Court File No. CV-09-8122-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

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

Applicants

RESPONDING BOOK OF AUTHORITIES OF THE UNITED STEELWORKERS (Motion Returnable July 24, 2013)

July 10, 2013

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TAB 1

CITATION: Murphy v. National Bank of Canada, 2012 ONSC 1360
BARRIE COURT FILE NO.: 10-1393
DATE: 20120228

2012 ONSC 1360 (CanLII)

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: WENDY PATRICIA MURPHY, Plaintiff

AND:

NATIONAL BANK OF CANADA, Defendant

BEFORE: EBERHARD J.

COUNSEL: no-one appeared for the Plaintiff

M. Hackl Counsel, for the Defendant

HEARD: February 27, 2012

ENDORSEMENT

[1] The Plaintiff did not appear today.

[2] The motion, brought by the Defendant, was peremptory on the Plaintiff.

[3] The determination whether to proceed in her absence is complicated by a February e-mail from the Court's Trial Co-ordinator to the Plaintiff and Defendant that the judge assigned to hear the matter on February 27, 2012 was otherwise assigned and suggested a March 1, 2012 date:

> **From:** Donnelly, Marianne (JUD)
> **Sent:** February 15, 2012 4:52 PM
> **To:** 'murphy.w.3@hotmail.com'; 'hackl@phmlaw.com'
> **Subject:** Murphy v National Bank of Canada
>
> Good afternoon Ms. Murphy and Mr. Hackl.
>
> As you may recall at the last attendance before the court in Barrie on December 7th, 2011, the Murphy v National Bank motion was adjourned to February 27, 2012 at 9:30.
>
> Unfortunately, the Judge previously assigned to hear this motion is now no longer available and so we are suggesting the matter now be heard on Thursday, March 1, 2012 at 9:30 a.m.

Please confirm your availability for that day.

Thank you in advance,

Marianne Donnelly
Superior Court of Justice
Trial Coordinator

[4] The Plaintiff declined that date but did not participate in scheduling another.

From: wendy murphy [mailto:murphy.w.3@hotmail.com]
Sent: February 20, 2012 9:32 PM
To: Donnelly, Marianne (JUD)
Subject: Murphy vs. National Bank

Marianne Donnelly
Superior Court of Justice
Trial Coordinator
73 Mulcaster St.
Barrie, On.
L4M 3P2

I have received your e-mail in regards to the Judge set for trial, not being available for Feb.27,2012,and have notified my council the same. I am unfortunately unavailable Mar.1,2012.
I will have my representative in the matter contact Mr. Hackl and confirm acceptable dates for all in this matter, and they will in turn contact you to set an acceptable trial date.
Thank you for your e-mail,

Wendy Murphy
muprhy.w.3@hotmail.com
705-538-1080

[5] No "council" or representative contacted Mr. Hackl or the court.

[6] By the morning of February 23, 2012 the Plaintiff and Defendant were advised that a motions judge was available and the matter would proceed on February 27th as originally scheduled.

From: Donnelly, Marianne (JUD)
Sent: February 23, 2012 9:34 AM
To: 'wendy murphy'; 'Michael Hackl'
Subject: RE: Murphy vs. National Bank

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Good morning.

I am glad to say that it now appears that a Judge will become available for Monday after all. Your motion will now proceed on February 27th at 9:30.

Sorry for any inconvenience this may have caused.

Marianne Donnelly
Superior Court of Justice
Trial Coordinator

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[7] When the trial co-ordinator arrived in her office on Monday, February 27th she found an e-mail from the Plaintiff sent at 5:35pm February 24, 2012, a Friday, after office hours, as follows:

From: wendy murphy [mailto:murphy.w.3@hotmail.com]
Sent: February 24, 2012 5:53 PM
To: Donnelly, Marianne (JUD)
Subject: Murphy vs. National Bank

Marianne Donnelly
Superior Court of Justice
Trial Coordinator
73 Mulcaster St.
Barrie ON
L4M 3P2

Marianne
in regards to the judge now being available for Feb. 27, 2012, unfortunately when this date was changed I went out of town on an urgent personal matter and will not be back until March 9, 2012. At that time I will have a list of dates that all parties involved can that coordinate, and carry this matter out in a timely fashion.

Thank you again

Wendy Murphy

[8] Despite my observation that this e-mail patently could not have been expected to be received before Monday office hours, I instructed the trial coordinator to telephone and e-

mail the Plaintiff requiring her to call or e-mail the court by 11:00 a.m. There was no response.

[9] The full correspondence and reasons were reviewed in court and the e-mails made exhibits on the motion.

[10] In preparation for the motion I had read the material. The Plaintiff had filed nothing further since December 7, 2011 and the opportunity to do so had expired before any uncertainly about the date for hearing arose. The Plaintiff invokes counsel saying that such person is not available March 1, 2012 but never naming him to the court or opposing counsel.

[11] On the basis of the material, and without allowing the Defendant to address me on the point, I had a concern that the conduct and claim of the Plaintiff suggest the hallmarks of a vexatious litigant.

[12] I considered the factors observed by Henry J., in *Re Lang Michener and Fabian*, (1987) 59 O.R. (2d) 353 at para.19, where he considered a number of judicial decisions and stated as follows:

> From these decisions the following principles may be extracted:
>
> (a) the bringing of one or more actions to determine an issue which has already been determined by a court of competent jurisdiction constitutes a vexatious proceeding;
>
> (b) where it is obvious that an action cannot succeed, or if the action would lead to no possible good, or if no reasonable person can reasonably expect to obtain relief, the action is vexatious;
>
> (c) vexatious actions include those brought for an improper purpose, including the harassment and oppression of other parties by multifarious proceedings brought for purposes other than the assertion of legitimate rights;
>
> (d) it is a general characteristic of vexatious proceedings that grounds and issues raised tend to be rolled forward into subsequent actions and repeated and supplemented, often with actions brought against the lawyers who have acted for or against the litigant in earlier proceedings;
>
> (e) in determining whether proceedings are vexatious, the court must look at the whole history of the matter and not just whether there was originally a good cause of action;

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(f) the failure of the person instituting the proceedings to pay the costs of unsuccessful proceedings is one factor to be considered in determining whether proceedings are vexatious;

(g) the respondent's conduct in persistently taking unsuccessful appeals from judicial decisions can be considered vexatious conduct of legal proceedings.

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[13] Here, the mortgage action brought by the Defendant against the Plaintiff was completed by default judgment in July 2011, notice of eviction in August 2011 and actual eviction in September 2011. That action was neither appealed nor was there a motion to stay eviction nor a motion to set aside the judgment. The property was already sold before the fresh claim was brought by the former Defendant Mortgagor against the former Plaintiff Mortgagee. The claim is for $10,000,000.

[14] The conduct of the now Plaintiff, in failing to attend at a peremptory hearing would itself be sufficient to proceed in her absence but for the complication of the court's notification of scheduling difficulties. However, I am persuaded by the conduct of the Plaintiff in response to that difficulty that the court has little responsibility for her failure to appear today.

[15] The case law has also evolved over the years so that courts may consider the behaviour of a litigant in determining whether restrictions should be imposed on a litigant who brings frivolous and vexatious claims.

[16] Experience over the years has alerted me to the dangers of bending rules over and over to accommodate claims for extravagant undifferentiated damages on the basis that there was unfair treatment in relation to a prior litigation before the court. Boswell J. in *Roskam v. Jacoby-Hawkins* commented:

> [25] The control of vexatious proceedings is necessary to protect the integrity of the judicial system. The purpose of the section is to prevent people from abusing the system for improper purposes such as harassment or oppression: *Dale Streiman & Kurz LLP v. De Teresi*, [2007] O.J. No. 255, at para. 7. Accordingly, a litigant's behaviour both inside and outside of the court is relevant: *Canada Post Corporation v. Varma*, [2000] F.C.J. No. 851. It is not unheard of for a litigant to utilize the court's processes as part of an overall strategy of harassment and abuse and the court must be vigilant to protect its process from being misused in that fashion.

[17] While I certainly could and would not, before considering submissions, form any opinion as to the historical conduct of the Plaintiff, the mere fact of leaving town without any discussion with opposing counsel or the trial co-ordinator and e-mailing she would not be attending the motion on the date originally fixed after office hours is at least potentially a cynical act to avoid the scheduled adjudication of the motion which seeks to end the litigation.

[18] I have a duty to the Administration of Justice to scrutinize unauthorized failures to attend and control the court's own proceedings to avoid the waste of time and resources which I have many times seen to multiply.

[19] I therefore determined to hear the Defendant's motion. I intend to adjudicate but make my ruling effective three weeks after the Plaintiff's availability (according to her e-mail note). It will become effective unless, in those three weeks, the Plaintiff obtains leave by *ex parte* motion (without notice served on the Defendant) to return the Defendant's motion before me for hearing of her argument and the Defendant's reply. This leave motion may be placed before me or any judge of the Superior Court of Justice in Barrie, and granted on the basis that the judge is satisfied the "urgent personal matter" mentioned in her February 24, 2012 email has been demonstrated to exist and that it justifies failure to appear on the peremptory date or communicate with counsel or the trial coordinator as to an alternative date. The fact of her email after hours on Friday demonstrates that she has the means of communication.

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[20] I now continue to the substance of the motion argued by the Defendant.

Statement of Claim Disclosing a Cause of Action

[21] For this argument I look only to the Statement of Claim to determine whether, if proven, the claims made support a cause of action known to law. I will summarize the claim as I read it:

[22] The facts plead assert accounting irregularities, the refusal of full payment tendered on the mortgage, and an agreement by the mortgagee to forbear from enforcement.

[23] The claim is framed in negligence by (a) failing to honour the forbearance agreement; (b-e) collection irregularities, poor and unresponsive service; (f) procedural failure to address the Plaintiff's disabilities; (g) eviction in face of forbearance agreement; (h) falsely alleging non-payment when had possession of money orders and (i) collection regularities resulting in higher fees.

[24] The Statement of Claim cites legislation: the *Charter*, the *Negligence Act* and the *Rules of Civil Procedure.*

[25] The Statement of Claim claims damages for loss of chattels and a custom built home; personal and psychological injuries from stress and loss of rehabilitation equipment; and a resulting in a loss of lifestyle.

[26] While none of this appears to be negligence, I can discern in it an assertion that payment was actually made such that there was no default upon which Default Judgment could be granted and that there was a forbearance agreement which should have impacted the granting of Default Judgment. Although the claim for $10,000,000 is in no way connected to the losses alleged to have been experienced, the quantum does not in itself negate a claim that the eviction was based on a Default Judgment for non-payment when payment was made.

[27] This is put forward as a cause of action. It is, however, actually a defence to the mortgage action which is complete.

[28] This defence is dressed up with characterizations such as negligence or libel by the mortgagee in making false claims of non-payment. Nevertheless, the claims are, at their basic nature, assertions that judgment should not have been granted in the mortgage action.

[29] Assuming the assertions of payment and a forbearance agreement to be true, I must nevertheless find that they were the proper subject matter of the mortgage action. The assertions could have been raised at any number of stages in that mortgage action: by way of Statement of Defence, by way of motion to stay eviction, or by way of motion to set aside Default Judgment.

[30] Without referring to affidavit evidence, as I may not for this argument, it is clear that the Statement of Claim, while disclosing a claim based on payment and/or forbearance while quantum and irregularities were addressed, does not disclose a new cause of action. It raises rather assertions that could and should have been raised in the context of the mortgagee's claim to enforce a mortgage based on non-payment with no process in place to prevent proceeding to Default Judgment.

[31] The principles of *Res Judicata* are cited in *Reddy v. Oshawa Flying Club* 1992 CarswellOnt 349, 11 C.P.C. (3d) 154 para 7

> The doctrine of cause of action estoppel is based on the premise that, where the legal rights or liabilities of the parties have been determined in a prior action, they should not be re-litigated. Cause of action estoppel applies not only to points on which the court has pronounced but to every point which properly belonged to the subject of the litigation (67 E.R313. 3 Hare 100 (Ch.D.), at p. 381 [E.R.]).

[32] The significance of *Res Judicata* in a Default Judgment is not diminished even though the issues were not raised in the action because no defence was filed, the basic requirement of a Default Judgment:

> The plea of res judicata applies, except in special cases, not only to points upon which the Court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which properly belonged to the subject of litigation, and which the parties exercising reasonable diligence might have brought forward at the trial. (*Reddy* para 8 citing *Upper v Upper* [1933]O.R. 1.

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Abuse of Process

[33] Even if it could be said that by characterizing the conduct differently the mortgagors had expanded the issues beyond the bounds of *Res Judicata*, the raising of the issues may amount to frivolous, vexatious or abuse of the process of the court.

