case. The process in YBM's situation was established specifically to prevent the Receiver from being in the position of suing its audit clients, including the Underwriters. For example, a separate affiliate was set up to be the "Receiver", and paragraph 3(o) was included in the receivership order. Perhaps the process could have been established and communicated more clearly, but it was established. In addition, the evidence shows that standard and specific informational safeguards were implemented, although some were at a later date than others.

60 Despite the factual differences, I would be hesitant to apply the broad statement made in the emphasized portion of *Royal Trust Corp. of Canada* to this case. In my view, it is crucial to reflect on the difference between the audit function of accounting firms and other functions, such as forensic investigations. I prefer the reasoning in *Bolkiah*, as cited in *Drabinsky*, where the court made such a distinction. In my view, the issue of conflict ought to be dealt with on a case by case basis, depending, in part, on the nature of the relationship.

(iv) conclusion on nature of conflict

61 I find that the potential for a conflict always existed, as was recognized by the parties from the outset. However, the concern regarding possession of confidential information was adequately addressed (as detailed later in these Reasons), as was the concern regarding suing an audit client. In light of the authorities and given practical considerations, I am convinced that a conflict based on the Receiver's affiliate's audit relationships is less serious than a conflict based on a forensic accounting or investigative function. Finally, the evidence indicates that the Receiver has not favoured the interests of some stakeholders over others, but has always acted in what it believed to be the best interests of YBM's estate.

62 Therefore, the conflict or potential conflict here was not a grave one, in light of the circumstances and the measures taken.

(b) Receiver's Qualifications

63 The Underwriters did not challenge the Receiver's qualifications. The Underwriters acknowledged that the Receiver has extensive experience and familiarity with YBM's estate by agreeing that it would be appropriate for the Receiver to continue as receiver in all aspects of YBM's estate, other than for the Litigation Assets.

(c) Prejudice to the Estate

64 The Underwriters submit that there would be minimal prejudice to YBM's estate by replacing the Receiver for the Litigation Assets, as the Receiver itself is planning to apply for an Independent Litigation Supervisor, to further distance itself from the future anticipated litigation. It is true that an Independent Litigation Supervisor would have a learning curve, as would a new receiver.

65 The Receiver notes that, to the application date, YBM's stakeholders have over 14,400 hours and millions of dollars invested in the Receiver and the Receiver's Counsel. The Receiver submits that the Receiver and the Receiver's Counsel have knowledge and experience with the complicated issues of YBM's estate, such that great cost, delay, inefficiency and prejudice would result from their removal.

66 All of the prejudice factors are very significant, in the YBM's estate is extremely complicated and highly unusual. I agree with the Receiver that a new receiver could not be brought up to speed merely by reading the 3(o) Report, as suggested by the Underwriters. Not only did the Receiver not generate the 3(o) Report, but the Receiver (and Receiver's Counsel) have a great deal of background information that would not be contained in any report and would not be easily transferrable, if at all.

(d) Receiver's Conduct

67 I must also examine the Receiver's conduct — for example, whether the Receiver has: (i) disclosed the conflict or potential conflict; (ii) established measures to reduce the dangers of conflicts or potential conflicts; and (iii) in any way acted improperly.

68 As already discussed, the Receiver disclosed the potential for conflict from the start. It was disclosed to the court at the time the receivership order was sought. It was clearly set out in the February 25, 1999 letters to FMSL's counsel and to Griffiths. FMSL's awareness also obviously preceded that letter.

69 Ernst & Young and the Receiver implemented measures to reduce the danger of conflicts. Regarding the potential problem of suing one's own audit client, the initial Receivership Order relieved the Receiver of the obligation to initiate any actions. The subsequent delegation to the Receiver's Counsel of the entire assessment process further isolated the Receiver from participation, either by gathering information or by assessing it. Regarding the confidentiality concerns, the Receiver had its standard confidentiality policies in place. In addition, it moved YBM files to a secure location in the spring of 1999. In October 1999, it went even farther, requiring specific confidentiality agreements for those working on the project.

70 I am satisfied that the Receiver's steps to reduce the danger of conflicts were clear and effective.

71 I do not find that the Receiver has acted improperly in these difficult circumstances. As stated elsewhere, I do not accept the Underwriters' claims that the Receiver has been preferring or favouring one group over another. Nor do I agree with the Underwriters' insinuations that the Receiver somehow contrived to mislead the Underwriters into thinking that they would never be investigated or sued for any of their actions. Paragraph 3(o) of the receivership order is clear that litigation is contemplated, but that the Receiver will not bring it. In addition, Walsh (upon whose evidence both of the Underwriters rely) admitted in cross-examination that he understood that the bankruptcy process required someone to determine against whom claims could be brought.

(e) Delay

72 The Receiver submits that the Underwriters' delay in bringing this conflict of interest application is so unreasonable that the application should be dismissed on this basis alone. While I will not go that far, the delay is an extremely significant factor in my decision to dismiss this application.

73 A case closely on point is *Canadian Commercial Bank v. Pilum Investments Ltd.*, [1987] O.J. No. 29 (H.C.J.); appeal quashed (February 10, 1987), Doc. 48/87 (Ont. C.A.). There, a motion to remove the receiver was brought at the same time as the receiver's motion for the sale of certain property. The court held that such a motion for removal, if made at all, should have been made sooner. The judge also held that the matters advanced as the basis for removal had been known for some time. The applicant knew of the lack of harmony between it and the receiver, had processes available to investigate the receiver's conduct, and could observe the receiver's alleged mismanagement throughout the course of the receivership.

74 The motion in the present case is also made at a very late stage, after considerable time, effort and monies have been expended. The potential or perceived conflict of interest was obvious to everyone from the beginning or soon after, particularly to the Underwriters. This is evident from the fact that the Underwriters initially expressed concerns, then appeared to be satisfied in the resolution of those concerns.

(f) Tactics

75 The Receiver also encourages me to dismiss the application as it states that the Underwriters' motive is to gain a tactical advantage. In my view, there is too little evidence on this point to justify a lengthy discussion. In any event, it is unnecessary to my disposition of this matter.

(g) Wishes of Stakeholders

76 In addition to the Underwriters, oral submissions were presented by several other stakeholders. Deloitte & Touche LLP conducted YBM's 1996 audit, but refused to complete the 1997 audit. Although admittedly a potential "target" of future litigation, it submits there should be no barrier to the Receiver continuing to act because there was never a conflict in these circumstances, and because any conflict was fully disclosed early on.

77 The Plaintiffs' Executive Committee (for one of the class actions) does not support removing the Receiver. It emphasized that the current application is adversely impacting the Receiver's effectiveness. Counsel for the Ontario prospectus class action plaintiffs, in which action CCL is a named plaintiff, understands that the Receiver may take a position contrary to CCL's interests. It cites tremendous prejudice if the Receiver were to be removed at this late stage. The Underwriters suggest these submissions are largely driven by self-interest. I have considered their submissions in that light, but do recognize a potential prejudice to them nonetheless. It is not a material fact in my consideration.

6. Conclusion on Receiver's Removal

78 In these circumstances, I am satisfied that the Receiver should not be removed. The Receiver's affiliate was (or still is) the auditor for the Underwriters. It is not and was not involved in a forensic investigation, such as in *Bolkiah*. Moreover, I acknowledge the commercial reality, particularly in these complex and unusual circumstances, that very few firms would have the ability to be YBM's receiver, with the willingness to do so and no audit history with any potential "target". As well, appropriate measures were taken to deal with the conflict concerns presented by the situation.

79 It is unnecessary, inconvenient and prejudicial to YBM's estate to remove the Receiver. I would not necessarily have reached the same conclusion had this application been made at the time of the Receiver's initial appointment. However, the Underwriters had concerns at that time, raised their concerns, and did nothing further while the receivership progressed.

7. Removal of Receiver's Counsel

80 I have also concluded that the application to remove the Receiver's Counsel must be dismissed. The application appears to be grounded on two bases: (1) because it is tainted with the Receiver's conflict of interest; and (2) because it owes loyalties to its former client, CCL.

81 Dismissal on the first ground is self-evident because I have already found that the Receiver itself should not be removed for conflict of interest.

82 Regarding the second basis, there are two important principles. First, it is clear from *MacDonald Estate* that parties are not to be deprived of counsel of their choice without good cause (at 254). Second, there is a need to prevent the possibility of a lawyer subsequently using against a client, confidential information obtained through the solicitor-client relationship. This stems from the concern to maintain the legal profession's high standards and the integrity of the justice system.

83 In the present circumstances, the Underwriters do not allege that the Receiver's Counsel is in danger of misusing CCL's confidential information. Even if the Underwriters were to have the standing to make such an allegation on behalf of another party, it is contrary to their submission that the Receiver and the Receiver's Counsel have been favouring CCL's position ahead of others such as the Underwriters.

84 I am satisfied that CCL's retainer of the Receiver's Counsel ended prior to the Receiver's Counsel becoming involved as counsel for the Receiver. I am also satisfied that the Receiver's Counsel has not been party to any favouritism directed against the Underwriters, nor has there been any such favouritism. Finally, I am satisfied that CCL itself, the only party that could be harmed by the Receiver's Counsel's possession of any confidential information, is not concerned with the Receiver's Counsel's continuing to act.

8. Release of 3(o) Report to Underwriters

85 The Underwriters asked that a new receiver not be able to use the 3(o) Report until the Underwriters had vetted it for confidential information learned by Ernst & Young as auditors. As there is to be no new receiver, this portion of the application is also dismissed. As the evidence indicates that confidentiality measures were in place, with no complaints from the Underwriters until this late date, I am also satisfied that the Underwriters should not have access to the 3(o) Report, unless at some point the Receiver decides that it is in the best interests of YBM's estate.

Conclusion

86 There is no evidence that the Receiver here has preferred the interests of some groups of creditors over others. The Underwriters are contingent creditors who disapprove of or dislike certain of the Receiver's recent decisions, such as its application to court for release of the 3(o) Report and the Receiver's Counsel's disallowance of the Underwriters' proof of claim at this stage (pending review by an Independent Litigation Supervisor, if and when appointed). While the Underwriters may disagree with some of the Receiver's applications, or the outcome of them, that disagreement can hardly be taken as evidence of bias.

87 A receiver is often obliged to make difficult decisions that are not universally accepted. Those decisions will naturally be unpopular in some quarters. If it were otherwise, there would rarely be contested court applications, as all potential stakeholders would have identical interests and agree on a mutually beneficial course of action. A court must presume that its receiver, as an officer of the court, acts properly and impartially, unless there is clear evidence to the contrary. Further, the Receiver has decided to bring applications for directions to the court, and left those decisions in the court's hands. It is difficult to suggest any preferential treatment by the Receiver when it is merely a request for court direction.

88 The Underwriters have not met their heavy burden to convince me to exercise my discretion to remove the Receiver. This is clearly not the type of situation described in *Canada Trustco Mortgage Co.* where there has been "blatant intentional action contrary to the interests of one involved group". In weighing the factors to reach the conclusion not to remove the Receiver, I am greatly influenced by the lengthy delay in bringing this conflict application, when the potential for conflict was apparent and was discussed among the parties from the very beginning. Also highly relevant are the most significant measures taken to deal with the potential for conflict.

89 One cannot help but speculate that if the Underwriters were genuinely concerned with the Receiver's motives and decisions, they would not likely be comfortable with the Receiver retaining authority over any aspect of the YBM assets. However, the Underwriters state that they only seek the Receiver's removal relating to the Litigation Assets.

90 It is inappropriate to replace the Receiver's Counsel for either of the two reasons put forward by the Underwriters. First, the Receiver's Counsel is not tainted by the Receiver's potential conflict, as I have found that there is no conflict justifying removal in these circumstances. Second, the Receiver's Counsel is not tainted by its prior association with CCL, as that retainer was over before the Receiver's Counsel took on its present role.

91 Finally, the Underwriters are not entitled to review the 3(o) Report before the Receiver uses it in the best interests of YBM's estate.

92 The application is dismissed, with leave to speak to costs.

Application dismissed.

TAB 6

BENNETT

on

RECEIVERSHIPS

Third Edition

by

Frank Bennett

L.S.M., LL.M.

Toronto, Canada

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proceedings or the authority to distrain, the receiver requires leave of the court to pursue delinquent tenants in its own name or in the name of the debtor.[187]

(iv) Renewal of Lease and New Leases

Unlike foreclosure under a mortgage, a receiver, whether privately or court-appointed, may, if the power is expressly afforded, renew leases and enter into new leases in the debtor's name. Although the mortgagee or receiver should avoid lengthy terms extending beyond the maturity date, if any, of the security instrument, it should, where possible, seek to renew or let on a basis consistent with that of the previous term of lease. New leases and renewals of longer terms may impair the sale of the property in situations where a prospective purchaser wishes occupation, as well as impair and prejudice the debtor's right to redeem. However, apartment and shopping complexes by their very nature differ in such a way that continuation of tenancy agreements is mandatory even where the term of the lease extends beyond the expiry of the redemption period.

In the absence of a general power to let and renew leases, the court-appointed receiver should obtain leave of the court if the proposed lease or renewal lease is for a period of time extending beyond the redemption period, if any, or is for a period of time that may be excessive given the circumstances of the debtor's business. On the other hand, the privately appointed receiver takes the risk that the new lease or renewal lease is commercially reasonable. However, if there is legislation permitting the receiver to apply to the court for directions as to the terms of the proposed lease or renewal lease, the receiver should proceed on that basis where such terms may materially prejudice the debtor's right to redeem.

5. CONTRACTS

(a) Existing Contracts with Debtor

At the commencement of any receivership, the receiver reviews the terms of any on-going or executory contracts at the time of the appointment or order with a view to determining whether the receiver should perform or disclaim them. Where the *Bankruptcy and Insolvency Act* applies to the receivership, subsection 14.06(1.2) provides that a trustee, including a receiver, is not liable for claims arising prior to the appointment of the receiver. If the receiver completes the contract, the receiver may be conferring a preference on a creditor who would otherwise be unsecured. In cases where the contract is almost complete, such as in the case where the debtor had sold goods but had not delivered them, the court examines the terms of the contract, the intention of the parties, and the debtor's conduct. If the debtor intended that title to the goods passes to the purchaser and separated the goods from its other inventory, the court will enforce the contract in favour of the purchaser[188] or in the

187 *Stuart v. Grough* (1887), 14 O.R. 255 (Ont. Ch.).

188 *NEC Corporation v. Steintron International Electronics Ltd.* (1985), 59 C.B.R (N.S.) 91, 1985 CarswellBC 496, [1985] B.C.J. No. 611 (B.C. S.C.).

case of real property where equitable title has passed, direct the receiver to perform the contract.[189] However, if a creditor has a claim for commission on the sale of the debtor's assets prior to the receivership, the court will not honour the claim if the listing agreement expired and the receiver does not renew it.[190] Similarly, the court will not permit the payment of a fee to a consultant who marketed and arranged the sale of certain assets of the debtor prior to the appointment of the receiver even though the court subsequently approved the sale, and despite the fact that the receiver would have had to market and incur costs as did the debtor.[191]

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 unless the receiver continues to perform them.[192] 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 its standard of care by dissipating the debtor's assets. If the receiver operates the business, the receiver has a duty to preserve the goodwill and the assets of the business. Consequently, the receiver should not disregard executory contracts where they are beneficial to the stakeholders. Thus, if the receiver chooses to break a material contract, the receiver should seek leave of the court where the receiver does not have the power to do so under the initial order.[193] The debtor remains liable for any damages as a result of the breach.[194]

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189 *Freevale Ltd. v. Metrostore (Holdings) Ltd.*, [1984] 1 Ch. 199, [1984] 2 W.L.R. 496, [1984] 1 All E.R. 495 (Eng. Ch. Div.).

See also *Armadale Properties Ltd. v. 700 King Street (1997) Ltd.* (2001), 25 C.B.R. (4th) 198, 2001 CarswellOnt 1567, [2001] O.J. No. 1727 (Ont. S.C.J. [Commercial List]) where the court ordered a trustee in bankruptcy to complete an agreement of purchase and sale even though there was no benefit to the estate.

190 *Howlett v. 512046 B.C. Ltd.* (2000), 17 C.B.R. (4th) 224, 2000 BCSC 871 (CanLII), 2000 CarswellBC 1130 (B.C. S.C. [In Chambers]).

191 *Textron Financial Canada Ltd. v. Beta Ltée/Beta Brands Ltd.* (2007), 36 C.B.R. (5th) 296, 2007 CarswellOnt 5799 (Ont. S.C.J.). However, if the receiver adopts the contract, it may be possible for the creditor to argue the principles of *quantum meruit* and unjust enrichment.

192 *Re Bayhold Financial Corp. v. Clarkson Co.* (1991), 108 N.S.R. (2d) 198, 86 D.L.R. (4th) 127, 10 C.B.R. (3d) 159 (N.S. C.A.), dismissing an appeal from (1990), 99 N.S.R. (2d) 91, 270 A.P.R. 91, 1990 CanLII 4134 (N.S. T.D.); *Re Pope & Talbot Ltd.* (2008), 46 C.B.R. (5th) 34, 2008 BCSC 1000 (CanLII), 2008 CarswellBC 1726 (B.C. S.C. [In Chambers]); *2155489 Ontario Inc. v. SMK Speedy International Inc.*, 2009 CanLII 4847, 2009 CarswellOnt 668 (Ont. S.C.J. [Commercial List]).

Referred to in *Alberta Health Services v. Networc Health Inc.* (2010), 28 Alta. L.R. (5th) 118, [2010] 11 W.W.R. 730, 2010 ABQB 373 (CanLII) (Alta. Q.B.) where on the basis of strong public policy issues, the court dismissed an application by the landlord to lift the stay of proceedings and to compel the court-appointed receiver to accept or disclaim a lease.

193 *Bank of Montreal v. Probe Exploration Inc.* (2000), 33 C.B.R. (4th) 173, 2000 CarswellAlta 1659, [2000] A.J. No. 1752 (Alta. Q.B.), appeal dismissed (2000), 33 C.B.R. (4th) 182, 2000 CarswellAlta 1621, [2000] A.J. No. 1751 (Alta. C.A.) where the court refused to allow the receiver to terminate a contract essentially on the basis that the receiver is bound to act in an equitable manner, must be fair and equitable to all, and must not prefer one creditor over another.

194 Cited in *Bank of Montreal v. Scaffold Connection Corp.* (2002), 36 C.B.R. (4th) 13, 2002 ABQB 706 (CanLII), 2002 CarswellAlta 932 (Alta. Q.B.) and in *New Skeena Products Inc. v. Kitwanga Lumber Co.* (2005), 39 B.C.L.R. (4th) 327, 251 D.L.R. (4th) 328, 9 C.B.R. (5th) 267 (B.C. C.A.),

On the other hand, if the receiver chooses to perform such contracts or allows key employees to continue with the contracts, the receiver can be considered to have adopted the contracts and it will become liable for their performance.[195] However, if the receiver does nothing, that is, neither affirms nor disclaims a contract and does not continue to order goods or services under an existing contract, the receiver is not liable for payments. In order to fix a receiver with the liability, the receiver must expressly or by implication on the facts affirm the contract.[196]

In *Re Newdigate Colliery Co.*,[197] the debtor carried on a business of mining and selling coal. When the court-appointed receiver took possession of the property, the receiver found that the debtor entered into many contracts which, if completed, would not generate sufficient profits. The price of coal had risen and the receiver sought authority to disclaim the contracts. However, the court concluded that the increased profits that could be generated by allowing the receiver to break the debtor's contracts were not a sufficient reason to give the receiver power to disclaim contracts generally. The court reviewed the differences between a court-appointed receiver and a court-appointed manager and stated categorically that the court-appointed receiver and manager owes a duty to both the debenture holder and the debtor. In this case, the increased profits would ultimately become subject to the claims of persons who would be entitled to damages for breach of contract. If the

affirming (2004), 19 C.B.R. (5th) 45, 2004 BCSC 1818 (CanLII), 2004 CarswellBC 3540 (B.C. S.C.) where the court concluded that the receiver had the power in the initial order to apply for a vesting order to convey assets free and clear of security including executory contracts. The court went on to discuss and conclude that trustees in bankruptcy have a common law right to disclaim contracts.

See also *Re Pope & Talbot Ltd.* (2009), 50 C.B.R. (5th) 99, 2009 BCSC 17 (CanLII), 2009 CarswellBC 88 (B.C. S.C.).

See also *bcIMC Construction Fund Corp. v. Chandler Homer Street Ventures Ltd.* (2008), 86 B.C.L.R. (4th) 114, 44 C.B.R. (5th) 171 at para. 58, 72 R.P.R. (4th) 68 (B.C. S.C.) where the court reviews the case law on the right of the receiver to terminate existing contracts and summarizes the effects; namely, (a) the receiver is not bound by existing contracts entered into before the receivership unless it decides to be bound by them; (b) the receiver should seek leave of the court before disclaiming contracts; (c) the debtor remains liable for any damages if the receiver disclaims the contracts; (d) the receiver owes a duty of care to preserve the goodwill to the debtor, not to the creditors; (e) the receiver can disclaim the contract with a third party even if the third party has an equitable interest; and (f) if the receiver decides to perform the contract entered into by the debtor before the receivership, then the receiver is liable for the performance. Referred to in *2155489 Ontario Inc. v. SMK Speedy International Inc.* (2009), 2009 CanLII 4847, 2009 CarswellOnt 668 (Ont. S.C.J. [Commercial List]).

See also *Royal Bank of Canada v. Penex Metropolis Ltd.* (2009), 2009 CanLII 45848, 2009 CarswellOnt 5202, [2009] O.J. No. 3645 (Ont. S.C.J.), where the court granted the receiver power to disclaim contracts in the initial order. In this case, the court re-iterated that as long as the receiver's decision to terminate a contract is commercially reasonable or "within the broad bounds of reasonableness", the court will not interfere.

195 *General Motors Corp. v. Peco Inc.* (2006), 19 C.B.R. (5th) 224, 15 B.L.R. (4th) 282, 2006 CarswellOnt 987 (Ont. S.C.J.).

196 *Re Pope & Talbot Ltd.* (2009), 50 C.B.R. (5th) 99, 2009 BCSC 17 (CanLII), 2009 CarswellBC 88 (B.C. S.C.). Distinguished in *Bank of Montreal v. Grafikom Ltd. Partnership* (2009), 59 C.B.R. (5th) 90, 2009 CarswellOnt 6162 (Ont. S.C.J.) where a former employee authorized a payroll company to issue cheques to employees without the receiver's knowledge, direction, or authority on the day the receiver was appointed. In this case, the court concluded that the receiver was not liable for the payments.

197 [1912] 1 Ch. 468 (Eng. Ch. Div.).

TAB 7

2002 ABQB 706
Alberta Court of Queen's Bench

Bank of Montreal v. Scaffold Connection Corp.

2002 CarswellAlta 932, 2002 ABQB 706, [2002] A.W.L.D. 420,
[2002] A.J. No. 959, 115 A.C.W.S. (3d) 620, 36 C.B.R. (4th) 13

BANK OF MONTREAL (Plaintiff) and SCAFFOLD CONNECTION CORPORATION, P.S.P. ERECTORS INC., SC ERECTORS INC., SCAFFOLD WORKS INC., INDUSTRIAL INNOVATIONS AND SERVICES LIMITED, AND SCAFFOLD CONNECTION (USA) INC. (Defendants)

Wachowich C.J.Q.B.

Heard: July 23, 2002
Judgment: July 26, 2002
Docket: Edmonton 0103-23333

Counsel: *J. Hocking*, *D. Polny*, *T. Reid*, for Receiver
R. Rutman, for Plaintiff
D. Shell, for Roynat Inc.
J. Topolniski, for Sit Down Export AB and Sit Down AB

Subject: Corporate and Commercial; Insolvency; Estates and Trusts

Related Abridgment Classifications

Debtors and creditors

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

Headnote

Receivers --- Conduct and liability of receiver — Rights

Debtor companies acquired assets from secured creditor pursuant to distributor agreement — Distributor agreement provided that upon termination of agreement debtor companies were to be allowed to sell any existing units in their possession — Distributor agreement provided that it was to be construed according to Swedish law and that disputes arising under it were to be arbitrated in London, England — Court appointed receiver of debtor companies — Receiver was empowered to sell debtors' property — Secured creditor advised debtors of termination of distributor agreement — Receiver brought applications for approval of sale of assets and for declaration that assets would vest in purchaser, free and clear of all charges or claims — Applications granted — No basis existed to suggest that receiver was bound by agreement entered into between debtor companies and secured creditor — In court-appointed receivership receiver is not bound by existing contracts made by debtor — Agreement between secured creditor and debtor companies was terminated by secured creditor shortly after appointment of receiver — Although not bound by distributor agreement receiver did have duty to act fairly and reasonably and court could consider agreement in determining whether receiver had fulfilled its duty in relation to proposed sales — Very clear language of distributor agreement would have permitted debtor companies to sell assets upon termination of agreement — Nothing beyond speculation was before court to suggest that provisions of agreement would be interpreted differently by London arbitrator applying Swedish law.

Table of Authorities

Cases considered by *Wachowich C.J.Q.B.*:

Bayhold Financial Corp. v. Clarkson Co., 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.) — followed

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
s. 82(1) — considered

s. 82(2) — considered

APPLICATIONS by receiver for approval of sale of assets of debtor companies and for declaration that assets would vest in purchaser free and clear of all charges or claims.

***Wachowich C.J.Q.B.*:**

1 KPMG Inc., the Court-Appointed Receiver and Manager (the "Receiver") of the Defendants ("Scaffold"), seeks the Court's approval of a sale of certain assets ("Seating Equipment") of Scaffold. Some or all of the Seating Equipment was acquired by Scaffold from Sit Down Export AB, a secured creditor of Scaffold.

2 The Receiver further seeks a declaration that: the Seating Equipment shall vest in the Purchaser free and clear of all encumbrances, charges, interests or claims; and Sit Down Export AB, Swedish Export Funding AB and the Swedish Export Credits Guarantee Board, or any party claiming through or under them, have no claims whatsoever to the Seating Equipment or the proceeds of the Sale, or against the Receiver in respect of the Sale. The Receiver's applications were adjourned to allow Sit Down to present its objection to the proposed sale.

3 Under the Consent Receivership Order filed November 16, 2001, the Receiver is empowered to sell the property of Scaffold.

4 Sit Down disputes this Court's jurisdiction in this matter on the basis that the assessment of the propriety of the proposed sale requires an interpretation of the Distributor Agreement between Sit Down and Scaffold, which Agreement specifies that all disputes arising in connection with the Agreement shall be arbitrated in London, Great Britain and that the Agreement shall be construed according to the laws of Sweden.

5 The Distributor Agreement clearly provides that upon termination of the Agreement, Scaffold shall be allowed to sell any existing units within its possession at the time of termination.

6 In a letter dated November 23, 2001 to the Receiver, counsel for Sit Down advised that Sit Down considered the contract between it and Scaffold to be at an end pursuant to Article 1.18 of the Distributor Agreement. In a further letter dated November 28, 2001 to Scaffold, Sit Down's Swedish counsel terminated the agreements in effect between Scaffold and Sit Down.

7 Counsel for Sit Down submits that the Distributor Agreement contains restrictions on the use of Sit Down's intellectual property rights in and relating to the Seating Equipment, and requires the parties to exert reasonable efforts to "transit (which Sit Down defines as "convey") the relationship of the parties", which Sit Down understands to be the

package of rights under the Distributor Agreement. Counsel for Sit Down did not articulate the manner in which the proposed sale would result in breach of any intellectual property rights.

8 The Receiver, the Bank of Montreal and Roynat Inc. (secured creditor) argue that the Receiver is not bound by the contracts entered into by Scaffold. The contemplated sale does not purport to assign any interest in intellectual property, nor does it purport to convey the distribution or manufacturing rights which arose under the agreements between Sit Down and Scaffold. The clear language of the Distributor Agreement permits sale of units in Scaffold's possession upon termination.

9 The Receiver provided evidence that there will not be sufficient assets to discharge the claims of Roynat and the Bank of Montreal and therefore no funds will be available for subordinate creditors.

10 Further, under s. 82(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, where any property of a bankrupt vesting in a trustee consists of patented articles that were sold to the bankrupt subject to any restrictions or limitations, the trustee is not bound by the restrictions or limitations but may sell and dispose of the patented articles free and clear of the restrictions or limitations. The Receiver argues that by analogy, the Receiver likewise should not be bound. I note that ss. (2) provides that where the manufacturer or vendor of the patented articles objects to the disposition and gives notice, the manufacturer or vendor has the right to purchase the patented articles at the invoice prices thereof, subject to any reasonable deduction for depreciation or deterioration.

11 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: *Bayhold Financial Corp. v. Clarkson Co.* (1991), 10 C.B.R. (3d) 159 (N.S. C.A.), *Bennett on Receivership*, 2d ed. (Toronto: Carswell, 1999) at 169, 341. The Receiver in this case is not breaking a contract which it has adopted, as the agreements between Sit Down and Scaffold were terminated by Sit Down shortly after the appointment of the Receiver. Thus, there is no basis to suggest that the Receiver is bound by any of the contractual terms entered into between Sit Down and Scaffold.

12 Although the Receiver is not bound by the Distributor Agreement, the Receiver does have a duty to act fairly and reasonably, and I conclude that this Court may consider that Agreement in determining whether the Receiver has fulfilled its duty in relation to the proposed sale.

13 The very clear language of the Distributor Agreement would have permitted Scaffold to sell the Seating Equipment on termination. There is nothing before the Court beyond speculation to suggest that the provisions in question would be interpreted any differently by a London arbitrator applying Swedish law. Further, there is nothing before the Court beyond vague speculation that the proposed sale will adversely affect any intellectual property rights of Sit Down, and counsel for Sit Down did not propose any concrete method of avoiding the result it fears.

14 The applications of the Receiver are granted.

Applications granted.

TAB 8

1925 CarswellOnt 5
Ontario Supreme Court, In Bankruptcy, Appellate Division

Thomson Knitting Co., Re

1925 CarswellOnt 5, [1925] 2 D.L.R. 1007, 56 O.L.R. 625, 5 C.B.R. 489

In re Thomson Knitting Company

Ex parte Bever & Wolf

Latchford, C.J., Hodgins, Middleton and Orde, JJ.A.

Judgment: March 6, 1925

Counsel: *M. H. Ludwig, K.C.*, for trustee, appellant.
W. J. McWhinney, K.C., for Bever & Wolf, claimants, respondents.

Subject: Corporate and Commercial; Insolvency; Estates and Trusts

Related Abridgment Classifications
Bankruptcy and insolvency

VIII Property of bankrupt
VIII.2 Choses in action
VIII.2.c Incomplete contracts of bankrupt

Bankruptcy and insolvency

XIV Administration of estate
XIV.5 Trustee fulfilling contracts of bankrupt

Headnote
Bankruptcy --- Administration of estate — Trustee fulfilling contracts of bankrupt

Breach of Contract — Provision in Contract for Suspension of Deliveries or Cancellation — Bankruptcy of Purchaser — Rights of Vendor — Election of Trustee — Reasonable Time — Assumption by Trustee of Purchaser's Obligations — Tender of Goods — Vendor's Damages for Breach of Contract.

Where contracts between vendor and purchaser contain the following provisions: "If any payment is in arrear either under this or any other contract, deliveries may be suspended or contract cancelled at our (vendor's) option", the vendor, on the purchaser's default in payment under any one of the contracts, may, without any further notice to him and without cancelling the contract, suspend the deliveries until such time as the purchaser pays up the arrears.

While bankruptcy does not of itself constitute a breach of a contract, it entitles a vendor to treat a contract as broken if the trustee does not within a reasonable time approbate the contract and call for its completion, and the date of the first meeting of creditors is a reasonable time.

It is not necessary for the vendor to first tender the goods to the trustee before he can treat the contract as broken (*Ex parte Stapleton; In re Nathan* (1879), 10 Ch. D. 586, 40 L.T. 14, 27 W.R. 327).

A trustee for a purchaser cannot call for completion of a contract by the vendor without full performance on his part of all the purchaser's obligations thereunder (*William Hamilton Mfg. Co. v. Hamilton Steel and Iron Co.* (1911), 23 O.L.R. 270).

Appeal by the trustee from the judgment of Fisher, J., November 1, 1924, 5 C.B.R. 189, 27 O.W.N. 167, in an issue to determine what damages, if any, creditors are entitled to for breach of contract.

The judgment of the Court was delivered by *Orde, J.A.*:

1 The trustee appeals from the judgment of Fisher, J., of November 1, 1924 [5 C.B.R. 189, 27 O.W.N. 167], whereby the claimants were declared entitled to rank against the bankrupt estate for damages for the breach of certain contracts for the sale of goods by the claimants to the insolvent company.

2 Each contract called for delivery in instalments and payment for each shipment was to be made within a specified period thereafter. Each contract contained the following provision:

> If any payment is in arrear either under this or any other contract, deliveries may be suspended or contract cancelled at our (i.e. the vendors') option.

3 The purchasers fell into arrears and the vendors suspended further deliveries, but the contract was neither cancelled by the vendors, nor repudiated by the purchasers prior to the making of the receiving order against the purchasers.

4 The trustee contends that by reason of the special provision for suspension of deliveries and of the vendors' option to enforce it, it became incumbent upon the vendors before filing any proof of their claim for damages to notify the purchaser or the trustee either that they had cancelled the contracts or were ready to deliver.

5 No authority was cited in support of this argument, and it is unsound in principle. Notwithstanding that deliveries and payments were to be made in instalments, each contract was an entire one. It was the default of the purchasers which brought about the suspension of deliveries and unless the vendors saw fit later to cancel, they were under no further duty to the purchasers except to be ready to resume deliveries as soon as the purchasers paid up the arrears.

6 While the bankruptcy did not of itself constitute a breach of the contract, it did not, on the other hand, cast any further burden upon the vendors. But it had this effect: It entitled the vendors to treat the contract as broken if the trustee did not within a reasonable time approbate the contract and call for its completion. Nor was it necessary for the vendors first to tender the goods to the trustee: *Ex parte Stapleton; In re Nathan* (1879), 10 Ch. D. 586, 40 L.T. 14, 27 W.R. 327. And the trustee could not insist upon delivery of the balance of the goods except upon full payment, not only of the prices of the goods so delivered, but also of all the arrears. In other words, the trustee cannot call for completion of the contract by the vendors without full performance on his part of all the purchasers' obligations thereunder: *William Hamilton Mfg. Co. v. Hamilton Steel and Iron Co.* (1911), 23 O.L.R. 270.

7 There is a close analogy between the rights of the vendors under these contracts and the right of stoppage *in transitu* or *ante transitum* the exercise of which does not of itself rescind the contract (*The Sale of Goods Act, 1920* (Ont.), ch. 40, secs. 43 and 47).

8 I also agree with the ruling of the learned Judge in Bankruptcy [5 C.B.R. 189, 27 O.W.N. 167] as to the date when the breach must be deemed to have taken place, namely, that of the first meeting of creditors. Whether some earlier date between that of the receiving order and the first meeting might, in certain circumstances, constitute a reasonable time, we need not consider. The trustee cannot complain if the vendors waited until that date before treating the contracts as broken.

9 The appeal will be dismissed with costs against the trustee, who will be entitled to indemnify himself out of the estate if he has taken the usual steps to protect himself in that regard.

Appeal dismissed.

TAB 9

COURT FILE NO.: 06-CL-6820
DATE: 2007-08-01

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:	
TEXTRON FINANCIAL CANADA LIMITED Applicant	E. Patrick Shea, for the Applicant Textron Financial Canada Limited
- and -	
BETA LIMITEE/BETA BRANDS LIMITED Respondent	Steven Weisz, for the Respondent Sun Beta Brands
- and -	
BAKERY, CONFECTIONERY, TOBACCO WORKERS AND GRAIN MILLERS INTERNATIONAL UNION, LOCAL 242	Duncan Grace - solicitor for the moving party, the Bakery, Confectionery, Tobacco Workers and Grain Millers International Union, Local 242
- and -	
MINTZ & PARTNERS LIMITED	Jeffrey J. Simpson - solicitor for Mintz & Partners Limited
- and -	
CAPITALINK, L.C.	Kenneth D. Kraft – solicitor for Capitalink, L.C.
	Frank A. Highley – solicitor for Rob Neable, Gary Musick and Anita Varallo
	HEARD: July 19, 2007

LEITCH R.S.J.:

[1] Mintz & Partners Limited, (the "Receiver"), in its capacity as interim receiver and receiver of Beta Limited/Beta Brands Limited, ("Beta Brands"), applies for advice and directions in respect of the following:

(A) The payment by the Receiver of a fee (the "Capitalink Fee") of US$120,000 being claimed by Capitalink, L.C. ("Capitalink") as a result of the successful completion by the Receiver of a transaction (the "Bremner Transaction") to sell certain of the assets of Beta Brands to Bremner Food Group In. ("Bremner"); and

(B) The payment of $198,000 by the Receiver in key employee retention payments (the "KERP Payments") representing payments in the amount of $66,000 each being claimed by Mr. Robert Neable, Mr. Gary Musick, and Ms. Anita Varallo.

PART (A): THE CAPITALINK FEE

Background Facts

[2] Capitalink became involved with Beta Brands in the fall of 2004. At that time, Beta Brands established an agreement with Capitalink (the "Capitalink Agreement") to, *inter alia*, market its assets and property for sale. Beta Brands was required to pay Capitalink a fee based on the consideration received by Beta Brands from any transaction with a party introduced to it by Capitalink.

[3] Capitalink provided expert advice to Beta Brands from September 2005 to December 2006. It investigated several marketing options for Beta Brands and prepared information memoranda to be made available to prospective purchasers.

[4] As a result of Capitalink's marketing efforts, Ralcorp Holdings submitted a purchase proposal in March 2006. Bremner, the subsidiary of Ralcorp, executed an Asset Purchase Agreement on December 13, 2006.

[5] The Receiver was appointed interim receiver and receiver of all assets, undertaking and property of Beta Brands on January 3, 2007. The Receiver subsequently brought a motion for approval of the Bremner Transaction. The order approving the transaction was given on January 5, 2007. In its Reasons, the court described the transaction as "fair and reasonable" producing "a provident sale."

[6] There is no issue that, as set out in the Pre-Receivership Report and the Receiver's First Report the Receiver relied exclusively on Capitalink's marketing efforts and reports in recommending that the court direct the Receiver to complete the Bremner Transaction.

[7] There is also no issue that, in accordance with the contractual arrangements between Beta Brands and Capitalink, Capitalink is entitled to be paid the Capitalink Fee. The issue in contention here is whether the obligation to pay the Capitalink Fee extends to the Receiver.

Positions Advanced on this Motion

[8] Mr. Shea, on behalf of Textron, Beta Brands' primary secured creditor, took the position that the Receiver adopted Capitalink's marketing, the court relied on Capitalink's marketing efforts and the Capitalink Fee ought to be paid. He asserted that the principles of

unjust enrichment apply to these circumstances – namely that (1) reliance and enrichment, (2) deprivation and (3) an absence of juristic reason for the enrichment are made out on these facts. He pointed out that the commission fee was always factored into the cash flows presented in connection with the Bremner Transaction, and it was always assumed that the commission would be paid.

[9] Mr. Kraft, on behalf of Capitalink, noted that both the Receiver and secured creditor wish to pay the fee, however, his position was that the Receiver was bound by the contract with Capitalink because the Receiver had adopted it by its actions. The quantum meruit claim put forward by Mr. Shea is relied upon as an alternative position. Essentially, Capitalink's position is that the Receiver is bound by the agreement with Capitalink by virtue of the fact that the deal was closed or, alternatively, it is just and equitable for the Capitalink Fee to be paid.

[10] Capitalink pointed to the Receivership Order dated January 3, 2007 in support of its position. This Order authorized the Receiver to engage consultants and experts to assist with the exercise of its powers and duties and to market any or all of Beta Brands' property.[1] The Receivership Order also included a provision relating to the expenditures or liability incurred by the Receiver in the course of fulfilling its duties:

> RECEIVER'S ACCOUNTS
>
> 17. THIS COURT ORDERS that any expenditure or liability which shall properly be made or incurred by the Receiver, including the fees of the Receiver and the fees and disbursements of its legal counsel, incurred at the standard rates and charges of the Receiver and its counsel, shall be allowed to it in passing its accounts and shall form a first charge on the Property in priority to all security interests, trust, liens, charges and encumbrances, statutory or otherwise, in favour of any Person (the "Receiver's Charge").

[11] Capitalink submitted that its marketing efforts enabled the Receiver to comply with its obligation to deal with Beta Brands' property in a "commercially reasonable manner." Capitalink states that if its work had not been performed, the Receiver would have had to conduct a marketing process itself or retain someone else to do so to fulfill its statutory obligation under the *BIA*. Any fees incurred by such marketing would have been covered by the Receiver's Charge included in the Receivership Order. Yet, in this case, the Receiver did not incur any fees because of reliance on Capitalink. It is Capitalink's submission that this creates an unjust result.

[12] Capitalink also pointed to the Receiver's obligation to act fairly and honestly on behalf of all of the parties that have an interest in the property of Beta Brands. The decisions in *Armadale Properties Ltd. v. 700 King Street (1997) Ltd.*, (2001) 25 C.B.R. (4th) 198 (Super. Ct.) ("*Armadale*") and *Panamerica de Bienes y Servicos, S.A. v. Northern Badger Oil & Gas Ltd.*, (1991), 8 C.B.R. (3d) 31 (Alta. C.A.) ("*Panamerica*") are submitted in support of this position. According to Capitalink, the Receiver would not be complying with its obligations to act honestly and in good faith if it was entitled to rely on Capitalink's efforts without paying the Capitalink Fee.

[1] These powers are found specifically within paragraphs 3(d) and 3(k) of the Receivership Order

[13] The Receiver took the position that it would be dishonourable to resile from Capitalink's claim for the Capitalink Fee, citing *Armadale, supra*, and placing considerable emphasis on paragraph 15 which provides as follows:

> The trustee is an officer of the court and must act fairly to all parties with an interest in the estate. It would be dishonourable for the trustee to disclaim this contract. I therefore find that the trustee is bound by the contract in the same manner and to the same extent as the bankrupt was at the time of the bankruptcy and has no power to disclaim the contract.

[14] Mr. Grace, on behalf of Local 242, opposed payment of the Capitalink Fee. He did not seek to minimize in any way the work performed by Capitalink but asserted that Capitalink was not entitled to the priority it sought. As Mr. Grace pointed out, there was no authority advanced for the proposition that this unsecured claim of Capitalink should have any priority. In addition**,** the fact that this payment was reflected in the cash flows presented in the Pre-Receivership Report does not amount to a court endorsement of such payments.

[15] Mr. Grace noted that Mr. Shea's position was that the Capitalink Fee should be paid on a quantum meruit basis and he did not advance the position of Mr. Kraft that the Capitalink Fee was a direct obligation of the Receiver. Further, Mr. Grace noted no restitution principles had been cited in any of the materials filed on the motion.

[16] In reply, Mr. Shea and Mr. Simpson, on behalf of the Receiver, stated that it was always expected and assumed that the Capitalink Fee would be paid because its work had been relied upon and the fee was fair and reasonable.

[17] Mr. Simpson further noted in reply that it always intended to pay the Capitalink Fee and such payment was part of the motion relating to the approval of the Bremner Transaction, however, because of the objections of Local 242, that motion was carved back to the bare minimum, leaving three outstanding issues – a distribution to Textron (which has since been resolved on consent by an interim distribution order made March 1, 2007), the payment of the Capitalink Fee, and the KERP payments.

[18] The issues that must be addressed then, in assessing whether the Receiver is bound by the Capitalink Agreement and therefore required to pay the Capitalink Fee are as follows:

> 1) Has the Receiver, by virtue of its conduct, adopted the arrangements with Capitalink thereby obligating itself to Capitalink? and
>
> 2) Does quantum meruit apply such that the Receiver is required to pay the Capitalink Fee?

(1) Has the Receiver Adopted the Arrangements with Capitalink?

Relevant Legal Principles

[19] Section 14.06(1.2) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") addresses the liability of a trustee or receiver as follows:

> Notwithstanding anything in any federal or provincial law, where a Trustee carries on in that position the business of the debtor or continues the employment of the debtor's employees, the trustee is not by reason of that fact personally liable in respect of any claim against the debtor or related to a requirement imposed on the debtor to pay an amount where the claim arose before or upon the trustee's appointment.

[20] The section establishes that a receiver is not personally bound or in any way liable under pre-receivership contracts. An exception to this principle arises where there is evidence that the receiver adopted or otherwise agreed to be personally bound by the agreement. See *Howlett v. 512046 B.C. Ltd.* (2000), 17 C.B.R. (4th) 224 (B.C.S.C.) ("*Howlett*"). As a result, if the claim involved is one for commission on the sale of an insolvent debtor's property, that claim will remain enforceable against the contracting party, but is an unsecured claim in the seller's estate. See *Howlett, supra.*

[21] Although the receiver is not generally bound under pre-receivership contracts in accordance with s. 14.06(1.2), the receiver must still comply with certain statutory obligations to act honestly, in good faith and in a commercially reasonable manner. These obligations are set out in s. 247 of the *BIA* as follows:

> 247. A receiver shall
>
> (a) act honestly and in good faith; and
>
> (b) deal with the property of the insolvent person or the bankrupt in a commercially reasonable manner.

[22] Case law has emphasized the obligation of the Receiver to act fairly on behalf of all interested parties. As noted, in *Armadale, supra*, Lax J. described the duty of a Trustee in Bankruptcy at paragraph 15 as a duty to "act fairly to all parties with an interest in the estate." This principle is further emphasized in *Panamerica* at para. 38:

> A receiver appointed by the court must act fairly and honestly as a fiduciary on behalf of all parties with an interest in the debtor's property and undertaking. The receiver is not the agent of the debtor or the creditor or of any other party, but has the duty of care, supervision and control which a reasonable person would exercise in the circumstances.

Analysis and Conclusions

[23] Although Capitalink is correct in law in setting out the requisite statutory obligations with which the Receiver must comply, such obligations fail to govern the issue involved here, that being priority to payment under the receivership. The Capitalink claim is unsecured and therefore retains no priority to payment within the receivership scheme. As such, Capitalink's claim remains enforceable against Beta Brands, but exists as an unsecured claim in the context of the receivership. The decisions submitted by Capitalink in respect of the Receiver's obligations

are distinguishable as they do not involve priority disputes and fail to address the principles limiting the liability of a receiver as set out in section 14.06(1.2) of the *BIA.*

[24] In *Armadale, supra,* Deloitte & Touche Inc, in its capacity as Construction Lien Trustee and as Trustee in Bankruptcy brought a motion for direction on whether or not to perform an agreement where the estate would receive no benefit from the transaction. The court directed the Trustee to complete the transaction. Lax J. pointed to s. 75 of the *BIA,* which prevents a trustee from disclaiming a contract: "An agreement for sale in favour of a bona fide purchaser or mortgagee for valuable consideration is valid and effectual as if no receiving order had been made." See: *Armadale, supra* at para. 11.

[25] Lax J. further asserted that even if s. 75 did not apply, the trustee had no right to terminate property rights that had passed under contract prior to the bankruptcy. This determination was based on the equitable interest of the purchaser and the principle of specific performance.

[26] These were the primary reasons that the court in *Armadale* ordered the Trustee to proceed with the transaction. The decision did not turn simply on the Trustee's obligations to act fairly to all parties with an interest in the estate. In addition, unlike the circumstances in this case, an agreement of purchase and sale for land was involved in which equitable title had already passed to the purchaser prior to the bankruptcy. This was a significant feature that influenced the court's ultimate determination.

[27] It is my view that the principles established in section 14.06(1.2) of the *BIA* govern the result in this motion. The Agreement of Purchase and Sale was executed *before* the Receiver was appointed. The Receiver's reliance on Capitalink's marketing efforts after its appointment was conduct in accordance with its statutory obligation to act in a commercially reasonable manner. There is no evidence which establishes that the Receiver adopted or agreed to be personally bound by the terms of the Agreement.

[28] Further, the court order approving the Bremner Transaction did not represent an adoption of, nor did it have the effect of, imposing personal liability on the Receiver for the payment of the commission required pursuant to the Capitalink Agreement. To suggest otherwise would create a result that operates in contrast to the policy interests underlying section 14.06(1.2) designed to insulate receivers from pre-appointment matters that would expose them to liabilities and have the effect of rendering the receivership unviable.

[29] In consequence of this conclusion, Capitalink's unsecured claim ranks with all other unsecured claims to which Beta Brands is subject. The Receiver is not bound by the Capitalink Agreement and is not obligated to pay the Capitalink fee.

(2) Quantum Meruit Claim

Relevant Legal Principles

[30] As an alternative position, Mr. Shea asserted that the principles of unjust enrichment apply and thereby obligate the Receiver to pay the Capitalink Fee. However, this alternative

position was not advanced in the materials filed on this motion and no restitutionary principles were cited in any materials.

[31] It is a well-established principle that judges should not decide matters in respect of which the parties have not had an opportunity to make submissions. For example, in *Rodaro v. Royal Bank of Canada*, [2002] O.J. No. 1365 at para. 60, the Court of Appeal stated: "It is fundamental to the litigation process that lawsuits be decided within the boundaries of the pleadings." However, a number of courts have adjudicated on issues of quantum meruit even though they were not specifically pleaded.[2] For example, in *Ram Industrial Equip. (Toronto) Ltd. (c.o.b. Pioneer Ram Construction) v. Kolson*, [1998] O.J. No. 4531 (C.A.), at trial, the judge heard submissions on the issue of quantum meruit even though it had not been included within the pleadings. The trial judge determined that it could properly adjudicate quantum meruit because it had been canvassed throughout the trial and its consideration did not prejudice the defendant. The Court of Appeal affirmed the trial judge's ruling, finding no evidence of prejudice, and ample evidence that the defendant was aware of the quantum meruit issue and had had the opportunity to make submissions on it at trial.

[32] In essence, quantum meruit may be adjudicated despite not being sufficiently pleaded in circumstances where there is no prejudice to the opposing party, that party is aware of the issue and was given the opportunity to make submissions on it before the court.

[33] Restitutionary quantum meruit is based on principles of unjust enrichment. It may be applied where no contractual relationship exists between the parties, and one party performed services for the other, which benefited that party, on a reasonable expectation that the services were compensable.

[34] It is well established that for a claim of unjust enrichment to succeed, there must be:

a. an enrichment;
b. a corresponding deprivation; and,
c. an absence of any juristic reason for the enrichment or non-payment.

[35] In *Consulate Ventures Inc. v. Arnico Contracting & Engineering (1992) Inc. et al.*, 2007 ONCA 324, Madam Justice Cronk stated the following in respect of quantum meruit and unjust enrichment at para. 99:

> …where the claim for restitutionary relief is based on quantum meruit…an explicit mutual agreement to compensate for services rendered is not a prerequisite to recovery. It suffices if the services in question were furnished at the request, or with the encouragement or acquiescence, of the opposing party in circumstances that render it unjust for the opposing party to retain the benefit conferred by the provision of the services.

[2] See: *Hoffer v. Verdone*, [1994] O.J. No. 1967 (Gen. Div.); *Honey-Bee Sanitation Inc. v. Essex (County)*, [1993] O.J. No. 178 (Gen. Div.); *Hill v. Develcon Electronics Ltd.*, [1991] S.J. No. 311 (Q.B.); *Johnson v. H.G. Precision Machine Ltd*., [1991] B.C.J. No. 843 (S.C.); *Aurora Development Ltd. v. Paradise (Town)* (1991), 90 Nfld. & P.E.I.R. 5 (T.D.).

Analysis and Conclusions

[36] Mr. Shea's submissions in respect of quantum meruit should have been included within the materials filed on the motion. He failed to do this or draw the court's attention to any case law in which the principle of quantum meruit was applied successfully against a Receiver. Nonetheless, Mr. Shea and Mr. Grace made submissions on this issue and the quantum meruit argument will be considered in this analysis.

[37] In this case, Capitalink and the Receiver did not enter into a contract and, as previously determined, the Receiver was not bound by the agreement. Rather, the contract that was established existed between Capitalink and Beta Brands only. This leaves open the possibility for the application of restitutionary quantum meruit and a consideration of the principles of unjust enrichment.

[38] It is my view that the requirements for unjust enrichment and the application of the quantum meruit remedy have not been established in this case.

[39] In completing the sale, the Receiver relied on the marketing efforts of Capitalink, thereby avoiding having to undertake any independent marking activities. The Receiver did not have to personally engage additional consultants or experts to assist with the sale or market any of the property through advertising or soliciting offers. The conduct of Capitalink clearly benefited the Receiver thereby satisfying the first essential requirement for an unjust enrichment claim.

[40] The second consideration within the unjust enrichment analysis is whether there has been a corresponding deprivation. There is no issue that Capitalink is entitled to be paid the Capitalink Fee in accordance with its contractual arrangements with Beta Brands. The receivership status of Beta Brands means that there is a possibility that Capitalink will be deprived of payment. However, this deprivation does not correspond to the conduct of the Receiver, but rather, to the financial status of Beta Brands. Thus, it appears that the second requirement for the unjust enrichment has not been satisfied.

[41] The difficulty that arises in respect of Capitalink's claim is that the efforts rendered by Capitalink did not create a reasonable expectation that such were compensable by the Receiver. Capitalink's arrangement for payment extended only to Beta Brands. Capitalink engaged in marketing efforts in order to fulfill the contractual agreement established with Beta Brands. The court order approving the Bremner Transaction is insufficient to establish a reasonable expectation that the Receiver should compensate Capitalink for its efforts.

[42] In addition, this is not a situation where there is an absence of a juristic reason for the enrichment. The Receiver had an obligation to deal with Beta Brands' assets in a commercially reasonable manner. In relying on the marketing efforts of Capitalink, the Receiver was simply complying with this obligation. In my view this represents a sufficient juristic reason for non-payment.

[43] Thus, the requirements for the claim of unjust enrichment and quantum meruit have not been satisfied. Although the marketing efforts of Capitalink were relied upon by the Receiver, there was no expectation that Capitalink would receive payment for such efforts and the circumstances of Beta Brands (existing in a state of receivership) do not render it unjust for the Receiver to retain the benefit conferred by the provision of those services in this case.

PART (B): The KERP Payments

Background Facts

[44] There had been seven senior management positions in Beta Brands but by the fall of 2006, only three remained – Mr. Neable, Mr. Musick and Ms. Varallo (the "Key Employees"). Mr. Neable was Vice President, Finance and a director and officer of Beta Brands. Mr. Musick was the President and a director and officer of Beta Brands. Ms. Varallo was the Vice President of Logistics and Beta Brands.

[45] As a result of uncertainty concerning the future prospects of Beta Brands, the Key Employees were provided with letters from Beta Brands setting out severance arrangements. The payments included within these letters ranged from $50,000 to $249,000 if the addressee continued in their employment with Beta Brands and the addressee's employment was terminated without cause.

[46] As a result of these letters, the Key Employees continued to carry out their duties and responsibilities until the termination of the employment in January 2007. During their time of employment, the Key Employees performed extensive work in respect of the Bremner Transaction, which included arranging for meetings with members of the Ralcorp team and liaising with Ralcorp executives and engineers to satisfy concerns on the part of those parties with the ability of Beta Brands to achieve an inventory build required by the purchaser.

[47] A KERP arrangement was never solidified between the parties. The Key Employees rely on the fact that the secured creditors agreed that the incentive payments totalling $166,000 would be included in the cash flows relating to the Bremner Transaction and would be paid on the closing of the Bremner Transaction. To date, the Receiver has not undertaken to make the KERP Payments, but rather, applies for advice and direction on that point to this court.

Positions Advanced on the Motion

[48] The Receiver, Textron and Sun Beta support an order authorizing and directing the Receiver to pay to each of Mr. Neable, Mr. Musick and Ms. Varallo the amount of $66,000. These payments would be made from the realization of the Beta Brands' assets and thus are approved by the secured creditors with the *prima facie* right to receive such proceeds of realization.

[49] Mr. Shea, on behalf of Textron, pointed out that a shortfall to Textron and Sun Beta is likely. However, Textron and Sun Beta do not object to the KERP Payments being made from the proceeds of realization of the Beta Brands' assets because they consider the management team a key part of the conclusion of the Bremner Transaction. The management team was essential to the inventory build, a key aspect of the arrangements with Bremner. Mr. Shea asserted that these payments were, in essence, a reward when the deal closed for getting the job done and he asserts that it was appropriate business judgment that Beta Brands enter into these arrangements.

[50] Mr. Weisz confirmed Sun Beta's position that there was no contract between Textron or Sun Beta and the key three employees and thus no liability to those individuals. However, both secured creditors were consulted regarding these arrangements and did not object to the KERP payments being made out of the cash flow from the closing of the Bremner Transaction.

[51] Mr. Simpson, on behalf of the Receiver, took the position that the Receiver should not disclaim these arrangements and, as a matter of commercial reasonableness and morality where the Receiver relies on third parties and consultants, they should be paid. As he indicated, it may be that such payments would have the effect of "jumping the queue" but the Receiver did not view that as a compelling factor to not authorize the payments considering the Receiver's use of the efforts of the employees. He referred, again, to *Armadale, supra.*

[52] Mr. Highley, on behalf of the employees**,** asserted that the KERP Payments are not a severance payment in any way and he noted that if the plant had shut down in October and the employees had not succumbed to inducements, the Bremner Transaction could not have been negotiated and there would have been no way to complete the inventory build and more than likely the Receiver would have been appointed much earlier at significant expense. He asserted that the contributions of the three senior managers reduced realization costs; they assumed extraordinary duties and extensive workload; and their efforts generated a large amount of money. His position was that their claimed fee is fair and reasonable, particularly given that these three employees not only ran the plant, but created the conditions for the sale to Bremner and indeed "shepherded" the deal from the original negotiations to conclusion.

[53] Mr. Highley asserted that the payment to these Key Employees could be justified on the basis of: (a) inducement; (b) realization; (c) costs of realization; and (d) work load. However, Mr. Highley was unable to draw the court's attention to any case law that supported his argument seeking the KERP payments.

[54] Mr. Grace, on behalf of Local 242, emphasized that the issue is whether the Receiver has the authority to make the KERP Payment out of the realization proceeds in these circumstances, where such payment will in all probability increase the deficiency to Textron and Sun Media and thus increase the probability that there will be no proceeds available to the unsecured creditors, including but not limited to the employees of Beta Brands.

Relevant Legal Principles

[55] KERP arrangements, also referred to as "pay to stay" compensation plans, are typically the subject of careful review before being paid out. This principle applies even in the context of a restructuring process designed to preserve the debtor and its business:

> KERPs and special director compensation arrangements are heavily negotiated and controversial arrangements…Because of the controversial nature of KERP arrangements, it is important that any proposed KERP be scrutinized carefully by the monitor with a view to insisting that only true key employees are covered by the plan and that the KERP will not do more harm than good by failing to include the truly key employees and failing to treat them fairly.
>
> Because any KERP arrangement is intended to secure key personnel for the duration of the restructuring process, the additional compensation offered to the affected employees should be deferred until after the restructuring or sale of the business or assets has been completed. In many cases, employees will require staged "stay bonuses" that are payable at specified times in the future if they stay until that time.
>
> *Re Warehouse Drug Store Ltd.*, [2006] O.J. No. 3416 at para. 14 (Super. Ct.) ("*Warehouse Drug Store*") referring to Kevin McElcheran, *Canadian Insolvency in Canada* (LexisNexis-Butterworths) at 231.

[56] The court in *Warehouse Drug Store, supra,* accepted these principles, but determined that the circumstances involved in that case could be distinguished based on the facts. In that case, the court dealt with a motion to determine whether the former CFO of Warehouse Drug Store Ltd., ("Warehouse"), should be entitled to recover a "retention bonus" established within the terms of a termination agreement. The CFO was persuaded by this agreement to forego alternative employment he had acquired and remain employed with Warehouse during its restructuring process which subsequently turned into a realization process.

[57] After Warehouse filed under the *Companies' Creditors Arrangement Act,* the termination agreement was made known to the Monitor but was not noted in any Monitor's report until after the transaction that triggered the CFOs termination was in process. Despite this error, Campbell J. ordered the payment of the retention bonus, asserting at paragraph 9 that it was "reasonable to infer that had the issue of the termination agreement been included in a report to the Court soon after the appointment of the Monitor, it would likely have been approved."

[58] Mr. Grace referred to the principles established by American case law in respect of KERP payments and specifically the decision in *In Re Global Home Products, LLC et al.* Case No. 06-10340 (Delaware Bankruptcy Court), which established the requirements that must be satisfied before the court can approve a "pay for value" compensation or incentive plan:

> a. there is a reasonable relationship between the plan proposed and the results to be obtained;
>
> b. the cost of the plan is reasonable in the context of the debtor's assets, liabilities and earning potential;

c. the scope of the plan is fair and reasonable in that it either applies to all employees or treats them differently for rational and fair reasons;

d. the plan is consistent with industry standards;

e. the debtor has undertaken a reasonable investigation to determine the need for an incentive plan, has analyzed which key employees need to be incentivised and what is generally applicable in a particular industry; and

f. the debtor received independent counsel in performing the diligence and in creating and authorizing the incentive compensation or, alternatively, there were good and valid reasons why such independent counsel was not utilized or needed.

[59] It is noteworthy to point out that the payment of KERPs in the United States is governed by restrictive legislation that require insolvent debtors to satisfy rigorous standards before the court can approve the payment of KERPs or severance payments to insiders of an insolvent company. Equivalent legislative principles have not been established in Canada. In addition, the principles established in *Global Home Products, supra,* have not been adopted by Canadian case law.

Analysis and Conclusions

[60] It is apparent that the circumstances involved in *Warehouse Drug Store, supra,* are distinct from those involved in this case. Unlike the CFO in that decision, there has been no suggestion that any of the Key Employees had alternative employment opportunities that they chose to forego upon receipt of the letters setting out the severance arrangement or when the Bremner Transaction was in play. Further, Beta Brands did not reorganize during the relevant period of time. The efforts of these three employees were designed, seemingly, to ensure that the Bremner Transaction could be completed on terms acceptable to Textron.

[61] Despite these distinctions, the principles enunciated by the court in respect of the KERP payments remain applicable and relevant to these proceedings. The proposed KERP payments in this case must be subject to careful scrutiny.

[62] In this case, the court is being asked to approve KERP payments for which there is no contractual basis. Such payments have not been reviewed by the Receiver, nor has the Receiver submitted any comment in respect of these payments in any report. In addition, the extent to which the services rendered by these employees went beyond their normal duties as salaried members of senior management is unclear.

[63] As a result, there is a very thin evidentiary record before the court. I agree with Mr. Grace that these former employees, who worked to get the Bremner Transaction completed and to build the inventory are attempting to “jump the queue” of unsecured creditors in advancing this claim.

[64] In addition, the circumstances indicate that the payments sought by these employees are more in the nature of a severance payment than a KERP payment. As noted, a KERP agreement

was never concluded between the parties. The payments were arranged at a time when Beta Brands had written severance arrangements in place. Thus, the payments are in substance payments in lieu of severance and were designed to replace those severance arrangements.

[65] Even if the payment in issue is properly characterized as a KERP, it is not entitled to statutory priority or preference. In essence, those who support the payment being made now rely on the fact that the payment was reflected in the cash flow projections that were acceptable to the largest secured creditors.

[66] For these reasons, it seems to me that it is inappropriate to order the Receiver to make the payments requested by Mr. Neable, Mr. Musick and Ms. Varallo. There is no legal basis for them to acquire priority over other creditors including other employees seeking termination and severance pay.

SUMMARY OF CONCLUSIONS

[67] Capitalink's request for an order authorizing and obligating the Receiver to pay the Capitalink Fee is denied. The Receiver is not bound by the Capitalink Agreement and therefore not obligated to pay the Capitalink Fee. Capitalink's unsecured claim ranks with all other unsecured claims to which Beta Brands is subject.

[68] The Receiver is not obligated to make the payments in the amount of $66,000 each being claimed by Mr. Neable, Mr. Musick and Ms. Varallo (the KERP Payments).

"Regional Senior Justice Lynne C. Leitch"
Regional Senior Justice Lynne C. Leitch

Released: August 1, 2007.

Court File No.: 06-CL-6820
Date: August 1, 2007.

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

TEXTRON FINANCIAL CANADA LIMITED

Applicant

- and -

BETA LIMITEE/BETA BRANDS LIMITED

Respondent

- and -

BAKERY, CONFECTIONERY, TOBACCO WORKERS AND GRAIN MILLERS INTERNATIONAL UNION, LOCAL 242

- and -

MINTZ & PARTNERS LIMITED

- and -

CAPITALINK, L.C.

REASONS FOR JUDGMENT

LEITCH R.S.J.

Released: August 1, 2007.

TAB 10

THE LAW OF CONTRACT IN CANADA

by

G.H.L. FRIDMAN, Q.C., F.R.S.C.
M.A., B.C.L., LL.M.

of the Ontario Bar, and
of the Middle Temple,
Barrister-at-Law,
Emeritus Professor of Law, University of Western Ontario

Sixth Edition

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Performance

1. The duty to perform

(a) Strictness

Generally speaking the parties to a contract are obliged to perform in accordance with the express and implied terms of the contract.[1] The duty to perform must be carried out precisely and exactly.[2] As long as a party has done what was required by

1 E.g. execute a new will: *Kokotailo v. Ramchuk* (1980), 28 A.R. 127 (Alta. Q.B.); pay correct winner of lottery: *Western Canada Lottery Foundation v. Paul* (1981), 127 D.L.R. (3d) 502 (Sask. C.A.) comply with an implied term that a lessee shall have quiet enjoyment of the demised premises: *Shun Cheong Holdings B.C. Ltd. v. Gold Ocean City Supermarket Ltd.* (2002), 216 D.L.R. (4th) 392 (B.C.C.A.). The corollary of this is that a party cannot demand that the other party perform something not provided for in the contract, such as allow for reductions in the price of a company: *CSRS Ltd. v. Embley* (2008), 87 B.C.L.R. (4th) 251 (B.C.C.A.).

2 See, *e.g.*, *Beuker v. H& R Block Canada Inc.* (2000), 201 Sask. R. 1 (Sask. Q.B.), failure to prepare income tax return according to law; *Continental Securities v. McLeod* (1995), 10 B.C.L.R. (3d) 307 (B.C.S.C.), failure to comply with the rules of the Vancouver Stock Exchange as expressly stipulated in the contract deprived plaintiff brokers of a claim against their client; *Fyten Construction Ltd. v. O'Brien* (1998), 235 A.R. 353 (Alta. Q.B.), failure to complete clearance of land by end of summer or freeze-up, a breach of the contract; *Harpestad v. Hughes Agencies Ltd.* (2004), 253

the contract, he or she will not be in breach.[3] Anything less than such performance is a breach of contract[4] and may preclude the party in default from enforcing the provisions of the contract that are for his benefit.[5] Under the doctrine of frustration, however, a party may be excused from performance of the contract as a whole or that part which has yet to be performed.[6] Performance may be dispensed with completely, or its character altered, by virtue of some subsequent agreement between the parties, or conduct by one party which gives rise to an estoppel, or the waiver of such party's right to demand performance, or a certain previously agreed manner of performance.[7] The duty to perform may also be transferred to another party by novation[8] or assignment.[9] Failing such modifications, performance must adhere strictly to the language and meaning of the contract.

When a contract stipulated that no charge was to be made for certain services, it was a breach of contract to purport to claim payment for their provision.[10] In *Bank of Nova Scotia v. Guenette,*[11] the bank failed to include the wife in the credit account supposed to be in their joint names in pursuance of their agreement with the bank with the result that there was no consideration for the agreement by the bank to a loan of money. In *Clareview Rental Project (Edmonton) Ltd. v. Dockery*,[12] an investor who failed to pay certain cash calls when made by his investment agent was guilty of a failure to perform an obligation that was properly put upon him. On the other hand, where a contract was under seal, and therefore was not required to be supported by consideration, the requirement of nominal consideration contained in the contract under seal did not have to be fulfilled; therefore, the non-payment of such nominal consideration was not a breach of contract by the party on whom

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Sask. R. 31 (Sask. Prov. Ct.), failure to obtain insurance coverage; reversed (2005), 261 Sask. R. 125 (Sask. Q.B.).

3 *IT/Net Inc. v. Cameron* (2006), 207 O.A.C. 26 (Ont. C.A.), no breach because no communication of confidential information as stated in contract: *Van Hooydonk v. Jonker* (2009), 3 Alta. L.R. (5th) 174 (Alta. Q.B.); additional reasons at 5 Alta. L.R. (5th) 37 (Alta. Q.B.), defendant provided plaintiff with gentle horse, therefore not in breach of contract: contrast *Nova Scotia Power Inc. v. AMCI Export Corp.* (2008), 268 N.S.R. (2d) 15 (N.S.S.C), no concurrent obligation on plaintiff, therefore defendant in breach by not supplying work; *Exchanger Industries Ltd. v. Dominion Bridge Co.* (1986), 69 A.R. 22 (Alta. Q.B.), failure to adhere to instructions in process of annealing steel tubes, a breach of contract.

4 Even if it is unintended: *Aspen Wapiti Ltd. v. Jensen* (2001), 207 Sask. R. 189 (Sask. C.A.), delivery of bull calf instead of heifer calf elk.

5 *Jedfro Investments (U.S.A.) Ltd. v. Jacyk Estate* (2006), 210 O.A.C. 153 at 156 (Ont. C.A.) *per* Laskin J.A.; [2007] 3 S.C.R. 679. Such as to sue for wrongful dismissal, as in *Petrone v. Marmot Concrete Services Ltd.* (1996), 37 Alta. L.R. (3d) 222 (Alta. Q.B.), or may entitle the other party to a set-off: *CIBC Mortgage Corp. v. Rowatt* (2002), 220 D.L.R. (4th) 139 (Ont. C.A.); leave to appeal refused (2003), 320 N.R. 188 (note) (S.C.C.).

6 Below, Chapter 16.

7 Below, pp. 548-555.

8 Below, pp. 555-559.

9 Below, Chapter 18.

10 *Pierce v. Krahn* (1979), 10 Alta. L.R. (2d) 49 (Alta. T.D.).

11 (1986), 68 A.R. 368 (Alta. Q.B.). The failure to provide a computer system invented by the plaintiff was a breach of contract in *Orbitron Software Design Corp. v. M.I.C.R. Systems Ltd.* (1990), 48 B.L.R. 147 (B.C.S.C.).

12 (1990), 78 Alta. L.R. (2d) 106 (Alta. Q.B.). See also *Herron v. Hunting Chase Inc.* (2003), 16 Alta. L.R. (4th) 225 (Alta. C.A.) breach of obligation to pay bonus.

TAB 11

Canadian Contractual Interpretation Law

THIRD EDITION

Geoff R. Hall
B.A. (McGill), M.A., LL.B. (Toronto), LL.M. (Harvard)

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2.2 A CONTRACT IS TO BE CONSTRUED AS A WHOLE WITH MEANING GIVEN TO ALL OF ITS PROVISIONS

2.2.1 The principle

It is a fundamental precept that contractual interpretation requires an examination of a contract as a whole, not just a consideration of the specific words in dispute.[35] Individual words and phrases must be read in the context of the entire document. "The key principle of contractual interpretation here is that the words of one provision must not be read in isolation but should be considered in harmony with the rest of the contract and in light of its purposes and commercial context."[36] The rule is so basic that it has aptly been described as a "well-known" principle of contractual interpretation.[37]

The corollary of this principle is the precept that meaning must be given to all of the words in a contract:

> To the extent that it is possible to do so, [a contract] should be construed as a whole and effect should be given to all of its provisions. The provisions should be read, not as standing alone, but in light of the agreement as a whole and the other provisions thereof: *Hillis Oil & Sales Ltd. v. Wynn's Canada Ltd.*, [1986] 1 S.C.R. 57 at p. 66, 25 D.L.R. (4th) 649 at p. 655. The court should strive to give meaning to the agreement and "reject an interpretation that would render one of its terms ineffective": *National Trust Co. v. Mead*, [1990] 2 S.C.R. 410 at p. 425, 71 D.L.R. (4th) 488 and p. 499.[38]

Put another way: "Words in a contract are presumed to have meaning."[39]

There is an important extension to the principle that a contract must be read as a whole: a contract must also be read in light of related contracts. Given how common it is that complex transactions are effected by a series of inter-related contracts, this elaboration is an important one. The related contracts doctrine is a very sensible extension of the precept that a contract must be read as a whole.

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35 *Hnatiuk v. Court*, [2010] M.J. No. 52, 251 Man. R. (2d) 178 at para. 43 (Man. C.A.).

36 *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, [2010] S.C.J. No. 4, [2010] 1 S.C.R. 69 at para. 64 (S.C.C.), per Cromwell J. See also *Canadian Newspapers Co. v. Kansa General Insurance Co.*, [1996] O.J. No. 3054, 30 O.R. (3d) 257 at 270 (Ont. C.A.), leave to appeal refused [1996] S.C.C.A. No. 553 (S.C.C.); *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1999] O.J. No. 3290, 45 O.R. (3d) 417 at para. 9 (Ont. C.A.); and *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust*, [2007] O.J. No. 1083, 85 O.R. (3d) 254 at para. 24 (Ont. C.A.), which are to a similar effect.

37 *Geoffrey L. Moore Realty Inc. v. Manitoba Motor League (c.o.b. CAA Manitoba)*, [2003] M.J. No. 191, [2003] 9 W.W.R. 385 at para. 12 (Man. C.A.), citing *National Trust Co. v. Mead*, [1990] S.C.J. No. 76, [1990] 2 S.C.R. 410 (S.C.C.).

38 *Scanlon v. Castlepoint Development Corp.*, [1992] O.J. No. 2692, 11 O.R. (3d) 744 at 770-71 (Ont. C.A.), leave to appeal refused [1993] S.C.C.A. No. 62, [1993] 2 S.C.R. x (S.C.C.). This statement was quoted and followed in *369413 Alberta Ltd. v. Pocklington*, [2000] A.J. No. 1350, 88 Alta. L.R. (3d) 209 at para. 19 (Alta. C.A.).

39 *Pass Creek Enterprises Ltd. v. Kootenay Custom Log Sort Ltd.*, [2003] B.C.J. No. 2508 at para. 17 (B.C.C.A.).

TAB 12

2011 ABQB 142
Alberta Court of Queen's Bench

BA Energy Inc., Re

2011 CarswellAlta 2645, 2011 ABQB 142, 200 A.C.W.S. (3d) 588, 506 A.R. 359

In the Matter of Section 193 of the Alberta Business Corporations Act, R.S.A. 2000, c. B-9, as amended; and in the matter of the Judicature Act, R.S.A. 2000, c. J-2, as amended, And in the Matter of a Proposed Arrangement involving Value Creation Inc., BA Energy Inc. and the holders of common shares of Value Creation Inc. And in the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended; and in the Matter of BA Energy Inc.

Romaine J

Judgment: March 9, 2011
Docket: Calgary 0801-16292

Counsel: Stanley Carscallen, Q.C. Carscallen Leitch LLP, for Samson Controls Inc. Howard A. Gorman and Kyle D. Kashuba Macleod Dixon LLP, for BA Energy Inc.

Subject: Corporate and Commercial

***B.E. ROMAINE*:**

Reasons for Decision

Introduction

1 This Application deals with the interpretation of substantively identical provisions in purchase orders for machinery entered into between sophisticated commercial parties. The clauses at issue provide the purchaser with the right to return purchased materials that are surplus to project requirements, subject to a re-stocking fee.

2 BA Energy Inc., the purchaser, seeks to rely on this provision to return delivered equipment and obtain a refund of money paid. Samson Controls Inc., the vendor, has refused to accept return of the equipment, and seeks payment of a remaining outstanding invoice and storage costs for equipment not yet accepted by BA Energy.

Facts

3 As part of a plan to construct the Heartland Upgrader northeast of Edmonton, BA Energy, through its agent, entered into four orders (with subsequent change orders) for the purchase of forty-eight on/off ball valves with accompanying actuators and accessories (the "Valves"). Three of the purchase orders were dated November 23, 2006 and one was dated February 15, 2007.

4 The purchase orders include a surplus return clause which reads as follows:

> All material (in like new, resalable condition) surplus to project requirements shall be accepted for return, freight prepaid to Seller's Warehouse, subject to a 20% re-stocking charge.

5 The purchase orders also include termination and cancellation clauses. The termination clause provides that the purchaser may terminate the order at any time and will be relieved of further obligations "except for the payment of the balance outstanding for the goods received or work performed to the time of termination, plus all proper costs incurred by Seller resulting directly from termination."

6 The cancellation clause reads as follows:

> Cancellation charges for cancelling the Purchase Order after authorization to proceed with procurement of materials and to fabricate or manufacture.

Milestone Events	Cancellation Charges
2-4 weeks	20%
4-8 weeks	40%
8-16 weeks	60%

7 BA Energy authorized Samson to proceed with not only procurement but with the fabrication and manufacture of the Valves. Samson began the process of procuring the necessary materials and manufacturing the Valves in or about January 2007.

8 Thirty-seven of the Valves had been manufactured, paid for and delivered to BA Energy by May 21, 2008. They have been stored at the Heartland Upgrader site.

9 In July, 2007 and again in October, 2007, BA Energy attempted to cancel the orders for some of the Valves, but Samson refused to do so, suggesting that a "restocking charge" of 100% of the purchase price would be applied to certain of the orders. In November, 2008, BA Energy inquired whether Samson would buy back or resell any of the Valves but Samson refused on the basis that the Valves were a custom order.

10 On or about December 24, 2008, Samson advised BA Energy that the remaining eleven Valves had arrived in Canada and were ready for pick-up. The eleven Valves have remained in storage with a third party and Samson has incurred delivery and storage charges for them.

11 In late 2008, BA Energy was forced, due largely to the global economic crisis, to halt construction of the Heartland Upgrader. On December 30, 2008, BA Energy sought and obtained an Initial Order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA"). All work on the upgrader had ceased by January, 2009.

12 On February 27, 2009, BA Energy advised Samson that the Valves were surplus to BA Energy's project requirements. BA Energy requested that Samson accept the return of the Valves by freight prepaid to Samson's warehouse and issue a refund of $1,875,255.20 (being the money already paid for the Valves minus a 20% re-stocking fee).

13 On March 13, 2009, Samson refused to accept return of the Valves. Samson issued invoices to BA Energy for the last eleven Valves in the amount of $195,279.54.

Analysis

Principles of Contractual Interpretation

14 In *Kensington Energy Ltd. v. B & G Ltd.*, 2008 CarswellAlta 528, the Alberta Court of Appeal provided the following synopsis of the law with respect to the legal principles to be followed in the interpretation of a contract:

> When interpreting a contract, the court should give expression to the intention of the parties. If the wording of a contract is unambiguous, the court should not give it a meaning different from that which is expressed by its clear terms, unless the contract is unreasonable or has an effect contrary to the intention of the parties: *Scott v. Wawanesa Mutual Insurance Co.*, [1989] 1 S.C.R. 1445 at 1467, (1989) 59 D.L.R. (4th) 660. When possible, effect is to be given to all the terms of a contract. The various parts of a contract are not to be read in isolation, but are to be interpreted in the context of the parties' intentions as evident from the contract as a whole. A word or phrase of debatable import may achieve a clear meaning when the entire document is read: *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12 at 23-24, (1993) 99 D.L.R. (4th) 577.

15 Thus, individual provisions of a contract, such as the surplus return provision at issue, are not to be read in isolation, but instead must be read in harmony with the whole of the contract. Whenever possible, meaning should be given to all provisions. No term in a contract should be found to be meaningless or redundant: *National Trust Co. V. Mead*, [1990] 2 S.C.R. 410 at para. 31.

Are the Valves "material"?

16 Samson submits that the Valves are not "material" as referenced in the surplus return clause, and that thus the clause does not apply to them. This interpretation does not accord with the purchase orders read as a whole in the context of the surrounding factual matrix. As BA Energy points out, the finished Valves are the sole subject matter of the purchase orders, and are in fact listed in the schedule of "Material Description" included in the purchase orders. They were the only "material" purchased by BA Energy from Samson.

17 Samson also submits that it is relevant in this context that the provision setting out graduated cancellation charges had long since expired. The surplus return clause is not linked to the cancellation charge clause either by express language or necessary implication: it is readily conceivable that material that otherwise meets the requirement of the surplus return clause would not be discovered to be "surplus to project requirements" until long after the cancellation charge clause ceases to be operable.

18 Samson also submits that the termination clause of the contract should pre-dominate since, it argues, there is no sense in having a termination clause in a contract if the material can be returned at any time. However, the surplus return clause does not permit the return of material at any time, but only if it meets the conditions of the clause.

19 Samson also suggests that the distinction between "material" and "goods" in the payment terms clause of the purchase orders is relevant. The term in such clause is actually "material for production", and refers to the production process within Samson and not the Valves as delivered and subsequently sought to be returned. The distinction does not aid in interpreting the meaning of the surplus return clause.

20 The Valves were what BA Energy purchased under its contract with Samson, and for the surplus return clause to have any meaning, "material" must include the Valves as fabricated and delivered. The clause includes the words "return, freight prepaid", supporting the interpretation that it operates with respect to items manufactured by Samson and delivered to the customer.

Are the Valves "like new"?

21 Samson submits that, for the Valves to be considered "like new", they must have been properly maintained, inspected and kept in mechanical and operational condition. Samson is critical of the conditions in which some of the Valves have been stored at the Heartland Upgrader site.

22 Samson concedes that it has no knowledge of the actual condition of the Valves, other than the observations of one of its representatives from a brief visit to the site, but submits that BA Energy cannot attest to the fact that the Valves are "like new" since it relies only on an opinion to that effect by one of their employees (whom, Samson says, lacks the proper qualifications to give such an opinion) and the opinion of a consultant company on preservation and maintenance protocols generally.

23 BA Energy notes that the Valves have never been used and have been stored in their original shipping crates. The employee in question who opined that the Valves are in good condition is the employee tasked with quality assurance and preservation duties for the company. BA Energy's storage and maintenance protocols have been independently evaluated as "superior" and maintained by a consultant that specializes in industrial-based insurance services. This consultant insures all equipment on site, and thus has a financial interest in the preservation of the Valves. BA Energy's representative, Mr. Carillo, testified on cross-examination on affidavit that the Valves were included in the consultant's inspection and report.

24 Mr. Carillo also testified that BA Energy's storage procedures have substantively complied with Samson's prescribed storage requirements, other than the fact that BA Energy failed to retain the services of a Samson representative to inspect the Valves for warranty purposes.

25 The warranty issue is a red herring. When BA Energy first sought to return the Valves in February, 2009, the warranty had not expired on any of them. As BA Energy submits, Samson's refusal to accept the return of the Valves and the resulting passage of time leading to the expiry of warranty periods cannot be the basis for a refusal to accept an otherwise valid return of surplus material. The lack of warranty does not mean the Valves are no longer "like new": it merely means that the contractual obligations and benefits of a warranty between these two parties are no longer in force.

26 I find that BA Energy has adduced sufficient evidence to establish on a balance of probabilities that the Valves are "like new", and that Samson has not countered that evidence in any effective manner. Had Samson accepted the return of the Valves in February, 2009 and found them to be damaged by poor maintenance or preservation, it may have been able to establish otherwise, but it did not do so, and is thus unable to effectively challenge the evidence adduced by BA Energy on this issue.

Are the Valves in "resalable condition"?

27 Samson also submits that the Valves are not in "resalable condition" because they are unique and custom-fabricated to BA Energy's specifications. Even if the Valves are unique, they are the only product purchased from Samson by BA Energy. However, the Samson representative testified on cross-examination that the fully-assembled Valves would never have been in "resalable condition" given their unique characteristics. In order that the surplus return clause be given any meaning, the fact that the Valves may be unique cannot prevent them from being subject to the clause.

28 The evidence is that the Valves are fitted with a metal seat rather than a "soft" seat and that a special coating material was applied to them for pressure and temperature purposes. Samson does not dispute this, but argues that these changes made the Valves expensive.

29 It is also in evidence that Samson received inquiries about the possibility of purchasing the Valves from an Italian customer. The Samson representative, Ms. Jensen, stated that the sale did not materialize because of the Valves' "unique design, inadequate storage procedures and the substantial expiring of the manufacturer's warranty". On cross-examination, she said that the Valves were "over designed for what the customer was looking for, and with no or little warranty being left available on [them]". Samson refused to provide copies of any written communication between the Italian customer and Samson to BA Energy. The issue of the lack of warranty between BA Energy and Samson has already been discussed. That a customer may not be interested in purchasing material because Samson will not provide a new warranty does not make the material unsaleable.

30 I am not persuaded by the evidence that the unique aspects of the Valves make them unsaleable, either by reason of the enhancements that were made or the lack of warranty.

31 Samson also submits that it would be necessary for a Samson representative to assess the condition of the Valves in order to satisfy itself that they are functional and thus resalable. However, I am satisfied from the evidence before me that BA Energy has made out a *prima facie* case that the Valves are in resalable condition. Samson has not provided evidence to counter or contradict the *prima facie* case.

32 In summary, all of the arguments made by Samson with respect to the meaning of "material", "like new" and "resalable condition", if successful and taken to their logical conclusion, would have rendered the surplus return clause redundant and meaningless, contrary to principles of contractual interpretation. However, the issue of whether the Valves are surplus to project requirements is different.

Are the Valves "surplus to project requirements"?

33 BA Energy takes the position where that its financial circumstances resulted in the Valves becoming "surplus to project requirements".

34 As BA Energy itself notes, "surplus" means "an amount left over when requirements have been met... exceeding what is needed or used": *Oxford Concise English Dictionary*, 9th edition (Oxford: Clarendon Press). Because of BA Energy's financial position, the Heartland Project was put on hold and construction was halted. Mr. Carillo testified that the future of the project is uncertain, that it may or may not proceed after the restructuring is complete. Mr. Carillo made it clear in his cross-examination on affidavit that the Valves were redundant "at this time", that BA Energy was disposing of everything it could as part of the restructuring in order to come up with a plan that would be accepted by its creditors, but that at some time in the future, BA Energy may be in a position where it would have to re-order components, including valves, in order to complete construction of the upgrader facility.

35 Mr. Carillo testified as follows:

> Q.... and I take it that those purchase orders, which pertain to these valves, are surplus to the project requirements simply because BA Energy is in insolvency currently, and it's surplus because the project isn't moving forward at this time?
>
> A. Yes.
>
> Q. And is that what you've been doing with the other components of the upgrader?
>
> A. Most of the components that we have on site... we put... on sale through an auction... we were selling everything... that was either critical or not critical assets to BA, because we needed to monetize the company.

36 Samson submits that "surplus to project requirements" cannot be interpreted to encompass any eventuality but must be restricted to situations where the material is no longer required for the project, as constructed or being constructed. I must agree. To give the phrase the interpretation sought by BA Energy would be to create an entirely new cancellation or termination clause in the purchase orders that would be inconsistent with existing provisions. It is this context that limits the surplus return clause to situations of operational or physical surplus. While the clause is intended to give a purchaser flexibility in the event of changes or unforseen events in the construction of projects that are often complex and innovative in an engineering and design sense, that flexibility cannot be interpreted to extend to financial difficulties that lead to a halt in construction. As conceded by BA Energy, the Valves are only surplus *at this time*. The project as constructed may well require the Valves, or valves similar to them, if it is eventually completed. In that sense, the Valves cannot be considered "surplus to project requirements".

Conclusion

37 I find, therefore, that BA Energy cannot rely on the surplus return clause to compel Samson to accept return of the Valves, or to pay a refund of $1,875,255.20. The invoiced amount of $195,279.43 for the eleven Valves not yet delivered must be paid.

38 The remaining question is whether BA Energy must pay storage costs for the Valves not yet delivered. There is nothing in the documentation between the parties that requires the payment of storage costs. Samson was aware from about July, 2007 that BA Energy was seeking to cancel its orders for at least fourteen of the Valves, and became aware as of November 7, 2008 that BA Energy wished Samson to buy back or re-sell some of the Valves. Despite this, Samson advised BA Energy on about December 24, 2008 that the Valves were ready for pick-up from its warehouse facility in Toronto. The initial order in the CCAA proceedings was granted on December 30, 2008. With knowledge of this state of affairs, Samson moved the eleven Valves from its warehouse facility to an offsite warehouse facility at the end of March, 2008.

39 BA Energy is not contractually responsible for storage costs. If it must pay such costs to obtain possession of the Valves, it is entitled to set off the amount of such costs against the $195,279.54 owing to Samson.

40 If the parties are unable to agree on costs, I will hear submissions on that issue.

End of Document

TAB 13

THE INTERPRETATION OF CONTRACTS

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SIR KIM LEWISON
A Lord Justice of Appeal

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3. GIVING EFFECT TO ALL PARTS OF A CONTRACT

In construing a contract all parts of it must be given effect where possible, and no part of it should be treated as inoperative or surplus.[44]

7.03 The construction of a document as a whole necessarily involves giving effect to each part of it in relation to all other parts of it. Accordingly, as a corollary of the principle that a document must be construed as a whole, effect must be given to each part of the document. This in turn means that in general each part of the document is taken to have been deliberately inserted, having regard to all the other parts of the document, with the result that there is a presumption against redundant words (usually called "surplusage").[45] This principle is sometimes labelled the argument from redundancy.

In *Re Strand Music Hall Co Ltd*,[46] Lord Romilly M.R. said:

"The proper mode of construing any written instrument is, to give effect to every part of it, if this be possible, and not to strike out or nullify one clause in a deed, unless it be impossible to reconcile it with another and more express clause in the same deed."

So also in *SA Maritime et Commerciale of Geneva v Anglo-Iranian Oil Co Ltd*,[47] Somervell L.J. said:

"Although one finds surplusage in contracts, deeds and Acts of Parliament, one leans towards treating words as adding something, rather than as mere surplusage."

In *Dwr Cymru Cyfyngedig (Welsh Water) v Corus UK Ltd*,[48] Moore-Bick L.J. said:

"In my view what points most strongly to the conclusion that they intended clause 17 to have contractual effect is the very fact that they chose to include it in the Agreement. Surplusage is by no means unknown in commercial contracts, of course, but it is unusual for parties to include in the operative part of a formal agreement of this kind a whole clause which is not intended to have contractual effect of any kind. One starts, therefore, from the presumption that it was intended to have some effect on the parties' rights and obligations."

---

[44] This paragraph was referred to with approval in *Newall v Lewis* [2008] 4 Costs L.R. 626; *Programme Holdings Pty Ltd v Van Gogh Holdings Pty Ltd* [2009] WASC 79; *Jerram Falkus Construction Ltd v Fenice Developments Ltd* [2011] EWHC 1935 (TCC); 138 Con. L.R. 21; and *Phoenix Life Assurance Ltd v The Financial Services Authority* [2013] EWHC 60 (Comm). See also *Secretary of State for Defence v Turner Estate Solutions Ltd* [2015] EWHC 1150 (TCC). Compare the *European Principles of Contract Law*, para.5:106: "An interpretation which makes the terms of the contract lawful, or effective, is to be preferred to one which would not". The Unidroit Principles of International Commercial Contracts state at para.4.5: "Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect".

[45] The presumption against surplusage is "not the strongest of weapons": *The Marielle Bolten* [2010] 1 Lloyd's Rep. 648 at 654.

[46] (1865) 35 Beav. 153, applied in *Singapore Airlines Ltd v Buck Consultants Ltd* [2011] EWHC 59 (Ch). The principle was accepted on appeal: [2011] EWCA Civ 1542; [2012] Pens. L.R. 1. The principle was also applied in *Morris v Blackpool Borough Council* [2014] EWCA Civ 1384; [2015] L. & T.R. 6.

[47] [1954] 1 W.L.R. 492.

[48] [2007] EWCA Civ 285.

TAB 14

THE NEW SHORTER OXFORD ENGLISH DICTIONARY

ON HISTORICAL PRINCIPLES

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protected (*from* something injurious or distasteful); not susceptible (*to*). LI9. **b** Of a computer system: protected against damage by hackers and viruses. L20.

1 W. S. CHURCHILL The officials pleaded that they were immune because they were acting under Government orders. **2b** K. LANDSTEINER The immune antibodies . . react . . with the antigens that were used for immunizing. *Times* A deficiency disease of the body's immune defence system. **3** *New York Times* Golden ages when these who governed . . have been immune from acts of rage and insanity. B. CHATWIN She failed to charm him: he was immune to her kind of charm.

Special collocations: †**immune body** an antibody. **immune globulin** (*a*) a preparation containing antibodies, suitable for use as an antiserum; (*b*) = IMMUNOGLOBULIN. **immune response** the reaction of the body to the introduction of an antigen. **immune system** those structures and functions of an organism responsible for maintaining immunity.

B *n.* An immune person or thing. LI9.

immune /ɪ'mjuːn/ *v.t. rare.* MI9. [f. the adj.] Make immune.

immunise *v.* var. of IMMUNIZE.

immunity /ɪ'mjuːnɪtɪ/ *n.* LME. [L *immunitas*, f. asIMMUNE *a.* & *n.*: see -ITY.] **1** *Law.* Exemption *from* taxation, jurisdiction, an obligation or duty, etc.; *gen.* privilege. LME. **b** An exemption or privilege; *spec.* (*Eccl.*) (an) exemption from a secular or civil liability, duty, etc. LME. †**2** Undue freedom, licence. LI6–LI7. **3** Freedom or protection from or *from* anything injurious or distasteful; lack of susceptibility (*to*). LI6. **4** *Biol.* The ability to resist a specific infection, poison, etc., esp. owing to lymphocytes and phagocytes and (in vertebrates) antibodies. Cf. IMMUNE *a.* 2. LI9.

1 *diplomatic immunity*: see DIPLOMATIC *a.* **3** P. ACKROYD He was offered immunity from prosecution if he would testify. **4** BETTY SMITH Vaccination was a giving of the harmless form of smallpox to work up immunity.

immunize /'ɪmjʊnʌɪz/ *v.* Also **-ise.** LI9. [f. IMMUNE *a.* + -IZE.] **1** *v.t.* Make immune, esp. by inoculation. LI9. **2** *v.i.* Of an antigen: produce immunity *against* an agent. M20.

immuni'zation *n.* LI9. **immunizer** *n.* E20.

immuno- /'ɪmjʊnəʊ, ɪ'mjuːnəʊ/ *comb. form* of IMMUNE *a.*, IMMUNITY, IMMUNOLOGY: see -O-.

immuno'assay *n.* (a) determination of the presence or quantity of a substance, esp. a protein, through its properties as an antigen M20. **immuno'competent** *a.* having a normal immune response M20. **immuno'compromised** *a.* having an impaired immune system L20. **immunocyto'chemistry** *n.* the cytochemistry of the immune system M20. **immunode'ficiency** *n.* a reduction in the normal immune defences of the body M20. **immunode'ficient** *a.* (partly) lacking in immunity L20. **immunode'pressant** *a.* & *n.* = IMMUNOSUPPRESSANT M20. **immunode'pressed** *a.* = IMMUNOSUPPRESSED L20. **immunode'pression** *n.* = IMMUNOSUPPRESSION M20. **immunode'pressive** *a.* = IMMUNOSUPPRESSIVE *a.* M20. **immunodi'ffusion** *n.* a technique for detecting or measuring antibodies and antigens by their precipitation when diffused together through a gel or other medium M20. **immunofluo'rescence** *n.* a technique for determining the location of an antigen (or antibody) in tissues by reaction with an antibody (or antigen) labelled with a fluorescent dye M20. **immunofluo'rescent** *a.* of, pertaining to, or involving immunofluorescence M20. **i'mmunogen** *n.* any substance that elicits an immune response or produces immunity in the recipient E20. **immuno'genic** *a.* of, pertaining to, or possessing the ability to elicit an immune response M20. **immunosu'ppressant** *a.* & *n.* = IMMUNOSUPPRESSIVE M20. **immunosu'ppressed** *a.* (of an individual) rendered incapable of an effective immune response M20. **immunosu'ppression** *n.* suppression of the immune response in an individual, esp. to prevent rejection of transplanted tissue M20. **immunosu'ppressive** *a.* & *n.* (*a*) *adj.* suppressing the function of the immune system; (*b*) *n.* a drug which promotes immunosuppression: M20. **immuno'therapy** *n.* the prevention or treatment of disease by modification of the immune response E20.

immunochemistry /ˌɪmjʊnəʊ'kɛmɪstrɪ, ɪˌmjuː-nəʊ-/ *n.* E20. [f. IMMUNO- + CHEMISTRY.] The chemical study of immunity; biochemical study or investigation of or using immunoglobulins.

immunochemical *a.* E20. **immunochemically** *adv.* M20. **immunochemist** *n.* an expert in or student of immunochemistry M20.

immunoelectrophoresis /ˌɪmjʊnəʊɪˌlɛktrəfə'riːsɪs, ɪˌmjuːnəʊ-/ *n.* M20. [f. IMMUNO- + ELECTROPHORESIS.] A technique for identification of proteins in a mixture (as serum) by electrophoresis and subsequent immunodiffusion.

immunoelectrophoretic *a.* M20. **immunoelectrophoretically** *adv.* M20.

immunogenetics /ˌɪmjʊnəʊdʒɪ'nɛtɪks, ɪˌmjuːnəʊ-/ *n.* M20. [f. IMMUNO- + GENETICS.] Genetics studied by means of immunological techniques; the branch of medicine that deals with the genetic aspects of immunity.

immunogenetic *a.* of or pertaining to immunogenetics M20. **immunogenetically** *adv.* L20.

immunoglobulin /ˌɪmjʊnəʊ'glɒbjʊlɪn, ɪˌmjuː-nəʊ-/ *n.* M20. [f. IMMUNO- + GLOBULIN.] *Biochem.* & *Med.* Any of a group of proteins present in vertebrates in the serum and cells of the immune system, which have a characteristic arrangement of subunits in their molecular structure, and function as antibodies.

immunology /ɪmjʊ'nɒlədʒɪ/ *n.* E20. [f. IMMUN(ITY + -OLOGY.] The branch of science which studies resistance to infection in humans and animals.

immuno'logic, -'logical *adjs.* of or pertaining to immunology or immunity E20. **immuno'logically** *adv.* E20. **immunologist** *n.* E20.

immure /ɪ'mjʊə/ *v.* & *n.* LI6. [Fr. *emmurer* or med.L *immurare*, f. as IM-[1] + *murus* wall.] **A** *v.t.* †**1** Surround with a wall or walls; fortify. LI6–MI8. **2** Enclose within walls; confine (as) in a prison; *fig.* enclose, surround, confine. LI6. **3** Build into or entomb in a wall. LI7.