[34] In *Canada Trustco Mortgage Co. v. McLean* [1983] O.J. No. 269 Potts J considered relief sought after Default Judgment when the mortgagors resisted a writ of possession being issued:

> A defendant who has been served with the writ of summons containing the plaintiffs claim for possession stands in a wholly different position, however. He has already been given an opportunity to have his rights determined and an opportunity to vacate.

[35] The bringing of a fresh action against a mortgagee following unsuccessful appeal of a judgment in a mortgage action was addressed in *Shrivastava v. Bank of Nova Scotia* 2011 CarswellOnt 7131, 2011 ONSC 3994:

> 12 The plaintiffs' fundamental complaint is that their home has been taken from them as a result of a criminal conspiracy on the part of the defendants, allegedly involving Canada Revenue Agency. They claim that the mortgage to National Trust was not in default or that the default was minor, and that the transfer of the mortgage by National Trust to the other defendants (whom they describe as a "group of thugs") was unlawful and invalid. The claim includes a long list of complaints against BNS, including allegations of racist lending practices, discrimination, hate crimes. Bad-faith conduct, deceit, conspiracy, unjust enrichment, receipt of money under false pretences, breach of contract. Breach of trust, crimes against humanity, deceptions through false affidavit, abuse of process, conversion, extortion, blackmail, fraud, forgery, breach of covenants and violation of banking law.
>
> 13 The loss of the plaintiffs' home, unfortunate as it is, is the result of decisions of this Court in two legal proceedings. ....
>
> 14 Any objections that the plaintiffs may have had about the validity of the mortgage or the actions of the mortgagee should have been raised in the action brought by National Trust. This is a classic attempt to re-litigate a case that has already been decided by a court of competent jurisdiction — as such, it is an abuse of process and is frivolous and vexatious: *Currie v. Halton (Region) Police Services Board*(2003). 179 0.A.C.67. [2003] O.J. No. 4526 (C.A.); see also Re. (19871 59 O.R. ad) 353. [1987] O.J. No. 355

(H.C.) at para. 19; *Reddy v. Oshawa Flying Club,*\mi\ O.J-No. 1337. II C.P.C. (3d) 154 (Gen. Div.).

15 Moreover, many of the allegations made in the previous proceedings are being repeated in this action : *Donmor Industries Ltd v. Kremlin Canada Inc.* (No. 1) (1991). 6 O.R. (3d) 501. [1991] O.J. No. 3666 (Gen. Div.) at para. 19.

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[36] When considering this ground for the Defendant's motion I may consider the affidavit material. I did so firstly to determine what the Plaintiff mortgagor says happened. The Plaintiff's "brother" David "Tucker" Beeston deposes that it was he who at all times dealt with the mortgagees' representatives. A Mr. "Tucker" is sometimes referred to. Perhaps it is the same individual.

[37] For all the dispute about discussions, forbearance or surprise upon notice of eviction, ignoring for the purpose of this argument the correspondence contrary to these assertions (which appears to have repeatedly emphasized that there were identified errors, that the mortgagee intended to proceed to judgment and urging the mortgagor to consult legal counsel,) there can be no doubt that by August 2011 the mortgagor was aware of the intention to evict and in September she was evicted. A lawyer, whose name does appear in the Law Society register of practising lawyers, did contact the mortgagee, but there was no follow up. The opportunity to raise the defences of payment and a forbearance agreement was in the context of those proceedings. Lack of notice cannot be claimed by that point.

[38] It is abuse of process to repackage the defences to the issues that gave rise to a judgment now final and enforced, and to claim damages for losses arising from what, in the context of the mortgage action, the mortgagee was entitled to do unless issues were raised to the court to dispute that right

[39] I find that the Plaintiff does not raise a new cause of action and it is abuse of process to allow a second kick at the same can.

[40] It is not necessary for me to proceed to a consideration of Summary Judgment. However, were I to do so I can identify that there are credibility issues as between the assertions of Mr. Beeston and the assertions of Mr. Myers and Mr. Yaccarinni. In the recent development of the law relating to Summary Judgment I have expanded scope to consider whether a trial is necessary to adjudicate the issues about which the credibility issues linger. The best foot forward criteria for resisting Summary Judgment would, if it were necessary for me to consider the matter, create challenges for the Plaintiff.

[41] Order to go, effective March 30, 2012, dismissing the Statement of Claim for failure to disclose a cause of action and as abuse of process unless, before March 30, 2012, the Plaintiff obtains leave to appear before me to advance her argument based on the materials now before the court. If no leave is granted by March 30, 2012 this order becomes final and may be issued and entered without further process required.

[42] Costs for December 7, 2011 were fixed by Healey J. at $800. I find, as she invited me to determine, that these costs are payable by the Plaintiff to the Defendant.

[43] Further, I have a cost memorandum from the Defendant's counsel claiming $21,916 in partial indemnity and $31,215.50 in substantial indemnity including today (the first return of the motion having been addressed by Healey J.). I fix costs at partial indemnity noting that the extravagant quantum of the claim, the allegations of malicious conduct and the procedural conduct may have attracted an enhanced rate.

[44] Costs fixed, in total including December 7, 2011 at $22,000.

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EBERHARD J.

Date: February 28, 2012

TAB 2

CITATION: Elguindy v. The Warden of Warkworth Institution, 2011 ONSC 4670
COURT FILE NO.: 0367-11
DATE: 20110803

ONTARIO

SUPERIOR COURT OF JUSTICE

2011 ONSC 4670 (CanLII)

BETWEEN:	
EMAD ELGUINDY	
Applicant	The Applicant, Self Represented
– **and** –	
THE WARDEN OF WARKWORTH INSTITUTION A penitentiary operated by Correctional Service of Canada	
Respondent	M.J. Sims, for the Respondent
	HEARD: July 20, 2011

HEALEY, J.

[1] By this application the applicant seeks the remedy of *habeas corpus*, together with an order that he be restored to full parole, or in the alternative, day parole. His application is based on the following grounds:

i) the decision to suspend the applicant's parole was unlawful as it was so unreasonable on its face as to result in loss of jurisdiction;

ii) the decision to suspend was neither necessary nor reasonable to protect society;

iii) the decision to suspend was not tied to the criteria set out in the *Corrections and Conditional Release Act* S.C. 1991, c.20 ("*CCRA*");

iv) the decision to suspend parole was beyond the scope of what Parliament intended and therefore the decision lacked jurisdiction and was unlawful;

v) the decision to suspend exceeded the jurisdiction of the Correctional Service of Canada ("CSC") and the parole officer;

vi) the subsequent decision of the parole board to revoke the applicant's parole cannot cure the unlawful aspect of the parole officer's decision to suspend parole;

vii) the *CCRA* does not provide a complete, comprehensive and expert procedure for the review of the lawfulness of a parole officer's decision to suspend;

viii) the procedure, if any, set out in the *CCRA* to review lawfulness is less advantageous than the availability of *habeas corpus* in the Superior Court of Justice;

ix) the applicant did not breach any of his release conditions or commit any crime during his parole; and

x) the parole officers who suspended parole acted in bad faith and fabricated reasons for their decision and the reasons were not tied to the criteria for suspending parole.

[2] On July 20, 2011 this court declined to exercise its jurisdiction to hear the application, with these written reasons to follow.

[3] The facts are that the applicant is a first time federal offender serving a six year sentence for fraud over $5,000 for stealing approximately $248,000 from a mentally ill client of his unlicensed paralegal practice. However, he has a criminal record stretching back to 1993, and has been convicted of numerous dishonesty related offences, for which he served time in provincial custody.[1]

[4] The applicant was granted day parole on October 2, 2009 subject to various special conditions imposed by the Parole Board of Canada (the "Board"). His day parole was suspended by his parole officer three weeks later. In her opinion a suspension of the applicant's parole was required for the protection of society, as his continuing deceit and manipulation meant that his risk of re-offending was unmanageable in the community.[2]

[5] The Assessment for Decision details the various forms of deceit and manipulative behaviours engaged in by the applicant during his day parole and up until the time of his suspension.[3]

[6] During the three weeks that the applicant was on day parole he had three disciplinary interviews.[4]

---

[1] *R. v. Elguindy*, Reasons for Sentence, October 2, 2008, at pp. 5, 17, Respondent's record, Tab B, pp. 105, 117.
[2] Application Record, Tab 13, p. 59
[3] Application Record, Tab 13
[4] Ibid., p. 57

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[7] In November 2009 the applicant appeared before the Board for a post-suspension hearing. He made lengthy written submissions in advance of the hearing.[5] The Board reviewed the grounds for suspension, questioned the applicant, received his evidence, listened to his submissions, and ultimately confirmed the suspension and revoked his day parole.[6]

[8] The applicant appealed that decision to the Appeal Division of the Board, where he made further lengthy written submissions.[7] In a unanimous decision, the Appeal Division affirmed the Board's decision and denied the appeal.[8]

A Previous *Habeas Corpus* Application

[9] In 2010 the applicant brought an application for *habeas corpus* with *certiorari in aid* to quash the Board's decision.[9] On that prior application the applicant argued that the CSC had acted without jurisdiction in suspending his parole, and that the Board had erred in revoking his parole. In an endorsement dated March 17, 2010, Brown, J. declined to exercise his jurisdiction to hear the application, in favour of a judicial review proceeding before the Federal Court.[10] In his endorsement Brown, J. explained that he declined to exercise his jurisdiction to hear the application for *habeas corpus* on the basis that the statutory appeal process to the National Parole Board under section 147 of the *CCRA* is a complete, comprehensive and expert procedure to challenge the decision of the Board, citing *L.R.F. v. Canada (National Parole Board)*, [2008] N.S.J. No. 252 (NSCA) at para. 15, and *R. v. Latham*, [2009] S.J. No. 103 (SKCA) at para. 25. It was his view that the issue placed before the Superior Court of Justice on that application should more properly be litigated in the Federal Court as a judicial review proceeding.

[10] The applicant argues that the current application differs from the application heard by Brown, J. in that he now seeks *habeas corpus* to challenge the suspension of his parole instead of its revocation. He also argues that there is fresh evidence that this court should consider on this application, which should compel it to exercise its jurisdiction. Such evidence, he argues, constitutes special circumstances of the sort referred to by Brown, J. when he wrote:

> There may be exceptional circumstances where a statutory appeal procedure, comprehensive on its face, is so ineffective as to warrant the exercise of judicial discretion by *habeas corpus*.[11]

---

[5] Responding Brief, November 24, 2009, Application Record, Tab 14, pp.63 - 99.
[6] Decision of the Parole Board, January 14, 2010, Application Record, Tab 15, pp. 100-102.
[7] Notice of Appeal to the Appeal Division, Memorandum of Argument, Supplementary Notice of Appeal, Respondent's Record, Tabs 87, 88, 89, pp. 77-88.
[8] Decision of the Appeal Division, February 24, 2010, Application Record, Tab 16, pp. 103-108.
[9] Notice of Application dated February 3, 2010, Respondent's Record, Tab 1 pp. 6-13; Affidavit of Emad Elguindy sworn February 3, 2010, Respondent's Record, Tab 2, pp. 14-23.
[10] Endorsement of Brown, J. March 17, 2010, Application Record, Tab 21, pp. 143-144.
[11] Endorsement of Brown, J. supra

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The applicant argues that the special circumstances in this case arise out of the fact that there is a lengthy delay in the judicial review proceeding which therefore merits the exercise of jurisdiction by this court. He further argues that his health is deteriorating while in jail, and in part relies on the facts behind this assertion as being fresh evidence. Further, the applicant was permitted at the hearing of this application to give *viva voce* testimony with respect to what he considered to be further new evidence, namely a recent assault upon him by another inmate.

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Fresh Evidence

[11] With respect to the fresh evidence, the applicant firstly supplied no corroborating medical evidence from any physician or health care provider even though he claims that he is at risk of a further heart attack or other assaults to his heart muscle as a result of the stress of the penal environment. In his oral testimony he was permitted to described an alleged assault that occurred at the Warkworth penitentiary on July 12, 2011. He described a vicious assault whereby he was punched in the face and particularly the eye area by an aggressive inmate. He stated that he was bleeding from his eyes and that blood was pouring down his face from the various injuries and lacerations inflicted by the other inmate. When he was testifying, a mere eight days after this supposedly severe beating, I noted that the applicant had a noticeable yet small purple bruise under one of his eyes. He filed no records, medical or otherwise, arising from this event. I find the applicant's evidence lacking in credibility. The applicant's testimony lacked any air of reality, was exaggerated and not believable in the slightest. Further, even if the events in question are partially true such evidence would not be considered fresh evidence of the sort necessary to change the course of this application.