2 I. MURDOCH Otto was still immured in the summer-house. K. LINES You shall be immured in a vault . . until you are released by death. JO GRIMOND The increasing volume of legislation which keeps Members . . immured together and isolated from the world. **3** G. G. SCOTT The end of the tomb has been immured in the lower part of the chapel.

†**B** *n.* A wall. *rare* (Shakes.). Only in EI7.

immu'ration *n.* imprisonment, confinement LI9. **immurement** *n.* = IMMURATION MI8.

immusical /ɪ'mjuːzɪk(ə)l/ *a.* Now *rare.* EI7. [f. IM-[2] + MUSICAL *a.*] Unmusical.

immutable /ɪ'mjuːtəb(ə)l/ *a.* LME. [L *immutabilis*, f. as IM-[2] + *mutabilis* MUTABLE.] **1** Not mutable; not subject or liable to change; unalterable. LME. **2** Not varying in different cases; invariable. EI7.

1 P. USTINOV Those for whom the . . law is immutable, instead of being as changeable as the seasons.

immuta'bility *n.* LI5. **immutably** *adv.* EI7.

immy /'ɪmi/ *n.* Also **immie.** M20. [Prob. f. IMITATION: see -Y[6].] A kind of glass marble made to imitate one of another material.

imp /ɪmp/ *n.* OE. [Rel. to next.] **1** A young shoot of a plant; a sapling; a sucker, a scion. *obs.* exc. *Sc.* OE. †**b** A young person. LME–LI6. †**2** A shoot or slip used in grafting; a graft. LME–EI8. **3** A scion or descendant, esp. of a noble family; an offspring, a child. *arch.* LME. **b** A follower, an adherent, esp. of glory, chivalry, etc. *arch.* LME. **4** A (person regarded as a) child of the Devil; a little devil. EI6. †**5** A young man, a youth; a lad, a boy. LI6–LI9. **6** A piece added on to eke out or enlarge something. *obs.* exc. *dial.* LI6. **7** A mischievous child; a scamp, an urchin. MI7.

4 LINCOLN *imp.*

imp /ɪmp/ *v.t.* [OE *impian* corresp. to OHG *impfōn* (G *impfen*), shortened analogues of *impitōn* (MHG *impfeten*), f. Proto-Romance, f. med.L *impotus* graft, f. Gk *emphutos* implanted, engrafted, vbl adj. of *emphuein*, f. *en-* IM-[1] + *phuein* plant.] †**1** Graft, engraft. OE–MI8. **2** *fig.* Implant, set or fix in. *arch.* ME. **3** *Falconry.* †**a** Add (feathers) to the wing of a bird to improve the power of flight. Also foll. by *in.* LI5–EI8. **b** Add feathers to (the wing of a bird) to improve the power of flight. Also foll. by *with.* LI6. **4** Enlarge, add to, (as) by grafting. *arch.* LI6.

3b imp the wings of strengthen or improve the flight or power of.

impack /ɪm'pak/ *v.t. rare.* LI6. [AL *impaccare* pack, f. as IM-[1] + *paccare* pack wool etc.: see PACK *v.*[1]] Pack (up); press together into a mass.

impact /'ɪmpakt/ *n.* LI8. [f. L *impact-* pa. ppl stem of *impingere* IMPINGE.] **1** The striking of one body on or against another; a collision. LI8. **2** The (strong) effect of one thing, person, action, etc., on another; an influence; an impression. EI9.

1 A. TREW The impact was softened by the sand. *Manchester Evening News* The car . . careered . . into the path of the wagon. She was killed on impact. **2** L. WOOLF To describe the impact of illness or insanity upon such a remarkable mind. **make an impact** have an effect (*on*).

Comb.: **impact crater** a crater or hollow supposedly produced by the impact of a meteorite; **impact printer**: that depends on mechanical pressure to transfer ink from a ribbon to the paper; **impact strength** the ability of a material to resist breaking when struck; **impact test** any of various tests which measure an object's resistance to breaking under sudden stress, usu. by applying a blow; **impact wrench** an electric or pneumatic power wrench used for inserting and removing nuts, bolts, screws, etc.

impact /ɪm'pakt/ *v.* EI7. [Partly f. L *impactus* pa. pple of *impingere* IMPINGE, partly back-form. f. IMPACTED.] Chiefly as *impacted* pa. pple. **1** *v.t.* Press closely or fix firmly (*in, into*). EI7. **2** *v.t.* Stamp or impress *on. rare.* LI7. **3** *v.i.* Come forcibly into contact with a (larger) body or surface. (Foll. by *against, on,* etc.) E20. **b** Have a pronounced effect *on.* E20. **4** *v.t.* Cause to impinge *on, against,* etc. M20.

1 *fig.*: A. CARTER Both intent on impacting a thousand stories into the single night.

impacted /ɪm'paktɪd/ *a.* EI7. [f. L *impactus* (see prec.) + -ED[1].] **1** Pressed closely in, firmly fixed. EI7. **b** *Med.* Of faeces: wedged in the intestine. Of the intestine: blocked by hardened faeces. MI9. **c** *Med.* Of a bone fracture: having the broken parts driven firmly together. MI9. **d** Of a tooth: prevented from erupting by bone or another tooth. LI9. **2** That has been struck by an impacting body; (of an impacting body) that has struck something. E20. **3** *fig.* Of an area: overcrowded, esp. so as to put severe pressure on public services etc. *US.* M20.

1d *Practical Health* The shock of having impacted wisdom teeth removed.

impaction /ɪm'pakʃ(ə)n/ *n.* MI8. [f. IMPACT *v.* + -ION.] **1** The action of becoming or condition of being impacted. MI8. **2** *spec.* in *Med.* The lodging of a mass of (usu. hardened) faeces in the intestine so that defecation is prevented or impeded; the obstruction so caused. MI9. **b** An impacted mass of faeces. E20. **3** The action or process of causing a body to impact on a surface etc. M20.

impactite /ɪm'paktʌɪt/ *n.* M20. [f. IMPACT *n.* + -ITE[1], after TEKTITE.] *Geol.* Any piece of glassy material formed in or around a meteorite crater by the heat of impact.

impactive /ɪm'paktɪv/ *a.* M20. [f. IMPACT *n.* + -IVE.] Of, pertaining to, or characterized by impact; having an impact.

impactor /ɪm'paktə/ *n.* E20. [f. IMPACT *v.* + -OR.] **1** A device etc. that delivers impacts or blows. E20. **2** An impinger, *esp.* one in which particles are deposited on a dry surface rather than in a liquid. M20.

impaint /ɪm'peɪnt/ *v.t.* Long *rare.* LI6. [f. IM-[1] + PAINT *v.*] Depict by painting on something.

impair /ɪm'pɛː/ *n.*[1] *arch.* MI6. [f. IMPAIR *v.*] An act of impairing; the fact of being impaired; impairment.

impair /'ɪmpɛː; *in senses A.3, B.1 foreign* ɛ̃:pɛr (*pl. same*)/ *a.* & *n.*[2] EI7. [Fr. = unequal, f. as IM-[2] + PAIR *n.*[2] & *a.*] **A** *adj.* †**1** Unfit, inferior. *rare* (Shakes.). Only in EI7. **2** Not paired; not forming one of a pair. MI9. **3** *Roulette.* Of or pertaining to an odd number or the odd numbers collectively. M20. **B** *n.* **1** *Roulette.* An odd number; the odd numbers collectively. MI9.

2 An unpaired individual thing; an odd one. *rare.* LI9.

impair /ɪm'pɛː/ *v.* Orig. **†app-**; also **†em-**. ME. [OFr. *empeirier* f. Proto-Romance, f. as IM-[1] + late L *pejorare*, f. L *pejor* worse.] **1** *v.t.* Make less effective or weaker; devalue; damage, injure. ME. **2** *v.i.* Become less effective or weaker; deteriorate; suffer injury or loss. Now *rare* or *obs.* ME.

1 A. BURGESS Being toothless did not impair one's capacity to eat army food. *Which?* Corneal ulcers . . can permanently impair vision. **2** SOUTHEY His own health and faculties impairing day by day.

impairer *n.* LI6. **impairment** *n.* the action of impairing, the fact of being impaired ME.

impaired /ɪm'pɛːd/ *ppl a.* EI7. [f. IMPAIR *v.* + -ED[1].] **1** *gen.* That has been impaired. EI7. **2** Of the driver of a vehicle, or driving: adversely affected by alcohol or narcotics. *Canad.* M20.

1 F. SPALDING An attack of rheumatic fever . . left his health permanently impaired. J. GATHORNE-HARDY They become anxious, their performance impaired. **2** *Toronto Daily Star* Ange Gardien . . was charged with impaired driving.

impala /ɪm'pɑːlə, -'palə/ *n.* Also **-lla**. LI9. [Zulu *i-mpala*: cf. PALLAH.] A medium-sized reddish-brown grazing antelope, *Aepyceros melampus*, of southern and eastern African savannah, the male of which has lyre-shaped horns.

impalace /ɪm'palɪs/ *v.t. arch.* LI8. [f. IM-[1] + PALACE.] Place or install in a palace. Usu. in *pass.*

impale /ɪm'peɪl/ *v.t.* Also **em-** /ɪm-, ɛm-/. M16. [Fr. *empaler* or med.L *impalare*, f. as IM-[1] + *palus* stake, PALE *n.*[1]] **1** Enclose with pales, stakes, etc.; surround (as) with a palisade; fence in (*lit.* & *fig.*). Now *rare.* M16. **†b** *Mil.* Enclose or surround (troops) for defence. M16–M17. **2** Surround for adornment; encircle as with a crown or garland; border, edge. *arch.* M16. **3** *Her.* Combine (two coats of arms, or one coat *with* another) by placing them side by side on one shield, separated by a vertical line down the middle. EI7. **4** Transfix (a body etc. *on* or *with* a stake etc.), esp. (*Hist.*) as a form of torture or capital punishment. EI7.

1 T. HOOD So he might impale a strip of soil. **2** LYTTON All the laurels that ever with praise Impaled human brows. **3** T. H. WHITE It was charged with the impaled arms of her husband and of her father. **4** R. GRAVES He would hang or impale any man found guilty of rape. B. COTTLE The cruel shrike . . impales his little victims on thorns. *fig.*: P. ACKROYD Impaled upon his own lacerating self-consciousness he has fantasies of suicide.

impaler *n.* LI7. **impaling** *n.* (*a*) the action of the vb; (*b*) = IMPALEMENT 2: LI6.

impalement /ɪm'peɪlm(ə)nt/ *n.* Also **em-** /ɪm-, ɛm-/. LI6. [Fr. *empalement*, f. *empaler*: see prec., -MENT. Later f. the vb.] **1** The action or an act of enclosing with pales, stakes, etc.; an enclosing fence or palisade. LI6. **2** *Her.* The combining of two coats of arms placed side by side on one shield and separated by a vertical line down the middle; the arms so combined. EI7. **3** The action or an act of transfixing a body etc. on, *on*, or *with* a stake etc., esp. (*Hist.*) as a form of torture or capital punishment; the fact of being so impaled. M17. **†4** *Bot.* The calyx of a flower; (in a plant of the composite family) the involucre. LI7–LI8.

impall /ɪm'pɔːl/ *v.t. rare.* M17. [f. IM-[1] + PALL *n.*[1]] Enfold or wrap (as) in a pall.

impalla *n.* var. of IMPALA.

impalpable /ɪm'palpəb(ə)l/ *a.* EI6. [Fr., or late L *impalpabilis*, f. as IM-[2] + PALPABLE.] **1** Imperceptible to the touch; intangible; *esp.* (of powder) very fine, not containing grains that can be felt. EI6. **2** Not easily grasped or understood by the mind; producing no definite mental impression. LI8.

2 H. STURGIS Sainty was aware of the slightest, most impalpable change in his friend's manner.

impalpa'bility *n.* EI7. **impalpably** *adv.* LI8.

impalsy /ɪm'pɔːlzi, -'pɒl-/ *v.t. rare.* LI6. [f. IM-[1] + PALSY *n.*[1]] Affect (as) with palsy; paralyse.

impanate /ɪm'peɪnət/ *a.* M16. [med.L *impanatus* pa. pple of *impanare*, f. as IM-[1] + *panis* bread: see -ATE[2].] *Chr. Ch.* Of the body and blood of Christ: present in the bread (and wine) after consecration.

impanated /ɪm'peɪneɪtɪd/ *a.* Long *rare.* LI6. [f. med.L *impanat-* (see next) + -ED[1].] = IMPANATE.

impanation /ɪmpə'neɪʃ(ə)n/ *n.* M16. [med.L *impanatio(n-)*, f. *impanat-* pa. ppl stem of *impanare*: see IMPANATE, -ATION.] *Chr. Ch.* In Eucharistic doctrine: the presence of the body and blood of Christ in the bread (and wine) after consecration.

impanator /'ɪmpəneɪtə/ *n.* M19. [med.L, f. as prec.: see -OR, -ATOR.] *Chr. Ch.* A person who holds the doctrine of impanation.

impanel /ɪm'pan(ə)l/ *v.*[1]*t. rare.* Infl. **-ll-**, ***-l-**. LI6. [f. IM-[1] + PANEL *n.*[1]] **1** Fit (as) with a panel or panels. LI6. **2** Insert as a panel or panels. M19.

impanel *v.*[2] & *n.* var. of EMPANEL.

imparadise /ɪm'parədaɪs/ *v.t.* Also **em-** /ɪm-, ɛm-/. LI6. [f. IM-[1], EM-[1] + PARADISE. Cf. Fr. *emparadiser*, It. *imparadisare*.] **1** Place (as) in paradise; bring into a state of supreme happiness; enrapture. LI6. **2** Make a paradise of (a state or place). M17.

†impardonable *a.* EI6–LI8. [f. IM-[2] + PARDONABLE.] Not to be pardoned, unpardonable.

imparipinnate /ɪm,parɪ'pɪneɪt/ *a.* M19. [f. L *impar* uneven after PARIPINNATE.] *Bot.* Pinnate with a terminal leaflet and an odd number of leaflets in all.

imparisyllabic /ɪm,parɪsɪ'labɪk/ *a.* & *n.* M18. [f. L *impar* unequal after PARISYLLABIC.] *Gram.* **A** *adj.* Of a Greek or Latin noun: not having the same number of syllables in all cases of the singular. M18. **B** *n.* An imparisyllabic noun. LI9.

imparity /ɪm'parɪti/ *n.* Now *rare* or *obs.* M16. [Late L *imparitas*, f. L *impar* unequal, uneven, f. as IM-[2] + *par* equal. Cf. PARITY *n.*[1]] **1** The quality or condition of being unequal: inequality. M16. **†2** The quality of being unlike; dissimilarity in nature or character. Only in 17. **†3** The quality, in a whole number, of not being divisible into two equal integral parts; an odd number. Only in M17.

impark /ɪm'pɑːk/ *v.t.* LME. [AN *enparker*, OFr. *emparquer* (AL *imparcare*), f. as EM-[1], IM-[1] + *parc* PARK *n.*] **1** Enclose (animals) in a park. LME. **2** Enclose (land) for a park; fence in. LME.

imparl /ɪm'pɑːl/ *v. obs.* exc. *Hist.* Also **†em-**. LME. [AN *enparler*, OFr. *emparler* speak, plead, f. as EM-[1], IM-[1] + *parler* speak: see PARLE.] **1** *v.i. Law.* (Obtain time to) confer in order to settle a dispute amicably. LME. **†2** *v.i.* Consult *together* or *with* another on a matter; confer. LME–EI7. **†3** *v.t.* Talk over; discuss. *rare.* EI7–EI9.

imparlance /ɪm'pɑːləns/ *n. obs.* exc. *Hist.* Also **†em-**. LI6. [OFr. *emparlance*, f. *emparler*: see prec., -ANCE.] **†1** The action of consulting together on a matter, esp. before taking action; conference, discussion. LI6–EI9. **2** *Law.* An extension of the time allowed for a response in pleading a case, so that the two parties can confer and negotiate an amicable settlement; a petition for, or the granting of, this time. EI7.

imparsonee /ɪm,pɑːsə'niː/ *a.* EI7. [Repr. med.L (*persona*) *impersonata*, f. L *im-* IN-[2] + AL *personata* fem. pa. pple of *personare* indict, institute, f. L *persona*: see PARSON, PERSON *n.*, -EE[1].] *Eccl. Hist.* Presented, instituted, and inducted into a parsonage or rectory. Only in *parson imparsonee.*

impart /ɪm'pɑːt/ *v.* LME. [OFr. *impartir* f. L *impartire*, f. as IM-[1] + *part-*, *pars* PART *n.*] **1** *v.t.* Give a part or share of (a thing *to* a person etc.); bestow, give. LME. **†2** *v.i.* Share, partake *in.* LI5–EI7. **b** *v.t.* Have or get a share of; share, partake. (Foll. by *of.*) M16–M17. **3** *v.t.* Communicate (information, news, etc., *to*); tell, relate, (a story, an account, etc.). M16. **†4** *v.t.* Give a share of (something) to each of a number of people; distribute. M16–EI7.

1 J. GALSWORTHY The moustache . . imparted a somewhat military look to his face. R. C. HUTCHINSON A particular countryside imparts a special character to the men it breeds. **3** J. AGATE The first object in writing is to impart information.

impartable *a.* (long *rare*) LME. **impar'tation** *n.* the action of imparting, impartment, communication EI9. **imparter** *n.* LI6. **impartment** *n.* the action or fact of imparting; something imparted, *esp.* a communication: EI7.

impartial /ɪm'pɑːʃ(ə)l/ *a.* LI6. [f. IM-[2] + PARTIAL *a.*] **1** Not partial; not favouring one party or side more than another; unprejudiced, unbiased; fair. LI6. **†2** Partial. LI6–EI7. **†3** Not partial or fragmentary; entire, complete. *rare.* Only in EI8.

1 J. G. FARRELL An impartial and objective justice was abandoned. P. NORMAN Mrs Durham made no distinction, treating Anthony and him with impartial severity.

impartialist *n.* a person who is or professes to be impartial M17. **impartially** *adv.* EI7.

impartiality /ɪm,pɑːʃɪ'alɪti/ *n.* EI7. [f. IMPARTIAL + -ITY.] **1** The quality or character of being impartial; freedom from prejudice or bias; fairness. EI7. **†2** Completeness. *rare.* Only in EI8.

impartible /ɪm'pɑːtɪb(ə)l/ *a.* & *n.* LI6. [Late L *impartibilis*, f. as IM-[2] + *partibilis* PARTIBLE.] **A** *adj.* Incapable of being divided or parted; indivisible LI6. **B** *n.* A thing that is indivisible. LI8.

impartibility *n.* M17. **impartibly** *adv.* M17.

imparticipable /ɪmpɑː'tɪsɪpəb(ə)l/ *a.* & *n.* LI8. [f. IM-[2] + PARTICIPABLE.] (A thing that is) unable to be shared or participated in.

impartite /ɪm'pɑːtaɪt/ *a. rare.* M19. [f. IM-[2] + PARTITE.] Not divided into parts, undivided.

impassable /ɪm'pɑːsəb(ə)l/ *a.* M16. [f. IM-[2] + PASSABLE, perh. through Fr. *impassable*.] **1** Impossible to traverse or travel through. M16. **†2** That cannot pass (away or through). LI8–M19. **3** Unable to be passed or made to pass. *rare.* M19.

1 M. KEANE Now, most of the paths were choked and impassable. **2** *Examiner* As impassable through Heaven's gates, as is a camel through the needle's eye. **3** *Pall Mall Gazette* When half a million gilt sixpences in circulation make half-sovereigns practically impassable.

impassa'bility *n.* LI8. **impassableness** *n.* EI8. **impassably** *adv.* EI9.

impasse /am'pɑːs, 'ampɑːs, *foreign* ɛ̃pɑːs/ *n.* M19. [Fr., f. as IM-[2] + stem of *passer* PASS *v.*] **1** A position from which there is no escape, a deadlock. M19. **2** *lit.* A road etc. without an outlet, a blind alley. LI9.

1 F. ASTAIRE I find myself blocked by a sort of mental impasse. E. M. BRENT-DYER Margot . . scribbled in the details . . thankful to be out of the impasse so easily.

impassible /ɪm'pasɪb(ə)l/ *a.* ME. [(O)Fr. f. eccl.L *impassibilis*, f. as IM-[2] + PASSIBLE.] **1** Chiefly *Theol.* Incapable of suffering or feeling pain. ME. **2** Incapable of suffering injury or damage. LI5. **†3** Not to be endured; insufferable. EI6–M17. **4** Incapable of feeling or emotion. LI6.

impassi'bility *n.* ME. **impassibleness** *n.* M17. **impassibly** *adv.* LI7.

impassion /ɪm'paʃ(ə)n/ *v.t.* Also **†em-**. LI6. [It. **†***impassionare* (now *-nn-*), f. as IM-[1] + *passione* PASSION *n.*] Fill with passion; arouse the feelings of; excite.

impassionment *n.* (*rare*) the action of impassioning; the state of being impassioned: LI6.

impassionate /ɪm'paʃ(ə)nət/ *a.*[1] Now *rare.* LI6. [It. **†***impassionato* pa. pple of **†***impassionare*: see prec., -ATE[2].] = IMPASSIONED.

impassionately *adv.* EI9.

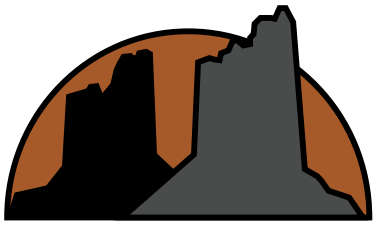
impassionate /ɪm'paʃ(ə)nət/ *a.*[2] Now *rare.* EI7. [f. IM-[2] + PASSIONATE *a.*] Free from passion; calm, dispassionate.

impassionate /ɪm'paʃ(ə)neɪt/ *v.* Now *rare* or *obs.* LI6. [f. IMPASSIONATE *a.*[1]: see -ATE[3].] **1** *v.t.* = IMPASSION. LI6. **†2** *v.i.* Be or become impassioned. Only in M17.

impassioned /ɪm'paʃ(ə)nd/ *a.* Also **†em-**. EI7. [f. IMPASSION + -ED[1].] Filled with passion; deeply moved or excited; passionate, ardent.

M. BARING An ardent naturalist and an impassioned bird's egg collector. P. GAY Erikson's book . . generated some impassioned debates.

TAB 15



TWIN BUTTE ENERGY LTD.

2016

SECOND QUARTER REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of August 11, 2016

INTRODUCTION

The following Management Discussion and Analysis ("MD&A") is management's assessment of Twin Butte Energy Ltd.'s ("Twin Butte" or the "Company") financial and operating results and should be read in conjunction with the message to shareholders and the interim financial statements of the Company for the three and six months ended June 30, 2016 and the audited financial statements and MD&A for the year ended December 31, 2015. This MD&A is presented in Canadian dollars (except where otherwise noted). Additional information relating to the Company, including the Company's Annual Information Form can be found on www.sedar.com.

The Company's principal activity is the acquisition of, exploration for and the development and production of petroleum and natural gas properties in Western Canada.

Basis of Presentation – The reporting and measurement currency is the Canadian dollar.

boe Presentation – Barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion rate of 6 Mcf to 1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in the report are derived by converting gas to oil equivalent barrels at the ratio of six thousand cubic feet of gas to one barrel of oil.

Non-GAAP Financial Measures – Certain measures in this document do not have a standardized meaning as prescribed by IFRS and therefore are considered non-GAAP measures. These measures may not be comparable to similar measures presented by other issuers. These measures have been described and presented in this document in order to provide shareholders and potential investors with additional information regarding the Company's liquidity and its ability to generate funds to finance its operations. Management's reasoning to use the measures, as well as reconciliation to the closest comparable GAAP measure, is detailed in the section entitled, "Non-GAAP Financial Measures".

FORWARD-LOOKING STATEMENTS

Certain statements contained in this MD&A constitute forward-looking information within the meaning of securities laws. Forward-looking information may relate to our future outlook and anticipated events or results and may include statements regarding the future financial position, business strategy, budgets, projected costs, capital expenditures, financial results, taxes and plans and objectives of or involving Twin Butte. Particularly, statements regarding our future operating results and economic performance are forward-looking statements. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts.

These statements are based on certain factors and assumptions regarding expected growth, results of operations, performance and business prospects and opportunities. While we consider these assumptions to be reasonable based on information currently available to us, they may prove to be incorrect.

Forward looking-information is also subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what we currently expect. These factors include risk associated with oil and gas exploration, production, marketing, and transportation such as loss of market, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risk, and competition from other producers and ability to access sufficient capital from internal and external resources. Other than as required under securities laws, we do not undertake to update this information at any particular time.

All statements, other than statements of historical fact, which address activities, events, or developments that Twin Butte expects or anticipates will or may occur in the future, are forward-looking statements within the meaning of applicable securities laws. These statements are subject to certain risks and uncertainties, and may be based on estimates or assumptions that could cause actual results to differ materially from those anticipated or implied.

Further, the forward-looking statements contained in this MD&A are made as of the date hereof, and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, as a result of new information, future events or otherwise, except as may be required by applicable securities laws. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement. Certain risk factors associated with these forward-looking statements include, but are not limited to, the following:

- Fluctuations in natural gas, condensate, NGL's, and crude oil production levels;
- Twin Butte's inability to successfully market its natural gas, condensate, NGL's, and crude oil;
- Lower than expected market prices for natural gas, condensate, NGL's, and crude oil;
- Adverse changes in foreign currency exchange rates and/or interest rates;
- Uncertainties associated with estimating reserves;
- Competition for capital, asset acquisitions, undeveloped lands, and skilled personnel;
- Operational hazards characteristic of the oil and gas industry such as: geological and drilling problems; and well production, pipeline, and mechanical difficulties;
- Lower than envisaged success in the finding and development of reserves and/or higher than expected costs;
- Changes to dividend payment policy or amounts;
- Adverse changes in general economic conditions in Western Canada, Canada more generally, North America or globally;
- Adverse weather conditions;
- The inability of Twin Butte to obtain financing on favorable terms, or at all;
- Adverse impacts from the actions of competitors;
- Adverse impacts of actions taken and/or policies established by governments or regulatory authorities including changes to tax laws, incentive programs, royalty calculations, and environmental laws and regulations; and
- Reliance on natural gas and NGL processing, pipeline, and storage infrastructure not operated by Twin Butte, the availability of which is essential to Twin Butte's sales and marketing activities.

Additional information relating to Twin Butte, including Twin Butte's financial statements can be found on SEDAR at www.sedar.com or the Company's website at www.twinbutteenergy.com.

PETROLEUM AND NATURAL GAS SALES

Twin Butte realized the following sales, production volumes, and commodity prices:

	Three months ended June 30		Six months ended June 30	
	2016	2015	**2016**	2015
Sales *($000s)*				
Medium & light oil	**24,415**	39,950	**41,348**	71,174
Heavy oil	**14,911**	33,831	**23,855**	60,767
Natural gas	**1,085**	2,846	**2,700**	5,807
Natural gas liquids	**369**	691	**725**	1,283
Total petroleum and natural gas sales	**40,780**	77,318	**68,628**	139,031
Average Daily Production				
Medium & light oil (bbl/day)	**6,534**	7,882	**6,820**	8,180
Heavy oil (bbl/day)	**4,612**	7,312	**4,808**	7,893
Natural gas (Mcf/day)	**8,614**	12,189	**9,345**	12,165
Natural gas liquids (bbl/day)	**146**	125	**150**	149
Total (boe/d)	**12,728**	17,351	**13,336**	18,250
% oil and liquids production	**89%**	88%	**88%**	89%
Average Twin Butte Realized Commodity Prices [(1)]				
Medium & light oil ($ per bbl)	**41.06**	55.70	**33.31**	48.07
Heavy oil ($ per bbl)	**35.53**	50.84	**27.26**	42.53
Natural gas ($ per Mcf)	**1.38**	2.57	**1.59**	2.64
Natural gas liquids ($ per bbl)	**27.77**	60.69	**26.60**	47.44
Barrels of oil equivalent ($ per boe, 6:1)	**35.21**	48.97	**28.28**	42.09
Benchmark Pricing				
WTI crude oil (US$ per bbl)	**45.59**	57.94	**39.52**	53.29
Edmonton crude oil (Cdn$ per bbl)	**54.71**	67.63	**47.70**	59.72
WCS crude oil (Cdn$ per bbl)	**41.64**	57.43	**33.99**	50.10
AECO natural gas (Cdn$ per Mcf) [(2)]	**1.33**	2.52	**1.53**	2.56
Exchange rate (US$/Cdn$)	**1.29**	1.23	**1.33**	1.24

(1) The average selling prices reported are before realized derivative instrument gains/losses and transportation charges.

(2) The AECO natural gas price reported is the average daily spot price.

Sales for the three months ended June 30, 2016 were $40.8 million, as compared to $77.3 million for the three months ended June 30, 2015 representing a decrease of $36.5 million or 47%. Both sales volumes and the average realized commodity price decreased from the prior year quarter, resulting in decreased sales. Excluding the impact of derivative instruments, the average realized commodity price decreased from $48.97 in the second quarter of 2015 to $35.21 during the second quarter of 2016. The WCS benchmark decreased 27% from the prior year quarter, due to a 17% decrease in the WTI benchmark, as denominated in Canadian dollars, and the change in WTI to WCS differentials, which widened 24% once exchanged to Canadian dollars.

Production decreased from 17,351 boe/d in the three months ended June 30, 2015 to 12,728 boe/d for the three months ended June 30, 2016. This decrease of 4,623 boe/d is due to expected oil declines, shut-in barrels that are uneconomic in the current pricing environment and reduced drilling. Natural gas sales volumes have also declined from comparative periods due to economically driven shut-ins.

Revenues for the six months ended June 30, 2016 were $68.6 million, as compared to $139.0 million for the six months ended June 30, 2015, representing a decrease of $70.4 million or 51%. This decrease in revenue is attributed to a 27% production decrease and a 33% decrease in realized pricing. Production decreased from 18,250 boe/d in the six months ended June 30,

2015 to 13,336 boe/d in the comparable period in 2016. The average realized commodity price before hedging decreased from $42.09 per boe in the six months ended June 30, 2015 to $28.28 per boe in the comparable period of 2016.

CASH GAIN (LOSS) AND PROCEEDS ON DERIVATIVES

	Three months ended June 30		Six months ended June 30	
(000's except per boe amounts)	**2016**	2015	**2016**	2015
Realized gain (loss) on derivatives	**1,655**	25,334	**5,682**	68,106
Realized gain (loss) on derivatives per boe	**1.43**	16.05	**2.34**	20.62

The Company realized a cash gain on financial derivatives of $1.7 million ($1.43 per boe) for the three months ended June 30, 2016, compared to a cash gain of $25.3 million ($16.05 per boe) for the prior year quarter, due to a reduced volume of barrels hedged. During the quarter, the cash gain was on crude oil sales price derivatives, as compared to a $25.1 million gain on crude oil sales price derivatives, a $0.4 million gain on natural gas sales price derivatives and a $0.2 million loss on foreign exchange contracts in the first quarter of 2015.

The Company realized a cash gain on financial derivatives of $5.7 million ($2.34 per boe) for the six months ended June 30, 2016, compared to a cash gain of $68.1 million ($20.62 per boe) for the prior year period. During the period the cash gain was on crude oil sales price derivatives, as compared to a $67.5 million gain on crude oil sales price derivatives, a $0.9 million gain on natural gas sales price derivatives and a $0.3 million loss on foreign exchange contracts in the comparable period of 2015.

ROYALTIES

	Three months ended June 30		Six months ended June 30	
($000s except per boe amounts)	**2016**	2015	**2016**	2015
Medium & light oil	**2,355**	4,269	**4,635**	7,404
Heavy Oil	**1,507**	3,237	**2,047**	7,243
Natural Gas	**(5)**	97	**23**	124
NGLs	**149**	269	**273**	528
Total Royalties	**4,006**	7,872	**6,978**	15,299
Total royalties per boe	**3.46**	4.99	**2.88**	4.63
% of P&NG Sales	**10%**	10%	**10%**	11%

Royalties for the three months ended June 30, 2016 were $4.0 million, as compared to $7.8 million for the three months ended June 30, 2015. As a percentage of sales, the average royalty rate was consistent at 10% for both the second quarter of 2016 and the second quarter of 2015. Royalties were consistent with the prior year quarter due to decreased benchmark commodity prices and the corresponding provincial royalty calculation input prices in the continuing low price environment. In Q2 2016, medium & light oil royalty rates averaged 10%, heavy oil averaged 10%, and gas averaged nil.

Royalties for the six months ended June 30, 2016 were $7.0 million, as compared to $15.3 million for the six months ended June 30, 2015. Royalties decreased from the prior year period due to decreased benchmark commodity prices and the corresponding provincial royalty calculation input prices. As a percentage of revenues, the average royalty rate for the six months ended June 30, 2016 was 10%, compared to 11% in 2015. In the six months ended June 30, 2016, medium & light oil royalties averaged 11%, heavy oil royalties averaged 9%, and gas averaged 1%.

OPERATING & TRANSPORTATION EXPENSE

	Three months ended June 30		Six months ended June 30	
($000s except per boe amounts)	**2016**	2015	**2016**	2015
Operating expense	**20,901**	29,054	**42,412**	61,590
Transportation expense	**1,089**	1,277	**2,353**	2,932
Total operating & transportation expense	**21,990**	30,331	**44,765**	64,522
Operating expense per boe	**18.04**	18.40	**17.47**	18.65
Transportation expense per boe	**0.94**	0.81	**0.97**	0.89
Total per boe	**18.98**	19.21	**18.44**	19.54

Operating expenses were $20.9 million or $18.04 per boe for the three months ended June 30, 2016 as compared to $29.1 million or $18.40 per boe for the three months ended June 30, 2015. The decrease on an absolute dollar basis is attributable to decreased volumes and a reduced per boe cost. In comparison to the prior year quarter, reductions from reduced water volumes hauled due to new water disposal and handling facilities and reduced service costs were partially offset by upward pressure due to fixed costs spread over lower volumes.

Operating expenses were $42.4 million or $17.47 per boe for the six months ended June 30, 2016, as compared to $61.6 million or $18.65 for the six months ended June 30, 2015. The decrease on an absolute dollar basis is attributable to decreased volumes and a per boe reduction. On a per boe basis, cost decreases are also related to the production mix shift toward additional volumes at lower-cost properties and reduced propane costs.

Transportation expenses for the three months ended June 30, 2016 were $1.1 million or $0.94 per boe, compared to $1.3 million or $0.81 per boe in the prior year comparative quarter. Transportation expenses for the six months ended June 30, 2016 were $2.4 million or $0.97 per boe compared to $2.9 million or $0.89 per boe in the prior year comparative period. Transportation costs are consistent with the prior year periods on a per boe basis due to the variable nature of the costs.

The Company has combined operating and transportation costs of $18.98 per boe for the quarter, a decrease from $19.21 per boe in the second quarter of 2015.

GENERAL AND ADMINISTRATIVE ("G&A") EXPENSES

	Three months ended June 30		Six months ended June 30	
($000s except per boe amounts)	**2016**	2015	**2016**	2015
G&A expense	**4,724**	5,155	**9,366**	11,154
Capitalized G&A expense	**(1,086)**	(1,047)	**(2,028)**	(2,332)
Recoveries	**(233)**	(546)	**(388)**	(1,253)
Total net G&A expense	**3,405**	3,562	**6,950**	7,569
Total net G&A expense per boe	**2.94**	2.26	**2.86**	2.29
Transaction expense	**786**	–	**796**	–
Transaction expense per boe	**0.68**	–	**0.33**	–

General and administrative expenses, net of recoveries and capitalized G&A, were $3.4 million or $2.94 per boe for the three months ended June 30, 2016 as compared to $3.6 million or $2.26 per boe in the prior year comparative quarter. While the Company reduced employee, executive and director compensation in comparison to the second quarter of 2015, the Company incurred increased legal and advisor costs associated with changes to the credit facility and a lower level of drilling activity that reduced G&A recoveries. Net G&A expense for the six months ended June 30, 2016 was $7.0 million or $2.86 per boe, consistent with $7.6 million or $2.29 per boe in the prior year comparative period.

Transaction expense relates to legal and advisor costs attributed Company's strategic alternatives review initiated in December 2015, and the proposed Arrangement, as discussed in the section entitled "Proposed Plan of Arrangement" in this MD&A.

FINANCE EXPENSE

	Three months ended June 30		Six months ended June 30	
(000's except per boe amounts)	**2016**	2015	**2016**	2015
Interest and bank charges	**3,926**	2,577	**8,151**	4,742
Interest on convertible debentures	**1,328**	1,328	**2,656**	2,656
Accretion on convertible debentures	**365**	310	**730**	621
Accretion on decommissioning provision	**989**	1,102	**2,000**	2,190
Total finance expense	**6,608**	5,317	**13,537**	10,209
Total interest per boe	**4.14**	2.47	**4.46**	2.24
Total accretion per boe	**1.07**	0.90	**1.12**	0.85
Total finance expense per boe	**5.21**	3.37	**5.58**	3.09

For the three months ended June 30, 2016, finance charges were $6.6 million as compared to $5.3 million in the three months ended June 30, 2016. This increase is due to increased interest rates on bank debt, which accounted for $1.2 of the increase. For the six months ended June 30, 2016, finance charges also increased and were $13.5 million, as compared to $10.2 million in the prior year comparative period. Increases over the six month period related to $1.1 million in renegotiation and duration fees paid to the bank syndicate, and increased interest rates.

For Q2 2016, the Company's interest charge on the bank line was prime of 2.7% plus a margin of 2.5% to 3.5%, depending on the month, the rate on the term debt averaged 7.2%, and the Company's convertible debentures accrue an interest rate of 6.25% annually. Excluding renegotiation and duration fees, the combined effective interest rate for the three and six months ended June 30, 2016 was 7.3% and 6.8% (5.0% and 4.7% – June 30, 2015).

NETBACKS [(1)]

The following table summarizes netbacks for the past eight quarters on a barrel of oil equivalent basis:

($ per boe)	**Q2 2016**	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014
Petroleum and natural gas sales	**35.21**	21.95	31.79	37.72	48.97	35.79	58.64	74.13
Cash gain (loss) on financial derivatives	**1.43**	3.17	17.36	13.24	16.05	24.81	4.87	(6.26)
Royalties	**(3.46)**	(2.34)	(2.04)	(4.58)	(4.99)	(4.31)	(8.92)	(14.98)
Operating expense	**(18.04)**	(16.95)	(19.18)	(19.23)	(18.40)	(18.87)	(20.89)	(20.01)
Transportation expense	**(0.94)**	(1.00)	(0.91)	(0.92)	(0.81)	(0.96)	(1.09)	(1.17)
Operating netback [(1)]	**14.20**	4.83	27.02	26.23	40.82	36.46	32.61	31.71
General and administrative expense	**(2.94)**	(2.79)	(1.62)	(2.21)	(2.26)	(2.32)	(1.68)	(1.74)
Transaction costs	**(0.68)**	(0.01)	(0.07)	–	–	–	–	–
Interest and bank charges	**(4.54)**	(4.38)	(2.16)	(2.12)	(2.47)	(2.03)	(2.03)	(2.15)
Funds flow netback [(1)]	**6.04**	(2.35)	23.17	21.90	36.09	32.11	28.90	27.82

(1) Operating netback and Funds flow netback are non-GAAP measures. Refer to "Non-GAAP Measures" in this MD&A for further discussion and reconciliation to GAAP measures if applicable.

Due to a reduced level of hedging, continuing low sales prices, and increased interest rates and charges on outstanding debt, the Company's funds flow netback in Q2 2016 was low in comparison to historical levels.

SHARE-BASED PAYMENT EXPENSE

	Three months ended June 30		Six months ended June 30	
($000s except per boe amounts)	**2016**	2015	**2016**	2015
Share-based payment expense	**3,819**	1,186	**4,730**	2,618
Share-based payment expense per boe	**3.01**	0.75	**1.95**	0.79

During the three months ended June 30, 2016, the Company expensed $3.8 million in share-based payment expense, an increase from $1.2 million in the three months ended June 30, 2015. Share-based payment expense for the quarter includes $3.0 million related to unvested awards that will accelerate and vest upon closing of the proposed Arrangement. During the six months ended June 30, 2016, the Company expensed $4.7 million in share-based payment expense as compared to $2.6 million in the six months ended June 30, 2015.

The Company awarded 1,080,050 share awards in the second quarter of 2016 as compared to 316,700 share awards and 266,048 performance share awards in the second quarter of 2015. Total share awards forfeited due to employee departures were 569,489 in the quarter versus 599,331 awards forfeited in the second quarter last year.

At June 30, 2016, the Company has 15,145,625 restricted share awards, 8,714,289 performance share awards and 120,000 options outstanding. The total of these share awards and options represents 7% of common shares outstanding.

UNREALIZED DERIVATIVE ACTIVITIES

	Three months ended June 30		Six months ended June 30	
(000's except per boe amounts)	**2016**	2015	**2016**	2015
Unrealized gain (loss) on derivatives	**(2,610)**	(45,859)	**(5,417)**	(90,171)
Unrealized gain (loss) on derivatives per boe	**(2.06)**	(29.04)	**(2.23)**	(27.30)

As part of the financial management strategy, the Company has adopted a commodity price risk management program with the aim of stabilizing future cash flow against the unpredictable commodity price environment and an emphasis on protecting downside risk. Due to bank syndicate restrictions, the Company is not currently permitted to enter into any new derivative contracts.

With derivative instruments there is a risk that the counterparty could become illiquid or that Twin Butte may not have the actual sales volumes to offset the hedge position. To manage risk, the Company's counterparties on derivative instruments are major Canadian and international banks and the Company limits the maximum volumes hedged in relation to expected production.

The Company also enters into fixed price power swaps in order to stabilize future operating costs. As power costs make up a significant percentage of operating expense in the Provost region, these contracts assist the Company in maintaining consistent and low operating costs in these areas. Current contracts are for approximately 88% of estimated power usage in 2016, and 60% in 2017.

Unrealized derivative assets and liabilities

As at June 30, 2016, the Company has a net unrealized financial derivative asset in the amount of $1.7 million, as compared to an asset of $7.1 million at December 31, 2015. This net unrealized asset position reflects hedges priced higher than the strip oil pricing for 2016. If WTI prices meet the current forecasted benchmarks these gain positions would be realized, somewhat offsetting decreased sales due to the weak commodity pricing.

As the net unrealized financial derivative asset has decreased over the periods due to the settlement of realized derivative gains in Q1 and Q2, the Company has recognized an unrealized loss for the three and six months ended June 30, 2016. This unrealized loss totaled $2.6 million for the three months ended June 30, 2016 as compared to $45.9 million for the prior year comparative quarter. For the six months ended June 30, 2016, the unrealized loss was $5.4 million, compared to $90.2 million in the prior year comparative period.

The following is a summary of derivatives as at June 30, 2016 and their related fair market values (unrealized gain (loss) positions):

Crude Oil Sales Price Derivatives

Daily barrel (bbl) quantity	Term of contract		WTI[1] Fixed price per bbl	Fixed price per bbl WCS [2] vs. WTI [1]	Fixed written call price per bbl WTI [1]	Fair market value *$000s* ($CAD)
1,000	January 1, 2016 to December 31, 2016	$CAD	$ 85.00			3,757
5,500	January 1, 2016 to December 31, 2016	$CAD		$ (18.61)		(430)
1,000	January 1, 2017 to December 31, 2017	$USD		$ (13.30)		662
1,000	January 1, 2017 to December 31, 2017	$CAD			$ 85.00	(1,054)
Crude oil fair value position at June 30, 2016						**2,935**

(1) WTI represents posting price of West Texas Intermediate oil

(2) WCS represents the posting price of Western Canadian Select oil

Power Purchase Price Derivatives

Daily Megawatt (MW) hours quantity	Term of contract	Fixed price per MW	Fair Market Value *$000s*
384	January 1, 2016 to December 31, 2016	$ 45.48	(847)
264	January 1, 2017 to December 31, 2017	$ 41.28	(360)
Power purchase contract fair value position at June 30, 2016			(1,207)

DEPLETION, DEPRECIATION & IMPAIRMENT

	Three months ended June 30		Six months ended June 30	
($000s except per boe amounts)	**2016**	2015	**2016**	2015
Depletion & Depreciation	**18,410**	33,030	**38,119**	70,227
Depletion & Depreciation per boe	**14.51**	20.91	**15.71**	21.26

For the three months ended June 30, 2016, depletion and depreciation of capital assets was $18.4 million or $14.51 per boe compared to $33.0 million or $20.91 per boe for the prior year quarter. The total decrease relates to declining production and lower depletion rates for all cost generating units (CGUs), following impairment in 2015. The decrease on a per boe basis is also due to 2015 impairment and resulting lower depletion rates.

For the six months ended June 30, 2016, depletion and depreciation of capital assets was $38.1 million, or $15.71 per boe, compared to $70.2 million or $21.26 per boe in the prior year comparative period.

At June 30, 2016, the Company assessed for indicators of impairment for all of its CGUs. Following the announced plan of Arrangement, the Company determined that the value implied by the Arrangement indicated asset impairment. Twin Butte estimated the recoverable amount of each of the CGUs based on the fair value less costs of disposal of the entity. Based on the assessment, the after-tax recoverable amount did not exceed the carrying value of the South East Medium, Heavy Oil, Plains, West-Central and Pincher Creek CGUs and the total non-cash pre-tax impairment charge at June 30, 2015 was $138.2 million ($138.2 million after tax).

GAIN OR LOSS ON DISPOSITIONS

During the six months ended June 30, 2016, Twin Butte completed non-core PP&E and E&E asset dispositions for net proceeds of $0.1 million ($0.3 million – June 30, 2015). A $0.7 million loss was recognized on these transactions ($0.7 million gain – June 30, 2015). E&E acquisitions and purchases during the six months ended June 30, 2016 include a non-cash addition to E&E of $1.3 million for lands acquired at the cost of assuming decommissioning liabilities associated with $nil value PP&E assets.

INCOME TAXES

Deferred tax amounted to $nil for the three months ended June 30, 2016 compared to $7.8 million recovery for the three months ended June 30, 2015. In the six months ended June 30, 2016, deferred tax amounted $nil, as compared to a $14.8 million recovery in the prior year. The $nil result is due to an allowance taken on the change in the net deferred tax asset.

In 2015 the Company received a letter from the Canada Revenue Agency ("CRA") proposing to reassess the Company's income tax filings related to Scientific Research and Experimental Development ("SR&ED") tax deductions utilized in 2011 by a predecessor of the Company, and in 2014 by the Company, and certain non-capital losses. Subsequent to June 30, 2016, the Company received notices of reassessment for the 2011, 2014 and 2015 taxation years, disallowing the SR&ED deductions, certain non-capital losses and resulting in $5.9 million of taxes payable for the 2015 tax year. These disallowed amounts would be deductible, and any taxes paid refundable, on a successful appeal of the reassessments.

Twin Butte's management remains of the opinion that, after careful consideration and consultation at the time of the deductions and at this time, Twin Butte's tax returns were correct as filed and the Company has not recorded a liability for the reassessments. Twin Butte's management will vigorously defend the Company's tax filing position, and will be required to deposit 50% of the taxes payable when filing the objection.

NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

	Three months ended June 30		Six months ended June 30	
($000s except per share amounts)	**2016**	2015	**2016**	2015
Net Income (loss)	**(171,852)**	(23,290)	**(200,292)**	(45,737)
Net Income (loss) per share	**(0.48)**	(0.07)	**(0.56)**	(0.13)

Net and comprehensive income for the three months ended June 30, 2016 was a net and comprehensive loss of $171.9 million, compared to net and comprehensive loss of $23.3 million in the three months ended June 30, 2015. The net loss in the quarter is mainly due to impairments, additional interest charges and the current commodity environment, which significantly reduced sales revenue. Net and comprehensive income for the six months ended June 30, 2016 was a net loss of $200.3 million, compared to a net loss of $45.7 million in the prior year comparative period. The net loss in the current year is also mainly due to impairments, interest and the current commodity environment.

QUARTERLY FINANCIAL SUMMARY

The following table highlights Twin Butte's performance for each of the past eight quarters:

($000s except per share amounts)	**Q2 2016**	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014
Average production (boe/d)	**12,728**	13,944	15,444	16,303	17,351	19,158	20,430	20,981
Petroleum and natural gas sales	**40,780**	27,847	45,162	56,577	77,318	61,713	110,219	143,088
Operating netback (per boe) [(1)]	**14.20**	4.83	27.02	26.23	40.82	36.46	32.61	31.71
Funds flow [(1)]	**6,994**	(2,980)	32,923	32,851	56,982	55,367	54,324	53,699
Per share basic	**0.02**	(0.01)	0.09	0.09	0.16	0.16	0.16	0.15
Per share diluted	**0.02**	(0.01)	0.09	0.09	0.16	0.16	0.16	0.15
Net income (loss)	**(171,852)**	(28,440)	(249,252)	(41,943)	(23,290)	(22,447)	(84,086)	34,805
Per share basic	**(0.48)**	(0.08)	(0.70)	(0.12)	(0.07)	(0.06)	(0.24)	0.10
Per share diluted	**(0.48)**	(0.08)	(0.70)	(0.12)	(0.07)	(0.06)	(0.24)	0.10
Capital expenditures [(1)]	**3,463**	2,763	9,402	26,583	17,012	25,042	34,128	43,884
Total assets	**356,959**	526,627	563,332	862,128	925,847	989,878	1,043,249	1,150,834
Net debt [(1)]	**290,873**	293,987	287,874	308,370	307,672	333,916	353,299	355,918

(1) Operating netback, Funds flow, Corporate acquisitions, Capital expenditures and Net debt are non-GAAP measures. Refer to "Non-GAAP Measures" in this MD&A for further discussion and reconciliation to GAAP measures if applicable.

Quarterly variances in sales are connected to changes in production volumes and prices. In Q3 2014 high production, changes in the Company's production mix and strong commodity prices resulted in significantly increased sales. Reduced commodity prices and declining production since Q4 2014 have since decreased quarterly sales throughout 2015 and into Q1 and Q2 2016.

Through its strategy to protect cash flows, Twin Butte aims to hedge a percentage of production using financial derivatives. As such, commodity price swings in oil can have a moderated effect on funds flow from operations, as only current quarter realized cash gains or losses are included. In Q3 through Q4 2014, funds flow increased each quarter due to higher netbacks on Provost properties and cost savings. In the first half of 2015, significant hedging gains and operating cost reductions resulted in record funds flow. Although hedging levels were lower in the second half of 2015, gains from hedging contributed significantly to funds flow in Q3 and Q4 2015. In Q1 2016, due to further reduced hedging levels, lower sales revenues, and additional bank fees, funds flow was negative. A modest price recovery led to positive cash flow in Q2 2016.

Quarterly variances in net income, however, are largely driven by non-cash items, such as impairments, unrealized gains or losses on derivatives, deferred tax expense or recovery, and gains or losses on asset acquisitions and dispositions. In Q3 2014 net income was due to unrealized gains on derivatives and gains on the sale of non-core assets. In Q4 2014, the net loss was related to impairment losses, which offset unrealized gains on derivatives. In Q1 and Q2 2015 as gains on derivatives were recognized in income in 2014, the current commodity price environment contributed to a net loss. Impairments and the current commodity price environment resulted in the losses in Q3 2015 and Q4 2015. In Q1 2016, the net loss was driven by negative funds flow, unrealized losses on derivatives and losses on disposition. Again in Q2 2016, Impairments on PP&E and E&E resulted in a net loss.

FUNDS FLOW FROM OPERATIONS [1]

Funds flow from operations ("Funds Flow") is a non-GAAP measure. Refer to "Non-GAAP Measures" in this MD&A for further discussion and reconciliation to GAAP measures. Twin Butte considers Funds Flow a key measure of performance as it demonstrates the Company's ability to generate cash flow.

	Three months ended June 30		Six months ended June 30	
(000's except per share amounts)	**2016**	2015	**2016**	2015
Funds flow [1]	**6,994**	59,982	**4,014**	112,349
Funds flow per share	**0.02**	0.16	**0.01**	0.32

(1) Funds flow is a non-GAAP measure. Refer to "Non-GAAP Measures" in this MD&A for further discussion and reconciliation to GAAP measures if applicable.

Funds flow from operations for the three months ended June 30, 2016 was $7.0 million, a decrease from second quarter 2015 funds flow of $60.0 million, due to the current commodity price environment, reduced hedging levels and additional finance costs. This represents $0.02 per diluted share compared to $0.16 per diluted share in 2015. Funds flow from operations for the six months ended June 30, 2016 were $4.0 million, a decrease from funds flow of $112.3 million in the comparable period of 2015, also due to the current commodity price environment, reduced hedging levels and increased finance costs. This represents $0.01 per diluted share compared to $0.32 per diluted share for in 2015, due to decreased funds flow over a comparable number of shares.

CAPITAL EXPENDITURES

	Three months ended June 30		Six months ended June 30	
($000s)	**2016**	2015	**2016**	2015
Land acquisition	**49**	261	**258**	1,034
Geological and geophysical	**22**	235	**60**	666
Drilling and completions	**980**	5,614	**1,722**	19,340
Equipping and facilities	**1,327**	8,855	**2,138**	17,820
Other	**1,086**	2,172	**2,138**	3,456
Development capital [1]	**3,464**	17,137	**6,316**	42,316
Property dispositions - Cash received	**(1)**	(125)	**(90)**	(262)
Capital expenditures [1]	**3,463**	17,012	**6,226**	42,054

(1) Development capital and Capital expenditures are non-GAAP measures. Refer to "Non-GAAP Measures" in this MD&A for further discussion and reconciliation to GAAP measures if applicable.

During the second quarter of 2016, the Company invested $3.5 million on development capital, a decrease from $17.1 million in development capital invested in Q2 2015. As only one well was drilled in the quarter, the Company's development capital expenditures for the quarter mainly consisted of site preparation and recompletion costs.

For the six months ended June 30, 2016, the Company invested $6.3 million on development capital, a decrease from $42.3 million in the comparable period of 2015. Proceeds from property dispositions in 2016 totaled $0.1 million, compared to $0.3 million in the six months ended June 30, 2015.

Drilling Results

In the three and six months ended June 30, 2016, the Company drilled 1.0 (1.0 net) well, as compared to 6 (6.0 net) and 23 (23.0 net) wells in the three and six months ended June 30, 2015.

Undeveloped Land

The Company's net undeveloped land holdings have decreased from 247,096 acres as at December 31, 2015 to 209,403 acres on June 30, 2016, as reductions from dispositions and expiries were greater than purchases.

PROPOSED PLAN OF ARRANGEMENT

On June 24, 2016, Twin Butte entered into a plan of arrangement (the "Arrangement") with Reignwood Resources Holding Pte. Ltd. (the "Purchaser") and Reignwood Resources Trading UK Limited (the "Acquiror"). Pursuant to the proposed Arrangement, the Purchaser agreed to acquire: i) all of the outstanding common shares of Twin Butte for cash consideration of $0.06 per share and ii) all of the outstanding 6.25% convertible unsecured subordinated debentures for cash consideration of $140 per $1,000 principal amount of debentures plus accrued and unpaid interest.

The Transaction requires shareholder and debentureholder ("Securityholders") approval, and is subject to various closing conditions, including receipt of Court approval and regulatory approvals under the Investment Canada Act (Canada) and the Competition Act (Canada). Review under the Investment Canada Act is on-going. Approval of the Arrangement under the Competition Act (Canada) was received on July 29, 2016.

Subsequent to the end of the second quarter, the Twin Butte special meeting was postponed from August 10, 2016 to August 29, 2016 to allow Securityholders time to properly take into account the information provided in the August 9, 2016 fairness opinion for debentureholders. In connection with the postponement of the meeting and related matters, Twin Butte has entered into an amending agreement with the Purchaser to postpone the meeting, without the consent of Twin Butte's lenders under its credit agreement. Failure to obtain such consent to the amending agreement is an event of default under Twin Butte's credit agreement. Twin Butte is seeking waivers from its lending syndicate for the entering into of the amending agreement. There are no assurances that the lenders will consent to the amending agreement, agree to any necessary waivers or refrain from exercising any rights or remedies they have, including accelerating the repayment of the Company's outstanding bank debt and enforcing their security by appointing a receiver to liquidate the Company's assets and manage the Company's affairs. In such events, the Arrangement will be terminated.

LIQUIDITY AND CAPITAL RESOURCES

The Company also evaluates its ability to carry on business as a going concern on a quarterly basis, with the key indicator being whether the non-GAAP measure, funds flow from operations, will be sufficient over time to cover all obligations, specifically the non-GAAP measure of net debt. Twin Butte considers these measures and the related ratio to be key measures of liquidity and the management of capital resources.

	Three months ended June 30		Six months ended June 30	
(000's)	**2016**	2015	**2016**	2015
Funds flow [1]	**6,994**	56,982	**4,014**	112,349
Annualized funds flow [1]	**27,976**	227,928	**8,028**	224,698
Net debt [1]	**290,873**	307,672	**290,873**	307,672
Net debt to annualized funds flow [1]	**10.4**	1.3	**36.2**	1.4

(1) Funds flow, Annualized funds flow and Net debt are non-GAAP measures. Refer to "Non-GAAP Measures" in this MD&A for further discussion and reconciliation to GAAP measures if applicable.

For the six months ended June 30, 2016, the net debt to annualized funds flow ratio was 36.2 (1.4 – June 30, 2015). Based on net debt of $290.9 million at June 30, 2016 and forecasted annual funds flow for 2016 at current benchmark oil pricing, the Company expects the net debt to annualized funds flow ratio to remain high in 2016.

The Company reviews capital expenditures on an on-going basis to ensure that funds flow will provide adequate funding. In cases such as the current commodity price environment, where funds flow may not be adequate to provide funding for capital expenditures, the Company will adjust capital expenditures to manage debt levels.

In the management of capital, the Company includes working capital and net debt in the definition of capital. The Company's share capital is not subject to external restrictions; however, its credit facility value is based primarily on its petroleum and natural gas reserves and covenants detailed below. The Company confirms there are no off-balance sheet financing arrangements.

Net Debt

At June 30, 2016, the Company's net debt of $290,873 million consisted of $203.6 million drawn on its revolving and term debt credit facility, a working capital deficit of $6.3 million and $81.0 million of convertible debentures. During the six months ended June 30, 2016, Net Debt increased by $3.0 million, due to the combination of low funds flow and minimal capital and decommissioning provision expenditures.

Going Concern

As described in Note 2 to the annual financial statements as at and for the year ended December 31, 2015, circumstances existed that resulted in material uncertainty surrounding the Company's ability to continue as a going concern and lend significant doubt as to the ability of the Company to meet its obligations as they become due and, accordingly the appropriateness of the use of accounting principles applicable to a going concern. The Plan of Arrangement described above is intended to address these uncertainties, if approved by Securityholders and Investment Canada, and provided the Company is able to obtain a waiver from the banking syndicate for failure to obtain consent to postpone the annual and special meeting of securityholders to August 29, 2016.

However, if the Company is unable to obtain the waiver for failure to obtain consent, or if final approval by the Securityholders or under the Investment Canada Act is not obtained, material uncertainty as to the Company's ability to continue as a going concern and meet its obligations as they become due would continue to exist. As such, the Company includes a note on going concern uncertainty in its financial statements.

Credit Facility

On January 15, 2016, the Company completed the semi-annual borrowing base review which reduced the borrowing base for the revolving line of credit from $275 million to $140 million, and established a term loan of $85 million payable on April 30, 2016, which after multiple extensions was ultimately extended to June 23, 2016. During the quarter, the expiry of the revolving period of the Company's $140 million revolving line of credit was also extended to June 23, 2016.

On June 23, 2016, to enable the Company to complete the Arrangement, Twin Butte entered into a forbearance and amending agreement to the existing credit agreement with its bank syndicate in connection with the Company's failure to repay the $85 million non-revolving credit facility on June 23, 2016, which constituted an event of default under the Company's credit agreement. This forbearance and amending agreement also extended the revolving period of the Company's $140 million revolving credit facility from June 23, 2016 to the earlier of closing of the Transaction and termination of the Arrangement Agreement. The bank syndicate agreed to forbear from exercising its rights and remedies related thereto and to any non-payment of interest on the outstanding Convertible Debentures until the earlier of closing of the Transaction, subject to certain milestones being met in accordance with the forbearance and amending agreement, and termination of the Arrangement Agreement. On August 9, 2016, without the consent of Twin Butte's lenders under its credit agreement, Twin Butte entered into an amending agreement with the Purchaser to postpone the annual and special Securityholders meeting. Failure to obtain such consent to the amending agreement is an event of default under Twin Butte's credit agreement. Twin Butte is seeking waivers from its lending syndicate for the entering into of the amending agreement. There are no assurances that the lenders will consent to the amending agreement, agree to any necessary waivers or refrain from exercising any rights or remedies they have, including accelerating the repayment of the Company's outstanding bank debt and enforcing their security by appointing a receiver to liquidate the Company's assets and manage the Company's affairs.

The $140 million revolving bank facility consists of a revolving line of credit of $115 million and an operating line of credit of $25 million, and was limited to $134 million as of June 30, 2016. The revolving bank facility has been presented as current due to the June 23, 2016 forbearance and amending agreement.

For the six months ended June 30, 2016, Interest rates for the revolving facility were set at the prime rate plus 2.5% or 3.5%, depending on the month. Interest rates for the term loan were set at prime plus 6.0% in January, increasing to prime plus 9.25% by the end of April, and reduced to 5.2% in May. The convertible debentures accrue 6.25% interest annually. After removing $1.1 million in additional fees paid to the syndicate during the first quarter, the effective interest rate on the total of bank indebtedness and convertible debentures for the three and six months ended June 30, 2016 was 7.3% and 6.8% (June 30, 2015 – 5.0% and 4.7%).

The Company is also subject to certain non-financial covenants including monthly reporting, Arrangement requirements, permitted dispositions and permitted encumbrances. The Company's revolving credit facility also contains standard commercial financial covenants for facilities of this nature, including a requirement for Twin Butte to maintain an adjusted current ratio of not less than 1.0:1.0, which includes the undrawn portion of the credit facility as a current asset. Although bank syndicate restrictions currently prevent the Company from entering into new derivative contracts, the facility also contains a covenant that limits financial commodity agreements to less than 80% of the average daily production of the prior quarter at the time the commodity agreement is signed. As commodity agreements extend beyond 12 months, the maximum percentage decreases to 70%, and then to 60% for those agreements with terms greater than 24 months. Non-commodity financial instruments, such as power and currency agreements, are required by covenant to have a maximum term of 36 months, and aggregate amounts hedged must not be more than 60% of the facility's borrowing base. At June 30, 2016, with the exception of the default covered by the June 23, 2016 forbearance and amending agreement, the Company is in compliance with all remaining covenants. On August 9, 2016, the Company defaulted on the forbearance and amending agreement by failing to obtain consent for an amending agreement with the Purchaser to move the annual and special securityholders meeting.

Convertible Debentures

In December 2013, the Company issued convertible unsecured subordinated debentures for gross proceeds of $85.0 million ($81.4 million net of issuance costs) at a price of $1,000 per debenture. The debentures pay interest at a rate of 6.25% per annum, payable in arrears on a semi-annual basis on June 30 and December 31 of each year. Per the June 23, 2016 amending and forbearance agreement, the Company is required to defer the interest payment scheduled for June 30, 2016. The interest payment, including accrued and unpaid interest up to the closing date, will be paid if the Arrangement closes successfully. The debentures mature on December 31, 2018. As at June 30, 2016, no conversions or redemptions have occurred.

SHARE CAPITAL

In the second quarter of 2016, 0.1 million shares were issued on account of vested share and performance share awards that were exercised, compared to 0.5 million shares issued on account of share awards in the second quarter of 2015.

As of August 11, 2016 the Company has 354,847,889 Common Shares, 120,000 stock options and 23,859,914 share awards, including reinvested dividends and performance multipliers, outstanding.

CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The Company enters into short term contractual obligations in the normal course of business, including purchase of assets and services, operating agreements, transportation commitments, sales commitments, royalty obligations, lease rental obligations and employee agreements. These obligations are of a recurring, consistent nature and impact cash flows in an ongoing manner.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS ARE AS FOLLOWS:

As at June 30, 2016	Less than one year	One to three years	Three to five years	Total
Crude oil derivative liability	1,984	707	–	2,691
Bank indebtedness - principal [1]	203,628	–	–	203,628
Bank indebtedness - interest	1,361	–	–	1,361
Convertible debentures - principal [2]	–	85,000	–	85,000
Convertible debentures - coupon [3]	7,969	7,969	–	15,938
Purchase obligations [4]	5,186	2,005	–	7,191
Other [5]	1,621	1,641	–	3,262
	221,749	97,322	–	319,071

(1) Repayment of this principal amount in one to three years is based on the June 23, 2016 amending and forbearance agreement and does not consider the potential approval of the Arrangement or potential credit facilities in place following the close of the Arrangement.

(2) Repayment of the Convertible Debentures assumes that all holders of the debentures will not convert their holdings into shares, and does not consider the potential approval of the Arrangement and cash consideration of $140 per $1000 principal of debentures as per the proposed Arrangement.

(3) Payment of the coupon on the convertible debentures is currently restricted by the June 23, 2016 forbearance and amending agreement. Further interest shown here does not consider the forbearance agreement or potential approval of the Arrangement.

(4) Purchase obligations are contracts to purchase and consume electricity during 2016 and 2017. The fair value of these contracts is recorded as a financial liability on the Company's balance sheet.

(5) Other includes contractual obligations and commitments for office rent and equipment.

Twin Butte also has long-term contractual obligations and commitments. The Company is responsible for the retirement of long-lived assets related to its oil and gas properties at the end of their useful lives. Twin Butte has recognized a liability of $199.2 million (December 31, 2015 – $202.7 million) based on current legislation and estimated costs. Actual costs may differ from those estimated due to changes in legislation or actual costs.

If the Arrangement is approved and closed successfully, the Company has contingent payments of $4.3 million, including $1.0 million due to executives under contractual change of control provisions.

RELATED PARTY TRANSACTIONS

During the three months ended June 30, 2016, the Company incurred related party costs totaling $0.7 million ($0.5 million – June 30, 2015) for oilfield services and legal counsel rendered by three companies of which a director of Twin Butte is a director. During the six months ended June 30, 2016, the Company incurred related party costs totaling $0.9 million ($1.5 million – June 30, 2015).

These costs were incurred in the normal course of business and were recorded at the amount exchanged between the parties. As at June 30, 2016, the Company had $0.3 million ($0.5 million – December 31, 2015) included in accounts payable and accrued liabilities related to these transactions.

SUBSEQUENT EVENTS

Proposed Arrangement

On August 9, 2016 the Special and Annual General Meeting for the Company's shareholders and debentureholders to vote on the Arrangement was moved from August 10, 2016 to August 29, 2016 to allow Securityholders time to properly take into account the information provided in the August 9, 2016 fairness opinion for debentureholders. In connection with the postponement of the meeting, Twin Butte has entered into an amending agreement to the arrangement agreement with the Purchaser to postpone the meeting, without the consent of Twin Butte's lenders under its credit agreement. Failure to obtain such consent to the amending agreement is an event of default under Twin Butte's credit agreement. Although Twin Butte is seeking waivers from its lending syndicate for the entering into of the amending agreement, there are no assurances that the lenders will consent to the amending agreement, agree to any necessary waivers or refrain from exercising any rights or remedies they have, including accelerating the repayment of the Company's outstanding bank debt and enforcing their

security by appointing a receiver to liquidate the Company's assets and manage the Company's affairs. In such events, the Arrangement will be terminated.

Tax Reassessments

On August 8, 2016 the Company received reassessments for the 2011, 2014 and 2015 taxation years, resulting in $5.9 million of cash taxes owing. Twin Butte's management remains of the opinion that Twin Butte's tax returns were correct as filed and the Company has not recorded a liability for the reassessments. See Income Taxes in this MD&A.

NON-GAAP FINANCIAL MEASURES

Certain measures in this document do not have a standardized meaning as prescribed by IFRS and therefore are considered non-GAAP measures. These measures may not be comparable to similar measures presented by other issuers. These measures have been described and presented in this document in order to provide shareholders and potential investors with additional information regarding the Company's liquidity and its ability to generate funds to finance its operations. Management's reasoning to use the measures, as well as reconciliation to the closest comparable GAAP measure, is detailed below.

Funds Flow, Funds Flow Netback and Funds Flow - Annualized

Twin Butte uses the term "Funds Flow" and its derivatives, "Funds Flow Netback" and "Funds flow – Annualized" as indicators of financial performance, but the terms should not be considered an alternative to, or more meaningful than the closest comparable GAAP measure, "Cash provided by (used in) Operating Activities" as disclosed on the Statement of Cash Flows in the attached financial statements. Funds flow is presented in the Company's MD&A to assist management and investors in analyzing operating performance in the stated period. A reconciliation of Funds Flow to the Cash provided by (used in) Operating Activities is as follows:

	Three months ended June 30		Six months ended June 30	
(000's except per boe amounts)	**2016**	2015	**2016**	2015
Cash provided by (used in) Operating Activities	**9,173**	54,830	**16,203**	102,538
Expenditures on decommissioning provision	**157**	1,508	**267**	1,984
Change in non-cash operating working capital	**(2,336)**	644	**(12,456)**	7,827
Funds flow	**6,994**	56,982	**4,014**	112,349
Total boe in the period *(000's)*	**1,158**	1,579	**2,427**	3,303
Funds flow netback ($/boe)	**6.04**	36.09	**1.65**	34.01
Annualizing factor	**4.0**	4.0	**2.0**	2.0
Funds flow - Annualized	**27,976**	227,928	**8,028**	224,698

Net Debt

Twin Butte uses the term "Net Debt" as an indicator of financial performance and it is presented in the Company's MD&A and Financial Statements to assist management and investors in analyzing total cash-based obligations in the stated period. A reconciliation of Net Debt to the Balance Sheet is as follows:

(000's except per share amounts)	**June 30, 2016**	December 31, 2015
Bank Indebtedness	**203,628**	205,078
Convertible debentures	**80,967**	80,237
Working Capital Deficit	**6,278**	2,559
Net Debt	**290,873**	287,874

Working Capital Deficit

Twin Butte uses the term "Working Capital Deficit" as an indicator of financial performance. This term is presented in the Company's MD&A and Financial Statements to assist management and investors in analyzing net working capital amounts in the stated period. A reconciliation of Working Capital Deficit to the Balance Sheet is as follows:

(000's except per share amounts)	**June 30, 2016**	December 31, 2015
Accounts receivable	**(20,300)**	(28,598)
Deposits and prepaid expenses	**(1,860)**	(3,696)
Accounts payable and accrued liabilities	**28,438**	34,853
Dividend Payable	**–**	–
Working capital deficit (surplus)	**6,278**	2,559

Net debt to funds flow - annualized

"Net debt to funds flow - annualized" is a non-GAAP measure defined as the ratio of Net debt to Funds flow – annualized. Twin Butte uses this term to monitor whether funds flow from operations will be sufficient to cover all obligations, specifically the non-GAAP measure of net debt. Twin Butte considers this ratio to be a key measure of liquidity and management of capital resources.

Operating netback, Field netback and Funds flow netback

"Operating netback", "Field netback" and "Funds flow netback" are common metrics used in the oil and gas industry and are presented in the Company's MD&A to assist management and investors to evaluate oil and gas operating performance in the stated period. As they are industry specific terms, there is no comparable GAAP measure.

Operating Netback is determined as the sum of Petroleum and natural gas sales, Royalties, Operating Expense, and Transportation Expense as defined on the Statement of Income (Loss) and Comprehensive Income (Loss), and the Realized Gain (Loss) on financial instruments per note 5 to the financial statements, all on a per unit basis. Field netback is the operating netback, excluding the realized gain (loss) on financial instruments on a per-unit basis. Funds flow netback is the operating netback, plus general and administrative expense and transaction costs per the Statement of Income (Loss) and Comprehensive Income (Loss), and interest paid per the Statement of Cash Flows on a per-unit basis. Total units (boe) and each of the per-unit line items referenced above are also defined in the related sections of this MD&A.

Capital Expenditures and Development Capital

Management uses the Non-GAAP measures "Capital expenditures" and "Development Capital" in its analysis of cash used in investing activities. Capital expenditures and Development Capital are reconciled to GAAP measures, as defined on the Statement of Cash flows in the attached financial statements, below:

	Three months ended June 30		Six months ended June 30	
(000's)	**2016**	2015	**2016**	2015
Expenditures on property and equipment	**(3,405)**	(16,576)	**(6,026)**	(40,548)
Expenditures on exploration and evaluation assets	**(59)**	(561)	**(290)**	(1,768)
Development capital	**(3,464)**	(17,137)	**(6,316)**	(42,316)
Proceeds on disposition of property and equipment	**27**	–	**32**	–
Proceeds on disposition of exploration and evaluation assets	**(26)**	125	**58**	262
Capital expenditures	**(3,463)**	(17,012)	**(6,226)**	(42,054)

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates, and differences could be material. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Estimates and assumptions

Information about significant areas of estimation uncertainty in applying accounting policies that have the most significant effect on the amounts recognized in the interim financial statements for the three and six months ended June 30, 2016 is included in the following annual notes to the audited Financial Statements for the year ended December 31, 2015:

- Note 5 – valuation of financial instruments;
- Note 8 – valuation of property and equipment;
- Note 11 – measurement of decommissioning provision;
- Note 12 – measurement of share-based compensation; and
- Note 17 – income tax expense.

Judgements

In the process of applying the Company's accounting policies, management makes judgements, apart from those involving estimates, which may have a significant effect on the amounts recognized in the financial statements. Management's areas of judgement have not significantly changed from the annual financial statements for the year ended December 31, 2015.

Significant Accounting Policies

During the three and six months ended June 30, 2016, the Company has not adopted any new or revised standards. A description of standards and interpretations that will be adopted by the Company in future periods in disclosed in note 3 of the annual financial statements for the year ended December 31, 2015. The accounting policies followed in the condensed interim financial statements are consistent with those of the previous year with the exception of income tax expense. Income tax expense for an interim period is based on an estimated annual average effective income tax rate.

ASSESSMENT OF BUSINESS RISKS

The following are the primary risks associated with the business of Twin Butte. These risks are similar to those affecting other companies competing in the conventional oil and natural gas sector. Twin Butte's financial position and results of operations are directly impacted by these factors and include:

Operational risk associated with the production of oil and natural gas:

- Reserve risk in respect to the quantity and quality of recoverable reserves;
- Exploration and development risk of being able to add new reserves economically;
- Market risk relating to the availability of transportation systems to move the product to market;
- Commodity risk as crude oil and natural gas prices fluctuate due to market forces;
- Financial risk such as volatility of the Canadian/US dollar exchange rate, interest rates and debt service obligations;
- Environmental and safety risk associated with well operations and production facilities;
- Changing government regulations relating to royalty legislation, income tax laws, incentive programs, operating practices and environmental protection relating to the oil and natural gas industry; and
- Continued participation of Twin Butte's lenders.

Twin Butte seeks to mitigate these risks where possible by:

- Acquiring properties with established production trends to reduce technical uncertainty as well as undeveloped land with development potential;
- Maintaining a low cost structure to maximize product netbacks and reduce impact of commodity price cycles;
- Diversifying properties to mitigate individual property and well risk;
- Maintaining product mix to balance exposure to commodity prices;
- Conducting rigorous reviews of all property acquisitions;
- Monitoring pricing trends and developing a mix of contractual arrangements for the marketing of products with creditworthy counterparties;
- Maintaining a hedging program to hedge commodity prices with creditworthy counterparties;
- Adhering to the Company's safety program and adhering to current operating best practices;
- Keeping informed of proposed changes in regulations and laws to properly respond to and plan for the effects that these changes may have on our operations;
- Carrying industry standard insurance;
- Establishing and maintaining adequate resources to fund future abandonment and site restoration costs; and
- Monitoring our joint venture partners' obligations to us and cash calling for capital projects to limit the Company's credit risk.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures ("DC&P"), as defined in National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings, are controls and other procedures of an issuer that are designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by an issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the issuer's management, including its certifying officers, as appropriate to allow timely decisions regarding disclosure.

Twin Butte's Chief Executive Officer and Chief Financial Officer have evaluated, or caused to be evaluated under their supervision, the effectiveness of Twin Butte's DC&P as at June 30, 2016. Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Twin Butte's DC&P were effective as at June 30, 2016.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal controls over financial reporting ("ICFR"), as defined in National Instrument 52-109, means a process designed by, or under the supervision of, an issuer's certifying officers, and effected by the issuer's board of directors, management or other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP and includes those policies and procedures that:

(a) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(b) are designed to provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the issuer's GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and

(c) are designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisitions, use or disposition of the issuer's assets that could have a material effect on the annual financial statements or interim financial statements.

Twin Butte's officers used the Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") to design ICFR. Twin Butte's Chief Executive Officer and Chief Financial officer have evaluated, or caused to be evaluated under their supervision, the effectiveness of ICFR at June 30, 2016. Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Twin Butte's ICFR were effective as at June 30, 2016.

It should be noted that while Twin Butte's officers believe that the Company's controls provide a reasonable level of assurance with regard to their effectiveness, they do not expect that the DC&P or ICFR will prevent all errors and/or fraud. A control system, no matter how well designed or operated, can only provide reasonable, but not absolute, assurance that the objectives of the control system are met.

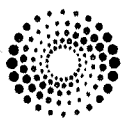
Twin Butte's Chief Executive Officer and Chief Financial Officer are required to disclose any change in the internal controls over financial reporting that occurred during our most recent reporting period that has materially affected, or is reasonably likely to affect, the Company's internal controls over financial reporting. During the three and six months ended June 30, 2016, there were no changes to Twin Butte's ICFR that materially affected, or are reasonably likely to materially affect the Company's ICFR.

TAB 16

Black's Law Dictionary®

Tenth Edition

Bryan A. Garner
Editor in Chief



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> "A town is a precinct anciently containing ten families, whereupon in some countries they are called tithings, within one of which tithings every man must be dwelling, and find sureties for his good behaviour, else he that taketh him into his house is to be amerced in the leet." Henry Finch, *Law, or a Discourse Thereof* 80 (1759).

town-bonding act. (1872) A law authorizing a town, county, or other municipal corporation to issue its corporate bonds for the purpose of aiding in construction, often of railroads. — Also termed *town-bonding law.*

town clerk. See CLERK (1).

town collector. (18c) A town officer charged with collecting the taxes assessed by a town.

town commissioner. See COMMISSIONER.

town council. See CITY COUNCIL.

town crier. (17c) *Hist.* A town officer responsible for making proclamations related to town business, usu. by walking the streets and shouting news, alerts, warning, etc. — Often shortened to *crier.*

town hall. (15c) **1.** A building that houses the offices of a town's government. **2.** An informal public meeting where participants voice their opinions and pose questions to elected officials, political candidates, or others involved in issues important to the community. — Also termed (in sense 2) *town-hall meeting*; *town meeting.* Cf. CITY HALL.

townhouse. (1965) A dwelling unit having usu. two or three stories and often connected to a similar structure by a common wall and (particularly in a planned-unit development) sharing and owning in common the surrounding grounds. — Also termed *townhome.*

town meeting. (17c) **1.** A legal meeting of a town's qualified voters for the administration of local government or the enactment of legislation. • Town meetings of this type are common in some New England states. **2.** More generally, any assembly of a town's citizens for the purpose of discussing political, economic, or social issues. **3.** Modernly, a televised event in which one or more politicians meet and talk with representative citizens about current issues.

town officer. See *municipal officer* under OFFICER (1).

town order. (18c) An official written direction by the auditing officers of a town, directing the treasurer to pay a sum of money. — Also termed *town warrant.*

town purpose. (1827) A municipal project or expenditure that concerns the welfare and advantage of the town as a whole.

township. (17c) **1.** In a government survey, a square tract six miles on each side, containing thirty-six square miles of land. **2.** In some states, a civil and political subdivision of a county having some local government. **3.** TOWN (1). **4.** TOWN (2). **5.** TOWN (3). — Abbr. tp.

township trustee. See TRUSTEE (1).

townsite. (1821) A portion of the public domain segregated by proper authority and procedure as the site for a town.

town treasurer. (17c) An officer responsible for maintaining and disbursing town funds.

town warrant. See TOWN ORDER.

toxic, *adj.* (17c) Having the character or producing the effects of a poison; produced by or resulting from a poison; poisonous. — Also termed *toxical.* Cf. NONTOXIC.

toxicant (tok-si-kənt), *n.* (1879) A poison; a toxic agent; any substance capable of producing toxication or poisoning.

toxic asset. See *troubled asset* under ASSET.

toxicate, *vb.* (17c) *Archaic.* To poison. See INTOXICATION.

toxic convert. See DEATH-SPIRAL DEAL.

toxicology (tok-si-**kol**-ə-jee). (18c) The branch of medicine that concerns poisons, their effects, their recognition, their antidotes, and generally the diagnosis and therapeutics of poisoning; the science of poisons. — **toxicological** (tok-si-kə-**loj**-i-kəl), *adj.*

toxic tort. See TORT.

toxic waste. See WASTE (2).

toxin, *n.* (1886) **1.** Broadly, any poison or toxicant. **2.** As used in pathology and medical jurisprudence, any diffusible alkaloidal substance — such as the ptomaines, abrin, brucin, or serpent venoms — and esp. the poisonous products of disease-producing bacteria.

tp. *abbr.* TOWNSHIP.

TPL. *abbr.* Third-party logistical service provider. See FREIGHT FORWARDER.

TPM restriction. *abbr.* TIME-PLACE-OR-MANNER RESTRICTION.

TPO. *abbr.* Time and place of occurrence.

TPPM. *abbr.* TANGIBLE-PERSONAL-PROPERTY MEMORANDUM.

TPR. *abbr.* TERMINATION OF PARENTAL RIGHTS.

TPR hearing. *abbr.* See *termination-of-parental-rights hearing* under HEARING.

trace, *n.* **1.** A small or slight indication that someone or something was present at a place or existed. **2.** An extremely small amount of a substance, quality, emotion, etc. that is difficult to see or notice. **3.** An electronic search to find out where a telephone call originated. **4.** The mark or pattern made on a computer screen or paper by a machine that records electronic signals.

tracer, *n.* A bullet that, when shot, leaves a line of smoke or flame behind it.

traces, *n.* See *retrospectant evidence* under EVIDENCE.

tracing, *n.* (16c) **1.** The process of tracking property's ownership or characteristics from the time of its origin to the present <tracing the vehicle's history>. • Parties in a divorce will be expected to trace the origins of property in existence at the time of marital dissolution in order to characterize each asset as separate or marital property (or as community property in some states). — Also termed *tracing of funds*; *tracing of property.* Cf. COMMINGLE. **2.** The act of discovering and following a person's actions or movements <tracing the robber's steps>.

tracking dog. See DOG (1).

tract. (14c) A specified parcel of land <a 40-acre tract>.

tract index. See INDEX (1).

tractus futuri temporis (**trak**-təs fyoo-t[y]oor-i tem-pə-ris). [Latin] (1805) *Hist.* A tract of future time.

trade, *n.* (14c) **1.** The business of buying and selling or bartering goods or services; COMMERCE.

▸ **fair trade.** See FAIR TRADE.

▸ **illegal trade.** Traffic or commerce carried on in violation of federal, state, or local law.

▸ **inland trade.** (17c) Trade wholly carried on within a country, as distinguished from foreign commerce.

▸ **precarious trade.** *Int'l law.* Trade by a neutral country between two belligerent powers, allowed to exist at the latter's sufferance.

▸ **unfair trade.** See UNFAIR TRADE.

2. A transaction or swap. **3.** A business or industry occupation; a craft or profession. — **trade,** *vb.*

trade acceptance. See ACCEPTANCE (4).

trade agreement. (1898) **1.** An agreement — such as the North American Free Trade Agreement — between two or more countries concerning the buying and selling of each country's goods. **2.** COLLECTIVE-BARGAINING AGREEMENT.

trade and commerce. (16c) Every business occupation carried on for subsistence or profit and involving the elements of bargain and sale, barter, exchange, or traffic.

Trade and Development Program. See UNITED STATES TRADE AND DEVELOPMENT AGENCY.

trade association. See ASSOCIATION.

trade balance. See BALANCE OF TRADE.

trade council. (1876) A central labor union; the central organization of a local trade union. — Also termed *trades council.* See UNION.

trade defamation. See DEFAMATION.

trade deficit. See DEFICIT (1).

trade discount. See DISCOUNT.

trade disparagement. (1930) The common-law tort of belittling someone's business, goods, or services with a remark that is false or misleading but not necessarily defamatory. • To succeed at the action, a plaintiff must prove that (1) the defendant made the disparaging remark; (2) the defendant either intended to injure the business, knew the statement was false, or recklessly disregarded whether it was true; and (3) the statement resulted in special damages to the plaintiff, usu. by passing off. — Also termed *commercial disparagement; product disparagement; injurious falsehood.* Cf. *trade defamation* under DEFAMATION.

trade dispute. (1875) **1.** *Int'l law.* A dispute between two or more countries arising from tariff rates or other matters related to international commerce. **2.** *Labor law.* A dispute between an employer and employees over pay, working conditions, or other employment-related matters. • An employee who leaves during a trade dispute is not entitled to benefits under the Unemployment Insurance Act.

trade dollar. (1878) *Hist.* A United States dollar coin, made of silver, issued from 1873 to 1878 for use in foreign trade, esp. in eastern Asia. • A trade dollar was legal tender within the U.S. until 1876 when the coin's silver content fell to less than one dollar. From 1878 to 1885, trade dollars were minted only in proof sets, then discontinued.

trade draft. See DRAFT (1).

trade dress. (1899) *Trademarks.* The overall appearance and image in the marketplace of a product or a commercial enterprise. • For a product, trade dress typically comprises packaging and labeling. For an enterprise, it typically comprises design and decor. If a trade dress is distinctive and nonfunctional, it may be protected under trademark law. — Also termed *get-up; look and feel.*

> "The 'trade dress' of a product is essentially its total image and overall appearance. It 'involves the total image of a product and may include features such as size, shape, color or color combinations, texture, graphics, or even particular sales techniques.'" *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 765 n.1, 112 S.Ct. 2755, 2755 n.1 (1992).

trade embargo. See EMBARGO (3).

trade fixture. See FIXTURE.

trade gap. See *trade deficit* under DEFICIT (1).

trade guild. See GUILD (1).

trade-in, *n.* (1917) **1.** A consumer product (such as a car, refrigerator, or cellphone) given as payment, or more usu. partial payment, for a purchase usu. of a similar product. **2.** The method of purchase that uses such a payment. — Also termed (BrE) *part exchange.*

tradeland. A fee property donated to a nonprofit with the expectation that the nonprofit will sell the property and use the funds to further its work. • The donor may qualify for a tax deduction. These properties may or may not have significant characteristics suitable to the nonprofit's substantive mission, but the proceeds of sale benefit that mission.

trade libel. See LIBEL (2).

trademark, *n.* (1838) **1.** A word, phrase, logo, or other sensory symbol used by a manufacturer or seller to distinguish its products or services from those of others. • The main purpose of a trademark is to designate the source of goods or services. In effect, the trademark is the commercial substitute for one's signature. To receive federal protection, a trademark must be (1) distinctive rather than merely descriptive or generic; (2) affixed to a product that is actually sold in the marketplace; and (3) registered with the U.S. Patent and Trademark Office. In its broadest sense, the term *trademark* includes a servicemark. Unregistered trademarks are protected under common-law only, and distinguished with the mark "TM." — Often shortened to *mark.* **2.** The body of law dealing with how businesses distinctively identify their products. — Abbr. TM. See LANHAM ACT; MERCHANT'S MARK. Cf. SERVICEMARK; *registered trademark*; BRAND; TRADENAME.

> "The protection of trade-marks is the law's recognition of the psychological function of symbols. If it is true that we live by symbols, it is no less true that we purchase goods by them. A trade-mark is a merchandising short-cut which induces a purchaser to select what he wants, or what he has been led to believe he wants. The owner of a mark exploits this human propensity by making every effort to impregnate the atmosphere of the market with the drawing power of a congenial symbol. Whatever the means employed, the aim is the same — to convey through the mark, in the minds of potential customers, the desirability of the commodity upon which it appears. Once this is attained, the trademark owner has something of value. If another poaches upon the commercial magnetism of the symbol he has created, the owner can obtain legal redress." *Mishawaka Rubber & Woolen Mfg. Co. v. S.S. Kresge Co.*, 316 U.S. 203, 205, 62 S.Ct. 1022, 1024 (1942).

> "A trademark functions on three different levels: as an indication of origin or ownership, as a guarantee of constancy of the quality or other characteristics of a product or service, and as a medium of advertisement. Thus, a trademark guarantees, identifies, and sells the product or service to which it refers. These three facets of a trademark — of differing

TAB 17

Most Negative Treatment: Reversed
Most Recent Reversed: Smoky River Coal Ltd., Re | 2001 ABCA 209, 2001 CarswellAlta 1035, 95 Alta. L.R. (3d) 1, [2001] A.J. No. 1006, 299 A.R. 125, 266 W.A.C. 125, 28 C.B.R. (4th) 127, [2001] 10 W.W.R. 204, 107 A.C.W.S. (3d) 724, 205 D.L.R. (4th) 94 | (Alta. C.A., Aug 2, 2001)

2000 ABQB 621
Alberta Court of Queen's Bench

Smoky River Coal Ltd., Re

2000 CarswellAlta 830, 2000 ABQB 621, [2000] 10 W.W.R. 147, [2000] A.W.L.D. 621, [2000] A.J. No. 925, 19 C.B.R. (4th) 281, 297 A.R. 1, 83 Alta. L.R. (3d) 127, 99 A.C.W.S. (3d) 13

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

In the Matter of Smoky River Coal Limited

Allstate Insurance Company, Allstate Life Insurance Company, Security Life of Denver Insurance Company, Indiana Insurance Company, Peerless Insurance Company, Pacific Life Insurance Company, AH (Michigan) Life Insurance Company, Northern Life Insurance Company, Reliastar Life Insurance Company, Modern Woodmen of America, Phoenix Home Life Mutual Insurance Company, American International Life Assurance Company of New York, and Phoenix American Life Insurance Company, Petitioners

Montreal Trust Company of Canada Ltd., Plaintiff and Smoky River Coal Limited, Copton Excol Ltd. and 378419 Alberta Ltd., Defendants

LoVecchio J.

Heard: July 4-5, 2000
Judgment: July 31, 2000 *
Docket: Calgary 9801-10214, 0001-05474

Counsel: *B.A.R. Smith, Q.C.*, *D.W. Mann* and *D. LeGeyt*, for Petitioners.
J. Ircandia and *P. McCarthy, Q.C.*, for Receiver.
R.T.G. Reeson, Q.C., for Finning (Canada).
G. Di Pinto, for Coneco Equipment Inc.
D. Williams, for United Steelworkers of America, Local 7621.
B. Clapp, for Non-Union Employees.
D. Ast, for William H. Mercer Limited, Administrator of S.R.C.L. Retirement Plan.
K.M. Horner and *Mr. Simard*, for ATCO Electric Ltd.
S. McDonough, for Alberta Department of Resource Development.
Mr. Peskett, for Municipal District of Greenview.
Mr. Petrick, for Neptune Bulk Terminals.
T. Warner, for CN.
H. Arnesen, for Ro-Dar Contracting Ltd.
B. Beller, for BCL Consulting Group.
Mr. Glenn, for Icon Office Solutions.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.1 General principles
XIX.1.c Application of Act
XIX.1.c.i Relationship between Act and Bankruptcy and Insolvency Act

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Headnote

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

Company obtained CCAA protection pursuant to court order — Court order provided that "post-petition trade creditors" who provided essential goods and services during reorganization would benefit from charge securing company's indebtedness in respect of same — Interim receiver was appointed under Bankruptcy and Insolvency Act and CCAA proceedings were stayed, but obligations established throughout proceedings were preserved — Creditors brought applications for recognition as post-petition trade creditors — Applications granted in part — Only creditors who supplied goods and services essential to day-to-day operations during reorganization period qualified as post-petition trade creditors — Body which provided company's coal leases qualified in respect of royalties for coal extended during reorganization — Electricity supplier did not qualify in respect of exit obligations triggered by decline in electrical consumption, as they were not costs associated with regular day-to-day operations — Equipment lessee did not qualify in respect of cost of equipment repairs, as claim really represented attempt to recover for breach of contract — Second equipment lessee did not qualify in respect of claims for legal fees, transportation and payments for unexpired term of lease, as these were costs associated with cessation of lease — Municipality did not qualify in respect of property taxes due, since services would have been provided in any event — Employees who continued to work during reorganization were entitled to payment of statutory severance — Union dues deducted but not remitted during reorganization period did not qualify under charge — Creditor who claimed in respect of future liabilities was not protected under charge — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

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Canadian Imperial Bank of Commerce v. Melnitzer (Trustee of) (1997), 50 C.B.R. (3d) 79 (Ont. C.A.) — considered

Citibank Canada v. Chase Manhattan Bank of Canada (1991), 5 C.B.R. (3d) 165, 2 P.P.S.A.C. (2d) 21, 4 B.L.R. (2d) 147 (Ont. Gen. Div.) — referred to

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 307 (B.C. S.C.) — considered

International Corona Resources Ltd. v. Lac Minerals Ltd., 6 R.P.R. (2d) 1, 44 B.L.R. 1, 35 E.T.R. 1, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.*) 69 O.R. (2d) 287, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.*) 26 C.P.R. (3d) 97, (sub nom. *LAC Minerals Ltd. v. International Corona*

Resources Ltd.) 61 D.L.R. (4th) 14, 101 N.R. 239, 36 O.A.C. 57, *(*sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* [1989] 2 S.C.R. 574 (S.C.C.) — referred to

Kirklinton v. Wood (1916), [1917] 1 K.B. 332, [1916-17] All E.R. Rep. 813, 86 L.J.K.B. 319, 115 L.T. 920, 33 T.L.R. 108, 61 Sol. Jo. 147 (Eng. K.B.) — distinguished

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

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 63 Alta. L.R. (2d) 361, 92 A.R. 81, 72 C.B.R. (N.S.) 1 (Alta. Q.B.) — referred to

Royal Oak Mines Inc., Re (1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]) — applied

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Soulos v. Korkontzilas, 212 N.R. 1, 9 R.P.R. (3d) 1, 46 C.B.R. (3d) 1, 32 O.R. (3d) 716 (headnote only), 146 D.L.R. (4th) 214, 100 O.A.C. 241, 17 E.T.R. (2d) 89, [1997] 2 S.C.R. 217 (S.C.C.) — applied

United Used Auto & Truck Parts Ltd., Re (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]) — considered

Westar Mining Ltd., Re, 70 B.C.L.R. (2d) 6, 14 C.B.R. (3d) 88, [1992] 6 W.W.R. 331 (B.C. S.C.) — distinguished

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s. 244 — referred to

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

Electric Utilities Act, S.A. 1995, c. E-5.5
Generally — referred to

Employment Standards Code, S.A. 1996, c. E-10.3
Generally — referred to

s. 109(3) — referred to

APPLICATIONS by creditors for recognition as post-petition trade creditors.