[12] I also note that there have been previous judicial findings with respect to the applicant's complete lack of credibility. In sentencing the applicant in 1994 for his conviction for fraud over $1,000 and failure to comply with the recognizance, Allen, J. wrote:

> There is no real indication of remorse on the part of this man. He is a thoroughly dishonest, untrustworthy person and he is not a violent person, but I have very strong suspicion that he has absolutely no intention of stopping his dishonest conduct.[12]

In passing sentence on the applicant following his current conviction for fraud, Justice Langdon of the Superior Court of Justice found:

> One could imagine a worse offender than Mr. Elguindy, but it would take some difficulty. My observations of him, his actions and his testimony have convinced me that he is a cunning, amoral, unscrupulous, untrustworthy, lying, parasite who is incapable of

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[12] *R. v. Elguindy*, [1994] O.J. No. 4357 (O.C.J.) at para. 3, Respondent's Authorities, Tab 3

feeling concerned for anyone but himself, and that, given the opportunity, he would repeat this offence in a heartbeat.[13]

[13] The applicant also argues, by way of fresh evidence, that he does not have proof that the warrant was faxed to the National Parole Board within the required time limitation of 30 days from the suspension. He objects to the evidence of a handwritten note on the warrant of apprehension which indicates that it was faxed to "N.P.B. police fax 2009/10/22", saying that such evidence is unreliable. Even if this court were to accept the respondent's submission that there is insufficient proof that the warrant was faxed to the Board, which I do not accept, this argument and this evidence was available for the applicant to bring forward both at the initial post-suspension hearing before the Board, at the Appeal Division, and before Mr. Justice Brown.

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Issues

[14] The two issues for determination on this application are 1) should this court decline to exercise its jurisdiction to hear this matter; and 2) is this application barred by the doctrine of *res judicata.*

[15] As earlier indicated this court has already determined that it will not exercise its jurisdiction to hear this matter.

[16] Part II of the *CCRA* governs the conditional release of offenders in the community. Parliament has granted the Board exclusive jurisdiction and absolute discretion regarding parole matters, including parole revocation and the cancellation of parole suspensions.[14]

[17] Subsections 135(1) and (3) of the *CCRA* set out the statutory parole suspension process. A person designated by the chair of the Board may suspend an offender's parole when that offender breaches a condition of his parole, or when the designated person is satisfied that it is necessary and reasonable to do so to prevent a breach of any condition or to protect society.[15] A parole supervisor is such a designated person. Once a federal offender's parole has been suspended, his or her case must be referred to the Board for a post-suspension hearing within 30 days of the recommitment. On the hearing, the Board has three options:

a) where it is satisfied that, in view of the offender's behaviour since release, the offender will not present an undue risk to society by reoffending before the expiration of the offender's sentence according to law, it shall cancel the suspension;

b) where the Board is not satisfied as provided in paragraph (a), it shall revoke the parole; or

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[13] *R. v. Elguindy*, Reasons for Sentence, October 2, 2008, Respondent's Record, Tab B, p. 122
[14] *Corrections and Conditional Release Act,* S.C. 1992, c.20 as amended, section 107(1).
[15] Ibid., section 135(1).

c) where the offender is no longer eligible for parole, the Board shall revoke it.[16]

[18] An offender has the right of appeal from decision of the Board to the Appeal Division, which has broad remedial powers.[17] Judicial review of a decision of the Appeal Division lies to the Federal Court pursuant to section 18.1 of the *Federal Courts Act*, R.S.C. 1985, c.F-7, as amended.

[19] The leading case on the availability of *habeas corpus* is the decision of the Supreme Court of Canada in *May v. Ferndale Institution*, [2005] 3 S.C.R. 809. In *May v. Ferndale* the court held that provincial superior courts retain the jurisdiction to hear a *habeas corpus* application alleging an "unlawful restriction of liberty" despite the fact that such allegations can also be raised in the Federal Court by way of judicial review.[18] However, the ratio of *May v. Ferndale Institution* is that superior courts should decline to exercise their jurisdiction in cases where there is a complete, comprehensive and expert procedure for review of an administrative decision. In such circumstances, any review of the administrative decision in question should more appropriately be carried out by the Federal Court on an application for judicial review.[19]

[20] The statutory review process set out in section 135 and 147 of the *CCRA* has been recognized by the Courts of Appeal of six provinces as constituting such a complete, comprehensive and expert procedure: *John v. Canada (National Parole Board)*, 2011 BCCA 188 at para. 35; *Armaly v. Canada (Parole Service)*, 2001 ABCA 280 at para. 2; *R. v. Latham*, 2009 SKCA 26 at para. 25; *R. v. Graham*, 2011 ONCA 138 at para. 10; *Lena v. Donnacona Prison*, 2011 QCCA 140 at para. 9; *L.R.F. v. Canada (National Parole Board)*, 2008 NSCA 56 at para. 15.

[21] As previously stated, in dismissing the applicant's prior application for *habeas corpus*, Brown, J. referred to the decision of the Courts of Appeal of Nova Scotia and Saskatchewan in *L.R.F. v. Canada*, supra and *R. v. Latham*, supra, respectively.

[22] The applicant relies on a decision of the British Columbia Supreme Court in *Woodhouse v. William Head Institution*, 2010 BCSC 754 where at para. 341 Walker, J. held that,

> The *CCRA* does not provide a complete, comprehensive, expert procedure in respect of the review of the lawfulness of decisions made by parole officers to suspend parole.

However, the decision in *Woodhouse* was overturned by the Ontario Court of Appeal in *R. v. Graham*, supra, upholding the decision of the application judge. Blair, J.A., delivering the unanimous judgment of the court, referred to other Canadian appellate and lower court decisions that have also come to the conclusion that the *CCRA* provides a

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[16] *CCRA*, supra, subsections 135(3) and 135(5).
[17] Ibid., section 147.
[18] *May v. Ferndale Institution*, supra, at para. 33.
[19] *May v. Ferndale Institution*, supra, at para. 44.

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complete, comprehensive and expert procedure for administering the parole review process including *Armaly v. Canada (Parole Service)*, supra, *R. v. Latham*, supra, *Lord v. Coulter* (2009), 266 B.C.A.C. 122 (C.A.); *McGrayne v. Canada (Attorney General)*, [2002] O.T.C. 191 (Sup. Ct.); as well as the decision of Brown, J. in *R. v. Elguindy*, 2010 ONSC 1757 (S.C.J.).[20]

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[23] Accordingly there is clear direction from the Ontario Court of Appeal that the *CCRA* provides the type of complete, comprehensive and expert procedure that places it more appropriately within the realm of the Federal Court on an application for judicial review as directed by *May v. Ferndale Institution*, supra, and therefore this court declines to exercise its jurisdiction.

The Doctrine of *Res Judicata*

[24] While not necessary to consider this aspect of the respondent's argument, I will do so for sake of completeness.

[25] I further find that this application is barred by the doctrine of *res judicata*, and specifically by cause of action estoppel.

[26] Cause of action estoppel precludes a party from bringing an action against another when the same cause of action has been determined in earlier proceedings by a court of competent jurisdiction.[21] The leading modern case on cause of action estoppel remains the decision of the Supreme Court in *Grandview (Town) v. Doering*, [1976] 2 S.C.R. 621, which adopted the following oft-quoted passage from *Henderson v. Henderson* (1843) 3 Hare 100 at 114 (P.C.):

> In trying this question I believe I state the rule of the court correctly when I say that, where a given matter becomes a subject of litigation in, and of adjudication by, a court of competent jurisdiction, the court requires the parties to that litigation to bring forward their whole case, and will not (except under special circumstances) permit the same parties to open the same subject of litigation in respect of matter which was not brought forward, only because they have, from negligence, inadvertence or even accident, omitted part of their case. The plea of *res judicata* applies, except in special cases, not only to points upon which the court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which properly belonged to the subject of litigation, in which the parties, exercising reasonable diligence, might have brought forward at the time.

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[20] *R. v. Graham,* supra, at para. 10

[21] *Angle v. Minister of National Revenue*, [1974] 2 S.C.R. 248 at 254.

[27] The traditional criteria for cause of action estoppel, drawn from the decisions in *Angle v. Minister of National Revenue*, [1974] 2 S.C.R. 248 and *Grandview (Town) v. Doering*, supra are:

1) there must be a final decision of a court of competent jurisdiction in the prior action;

2) the parties to the subsequent litigation must have been parties to or in privy with the parties to the prior action;

3) the cause of action in the prior action must not be separate and distinct;

4) the basis of the cause of action and the subsequent action was argued or could have been argued in the prior action if the parties had exercised reasonable diligence.[22]

[28] Thus, cause of action estoppel will bar a party from asserting not only issues that were raised before the court on the previous proceeding, but also issues that could have been decided had they been brought before that court.[23]

[29] Furthermore, a party may not simply reframe its case, predicated on the same set of facts in order to avoid the operation of the doctrine of cause of action estoppel. In *Las Vegas Strip Ltd. v. Toronto (City)* (1996), 30 O.R. (3d) 286 at para. 24 (Gen. Div.); affirmed (1997), 32 O.R. (3d) 651 (C.A.), Sharpe, J. held that "the authorities establish that a litigant cannot establish a new and fresh cause of action by advancing a new legal theory in support of a claim based upon essentially the same facts".

[30] On this application, the applicant challenges the decision to suspend as well as the evidence before the Board on the post-suspension hearing, together with the other elements that he characterizes as fresh evidence and which I have previously rejected on the basis of lack of reliability and relevance. In this application he focuses on the decision to suspend, rather than to revoke, although the actions of the parole officer and parole supervisor in suspending were also the subject matter of his previous application. In particular, in paragraph 2 of his earlier application he sets out one of the grounds as follows:

> 2. The Correctional Service of Canada erred in law and acted unlawfully and without jurisdiction while suspending the applicant's day parole when he did not violate any of the conditions of his release.

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[22] *Cliffs Over Maple Bay Investments Ltd. (re.)*, 2011 BCCA 180 at para. 28.

[23] In *Hoque v. Montreal Trust Co. of Canada* (1997), 162 N.S.R. (2d) 321 at para. 37 (C.A.), leave to appeal ref'd 167 N.S.R. (2d) 400n, Cromwell, J.A. held that the rule is that any issue that *should* have raised, rather than *could* have been raised, will be barred by operation of the doctrine.

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As part of his affidavit in support of that application he relied on the following statements:

> 7. I resided at the halfway house from October 2nd, 2009 till October 22nd, 2009 when my community parole officer (C.P.O.) suspended my parole and sent me back to jail. She prepared an Assessment for Decision (A4D) dated November 11th and 12th, recommending revocation of my parole. I do not feel that I did anything wrong to deprive me of my accelerated parole. I never violated any of my release conditions.

His affidavit continued from there to outline various interactions between he and his community parole officer.

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[31] Furthermore, both applications are based, *inter alia*, on the fact that CSC erred in law and acted without jurisdiction in suspending the applicant's day parole when he did not breach a condition of his release, and that the parole review regime is unfair and inadequate.

[32] In *Graham*, supra, the Ontario Court of Appeal has held that the suspension and revocation of parole are part of the same process.[24] Accordingly, when Brown, J. declined to exercise his jurisdiction to review the applicant's detention on the prior application he disposed of all issues that were or could be raised by the applicant relating to both suspension and revocation of his parole.

[33] Finally, in the present application the applicant has adduced most of the same evidence that he relied on before Justice Brown, or relies on evidence that was available to him at the time of his previous application. While he claimed during argument that a new issue was raised by the matter of the faxing of his warrant of apprehension, this was evidence that was available at the time of the hearing before Brown, J. and in any event would not affect the outcome of any *habeas corpus* application had I exercised this court's jurisdiction to hear such application.

[34] In fact, what has compelled this present application is precisely described by the applicant in his affidavit sworn May 2, 2011 at para. 48:

> After I had researched the law and consulted with many lawyers I realized that the only remedy for my compensation was a claim against Alina and Justin in order to free myself from the unlawful incarceration was by *habeas corpus* challenging the decision to suspend me not the decision of the Parole Board which was only in the hands of the Federal Court.[25]

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[24] *Graham*, supra, at paras. 14, 16.
[25] Application record, tab 2, p. 19

Accordingly, this is a new legal theory being advanced by the applicant, but on the same facts that were placed before Brown, J.

[35] Accordingly this application meets the four criteria for being barred by cause of action estoppel:

1. the decision of Brown, J. was a final decision with respect to whether the statutory appeal process set out in the *CCRA* is a complete, comprehensive and expert procedure;

2. the parties to this application are the same as the parties to the previous application. The Crown is the respondent in both applications, notwithstanding that different Crown agents were named as respondents;

3. the cause of action in this application and the prior application are not separate and distinct, in that both applications challenge the lawfulness of the Board's decision to suspend and revoke; and

4. the basis of this application was argued or could have been argued in the prior action if the applicant had exercised reasonable diligence.

[36] I would go further than this and state that in substance there is nothing novel contained in this application beyond that which was contained in the application heard and determined by Brown, J.

[37] For the foregoing reasons the application is dismissed.

HEALEY, J.

Released: August 3, 2011

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TAB 3

Enron Canada Corp. v. National Oil-Well Canada Ltd., 2000 ABCA 285

Date: 20001024
Docket: 99-18564/18565
18566/18567/18568/18569/18570/18571 and 18802

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IN THE COURT OF APPEAL OF ALBERTA

THE COURT:

THE HONOURABLE MADAM JUSTICE RUSSELL
THE HONOURABLE MR. JUSTICE SULATYCKY
THE HONOURABLE MR. JUSTICE WITTMANN

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985 c. C-36, as amended
AND IN THE MATTER OF BLUE RANGE RESOURCES CORPORATION

BETWEEN:

ENRON CANADA CORP., and THE CREDITOR'S COMMITTEE

Appellants (Appellants)

- and -

NATIONAL OIL-WELL CANADA LTD. et al.

Respondents (Respondents)

Appeal from the Decision of
THE HONOURABLE MR. JUSTICE LoVECCHIO
Dated the 9th day of November, 1999

REASONS FOR JUDGMENT RESERVED

REASONS FOR JUDGMENT OF THE HONOURABLE MR. JUSTICE WITTMANN
CONCURRED IN BY THE HONOURABLE MADAM JUSTICE RUSSELL
AND CONCURRED IN BY THE HONOURABLE MR. JUSTICE SULATYCKY

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D. W. Dear (for Rigel Oil & Gas Ltd.)
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K. E. Staroszik (for Founders Energy Ltd.)
J. N. Thom (for National-Oilwell Canada Ltd. and Campbell's Industrial Supply Ltd.)

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REASONS FOR JUDGMENT OF THE HONOURABLE
MR. JUSTICE WITTMANN

2000 ABCA 285 (CanLII)

Introduction

[1] The ***Companies' Creditors Arrangement Act***, R.S.A. 1985, c. C-36, as amended ("***CCAA***"), permits the compromise and resolution of claims of creditors against an insolvent corporation. In this appeal, as part of the ongoing resolution of the insolvency of Blue Range Resources Corporation ("Blue Range"), this Court has been asked to state the applicable criteria in considering whether to allow late claimants to file claims after a stipulated date in an order ("claims bar order").

[2] In his decision below, the chambers judge determined that in the circumstances of this case it was appropriate to allow the respondents ("late claimants") to file their claims thus entitling them to participate in the ***CCAA*** distribution.

Facts

[3] Blue Range sought and received court protection from its creditors under the ***CCAA*** on March 2, 1999. The claims procedure established by PriceWaterhouse Coopers Inc. ("the Monitor"), and approved by the court in a claims bar order, fixed a date of May 7, 1999 at 5:00 p.m. by which all claims were to be filed. Due to difficulties in obtaining the appropriate records, the date was extended in a second order to June 15, 1999 at 5:00 p.m., for the joint venture partners. The relevant orders stated that claims not proven in accordance with the set procedures "shall be deemed forever barred" (A.B.P.01, A.B.P.06). Under this procedure $270,000,000 in claims were filed.

[4] The respondent creditors in this appeal fall into two categories: first, those who did not file their Notices of Claim before the relevant dates in the claims bar orders, and second, those who filed their initial claims in time but sought to amend their claims after the relevant dates. All of these creditors applied to the chambers judge for relief from the restriction of the date in the claims bar orders and to have their late or amended claims accepted for consideration by the Monitor.

[5] The chambers judge allowed the late and amended claims to be filed. The appellants, Enron Capital Corp. ("Enron") and the Creditor's Committee, seek to have that decision overturned. I granted leave to appeal on January 14, 2000 on the following question:

> What criteria in the circumstances of these cases should the Court use to exercise its discretion in deciding whether to allow late claimants to file claims which, if proven, may be recognized, notwithstanding a previous claims bar order containing a claims bar date which would otherwise bar the claim of the late claimants, and applying the criteria to each case, what is the result? (A.B.928).

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Judgment Below

[6] The chambers judge found that the applicable section of the ***CCAA***, s. 12(2)(iii) did not mandate a claims procedure. He stated that preserving certainty in the ***CCAA*** process was not a sufficient reason to deny the late claimants a second chance. In his view, taking a strict reading of the claims bar orders would have the effect of denying creditors, who have a logical explanation for their non- compliance with the order, any recovery. While the chambers judge noted that compromise is required by creditors in a ***CCAA*** proceeding, he did not think it fair that these late claimants be required to compromise 100 per cent of their legitimate claims. In addition, the chambers judge was of the view that process required flexibility and should avoid pitting creditors against one another.

[7] Having decided that flexibility in the process was required, the chambers judge then considered an appropriate test for allowing the filing of late claims. Although encouraged by the appellants to adopt an approach similar to that contained in the ***United States Bankruptcy Code***, ***Federal Rules of Bankruptcy Procedure***, for Chapter 11 Reorganization Cases, ("***U.S. Bankruptcy Rules***") the chambers judge chose to incorporate the test in place under the ***Bankruptcy and Insolvency Act*** R.S.C. 1985 c. B-3 ("***BIA***"). Specifically, he found that because the situation of Blue Range was essentially a liquidation, the approach used in the ***BIA*** was appropriate. Under the ***BIA***, late claims are permitted under almost any circumstance provided no injustice is done to other creditors. A late filing creditor under the ***BIA*** may only share in undistributed assets. Therefore, the chambers judge found that the creditors should be allowed to file late claims, or to amend existing claims late.

Standard of Review

[8] It has been recently held by this court that decisions of a ***CCAA*** supervising judge should only be interfered with in clear cases. Deference to a ***CCAA*** supervising judge is generally appropriate where the questions before the court deal with management issues and are of necessity matters which must be decided quickly. This issue was addressed by Macfarlane, J.A. in ***Pacific National Lease Holding Corp.*** (1992), 15 C.B.R. (3d) 265 (B.C.C.A.) (cited with approval by Hunt, J.A. in ***Luscar Ltd. v. Smoky River Coal Ltd.***, [1999] A.J. No. 676 (C.A.)) as follows at 272:

> ...I am of the view that this court should exercise its powers sparingly when it is asked to intervene with respect to questions which arise under the CCAA. The process of management which the Act has assigned to the trial court is an ongoing one. In this case a number of orders have been made...
>
> ...
>
> Orders depend on a careful and delicate balancing of a variety of interests and of problems. In that context appellate proceedings may well upset the balance, and delay or frustrate the process under the CCAA.

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The chambers judge was exercising his discretion under the ***CCAA*** in granting an extension of the claims bar dates. However, the criteria upon which that discretion is to be exercised is a matter of legal principle, and therefore on that issue, the standard of review is correctness.

Analysis

[9] As a preliminary matter I wish to comment on the nature of the order granted and the notices sent out to the individual creditors. The order dated April 6, 1999 stated in paragraph 2:

> Claims not proven in accordance with the procedures set out in Schedules "A" and "B" shall be deemed forever barred and may not thereafter be advanced as against Blue Range in Canada or elsewhere. (A.B.P.01)

The first page of Schedule "A" stated in part:

> A Claims' Bar Date of 5:00 p.m. Calgary time on May 7, 1999 has been set by the Alberta Court of Queen's Bench. All claims received by the monitor or postmarked after the Claims' Bar Date will be <u>forever extinguished, barred and will not participate in any voting or distributions in the CCAA proceedings.</u>
>
> [Emphasis added] (A.B.P.03).

The language used in Schedule "A" goes beyond the text of the order. Although it may not be of practical significance, barring the right of a claimant to a remedy is fundamentally different from erasing the debt. The court under the ***CCAA*** has powers to compromise and determine, but only in accordance with the process prescribed in the statute.

[10] It was urged before the court in oral argument by counsel for the appellants that the purpose of the wording of the claims bar orders was to "smoke out" the creditors. I am dubious that the severe wording of the claims bar orders is effective to "smoke out" the creditor who may otherwise lie dormant. The objective of making certain that all legitimate creditors come forward on a timely basis has to be balanced against the integrity and respect for the court process and its orders. Courts should not make orders that are not intended to be enforced in accordance with their terms. All counsel conceded that the court had authority to allow late filing of claims, and that it was merely a matter of what criteria the court should use in exercising that power. It necessarily follows that a claims bar order and its schedule should not purport to "forever bar" a claim without a saving provision. That saving provision could be simply worded with a proviso such as "without leave of the court", which appears to be not only what was contemplated, but what in fact occurred here.

The Appropriate Criteria

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[11] The appellants advocated the adoption of the criteria under the ***U.S. Bankruptcy Rules***, Chapter 11, while the respondents favoured either the application of the tests under the ***BIA*** or some blending of the two standards.

[12] Rule 9006 of the ***U.S. Bankruptcy Rules*** deals with the extension of time in these circumstances. The relevant portion of the Rule states:

> 9006 (b)(1) ... when an act is required or allowed to be done at or within a specified period by these rules or by a notice given thereunder or by order of court, the court for cause shown may at any time in its discretion (1) with or without motion or notice order the period enlarged if the request is made before the expiration of the period originally prescribed or as extended by a previous order or (2) on motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect.

The key phrase in this section is "excusable neglect". In ***Pioneer Investment Services Company v. Brunswick Associates v. Brunswick Associates Limited Partnership et al.*** 507 U.S. 380, 113 S.Ct. 1489 (1993) the U.S. Supreme Court dealt with the interpretation of this phrase. In ***Pioneer***, the creditor's attorney, due to disruptions in his legal practice and confusion over the form of notice, failed to file a Notice of Claim in time. The U.S. Supreme Court noted that excusable neglect may extend to "inadvertent delays" (at pg 391) and went on to identify the relevant considerations when determining whether or not a delay is excusable. The Court said at 395:

> Because Congress has provided no other guideposts for determining what sorts of neglect will be considered "excusable", we conclude that the determination is at bottom an equitable one, taking account of all relevant circumstances surrounding the party's omission. These include, as the Court of Appeals found, the danger of prejudice to the debtor, the length of the delay and its potential impact on judicial proceedings, the reason for the delay, including whether it was within the reasonable control of the movant, and whether the movant acted in good faith.

The American authorities also seem to reflect that the burden of meeting all of these elements, including showing the absence of prejudice, lies with the party seeking to file the late claim: e.g. ***In re Specialty Equipment Companies Inc.***, 159 B.R. 236 (1993).

[13] The Canadian approach under the ***BIA*** has been somewhat different. Canadian courts have been willing to allow the filing of late or amended claims under the ***BIA*** when the claims are delayed due to inadvertence, (which would include negligence or neglect), or incomplete information being available to the creditors, see: ***Re Mount Jamie Mines (Quebec) Ltd.*** (1980),

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110 D.L.R. (3rd) 80 (Ont. S.C.). The Canadian standard under the ***BIA*** is, therefore, less arduous than that applied under the ***U.S. Bankruptcy Rules***.

[14] I accept that some guidance can be gained from the ***BIA*** approach to these types of cases but I find that some concerns remain. An inadvertence standard by itself might imply that there need be almost no explanation whatever for the failure to file a claim in time. In my view inadvertence could be an appropriate element of the standard if parties are able to show, in addition, that they acted in good faith and were not simply trying to delay or avoid participation in ***CCAA*** proceedings. But I also take some guidance from the ***U.S. Bankruptcy Rules*** standard because I agree that the length of delay and the potential prejudice to other parties must be considered. To this extent, I accept a blended approach, taking into consideration both the ***BIA*** and ***U.S. Bankruptcy Rules*** approaches, bolstered by the application of some of the concepts included in other areas, such as late reporting in insurance claims, and delay in the prosecution of a civil action.

[15] In ***Lindsay v. Transtec Canada Ltd.*** (1994), 28 C.B.R. (3d) 110 (B.C.S.C.), the applicant was an unsecured creditor of Alberta Pacific Terminals Ltd. ("APCL"). Transtec Canada Ltd. was indebted to the applicant and APCL had guaranteed the obligation. APCL sought protection under the ***CCAA***. Through oversight, the applicant Lindsay was not sent the relevant ***CCAA*** materials by APCL and was not included in the ***CCAA*** proceedings. He did not, therefore, have the opportunity to vote on the plan of arrangement. It is clear, however, that Lindsay at some point during the ***CCAA*** proceedings became aware of them, and at various stages had his lawyers contact APCL's lawyers to inquire about the process. Despite this knowledge he did not pursue the matter. Lindsay then came to the court seeking permission to sue APCL as a guarantor, potentially recovering considerably more than those creditors who participated in the ***CCAA*** process.

[16] After reviewing all of the facts, Huddart, J. found that "Lindsay (or solicitors on his behalf) made considered, deliberate, decisions not to notify Alberta-Pacific of his claim until after the approval order and then not until after the closing of the share purchase agreement" (para 19). She then went on to conclude that Lindsay preferred not to participate in the ***CCAA*** process and chose to take his chances later on.