***LoVecchio J.*:**

Introduction

1 This decision relates to the applications of several creditors of Smoky River Coal Limited for recognition as a 'post-petition trade creditor'. The creditors are seeking such recognition in order to participate in a Charge established for the benefit of the PPTC's by the Order of Prowse, J. dated August 19, 1998 under the *Companies' Creditors Arrangement Act* [1].

Background

2 Smoky, until very recently, operated a coal mine located in Grande Cache, Alberta. Smoky has been experiencing financial difficulties since 1998.

3 As of July 31, 1998, Smoky obtained the protection of the CCAA pursuant to an Order of Cairns, J. dated August 10, 1998. This Order stayed all proceedings against Smoky and provided for the creation of certain charges.

4 As stated, the Charge was established by Prowse, J. by an Order dated August 19, 1998. The Charge was established to encourage the regular trade creditors of Smoky to continue to provide essential goods and services to Smoky during its reorganization period. The relevant sections of the Order are as follows:

> 2.(d) Post-Petition Trade Creditors shall be entitled to the benefit of and are hereby granted a charge ("Post-Petition Trade Creditors' Charge") against, and security interest in, the Property, as security for indebtedness incurred to them from the issuance of the Petition up to the date of the Special Hearing referred to in paragraph 5 below, and the Post-Petition Trade Creditors' Charge shall rank in priority to the Petitioners and any encumbrance, security or security interest of the Petitioners in respect of the property and shall rank subsequent to the CCAA Lender's Charge, the Monitor's Charge, the balances owing to CIBC on its bridge financing with Smoky River Coal and the Directors' Charge.
>
> 5. This Court directs that a hearing ("Special Hearing") be scheduled as soon as counsel can secure a special chamber date, for determination of whether or not and what terms, including priority, if any, Post-Petition Trade Creditors shall be entitled to the benefit of and granted a charge against, and security interest in, the Property, as security for indebtedness incurred to them from and after the date of the Special Hearing.

The term Post-Petition Trade Creditor was not defined in the Order and no 'Special Hearing' to determine entitlement was ever scheduled prior to the applications made in these proceedings.

5 KPMG was originally appointed as Monitor of Smoky. By an Order dated October 14, 1998, PricewaterhouseCoopers Inc. was appointed Monitor, replacing KPMG.

6 Pursuant to an Order that I granted, dated June 16, 1999, the Charge was limited to the sum of $ 7,000,000.00.

7 In the fall of 1999, an offer was made by SRCL Acquisition Inc. and Westshore Terminals Ltd. to purchase the assets of Smoky, as a going concern, and Smoky filed a plan of arrangement in accordance with the CCAA in order to seek the creditors' approval of the sale. The contemplated transaction was never voted on and eventually failed.

8 On March 17, 2000 the stay of proceedings was lifted allowing the Petitioners to accelerate their claims, make a demand for payment, and deliver to Smoky a notice pursuant to Section 244 of the *Bankruptcy and Insolvency Act* [2]. The Order further stipulated that Smoky should only operate and make expenditures as required in the ordinary course of business, or to preserve the status quo.

9 On March 22, 2000 a Notice of Motion was filed seeking to further lift the stay of proceedings to enable the Petitioners to issue a Statement of Claim, and appoint a Receiver/Manager over the undertaking, property and assets of Smoky and its subsidiary corporations. The Notice of Motion also proposed a 'wind-down' of the mining operations given the large number of employees involved. The Motion was adjourned until March 29, 2000, and then again to March 31, 2000.

However, a plan for the 'ramping down' of activities was to be formulated to ensure a smooth transition into receivership and, as will be noted below, this was done.

10 In connection with the proposed plan for the 'winding-down' of Smoky's operations, Barry Davies, former President, Chief Executive Officer and Director of Smoky intended to commence termination of both union and non-union employees on the afternoon of March 24, 2000. At this time, Davies wrote to PricewaterhouseCoopers regarding Smoky's intention to pay severance to the employees upon their termination. Specifically, Davies sought PWC's position on payment to the unionized employees of accrued wages, vacation pay and the severance amounts as provided under the collective agreement. In addition, Davies indicated that the company intended to pay the statutory severance amounts, as provided by the *Employment Standards Code*[3] of Alberta, to the non-union employees.

11 Counsel for PricewaterhouseCoopers responded to Davies' letter the same day and reiterated that the receivership had not officially commenced and therefore the company was still governed by the Orders granted in the CCAA Proceedings. Counsel for PWC made specific reference to the March 17, 2000 Order and indicated that commencing the 'wind-down' plan may run contrary to the direction to maintain the "status quo". Smoky was also advised that it may be more prudent to seek both the Court's as well as the Noteholders' approval of the wind-down plan before taking the contemplated actions.

12 On March 25, 2000 Smoky submitted an 'Orderly Shutdown Plan' to PWC. Smoky further indicated that the company intended to establish a trust fund for the payment of vacation pay and severance to the remaining employees.

13 Upon a joint application by PWC and the Petitioners, an Order was granted on March 29, 2000. The Order directed that until March 31, 2000 (when the receivership application was to be considered) or further Order, Smoky's payments to any employee were to be restricted to outstanding wage claims. This Order specifically provides that it was not in any way to be determinative of the legal entitlement of the employees to vacation pay or severance.

14 By Order granted March 31, 2000 in the CCAA Proceedings, the Petitioners were granted leave to commence Proceedings under the BIA and the CCAA Proceedings were stayed. By a second Order granted March 31, 2000 under the BIA, PricewaterhouseCoopers was appointed as the Interim Receiver of Smoky. The obligations established throughout the CCAA Proceedings were preserved by the following provisions of the Order:

> 7. The Receiver may without further order of the Court and on notice to The Noteholders make payments:
>
> (a) to employees of Smoky River Coal Limited up to the extent of their statutory priority;...
>
> (e) to creditors entitled to the benefit of the CCAA post-petition trade creditors' charge;
>
> provided that the priority of such payments is in accordance with the priorities set out in previous orders of the Court relating to the CCAA Proceedings of the Defendant Smoky River Coal Limited, and shall make no other distribution to the Plaintiff of other creditors of any class without first having obtained the leave of this Court.
>
> 19. The Receiver shall be bound by all the charges, priorities and obligations created or approved by this Court in the CCAA Proceedings, and the Receiver is directed to:
>
> (a) determine which creditors are entitled to the benefit of the postpetition trade creditors' charge; and
>
> (b) determine what other charges, priorities and obligations need to be maintained;
>
> and if necessary seek this direction of this Court within 45 days hereof.

15 As Interim Receiver, PWC sought to maximize recoveries to the estate. After exhausting efforts to again conclude a going concern sale, the Interim Receiver conducted a solicitation and sales program of the individual assets of Smoky with the approval of this Court. The total amount, which it is anticipated will be realized from the sale program, is

approximately $11,679,313 and the total expected recoveries from the liquidation (with the exclusion of Smoky's interest in the Neptune Terminals) ranges between $12.9 million and $16 million. After the appropriate disbursements are made, it is clear that there will be little or no funds available to the Noteholders who are secured creditors.

16 In light of this bleak recovery, many creditors are seeking the protection of the Charge in order to elevate their claim to a super-priority status.

17 On May 9, 2000, the Interim Receiver sought direction from this Court in an attempt to deal with the various claims made. By Order dated May 9, 2000, the Receiver was authorized to send out notices to all creditors who were claiming refuge under the Charge. The notice would inform the creditor of whether or not the claim had been accepted. Any creditors whose claim had been rejected were provided with a mechanism for the resolution of any disputes.

18 On May 25, 2000, the May 9 Order was amended to extend certain deadlines for the filing of materials associated with the resolution of any disputes, and a hearing was scheduled to commence on July 4, 2000.

19 During the week of June 7, 2000, the Interim Receiver paid out a total of $1,103,868.31 for vacation pay to the union and non-union employees who were terminated between March 29 and March 31 by either Smoky or the Interim Receiver. The amount paid represents the statutory maximum priority of $7,500.00 per employee that is provided under Section 109(3) of the *Employment Standards Code*.

20 As of the date of this hearing, the Interim Receiver has accepted claims under the Charge totalling $5,369,287.11, not including the approximately $1.1 million paid out for vacation pay. The following parties made submissions disputing the Interim Receiver's decision to disallow their claims under the Charge:

Alberta Department of Resource Development	$126,117.81
ATCO Electric	$975,240.00
Coneco Equipment Inc.	$284,773.00
Finning Ltd.	$4,136,675.51
Municipal District of Greenview	$571,978.41
Non-union Employees	$646,527.60
Unionized Employees	$1,593,427.54
Union Dues	$24,802.69
Neptune Bulk Terminals Ltd.	0.00

21 The following parties had their submissions adjourned *sine die*:

Icon Office Solutions

BCL Consulting Group

22 Ro-Dar Contracting Ltd. is subject to a separate Order dated July 14, 2000.

Parameters of the Issue

23 In order to determine whether or not a creditor should participate in the Charge, two issues must be resolved. The first matter for clarification is the appropriate time period to be designated as the CCAA period. The second matter requires the establishment of the determinative factors which will define whether or not a creditor may participate in the benefit of the Charge. These factors must then be applied to each creditor involved in this dispute. The final question to be addressed is whether a creditor should be entitled to the benefit of an alternative charge if the claim is disallowed under the Charge.

Decision

24 The CCAA period commenced on July 31, 1998 pursuant to the Order dated August 10, 1998. The Order dated March 31, 2000 stayed the CCAA Proceedings and an Interim Receiver was put in place under the BIA. Thus, the relevant period to be applied to the Charge is July 31, 1998 through March 31, 2000. In order to be considered for participation under the Charge, the debt in question must have been incurred by Smoky within this time frame.

25 The critical factor to consider when determining who is entitled to participate in the Charge is whether the obligation was incurred in connection with the daily operating activities of Smoky as opposed to those that may arise from the cessation or termination of services. This factor must be considered within the context of the CCAA, which is a statute providing temporary protection while a company seeks to reorganize its affairs so as to avoid liquidation. The existence of security is not in and of itself determinative of whether a creditor's claim should be given super-priority under the Charge.

26 Based on these parameters, the creditors who are entitled to participate in the Charge are as follows: the Alberta Department of Resource Development and the employees (both Union and non-union) to the extent of their claims for statutory severance. The remaining parties do not fit within the parameters of the Charge and are not entitled to payment from this fund.

27 As the $7,000,000.00 limit imposed on the Charge by the June 16, 1999 Order will be exceeded, all participants entitled to its protection will have to share in its benefit *pari passu*.

Discussion

The Scope and Purpose of the CCAA

28 The CCAA is a statute that provides protection for companies who are experiencing financial difficulties, enabling them to reorganize their affairs in the hopes of continuing on in business. A broad and liberal interpretation of the Act has been adopted by the Courts in order to achieve the intended mandate. In *Re Lehndorff General Partner Ltd.*[4] the Court stated:

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the Court. In the interim, a judge has great discretion under the CCAA to make orders so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors.

See also *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*[5], and *Citibank Canada v. Chase Manhattan Bank of Canada*[6].

29 It is within this context that the Charge was established. Clearly, ordinary creditors needed some assurance of payment for goods and services so that they would continue to deal with Smoky and to permit Smoky to continue the operation of the mine while Smoky reorganized its affairs.

The Relevant Time Frame for Participation in the Charge

30 The relief provided under the CCAA is temporary. A company may continue to operate under this umbrella as long as there is an opportunity for successful reorganization. Once it becomes apparent that a reorganization cannot be achieved, the protective umbrella should be collapsed. The British Columbia Court of Appeal in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*[7] stated:

> When a company has recourse to the CCAA, the Court is called on to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical.

31 The legal basis for the Charge is the discretionary authority of the Court granted under the CCAA. There is no issue with respect to the date that this protection commenced. It was July 31, 1998. In addition, the August 19, 1998 Order establishing the Charge made it clear that the trade creditors of Smoky were only protected for claims arising after the initial CCAA Order.

32 Counsel for some of the Claimants have made the argument that as no 'special hearing' (as contemplated by the August 19, 1998 Order) has been held to determine participation in the Charge (prior to these proceedings) their protection should continue to accrue up to the date of these proceedings.

33 The CCAA Proceedings were stayed on March 31, 2000 when the Interim Receiver was appointed under the BIA. This was done as it became clear that Smoky did not have any realistic hope of reorganization. In my view, this Order ended the CCAA Proceedings. It follows that the protection of the Charge must also end as the statutory basis for the exercise of discretion is gone. Thus, only actual debts incurred to trade creditors between July 31, 1998 and March 31, 2000 are eligible for consideration.

Characterization of a Post-Petition Trade Creditor

34 While the CCAA requires a large and liberal interpretation in order to be effective, the need for caution arises when the Court exercises its inherent jurisdiction under this statute. Although the CCAA serves a vital and important role in a reorganization, the general statutory scheme of priorities of creditors must not be overlooked. As the Court is altering this scheme, the exercise of the power of the Court to create classes of creditors with a super-priority status should not be taken lightly. Especially in light of the fact that this action could prejudice the recovery of creditors who would, but for the Order, enjoy a priority if a receivership or bankruptcy ultimately ensues. In *Re United Used Auto & Truck Parts Ltd.* [8], the British Columbia Supreme Court made the following comment:

> While I agree with Macdonald, J. that there are considerations in a CCAA situation which do not exist in relation to a receivership, it is my view that the inherent jurisdiction of the Court to subordinate existing security should only be exercised in extraordinary circumstances.

35 The term Post-Petition Trade Creditor is not defined in any case law or in the CCAA itself and it was not defined in the August 19, 1998 Order of Prowse, J. The term must glean its meaning from the context in which it was used and in light of the purpose it was intended to serve.

36 Counsel for the Noteholders drew an analogy between a DIP financing (a technique frequently utilized in CCAA proceedings) and the Charge established in the case at hand. This analogy is based on the premise that both instruments create a super-priority for the creditors entitled to its benefit, and effectively subordinates existing secured creditors. This analogy is appropriate to consider as there is no authority outlining the legal definition of a Post-Petition Trade Creditor within the CCAA context, therefore the authorities on DIP financing will be helpful in establishing the basic guidelines to be followed.

37 In *Re Royal Oak Mines Inc.* [9], the Court considered the scope that should be afforded to the use of extraordinary relief such as DIP financing in the CCAA context:

> It follows from what I have said that, in my opinion, extraordinary relief such as DIP financing with super priority status should be kept, in Initial Orders, *to what is reasonably necessary to meet the debtor company's urgent needs over the sorting-out period*. Such measures involve what may be a significant re-ordering of priorities form those in

> place before the application is made, not in the sense of altering existing priorities as between the various secured creditors but in the sense of placing encumbrances ahead of those presently in existence
>
> (emphasis added)

38 In this case, Smoky is seriously indebted to the Noteholders and they are expected to recover very little from their security at the conclusion of the receivership. While this fact does not directly impact the determination of who is a 'post-petition trade creditor', the fact that any entitlement to the Charge will diminish the recovery of secured creditors, who would enjoy a statutory priority over unsecured creditors, also warrants a restrictive approach.

39 Counsel for some of the Claimants argued for an application of the ordinary meaning of the words 'trade creditor'. While this definition may be helpful in establishing a loose framework, it is too broad to apply directly to these circumstances.

40 The main purpose of the Charge was to encourage the creditors who supply Smoky with goods and services to continue to deal with Smoky during the reorganization period. The critical characteristic of the service provided by the creditors must have been that it was essential to keeping 'the lights of the company on'. Thus, the costs or expenses incurred must be essential to the continued day to day operations of the mine. Penalties or obligations associated with a breach are not expenses associated with continued operations.

41 Counsel for the Noteholders argued that vulnerability should also be a determinative factor for entitlement to the Charge. This argument suggests that if a creditor is secured by other means, be it statutory or otherwise, their claim should automatically be disqualified from consideration. The availability of other security may be a consideration, but to me cannot alone be determinative. The fact that a trade creditor may have an existing security interest in the assets of Smoky should not in and of itself detract from the fact that they have continued to provide essential goods and services to Smoky during a precarious time, enabling it to keep the lights on.

Application to the Individual Claimants

Alberta Department of Resource Development

42 The Alberta Department of Resource Development is making a claim for unpaid coal royalties in the amount of $ 126,117.81 for the months of February and March 2000. The ADRD provided Smoky with the most basic element required to keep Smoky in business: its coal leases. Under the leases, the right to mine and market coal in return for the payment of royalties on a monthly basis was granted. Although the ADRD could have realized on its security by cancelling Smoky's coal leases, this action would have put Smoky out of business and effectively defeated any attempt by Smoky to continue its operations. The ADRD is only seeking royalties on the coal which has already been extracted by Smoky. Payments of the monthly royalties is necessary to keep the leases in good standing and this permits day to day operations of the mine to continue. As a result, the ADRD should be entitled to recover under the PPTC Charge.

ATCO Electric Ltd.

43 ATCO is seeking recovery of $950,000.00 for Exit Obligations triggered by the decline in electricity consumed by Smoky. These charges represent an obligation imposed on ATCO as a distributer of electricity by the Transmission Administrator under the *Electric Utilities Act*[10]. This Exit Obligation which is imposed on the distributers may, if approved by the Board, be passed on by ATCO to its customers. The Board approved ATCO's application for such action effective April 1, 2000.

44 While the Court is sympathetic to ATCO's claim as its obligation arose from a statutory imposition, the Exit Obligation is a liability that is triggered only upon the cessation of operations. It is not a cost associated with the regular day to day operations. Thus, it does not fit within the parameters established for the Charge.

45 It must also be noted that Smoky was placed under receivership as of March 31, 2000. ATCO did not have the requisite approval of the Alberta Energy and Utilities Board to pass the Exit Obligation on to its customers until April 1, 2000, so Smoky was not legally bound by the Exit Obligation during the CCAA period. Counsel for ATCO argued that the Exit Obligation was incurred during the CCAA period because it was "determined with certainty" that Smoky would become legally subject to the obligation. The authority for this proposition was *Smith (Committee of) v. Wawanesa Mutual Insurance Co.*[11] Given that I have determined that the expense is not associated with daily operations, it is unnecessary for me to decide this point.

Coneco Equipment Inc.

46 Coneco had leased several pieces of equipment to Smoky for use in association with its mining operations. Coneco is seeking recovery of $284,773.00 in addition to the $49,886.92 that the Interim Receiver has already approved for payment under the Charge. The basis for this claim was not clearly itemized in the Claimant's submission, but the oral arguments made by Counsel alluded primarily to the cost of repairs to the equipment.

47 The Claimant is arguing that the cost of repairs to the equipment in question are a requirement or obligation of Smoky as a term of the lease agreement between Coneco and Smoky. The Claimant is further arguing that if trade creditors are not fully compensated according to the terms or conditions of their agreements, they will cease to provide assistance to companies such as Smoky during CCAA reorganization periods.

48 The policy argument raised by Counsel is valid, but it does not change the parameters imposed on entitlement to the Charge. Coneco is really trying to recover damages for breach of contract. Smoky promised to keep the equipment in good repair, but did not. This is a risk that Coneco faces when leasing its equipment to any customer, whether they are currently under the protection of the CCAA or not. Coneco was paid the monthly lease rate throughout the entire CCAA period, which is the only portion of the lease payment that relates to use of the equipment for daily operations. As a result, Coneco's claim for additional recovery under the Charge must fail.

Finning International Inc.

49 Finning also leased various pieces of equipment to Smoky for use in its mining operations. It is not disputed that the equipment supplied by Finning was essential to Smoky's surface operations. Finning is claiming that an additional $4,136,675.51 should be allowed under the PPTC Charge above the $82,729.70 that the Interim Receiver has already agreed to recognize. The claim is broken into four categories: (a) $1,475,526.63 for the cost of repairs that will be effected on the equipment in accordance with the lease agreement, (b) $29,035.78 for legal fees and disbursements incurred by Finning in association with Smoky's default under the leases, (c) the sum of $380,000.00 for the cost of dismantling and transporting the equipment from the mine site and (d) $2,252,113.10 for the unexpired portion of the lease agreement.

50 The claims for legal fees, transportation and payments for the unexpired term of the lease under (b), (c) and (d) above are costs clearly associated with the cessation of the lease, not daily operations. Unliquidated damages are not to be afforded super-priority under the Charge.

51 The lease agreement between Finning and Smoky sets out a maintenance schedule giving rise to repair obligations throughout the term of the lease. Counsel for Finning focussed on the fact that repairs were an incremental obligation, just as the monthly cost of the equipment rental. Counsel relied on the case of *Kirklinton v. Wood*[12] to advance the argument that "where a Lease contains a covenant to execute specific repairs in a particular time period, the obligation to repair attaches as soon as the time period begins, and the fact that the lease is terminated before the expiration of the time period does not relieve the lessee of its obligations to repair."

52 The problem with the above argument is that Smoky may have been obligated to make repairs, but there were no repairs made during the CCAA period and no expenses have been incurred by Finning for repairs not made by Smoky. The claim is simply one for unliquidated damages for breach of this obligation and it too must fail.

Municipal District of Greenview

53 The MD of Greenview is seeking $571,978.41 for 1999 property taxes. Counsel advanced the argument that the MD should be recognized as a Post-Petition Trade Creditor on the basis that the MD provides essential services to Smoky River in exchange for the payment of property taxes. The essential services referred to were the local infrastructure, garbage and waste disposal services, RCMP and police services and other emergency services.

54 The classification of property taxes as a 'traded commodity' is troublesome. Taxes are a means of revenue generation for government. The services provided by the MD would have been provided in any event. The arguments that the MD is proposing are not in line with the restrictive approach that should be taken when awarding super-priority status under the CCAA. The MD will have to rely on their priority charge on the property itself in order to recover the taxes.

The Employees

55 The claims of both the Union and the non-union employees can be considered together. The unionized employees (United Steelworkers of America, Local 7621) are seeking severance in the amount of $1,593,427.54. The claim of the non-union employees is two fold. First, they are seeking severance in the amount of $580,615.25, which represents the statutory minimum entitlement under the *Employment Standards Code*. Second, they are claiming an additional $65,912.35 in vacation pay as eight employees did not receive the full amount of vacation pay owing to them as a result of the $7,500 cap imposed by the Receiver when making the June payment.

56 The primary argument made by both parties was that the Interim Receiver holds the above amounts in trust, either express or constructive, for the employees. The position that the funds are held in trust is untenable. The Order of this Court on the 29th of March, 2000 prohibited Smoky from establishing such a trust. Counsel for the Noteholders accurately pointed out that the applicants cannot try and accomplish indirectly what they were prohibited from doing directly.

57 The alternative argument raised by the employees is that they should be entitled to participate in the Charge as Post-Petition Trade Creditors. Counsel for all parties conceeded that an employee is a Post-Petition Trade Creditor with respect to the entitlement to wages and vacation pay accrued during the CCAA period. The claim for severance is somewhat different. Severance represents a payment in lieu of working notice. If notice or payment in lieu is not given, then the employee is entitled to damages. See David Harris, Wrongful Dismissal [13]. Counsel for the Union and non-union employees argued that statutory minimum entitlements are not unliquidated damages as the entitlements are clearly established by the *Employment Standards Code*, and these amounts are not impacted by a duty to mitigate.

58 Counsel for the non-union employees also raised the inequitable treatment between the employees terminated prior to March 29 (who were given full severance), and those terminated afterwards (who have not received any severance). It must be noted that all employees were terminated during the CCAA period. Counsel urged that the March 29, 2000 Order was not meant to prejudice any employees with respect to their legal entitlements, and argued that to treat the employees terminated after this Order differently than those terminated prior would be inequitable. Counsel also noted that but for the March 29th Order, the employees would have been paid severance.

59 The Orders made throughout the CCAA period sought to protect the employees. The Order dated March 17, 2000 permitted Smoky to continue in the ordinary course of business, and preserve the status quo. The fact of the matter is that Smoky had been paying severance to the employees in the ordinary course of business. It is arguable that the status

quo is that all employees are entitled to the same treatment, whether terminated at the beginning of the reorganization period or at the end.

60 The Notice of Motion brought before this Court on March 22, 2000 proposed that a 'ramping down' of Smoky's operations would be prudent. The plan submitted by Smoky to PWC and the Noteholders contemplated the termination of the remaining employees and identified the amounts owed in severance and vacation pay to each employee. The subsequent Order of March 29, 2000 was not to be used as a basis to argue that the employees were not entitled to severance or vacation pay; it temporarily suspended the determination of entitlement and prevented the establishment of a trust fund for this purpose.

61 The Order dated March 31, 2000 specifically contemplates the statutory entitlements of the employees, and directs that the Interim Receiver is free to pay these amounts without further Order of this Court. The statutory priority referred to in clause 7 a) of that Order in no way referrs to the BIA and its related priority scheme. Rather, the entire clause is seeking to preserve the obligations established during the CCAA period. Thus, payment of vacation pay and the statutory entitlements to severance will not contravene any of the prior Orders and will have the effect of preserving the status quo established as to how employees were treated throughout the CCAA period.

62 The case *Re Westar Mining Ltd.* [14] was raised by Counsel for the Noteholders as a basis for denying payment to the employees. In *Westar*, there was a series of applications regarding the creation of funds or trusts for the payment of vacation pay and severance to employees. After making reference to the $4 million trust that had already been established, the Court concluded that to make an additional provision for vacation pay would be to "change the status quo to a degree which is unacceptable". It was argued that any additional payment to the employees would have the effect of treating them better than other unsecured creditors.

63 While there are many similarities between the circumstances in *Westar* and the case at hand, there is a critical distinguishing factor. In *Westar* there was a trust established which was to be shared equally by all of the employees, and only the application for an additional allocation to this trust was denied. The employees of Smoky did not have the benefit of a fixed trust amount, and are only seeking to be treated equitably throughout the CCAA period. Thus, all of the employees in *Westar* were in the same boat. For the employees of Smoky, some were given a spot on the life raft, while others were expected to go down with the sinking ship.

64 All employees gave their services to Smoky during a precarious time and deserve to be treated equally. As a result, both the Union and non-union employees should be entitled to the payment of statutory severance under the Charge.

65 All employees terminated after March 28, 2000 have received vacation pay to a maximum of $7,500. The non-union employees should not be entitled to recover vacation pay in excess of the amount provided by the statutory cap. Imposing the statutory limit as referred to in the March 31, 2000 Order will prevent additional disturbance to the priorities that will govern under the BIA and will also lead to a more consistent treatment as between these employees.

66 The Interim Receiver's payment of vacation pay in June of 2000 should also be accounted for under the Charge as these are amounts that had accrued to the employees during the CCAA period.

Union Dues

67 An application was made on behalf of the Union for recovery of $24,802.69 in union dues. The dues had been deducted from the employees' earnings by Smoky, but not remitted to the Union. Counsel is seeking a declaration that the amounts are held in trust for the Union, or in the alternative that the union dues should be paid under the Charge.

68 On a strict interpretation, the union dues could not qualify for payment under the Charge as the dues do not represent a good or service extended to Smoky in order for the mine to continue with day to day operations.

69 However, it is clear that the Union has been deprived of funds to which it was entitled. Smoky has been enriched as the funds in question were deducted from the employees' wages for the purpose of remitting them to the Union. Smoky only played an intermediary role as it would with any source deductions made by an employer. The deductions were made with the employees' approval for the Union's benefit so the argument that the union dues are held in trust for the Union warrants consideration. The money that should have been remitted to the Union is not Smoky's, although the funds were not segregated or kept in a separate account. An express trust was not established in this case, nor was there a statutory trust applicable to these remittances. The question remaining is whether a constructive trust should be imposed in a bankruptcy or receivership context.

70 In *Canadian Imperial Bank of Commerce v. Melnitzer (Trustee of)* [15], the Ontario Court of Appeal affirmed that a constructive trust can be used as a remedy in bankruptcy situations when strict requirements are met, although they denied the remedy in that case. At trial, the learned judge based this conclusion upon the Supreme Court of Canada decision in *International Corona Resources Ltd. v. Lac Minerals Ltd.* [16]. Under the proviso that a restitutionary claim must be established, the Court stated:

> ...a constructive trust should only be awarded if there is a reason to grant to the plaintiff additional rights that flow from the recognition of a right of property. Among the most important of these will be that it is appropriate that the plaintiff receive the priority accorded to the holder of a right of property in a bankruptcy. [17]

71 Thus, a constructive trust could be applicable in a bankruptcy context if the party claiming the relief can show a proprietary interest in the property and prove the elements required to establish a constructive trust.

72 The Supreme Court of Canada outlined the test for a constructive trust in *Soulos v. Korkontzilas* [18]. The trust can arise to remedy unjust enrichment or profit from wrongdoing. The critical elements are as follows: (a) the defendant has been enriched, (b) the plaintiff has been deprived, (c) there must be a substantial connection or proprietary interest in the property in question, (d) the defendant has no juristic reason to retain the property or no defence, and (e) the constructive trust is a just remedy to both sides.

73 In this case, the elements outlined in (a), (b) and (d) above are satisfied. It is not clear that the Union has a proprietary interest in the disputed property. The property is money that is no longer held by Smoky. The funds were not segregated and held in a separate account. The payment of the union dues would effectively allow the Union to recover damages for breach of contract, as Smoky has breached its agreement to remit the funds. Given the circumstances, that may be an unjust result.

Neptune Bulk Terminals Ltd.

74 Counsel for Neptune appeared for the purpose of trying to have Neptune recognized as a Post-Petition Trade Creditor in the event that some future liabilities may arise. Neptune has been paid every monthly installment owed by Smoky during the CCAA period. In order for Neptune to have a claim under the Charge, they would have to show some liability incurred by Smoky during the CCAA period which was related to the day to day operations of the business. Neptune has no such claim as all installments required to be made have been made in accordance with their contractual requirements. The fact that the CCAA period is finite, and the Charge is applicable only to this period makes it impossible for any potential contingent future liabilities to be considered in this context.

Other Charges

75 There is no basis on which any of the claims should be considered as part of the other charges established under the CCAA Proceedings for the protection of the Directors or for the use of the Monitor.

Petition for Receiving Order

76 The application for a Receiving Order made by the Noteholders in April of 2000 was adjourned until the date of these proceedings. The application is granted effective 12:01 a.m., April 1, 2000.

Conclusion

77 The applications made by the Alberta Department of Resource Development, the Union (with respect to the unionized employees) and the non-union employees with respect to their claims for statutory severance pay, are granted. All other applications for participation in the Charge are denied. By my calculations this brings the total amount approved to over the $7,000,000 limit. As a result, the participants accepted under the Charge will have to share on a *pari passu* basis with any creditors who are already approved, but have not yet been paid.

Costs

78 Counsel may speak to me concerning costs in the next 30 days if they wish.

Order accordingly.

Footnotes

* Changes in a corrigendum issued August 9, 2000 have been incorporated herein.

1 R.S.C. 1985, c. C-36.

2 R.S.C. 1985, c. B-3.

3 S.A. 1996, c. E-10.3, as amended.

4 (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at 31

5 (1988), 63 Alta. L.R. (2d) 361 (Alta. Q.B.)

6 (1991), 5 C.B.R. (3d) 165 (Ont. Gen. Div.)

7 (1990), 4 C.B.R. (3d) 307 (B.C. S.C.) at 315

8 (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]) at 152

9 (1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]) at 321

10 S.A. 1995, c. E-5.5

11 (1996), 38 C.C.L.I. (2d) 223 (Ont. Gen. Div.)

12 (1916), [1917] 1 K.B. 332 (Eng. K.B.)

13 looseleaf (Toronto: Carswell, 1984)

14 (1992), 14 C.B.R. (3d) 88 (B.C. S.C.)

15 (1997), 50 C.B.R. (3d) 79 (Ont. C.A.)

16 [1989] 2 S.C.R. 574 (S.C.C.)

17 ibid, at 51.

18 (1997), 146 D.L.R. (4th) 214 (S.C.C.)

End of Document

TAB 18

2001 ABCA 209
Alberta Court of Appeal

Smoky River Coal Ltd., Re

2001 CarswellAlta 1035, 2001 ABCA 209, [2001] 10 W.W.R. 204, [2001] A.J. No. 1006, 107 A.C.W.S. (3d) 724, 205 D.L.R. (4th) 94, 266 W.A.C. 125, 28 C.B.R. (4th) 127, 299 A.R. 125, 95 Alta. L.R. (3d) 1

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended; And In the Matter of Smoky River Coal Limited; Allstate Insurance Company, Allstate Life Insurance Company, Security Life of Denver Insurance Company, Indiana Insurance Company, Peerless Insurance Company, Pacific Life Insurance Company, AH (Michigan) Life Insurance Company, Northern Life Insurance Company, Reliastar Life Insurance Company, Modern Woodmen of America, Phoenix Home Life Mutual Insurance Company, American International Life Assurance Company of New York and Phoenix American Life Insurance Company (Petitioners)

Montreal Trust Company of Canada Ltd. (Plaintiff) and Smoky River Coal Limited, Copton Excol Ltd. and 378419 Alberta Ltd. (Defendants)

Canadian National Railway Company, Municipal District of Greenview No. 16, Finning (Canada) - A Division of Finning International Inc., Coneco Equipment Inc., Atco Electric Ltd. and Ro-Dar Contracting Ltd. (Appellants / Not named parties to the Queen's Bench Action) and Montreal Trust Company of Canada (Respondent / Plaintiff) and Pricewaterhousecoopers Inc. in its capacity as Interim Receiver of Smoky River Coal Limited, Her Majesty the Queen in right of Alberta as represented by the Department of Resource Development, Non-Union Employees of Smoky River Coal Limited and United Steelworkers of America Local 7621 (Respondents / Not named parties to the Queen's Bench Action)

Picard, Fruman, Wittmann JJ.A.

Heard: June 13-14, 2001
Judgment: August 2, 2001
Docket: Calgary Appeal 00-18924, 00-18944, 00-18947, 00-18950, 00-18957, 00-18958, 00-18975

Proceedings: reversing in part (2000), 2000 CarswellAlta 830 (Alta. Q.B.)

Counsel: *T.M. Warner*, *D.R. Peskett*, *R.T.G. Reeson*, *Q.C.*, *J. Di Pinto*, for Appellants
D. LeGeyt, *K. McHugh*, *S. McDonough*, *B. Clapp*, *D.T. Williams*, for Respondents

Subject: Insolvency; Corporate and Commercial

Related Abridgment Classifications
Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.1 General principles
XIX.1.c Application of Act
XIX.1.c.i Relationship between Act and Bankruptcy and Insolvency Act

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Headnote

Bankruptcy

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Application of Act

Company obtained protection under Companies' Creditors Arrangement Act, pursuant to court order — Court order provided that "post-petition trade creditors" who provided essential goods and services during re-organization would benefit from charge securing company's indebtedness in respect of same — Interim receiver was appointed under Bankruptcy and Insolvency Act, and Arrangement Act proceedings were stayed, but obligations established throughout proceedings were preserved — Several creditors brought applications for recognition as post-petition trade creditors — Certain applications allowed, certain applications dismissed — Two lessees, municipality and employees appealed dismissal of applications — Certain applications allowed, certain applications dismissed — Lessees were entitled to cost of repairs to leased equipment as obligation to maintain equipment was set out in lease agreements with company — Municipality was not entitled to recognition as post-petition creditor for property taxes as services provided by community were not traded services — Employees were entitled to recognition as post-petition creditor for vacation pay and severance pay as entitlement to vacation pay had been arranged between counsel, and trial judge's decision deserved deference regarding severance pay — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

Table of Authorities

Cases considered:

Alberta v. Bank of Canada (1991), 82 Alta. L.R. (2d) 392, 84 D.L.R. (4th) 335, (sub nom. *Canadian Commercial Bank, Re*) 8 W.A.C. 128, (sub nom. *Canadian Commercial Bank, Re*) 120 A.R. 128 (Alta. C.A.) — followed

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

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

Statutes considered:

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

s. 2(1) "date of the initial bankruptcy event" (a) [en. 1997, c. 12, s. 1(4)] — considered

s. 244 [en. 1992, c. 27, s. 89(1)] — referred to

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

Employment Standards Code, S.A. 1996, c. E-10.3

Generally — referred to

s. 109(3) — pursuant to

APPEAL by creditors from judgment reported at [2000] 10 W.W.R. 147, 83 Alta. L.R. (3d) 127, 19 C.B.R. (4th) 281, 2000 ABQB 621, 2000 CarswellAlta 830 (Alta. Q.B.), respecting designation as post-petition creditors.

***Per curiam*:**

1 The central issue in this appeal is determining which creditors of Smoky River Coal Ltd. are entitled to participate in a post-petition trade creditors' charge.

FACTS

2 The facts are set out in detail in the decision of LoVecchio, J.: *Re Smoky River Coal Ltd.*, [2000] A.J. No. 925 (Alta. Q.B.). They are briefly recapped here.

3 Until very recently, Smoky River operated a coal mine located in Grande Cache, Alberta. It had been experiencing financial difficulties since 1998. Effective July 31, 1998, Smoky River obtained the protection of the Companies' *Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA") pursuant to an order of Cairns, J. dated August 10, 1998. This order stayed all proceedings against Smoky River and provided for the creation of charges.

4 On August 17, 1998, Prowse, J. issued an order creating an express charge and priority over Smoky River's assets in favour of what were termed in the order "post-petition trade creditors" ("PPTC Charge"). Paragraphs 2(c) and (d) of the August 17, 1998 order state (AB 32):

> (c) obligations incurred by Smoky to trade creditors after the date of filing of the Petition ("Post-Petition Trade Creditors") shall be paid in accordance with their terms of credit;
>
> (d) Post-Petition Trade Creditors shall be entitled to the benefit of and are hereby granted a charge ("Post-Petition Trade Creditors' Charge") against, and security interest in, the Property, as security for indebtedness incurred to them [...].

5 The purpose of the PPTC Charge was to encourage the regular trade creditors of Smoky River to continue to provide essential goods and services to Smoky River during its reorganization period. The order did not define the term "post-petition trade creditor", but called for a special hearing as soon as possible to delineate post-petition trade creditors' entitlement to, and priority in, the PPTC Charge. That hearing was never held.

6 LoVecchio, J. was appointed the CCAA judge. On June 16, 1999, he capped the amount of the PPTC Charge at $7 million.

7 On March 17, 2000, the CCAA judge lifted the CCAA stay of proceedings, allowing the Petitioners, the holders of $75 million of secured notes, to accelerate their claims, make a demand for payment, and deliver a notice to Smoky River pursuant to s. 244 of the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3. The order further stipulated that Smoky River should only operate and make expenditures as required in the ordinary course of business, or to preserve the status quo.

8 On March 22, 2000, the Petitioners applied to issue a Statement of Claim, and appoint a Receiver/Manager over Smoky River and its subsidiary corporations. They also proposed a "wind-down" of the mining operations, given the large number of employees involved. A plan for the "ramping down" of activities was created to ensure a smooth transition into receivership.

9 On March 25, 2000, Smoky submitted an "orderly Shutdown Plan" to the Monitor. On March 29, 2000, the CCAA judge limited the payments that could be made by Smoky River. Notwithstanding the provisions of the *Employment Standards Code*, S.A. 1996, c. E-10.3, Smoky River was ordered to pay only outstanding wage claims of employees. The order specified that "the rights of any employee shall not otherwise be prejudiced by this order, nor shall this order be used as a basis for an argument to alter the legal entitlement of employees" (AB 158).

10 On March 31, 2000, the Petitioners were granted leave to commence proceedings under the *Bankruptcy and Insolvency Act* and the CCAA proceedings were stayed. By a second order on the same date, PricewaterhouseCoopers was appointed the interim receiver of Smoky River. The obligations established throughout the CCAA proceedings were preserved by the following provisions (AB 49):

> 7. The Receiver may without further order of the Court and on notice to the Noteholders make payments:
>
> (a) to employees of Smoky River Coal Limited up to the extent of their statutory priority; [...]
>
> (e) to creditors entitled to the benefit of the CCAA post-petition trade creditors' charge;
>
> provided that the priority of such payments is in accordance with the priorities set out in previous orders of the Court relating to The CCAA proceedings of the Defendant Smoky River Coal Limited, and shall make no other distribution to the Plaintiff or other creditors of any class without first having obtained the leave of this Court.
>
> 19. The Receiver shall be bound by all the charges, priorities and obligations created or approved by this Court in The CCAA proceedings, and the Receiver is directed to:
>
> (a) determine which creditors are entitled to the benefit of the post-petition trade creditors' charge; and
>
> (b) determine what other charges, priorities and obligations need to be maintained;
>
> and if necessary seek the direction of this Court within 45 days hereof. [...]

11 On May 9, 2000, the Receiver was authorized to send out notices to all creditors claiming refuge under the PPTC Charge, informing them whether or not their claims had been accepted. Creditors were provided with a mechanism for court review of the Receiver's decisions.

12 On July 4 and 5, 2000, the CCAA judge heard the applications of several creditors, including all the parties to this appeal, appealing the Receiver's determination of their entitlement, or lack of entitlement, to the PPTC Charge.

THE CCAA JUDGE'S DECISION

13 In his decision of July 31, 2000, *supra*, the CCAA judge set out two requirements for eligibility for the PPTC Charge. The first criteria was that the debt in question was incurred by Smoky River during the CCAA period, between July 31, 1998 and March 31, 2000.

14 The second criteria for eligibility was that the debt in question was incurred in connection with the daily operating activities of Smoky River, as opposed to debts that arose from the cessation or termination of services. As stated by the CCAA judge (*supra,* at para. 40):

> The main purpose of the Charge was to encourage the creditors who supply Smoky with goods and services to continue to deal with Smoky during the reorganization period. The critical characteristic of the service provided by the creditors must have been that it was essential to keeping "the lights of the company on". Thus, the costs or expenses incurred must be essential to the continued day to day operations of the mine. Penalties or obligations associated with a breach are not expenses associated with continued operations.

We are in substantial agreement with the two eligibility criteria delimited by the CCAA judge.

15 After setting out these requirements, the CCAA judge applied them to the applications of the various creditors. His decisions are discussed below, in the analysis of the individual appeals.

CREATING CCAA CHARGES

16 CCAA orders become the roadmap for the proceedings and the litigation which may follow. Orders must therefore be drafted with clarity and precision. The purpose of the CCAA must be kept at the forefront in both drafting and interpreting a CCAA order. The CCAA is remedial legislation. As was stated in *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]):

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan *[sic]* of compromise or arrangement to be prepared, filed and considered by their creditors and the court.

17 It is particularly important that the terms and scope of any charge created by an order be clearly defined. Creditors need to know from the outset whether or not they are entitled to benefit in any charge or other priority created by the order. Those extending credit, be it trade credit or otherwise, should not be forced to participate in litigation after the CCAA proceeding to discover whether or not they hold some form of security or are entitled to a super-priority. Similarly, secured creditors of a troubled company need to know from the outset the effect the CCAA process will have on their security. They should not be forced to wait until the end of the proceedings to discover that their security has been whittled away due to a broad judicial interpretation of qualification for super-priority status. A precise CCAA order will ensure commercial practicality by allowing all creditors of the debtor company to properly adjust the terms of their credit.

18 Terms for which there is no common and easily discernable meaning, such as "post-petition trade creditor", should be defined with as much precision as possible. In this case, the term was not defined in the original order, but was to be delineated in a special hearing to be "scheduled as soon as counsel can secure a special chambers date" to determine "whether or not and on what terms, including priority, if any, Post-Petition Trade Creditors shall be entitled to the benefit of and granted a charge against, and security interest in, the Property, as security for indebtedness incurred to them from and after the date of the Special Hearing" (AB 33-34). The parties charged with scheduling that hearing were Smoky River, the monitor, the Petitioners, the Canadian Imperial Bank of Commerce and Canadian National Railway Company. Their failure to convene the hearing has led to costly litigation and the appeals before us.

19 Parties in a CCAA proceeding, with the supervision of a CCAA judge, may define a post-petition trade creditors' charge as they see fit. Because they failed to do so in this case, the court must attempt to balance the interests of the parties. Most secured creditors are already protected, as they obtained an order capping the PPTC Charge at $7 million. Creditors who extended credit to Smoky River under the PPTC Charge have no similar protection. However, they are taken to understand the purpose of the CCAA and to expect that the PPTC Charge would be interpreted to accord with the commercial reality that the insolvent business would operate in its ordinary course. Therefore, while we accept the CCAA judge's requirement that to qualify, a debt must have been incurred in connection with the daily operating activities of Smoky River, in the circumstances of this case, we interpret that requirement on commercially reasonable terms.

THE APPEALS

20 The appeals have been consolidated. The CCAA judge's decisions, grounds of appeal and our conclusions are as follows:

Appeal of Coneco Equipment Inc.

21 Coneco Equipment Inc. leased heavy equipment to Smoky River during the CCAA period. The CCAA judge decided that Coneco was a post-petition trade creditor, entitled to the benefit of the PPTC Charge for the rental fee. Coneco appeals, asking for a declaration that it is also entitled to participate in the PPTC Charge for the cost of repairs to the equipment.

22 Coneco argues that the provisions of the August 17, 1998 order creating the PPTC Charge must be interpreted in a commercially reasonable manner -- in the manner that an unsecured creditor or business person being asked to provide credit would interpret them. It contends that it was commercially reasonable to assume that repair costs to the equipment leased to Smoky River were part of the terms of credit, and would be included in the PPTC Charge. Conoco bases its argument on the lease agreements, which provided that Smoky River would pay the repair costs.

23 The application of commercially reasonable terms to Conoco's claim for repairs involves applying a legal test to a particular set of facts. We review on a standard of correctness.

24 Coneco was clearly a post-petition trade creditor. The covenant to repair the equipment was just as much a term of the lease and a term of credit as Smoky River's obligation to pay rent. The repair costs were not a damage claim, but a clear contractual obligation that arose during the CCAA period. It is not commercially reasonable that Coneco would lease valuable equipment to Smoky River unless Smoky River maintained it in good operating condition. Had there been no obligation to maintain the equipment, the rental rate would have been considerably higher. This interpretation is consistent with commercial reasonableness.

25 The order states that post-petition trade creditors will be paid in accordance with their terms of credit and will have the benefit of the PPTC Charge. The repair costs were part of Coneco's terms of credit and Coneco is entitled to the benefit of the PPTC Charge. Coneco's appeal is allowed.

Appeal of Finning (Canada)

26 Finning (Canada) also leased heavy equipment to Smoky River during the CCAA period. The CCAA judge decided that Finning was a post-petition trade creditor, and was entitled to the benefit of the PPTC Charge for rental only. Finning appeals, asking for a declaration that it is also entitled to participate in the PPTC Charge for the costs of the maintenance, repairs, servicing and required change-outs of the leased equipment.

27 Finning relies on the terms and conditions of its leases with Smoky River, which contained a clear obligation to maintain the equipment in good repair and operating condition. In addition, contemporaneous with the execution of the leases, Finning and Smoky River established a maintenance schedule for the equipment. The schedule outlined the number of operating hours the equipment could be used before maintenance, repairs and change-outs were required, and set out the fees Smoky River agreed to pay Finning for the change-outs.

28 Finning's appeal is similar to Coneco's, and the same analysis and standard of review apply. The cost of maintenance, repairs, servicing and required change-outs to the equipment were part of Finning's terms of credit and it is entitled to the benefit of the PPTC Charge. Finning's appeal is allowed.

Appeal of the Municipal District of Greenview No. 16

29 The CCAA judge ruled that property taxes owed to the Municipal District of Greenview No. 16 were not a "traded commodity" and were not entitled to the benefit of the PPTC Charge.

30 Greenview appeals, asking for a declaration that it is a post-petition trade creditor entitled to participate in the PPTC Charge for all of its 1999 property tax claim and for the pro-rated portion of its 2000 tax claim for the time period in which Smoky River continued to operate under the protection of the CCAA.

31 Greenview argues that it provided Smoky River with services which were a benefit to Smoky River. It submits that taxes were a necessary obligation incurred by Smoky River in connection with its daily operating activities during the CCAA period, and Greenview is therefore entitled to the benefit of the PPTC Charge.

32 Trade is defined in *Black's Law Dictionary*, 6 th ed., as "the act or the business of buying and selling for money." In fact, Greenview was not selling its services to Smoky River for money. Counsel for Greenview conceded in oral argument that Greenview did not deny and could not have denied Smoky River the services it provided, although Smoky River did not pay its property taxes. Property taxes are not the purchase price for the services provided by Greenview; instead they are the means of generating the revenue to provide those services.

33 Greenview was not engaged in the act of trading and cannot be a trade creditor. While nothing prevents a government that exchanges goods or services for money from being a trade creditor, in this case the nature of the property tax is determinative.

34 Greenview was not entitled to the benefit of the PPTC Charge. Its appeal is dismissed.

Appeal of CNR re: Royalty Payments to the Alberta Department of Resource Development

35 The CCAA judge decided that resource royalties on coal leases payable to the Alberta Department of Resource Development were entitled to the benefit of the PPTC Charge. CNR appeals this decision. It argues that ADRD is not a trade creditor, and that because the royalties in issue are in the nature of a tax, they are not properly considered trade debt.

36 Smoky River was required to pay monthly royalties to the ADRD to keep its most fundamental asset, its coal leases, in good standing. Because Smoky River needed its coal leases to continue its coal mine operations, the ADRD provided goods to Smoky River that were essential to "keeping the lights on" during the CCAA period. The royalty payments were not a tax but an exchange of money for goods, which could properly be characterized as a trade debt. The CCAA judge did not err in deciding that the ADRD was entitled to participate in the PPTC Charge. CNR's appeal is dismissed.

Appeal of CNR re: Vacation Pay

37 The CCAA judge made the receiving order retroactive to April 1, 2000. With the agreement of counsel, he also held that the employees were entitled to the benefit of the PPTC Charge for their vacation pay.

38 CNR appeals these decisions. It argues that the employment relationship is not one which would give rise to a "trade debt". Employees, therefore are not "trade creditors", and as such cannot participate in the PPTC Charge.

39 CNR also argues that because the time and date of bankruptcy is established by s. 2.1(a) of the *Bankruptcy and Insolvency Act*, the CCAA judge did not have the discretion to make that date retroactive. As the date of the receiving order was July 31, 2000, this also was the date of bankruptcy. Accordingly, vacation pay would have been paid before the bankruptcy, would have been given super-priority status under s.109(3) of the *Employment Standards Code*, and should not have been included in the PPTC Charge. CNR argues that including vacation pay in the PPTC Charge diluted the payments to *bona fide* trade creditors.

40 Because the decision to include vacation pay in the PPTC Charge was based on a concession by counsel for all the parties that Smoky River's employees were PPTC creditors for wages and vacation pay accrued during the CCAA period, we will not interfere. However, we offer no opinion whether employees should be characterized as trade creditors or whether wages and vacation pay should be characterized as trade debts. It is also unnecessary for us to decide and we express no opinion whether the CCAA judge erred in making the receiving order retroactive to April 1, 2000. CNR's appeal is dismissed.

Appeal of CNR re: Severance Pay

41 Severance payments calculated under the *Employment Standards Code* were paid to all Smoky River employees whose employment was terminated before March 29, 2000. Severance payments were suspended under the March 29, 2000 order. However, the order indicated that employees' rights were not affected and that the order could not be used to alter their legal entitlement. The CCAA judge decided that severance obligations for employees terminated between March 29 and March 31, 2000 were entitled to benefit from the PPTC Charge.

42 CNR appeals this decision. It argues that employees were not trade creditors and that severance pay was not an obligation that was incurred in connection with the daily operating activities of Smoky River, but rather arose from the cessation or termination of services.

43 In a complex case such as this, a great deal of deference must be given to the CCAA judge. The CCAA judge dealt with more than 100 applications, attempting to balance the rights and equities of many parties. The lack of precision in the initial order of August 17, 1998, and the failure to hold the special hearing to define the scope of the PPTC Charge made this task even more complex.

44 *Alberta v. Bank of Canada* (1991), 84 D.L.R. (4th) 335 (Alta. C.A.), at 337 sets forth the proper standard of review to be taken by an appellate court in these circumstances:

> [The chambers judge] has heard numerous applications and has made many orders and directions with respect to these proceedings. He, better than anyone, has gained insight into the problems relating to this matter and how to attempt to resolve them. At times, no doubt, resolutions to these problems require some innovation. Suffice it to say that we will not lightly interfere with the enormous task undertaken by this chambers judge. We would do so only if clear error is shown.

45 This court also commented on the appropriate standard in *Re Smoky River Coal Ltd.* (1999), 175 D.L.R. (4th) 703 (Alta. C.A.), at 724:

> The fact that an appeal lies only with leave of an appellate court (s. 13, CCAA) suggests that Parliament, mindful that CCAA cases often require quick decision making, intended that most decisions be made by the supervising judge. This supports the view that those decisions should be interfered with only in clear cases.

46 The CCAA judge, in permitting the severance pay to be included in the PPTC Charge, clarified his March 29, 2000 order which expressly stated that it was not meant to alter the legal entitlements of employees. The CCAA judge interpreted his earlier order to mean that employees were to be treated equally: those terminated after March 29 were not to be denied the severance pay that employees terminated before March 29 had received. By deciding that the March 29, 2000 order did not create two classes of employees, the CCAA judge attempted to balance the equities.

47 Based on the unusual circumstances of this case and the standard of review, we dismiss CNR's appeal. In doing so we do not suggest that employees are properly considered trade creditors, or that severance pay is properly included in a PPTC Charge. We offer no opinion on either of these issues.

SUMMARY

48 The appeals of Coneco and Finning are allowed. The appeals of the Municipal District of Greenview No. 16 and CNR are dismissed. The judgment of the CCAA judge will be varied in accordance with these reasons.

Order accordingly.

End of Document

TAB 19

2004 ABQB 218
Alberta Court of Queen's Bench

Mirant Canada Energy Marketing Ltd., Re

2004 CarswellAlta 352, 2004 ABQB 218, [2004] A.W.L.D. 268, [2004] A.J. No. 331, 130 A.C.W.S. (3d) 237, 1 C.B.R. (5th) 252, 36 Alta. L.R. (4th) 87

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

And In the Matter of Mirant Canada Energy Marketing Ltd.
and Mirant Canada Energy Marketing Investments Inc.

Kent J.

Heard: March 10, 2004
Judgment: March 19, 2004 *
Docket: Calgary 0301-11094

Proceedings: additional reasons at *Mirant Canada Energy Marketing Ltd., Re* (2004), 2004 ABQB 334, 2004 CarswellAlta 561 (Alta. Q.B.)

Counsel: Brian P. O'Leary, Q.C. for Paramount Resources, NGX
Tristram J. Mallett, Geraldine Teixeira for Mirant Corporation
Frank R. Dearlove, Christopher D. Simard for Mirant Canada Energy Marketing Ltd., Mirant Canada Energy Marketing Investments Inc.
Alan R. Anderson, Cassandra P. Malfair for Enron Canada
William L. Severson for Robert Schaefer
Howard A. Gorman, Paul Nigol for El Paso, Trans Canada Pipeline

Subject: Insolvency; Employment; Public

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Labour and employment law

II Employment law
II.3 Interpretation of employment contract
II.3.b Essential terms

Headnote

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

M Ltd. applied for protection under Companies' Creditors Arrangement Act ("CCAA") on July 15, 2003 — Prior to December 15, 2002, S was employed by related company in Atlanta, Georgia — In March, 2002, S signed retention agreement — Under terms of agreement, S was entitled to "award amount" of $72,800 US on each of September 30, 2004, and September 30, 2005, provided that he was still employed by related company and was performing

in satisfactory manner — Retention agreement was never assigned to M Ltd. — Effective December 15, 2002, S ceased to be employed by related company and became employed by M Ltd. in Calgary — S's employment with M Ltd. was terminated on September 2, 2003 — S was entitled to $827,755.20 CDN as severance — S sought further $73,000 US in respect of retention agreement — Monitor under CCAA paid S statutory amount of four weeks' pay — S applied for immediate entitlement to severance pay and to $73,000 US — Application dismissed — Obligation to pay severance to S was not clear contractual obligation that was necessary for S to continue his employment, but obligation that arose on termination of services — Payment of severance amounts was discretionary — Discretion must be exercised in accordance with purpose of CCRA, which was to provide protection to company while it attempted to reorganize its affairs — Monitor correctly exercised his discretion — Retention agreement was never part of S's employment contract with M Ltd.

Employment law --- Elements of employment relationship — Interpretation of employment contract — General principles — Essential terms

M Ltd. applied for protection under Companies' Creditors Arrangement Act ("CCAA") on July 15, 2003 — Prior to December 15, 2002, S was employed by related company in Atlanta, Georgia — In March, 2002, S signed retention agreement — Under terms of agreement, S was entitled to "award amount" of $72,800 US on each of September 30, 2004, and September 30, 2005, provided that he was still employed by related company and was performing in satisfactory manner — Retention agreement was never assigned to M Ltd. — Effective December 15, 2002, S ceased to be employed by related company and became employed by M Ltd. in Calgary — S's employment with M Ltd. was terminated on September 2, 2003 — S was entitled to $827,755.20 CDN as severance — S sought further $73,000 US in respect of retention agreement — Monitor under CCAA paid S statutory amount of four weeks' pay — S applied for immediate entitlement to severance pay and to $73,000 US — Application dismissed — Obligation to pay severance to S was not clear contractual obligation that was necessary for S to continue his employment, but obligation that arose on termination of services — Payment of severance amounts was discretionary — Discretion must be exercised in accordance with purpose of CCRA, which was to provide protection to company while it attempted to reorganize its affairs — Monitor correctly exercised his discretion — Retention agreement was never part of S's employment contract with M Ltd.

Table of Authorities

Cases considered by *Kent J.*:

Smoky River Coal Ltd., Re (2000), 2000 CarswellAlta 830, [2000] 10 W.W.R. 147, 83 Alta. L.R. (3d) 127, 19 C.B.R. (4th) 281, 2000 ABQB 621, 297 A.R. 1 (Alta. Q.B.) — distinguished

Smoky River Coal Ltd., Re (2001), 2001 ABCA 209, 2001 CarswellAlta 1035, [2001] 10 W.W.R. 204, 205 D.L.R. (4th) 94, 28 C.B.R. (4th) 127, 95 Alta. L.R. (3d) 1, 299 A.R. 125, 266 W.A.C. 125 (Alta. C.A.) — referred to

Statutes considered:

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

APPLICATION by former employee for immediate payment of severance and for bonus provided in former employment contract.

***Kent J.*:**

FACTS

1 Mirant Canada Energy Marketing, Ltd. and Mirant Canada Energy Marketing Investments Inc. ("Mirant Canada") applied for protection under the *Companies' Creditors Arrangement Act* (Canada) [1] ("*CCAA*") on July 15, 2003. An order (the "Initial Order") was granted on that date.

2 Paragraphs 16(c) and (d) of the Initial Order provide as follows:

> (c) all outstanding (both pre and post the date of filing of the Petition) and future wages, salaries, employee benefits, deferred payments, earned or to be earned, vacation pay (for continuing employees in the normal course), employee severance (subject to approval by the Monitor) and retention payments, statutory deemed trust amounts in favour of the Crown in Right of Canada or of any province thereof which were required to be deducted from employee's wages including without limitation, amounts in respect of employment insurance, Canada Pension Plan, income taxes and other like amounts due or accruing due to employees and present and future directors and the reimbursement of business expenses properly incurred by employees and present and future directors, and payments to operate and fund the payroll accounts (including source deductions) in respect of such employees (the "Employee Obligations"). Sufficient funds to pay the anticipated Employee Obligations may be placed in trust pursuant to a formal Trust Indenture by the Applicants, but only with the approval of the Applicants' shareholders;
>
> (d) with the consent of the Monitor, all payments, expenses and capital expenditures, whether incurred before or after the making of this Order, reasonably necessary for the economic preservation of the Property;

3 Prior to December 15, 2002, Robert Schaefer ("Schaefer") was employed by Mirant Services LLC in Atlanta, Georgia. In March, 2002, at the request of his employer, Schaefer signed a Retention Agreement. Under the terms of the Retention Agreement, Schaefer was entitled to an "Award Amount" of $72,800.00 (U.S.) on each of September 30, 2004 and September 30, 2005 provided that he was still employed by Mirant Services LLC and was performing in a satisfactory manner. The Retention Agreement also provided that in the event Schaefer ceased to be employed by Mirant Services LLC and became employed by another Mirant Group company, the Retention Agreement " . . . shall be assigned to that other Mirant company, which shall accept such assignment." The Retention Agreement was never assigned by Mirant Services LLC to Mirant Canada.

4 Effective December 15, 2002, Schaefer ceased to be employed by Mirant Services LLC and became employed by Mirant Canada in Calgary. The terms of Schaefer's employment with Mirant Canada were governed by a letter agreement dated December 9, 2002 (the "Letter Agreement") which contained the following statement:

> This letter agreement supercedes and replaces any terms of employment, benefits, or entitlements outlined in any and all agreements between you and Mirant Americas Energy Marketing LP and Mirant Services LLC.

The Letter Agreement provided for severance pay based upon a specified formula in the event that Schaefer's employment with Mirant Canada was terminated without cause.

5 Schaefer's position with Mirant Canada was Vice-President, Marketing and Development. In his affidavit sworn November 28, 2003, he deposes that both before and after July 15, 2003, the date of the Initial Order, he was involved in various activities and transactions pertaining to the financial difficulties and *CCAA* protection of Mirant Canada. He further deposes that Rod Pocza, President of Mirant Canada, represented to him that the *CCAA* protection of Mirant Canada would in no way affect his employment with Mirant Canada. He relied upon those representations in remaining in Mirant Canada's employ. Schaefer's employment with Mirant Canada was terminated on September 2, 2003.

6 Schaefer submitted a claim in the *CCAA* proceedings for severance pay pursuant to the Letter Agreement in the amount of $827,755.20 (Cdn.) The amount of that claim was accepted by PricewaterhouseCoopers (the "Monitor") and Mirant Canada. Schaefer also filed a Proof of Claim for $145,600.00 (U.S.) pursuant to the Retention Agreement.

Schaefer and Mirant Canada have now agreed on an amount of approximately $73,000.00 (U.S.) in respect of that Retention Agreement.

7 The Monitor's eleventh report dated March 8, 2004 says that Mirant Canada had paid severance to three other employees. The payment to two were amounts determined to be in accordance with Mirant Canada's usual severance guidelines. The amount paid to the third was less than the guideline amount but was an amount agreed to by the employee. The Monitor further says that the guideline amounts would not apply to Schaefer in any event because his severance entitlement was determined pursuant to the Letter Agreement. In a letter attached to the eleventh report, the Monitor says that in deciding whether or not to approve severance pay it based its decision " . . . principally on the effect which, in its view, non-payment of severance amounts would have upon other employees, and to a lesser extent upon the magnitude of the payments." The only amount which the Monitor approved for payment to Mr. Schaefer was statutory severance of $18,184.62, being the equivalent of four weeks' pay. The Monitor proposed immediate payment of a compromise amount. Mr. Schaefer refused and brought this application.

ISSUE

8 Is Schaefer entitled to immediate payment of the severance amount of $827,755.20 and the award amount of $73,000.00 or is his claim an unsecured claim which must be dealt with in the course of the *CCAA* proceedings?

APPLICANT'S ARGUMENTS

9 Schaefer put forward four arguments why he was entitled to immediate payment. First, he argues that his job of finding and retaining customers was critical to the continued operation of Mirant Canada because without customers, there would be no business. In essence, he argues that his involvement was crucial to Mirant Canada's ability to carry on business post-*CCAA*.

10 Secondly, he argues that he is entitled to rely upon representations that he says were made to him by Rod Pocza to the effect that the *CCAA* proceedings would not affect his employment or compensation including his severance pay.

11 Third, he argues that his claim is like a post-petition claim and that, as a general proposition, post-petition creditors are entitled to be paid in full. His position is that his continued employment with Mirant Canada post-*CCAA* is equivalent to his having been re-hired after July 15, 2003 and that, in terminating him after that date, Mirant Canada took on the obligation to pay him in full the severance contemplated by the Letter Agreement.

12 Finally, Schaefer argues that there is no principled basis for treating him differently from the two employees referred to in the eleventh report who received their severance payments in full. He argues that the only difference between him and those employees is the quantum of the severance to be paid and that, if fairness of treatment is a goal of the *CCAA*, the Court should not permit that he be treated differently simply on the basis of the amount owing.

13 Schaefer asks the Court to draw an analogy between his severance payment and the cost of repairs at issue in *Smoky River Coal Ltd., Re*[2]. In that case, LoVecchio J. held that monthly rental payments under certain equipment leases entered into post-*CCAA* should be paid in priority to other claims, but that costs of repair contemplated by the same agreements should not. The Court of Appeal overruled that portion of the judgment, holding that the costs of repair were part of the same contractual obligation and should also be paid in priority. Schaefer asks that the Court treat his monthly salary as analogous to the rental payments in *Smoky River* and his severance pay as analogous to the costs of repair. Schaefer argues that, like the costs of repair in *Smoky River*, his severance entitlement is an obligation which arose during the *CCAA* period and should be paid in full.

14 In *Smoky River Coal*, LoVecchio J. said that to be paid as post petition creditor, it is necessary to find that the services provided or work done was necessary to "keep the lights of the company on" (p. 137). Schaefer, relying on the Court of Appeal's judgment argues that it is sufficient to conclude that the severance, like the costs of repair, is an integral part of the contract. Schaefer also argues that the Court of Appeal in *Smoky River* noted the need to balance equities in

CCAA proceedings. There is nothing inequitable in paying his severance notwithstanding the fact that it is an amount larger than that received by other employees.

15 With respect to the payment of the amount under the Retention Agreement, Schaefer argues that since Mirant Canada has agreed to the amount of approximately $73,000.00 (U.S.), there is no issue as to his entitlement to such payment or as to the amount of such entitlement. Rather, he submits that the only issue is whether he should be paid that amount now or should have to make a claim as an unsecured creditor.

RESPONDENTS' ARGUMENTS

16 Argument on behalf of the Respondents was made principally by Enron Canada Corp. ("Enron"), Mirant Canada's largest unrelated creditor. Enron argues that the governing principles of the *CCAA* are fairness and reasonableness and as a result all creditors should be treated equally absent a statutory priority or order of the Court. Enron says that in *Smoky River*, LoVecchio J. characterized the purpose of the *CCAA* as allowing a company to carry on business during reorganization and said that any priority given to a creditor must be given in that context. Furthermore, LoVecchio J. said that such priorities should not be created lightly.

17 Enron argues that while paragraph 16(c) of the Initial Order gives Mirant Canada the flexibility to pay severance to employees, the employees have no right to such a payment. The Initial Order creates no charge which would create a priority for employee severance claims; therefore, the present case is distinguishable from *Smoky River*, where a separate charge and fund had been created by Court order. Enron says that had the Initial Order made specific provision for Schaefer's severance, that provision could have been challenged by the other creditors.

18 Enron further says that the determination of Schaefer's severance entitlement pursuant to the terms of the Letter Agreement is merely a question of liquidated versus unliquidated damages and does not affect the question of payment of that amount in priority to other creditors.

19 With respect to the representations made to Schaefer by Rod Pocza, Enron notes that Schaefer claims to have relied upon the Retention Agreement and the Letter Agreement but that there is no evidence of any collateral post-*CCAA* contract. Enron says that while Schaefer may have a claim against Mirant Canada or Rod Pocza for negligent misrepresentation, that does not affect the question of priority of payments.

20 Enron challenges Schaefer's analogy to the costs of repair in *Smoky River* and notes that the Court of Appeal in that case held that claims in respect of the cessation or termination of business are not the same. Enron says that the authorities are unanimous in holding that termination of a contract gives rise to an unsecured claim without any special priority.

21 Trans Canada Pipelines ("TCPL"), another major non-related creditor of Mirant Canada, says that Schaefer's claim is for damages for breach of contract that existed pre-*CCAA*. TCPL acknowledges that parties who agree to continue their contracts post-*CCAA* should be paid in the ordinary course for goods and services actually received. Schaefer received his salary while he worked for Mirant Canada post-*CCAA*. With respect to the contractual amounts of severance for breach of his employment contract, TCPL argues that Schaefer is entitled to this amount on the same basis as other creditors rather than receiving it in priority.

22 TCPL says that the Initial Order is permissive, allowing Mirant Canada, with the approval of the Monitor, to pay severance amounts, but not compelling it to do so. Paragraph 17(b) of the Initial Order provides that Mirant Canada can lay-off employees and deal with the consequences of such terminations in the Plan of Arrangement. Once the Plan of Arrangement is filed, if it contemplates payment of Schaefer's severance amount in priority to other creditors, the other creditors would then have the opportunity to approve or disapprove of the Plan and therefore of the proposed priority payment.

23 Paramount, the third major non-related creditor, argues that the Court of Appeal in *Smoky River* in fact held that the costs of repair as part of the lease payment were necessary to 'keep the lights on'. Severance pay, on the other hand, is not an expense associated with the day-to-day operations of the company. Rather, a severance payment is a penalty or obligation associated with the breach of an employment contract.

24 Finally, the Court heard from the Monitor. The Monitor indicated that its decisions with respect to payment of severance pay were based upon the economic preservation of Mirant Canada's business which is contemplated in paragraph 16(d) of the Initial Order. Its decisions were based on balancing the effect of payment or non-payment on other employees versus the economic effect of payment on the company.

ANALYSIS

25 The starting point for analysis of this issue is the decision in *Smoky River* by the Court of Appeal. There are three passages which I think are relevant to consider. The first is the Court of Appeal's commentary on LoVecchio J.'s analysis of post petition creditors. At para. 14, the Court of Appeal says the following:

> The second criteria for eligibility was that the debt in question was incurred in connection with the daily operating activities of Smoky River, as opposed to debts that arose from the cessation or termination of services. As stated by the *CCAA* judge (supra, at para. 40):
>
> > The main purpose of the charge was to encourage the creditors who supplied Smoky with goods and services to continue to deal with Smoky during the reorganization period. The critical characteristic of the service provided by the creditors must have been that it was essential to keeping "the lights of the company on". Thus, the costs or expenses incurred must be essential to the continued day-to-day operations of the mine. Penalties or obligations associated with the breach are not expenses associated with continued operations.
>
> We are in substantial agreement with the two eligibility criteria delimited by the *CCAA* judge.

26 Secondly, the Court of Appeal qualifies what LoVecchio J. said with respect to post petition creditors at para. 19 when it says:

> Therefore, while we accept that a *CCAA* judge's requirement that to qualify, a debt must have been incurred in connection with the daily operating activities of Smoky River, in the circumstances of this case, we interpret that requirement on commercially reasonable terms.

27 Finally, in connection with the specific claim by the equipment leasor which Mr. Schaefer argues is analogous to his situation, the Court of Appeal says the following at para. 24:

> Coneco was clearly a post petition trade creditor. The covenant to repair the equipment was just as much a term of the lease and a term of credit as Smoky River's obligation to pay rent. The repair costs were not a damage claim, but a clear contractual obligation that arose during the *CCAA* period. It is not commercially reasonable that Coneco would lease valuable equipment to Smoky River unless Smoky River maintained it in good operating condition. Had there been no obligation to maintain the equipment, the rental rate would have been considerably higher. This interpretation is consistent with commercial reasonableness.

28 Thus, for me to find the decision of the Court of Appeal in *Smoky River* analogous to Schaefer's situation, I would need to find that the obligation to pay severance pay to Schaefer was a clear contractual obligation that was necessary for Schaefer to continue his employment and not an obligation that arose from the cessation or termination of services. In my view, to find it to be the former would be to stretch the meaning of the obligation in the Letter Agreement to pay severance pay. It is an obligation that arises on the termination of services. It does not fall within a commercially reasonable contractual obligation essential for the continued supply of services. Only is his salary which he has been paid falls within that definition.

29 Schaefer says that Mr. Pocza made a new promise to Schaefer that he would be paid the severance pay in consideration for Schaefer continuing to work. However, the Initial Order provides that employee's severance payments can only be made subject to the approval of the Monitor. I am satisfied that the Monitor applied the right test in determining whether or not payment of the full amount of the contractual obligation was appropriate. As indicated above, the Monitor had to balance the effect of non-payment on the continued operation of the business and more specifically the morale of other employees against the economic effect on the company if the payment was made. The Initial Order excludes severance pay from categorization as a post petition creditor; rather it falls within those discretionary payments which the Monitor may pay. The promise made by Mr. Pocza is irrelevant in light of the provisions of the Initial Order.

30 With respect to the second principle argument of Schaefer, namely that it is fair and equitable that he receive his full severance, fairness and equity in the context of *CCAA* proceedings must be looked at in a broader context. It cannot trump the clear provisions of the Initial Order. Paying severance amounts is discretionary. That discretion must be exercised in accordance with the purpose of the *CCAA* which is to provide protection to a company while it attempts to reorganize its affairs. The Monitor correctly exercised his discretion.

31 The application by Schaefer for immediate payment of the severance pay is dismissed.

32 With respect to the Award Amount, there was no assignment to Mirant Canada. The application is dismissed.

Application dismissed.

Footnotes

* Additional reasons at *Mirant Canada Energy Marketing Ltd., Re* (2004), 2004 ABQB 334, 2004 CarswellAlta 561, 1 C.B.R. (5th) 261, 36 Alta L.R. (4th) 96 (Alta. Q.B.).

1 R.S.C. 1985, c. C-36.

2 (2000), 83 Alta. L.R. (3d) 127 (Alta. Q.B.), reversed in part (2001), 95 Alta. L.R. (3d) 1 (Alta. C.A.) ("*Smoky River*").

TAB 20

1993 CarswellQue 25
Supreme Court of Canada

Crabtree (Succession de) c. Barrette

1993 CarswellQue 155, 1993 CarswellQue 25, [1993] 1 S.C.R. 1027, [1993] S.C.J. No. 37, 101 D.L.R. (4th) 66, 10 B.L.R. (2d) 1, 150 N.R. 272, 39 A.C.W.S. (3d) 608, 47 C.C.E.L. 1, 53 Q.A.C. 279, J.E. 93-650, EYB 1993-67870

GASTON BARRETTE et autres c. Les Héritiers de feu H. ROY CRABTREE et HAROLD R. CRABTREE

Lamer C.J.C., L'Heureux-Dubé, Sopinka, Gonthier and Iacobucci JJ.

Heard: December 1, 1992
Judgment: March 25, 1993
Docket: n[o]/Doc. 22505

Counsel: *Guy Bertrand* and *Claude Dallaire*, for appellants
André J. Payeur and *Madeleine Renaud*, for respondents

Subject: Corporate and Commercial; Employment

Related Abridgment Classifications

Business associations

III Specific matters of corporate organization
III.1 Directors and officers
III.1.h Liabilities
III.1.h.i Statutory liability for wages
III.1.h.i.B What recoverable

Headnote

Corporations --- Directors and officers — Liabilities — Statutory liability for wages — What recoverable

Liability of directors to employees — Insolvent corporation ordered to pay certain sums to former employees in lieu of notice of dismissal — Such sums not constituting "debts ... for services performed for the corporation" within meaning of s. 114(1) of Canada Business Corporations Act — Directors cannot be made personally liable for such sums — Canada Business Corporations Act, S.C. 1974-75-76, c. 33, s. 114(1). .

The appellants were former management employees of W. Corp. The appellants obtained a judgment ordering W Corp. to pay them more than $300,000 in lieu of notice of dismissal. As W Corp. was insolvent, the appellants brought an action seeking a personal order against the respondent directors of W Corp. pursuant to s. 114(1) of the *Canada Business Corporations Act* ("CBCA"). That section provides that directors are, within limits, liable for all "debts ... to each such employee for services performed for the corporation" payable by the corporation. The trial judge allowed the action and ordered the directors to pay the sums owed. The Quebec Court of Appeal reversed the judgment, holding that the sums awarded were not "debts" within the meaning of s. 114(1). The former employees appealed.

Held:

The appeal was dismissed.

The sums were not paid for services performed for the corporation, but as damages arising from non-performance of a contractual obligation.

Directors will not be liable for all debts of the corporation to its employees if the corporation becomes insolvent or bankrupt. While the primary purpose of s. 114(1) of the CBCA is to protect employees, that provision constitutes an exception to the fundamental principles of corporate law applying to directors' liability. The section is limited, applying only to amounts claimed as debts for "services performed for the corporation." Even if the amounts in question were "debts," they were not debts for services performed. An amount payable in lieu of notice does not flow from services performed, but from damages arising from non-performance of a contractual obligation. Thus, the directors could not be personally liable for such amounts under s. 114(1).

Table of Authorities

Cases considered:

Asbestos Corp. v. Cook (1932), [1933] S.C.R. 86 — *referred to*

Columbia Builders Supplies Co. v. Bartlett, [1967] Que. Q.B. 111 (C.A.) — *referred to*

Domtar Inc. c. St-Germain, 38 C.C.E.L. 267, [1991] R.J.Q. 1271 (C.A.) — *referred to*

Fee v. Turner (1904), 13 Que. K.B. 435 (C.A.) — *referred to*

Hills v. Canada (Attorney General), [1988] 1 S.C.R. 513, 88 C.L.L.C. 14,011, 30 Admin. L.R. 187, 84 N.R. 86, 48 D.L.R. (4th) 193 — *referred to*

Mesheau v. Campbell (1982), 39 O.R. 702, 141 D.L.R. (3d) 155 (C.A.) — *referred to*

Meyers v. Walters Cycle Co., 32 C.C.E.L. 206, [1990] 5 W.W.R. 455, 71 D.L.R. (4th) 190, 85 Sask. R. 222 (C.A.) — *distinguished*

Mills-Hughes v. Raynor (1988), 38 B.L.R. 211, 19 C.C.E.L. 6, 25 O.A.C. 248, 63 O.R. (2d) 343, 68 C.B.R. (N.S.) 179, 47 D.L.R. (4th) 381 (C.A.) [additional reasons at (1988), 47 D.L.R. (4th) 381 at 388, 63 O.R. (2d) 730 (C.A.)] — *referred to*

Schwartz c. Scott, 32 B.L.R. 1, [1985] C.A. 713 (Qué.) — *distinguished*

Turcot c. Conso Graber Inc., [1990] R.D.J. 166 (C.A. Qué.) — *referred to*

Statutes considered:

Business Corporation Law, N.Y. Consol. Laws 1983, §630 [am. 1984, c. 212, s. 1].

Business Corporation Law, N.Y. Laws 1961, c. 855 —

s. 630

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

s. 114 [am. S.A. 1987, c. 15, s. 14]

Business Corporations Act, The, R.S.S. 1978, c. B-10 —

s. 114

Canada Joint Stock Companies Act, 1877, S.C. 1877, c. 43 —

s. 69

Canada Joint Stock Companies Letters Patent Act, 1869, S.C. 1869, c. 13 —

s. 49

Civil Code of Lower Canada —

art. 1065

art. 1078.1

Companies Act, R.S.Q. c. C-38 —

art. 96

Companies Act, The, 1934, S.C. 1934, c. 33 —

s. 96

Formation of corporations for manufacturing, mining, mechanical or chemical purposes, An Act to authorize the, N.Y. Laws 1848, c. 40 —

s. 18

Labour Standards Act, The, R.S.S. 1978, c. L-1 —

s. 2(r)

Canada Business Corporations Act, S.C. 1974-75-76, c. 33 [R.S.C. 1985, c. C-44] —

art. 114(1) [rempl. S.C. 1978-79, ch. 9, art. 1] [L.R.C. 1985, ch. C-44, art. 119(1)]

art. 114(2) [rempl. S.C. 1978-79, ch. 9, art. 1] [L.R.C. 1985, ch. C-44, art. 119(2)]

art. 114(2)(a) [rempl. S.C. 1978-79, ch. 9, art. 1] [L.R.C. 1985, ch. C-44, art. 119(2)(a)]

art. 114(3) [rempl. S.C. 1978-79, ch. 9, art. 1] [L.R.C. 1985, ch. C-44, art. 119(3)]

art. 114(4) [rempl. S.C. 1978-79, ch. 9, art. 1] [L.R.C. 1985, ch. C-44, art. 119(4)]

art. 114(5) [rempl. S.C. 1978-79, ch. 9, art. 1] [L.R.C. 1985, ch. C-44, art. 119(5)]

art. 114(6) [rempl. S.C. 1978-79, ch. 9, art. 1] [L.R.C. 1985, ch. C-44, art. 119(6)]

Canada Business Corporations Act, R.S.C. 1985, c. C-44 —

art. 119(1)

Business Corporations Act, R.S.O. 1990, c. B.16 —

art. 131

Stock Corporation Law, N.Y. Laws 1901, c. 354 —

s. 54

Stock Corporation Law §71 [am. 1952, c. 794, s. 2].

Appeal from judgment reported at [1991] R.J.Q. 1193 (C.A.), reversing judgment of Gagnon J. ordering directors to pay debts owing to former employees by corporation.

***L'Heureux-Dubé J.*:**

1 This appeal concerns the interpretation of s. 114(1) of the *Canada Business Corporations Act*, S.C. 1974-75-76, c. 33 ("C.B.C.A.") (now s. 119(1) of the *Canada Business Corporations Act*, R.S.C., 1985, c. C-44). Specifically, the question is whether, under that provision, the directors of a corporation against which employees have obtained a judgment, can be held personally liable for sums of money awarded by a court as pay in lieu of notice of dismissal. Section 114 C.B.C.A. reads as follows:

> *114.* (1) Directors of a corporation are jointly and severally liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.
>
> (2) A director is not liable under subsection (1) unless
>
> (*a*) the corporation has been sued for the debt within six months after it has become due and execution has been returned unsatisfied in whole or in part;
>
> (*b*) the corporation has commenced liquidation and dissolution proceedings or has been dissolved and a claim for the debt has been proved within six months after the earlier of the date of commencement of the liquidation and dissolution proceedings and the date of dissolution; or
>
> (*c*) the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy Act* and a claim for the debt has been proved within six months after the date of the assignment or receiving order.
>
> (3) A director is not liable under this section unless he is sued for a debt referred to in subsection (1) while he is a director or within two years after he has ceased to be a director.
>
> (4) Where execution referred to in paragraph (2)(*a*) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.
>
> (5) Where a director pays a debt referred to in subsection(1) that is proved in liquidation and dissolution or bankruptcy proceedings, he is entitled to any preference that the employee would have been entitled to, and where a judgment has been obtained he is entitled to an assignment of the judgment.
>
> (6) A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

I Facts

2 On May 17, 1985 Wabasso Inc. (hereinafter "the corporation") closed its plant at Trois-Rivières after experiencing serious financial difficulties. The appellants, 29 former managerial employees, were laid off. There being no agreement as to the amount to be paid by the corporation to its managerial employees in lieu of notice of dismissal, the appellants brought an action in the Quebec Superior Court. By judgment dated December 14, 1987, J.E. 88-416, Laroche J. ordered the corporation to pay the appellants $300,358.66 as pay in lieu of notice of dismissal, in addition to the indemnity provided for in art. 1078.1 C.C.L.C.

3 That decision was not appealed.

4 On January 27, 1988, after the corporation became insolvent, the appellants brought an action in the Court of Quebec pursuant to s. 114(1) C.B.C.A. seeking a personal order against the directors of the corporation (the "respondents"). By judgment dated May 25, 1989 Judge Gagnon allowed the appellants' action and ordered the respondents jointly and severally to pay the appellants the sum of $300,358.66 as well as the additional indemnity provided for in art. 1078.1 C.C.L.C.

5 On April 15, 1991 the Quebec Court of Appeal allowed the respondents' appeal.

II Judgments

Court of Quebec, Trois-Rivières, No. 400-02-000129-880, May 25, 1989, J.E. 89-1311

6 Noting that the pre-conditions for the remedy had been met and that the respondents had admitted that they were directors, Judge Gagnon formulated the issue as follows (at p. 3):

> [Translation]
>
> The court must interpret s. 114(1) C.B.C.A. to determine whether the amounts awarded to the plaintiffs by the Superior Court as dismissal notice are debts resulting from their performance of services for the company.

7 Judge Gagnon first remarked that, unlike s. 96 of the *Companies Act*, R.S.Q., c. C-38, in which the concept of wages is the determining element, the concept of debt is the cause, principle and basis for the liability of directors under s. 114 C.B.C.A. He expressed the view that the amounts awarded to the appellants by the Superior Court were "debts" within the meaning of that section, and added (at p. 12):

> [Translation]
>
> The Court considers that the notice period is not only a debt but clearly results from the performance of services for the company. In Quebec law, the notice period is compulsory and necessary. The authors Robert Gagnon, Louis Le Bel and Pierre Verge [*Droit du travail* (1971)] give a good explanation of it when they write [at p. 38]:
>
> > The dismissal or resignation notice ('notice period' is also used) is necessary to terminate a contract. It is an obligation for the party who intends to make use of unilateral rescission and a right for the other party.
>
> The notice period is therefore not comparable to damages since its purpose is to minimize the impact of the job loss by allowing the employee to make reasonable advance provision for the effects of dismissal. Reasonable notice of dismissal is therefore an integral part of the employment contract for an indefinite term, as was the case with the plaintiffs. Accordingly, this debt is associated with the performance of services for the corporation.

8 Relying on the Quebec Court of Appeal judgment in *Schwartz c. Scott*, [1985] C.A. 713, Judge Gagnon added that, like pay in lieu of notice owed under a collective agreement, the money awarded by the Superior Court was for services rendered. He therefore concluded (at p. 15):

[Translation]

It follows, therefore, that the amounts awarded to the plaintiffs by judgment on December 14, 1987 are debts associated with the performance of services for Wabasso Inc. The defendants, in their capacity as directors of Wabasso Inc., are thus jointly and severally liable for these debts up to the amount of six months' wages.

Court of Appeal, [1991] R.J.Q. 1193

9 The court first distinguished *Schwartz* on the ground that, unlike in the case at bar, the amounts awarded as pay in lieu of notice had been agreed upon in a clause in the collective agreement covering layoffs. The court relied on its decision in *Turcot c. Conso Graber Inc.*, [1990] R.D.J. 166, to the effect that s. 114(1) C.B.C.A. does not cover damages arising from a quasi-delict or a breach of contract. The court also referred to *Mesheau v. Campbell* (1982), 141 D.L.R. (3d) 155, in which the Ontario Court of Appeal held that a claim based on wrongful dismissal was an action for unliquidated damages and so was excluded from the scope of s. 114(1) C.B.C.A.

10 Having concluded that s. 114(2)(*a*) C.B.C.A. was an indicium that Parliament was targeting a due and liquidated debt, the court added (at pp. 1195-96):

[Translation]

In our opinion, the wording clearly suggests that what is meant is debts, such as for due and unpaid wages, due and unpaid vacation leave, overtime worked and not yet paid for, but the amount of which is known because the rates are specified in the employment contract (individual or collective as the case may be) or by law. It does not appear to refer to a debt which may possibly be quantified for breach of contract, layoff for economic reasons or wrongful dismissal. The debt here is not a liquidated and due one, but simply a contingent debt. Though the judgment on which the debt is based has become *res judicata* between the insolvent company and employees, the fact remains that it does not necessarily have this finality vis-à-vis the [respondent] directors and that it made no ruling on a "debt for services performed."

The primary purpose of the claims was to obtain a declaration as to the nature of the termination of the employment contracts and then to quantify the resulting damages for term of notice. These were claims for unliquidated damages.

11 The Court of Appeal therefore concluded, unlike the Court of Quebec judge, that the sums awarded by the Superior Court did not fall within the scope of s. 114 C.B.C.A.

III Issue

12 The only issue in this Court is whether the sums awarded by the Superior Court as pay in lieu of notice of dismissal were "debts ... for services performed for the corporation" within the meaning of that expression in s. 114(1) C.B.C.A.

IV Analysis

13

(A) Introduction

14 Section 114(1) C.B.C.A. is ambiguous. This ambiguity is evidenced, first, in the diametrically opposite conclusions arrived at by the Court of Quebec and the Court of Appeal. It is also reflected in the rules of interpretation put forward by each party, which lead to opposite results.

15 According to the appellants, the rules of statutory interpretation generally give a broad meaning to the word "debts" in s. 114(1) C.B.C.A. Thus, by reason of the remedial nature of that provision, a broad and liberal interpretation should be adopted so as to include the amounts awarded by the Superior Court as pay in lieu of notice. The respondents, on

the other hand, point out that s. 114(1) C.B.C.A. imposes a liability on them that goes beyond what the law ordinarily prescribes, being an exception to the general rule that directors are not liable for a company's debts. The respondents accordingly submit that, given the exceptional nature of directors' personal liability, s. 114(1) C.B.C.A. requires instead a strict interpretation.

16 In the interpretation of a statutory provision it is, in my view, advisable to begin with a consideration of its background, however briefly (see *Hills v. Canada (Attorney General)*, [1988] 1 S.C.R. 513, at p. 528). By identifying the purpose of the remedy, this approach sets the parties' arguments in their proper context while shedding light on the interests at stake.

(B) Origin and Background of s. 114(1) C.B.C.A.

(1) New York Legislation

17 The remedy provided for in s. 114(1) C.B.C.A. is based on a New York State law dating from 1848. That statute, *An Act to Authorize the Formation of Corporations for Manufacturing, Mining, Mechanical or Chemical Purposes*, N.Y. Laws 1848, c. 40, s. 18, provided that shareholders of companies covered by the law "shall be jointly and severally liable for all debts that may be due and owing to all their laborers, servants and apprentices, for services performed for such corporation". This provision was included in a general statute governing joint stock corporations (*Stock Corporation Law*, N.Y. Laws 1901, c. 354, s. 54), and it was not until a 1952 amendment (N.Y. Laws 1952, c. 794, s. 2) that the amounts covered by the remedy were listed more specifically, though not exhaustively. Before that date, s. 71 of the *Stock Corporation Law* (formerly s. 54) read as follows:

> The stockholders of every stock corporation shall jointly and severally be personally liable for all debts due and owing to any of its laborers, servants or employees other than contractors, for services performed by them for such corporation. Before such laborer, servant or employee shall charge such stockholder for such services, he shall give him notice in writing, within thirty days after the termination of such services, that he intends to hold him liable.

18 The amendment inserted the words "wages or salaries" after the word "debts" as well as a new section drafted as follows:

> For the purposes of this section, wages or salaries shall mean all compensation and benefits payable by an employer to or for the account of the employee for personal services rendered by such employee. These shall specifically include but not be limited to salaries, overtime, vacation, holiday and severance pay; employer contributions to pension or annuity funds; and any other moneys properly due or payable for services rendered by such employee.

19 In 1963, the new general law governing joint stock companies limited this personal liability to a company's ten largest shareholders (*Business Corporation Law*, N.Y. Laws 1961, c. 855, s. 630). The new provision governing shareholders' personal liability was designed to clarify the procedure for recovering money paid by the shareholders who were sued while at the same time ensuring that suits were not brought against shareholders with small holdings:

> By an amendment in 1952, wages and salaries were defined to include every variety of fringe benefits, including vacation, holiday and severance pay, and contributions to pension or annuity funds. The vice inherent in the statute lies in its imposition of "several liability" — so that *any* shareholder, however small his holdings in the corporation, may be personally liable for the full judgment (which may be extremely large in view of the extended definition of wages and salaries). *Moreover, case law does not clarify the contribution rights of the shareholder who has paid the entire judgment*. [Emphasis in original.]

(S. Hoffman, "The Status of Shareholders and Directors Under New York's Business Corporation Law: A Comparative View" (1961-62), 11 Buff. L. Rev. 496, at p. 544.)

20 Another author sums up the effect of the 1963 amendments as follows:

Prior to 1963, shareholders' liability for the items covered by the statute was joint and several, and the case law was by no means clear as to whether an individual shareholder held liable could seek contribution from other shareholders. NY BCL s. 630 retains the essential character of the former provisions, but mitigates some of the harsher aspects of the liability:

1. The liability is restricted to the ten largest shareholders as determined by the value of their beneficial interests in the corporation as of the date when the unpaid services began.

2. The right of contribution as between the ten largest shareholders is made specific, provided timely notice is given to the shareholders from whom it is sought.

(C.L. Israels, *Corporate Practice* (3rd ed. 1974), at pp. 10-11.)

21 See also D. Rogers and D.F. McManus, "Stockholders' Booby-Trap: Partnership Liabilities of Stockholders Under Section 71, New York Stock Corporation Law" (1953), 28 N.Y.U. L. Rev. 1149.

22 Section 630 of the New York *Business Corporation Law* now reads as follows:

630. Liability of shareholders for wages due to laborers, servants or employees

(*a*) The ten largest shareholders, as determined by the fair value of their beneficial interest as of the beginning of the period during which the unpaid services referred to in this section are performed, of every corporation (other than an investment company registered as such under an act of congress entitled "Investment Company Act of 1940"), no shares of which are listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or an affiliated securities association, shall jointly and severally be personally liable for all debts, wages or salaries due and owing to any of its laborers, servants and employees other than contractors, for services performed by them for such corporation. Before such laborer, servant or employee shall charge such shareholder for such services, he shall give notice in writing to such shareholder that he intends to hold him liable under this section. Such notice shall be given within one hundred and eighty days after termination of such services, except that if, within such period, the laborer, servant or employee demands an examination of the record of shareholders under paragraph (*b*) of section 624 (Books and records; right of inspection, prima facie evidence), such notice may be given within sixty days after he has been given the opportunity to examine the record of shareholders. An action to enforce such liability shall be commenced within ninety days after the return of an execution unsatisfied against the corporation upon a judgment recovered against it for such services.

(*b*) For the purposes of this section, wages or salaries shall mean all compensation and benefits payable by an employer to or for the account of the employee for personal services rendered by such employee. These shall specifically include but not be limited to salaries, overtime, vacation, holiday and severance pay; employer contributions to or payments of insurance or welfare benefits; employer contributions to pension or annuity funds; and any other moneys properly due or payable for services rendered by such employee.

(*c*) A shareholder who has paid more than his pro rata share under this section shall be entitled to contribution pro rata from the other shareholders liable under this section with respect to the excess so paid, over and above his pro rata share, and may sue them jointly or severally or any number of them to recover the amount due from them. Such recovery may be had in a separate action. As used in this paragraph, "pro rata" means in proportion to beneficial share interest. Before a shareholder may claim contribution from other shareholders under this paragraph, he shall, unless they have been given notice by a laborer, servant or employee under paragraph (*a*), give them notice in writing that he intends to hold them so liable to him. Such notice shall be given by him within twenty days after the date that notice was given to him by a laborer, servant or employee under paragraph (*a*).

(New York Consolidated Laws Service, Vol. 3 (Cumulative Supplement (1992)).)

(2) Canadian Legislation

23 Unlike its American precursor, the federal provision at issue here places the liability for certain debts of the corporation to its employees on the shoulders of the directors, rather than on those of the shareholders. Its original wording goes back to the first general legislation dealing with the incorporation of federal companies. Section 49 of the *Canada Joint Stock Companies Letters Patent Act, 1869*, S.C. 1869, c. 13, read as follows:

> *49.* The Directors of the Company shall be jointly and severally liable to the laborers, servants and apprentices thereof, for all debts, not exceeding one year's wages, due for services performed for the Company whilst they are such Directors respectively; but no Director shall be liable to an action therefor, unless the Company has been sued therefor within one year after the debt became due, nor yet unless such Director is sued therefor within one year from the time when he ceased to be such Director, nor yet before an execution against the Company has been returned unsatisfied in whole or in part; and the amount due on such execution shall be the amount recoverable with costs against the Directors.