[17] In deciding how to exercise her discretion, Huddart, J. applied the following factors: "the extent of the creditor's actual knowledge and understanding of the proceedings; the economic effect on the creditor and debtor company; fairness to other creditors; the scheme and purpose of the ***CCAA*** and the terms of the plan" (para 56). On these criteria, Huddart, J. found that it would not be equitable to allow Lindsay to pursue a claim as he was well aware of what was going on in the ***CCAA*** proceedings, chose not to participate, and his late action would cause serious prejudice both to the debtor company and to the other creditors.

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[18] While ***Lindsay*** is clearly distinguishable on its facts from the within appeal, the case does highlight the issues of the conduct of the late claimants and the potential prejudice to other creditors and the debtor. Lindsay was the classic creditor "lying in the weeds", waiting for the appropriate moment to pounce. He did not act in good faith and his conduct was potentially prejudicial to other creditors and the debtor company. By avoiding the ***CCAA*** proceedings, Lindsay was attempting to gain an advantage not available to other creditors.

[19] There is further support for a blended approach in several other areas of the law where courts have had to deal with the impact of delays and late filings. In particular, I have considered the courts' treatment of delays in the prosecution of actions and the late filing of notices of claim to insurers.

[20] In ***Lethbridge Motors Co. v. American Motors (Can.) Ltd.*** (1987), 53 Alta. L.R. (2d) 326 (C.A.) the court had to decide whether or not to allow an action to continue where no steps had been taken by the plaintiff for five years. In deciding that the action could continue, Laycraft, C.J.A. relied on the following test from the English Court of Appeal in ***Allen v. Sir Alfred McAlpine & Sons Ltd.*** [1968] 1 All E.R. 543 where Salmon L.J. said at 561:

> In order for the application to succeed the defendant must show:
>
> (i) that there has been inordinate delay. It would be highly undesirable and indeed impossible to attempt to lay down a tariff - so many years or more on one side of the line and a lesser period on the other. What is or is not inordinate delay must depend on the facts of each particular case. These vary infinitely from case to case, but it should not be too difficult to recognise inordinate delay when it occurs.
>
> (ii) that this inordinate delay is inexcusable. As a rule, until a credible excuse is made out, the natural inference would be that it is inexcusable.
>
> (iii) that the defendants are likely to be seriously prejudiced by the delay. This may be prejudice at the trial of issues between themselves and the plaintiff, or between each other, or between themselves and the third parties. In addition to any inference that may properly be drawn from the delay itself, prejudice can sometimes be directly proved. As a rule, the longer the delay, the greater the likelihood of serious prejudice at the trial.

Relying on this test, as well as additional refinements, the Court found that the fundamental rule was that it was "necessary for a defendant to show serious prejudice before the court will exercise its jurisdiction to strike out an action for want of prosecution" (at pg. 331). The onus of showing serious prejudice has now been substantially altered as the result of amendments to the Alberta Rules of Court in 1994. Rule 244(4) now states that proof of inordinate and inexcusable

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delay constitutes *prima facie* evidence of serious prejudice: ***Kuziw v. Kucheran Estate***, 2000 ABCA 226 (Online: Alberta Courts).

[21] Similar questions can arise in an insurance context where an insured is required to file a proof of loss or other notice of claim within a certain time period under a contract of insurance. For example, s. 205 of the ***Insurance Act*** R.S.A. 1980, c. I-5 states:

> 205 [w]here there has been imperfect compliance with a statutory condition as to the proof of loss to be given by the insured or other matter or thing required to by done or omitted by the insured with respect to the loss and the consequent forfeiture or avoidance of the insurance in whole or in part and the Court considers it inequitable that the insurance should be forfeited or avoided on that ground, the Court may relieve against forfeiture or avoidance on such terms as it considers just.

[22] Similar wording is also found in ss. 211 and 385 of the ***Insurance Act*** and similar legislation exists throughout the common law provinces.

[23] When deciding whether to grant relief from forfeiture in an insurance context the Alberta courts have generally adopted a two part test, see: ***Hogan v. Kolisnyk*** (1983), 25 Alta L.R. (2d) 17 (Q.B.). In ***Hogan*** the court found it appropriate to look first at the conduct of the insured to determine whether the insured is guilty of fraud or wilful misconduct. Second, the court considered whether the insurer had been seriously prejudiced by the imperfect compliance with the statutory provision (at 35). The "noncomplying" party can show that there was no prejudice by showing that the innocent party had actual knowledge of the events in question and was thereby able to investigate the situation.

[24] Considering whether the insurer has suffered any prejudice, the court in ***Hogan*** quoted from a decision of Stevenson, D.C.J. in ***Schoeler (W.) Trucking Ltd. v. Market Ins. Co. of Can.*** (1980), 9 Alta L.R. (2d) 232 at 237 where Stevenson, D.C.J. said "[t]he root of the question is whether or not it (the insurer) would have acted any differently if it had been given notice of the loss when it should have been given notice". In ***312630 British Columbia Ltd.* v. *Alta. Surety Co.*** (1995), 10 B.C.L.R. (3d) 84 (C.A) the B.C. Court of Appeal set out a more recent formulation of the test, namely whether the insurer by reason of the late notice had lost a realistic opportunity to do anything that it might otherwise have done.

[25] These authorities arise in a clearly different context from that which I am dealing with in this case, but they demonstrate that there is a somewhat consistent approach in a variety of areas of the law when dealing with the impact of late notice or delays in particular processes.

[26] Therefore, the appropriate criteria to apply to the late claimants is as follows:

1. Was the delay caused by inadvertence and if so, did the claimant act in good faith?

2. What is the effect of permitting the claim in terms of the existence and impact of any relevant prejudice caused by the delay?

3. If relevant prejudice is found can it be alleviated by attaching appropriate conditions to an order permitting late filing?

4. If relevant prejudice is found which cannot be alleviated, are there any other considerations which may nonetheless warrant an order permitting late filing?

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[27] In the context of the criteria, "inadvertent" includes carelessness, negligence, accident, and is unintentional. I will deal with the conduct of each of the respondents in turn below and then turn to a discussion of potential prejudice suffered by the appellants.

National-Oilwell Canada Ltd. ("National")

[28] National, and National as the successor in interest to Dosco Supply, a division of Westburne Industrial Enterprises Ltd. ("Dosco") indicate that their claims were filed late due to the unexpected illness and resulting lengthy absence of their credit manager who was in charge of the Blue Range accounts receivable. National submitted the National and Dosco notices of claims on June 7, 1999 (AB V, pgs 538 and 542). National's claim is $58,211.00 and Dosco's claim is $390,369.13. National and Dosco clearly acted in good faith and provided the Notices of Claim as soon as the relevant personnel became aware of the situation.

Campbell's Industrial Supply Ltd. ("Campbell's")

[29] Campbell's initial claim in the amount of $14,595.22 was filed prior to the date in the relevant claims bar order. Campbell's then amended its claim on June 25, 1999 and again on July 8, 1999 to $23,318.88. The claim was amended after the relevant date as a result of a representative from Blue Range informing Campbell's that its claim should include invoices sent to Trans Canada Midstream, Berkley Petroleum, Big Bear Exploration and Blue Range Resources Corporation (A.B. 495-496). In addition, there appears to have been some delay due to the Notices of Claim not being sent to the correct Campbell's office. Campbell's acted in good faith throughout and it is in fact arguable that any delay in the proper filing of its claims was actually due to errors on the part of Blue Range rather than its own doing.

TransAlta Utilities Corporation ("TransAlta")

[30] TransAlta did not comply with the dates in the claims bar orders. It contends that it did not receive the claims package prior to the relevant dates. It is apparent from the evidence that the claims package was sent to TransAlta at its accounts receivable office, rather than the registered office for service (A.B.432-434). TransAlta was permitted to file its total claim of $120,731.00 by order of the chambers judge dated September 7, 1999. There is no evidence that TransAlta was attempting to circumvent the ***CCAA*** process. On the contrary, as soon as the

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appropriate personnel became aware of the situation, TransAlta took the necessary steps to have its Notice of Claim filed.

Petro-Canada Oil and Gas ("PCOG")

[31] PCOG filed extensive claims material with the Monitor prior to the relevant dates showing several unsecured claims. The Monitor's draft third interim report indicated that four of PCOG's claims should properly have been classified as secured. The mistake by PCOG was the result of a misapprehension of how operator's liens functioned under the CAPL Operating Procedures incorporated into the contracts giving rise to the claims. PCOG then sought to amend its claims and have them changed from unsecured to secured status (A.B. 554), on July 7, 1999. The change in status would result in claims of $137,981.30 being amended from unsecured to secured. There was no lack of good faith.

Barrington Petroleum Ltd. ("Barrington")

[32] Barrington was acquired by Sunoma Energy Corp ("Sunoma") in about September, 1998. An affidavit filed by Sunoma's controller indicates that the financial records of Barrington were found to have been in complete disarray. Barrington's initial Notice of Claim in the amount of $223,940.06 was submitted prior to the relevant date. Barrington received a Notice of Dispute of Claim which approved the claim to the extent of $57,809.37, but disputed the remainder. On reviewing the issue, Barrington's controller determined that Blue Range was correct, but at the same time she identified additional invoices of which she had been unaware (A.B.549-551). On discovering the additional invoices, Barrington then submitted an amended Notice of Claim on July 22, 1999 and an objection to the Notice of Dispute of Claim. Barrington acted in good faith.

Rigel Oil & Gas Ltd. ("Rigel")

[33] The full amount of Rigel's Notice of Claim was $146,429.68. This Claim was filed prior to the relevant date and the amount was approved by Blue Range. After the relevant date, on August 12, 1999, Rigel moved to amend and to allege that, despite Blue Range's claims to the contrary, its claim was secured, rather than unsecured. The only issue for Rigel on appeal is if their claim is properly secured can it be accepted because it was not claimed as secured until August 12, 1999.

Halliburton Group Canada Inc. ("Haliburton")

[34] Halliburton was in the process of attempting to collect on accounts receivable owed by Big Bear Exploration Ltd. through May and June, 1999. They subsequently became aware, after the relevant date, that a claim in the amount of $11,309.90 was in fact against Blue Range, and should properly have been filed as a Notice of Claim in the *CCAA* proceedings (A.B. 497-499). On making this discovery, Halliburton wrote to the Monitor on July 14, and July 26, 1999 requesting that its claim be included in the *CCAA* proceeding. The Monitor disputed this claim as having been filed too late (A.B. 498). It appears that Halliburton acted in good faith.

Founders Energy Ltd. ("Founders")

[35] Founders filed its claim prior to the relevant date, but, due to an oversight, claimed as an unsecured rather than a secured creditor. After filing its initial Notice of Claim, Founders received a Notice of Dispute from Blue Range. Within the 15 day appeal period, but outside the claims bar date, Founders then filed an amended Notice of Claim claiming a secured interest in the sum of $365,472.39, on July 26, 1999.

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Prejudice

[36] The timing of these proceedings is a key element in determining whether any prejudice will be suffered by either the debtor corporation or other creditors if the late and late amended claims are allowed. The total of all late and amended claims of the late claimants, secured and unsecured, is approximately $1,175,000. As set out above, in the initial claims bar order, the relevant date was 5:00 p.m. May 7, 1999. This date was extended for joint venture partners to 5:00 p.m. on June 15, 1999. The Plan of Arrangement, sponsored by Canadian Natural Resources Ltd. ("CNRL"), was voted on and passed on July 23, 1999. Status as a creditor, the classification as secured or unsecured, and the amount of a creditor's claim, are relevant to voting: s.6 ***CCAA***.

[37] Enron and the Creditor's Committee claim that they would be prejudiced if the late claims were allowed because, had they known late claims might be permitted without rigorous criteria for allowance, they might have voted differently on the Plan of Arrangement. Enron in particular submits that it would have voted against the CNRL Plan of Arrangement, thus effectively vetoing the plan, if it had known that late claims would be allowed. This bald assertion after the fact was not sufficient to compel the chambers judge to find this would in fact have been Enron's response. Nowhere else in the evidence is there any indication that late claimants being allowed would have impacted the voting on the different proposed Plans of Arrangement. In addition, materiality is relevant to the issue of prejudice. The relationship of $1,175,000 (which is the total of late claims) to $270,000,000 (which is the total of claims filed within time) is .435 per cent.

[38] Also, the contrary is indicated in the Third Interim Report of the Monitor where it is shown in Schedule D-1 (A.B.269) that $2 million was held as an estimate of unsecured disputed claims. Therefore, when considering which Plan of Arrangement to vote for, Enron, and all of the creditors, would have been aware that $2 million could still be legitimately allowed as unsecured claims, and would have been able to assess that potential effect on the amount available for distribution.

[39] Further, the late claimants were well known to the Monitor and all of the other creditors. The evidence discloses that officials at Enron received an e-mail from the Monitor on May 18, 1999 indicating that there were several creditors who had filed late, after the first deadline of May 7, and the Monitor thought that even though they were late the court would likely allow them (A.B.1040). Finally, all of the late claimants were on the distribution list as having potential claims. (A.B. 9-148). It cannot be said that these late claimants were lying in the weeds

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waiting to pounce. On the contrary, all parties were fully aware of who had potential claims, especially Enron and the Creditors Committee.

[40] In a ***CCAA*** context, as in a ***BIA*** context, the fact that Enron and the other Creditors will receive less money if late and late amended claims are allowed is not prejudice relevant to this criterion. Re-organization under the ***CCAA*** involves compromise. Allowing all legitimate creditors to share in the available proceeds is an integral part of the process. A reduction in that share can not be characterized as prejudice: ***Re Cohen*** (1956), 36 C.B.R. 21 (Alta. C.A.) at 30-31. Further, I am in agreement with the test for prejudice used by the British Columbia Court of Appeal in ***312630 British Columbia Ltd.*** It is: did the creditor(s) by reason of the late filings lose a realistic opportunity to do anything that they otherwise might have done? Enron and the other creditors were fully informed about the potential for late claims being permitted, and were specifically aware of the existence of the late claimants as creditors. I find, therefore, that Enron and the Creditors will not suffer any relevant prejudice should the late claims be permitted.

Summary of Criteria

[41] In considering claims filed or amended after a claims bar date in a claims bar order, a ***CCAA*** supervising judge should proceed as follows:

1. Was the delay caused by inadvertence and if so, did the claimant act in good faith?

2. What is the effect of permitting the claim in terms of the existence and impact of any relevant prejudice caused by the delay?

3. If relevant prejudice is found can it be alleviated by attaching appropriate conditions to an order permitting late filing?

4. If relevant prejudice is found which cannot be alleviated, are there any other considerations which may nonetheless warrant an order permitting late filing?

Conclusion

[42] Applying the criteria established, I find that the conclusion reached by the chambers judge ought not to be disturbed, and the late claims filed by the respondents should be permitted under the ***CCAA*** proceedings. The appeal is dismissed.

APPEAL HEARD on June 15, 2000

REASONS FILED at Calgary, Alberta,
this 24th day of October, 2000

WITTMANN J.A.

I concur:

RUSSELL J.A.

I concur:

SULATYCKY J.A.

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TAB 4

COURT FILE NO.: 02-CL-4804
DATE: 20041130

ONTARIO

SUPERIOR COURT OF JUSTICE

(COMMERCIAL LIST)

2004 CanLII 45450 (ON SC)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED, SECTION 18.6	*Michael McGraw*, for the Applicant, Noma Company
IN THE MATTER OF THE APPLICATION OF NOMA COMPANY, ANCILLARY TO PROCEEDINGS UNDER CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE	*Peter Carlisi*, for Despina Koutlemanis
Applicant	
	HEARD: November 25, 2004

CAMERON J.

[1] These are motions:

1. by Noma Company to:

    a) dismiss the action commenced by Despina Koutlemanis ("Ms. Koutlemanis") in 1997 against Noma Inc., a predecessor of Noma Company, for damages for harassment during employment (the "Action") set to be tried December 15, 2004;

    b) for a declaration that the Action is a claim which, in this proceeding under the *Companies' Creditors Arrangement Act* ("CCAA"), was barred and extinguished on April 14, 2003 pursuant to a Claims Process and Bar Order ("Claims Bar Order") dated February 7, 2003 and a Canadian Recognition Order dated October 9, 2003 confirming a U.S. Federal Court

order which confirmed a Plan of Reorganization respecting Noma Company and its affiliates ("Canadian Recognition Order").

2. by Ms. Koutlemanis for:

a) a declaration that the Action is a valid and subsisting action not subject to the Claims Bar Order or the Canadian Recognition Order; and

b) that this court can proceed to try the Action and that any judgment resulting therefrom is enforceable; or

c) that the Claims Bar Order be lifted as it may apply to the Action; or

d) that Ms. Koutlemanis be permitted to make a claim as contained in the Action notwithstanding the Claims Bar Order.

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Chronology

[2] The Action was commenced by Ms. Koutlemanis against Noma Inc. in 1997 for general, special and punitive damages totaling $650,000 for personal injuries resulting from harassment while she was an employee of Noma Inc. between 1990 and 1993.

[3] Aylesworth Thompson Phelan O'Brien LLP ("Aylesworth") represented Ms. Koutlemanis and Gowling Henderson ("Gowlings") represented Noma Inc. and later Noma Company in the Action.

[4] In or about 1998 Ms. Koutlemanis suffered personal injuries in a motor vehicle accident and in another incident and commenced actions in respect of them.

[5] In 1999 Noma Inc. amalgamated with a numbered company under the laws of Nova Scotia and continued as Noma Company.

[6] On October 11, 2002 (the "US Petition Date"), Noma's ultimate parent company, GenTek Inc. ("GenTek") and thirty-one of GenTek's subsidiaries and affiliates (the "Chapter 11 Debtors"), including Noma, filed petitions for relief under Chapter 11 of the United States Bankruptcy Code (the "US Proceedings") in the United States Bankruptcy Court for the District of Delaware (the "US Court") to facilitate a global restructuring of the GenTek group of companies.

[7] In November 2002 Aylesworth received a Notice of Commencement of Chapter 11 Bankruptcy Cases in the U.S. Court "In re GenTek Inc. et al." and "In re: Noma Company" as debtors, dated October 29, 2002 naming as debtors 32 companies including "Noma Corporation" and "Noma Company", all having the address of: Liberty Lane, Hampton, New Hampshire, 03842.

[8] The notice gave notice of a meeting of creditors on November 18, 2002 in Wilmington, Delaware and names as counsel for the debtors Skadden, Arps, Slater Meagher & Flom LLP of Wilmington, Delaware.

[9] The notice gave notice of names used by the debtors in the last six years for some of the debtors. There were no prior names given for Noma Corporation or Noma Company.

[10] On November 5, 2002 Aylesworth wrote to Gowlings asking whether the notice had any application to the Action against Noma Inc. Gowlings advised by voicemail that it was prepared to discuss the matter. Aylesworth, by letter, sought a written response. It received none.

[11] On December 10, 2002, Noma Company sought and obtained an Initial Order pursuant to section 18.6 of the CCAA, recognizing the U.S. Proceedings and granting Noma Company, amongst other things, a stay against claims, proceedings and the exercise of any contractual rights against it or its property in Canada (the "Stay Period");

[12] The Initial Order provides for a Stay of Proceedings against Noma Company such that actions could not be commenced or continued against Noma Company.

[13] Noma Company was and is represented in this proceeding by Blake, Cassels & Graydon ("Blakes").

[14] Neither Ms. Koutlemanis nor many other creditors of Noma Company received notice of the application for the Initial Order.

[15] By Order of the Honourable Mr. Justice Ground dated February 7, 2003 (the "Claims Bar Order"), the Court granted an order establishing a process for filing proofs of claim and a bar date of April 14, 2003 (the "Bar Date") for creditors of Noma Company resident in Canada.

[16] The Claims Bar Order provided that any Canadian resident with a claim against Noma Company which arose prior to October 11, 2002 was required to file a proof of claim to be received by Noma Company's claims agent on or before the Bar Date and that any party that failed to file such a proof of claim on or before the Bar Date, shall be forever barred, estopped and enjoined from asserting any claim against Noma Company.

[17] Paragraph 3 of the Claims Bar Order provided:

> This court orders that Noma is authorized and directed to mail to all known creditors of Noma resident in Canada according to its books and records a proof of claim with instructions and notice of bar date substantially in the form annexed hereto...on or before February 13, 2003.

[18] Paragraphs 10, 11, 12, 13 and 14 of the Claims Bar Order provided:

> 10. This court orders that notice of this Order and the Bar Date, substantially in the form of the notice of bar date attached hereto as Schedule "B" (the "Bar

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Date Notice"), shall be deemed good, adequate and sufficient notice if it is served by being deposited in the United States mail, first class postage prepaid, on or before February 13, 2003, upon:

(a) all Canadian Creditors listed on the Schedules at the address stated therein;

(b) all current and recent former employees of Noma who are resident in Canada;

(c) all current and recent former customers of Noma who are resident in Canada; and

(d) all persons and entities requesting notice of these proceedings.

11. This court orders that so long as the initial mailing of the Bar Date Notice occurs on or before February 13, 2003 as provided above, Noma may make supplemental mailings of the Bar Date Notice up to 23 days in advance of the Bar Date, as may be necessary in situations where (a) notices are returned by the Post Office with forwarding addresses, necessitating a re-mailing to the new address; (b) certain parties acting on behalf of parties in interest declining to pass along notices to such parties and instead return their names and addresses to Noma for direct mailing; and (c) additional potential claimants become known as a result of this process.

12. This court orders that Noma is entitled to establish Special Bar Dates (as defined in the US Order) with respect to any subsequently identified Canadian Creditors. All Special Bar Dates will be established in accordance with paragraph 14 of the US Order.

13. This court orders that Noma publish a bar date notice in substantially the form attached as Schedule "C" (the "Publication Notice"), in the Globe and Mail (National Edition), the Toronto Star and the Montreal Gazette (including a French translation) on or before February 15, 2003.

14. This court orders that notification of the Bar Date by the mailing of a notice of Bar Date and publication of the Publication Notice as provided herein is fair and reasonable and will provide good, sufficient and proper notice to all Canadian Creditors of their rights and obligations in connection with any claims they may have against Noma in these proceedings or the US Proceedings.

[19] An affidavit filed in support of the Claims Bar Order purported to exhibit a list of the Canadian creditors of Noma Company which would be the basis of the mailing of the proofs of claim and notices to Canadian creditors. There were on the list the names of about 700 creditors resident in Canada. Ms. Koutlemanis' name is on the list with an address "c/o Aylesworth Thompson Phelan, South Tower, Royal Bank Plaza, P.O. Box 15, Suite 3000, Toronto".

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[20] Gowlings was provided with a copy of the Claims Bar Order. There is no evidence that Gowlings advised Aylesworth of it.

[21] A document headed "Affidavit of Service" signed but not sworn by Kathleen M. Logan on February 28, 2003 stated that "I hereby certify under penalty that" on or about February 13, 2003 she caused copies of the proof of claim form and notice of bar date requiring filing of proofs of claim on or before the Bar Date to be inserted in first class, postage pre-paid and the pre-addressed envelopes and delivered to the U.S. Postal Service for delivery to those persons on the Service List attached to the "Affidavit of Service" as an exhibit. The Exhibit in the Applicant's Record herein is only page "94 of 181". The exhibit is headed:

SERVICE LIST
Notice of Bar Date Requiring Filing Of Proofs Of Claim On Or
Before April 14, 2003, At 4:00 P.M. Eastern Time
Noma Company – Canadian Entities

DEBTOR: GEN – TEK US AND CANADA

[22] The one page exhibit shows the names of 27 creditors with Canadian addresses whose names begin with "K" which includes:

Creditor ID: 189-03
Koutlemanis, Despina
c/o Aylesworth Thompson Phelan et al.
South Tower Royal Bank Plaza
PO Box 15 Ste 3000
Toronto ON M5J 2J1
Canada

[23] The affidavit of the lawyer of Blake Cassels & Graydon ("Blakes"), counsel for Noma Company herein, who swore the affidavit in support of this motion was patently incorrect in saying the "Affidavit of Service" was sworn but the error is not material.

[24] Counsel for Ms. Koutlemanis argues that a certificate is not sufficient to prove service. Rule 39 permits evidence to be given by affidavit unless a statute or rule provides otherwise. This argument is initially not unattractive. However, I am satisfied from the material before me that the certificate was probably accepted by the U.S. Court. Further, on its face it was made "under penalty" which I take to mean that the certifier recognizes that she is subject to sanction if the information is false. That sanction is unlikely to carry the moral sanction of an oath but appears to have the potential of prosecution not unlike that for perjury. I equate the certificate to a solemn affirmation in our jurisdiction.

[25] There is no evidence before me to suggest that the certification in the "Affidavit of Service" is not true.

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[26] On or about February 15, 2003, in accordance with the Claims Bar Order, Notice of the Bar Date was published in the Globe and Mail (National Edition), the Toronto Star and the Montreal Gazette.

[27] The unchallenged evidence on these motions is that neither Aylesworth nor Ms. Koutlemanis received the Notice or Notice and Proof of Claim. Neither Aylesworth nor Ms. Koutlemanis saw the published notice. The Notice and Proof of Claim addressed to Aylesworth were not returned to Kathleen Logan's company.

[28] Aylesworth moved its offices from Royal Bank Plaza to Toronto Dominion Centre in early June 2003.

[29] Ms. Koutlemanis did not file a Proof of Claim by the Bar Date.