24 By specifying that the sums paid by one director could be recovered from other directors, the federal statute avoided reproducing one of the flaws inherent in the American provision. Similarly, by placing this liability on the shoulders of directors rather than shareholders, the federal provision avoided the problem of the potential liability of shareholders with small holdings who had no part in the administration of the company. On the other hand, unlike its New York counterpart, the Canadian provision never formulated a specific definition of the amounts covered by the remedy. The most significant amendments were aimed at lowering the ceiling on directors' liability to six months' wages (S.C. 1877, c. 43, s. 69); shortening the time during which the company could be sued to six months rather than a year from the date the debt became due (S.C. 1934, c. 33, s. 96); replacing the list of beneficiaries by the generic term "employee" and modifying the company's bankruptcy date in the section regarding the pre-conditions of the remedy (S.C. 1974-75-76, c. 33, s. 114). Although a further modification arose after the commencement of the current litigation, this change has no bearing on the disposition of this appeal. Following the consolidation of December 12, 1988 the French version of s. 119(1) of the *Canada Business Corporations Act* now reads as follows:

> *119.* (1) Les administrateurs sont solidairement responsables, envers les employés de la société, des dettes *liées* aux services que ceux-ci exécutent pour le compte de cette dernière pendant qu'ils exercent leur mandat, et ce jusqu'à concurrence de six mois de salaire. [Emphasis added.]

25 The English wording has remained the same. Moreover, the above section was not intended to alter the substance of the earlier law:

> Consolidated statutes should be viewed as "declaratory of the law": although they may bring changes to the law, these are deemed to be purely formalistic.

(P.-A. Côté, *The Interpretation of Legislation in Canada* (2nd ed. 1991), at p. 433.)

26 Accordingly, the issue in this case is whether, in the absence of a specific definition of the nature of the debts Parliament had in mind, s. 114(1) C.B.C.A. applies to amounts awarded by a court as pay in lieu of notice. Parliament places the liability imposed by s. 114(1) C.B.C.A. on the shoulders of directors, on the one hand, for the benefit of a particular category of creditors, on the other. While clarifying the context of the remedy, both the case law and the doctrine indicate that these two facets are inseparable from its purpose.

(C) Purpose and Context of the Remedy

27 The primary purpose of the remedy provided for in s. 114(1) C.B.C.A. is to protect employees in the event of bankruptcy or insolvency of the corporation. This protection is part of a range of legislative measures which go far beyond the bounds of company law:

[Translation]

According to traditional wisdom, Parliament always was or should have been concerned with protecting employees affected by bankruptcy or insolvency.

This concern to provide protection can take various forms. It can be demonstrated by giving priority to a wage claim against the debtor's assets or against immovable property the value of which was increased by the employee's work, up to the amount of the value added. It can also take the form of providing a preferred claim in the debtor's bankruptcy or in the liquidation of the company.

In addition to these measures ... the protection of employees can take the form of a remedy against third parties, primarily the bank which has taken possession of the debtor's assets under s. 178(6) of the *Bank Act*, the beneficiary of an assignment of inventory and *the directors of an insolvent company*. [Emphasis added.]

(A. Bohémier and A.-M. Poliquin, "Réflexion sur la protection des salariés dans le cadre de la faillite ou de l'insolvabilité" (1988), 48 R. du B. 75, at p. 81.)

28 This overview of the general context indicates that the recourse provided for in s. 114(1) C.B.C.A. is distinguishable because it is brought against third parties, the directors. The observations of Hall J. in *Fee v. Turner* (1904), 13 Que. K.B. 435, clearly summarize the rationale underlying the remedy itself (at p. 446):

For lack of any other reason it occurs to me that what must have been had in view, was to protect to a limited extent those who were employed by such companies in positions which do not enable them to judge with any special intelligence what is the company's real financial position. The directors have personally this knowledge or should have it, and if, aware of the company's embarrassed affairs, and specially of the danger of a speedy collapse and insolvency, they continue to utilize the services of employees who have no means of securing this knowledge and who give their time and labour upon their sole reliance, often, on the good faith and respectability of the company's directors, it is not inequitable that such directors should be personally liable, within reasonable limits, for arrears of wages, thus given to their service.

29 Scholarly commentary has endorsed these observations concerning the purpose of the protection inherent in such measures. Thus, distinguishing employees from the corporation's other creditors, Prof. Marie-Louis Beaulieu dismisses as follows the argument that directors' liability is penal in nature:

[Translation]

And why would this penalty involve requiring them to pay the employees rather than the company's other creditors?

It will perhaps be said that such creditors deserve special consideration by the law: that is very true; and it is more logical to say that Parliament wished to protect the worker and nothing more, to give him a remedial action, a guarantee of payment, in view of his often difficult situation. As he has nothing to do with administration, he should not suffer the consequences of a disaster; he does not speculate, he will be paid for what his work is worth, whatever the company's profits.

("De la responsabilité des directeurs de compagnies pour le salaire des employés" (1930-31), 9 R. du D. 218 and 483, at p. 220.)

30 Iacobucci, Pilkington and Prichard similarly justify the protection at issue here by the special vulnerability of employees as compared with other creditors of the corporation:

This liability is an intrusion on the principle of corporate personality and limited liability, but it can be justified on the grounds that directors who authorize or acquiesce in the continued employment of workers when the corporation is

> not in a position to pay them should not be able to shift the loss onto the shoulders of the employees. Other creditors who supply goods and services to a failing corporation are not entitled to this kind of preference, but neither are they as dependent on the corporation as employees, nor as vulnerable.

(*Canadian Business Corporations* (1977), at p. 327.)

31 See also Raymond A. Landry, "Deux questions de politique législative en matière de faillite et d'insolvabilité l'indemnisation des salariés et les traitements préférentiels" (1986), 17 R.G.D. 305, at pp. 310-11.

32 Section 114(1) C.B.C.A. is located within a specific legal framework. In terms of the general principles governing company law, the provision is exceptional in at least three respects. First, the rule departs from the fundamental principle that a corporation's legal personality remains distinct from that of its members. In so doing, s. 114(1) C.B.C.A. creates an exception to the more general principle that no one is responsible for the debts of another. Further, unlike other statutory rules which may impose personal liability on directors, s. 114(1) C.B.C.A. does not contain an exculpatory clause as such:

> Contrary to the liability resulting from the inappropriate declaration of dividends, inappropriate financial assistance to shareholders and other statutorily created liability of directors, the statutes do not contain any exculpatory availabilities with respect to unpaid wages: the mere fact of having been a director at the time that the services were rendered by the employee renders the directors jointly and severally liable, provided the various statutory procedural requirements are fulfilled by the employee.
>
> The only possible exculpation, therefore, is proof by the director that he was *not* a director at the time the liability was incurred, that he was not sued within the proper prescriptive or statute of limitations period, or that the employee did not fulfil the relevant statutory pre-conditions which give rise to the director's liability.

(Yoine Goldstein, "Bankruptcy As It Affects Third Parties: Some Aspects", in Meredith Memorial Lectures 1985, *Bankruptcy — Present Problems and Future Perspectives* (1986), 198, at p. 212.)

33 Finally, the provision in question imposes on directors a positive obligation. This distinguishes it from most statutory rules, which prohibit directors from engaging in certain acts or transactions. As Marc Chabot points out:

> [Translation]
>
> In general, the statutory liability of directors involves the prohibition of certain actions. Liability is then associated with a decision which they took at some point on their own initiative. The obligation imposed on them is to avoid certain decisions in certain circumstances. The liability of directors for unpaid wages is perhaps the only case where a positive obligation is imposed on them: they must ensure that wages are paid in the event of bankruptcy or insolvency.

(*La protection des salaires en cas de faillite ou d'insolvabilité* (1985), at p. 91.)

34 It is against this background that the present appeal must be considered. While its purpose is to ensure that certain sums, including wages, are paid to employees in the event the corporation becomes bankrupt or insolvent, s. 114(1) C.B.C.A. constitutes a major excep tion to the fundamental principles of company law applicable to directors' liability. As we have seen, it also overrides the more general principle that no one is liable for the debts of another.

35 In this regard, there are two important parameters in connection with the employee's remedy. First, the directors' maximum liability is set at six months' wages. This parameter provides a ceiling which, while establishing a quantitative limit to the liability of the directors, does not in so doing determine the nature of the amounts covered by the action. The nature of the sums which Parliament had in mind must be considered instead from a second angle: regardless of quantum, the amounts claimed must be "debts ... for services performed for the corporation". I therefore cannot subscribe to the appellants' arguments that the first question to be answered is whether the job loss compensation falls within the broad

concept of "wages". In the context of s. 114(1) C.B.C.A., the word "wages" refers solely to the quantum of the directors' liability and cannot in itself guide the Court in disposing of the present case.

36 The parameter which is at the heart of the appeal is therefore not the concept of "wages", but the expression "debts ... for services performed for the corporation". In thus limiting the debts covered by the remedy, Parliament indicated that directors will not be personally liable for *all* debts assumed by the corporation to its employees. As Beauregard J.A. pointed out in *Schwartz c. Scott*, supra (at pp. 715-16):

> [Translation]
>
> The purpose of this provision is not to make directors liable for all the debts which a corporation may at its option assume more or less retroactively to its employees for past services.

37 In order to determine whether the amounts awarded as job loss compensation are "debts ... for services performed for the corporation", the nature of pay in lieu of notice of dismissal must therefore be examined in light of this criterion.

(D) Pay in Lieu of Notice of Dismissal and s. 114(1) C.B.C.A.

38 In the context of a contract of employment for an indefinite term, either of the parties may terminate the contract at any time by giving the other reasonable notice (*Asbestos Corp. v. Cook* (1932), [1933] S.C.R. 86, at pp. 99-100). The Quebec Court of Appeal restated the basis of this obligation in *Domtar Inc. c. St-Germain*, [1991] R.J.Q. 1271, at p. 1276:

> [Translation]
>
> For all classes of employees not mentioned in art. 1668, the principle of a reasonable notice applies. This principle, deriving from the customs and usages of old French corporations, has been elevated to a legal obligation in Quebec civil law under art.1024 of the *Civil Code*, which states:
>
> > The obligation of a contract extends not only to what is expressed in it, but also to all the consequences which, by equity, usage or law, are incident to the contract, according to its nature.

39 The main objective of this obligation is to give the employee the time to find a new job and the employer to find a new employee. Referring to Planiol and Ripert (*Traité pratique de droit civil français* (2nd ed. 1954), vol.11, at pp. 102-3), the Quebec Court of Appeal mentions this objective in *Columbia Builders Supplies Co. v. Bartlett*, [1967] Que. Q.B. 111, at p. 113:

> [Translation]
>
> The notice period is a period which anyone who takes the initiative in the termination must observe: it extends between the time notice of termination is given to the other party and the time he severs all working relations with that party ...
>
> The purpose of this institution is to avoid the other party being prejudiced by the sudden work stoppage: by being thus warned in advance, the employer can hire a new employee in good time to replace the one leaving, without any interruption in the work; similarly, the employee has time to look for a new position and avoid unemployment.

40 When, without reasonable cause, one of the parties breaches the obligation to give notice, or gives notice for an insufficient period of time, that party is liable to pay contractual damages under art. 1065 C.C.L.C. (see G. Audet, R. Bonhomme and C. Gascon, *Le congédiement en droit québécois en matière de contrat individuel de travail* (3rd ed. 1991), at p. 2-1). Professor Breton clearly summarizes the connection between an employer's contractual fault and the compensatory allowance awarded by the court:

> [Translation]

> The rules for a contract of employment for an indefinite term are that the employer can terminate it by giving the employee sufficient notice. This means that the employer has no obligation to go on providing work to an employee and, without reasonable cause, can terminate the contract at any time so long as this obligation of giving reasonable notice or the payment of wages in lieu thereof is satisfied. For this type of contract, the question of law which first arises is not whether the employer was entitled to terminate the contract, unless of course the employer relies on reasonable cause, but is rather the notice to which the employee was entitled in the circumstances. *This compensation for notice which may be awarded by the judge is to redress the damage resulting from the employer's fault in terminating the contract without meeting his obligation to give sufficient notice, assuming there was no reasonable cause of dismissal*. [Emphasis added.]

(L'indemnité de congédiement en droit commun" (1991), 31 C. de D. 3, at pp. 8-9.)

41 In light of the foregoing, it seems necessary to mention two separate errors made by the lower courts. These relate, first, to the characterization of the amounts awarded by the Superior Court, and second, to the requirements of s. 114(1) C.B.C.A.

42 After stressing that the notice of dismissal was mandatory and necessary, the trial judge concluded (at p. 12):

> [Translation]
>
> *The notice period is therefore not comparable to damages since its purpose is to minimize the impact of the job loss by allowing the employee to make reasonable advance provision for the effects of dismissal. Reasonable notice of dismissal is therefore an integral part of the employment contract* for an indefinite term, as was the case with the plaintiffs. Accordingly, this debt is associated with the performance of services for the corporation. [Emphasis added.]

43 With respect, the outcome of the appeal cannot depend simply on whether or not the obligation to give reasonable notice is part of the contract for an indefinite term. First, since the employer's failure to give reasonable notice is a contractual fault, the penalty for that failure must necessarily take the form of contractual damages. Second, as I noted earlier, the purpose of s. 114(1) C.B.C.A. is not to cover *all* debts assumed by the corporation to its employees. This point cannot be disregarded. Accordingly, the fact that the employer has an obligation under a contract of employment cannot in itself be conclusive for purposes of an action brought by the employee.

44 On the other hand, the fact that an obligation imposed on the employer is not expressed in specific monetary terms under the law or in the employment contract cannot be a bar to a remedy under s. 114(1) C.B.C.A. By concluding that this provision applied only to a debt [TRANSLATION] "the amount of which is known because the rates are specified in the employment contract (individual or collective, as the case may be) or by law" (p. 1196), the Court of Appeal added a condition that is not found in the wording of the provision. Section 114(1) C.B.C.A. establishes a quantitative limit on the amounts for which directors will be personally liable, and that is a sum equivalent to six months' wages. Directors are therefore in a position to know in advance the maximum amount of their potential liability in the event the company becomes bankrupt or insolvent. For the purposes of the present appeal, it does not seem necessary to dispose of the controversy that may arise as to the interpretation of the word "debts" taken in isolation. I am thus prepared to assume, without deciding, that the amounts payable in lieu of notice of dismissal are "debts" within the meaning of s. 114(1) C.B.C.A. However, the appellants' appeal must fail on another ground.

45 The term "debts" cannot be dissociated from the context in which it is used. According to the language used by Parliament, the debts must result from "services performed for the corporation". An amount payable in lieu of notice does not flow from services performed for the corporation, but rather from the damage arising from non-performance of a contractual obligation to give sufficient notice. The wrongful breach of the employment relationship by the employer is the cause and basis for the amounts awarded by the Superior Court as pay in lieu of notice. It is primarily for this reason that the Ontario Court of Appeal has excluded this type of compensation from the scope of s. 114(1) C.B.C.A. (see *Mesheau v. Campbell*, supra, at p. 157, and *Mills-Hughes v. Raynor* (1988), 47 D.L.R. (4th) 381, at pp. 386-87). In

the absence of additional legislative indicia, the performance of services by the employee remains the cornerstone of the directors' personal liability for debts assumed by the corporation. On the pretext of a broad interpretation, this Court cannot add to the text of the provision words which it does not contain. Taking account of the context in which s. 114(1) C.B.C.A. was enacted and the nature of the specific liability which departs from what the law ordinarily prescribes, it seems to me that only one conclusion logically follows.

46 In support of their arguments the appellants cited the Quebec Court of Appeal in *Schwartz c. Scott*, supra, and the Saskatchewan Court of Appeal in *Meyers v. Walters Cycle Co.* (1990), 85 Sask. R. 222. However, those two judgments can be distinguished from the case at bar.

47 In *Schwartz* the Court of Appeal held that the pay in lieu of notice provided for in the collective agreement was an amount for which the directors were personally liable. Under the collective agreement in that case, the employees were entitled to such compensation not only in the event of dismissal but also in the event of voluntary resignation. These amounts could therefore be regarded as "debts ... for services performed for the corporation", as the employees were entitled thereto simply because they had worked for a certain time. The judgment of the Saskatchewan Court of Appeal in *Meyers* was concerned not with s. 114(1) C.B.C.A. but with s. 114 of *The Business Corporations Act*, R.S.S. 1978, c. B-10, which reads:

> *114.* Directors of a corporation are jointly and severally liable, in accordance with *The Labour Standards Act*, to employees of the corporation for all debts payable to each such employee for services performed for the corporation while they are such directors respectively.

48 First, it is worth noting that provincial legislation provides, on a variety of conditions and to varying degrees, more or less extensive benefits for employees (see for example the *Companies Act*, R.S.Q., c. C-38, s. 96; the *Business Corporations Act*, R.S.O. 1990, c. B. 16, s. 131; the *Business Corporations Act*, S.A. 1981, c. B-15, s. 114). Moreover, the Court of Appeal relied chiefly on the definition of the term "wages" in *The Labour Standards Act*, R.S.S. 1978, c. L-1, s. 2, in concluding that the directors could be personally liable for the damages claimed for wrongful dismissal. That section reads as follows:

> *2.* In this Act:
>
> . . . . .
>
> (*r*) "wages" means all wages, salaries, pay, commission and any compensation for labour or personal services, whether measured by time, piece or otherwise, to which an employee is entitled; ...

49 Without commenting on the conclusion reached by the Court of Appeal in that case, it is important to note that, like the legislation of New York State since 1952, the Saskatchewan legislature has formulated its own definition of the sums that may fall within the directors' personal liability. Relying on this definition, therefore, the Court of Appeal was called upon to implement the legislative intent as expressed in the legislation in question. That is not the case here: the only benchmark provided by the wording of s. 114(1) C.B.C.A. is the performance by the employee of services for the corporation. In matters of statutory interpretation the courts cannot usurp the function of the legislature in the absence of clear language and legislative guidelines leading inevitably to a given conclusion. As Professor Côté points out, supra, at p. 248:

> *It would be unfair for the courts to impose a legislative intent, however true it might be, that the citizen could not infer from the text considered in its context*. The interpretative role of the courts does not allow them to add terms to a statute that are not already implicit therein. Even in the name of true intention, they may not override the public's reasonable expectation of the statute's meaning, as revealed by the words read in context. *This is true even if the results of interpretation obtained by reading the text in its context are less satisfactory than those resulting from inferred intention:* "*... it is better the law should be certain, than that every judge should speculate upon improvements in it*". [Emphasis added.]

(E) Conclusion

50 As with the examination of context surrounding the remedy provided for in s. 114(1) C.B.C.A., reference to comparative law makes it clear that the ambiguity of the provision in question should not be resolved by a mechanical application of a given rule of construction. Although the purpose of this provision is to ensure that cer tain sums are paid to employees in the event that the corporation becomes bankrupt or insolvent, the rule it states cannot be separated from either the legal context or the language in which Parliament has chosen to state the rule. In such circumstances, amounts awarded by a court for damages the basis of which is located, as here, in the non-performance of a contractual obligation and the wrongful breach of a contract of employment by the employer are not "debts ... for the performance of services for the corporation" for which the corporation's directors can thus be personally liable.

51 However much sympathy one may feel for the appellants, who have here been deprived of certain benefits resulting from the contract of employment with their employer, that does not give a court of law the authority to confer on them rights which Parliament did not intend them to have. In the absence of the provision here at issue, the employees would have suffered the same fate as any creditor dealing with an insolvent debtor, in this case the bankrupt employer. The Act provides a remedy, giving them recourse against the directors of the corporation, but it has limited that remedy both in quantity and in duration. Only Parliament is in a position, if it so wishes, to extend these benefits after weighing the consequences of so doing. This, in the final analysis, remains a political choice and cannot be the function of the courts.

52 With respect to costs, it seems to me that, given the circumstances of this case, the nature of the remedy and the ambiguity of the provision in question, each party should bear its own costs.

53 For these reasons I would dismiss the appeal, without costs.

Appeal dismissed.

End of Document

TAB 21

Most Negative Treatment: Distinguished
Most Recent Distinguished: Westar Mining Ltd., Re | 1996 CarswellBC 1360, 63 A.C.W.S. (3d) 1230, [1996] B.C.J. No. 1372, 41 C.B.R. (3d) 145, [1996] B.C.W.L.D. 1974, 96 C.L.L.C. 210-050, 77 B.C.A.C. 241, 126 W.A.C. 241, [1997] 1 W.W.R. 288, 25 B.C.L.R. (3d) 297, 136 D.L.R. (4th) 564 | (B.C. C.A., Jun 20, 1996)

1995 CarswellMan 173
Manitoba Court of Appeal

Brown v. Shearer

1995 CarswellMan 173, [1995] 6 W.W.R. 68, [1995] M.J. No. 182, 102 Man. R. (2d) 76, 12 C.C.E.L. (2d) 54, 19 B.L.R. (2d) 1, 33 C.B.R. (3d) 314, 55 A.C.W.S. (3d) 85, 93 W.A.C. 76

SCOTT BROWN v. DUNCAN SHEARER, KEITH VAN BEEK and RICHARD FOX

Huband, Philp and Kroft JJ.A.

Heard: March 23, 1995
Judgment: May 8, 1995
Docket: Doc. AI 94-30-02020

Counsel: *N.A. Cuddy* and *D.G. Joynt*, for appellant.
D.G. Douglas, for respondents.

Subject: Corporate and Commercial; Insolvency; Employment

Related Abridgment Classifications

Business associations

III Specific matters of corporate organization
III.1 Directors and officers
III.1.h Liabilities
III.1.h.i Statutory liability for wages
III.1.h.i.B What recoverable

Business associations

III Specific matters of corporate organization
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III.1.h.i.D Miscellaneous

Headnote

Corporations --- Directors and officers — Liabilities — Statutory liability for wages

Corporations --- Directors and officers — Liabilities — Statutory liability for wages — What recoverable

Corporations — Directors and officers — Liabilities — Statutory liability for wages — Employee's claim for severance pay not being claim respecting "services performed" under Canada Business Corporations Act —

Employee having no claim for severance pay against directors — Canada Business Corporations Act, R.S.C. 1985, c. C-44.

Corporations — Directors and officers — Liabilities — Statutory liability for wages — Directors liable to employee for vacation pay accrued while serving as directors under Canada Business Corporations Act since liability accruing as work performed — Canada Business Corporations Act, R.S.C. 1985, c. C-44.

Corporations — Directors and officers — Removal and resignation — No statutory limitation on right of director to resign.

The plaintiff was employed at MS Inc. for a three-year term. His employment contract included 12 months' severance pay and four weeks' vacation pay if he lost his position because the corporation ceased its operations. The three defendants had resigned as directors of MS Inc. on November 6, 1991; the company then had no directors. Two months later, MS Inc. went into receivership and the plaintiff's employment was terminated. As MS Inc. did not have the assets to satisfy his claims for severance pay and accumulated vacation pay, the plaintiff claimed against the three defendant directors of MS Inc. pursuant to s. 119(1) of the *Canada Business Corporations Act*. This section imposes liability on corporate directors to employees for debts not exceeding six months' wages for "services performed" for the corporation while they are directors.

The claim for vacation pay was resisted in part on the basis that no liability could be attached for the period of time after the defendants had resigned. The plaintiff responded that the resignations were invalid because they would have left the company without directors and therefore, they should be set aside under the oppression remedy in s. 241.

The plaintiff applied for summary judgment. The motions judge disallowed the claim for severance pay but allowed the claim for vacation pay. The plaintiff appealed and the defendants cross-appealed, claiming that the debt with respect to vacation pay did not crystallize until the plaintiff's employment was terminated.

Held:

The appeal was dismissed, and the cross appeal was allowed in part.

The plaintiff's claim for severance pay was not a claim for a debt in respect of "services performed." The amount payable for severance pay was unrelated to the quality or duration of service performed.

With respect to wages, the liability of a director under s. 119 cannot be avoided on the plea that the wages claim had not crystallized. Since the obligation to pay the employee's wages arises as and when the work is done, there was a debt. Similarly, there was a debt for vacation pay which accumulated as a result of the work performed by the employee. The existence of the debt did not hinge on whether the employee had completed the whole measure of work to entitle him to an annual vacation or on whether the employee had demanded his vacation rights. The plaintiff was entitled to vacation pay from the defendants for the amount which accumulated while they occupied their positions as directors.

The defendants' resignations were effective November 6, 1991. There is nothing in the *Canada Business Corporations Act* which limits the right of a director to resign. Section 111(2) contemplates the situation of a corporation continuing to operate without its directors. Moreover, it was not the resignations that caused the oppression to the plaintiff but rather the receivership and bankruptcy of MS Inc. The broad remedial powers under s. 241 of the *Canada Business Corporations Act* do not include the authority to retroactively cancel the resignations and reinstate the defendants against their will.

Table of Authorities

Cases considered:

Crabtree (Succession de) c. Barrette, (sub nom. *Barrette v. Crabtree Estate*) [1993] 1 S.C.R. 1027, 10 B.L.R. (2d) 1, 47 C.C.E.L. 1, (sub nom. *Barrette v. Crabtree (Succession de)*) 53 Q.A.C. 279, 150 N.R. 272, (sub nom. *Barrette v. Crabtree Estate*) 101 D.L.R. (4th) 66 — *followed*

Vopni v. Groenewald (1991), 39 C.C.E.L. 290, 10 C.B.R. (3d) 292, 84 D.L.R. (4th) 366 (Ont. Gen. Div.) — *not followed*

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16.

Canada Business Corporations Act, R.S.C. 1985, c. C-44 —

s. 108(1)

s. 108(2)

s. 111(2)

s. 119

s. 119(1)

s. 241

Vacations With Pay Act, The, R.S.M. 1987, c. V20, C.C.S.M., c. V20 —

s. 11(2)

s. 13(1)

s. 13(3)

Words and phrases considered:

SERVICES PERFORMED

. . . a claim for severance pay is not a claim for a debt in respect of "services performed" [as those words are found in s. 119(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44]. It is unlike salary or vacation pay which relate to work performed over a period of time. The severance pay is in the nature of a payment which [the employer] was entitled to make at any time to relieve itself of the burden of the employment contract . . . The amount was unrelated to the quality or duration of [the employee's] service to the company.

Appeal and cross-appeal from judgment reported at [1994] 8 W.W.R. 290, 96 Man. R. (2d) 34 (Q.B.), allowing in part an application for summary judgment on wage claim against directors under s. 119(1) of the *Canada Business Corporations Act*.

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

1 The plaintiff Scott Brown, whose employment at a company, MacLeod-Stedman Inc. (MSI), came to an end as a result of a receivership, has sued the defendants who were directors of MSI claiming severance pay and vacation pay. Brown contends that the directors are liable by virtue of s. 119(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44.

2 The defendants answer that there is no liability because they had resigned as directors over two months before Brown's employment was terminated and, in any event, the claims advanced do not fall within the ambit of s. 119(1), in that they are not "debts ...for services performed for the corporation."

3 The plaintiff Brown joined the staff of MSI at a high level position on October 1, 1990. There is no secret that the company was experiencing serious financial difficulties and it was hoped that Brown would be able to improve the situation. He was induced to accept the position as vice-president and general manager with a generous employment offer from MSI contained in a letter dated August 21, 1990. The letter specified a salary of $150,000 per annum. Benefits included four weeks' vacation starting in 1991, a company car, club membership, and possible bonuses. The letter specified that the contract was for a three-year term to be extended annually unless notice was given by either party 90 days prior to the concluding date of the contract. The letter then contained this additional provision:

> Twelve months of your current salary will be paid to you as severance under any one of the following three conditions:
>
> a) Your employment is terminated at any time for reasons other than just cause;
>
> b) You lose your job due to the sale of the company; or
>
> c) You do not have a position because the company ceases its operations.

4 The latter contingency occurred. Brown had worked 66.6 weeks when the receivership was imposed and his employment terminated on January 10, 1992.

5 It is agreed by the parties that during the course of his employment Brown had not taken his full vacation entitlement. As of January 10, 1992 he was entitled to accrued vacation pay of $7,437.51.

6 There is no doubt that as against MSI Brown would be entitled to his severance pay of $150,000, plus the accumulated vacation pay. The company went into bankruptcy and Brown filed a claim as an un secured creditor in bankruptcy, but the indications from the trustee in bankruptcy are that all of the assets will be used up to pay the claims of secured creditors. Thus Brown attempts to effect collection of his claim, or at least a substantial part of it, from the three defendant directors. Section 119(1) of the *Canada Business Corporations Act* reads as follows:

> Directors of a corporation are jointly and severally liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.

7 The maximum exposure under s. 119 with respect to the plaintiff Brown is $75,000.

8 As noted, the defendant directors deny the claim for severance pay on the basis that it does not relate to "services performed" and they deny liability for both the severance pay and the vacation pay because they had resigned as directors some two months prior to the receivership.

9 Kennedy J. of the Court of Queen's Bench disallowed the claim for severance pay [reported *Brown v. Shearer*, [1994] 8 W.W.R. 290 (Man.)], and the plaintiff Brown appeals. Kennedy J. allowed the claim for vacation pay in the full amount of $7,437.51, and the defendant directors cross appeal.

10 I agree entirely with the conclusion of Kennedy J. that the claim for severance pay is not a claim for a debt in respect of "services performed."It is unlike salary or vacation pay which relate to work performed over a period of time. The severance pay is in the nature of a payment which MSI was entitled to make at any time to relieve itself of the burden of the employment contract. The amount payable would be precisely the same if MSI had terminated the plaintiff Brown's employment, without cause, on the day after it had begun, or on the day before his contract was about to expire. The amount was unrelated to the quality or duration of his service to the company.

11 The disposition of this aspect of the claim is consistent with the decision of the Supreme Court of Canada in *Crabtree (Succession de) c. Barrette*, (sub nom. *Barrette v. Crabtree Estate)* [1993] 1 S.C.R. 1027, in which a claim for damages in lieu of notice, as compensation for wrongful dismissal, was not considered as a debt for the performance of services for the corporation.

12 I would dismiss the appeal of the plaintiff Brown.

13 I turn now to the cross appeal by the defendants with respect to the award of vacation pay in favour of the plaintiff Brown.

14 The defendants claim that the debt with respect to vacation pay did not crystallize until the termination of the plaintiff Brown's employment on January 10, 1992, and at that time each of the defendants had long since ceased to be a director of MSI.

15 The validity of the defendants' position depends on two things: firstly, that there was no "debt" with respect to vacation pay until January 10, 1992; and, secondly, that the resignations of the directors were effective when tendered some two months earlier on November6, 1991.

16 There is support for the first position in the case of *Vopni v. Groenewald* (1991), 84 D.L.R. (4th) 366, a decision of McKeownJ. of the Ontario Court (General Division). In that case an employee whose employment had been terminated sued a director for vacation pay. The director had resigned his position some five months earlier. While it was true that the obligation to allow the employee a vacation had gradually accrued during the time the defendant served as director, it was said that the right to a vacation had not been transformed into a debt for vacation pay until the actual termination of employment (at pp. 370-371):

> ...Mr. Vopni did not have an absolute right to take his vacation, except that he could have demanded his first year's entitlement within 10 months after the completion of the first year. While *Mills-Hughes v. Raynor* [(1988), 47 D.L.R. (4th) 381 (Ont. C.A.)], stated that upon termination, vacation pay is a debt due to employees for services performed, I am of the view that the debt did not crystallize until Mr. Vopni was terminated, and this was five months subsequent to Mr. Groenewald's resignation as a director. The purpose of s. 119 is to urge directors to keep payments to the employees current. In this case, all the company's obligations to Mr. Vopni were current while Mr. Groenewald was a director. There are no debts which crystallized at the time Mr. Groenewald ceased to be a director and thus he had no liability under s. 119.

17 With respect, I think McKeown J. was wrong in making his determination on the basis that the claim had not crystallized. There is a contractual obligation on the part of MSI not only to allow the plaintiff Brown an earned annual vacation, but to pay him his regular wage during that vacation time. As the employee earns his vacation entitlement by his work, week by week and month by month, so too he earns the right to be paid during his vacation time. At any given time the obligation with respect to vacation pay can be determined just as the obligation to pay wages can be determined. This is the thrust of *The Vacations with Pay Act*, R.S.M. 1987, c. V20, and in particular ss. 11(2), 13(1) and 13(3).

18 With respect to wages, the liability of a director under s. 119 cannot be avoided on the plea that the wages claim had not crystallized. To take an example, if the employee was being paid on a monthly basis, and the director resigned his position half way through the month, the director cannot escape liability which otherwise might arise under s. 119 by

asserting that the debt for wages would not crys tallize until the end of the month. The obligation to pay the employee his wages arises when the work is done. There is indeed a debt.

19 Similarly, there is a debt with respect to vacation pay which has accumulated due to the work performed by the employee, and the existence of the indebtedness does not hinge on whether the employee has completed the whole measure of work to entitle him to an annual vacation or whether the employee has demanded his vacation rights.

20 The extent of the contractual obligation has in fact been calculated by the parties in the present case. The accumulated vacation pay up to the date of the resignations of the defendant directors on November 6, 1991 was $5,377.10, and a further $2,060.41 accrued between then and January 10, 1992.

21 The plaintiff Brown is therefore entitled to the sum of $5,377.10 from the defendant directors, since that debt arose while they were occupyingtheir positions as directors.

22 Counsel for the defendant directors claims that his clients are not liable for vacation pay accruing after their resignations, namely, the remaining $2,060.41. That question is to be decided on the basis of whether the directors' resignations were effective.

23 The plaintiff Brown argues that the three directors could not validly resign on November 6th because it would have left the company with no directors, and a company cannot function in the absence of directors. It is argued that, if need be, the resignations should be set aside by the Court exercising its authority under s. 241 of the *Canada Business Corporations Act* on the grounds that the tendering of the resignations, without the knowledge of the plaintiff Brown, constituted oppressive conduct which the Court can remedy.

24 It would seem that the defendant directors tendered their resignations for proper reasons. MSI was in financial difficulty. In the fall of 1991 attempts were made to dispose of certain real property owned by MSI in the hope that the proceeds of sale would keep creditors at bay. When a sale of the real property could not be concluded, the principal secured creditors arranged that the accounting firm of Ernst & Young Inc. become involved in the management, with the intent that the business of MSI should be sold. Cotter & Co. was identified by Ernst & Young Inc. as a potential purchaser. All of the directors of MSI, save for the three defendants, resigned on October 28th and the three defendants resigned nine days later. The three defendants said they resigned because effective control was being exercised by Ernst & Young Inc. on behalf of the secured creditors. They thought a sale of the business would be successfully consummated. Two of the three remained as officers of MSI, and were compensated as such, after their resignations as directors.

25 Section 108(1) of the *Canada Business Corporations Act* states that a director ceases to hold office when he dies or resigns, and s. 108(2) specifies that a resignation becomes effective at the time that the written resignation is sent to the corporation, or at the time specified in the resignation, whichever is later. There is nothing in the Act which limits the right of a director to resign. (This is in contrast to the Ontario *Business Corporations Act*, as an example, which specifies that a director is not permitted to resign unless a successor is available.)

26 Counsel for the plaintiff Brown suggests that it is impossible to conceive of a corporation continuing to operate without directors, but the *Canada Business Corporations Act*, under s. 111(2), contemplates that very situation. It provides that if there is no quorum of directors, or if there has been a failure to elect the required number of directors, the directors then in office shall call a special meeting of shareholders to fill the vacancy and if they fail to call a meeting, *or if there are no directors then in office*, the meeting may be called by any shareholder.

27 Apart from a statutory limitation, no authority was cited to us to support the proposition that a director of a company must continue to serve as a director against his will after having tendered his resignation.

28 Counsel for the plaintiff Brown argues that this Court can provide a remedy under the broad authority of s. 241 of the *Canada Business Corporations Act*. The resignations, it is argued, give rise to oppression and as a remedy it is suggested that the resignations can be retroactively annulled.

29 It was not, however, the resignations that caused oppression but rather the receivership and bankruptcy of MSI. In any event, even the broad remedial powers under s. 241 do not include the authority to retroactively cancel the resignations and reinstate the defendants against their will.

30 In my view the resignations were effective as of November 6, 1991, with the consequence that the claim for vacation pay is limited to $5,377.10 which had accumulated while the defendants served as directors.

31 The appeal by the plaintiff Brown is dismissed. The cross appeal by the defendant directors is allowed in part. The defendants are entitled to costs of the appeal.

Appeal dismissed; cross appeal allowed in part.

TAB 22

Most Negative Treatment: Reversed
Most Recent Reversed: Norris, Re | 1996 CarswellAlta 884, 45 Alta. L.R. (3d) 1, 66 A.C.W.S. (3d) 1021, [1996] A.W.L.D. 1103, 193 A.R. 15, 135 W.A.C. 15, 44 C.B.R. (3d) 218, [1997] 2 W.W.R. 281, [1976] A.J. No. 975, [1996] A.J. No. 975 | (Alta. C.A., Nov 13, 1996)

1994 CarswellAlta 353
Alberta Court of Queen's Bench, In Bankruptcy

Norris, Re

1994 CarswellAlta 353, [1994] A.W.L.D. 831, [1994] A.J. No. 699, [1995] 1 W.W.R. 292, 161 A.R. 77, 23 Alta. L.R. (3d) 397, 28 C.B.R. (3d) 167, 50 A.C.W.S. (3d) 175

Re Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended; Re bankruptcy of DAVID CARL NORRIS

Agrios J.

Judgment: September 21, 1994
Docket: Doc. Edmonton BKCY 39553

Counsel: *K.A. Rowan*, for Browning, Smith Inc., trustee in bankruptcy of David Carl Norris.
S.J. Bocock, for Minister of National Revenue.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications
Bankruptcy and insolvency

XI Avoidance of transactions prior to bankruptcy
XI.2 Fraudulent preferences
XI.2.e View to prefer
XI.2.e.iii Intention other than to prefer
XI.2.e.iii.E Miscellaneous

Bankruptcy and insolvency

XI Avoidance of transactions prior to bankruptcy
XI.2 Fraudulent preferences
XI.2.g Doctrine of pressure

Headnote
Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Doctrine of pressure

Fraudulent preferences — Rebuttal of statutory presumption — Bankrupt making payment to Revenue Canada two months before date of bankruptcy — Revenue Canada unable to rebut presumption by showing that it was diligent creditor or that payment was made in ordinary course of business — Revenue Canada required to pay trustee amount received from bankrupt.

Revenue Canada was owed money by the bankrupt. It made several demands for payment. The bankrupt requested and was granted a one-month grace period, after which he paid $8,548.40 to Revenue Canada. Two months later, he made an assignment in bankruptcy. The trustee in bankruptcy applied for a declaration that the payment to Revenue Canada was a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act* and for an order requiring the payment to the trustee of $8,548.40.

Held:

The application was allowed.

Revenue Canada could rebut the statutory presumption under s. 95 by showing either that: (1) it was a diligent creditor, or (2) the payment was made in the ordinary course of business. Revenue Canada's forwarding of three letters to the bankrupt and the granting of a grace period could be described as steps that an ordinary creditor would take. Its actions were not sufficiently aggressive as to create an imminent business or personal crisis for the bankrupt. Had they been so, Revenue Canada would have rebutted the statutory presumption. As Revenue Canada did not constitute a trade creditor of the bankrupt, it could not be said that it received the payment in the ordinary course of business.

Table of Authorities

Cases considered:

Coopers & Lybrand Ltd. v. O'Brien Electric Co. (1983), 47 C.B.R. (N.S.) 243, 48 N.B.R. (2d) 189, 126 A.P.R. 189 (Q.B.) — *referred to*

Houston v. Thornton (1973), 18 C.B.R. (N.S.) 102 (Ont. S.C.) — *referred to*

Statutes considered:

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

s. 95

s. 95(2)

Application by trustee in bankruptcy for declaration that payment to Revenue Canada was fraudulent preference.

***Agrios J.*:**

1 In this bankruptcy I held that a payment of $8,548.40 made to Revenue Canada was a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act*.

2 At the time the decision was rendered, I indicated to counsel that should they require written reasons I would be happy to provide such and I now do so at the request of counsel for Revenue Canada.

Facts

3 The facts are not in issue. On November 25, 1992 Revenue Canada received a payment on taxes of $8,548.40 from David Carl Norris. On January 26, 1993 Mr. Norris made a voluntary assignment into bankruptcy.

4 Revenue Canada had made a series of demands on the bankrupt. There was a letter on September 12, 1992, a notice of October 9, 1992 amending the balance owing and again demanding payment, and a final letter on October 24, 1992 making still a further demand and stating that if arrangements were not made for payment, legal action such as garnishee of income or instructions to the Sheriff to seize and sell assets might be made. On October 29, 1992 the bankrupt called Revenue Canada in response to the last letter, and requested a one-month grace period, which was granted and the aforementioned payment was received on November 25, 1992.

Issues

5 There is no serious dispute that the prima facie presumption under s. 95 as raised by the Trustee had established the three required criteria, namely:

1. that the transfer took place within three months of bankruptcy;

2. that at the date the transfer was made, it gave the creditor a preference in fact;

3. that the debtor was an insolvent person at the date of the payment.

6 Section 95(2) of the Act provides that the presumption may be rebutted on a balance of probabilities that the dominant intention of the debtor was not to prefer the creditor. There were only two issues that Revenue Canada could use to rebut the presumption:

1. they were a diligent creditor;

2. alternatively, the payment was made in the ordinary course of business.

Ordinary Course of Business

7 I have accepted the submission of counsel for the Trustee. As stated in its brief of law, all of the cases cited by Revenue Canada can fairly be characterized as payments made by the debtor in the ordinary course of its business to trade creditors for two reasons Firstly, so that the bankrupt might take advantage of favourable payment terms or, secondly, to secure a continued supply of goods and services from those trade creditors in order that it might continue in its business. There is no doubt that evidence that after payment on account, goods were supplied to the bankrupt by a trade creditor which, under normal circumstances, rebut the presumption. I accept Mr. Rowan's submission that Revenue Canada was not a trade creditor and there was no evidence that would assist Revenue Canada to be considered a trade creditor in having received a payment in the ordinary course of business.

Diligent Creditor

8 The case of *Houston v. Thornton* (1973), 18 C.B.R. (N.S.) 102 (Ont. S.C.), followed by *Coopers & Lybrand Ltd. v. O'Brien Electric Co.* (1983), 47 C.B.R. (N.S.) 243 (N.B. Q.B.), is cited for the following proposition [p. 103]:

> Both creditors had substantially overdue accounts and both were exerting every effort to obtain payment of their accounts. As has been so often said, our law does not penalize a diligent creditor. In order for me to set aside these transactions, I must find that there was a fraudulent scheme on the part of the debtor to prefer these creditors over other creditors.
>
> On the evidence, I cannot find any such scheme. Rather, I think it is a situation where diligent creditors have managed to obtain substantial payments on their accounts at a time when other creditors, who were not as diligent, did not obtain payment.
>
> ... The only reason for making the payments to the respondents was because the respondents were pressing more vigorously than other creditors for payment of their accounts.

9 I have again accepted the submissions of counsel for the Trustee that these authorities are characterized by a theme of an extremely aggressive creditor whose actions would cause an imminent business crisis unless they were dealt with. As Mr. Rowan stated: "The payments were motivated by a desire to 'get the creditor off the debtor's back', and because the continued actions of the creditor would cause an immediate business crisis."

10 Frankly, in my view, the forwarding of three letters, one of which threatened legal action and the subsequent granting of one month's grace period, could best be described as steps that any ordinary creditor would take, making demands and threatening legal proceedings. I accept the proposition that the actions of Revenue Canada, when compared with those in the cited authorities, did not amount to such aggressive action such as to create an imminent business or personal crisis for the bankrupt. Had Revenue Canada in fact taken garnishee proceedings or instructed seizure, I should have held otherwise.

11 Accordingly, as the presumed intention was not, in my view, rebutted on the balance of probabilities, I ordered that Revenue Canada pay the Trustee the sum of $8,546.40.

Application allowed.

End of Document

Most Negative Treatment: Distinguished
Most Recent Distinguished: Andrews (Trustee of) v. Minister of National Revenue | 2011 MBQB 50, 2011 CarswellMan 102, 263 Man. R. (2d) 120, [2011] 4 C.T.C. 128, 75 C.B.R. (5th) 305, 199 A.C.W.S. (3d) 704, [2011] 8 W.W.R. 774 | (Man. Q.B., Mar 11, 2011)

1996 CarswellAlta 884
Alberta Court of Appeal

Norris, Re

1996 CarswellAlta 884, [1976] A.J. No. 975, [1996] A.W.L.D. 1103, [1996] A.J. No. 975, [1997] 2 W.W.R. 281, 135 W.A.C. 15, 193 A.R. 15, 44 C.B.R. (3d) 218, 45 Alta. L.R. (3d) 1, 66 A.C.W.S. (3d) 1021

The Attorney General of Canada (Appellant) and Browing Smith, Trustee of the Estate of David Carl Norris, a Bankrupt (Respondent)

Belzil, Bracco and O'Leary JJ.A.

Heard: April 12, 1996
Judgment: November 13, 1996
Docket: Edmonton Appeal 9403-0459-AC

Proceedings: reversing (1994), 23 Alta. L.R. (3d) 397 (Q.B.)

Counsel: *J.L. Medhurst*, for appellant.
K.A. Rowan, for respondent.

Subject: Insolvency

Related Abridgment Classifications
Bankruptcy and insolvency

XI Avoidance of transactions prior to bankruptcy
XI.2 Fraudulent preferences
XI.2.e View to prefer
XI.2.e.iii Intention other than to prefer
XI.2.e.iii.E Miscellaneous

Bankruptcy and insolvency

XI Avoidance of transactions prior to bankruptcy
XI.2 Fraudulent preferences
XI.2.g Doctrine of pressure

Headnote
Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Intention other than to prefer — Miscellaneous issues

Bankruptcy — Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Intention other than to prefer — Miscellaneous issues — Bankrupt making payment to Revenue Canada two months

prior to voluntary assignment into bankruptcy — Chambers judge setting aside payment as fraudulent preference — Chambers judge not being made aware of fact that bankrupt borrowing funds from relative to pay Revenue Canada and that bankrupt controlling timing of bankruptcy — Omitted evidence tending to be evidence to contrary rebutting presumption of intent to make preference — Matters to be remitted back for rehearing — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 95.

Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Doctrine of pressure

Bankruptcy — Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Doctrine of pressure — Bankrupt making payment to Revenue Canada two months prior to voluntary assignment into bankruptcy — Chambers judge setting aside payment as fraudulent preference — Chambers judge not being made aware of fact that bankrupt borrowing funds from relative to pay Revenue Canada and that bankrupt controlling timing of bankruptcy — Omitted evidence tending to be evidence to contrary rebutting presumption of intent to make preference — Matters to be remitted back for rehearing — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 95.

The bankrupt received three demand letters from Revenue Canada, the last of which threatened legal action. He obtained a one-month grace period, then borrowed money from a family member to pay the sum owing. Two months later, he made a voluntary assignment into bankruptcy. The trustee-in-bankruptcy applied to set aside the payment as a fraudulent transaction under s. 95 of the *Bankruptcy and Insolvency Act*. The trustee failed to disclose that any of the unsecured creditors claiming against the estate were family members of the bankrupt. The chambers judge allowed the trustee's application. Revenue Canada appealed.

Held:

Appeal allowed; new hearing ordered.

Per Belzil J.A. (Bracco J.A. concurring):

Section 95 of the Act creates and defines the concept of fraudulent preference as it applies in bankruptcy. It sets out three elements which must be proven by the trustee in order to establish a fraudulent preference, namely: that the payment was made to an ordinary creditor within three months of the bankruptcy; that the bankrupt was an insolvent person at the time the payment was made, and that the payment was made by the debtor with a view to giving that creditor a preference over other creditors. Once the first two elements are established and the trustee proves that the creditor received a preference in fact over other creditors, then s. 95(2) raises a presumption, in the absence of evidence to the contrary, that the preference was in fact made with a view to giving a preference over other creditors and was therefore fraudulent. The presumption is rebuttable if the totality of the evidence to the contrary is sufficient to show that the debtor did not have the dominant intent to prefer the creditor over others when he made the impeached payment. While there was no question that Revenue Canada did in fact receive a preference from the bankrupt, the evidence failed to establish that the bankrupt intended that the payment would confer such a preference. The fact that a family relationship existed between one of the creditors and the bankrupt was not brought to the attention of the chambers judge, and might have been evidence suggesting that a preference to Revenue Canada was unlikely. Likewise, the factual circumstances surrounding the payment to Revenue Canada were disclosed, but not in any detail, particularly the fact that the bankrupt himself orchestrated the events leading up to the payment as well as the timing of the bankruptcy. Both of those circumstances could have been evidence to the contrary capable of rebutting the presumption, but that evidence was not drawn to the courts' attention by the trustee. The trustee-in-bankruptcy was bound to perform his duty as an officer of the court and not adopt an adversarial and hostile role. In the present circumstances, the trustee failed to maintain that neutrality, and instead, despite having all of the relevant facts at his disposal, presented only sufficient evidence to invoke the presumption without disclosing facts which could have amounted to evidence to the contrary. In the result, the issues as to whether

the bankrupt was insolvent at the time of the payment and whether the presumption, if it arose, was rebutted by evidence to the contrary, should be retried.

Per O'Leary J.A. (dissenting):

As all of the facts were now before the court, any further investigation of the facts was unnecessary. This was not a test case; its resolution merely turned on the application of the fraudulent preference provisions of the Act and it was unlikely that there were any new facts which could be generated by a re-hearing that could have any effect on the principles governing the application of s. 95. The circumstances of the payment did not in themselves create any suspicion as to the bankrupt's intention. There was no foundation for questioning the diligence or good faith of the trustee-in-bankruptcy or its counsel.

Table of Authorities

Cases considered:

Per Belzil J.A. (Bracco J.A. concurring):

Craig (Trustee of) v. Devlin Estate (1989), 63 Man. R. (2d) 122, (sub nom. *Craig (Trustee of) v. Craig*) 76 C.B.R. (N.S.) 256 (C.A.) — *applied*

Harper v. Harper (1979), [1980] 1 S.C.R. 2, [1979] 5 W.W.R. 289, 98 D.L.R. (3d) 600, 27 N.R. 554, 13 R.F.L. (2d) 5 — *considered*

Hudson v. Benallack (1975), [1976] 2 S.C.R. 168, [1975] 6 W.W.R. 109, 21 C.B.R. (N.S.) 111, 7 N.R. 119, 59 D.L.R. (3d) 1 — *referred to*

Per O'Leary J.A. (dissenting):

Craig (Trustee of) v. Devlin Estate (1989), 63 Man. R. (2d) 122, (sub nom. *Craig (Trustee of) v. Craig*) 76 C.B.R. (N.S.) 256 (C.A.) — *considered*

Statutes considered:

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

s. 2*referred to*

s. 95*considered*

Exemptions Act, R.S.A. 1980, c. E-15*referred to*

Appeal of setting aside of transaction under Bankruptcy and Insolvency Act (1994), 23 Alta. L.R. (3d) 397, 28 C.B.R. (3d) 167, [1995] 1 W.W.R. 292, (sub nom. *Re Norris (Bankrupt)*) 161 A.R. 77.

***Belzil J.A.* (*Bracco J.A.* concurring):**

1 By amendment to the *Bankruptcy and Insolvency Act* effective November 30, 1992, the traditional priority of the Crown theretofore enjoyed at common law for its claims for income tax owed by a bankrupt are removed. In bankruptcies occurring after that date, proven Crown claims are to rank equally and be paid rateably with all other unsecured creditors.

2 The issue in this appeal is whether a payment of income tax to the Minister of National Revenue made within the three months preceding the taxpayer's bankruptcy was a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act* and void as against the Trustee. On application by the Trustee, the Court of Queen's Bench sitting in chambers in bankruptcy declared it to be so and ordered its repayment by the Minister to the Trustee. The order was granted orally in open chambers at the conclusion of the application on May 24, 1994.

3 At the request of the appellant Attorney General of Canada, the learned justice subsequently provided written reasons which were issued September 21, 1994, now reported in 23 Alta. L.R. (3d) 397. These are the only reasons before us in this appeal. We do not know what may have been said by the learned justice during the application when making his order in chambers.

4 The Attorney General of Canada, acting for Her Majesty in right of Canada represented by the Minister of National Revenue (herein called "Revenue Canada"), then obtained an order from a judge of this court granting leave for this appeal. The material supporting the application for leave alleges that of 24,902 active files in Edmonton alone involving Alberta individual and corporate taxpayers, 13,319 involve taxpayers in bankruptcy, with a number of potential cases in which Revenue Canada has received funds in circumstances similar to the present case. Counsel have found no other reported decision dealing with the position of Revenue Canada as ordinary creditor in these circumstances. The appeal is advanced as a test case which, it is said, will significantly impact other similar cases.

5 The basic facts giving rise to the issue are concisely set out in the reasons of the learned chambers judge as follows:

> The facts are not in issue. On November 25, 1992 Revenue Canada received a payment of taxes of $8,548.40 from David Carl Norris. On January 26, 1993 Mr. Norris made a voluntary assignment into bankruptcy.
>
> Revenue Canada had made a series of demands on the bankrupt. There was a letter on September 12, 1992, a notice of October 9, 1992 amending the balance owing and again demanding payment, and a final letter on October 24, 1992 making still a further demand stating that if arrangements were not made for payment, legal action such as garnishee of income or instructions to the Sheriff to seize and sell assets might be made. On October 29, 1992 the bankrupt called Revenue Canada in response to the last letter, and requested a one-month grace period, which was granted and the aforementioned payment was received on November 25, 1992.

6 The impeached payment to Revenue Canada was made pursuant to a notice of reassessment for 1991 and prior taxation years.

7 The vehicle for the Trustee's application was s. 95 of the *Bankruptcy and Insolvency Act* the pertinent sub-sections of which provide:

> (1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor with a view to giving that creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering it becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering it, be deemed fraudulent and void as against the Trustee in bankruptcy.
>
> (2) Where any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid

> or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily to support the transaction.
>
> (3) .....

8 The grounds of appeal are that the learned trial judge erred in finding that:

> (a) Norris was insolvent on November 25, 1992:
>
> (b) Revenue Canada was not acting as a diligent creditor when it solicited and received the Payment; and
>
> (c) The Payment was not made in the ordinary course of business between Revenue Canada and Norris.

9 Having reached this conclusion that the issues raised in this application should be returned to the Court of Queen's Bench for resolution by trial, I do not decide any of the grounds of appeal.

10 In his written reasons, the learned justice said:

> **Issues:**
>
> There is no serious dispute that the *prima facie* presumption under s. 95 as raised by the Trustee had established the three required criteria, namely:
>
> 1. that the transfer took place within three months of bankruptcy;
>
> 2. that at the date the transfer was made, it gave the creditor a preference in fact.
>
> 3. that the debtor was an insolvent person at the date of the payment.

11 This is manifest error: the presumption under s. 95 does not establish the three required criteria but rather it is the proof of the three criteria which raises the presumption.

12 No suggestion is made that the learned judge misunderstood the test in s. 95. The error obviously results from an inadvertent clerical transposition of thoughts or words, or from an accidental omission of part of his text, missed in proofreading before issue. This editorial error was not commented on by counsel at the hearing, and I would not have raised it but for the fact that the reasons are now reported and that this test case may go higher.

13 There is no disagreement between the parties as to the substance and effect of s. 95 of the *Act*. It creates and defines the concept of fraudulent preference as it applies in bankruptcy. It sets out the three elements which had to be proven by the Trustee in its application to set aside the payment as a fraudulent preference, namely, (1) that the payment in question was made to an ordinary creditor within three months of the bankruptcy; (2) that the bankrupt was at the date the payment was made an insolvent person within one of the definitions in s. 2 and; (3) that the payment was made by the debtor "with a view to giving that creditor a preference over the other creditors", in the words of the statute.

14 If elements (1) and (2) are established and the Trustee proves that the creditor received a preference in fact over other creditors, s. 95(2) then raises a presumption in the absence of evidence to the contrary that the preference in fact was made with a view to giving that creditor a preference over the other creditors, and was thus a fraudulent preference within s. 95(1).

15 The presumption is rebuttable and will be rebutted if the totality of the evidence to the contrary at the end of the case is sufficient to show on the balance of probabilities that the debtor did not have the dominant intent to prefer the creditor over others when he made the impeached payment.

16 In considering this section, it is well to keep in mind the distinction between preference in fact and fraudulent preference as that latter is defined in the *Act*. There can be no doubt in this case that Revenue Canada received a preference in fact from the payment of tax made by this debtor on November 25, 1992. Its debt was paid where the debts owing to other ordinary creditors were not. What would render that preference in fact a fraudulent one under s. 95 is the accompanying intent of the insolvent debtor who in the face of imminent bankruptcy is moved to prefer or favor, before losing control over his assets, a particular creditor over others who will have to wait for and accept as full payment their rateable share on distribution by the Trustee in the ensuing bankruptcy. It is called fraudulent because it prejudices other creditors who will receive proportionately less, or nothing at all, and upsets the fundamental scheme of the *Act* for equal sharing among creditors. That accompanying intent to favour one creditor over another is what makes a preference in fact a fraudulent preference and is referred to in the cases as the "dominant intent". The state of mind of the debtor at the time of making the payment is ultimately the paramount consideration to be addressed by the court. The intent or state of mind of the preferred creditor is irrelevant, *Hudson v. Benallack* (1975), 21 C.B.R. (N.S.) 111 (S.C.C.).

17 This concept of "dominant intent" of the debtor comes to us from English law. It is irrelevant under American law where preference in fact is sufficient for setting aside a preferential payment if other preconditions set out in that bankruptcy code are met.

18 Why a department of government charged to administer legislation and compelled by the rules of natural justice to act fairly and impartially, and unable to return a *quid pro quo* favor would ever be intentionally so favoured by an insolvent debtor over other creditors is difficult to understand. It is possible, but seems highly improbable at first blush. The allegation of it and its *prima facie* occurrence invites a close scrutiny of all surrounding circumstances for another and more likely purpose behind the preference in fact, particularly where the bankruptcy is not sought by creditors but is voluntary and its timing orchestrated by the debtor himself.

19 If after consideration of all of the evidence before it the court is satisfied on a balance of probability that the debtor was pursuing a purpose other than that of favouring the particular creditor over others, the presumption is displaced and the application fails. The finding of the court on that particular issue is one of fact which will not be disturbed on appeal, unless relevant evidence has not been taken into account by the trier of fact. This unfortunately is the situation in this appeal; two items of cogent evidence on the specific issue of dominant intent found in the material filed by the Trustee in support of its application were not brought to our attention at the hearing before us, and presumably not brought to the attention of the learned chambers judge at his hearing.

20 The first item of cogent evidence, not disclosed, was that of a family relationship existing between the creditor Carl Ortan Norris and the bankrupt. This issue was first raised by the court in a question to counsel for the Trustee because of the similarity in names, and counsel for the Trustee advised the court that there was no evidence of such relationship. He asserted to the court that as far as he knew the similarity in names was a mere coincidence. This was accepted by the court and the issue not then pursued further. Judgment was then reserved and the court recessed. When reviewing the material thereafter, in preparation for judgment, the court itself discovered that, contrary to what counsel for the Trustee had stated to it, there was indeed in the Trustee's own material a statement by the creditor Carol Ortan Norris that he was related to the debtor. That evidence was in his Proof of Claim for $15,000.00 filed with the Trustee's material. This positive assertion had been achieved by crossing out the word "not" appearing before the word "related" in the printed form. This alteration of the form seems to have escaped the attention of counsel for the Trustee as well as counsel for the appellant.

21 This was relevant to the issue of dominant intent. Just as preference given to a close relative can support an inference of a dominant intent to prefer that relative over others, so a preference given to an unrelated creditor which would materially adversely affect the claim of a close relative could support an inference against a dominant intent to prefer the unrelated creditor to the related one.

22 The other relevant evidence not drawn to the attention of the learned chambers judge, nor to us, is found in the Statement of Affairs signed by the bankrupt in support of his assignment into bankruptcy. To Question 9, appendix B: "within the last 12 months have you disposed of or transferred any of your assets", the answer is "No". To question 10A: "within the last 5 years have you sold, disposed of or transferred any real estate", the answer is "Yes". The explanatory note to question 10A reads that in August, 1992, he sold real estate property in Calgary for $179,000.00, and adds "net proceeds used as a down payment on another residence". No further details are given. Then in the statement of assets, under item 6 "real property" in form 74A is stated: "House ..... NE 24-69-12-W6 (JOINT) (Enc) (EXEMPT) ..... 75,000.00". The Statement of Affairs further discloses that the bankrupt was self-employed as a 50 per cent shareholder in a construction business which ceased to operate on September 1, 1992, and that he was unemployed at the date of the statement. The timing of the voluntary assignment and the orchestration of the events leading to the claimed expenditure remained throughout with the bankrupt. These were factual circumstances surrounding the alleged preferential payment to Revenue Canada which were relevant to the issue of dominant intent and to the issue of "evidence to the contrary" under s. 95. The respondent Trustee in bankruptcy was duty bound but failed to draw to the attention of the Court these factual circumstances.

23 The duty of a Trustee in bankruptcy, as well as those of counsel, is referred to in *Harper v. Harper* (1979), [1980] 1 S.C.R. 2, in the context of an application to admit fresh evidence. Laskin C.J. speaking for the unanimous nine member Court on this point, said at p. 13:

> It is clear that Justice Ritchie did not lay down an exhaustive test for the admissibility of fresh evidence in the Supreme Court, saying only what the special grounds under the proviso to. s. 67 include. In my opinion, they also include a situation where there has been a failure of an officer of the Court, *e.g.* a trustee in bankruptcy, to bring all the relevant matters to the Court's attention, although the matters were not newly discovered but existed before trial: see *Brown v. Gentleman*. Equally, in my opinion, they will yield to a situation where a solicitor as an officer of the Court has not brought to the Court's attention pre-existing matters of which he had knowledge or where a party to the proceedings has misled the Court as to facts in issue or has misled his own solicitor or counsel, with the result that the action has proceeded on an erroneous factual basis.

and at p. 16

> ... No Court can condone attempts to mislead it; and if the respondent put his counsel, be he Mr. Scoffield or Mr. Horn, in an unenviable position, the Court is entitled to have their co-operation in clarifying the record once they have become aware of the true state of the title.
>
> At the conclusion of the hearing of the motion for leave to adduce new evidence, the Court was unanimously of the opinion that the motion should be granted, with costs of the motion to the successful appellant and with reasons to be delivered later. The reasons have been set out in what has gone before, and I turn now to the merits in the light of the newly admitted evidence.

24 The duties of a Trustee in bankruptcy are also outlined in brief form in Houlden & Morawetz and I quote from the 1995 annotated *Bankruptcy & Insolvency* page 32:

> **C§10 Duties and Powers of Trustees - Generally**
>
> The Trustee is an officer of the court and should impartially represent the interest of creditors: *Re Roy* (1963), 4 C.B.R. (N.S.) 275 (Que. S.C.). He should act equitably and, as far as possible, hold an even hand between competing interests of various classes of creditors: *Re Reed* (1980), 34 C.B.R. (N.S.) 83 (Ont. C.A.). In bringing proceedings, such as an application to set aside a fraudulent preference, he should not adopt an adversarial or hostile role: *Touche Ross Ltd. v. Weldwood of Canada Sales Ltd.* (1983), 48 C.B.R. (N.S.) 83, additional reasons at 49 C.B.R. (N.S.) 284 Ont. S.C.). Rather, he should present the relevant facts to the court in a dispassionate, non-adversarial manner, and leave the matter to the court for decision.

> The trustee is under a continuing duty, until his discharge, to effect recovery of the assets of the bankrupt, and the fact that the bankrupt has received his discharge in no way affects that duty: *Re Salloum* (1988), 69 C.B.R. (N.S.) 255, 22 B.C.L.R. (2d) 77 (S.C.).

The Trustee in this case adopted an adversarial and hostile role in this application. Instead of presenting to the court, as it was his duty to do as an officer of the court, all the relevant facts which were within his knowledge as Trustee, he presented a bare bones skeletal case just sufficient to invoke the presumption in s. 95(2) without disclosing to the court those facts in his material to which I have already alluded which might, in the mind of the chambers judge, weigh against the presumption. This is conduct by a Trustee as an officer of the court which must not be tolerated or condoned. A judge is entitled to expect that all relevant and pertinent information on any application placed before him by officers of the court will be specifically drawn to his attention even if it is also in the written material. This was not followed here. Accordingly, the decision of the chambers judge cannot stand.

25 This is a proper case for adopting what was suggested by Huband J.A. of the Manitoba Court of Appeal in the case of *Craig (Trustee of) v. Devlin Estate* (1989), (sub nom. *Craig (Trustee of) v. Craig)* 76 C.B.R. (N.S.) 256 at 261, 63 Man. R. (2d) 122, where he said:

> When a motion for an order under s. 95 is contested and affidavit evidence is filed by a respondent, the normal practice will be to direct a trial of the issues so that the decision can be based upon *viva voce* evidence rather than affidavits and attached exhibits.

26 The two issues raised in this application whether the bankrupt was insolvent within s. 2 of the *Act*, and whether the presumption in s. 95, if it arose, was rebutted by evidence to the contrary, are referred back to the Court of Queen's Bench for trial.

O'Leary J.A. **(dissenting):**

27 I do not agree that this matter should be remitted to Queen's Bench for further inquiry into the facts. Revenue Canada and the Trustee have each been represented throughout by experienced and capable counsel. They were content to have this matter determined here and below on the basis of the evidence before the Trial Judge. Neither has complained that any relevant evidence is missing. In my view, we are not justified in initiating a further investigation of the facts on the strength of speculation that some material information has not been forthcoming. We have had the benefit of written and oral argument on the issues raised on appeal. I believe we should decide the appeal on the basis of the facts accepted by the Trial Judge and the parties.

28 Counsel for Revenue Canada has not indicated that any material evidence is missing, and has not asked for or even hinted that a re-hearing is necessary to bring forward further information. This Court undoubtedly has jurisdiction to remit a matter like this for further inquiry into the facts. In *Craig (Trustee of) v. Devlin Estate* (1989), (sub nom. *Craig (Trustee of) v. Craig)* 76 C.B.R. (N.S.) 256, the Manitoba Court of Appeal confirmed that such a direction is available in an appeal from a declaration that a payment was a fraudulent preference (although the matter was not sent back in that case). That is a direction which I believe should be made only where the decision of the trier of fact could reasonably have been affected by an intentional or inadvertent failure to bring forward material evidence or by reliance on false or misleading evidence or representations, or where for any other reason the interests of justice demand that missing relevant and material evidence be brought forward. This is not such a case.

29 A further inquiry into the facts cannot be justified on the basis that this is a test case. It was not presented here or below as a test case. Its resolution turns on the application of the fraudulent preference provisions of the *Bankruptcy and Insolvency Act* to a hitherto protected transaction. To that extent the case is novel, however no new principles of law are raised by the facts or advanced by the parties.

30 The circumstances of the payment do not in themselves create any suspicion as to the bankrupt's intention. I do not agree with the suggestion that the borrowing of money by an insolvent person from a relative, out of which income tax arrears are paid, does, without more, create suspicion that the payment was made for some purpose other than to give a preference.

31 In my opinion, there is no basis for suggesting that the Trial Judge and this Court have been deprived of material evidence. No such thing was suggested by Counsel for Revenue Canada. It does not appear the issue was raised below. The material before us is the same as was before the Trial Judge. It does not, in my view, raise any suspicion that evidence relevant to the issues has been kept from the Court.

32 Lastly, I do not believe there is any foundation in the filed material or in the conduct of Counsel for the Trustee for questioning the diligence or good faith of the Trustee or its Counsel.

33 Following is an elaboration of the above comments.

Test Case

34 The proceedings are not described as a test case in Revenue Canada's Factum. As far as I can determine from the Reasons for Judgment and the material filed at trial, it was not treated as such at that level. Revenue Canada filed an affidavit in support of its application for leave to appeal to this Court which stated that there were approximately 13,000 income tax collection files in its Edmonton office involving taxpayers in bankruptcy. It is not revealed in how many of these cases payments to Revenue Canada were made within three months of the date of bankruptcy. The deponent went on to say that "the point at issue in the appeal could have a significant impact on bankruptcy and insolvency practice in Alberta and potentially throughout Canada". In my view, that is an overstatement. No new principles of law are involved. None were advocated by Counsel for Revenue Canada. Its position on appeal was based on the application of well-known principles to the facts of this case. The only thing novel about this case is the identity of the creditor.

35 Shortly before this case arose Revenue Canada assumed the same position as any other creditor with respect to fraudulent preference claims under the *Bankruptcy and Insolvency Act*. In all s. 95 cases, the facts are critical. I am unable to appreciate how any new facts generated by a re-hearing could have any effect on the principles governing the resolution of s. 95 fraudulent preference claims against Revenue Canada. Where Revenue Canada is the target, the inquiry will be the same as it is in respect of other creditors - determining the dominant intention of the debtor in making the payment, having regard to the presumption contained in s. 95.

36 This case is not important to Revenue Canada or to bankruptcy law in general. It involves a modest amount of money and is no more than the application of existing principles to the facts of this particular case.

Circumstances of Payment

37 It is suggested that the fact the bankrupt borrowed from a relative and used a portion of the proceeds to make a preferential payment of income tax arrears creates suspicion about the bankrupt's intention. Why would an insolvent person pay an outstanding income tax assessment in preference to paying other creditors, and borrow money from a relative in order to do so? I do not agree that these circumstances create any suspicion that would not exist were the creditor not Revenue Canada and were the funds from the bankrupt's own resources. Revenue Canada was applying pressure. It had threatened to take formal steps to collect and had set a deadline for payment. There is no evidence that other creditors were pressuring the bankrupt for payment. It cannot be assumed the bankrupt, though insolvent, had the intention when he paid Revenue Canada to make an assignment in bankruptcy shortly thereafter. Preferential payments are, I suspect, often made in an effort to stave off bankruptcy rather than with a conscious intent to preferring the creditor in anticipation of imminent bankruptcy.

Missing Evidence

38 There is nothing in the material filed here or below or in the submissions of Counsel which indicates that any relevant or material evidence is missing. Revenue Canada does not say anything like that in its Factum and did not allege it in oral argument. The Trial Judge proceeded on the basis of affidavit evidence as he was entitled to do. He asked for and received written submissions from the parties. Revenue Canada did not dispute any of the allegations of fact in the affidavits filed on behalf of the Trustee. Nor did it question the accuracy or sufficiency of the information contained in the Statement of Affairs filed by the bankrupt. Similarly, the facts deposed to on behalf of Revenue Canada were unchallenged. Revenue Canada had ample opportunity to pursue any suspicions raised by the Trustee's affidavits or the Statement of Affairs and to alert the Trial Judge or this Court to its concerns.

39 The majority judgment points to two circumstances which it sees as suspicious. It assumes that further inquiry may reveal evidence relevant to the bankrupt's intention in making the impugned payment. In my view, there is no basis for suspicion that any relevant material evidence is not before the Court.

40 The first area of concern stems from the source of the funds used by the bankrupt to make the payment. He borrowed $15,000 from a relative the day before he paid Revenue Canada. It is fair to assume that he used $8,457 of the borrowed money to pay his tax arrears. The relative has filed a Proof of Claim as an ordinary creditor for the amount of the loan. We are not, of course, concerned with the validity of the Proof of Claim.

41 It is said that the source of the funds is relevant to the issue of the dominant intent behind the payment to Revenue Canada. I do not understand the logic of that suggestion in these circumstances. The question seems to be: why, in the absence of some indirect intention, would an insolvent debtor make an unsecured loan from a relative in order to pay a creditor like Revenue Canada and then make a voluntary assignment in bankruptcy two months later, leaving the relative with an unsecured claim in bankruptcy? In my view, the mere fact that the funds were borrowed from a relative, as opposed to a bank or other independent source, has no bearing on the dominant intention of the bankrupt in making the payment. There is absolutely no evidence the loan and subsequent payment were part of a scheme to benefit the bankrupt at the expense of his creditors. Nothing like that was alleged or even mentioned by Counsel for Revenue Canada.

42 Second, it is suggested that the property transactions revealed in the Statement of Affairs arouse suspicion and the Trustee should have explained them. Counsel for Revenue Canada apparently saw nothing suspicious in these transactions. Neither did the Trial Judge and neither do I.

43 In his Statement of Affairs the bankrupt gave the following answer to the question whether he had disposed of real property during the previous five years:

> Sold 251 Hawk Stone Close Northwest, Calgary, Alberta in August of 1992 for $179,000. *Net proceeds* used as *down payment* on another residence. [emphasis added]

44 The list of assets shows the bankrupt's current residence as a quarter section near Beaverlodge, Alberta, described as the NE 1/4 of 24 - 69 - 12, W6M ("the acreage"), owned in joint tenancy, and valued at $75,000. The bankrupt claimed his interest in the acreage as exempt pursuant to the *Exemptions Act*, R.S.A. 1980, c. E-15.

45 Had the bankrupt retained the house in Calgary his real property exemption would have been $40,000. If the house was owned in joint tenancy, the co-owner would have been entitled to a like exemption. The exemption for a rural residence is a quarter section. There can be no suspicion that the bankrupt sold his house and purchased the acreage with the proceeds and thereby increased his real property exemption at the expense of his creditors. Assuming clear titles, the bankrupt's exemption in the acreage would be $37,500 compared to $40,000 in the Calgary house.

46 Nor can it be speculated that the bankrupt is attempting to deprive his creditors of the difference between the sale proceeds of the residence and the purchase price of the acreage. There is no evidence of the equity in the residence when it was sold. The sale price of $179,000 says little about the equity or the net proceeds. The bankrupt says he used the "net proceeds" as the "down payment" on another residence, presumably the acreage valued at $75,000. That is an

unequivocal statement that the full amount realized by the bankrupt from the sale of his residence was used to buy the acreage and is reflected in its stated value.

47 I see nothing suspicious in these circumstances. In any event, they have no obvious relationship to the issue in these proceedings - the bankrupt's intention in making the payment to Revenue Canada.

The Trustee

48 There is no basis for criticizing the conduct of the Trustee or its Counsel. Nothing in the evidence indicates that any material information has been withheld from the Court or from Revenue Canada. Indeed, Revenue Canada does not complain about lack of disclosure or any other default or misconduct by the Trustee.

49 I assume the bankrupt was required to attend a meeting of his creditors and was subjected to the usual questioning by the Registrar. Apparently no creditor, including Revenue Canada, has alleged any impropriety on the part of the bankrupt. The Trustee is a licensed and accountable officer of the Court. It has a duty to enquire into suspicious circumstances surrounding the conduct or property of the bankrupt, and to make full disclosure of such matters to the Court. The Trustee is also under a duty to get in all of the property of the bankrupt and this includes investigating suspicious transactions. There is no basis for suspecting, much less finding, that the Trustee has defaulted in the execution of its duties in these circumstances. I decline to make such an assumption and I dissociate myself from any suggestion that either the Trustee or its counsel has been less than candid with the Court or has been guilty of any other misconduct or impropriety.

50 The Act provides adequate remedies to any creditor who is dissatisfied with the efforts of a Trustee to identify and get in the property of the bankrupt or who has any other complaint about the administration of the bankrupt estate.

Appeal allowed; new trial ordered.

End of Document

TAB 23

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

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.

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

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

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

Thomas & Co. v. Brown (1899), 4 Com. Cas. 186 — referred to

Vandepitte v. Preferred Accident Insurance Co. of New York, [1932] 3 W.W.R. 573, [1933] A.C. 70, [1933] 1 D.L.R. 289, [1932] All E.R. Rep. 527 (British Columbia P.C.) — not followed

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

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***

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

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-

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

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.

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.

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-

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

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

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 24

Court of Queen's Bench of Alberta

Citation: Liu v Calgary Chinatown Development Foundation, 2017 ABQB 149

Date: 20170303
Docket: 1401 13225
Registry: Calgary

Between:

Kwan Ying Liu, Thoai Phong Lam, Yin Ping Tam
Yuk Chun Chung, Tak Hing Tang and Pik Han Law

Appellants

- and -

Calgary Chinatown Development Foundation

Respondent

Reasons for Judgment
of the
Honourable Mr. Justice A.D. Macleod

Appeal from the Decision by Master K.R. Laycock
Dated the 07th day of July, 2015

[1] The six Appellants are tenants of a condominium development in Chinatown, a vibrant part of downtown Calgary. They are central to an ongoing dispute between the Bowside Manor Tenants' Advocacy Group ("TAG") and the Respondent, the Calgary Chinatown Development Foundation ("CCDF"). The dispute centers on the residential leases held by the six Appellants and the rent they are being charged by CCDF. This dispute was originally brought before the Residential Tenancy Dispute Resolution Service ("RTDRS") in the fall of 2014 but was then

referred by it to the Alberta Court of Queen's Bench in December of that year. The dispute was ultimately heard by Master Laycock in June 2015. The Master dismissed the application with costs and his judgment is appealed.

[2] Essentially, TAG seeks this Court's assistance in enforcing, on behalf of the six Appellant tenants, an agreement between CCDF and the Canada Mortgage and Housing Corporation ("CMHC") which was made pursuant to the *National Housing Act*, RSC 1985, c N-11. CCDF, the landlord, resists on various grounds including that the tenants are not privy to the contract between it and CMHC and the claims are barred by the *Limitations Act*, RSA 2000, c L-12.

[3] The standard of review in this appeal is one of correctness: *Bahcheli v Yorkton Securities Inc*, 2012 ABCA 166.

Background

[4] CCDF is a non-profit Alberta Society incorporated on May 6, 1976 and involved in the planning and construction of the residential and commercial development known as Bowside Manor in Calgary, Alberta. There are residential tenancies in the building, a few commercial tenancy units, and an underground parkade. Construction of the building was completed in the late 1970's and CCDF has operated and managed the building since it opened. The board of CCDF is made up of volunteers from the Calgary chinese community. The building sits on three parcels of land, two of which are leased to CCDF and the third is owned by CCDF.

[5] The financing of the building was accomplished in large part by a CMHC mortgage.

[6] CCDF received a subsidy from CMHC so that CCDF could offer, in some residential units, below-market rent geared to the income of the tenants. In addition to the mortgage document, CCDF entered into an Operating Agreement with CMHC dated March 12, 1979, which included the following terms:

> 2. Rental/Occupancy
>
> ...
>
> (2) Accommodation in the project shall be leased at rental rates according to the income of the tenant, as set forth in Schedule "A" attached up to the maximum rent. Where fully serviced accommodation is not provided the rent is to be reduced by an amount approved by the Corporation which represents the cost of services not provided as set forth in clause 1(11) above.
>
> ...
>
> (5) The Borrower shall obtain evidence of the income of the lessees at the time of initial occupancy and annually thereafter and adjust the amount of rent to be paid by the lessee in accordance with the change in income. Individual leases will make provision for this requirement. Verification by the auditor shall be provided in his report to the effect that a rent-to-income ratio has been applied, that income reviews and confirmation of incomes have been undertaken and necessary rent adjustments have been made.

(6) The amount of rent to be paid by the lessee shall not be increased more frequently than annually. However, the amount of rent paid may be reduced at any time upon receipt of concrete evidence that the income of the lessee has decreased since the last annual income review. The lease rent shall be reinstated when the income of the lessee increases to its original amount. Individual leases will make provision for this requirement. The actual policy regarding the above shall be determined by the non-profit corporation/cooperative association with the concurrence of the Corporation.

3. Leasing of House Unit

...

(3) Each lease will make provisions for the annual verification of income and rent to be charged according to the rent-to-income scale.

4. Federal Assistance

...

(4) Should the federal assistance paid in any fiscal year exceed the actual assistance required as established by the Corporation upon receipt of the Annual Project Data Report and financial statements of the Borrower, the excess will be refunded within thirty days of the Corporation by the Borrower subject to the provisions of paragraphs (6) and (7) of this clause.

...

(8) The borrower is required to submit an audited statement of final capital costs within six months of the interest adjustment date of the loan. Any necessary adjustments to the level of federal assistance will be made upon receipt of this audited statement.

...

7. Care Facilities

(1) The federal assistance will be restricted to the shelter component only of accommodation with care facilities.

(2) The Borrower shall provide adequate evidence that provincial or other per diem rates or grants will be available for the operating costs of the non-shelter components and that together with the federal assistance the project as a whole will operate on a break even basis.

...

10. Annual Review

(1) Three months following the end of the borrower's fiscal year the borrower shall submit to the Corporation a Project Data Report- Schedule "E" attached supported by audited financial statements and a project budget for the next fiscal year, as appropriate. Where applicable, the audited financial statements are to separate the revenue and expenses for the shelter and non-shelter components of the project.

(2) The Corporation shall review and adjust, if necessary, the economic rents annually on the basis of the data provided in (1) above.

(3) Where applicable, the annual project data report will only reflect data related to the shelter component of the project.

...

12. Books, Accounts and Audit

(1) The Borrower shall maintain books, records and accounts in a form satisfactory to the Corporation, and shall permit the Corporation to inspect such books, records and accounts by a representative of the Corporation at any time.

(2) For the purpose of verifying revenue or expenditures and of obtaining statistical or other information on the operation of the project, the Borrower will permit the Corporation to have access to the project and to its books and records.

(3) The Borrower will for statistical purposes, supply such information as is required by the Corporation.

(4) The duties of the borrower's auditor will include:

a) Preparations of a statement of profit and loss including details of all revenue and expenses;

b) Preparation of the balance sheet;

c) A statement indicating whether or not verification of the incomes of the occupants and the rent calculations as required by Clause 2(5) have been undertaken. This assessment by the auditor may be undertaken on a test basis.

d) Preparations of the Annual Project Data Report.

e) Auditor's statement.

...

18. Default

> The Corporation shall have the rights, in the event of the Borrower failing to maintain the low rental character of the project or otherwise committing a breach of this agreement, to declare the unpaid principal of any CMHC direct loan mortgage on the project due and payable forthwith or to discontinue all federal assistance on all NHA Loans or to avail itself of any recourse reserved in any CMHC direct loan mortgage document as though the text of this undertaking was reproduced in full therein which rights are in addition to any other rights to restrain any breach of or to enforce this agreement.

[7] All six of the Appellants are long term tenants who signed a residential lease in the 1990's and the first years of 2000. None of the six residential tenancy agreements before me contain clauses reflecting the substance of sections 3(3), 2(5), and 2(6) of the Operating Agreement despite the agreement that those clauses be inserted in the residential tenancy agreements. There was no explanation as to the omission and CMHC appears not to have raised it, notwithstanding that CMHC monitored the operation and the record is replete with evidence that CMHC adopted a supervisory role under the terms of the Operating Agreement.

[8] It would appear that CMHC was regularly consulted on matters of rent and CCDF provided annual reports and other financial statements, which included reports of the landlord's compliance with the terms of the Operating Agreement. While the record perhaps does not contain each and every report, communication, or financial statement submitted to CMHC by CCDF, there are many examples and it seems that CCDF was performing the reporting function as required by the Operating Agreement to the satisfaction of CMHC.

[9] In August 2007, CMHC and CCDF entered into an agreement to adjust the maximum federal assistance and in 2009 the parties entered into a Contribution Agreement under which CCDF received approximately $250,000 and which included terms requiring it to remain a non-profit society and to provide subsidized housing for a period of ten years from that time. The final payment on the CMHC mortgage was made in May of 2015 and under its terms the Operating Agreement came to an end.

[10] A number of issues were raised by the Appellants, three of which attracted the most concern:

a. Minimum Rent

[11] This term does not appear in the Operating Agreement but "minimum rent" is clearly a factor which is used to calculate the rent payable in the subsidized units remaining in Bowside Manor, of which there are 34.

[12] CMHC and CCDF were both concerned with the financial viability of the project. This is referred to in the Operating Agreement itself and in subsequent correspondence. For example, in a letter dated November 24, 1994 to CCDF, CMHC supports CCDF's proposal to increase the rent-to-income ratio from 25% to 28-30%. Ultimately CCDF chose 30%. With respect to the minimum rents which were then in place, while CMHC acknowledged that there was no provision in the Operating Agreement for CMHC approval of minimum rents, CCDF was

directed to administer minimum rents at their own discretion "in order to maintain financial viability of the project."

[13] From that time on there is evidence of discussions between CMHC and CCDF about minimum rents and the concept appeared to become an accepted factor for use in calculating rents for subsidized units. CMHC and CCDF were not, however, always in agreement as to the amount to be used as a minimum rent.

[14] The position of the Appellants is that the use of minimum rents was contrary to the Operating Agreement or, alternatively, the minimum rent set by CCDF was too high.

b. Electricity

[15] The Appellants claim that they are being charged too much for electricity and that under the Operating Agreement they should be responsible only for their pro-rata share of the cost of electricity for the residential portion of the building.

c. The Reserve

[16] The Appellants claim that CCDF is maintaining a reserve which is too high, resulting in higher rental charges.

The Role of CMHC

[17] During the course of argument I inquired about CMHC and their position in respect to this action. I was told by counsel that CMHC preferred not to be involved and the parties had not taken any steps to name it as a party. One would normally expect all parties to the contract to be before the Court to enable it to fully adjudicate the issues in question while being satisfied that no injustice is done either to the parties or to others who are interested in the subject matter: *Alberta Treasury Branches v Ghermezian*, 2000 ABCA 228 at para 15.

[18] CMHC's mandate was judicially considered in *Canada Mortgage and Housing Corp v Iness* (2004), 70 OR (3d) 148 (CA) at paras 5-8, leave to appeal to SCC refused, [2004] SCCA No 167:

> CMHC is a federal Crown corporation that is constituted as an agent of Her Majesty in Right of Canada pursuant to s. 5(1) of the *Canada Mortgage and Housing Corporation Act*, R.S.C. 1985, c. C-7; s. 4 of the *National Housing Act*, R.S.C. 1985, c. N-11; and Part I of Schedule III and Part X of the *Financial Administration Act*, R.S.C. 1985, c. F-11.
>
> The purposes of the *National Housing Act*, which are set out in s. 3, include: "to promote housing affordability and choice" and "to protect the availability of adequate funding for housing at low cost".
>
> In furtherance of those purposes, Parliament authorized CMHC to make loans and contributions and to attach terms and conditions thereto. The relevant provisions of the *National Housing Act* are as follows:
>
> > 95(1) [CMHC] may make loans and contributions to assist with the payment of the capital and operating costs of housing projects, and may forgive amounts owing on those loans.

> (2) [CMHC] may determine the terms and conditions on which it makes a loan or contribution or forgives an amount under subsection (1), including, without limiting the generality of the foregoing,
>
> > (a) conditions with respect to the operation or occupancy of a housing project.
>
> In the exercise of the authority conferred upon it under the *National Housing Act*, CMHC enters into operating agreements with housing co-operatives to which it provides funding.

[19] I have also had the benefit of the diligent work that Kelvin Kwok did (as part of TAG) in obtaining many of CMHC's documents under the *Access to Information Act*, RSC 1985, c A-1. This, together with CCDF's affidavits, has resulted in there being before me much of the correspondence involving CMHC and CCDF, as well as between CMHC and TAG. They include the following:

1. The letter of November 24, 1994 from CMHC to CCDF directing CCDF to administer minimum rents at their own discretion "in order to maintain financial viability of the project."

2. As early as September 19, 1983, CMHC wrote to CCDF noting the significant decline from current year's figures due to the deterioration of the rental market in Calgary. CMHC advises CCDF as follows:

   > Before adjusting your current rents downward you should first of all assess the impact it would have on the viability of the project. We suggest if current rents can be maintained without having a detrimental effect on the marketability of the units then you should not adjust them. If, on the other hand you are experiencing some difficulty in marketing the units at current levels then perhaps some adjustment should be implemented, the amount of which would be left to your discretion.

3. CMHC was receiving, reviewing and approving audited financial statements, annual project data reports and other materials. For example, there is a letter from Ms. O'Neil at CMHC to CCDF acknowledging receipt of audited financial statements, annual project data reports and other related materials for CCDF's fiscal year ended December 31, 2010. She goes on to say "that CMHC has now completed their review and are pleased to advise that the information is accepted as submitted. A summary of our review is attached." There is a similar letter from CMHC to CCDF dated July 19, 2013 and July 28, 2014.

4. There is a letter from CMHC to CCDF dated September 27, 2013 (originally sent in May 2012) advising CCDF of recent changes at CMHC. As a result of the March 2012 federal budget, CMHC had undertaken a review of its operations and government funded programs. As a result, the supervision of many of the projects, including Bowside Manor, was going to be less hands on.

5. On September 2, 2014, CMHC wrote to counsel for CCDF about the ongoing dispute between CCDF and TAG. The letter includes the following:

> In this regard, the differences of opinion in relation to operational and administrative matters are as between the tenants and its board of directors. In certain circumstances, operational matters may raise compliance issues under the Operating Agreement, but at this time and based on a review of information provided to date, CMHC has not raised concerns regarding the administration of Bowside Manor.

6. With respect to the reserve, in 2013 CCDF commissioned a Capital Replacement Funds Study from Read Jones Christoffersen Ltd. This was reviewed by CMHC who replied on April 10, 2014 approving the Capital Replacement Plan. The letter did require adjustments and provided directions for follow up, but it clearly indicates an active monitoring function on the part of CMHC.

[20] In the fall of 2013, the board of CCDF determined it necessary to increase rents and advised CMHC. There are a series of emails and correspondence indicating that Ms. O'Neil at CMHC thought that the minimum rents being charged were above the industry standard of $300 and recommended that they use the industry standard of $300 as a minimum rent. While CMHC's recommendation was communicated to the tenants, it would appear that this recommendation was, to the knowledge of CMHC, never implemented.

[21] According to the affidavit of Kelvin Kwok, a number of concerns were raised by TAG directly with CMHC. Mr. Kwok had been thorough in his requests under the federal access to information legislation and had marshalled some arguments in favour of lower rent. This culminated in a meeting between TAG and CMHC on June 16, 2016 in Calgary. During this meeting, according to the notes that Mr. Kwok attached as part of Exhibit "K" to his Affidavit, a number of issues were discussed between representatives of TAG and representatives of CMHC including:

(a) Why certain provisions of the Operating Agreement, which were required to be in the residential tenancies agreements, were not in those agreements?
(b) Did CMHC allow CCDF to charge a minimum rent greater than 30% of a tenant's household income while retaining huge operating surpluses in the last decade?
(c) Why did CCDF charge so much for domestic electricity?
(d) Why does CMHC allow CCDF to transfer the amount of money it does to its replacement reserve fund?
(e) A number of questions were asked about the rent charged to commercial tenants contrary to the Operating Agreement.

[22] In other words, the discussion covered all of the issues that have been raised in connection with this action. In each case, CMHC responded that it felt that CCDF had acted appropriately and CMHC had no concerns that it was not acting in compliance with the Operating Agreement. Moreover, CMHC felt that the tenants of Bowside Manor had received at least as much benefit in terms of subsidized rent as CCDF had received in government assistance.

[23] Obviously, TAG disagreed with the positions taken by CMHC and they have pursed this action.

[24] The question as to which position should be preferred as to between the Appellants and CMHC is a question for this Court's consideration only if it finds that terms of the Operating Agreement are:

(a) implied into each of the residential tenancy agreements, or
(b) found to be enforceable by the Appellants.

Implying Terms

[25] The Appellants argue that this Court should imply the terms which were left out of the residential tenancy agreements because the Operating Agreement mandates their inclusion in those agreements. However, the residential tenancy agreements stand on their own. They are workable and there is no compelling reason to imply terms to give them commercial efficacy: *Benfield Corporate Risk Canada Limited v Beaufort International Insurance Inc*, 2013 ABCA 200.

Enforcing Operating Agreement by the Appellants

[26] It is strongly argued that this Court should permit the Appellants to enforce the Operating Agreement such that the rent-to-income ratio applies rather than the minimum rents. They also argued before me that CCDF's reserve fund is too large which has resulted in a lesser subsidy to which the Appellants are entitled. Finally, they argue that the electricity charges are nearly double what they should be under the Operating Agreement.

[27] There has long been a judicial debate in this country as to when the doctrine privity of contract can be ignored and when benefits negotiated between A and B for the benefit of C, can be directly enforced by C. The two leading cases in this country are *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd*, [1999] 3 SCR 108 and *London Drugs Ltd v Kuehne & Nagel International Ltd*, [1992] 3 SCR 299.

[28] The Supreme Court has held that third party beneficiaries may enforce benefits conferred upon them in a contract to which they are not a party if:

(a) the parties to the contract intended to extend the benefit in question to the third parties seeking to rely on the contractual provision; and
(b) the activity performed by the third parties seeking to rely on the provision is the very activity contemplated as coming within the scope of the contract in general, or the provisions in particular, as determined by reference to the intention of the parties.

On its face, the two-prongs of the test are met here.

[29] Courts have imposed limits on the application of the exception. One of those is that it not be used as a sword; it may only be used as a shield. That reasoning is rather awkward here because while on one hand the Appellants are the aggressors in the litigation, on the other hand what they seek to do is to prevent CCDF from charging higher rent.

[30] However, the appellate courts in our country are reluctant to disregard the doctrine of privity and they have made it clear that the exception should only be applied to avoid injustice: *London Drugs* at 446.

[31] The Appellants argue that this is a clear case where the benefits were intended to extend to the tenants who were renting subsidized accommodation in Bowside Manor. While that may be so, argues CCDF, the Operating Agreement does not provide for enforcement by the tenants and the remedy for failing to comply with the agreement is exercisable only by the parties to it.

[32] At first blush, the Appellants have a strong argument that they should receive the benefit which was negotiated for them by CMHC. But upon a close examination of the facts of this case, the application of the doctrine of privity does not result in an injustice. I say this for the following reasons:

1. The Operating Agreement contemplates separate enforceable residential tenancy agreements which were indeed entered into. There is no evidence before me that the Appellants relied on the terms of the Operating Agreement prior to entering into their individual residential tenancy agreements. The Appellants did, however, rely on CMHC to perform its duty to monitor CCDF's activities and ensure that CCDF was offering subsidized housing.

2. CMHC has a large number of projects across the country and actively monitors them. If individual tenants could enforce those agreements it would be inimical to CMHC's adopting uniform policies of management across the country. It is clear that CMHC established policies for overseeing these projects and to allow the tenants to litigate these issues would be counterproductive.

3. The policies adopted by CMHC sometimes affected the interpretation of the Operating Agreements. A good example is the concept of minimum rent. While that concept does not appear in the Operating Agreement, CMHC had an overriding concern about the financial viability of their subsidized housing projects. There was the introduction of the minimum rent and the acceptance of that idea by CMHC who ultimately determined that CCDF should administer minimum rents at their own discretion in order to maintain the financial viability of the project. Accordingly, even if I were inclined to accede to the Appellants' arguments, I could do nothing other than to enforce the Operating Agreement as CMHC interprets it. The record before me, however, makes it clear that CMHC does not consider CCDF to be in noncompliance with the Operating Agreement. In my view, this is fatal to the Appellants' case. Given the dynamic relationship between CMHC and its borrower, it cannot be said that the Appellants were ever the beneficiary of a contractual right that had crystalized into a defined benefit to the tenants. Much was left to the discretion of CCDF. CMHC clearly wanted to preserve flexibility in the management of these projects, to among other things, preserve their financial viability.

[33] Accordingly, it is my view that this is not a case where the doctrine of privity should be ignored and the Appellants cannot, in my view, enforce the terms of the Operating Agreement against CCDF. It is unnecessary for me to consider the limitation issues.

[34] In conclusion, I agree with the result reached by the Master and the appeal is therefore dismissed.

[35] As to costs CCDF wanted to defer that question until after my decision. The Master granted enhanced costs against the tenants. I will hear the parties on costs but I feel compelled to say that I did not consider the arguments made by the tenants to be unmeritorious. Counsel for the Appellants has provided his services *pro bono* which is very much to his credit. It is my view that the Courts should be accessible to arguments such as the ones that have been put forward on behalf of the tenants. If counsel cannot agree on costs they may address me by correspondence.

Heard on the 8th day of November 2016 and 20th day of January, 2017.
Dated at the City of Calgary, Alberta this 3rd day of March, 2017.

A.D. Macleod
J.C.Q.B.A.

Appearances:

Mr. David Khan
for the Appellants

Mr. Jeffrey L. Smith, Q.C.
Mr. Richard E. Harrison
for the Respondent