[30] On June 17, 2003, Blakes sent a letter (the "June 17 Letter") to Aylesworth advising Aylesworth of Noma Company being the successor to Noma Inc. and of the Stay Period in the Initial Order, providing copies of the Initial Order, the Claims Bar Order, and an "Affidavit of Service" evidencing that Ms. Koutlemanis was served with a proof of claim and the notice as per the Claims Bar Order, and advising that Ms. Koutlemanis did not file a proof of claim by the Bar Date and a copy of an order extending the Stay Period to September 30, 2003. On June 18 Noma Company changed its solicitors in the Action to Blakes. On the same day Blakes attended at the pre-trial in the Action and advised Aylesworth again of the Stay Period and the bar of claims.

[31] Aylesworth asked Blakes at the pre-trial of the Action how the Action was affected by the Chapter 11 proceedings. Blakes suggested a possible change of name on the amalgamation of Noma Inc.

[32] Aylesworth took the position that Noma Inc.'s counsel was obliged to advise counsel of any change of its client's name.

[33] On August 11, 2003, Noma obtained an order in the US Proceedings approving a Canadian claims dispute process and ceding jurisdiction for the resolution of claims of Canadian creditors governed by Canadian law to this court. On August 19, 2003, this court granted the Claims Dispute Process Order, whereby Canadian claims, as defined therein, would be disputed in this jurisdiction, if necessary, and under the supervision of this court.

[34] On June 30, 2003, the Joint Plan of Reorganization under Chapter 11, Title 11, United States Code of GenTek Inc., et al., and Noma Company, Debtors was filed. On August 21, 2003 the Plan of Reorganization and Disclosure Statement was filed with the US Court. The final Disclosure Statement and Plan of Reorganization was filed in the US Court on August 28, 2003 (the "Plan of Reorganization"). The US Court approved the Disclosure Statement on August 25, 2003.

[35] In August 2003 Ms. Koutlemanis changed her solicitors from Aylesworth to Kapelos and Carlisi ("Kapelos"). Kapelos received the file from Aylesworth in September, 2003.

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[36] The Plan of Reorganization was approved by the requisite majority of creditors. By order of the US Court dated October 7, 2003 (the "US Confirmation Order"), the US Court found, among other things, that the Plan of Reorganization complied in all respects with the requirements of the US Bankruptcy Code and related rules.

[37] On October 9, 2003, Noma Company sought and obtained a confirmation recognition order recognizing the US Confirmation Order in its entirety and directing that the US Confirmation Order be implemented and effective in Canada in accordance with its terms (the "Canadian Recognition Order").

[38] Upon confirmation of the Plan of Reorganization, Noma Company was provided with a broad discharge and release of any and all claims and actions.

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[39] The Plan of Reorganization required claimants to elect by March 1, 2004 whether they wished to receive payment of their claims in money or in shares. In the absence of an election, the claimant was deemed to elect payment in shares. Successful unsecured claimants received six cents on the dollar or shares of the same value.

[40] On December 1, 2003, Kapelos, the new and current counsel to Ms. Koutlemanis, sent a letter to Blakes requesting an adjournment of the trial of the Action. On December 4, 2003, Blakes sent a reply letter to Kapelos (the "December 4 Letter"), providing copies of the Claims Bar Order, the Affidavit of Service and advising Kapelos that Aylesworth was served with the Notice and a Proof of Claim form but failed to file a proof of claim in advance of the Bar Date as mandated by the Claims Bar Order. Blakes stated that any claims by Ms. Koutlemanis against Noma Company, including the Action, are forever barred, estopped and enjoined from being asserted against Noma Company. Further, in the December 4 Letter, Blakes refused to consent to an adjournment of the trial of the Action and requested that Ms. Koutlemanis consent to an order dismissing the Action as against Noma Company. Ms. Koutlemanis has refused to provide such a consent.

[41] On February 4, 2004, Blakes received a copy of a letter (the "February 4 Letter") from Kapelos to the Court Office advising that they had attended Trial Scheduling Court on February 2, 2004 and by Order of the Honourable Mr. Justice Cameron, the Action was being transferred to case management and would be tried together with two other actions in which Ms. Koutlemanis is the plaintiff. Blakes was not present at Trial Scheduling Court. The status of the Action was not an issue before me then.

[42] Blakes attempted to contact Kapelos to confirm that the Action was not proceeding by leaving messages at Kapelos' office on February 5, 15, 23 and April 13, 2004, and did not receive a return call.

[43] On March 1, 2004 the accepted claims of unsecured creditors received shares and warrants of New Gen-Tek for their claims unless they elected to receive cash. Those electing the cash option received six cents on the dollar. The remaining available equity is reserved to satisfy disputed claims which are ultimately allowed.

[44] On June 2, 2004, Blakes sent a letter to Kapelos enclosing a copy of a draft motion record in these proceedings to dismiss the Action, advising Kapelos that Noma Company would be bringing a motion in these proceedings to have the Action dismissed.

[45] Kapelos asserted that the Action was not barred and extinguished because the Action was commenced against Noma Inc. and not Noma Company. On July 7, 2004 Blakes sent a letter to Kapelos enclosing a corporate search confirming that Noma Inc. and 3034843 Nova Scotia Company amalgamated on November 1, 1999 and continued as Noma Company and confirmed its position that the Action is forever barred and extinguished by the failure to file a proof of claim by the Bar Date.

[46] Kapelos obtained the affidavit of Andrea Taylor, a solicitor of Aylesworth, sworn July 28, 2004 (the "Taylor Affidavit"), in support of Ms. Koutlemanis' position.

[47] The Taylor affidavit in support of Ms. Koutlemanis' position was delivered to Blakes on September 27, 2004.

[48] Noma Company served its first version of the notice of motion herein on or about October 9, 2004.

[49] Ms. Taylor swore that Aylesworth was never advised by counsel for Noma Inc., the defendant in the Action, that the corporation became Noma Company in 1999, two years after commencement of the Action.

[50] Ms. Koutlemanis served her cross-motion herein on November 18, 2004 and cross-examined the Noma Company witness on November 19, 2004.

Issues

1. Is the claim in the Action barred and extinguished by Ms. Koutlemanis' failure to file a proof of claim prior to the Bar Date in the Claims Procedure and Bar Order?

2. If so, should this court give leave to file a late claim so as to exempt the Action from the Claims Procedure and Bar Order?

[51] I cast the second question in this way because all Ms. Koutlemanis lost by not receiving notice of the Claims Bar Order and requirement to file a proof of claim was her entitlement as an unsecured creditor in Noma Company's proposal. She has no grounds for the orders to have her claim excluded from the CCAA proceedings so that any judgment in the Action would be enforceable. She has not alleged fraud.

1. Bar of the Action

[52] The purpose of the CCAA is to facilitate compromises and arrangements between companies and their creditors. In furtherance of that objective it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors while the company attempts to carry on business as a going concern and to negotiate a corporate restructuring arrangement which is approved by the creditors: *Campeau* v. *Olympia & York Developments Ltd.* (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) at 309.

[53] Section 6 of the CCAA provides that where the requisite majority of creditors agrees to a compromise or arrangement and it is sanctioned by the court it is binding on the company and on all creditors (emphasis added). Consequently no action can be brought by a creditor to enforce its claim as if the compromise had not been sanctioned by the court: *Tuckahoe Financial Corp.* v. *George W. Tindall Ltd.*, [1995] O.J. No. 4121 (Gen. Div.) at para. 8, where a default judgment against the company obtained after court approval of the plan under the CCAA was declared a nullity.

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[54] *Lindsay* v. *Transtec Canada* (1994), 28 C.B.R. (3d) 110 (B.C.S.C.) was a case where a substantial unsecured creditor was, through inadvertence, not on the list of creditors and not given notice of the stay of proceedings or the CCAA approval of the plan.

[55] At p. 124 the court stated that once the creditors, the company and the court have agreed to the plan of reorganization, the company must be able to carry on business free of the burden of the creditors' claims except as the creditors have agreed to in approving the plan. In obtaining the creditors' agreement, the creditors will have agreed to compromise their claims. It would be unfair to them if a dissident or absent creditor cold remain outside the plan and assert its full claim. The purpose of the CCAA is to avoid such a result. Those who participate in CCAA proceedings must be assured that there are no other creditors waiting outside the process for a mistake to be made of which they can take advantage or that an oversight or inadvertence in complying with court orders, will result in some claims remaining outside the system. The certainty of court orders must be assured. See *Lindsay* v. *Transtec* at pp. 125 and 129.

[56] Counsel for Ms. Koutlemanis refers to *Ivorylane Corporation* v. *Country Style Realty Limited* June 22, 2004, 2004 CarswellOnt 2567, 2004 WL1353660 (Ont. S.C.J.) (Commercial) at paragraphs 45, 49-52 as authority for the proposition that a claims bar of which notice has been published in a newspaper which has not been seen by the creditor cannot bind the creditor. However, in *Ivorylane* the debtor company did not comply with a term of the bar order requiring service on the creditor by fax transmission, personal delivery or pre-paid mail. More importantly the creditor was not a creditor affected by the plan of reorganization or obliged to file a proof of claim: See para. 34.

[57] I am satisfied from:

a) the terms of the Claims Bar Order;

b) the certificate of mailing in the "Affidavit of Service" in accordance with the order;

c) advertising in accordance with the order;

d) Ms. Koutlemanis' failure to file a proof of claim by the Bar Date;

e) the Canadian Recognition Order; and

f) the provisions of s. 18.6 of the CCAA respecting recognition and co-ordination of proceedings under the CCAA with foreign proceedings dealing with the collective interests of the creditors generally,

that the claim in the Action was forever discharged and released.

2. Permitting a Late Claim

[58] Notwithstanding the effect of the terms of the CCAA and the court's orders herein, Ms. Koutlemanis seeks leave to file a late claim. I assume the motion is based on the equitable

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jurisdiction of this court. There are precedents for such claims: *Algoma Steel Corp.* v. *Royal Bank* (1992), 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 55 O.A.C. 303 (C.A.); *Enron Canada Corp.* v. *National-Oilwell Canada Ltd.* (2000), 193 D.L.R. (4th) 314 (Alta. C.A.).

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[59] *Enron* dealt with the issue of allowing the filing of late claims after a court ordered claims bar date. The court determined at para. 26 on p. 324, that the issue should be determined on the application of the following criteria:

1. Was the delay caused by inadvertence and if so, did the claimant act in good faith?
2. What is the effect of permitting the claim in terms of the existence and impact of any relevant prejudice caused by the delay?
3. If relevant prejudice can be found can it be alleviated by attaching appropriate conditions to an order permitting late filing?
4. If relevant prejudice is found which cannot be alleviated, are there any other considerations which may nonetheless warrant an order permitting late filing?

[60] In the context of the criteria, *Enron* stated that "inadvertent" includes carelessness, negligence and accident and is unintentional.

[61] The delay immediately following the mailing and advertising on February 13, 2003 was probably caused by the inadvertence of either the mailing agent, the U.S. Postal Service, Canada Post or Aylesworth. There is no evidence that the non-receipt was not inadvertent.

[62] However, on June 17, 2003 Blakes, Noma Company's new solicitor in the Action gave specific notice to Ms. Koutlemanis, through her solicitor, in the context of the Action, that the claims bar applied to the Action. Aylesworth was clearly on notice that the Claims Bar Order and the Stay Order applied to the defendant in the Action and to the claim in the Action and that Ms. Koutlemanis had not filed a proof of claim by the Bar Date.

[63] Any inadvertence by Ms. Koutlemanis ceased to run on or about June 17, 2003.

[64] The claim by Ms. Taylor on behalf of Ms. Koutlemanis that Noma Company could not be said to be Noma Inc. is not a *bona fide* reason for not reacting to the Blakes letter. The first sentence of the letter stated:

> We are counsel for Noma Company, successor in interest to Noma Inc. ("Noma").

[65] The letter was delivered in the context of the Action.

[66] If Aylesworth had any doubt of what it was being told, Aylesworth was put on notice with a duty to inquire. They could have done a corporate search to confirm Blakes' advice. There is no suggestion they did so.

[67] Kapelos received the file from Aylesworth in September, 2003. I assume the Blakes letter was in the file. There is no evidence it was not.

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[68] Kapelos clearly had a separate notification from Blakes on December 4,2003 confirming the information in the July 17, 2003 letter to Aylesworth and concluding that Ms. Koutlemanis' claim was barred. Kapelos did nothing. It continued as if the Action was still subsisting and refused to consent to a dismissal of the action requested by Blakes.

[69] On June 2, 2004 Blakes sent to Kapelos a draft motion record to dismiss the Action by way of offering an opportunity to respond before formally instituting the motion.

[70] Kapelos did not respond to the June 2, 2004 letter. They did not commence the cross-motion herein until after the Noma Company motion was served.

[71] In my opinion Ms. Koutlemanis' solicitors did not act in good faith after June 17, 2003. They waited over 17 months before bringing this motion.

[72] If Ms. Koutlemanis' claim is allowed, it would undermine the purpose and assumptions on which the CCAA process is based. By not reacting to the Blakes June 17, 2003 letter on a timely basis her counsel permitted the process of approval and confirmation of the plan of reorganization to continue.

[73] There is no evidence before me of the total of the proven claims against Noma Company. I am unable to assess the value of Ms. Koutlemanis' claims in the Action. There is no evidence before me of Noma Company's current net worth. Noma Company can issue additional equity only for disputed claims ultimately allowed, not for late claims. However, with a recovery potential of 6 cents on the dollar, the Action cannot be worth more than $39,000.

[74] Even if Ms. Koutlemanis had received the notice and filed the proof of claim by the Bar Date her recovery would not have exceeded $39,000, being 6% of her claim in the Action.

[75] I am offered no grounds on which the relevant prejudice could be alleviated save and except that she is an individual with a damage claim suing a corporation which her counsel implies is wealthy and so there may be money there.

[76] I am sensitive to her loss but that argument does not address the issue before me. I must also be alert to the prejudice to Noma Company, its creditors and the reliability of this court's orders as to their finality.

[77] It is argued that Gowlings knew of the change of name, the Initial Order and the Claims Bar Order and had a duty, as solicitor in the Action for Noma Company, to tell Aylesworth on a timely basis but that Gowlings failed to do so.

[78] Counsel for Ms. Koutlemanis could offer no authority for the existence of such a duty or when such a duty arose.

[79] If there was such a duty respecting notice of the Claims Bar Order, was Gowlings not entitled to rely on the notice provisions of that order, provided they were complied with?

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[80] When asked, Gowlings failed to respond to Aylesworth's request for information as to the application of the Notice of Commencement of Chapter 11 Proceedings to the Action and the defendant therein. In my opinion they should have done so. It was a reasonable request by Aylesworth and deserved a response. Communication, cooperation and common sense should govern relations between counsel in all civil proceedings, not just on the Commercial List.

[81] Even if Noma Company's counsel had made Aylesworth aware of the change of the defendant's name to Noma Company, it is unlikely Aylesworth would have received notice of the application for the Initial Order or of the Bar Date and the need to file a proof of claim. The problem only arises, respecting the motion for the leave to file a claim late, on the receipt by Aylesworth of Blakes' June 17, 2003 letter. At that point Aylesworth had clear knowledge of the change of name and the Claims Bar Order. Had this cross-motion been brought on a timely basis after June 17, 2003, leave would probably have been given. Instead, Ms. Koutlemanis' counsel, knowing of the problem, ignored it and delayed for 17 months. Noma Company acted in the interim in reliance on there being no other provable claims by preparing a proposal, putting it to its creditors and obtaining the approval of the U.S. Court and this court.

[82] Counsel referred to *Robinson* v. *Royal Bank of Canada, Ross & McBride and Morris* (1995), 1 R.P.R. (3d) 25, 26 O.R. (3d) 627 as authority for an obligation on a solicitor for a party to disclose to the other side important information. In *Robinson* the plaintiff sought to defend enforcement of the mortgage against her which she knew had been forged by her husband but failed to tell the mortgagee. Her husband later became bankrupt. The court determined that the plaintiff's knowledge of the forgery, without telling the mortgagee, estopped her from relying on the forgery to deny the validity of the mortgage and its enforceability against her. The mortgagee had been denied its opportunity to claim against the husband. This has no application to the issue of Noma Company's failure to tell Ms. Koutlemanis of its change of name or the effect of the Claims Bar Order.

Conclusion

[83] I declare that the claim in the Action is barred and extinguished and is no longer a valid and subsisting action.

[84] I decline to exercise my discretion to lift the Claims Bar Order as it applies to the Action to permit Ms. Koutlemanis to file a proof of claim.

[85] The Action is dismissed.

Costs

[86] Unless the parties agree as to costs, the issue may be addressed by written submissions to me. Those of Noma Company shall be made within 15 days after release of these reasons and those of Ms. Koutlemanis within 10 days thereafter.

Cameron J.

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Released: November 30, 2004

2004 CanLII 45450 (ON SC)

COURT FILE NO.: 02-CL-4804
DATE: 20041130

ONTARIO

SUPERIOR COURT OF JUSTICE

2004 CanLII 45450 (ON SC)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED, SECTION 18.6

IN THE MATTER OF THE APPLICATION OF NOMA COMPANY, ANCILLARY TO PROCEEDINGS UNDER CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE

Applicant

REASONS FOR JUDGMENT

CAMERON J.

Released: November 30, 2004

TAB 5

Court of Queen's Bench of Alberta

Citation: Gerrow v. Dorais, 2010 ABQB 560

Date: 20100903
Docket: 0903 13412
Registry: Edmonton

2010 ABQB 560 (CanLII)

Between:

Anthony Ford Gerrow

Plaintiff

- and -

Michel Joseph Dorais, Hinton Pine Holdings Inc., Hinton Leaf Holdings Inc., 1033543 Alberta Ltd., Hinton Sky Inc., Green Holdings Inc., Hinton Green Inc., Growth Partners Inc., Capitalplus Financial Inc., Zenith Capital Investment Corp., and Dorais Financial Inc.

Defendants

Reasons for Judgment
of the
Honourable Mr. Justice Don J. Manderscheid

I. Introduction

[1] This matter arises out of three Notices of Motion involving the respective rights of a Court appointed receiver and various secured creditors and the equitable doctrines of marshalling, apportionment and subrogation. As well, this matter involves the application of the *Statute of Elizabeth (Fraudulent Conveyances Act),* 1571 (13 Eliz. 1) c. 5, and the *Personal Property Security Act*, R.S.A. 2000, p-20. Counsel for 805251 Alberta Ltd. advised the Court that his client was not proceeding with their claim under the *Fraudulent Preferences Act*, R.S.A. 2000, F-24.

[2] Essentially this case asks whether a debtor, who owns several mortgaged properties, can transfer title of the mortgaged properties to a non-arms length corporation, have that corporation pay a portion of the debtor's debt to a primary debtor as a guarantor, and then have that corporation seek subrogation from the sale of property, depriving secondary mortgage holders on some of the property of their ability to realize on their security. It also asks whether lien and caveat holders can seek a division of the monies realized from the sale of the properties with the secondary mortgage holders.

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II. Facts

[3] The material facts surrounding this matter are as follows:

1. 1033543 Alberta Ltd. (103), Hinton Pine Holdings Inc. (Hinton Pine), and Hinton Leaf Holdings Inc.(Hinton Leaf), are all Alberta corporations. With the exception of a few hours during the course of Rollover Agreements described below, the sole shareholder and director of 103, Hinton Pine, and Hinton Leaf was Michel Dorais, who died in 2009.

2. 103 purchased three commercial properties in Hinton, Alberta:

   (a) Lots 1, 2, 3, Block 2, Plan 7823286, (Lots 1,2,3);

   (b) Lot 4, Block 1, Plan 0325182, (Lot 4); and

   (c) Lot 8, Block 2, Plan 0625170, (Lot 8).

3. 103 borrowed money from the Alberta Treasury Branch (ATB). The ATB indebtedness was comprised of various demand loans totalling of $1.6 million as at September 8, 2009.

4. ATB filed a General Security Agreement against 103 at Personal Property Registry on October 15, 2008 covering all present and after acquired property of 103. ATB also registered as a continuing collateral security for the ATB indebtedness collateral mortgages up to the principle sum of :

   (a) $1 million dollars at the North Alberta Land Registration District Office, (LTO), against the title to Lot 4 on October 6, 2004 as instrument number 042438868.

   (b) $535,000.00 at LTO against the title to Lots 1, 2,3, on November 12, 2003 as instrument number 032437572.

(c) $500,000.00 at LTO against the title to Lot 8 on February 21, 2007 as instrument number 072103522.

7. 805251 Alberta Ltd. (805), is an Alberta Corporation. It entered into a mortgage agreement with103, which was registered at LTO against the title to Lot 4, as instrument number 072152496 on March 16, 2007. Funds were advanced to103 and at April 13, 2010 there was $387,106.94 owing to 805 on the mortgage.

8. 805 filed a General Security Agreement covering all present and after acquired personal property at the Personal Property Registry against 103 on January 14, 2009.

9. Cedar Peaks Mortgage Investments Inc. (Cedar Peaks), is an Alberta corporation which entered into a mortgage agreement with 103. That mortgage was registered at the LTO against title to Lot 8 as instrument number 082 333 031 on August 9, 2008. Funds were advanced to 103 and at September 21, 2009 there was owing on that mortgage $796,001.74.

10. Cedar Peaks filed a General Security Agreement covering all present and after acquired personal property at the Personal Property Registry against 103 on July 30, 2008.

11. On or about September 1, 2008 103 transferred title to Lots 1,2,3 to Hinton Pine, and title to Lot 4 to Hinton Leaf. Mr. Dorais caused the transfers to take place pursuant to Rollover Agreements after he obtained tax advice. The agreements did not involve cash changing hands. Mr. Dorais did not tell the creditors of 103 about the Rollover Agreements and the transfers of land to Hinton Pine and Hinton Leaf.

12. When ATB learned of the transfers, they threatened to take action unless Hinton Pine and Hinton Leaf executed Guarantees of the ATB indebtedness. The Guarantees were subsequently executed by Hinton Pine and Hinton Leaf.

13. After Mr. Dorais died, the monthly mortgage payments on Lots 1,2,3, Lot 4 and Lot 8 were not made. ATB commenced foreclosure actions in respect of each of the Lots as follows:

(a) Lot 1,2, 3, Action No.: 0903 11949;

(b) Lot 4, Action No.: 0903 11948;

(c) Lot 8, Action No.: 0903 11950.

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14. Cedar Peaks commenced a foreclosure action on its mortgage against Lot 8 in action number 0903 13066.

15. Anthony Ford Gerrow was appointed Receiver of all Defendants in action number 0903 13412 by Justice Bielby on August 27, 2009 for the purpose of examining the affairs of Mr. Dorais and the Defendants to determine what assets might be available to satisfy the outstanding claims of the creditors against the Defendants, Mr. Dorais and various companies owned by him including Hinton Pine.

16. The Receiver has confirmed that there are approximately $5 million dollars in outstanding unsecured claims. In his capacity as Receiver, the Receiver has collected $31,996.73 from the rentals of Lots 1,2,3 paid to the Receiver under an agreement between ATB and the other secured creditors and this Court. The Receiver has also collected GST on the rents payable, however in most cases because the rentals were paid by the Government of Alberta, no GST was payable. The GST collected on account of the rental payments totals $12,257.57.

17. On September 21, 2009 Justice Bielby granted an Order Nisi in the three ATB foreclosure actions, and the properties were listed for sale under judicial listings. ATB obtained a Preservation Order for all three properties and hired a Preservation Agent, Lyle Stewart, to look after all three properties.

18. Lots 1,2,3 sold first; an Offer for $1,200,000 was approved by Justice Bielby on November 19, 2009 and Lots 1,2,3 sold for that amount. Lot 4 sold next; an Offer for $980,000 was approved by Justice Bielby on February 25, 2010, and Lot 4 sold for that amount. Lot 8 sold last; an offer for $965,000 was approved by an Order of Master Wacowich dated March 22, 2010, and Lot 8 sold for that amount.

19. The Town of Hinton has a claim against the proceeds from the sale of Lot 4, and it filed a Caveat claiming an interest under an agreement to pay offsite levies dated November 30, 2007 between 103 and Hinton. The Caveat was registered against the title to Lot 4 as instrument number 092407573 on November 12, 2009.

20. D.C. Electrical Services Ltd. and Hinton Plumbing and Heating Ltd., (collectively referred to as the Lien Holders), performed work and supplied materials in regards to Lot 8. Pursuant to the *Builder's Lien Act*, R.S.A. 2000, c. B-7, the Lien Holders registered builders' liens against the title to Lot 8 as instrument numbers 092 244 946 and 092 206 728, respectively. The amount of the respective builders' liens of the Lien Holders is $88,753.00, for D.C., and

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$6,634.00 for Hinton Plumbing.[1] Lot 8 serves as the only recourse for the Lien Holders for payment of their registered liens.

21. The ATB indebtedness was fully paid out from the rental proceeds, the sale of Lots 1,2,3, up to the mortgage amount of $535,000.00, and the remaining indebtedness was paid out from the sale of Lot 4. The ATB indebtedness had been fully repaid by the time Lot 8 was sold.

22. There was another secured creditor, Grant Dewar, who was paid out of the proceeds and who is not a party to these Actions. After this, there still remained funds totalling $391,275.17 resulting from the proceeds of the judicial sale of Lots 1,2,3. As mentioned above, ATB had required Hinton Pine to execute a Guarantee in favour of ATB of the ATB indebtedness of 103. ATB obtained judgment on the Guarantee against Hinton Pine and filed a Writ against the interest of Hinton Pine against the title to Lots 1,2,3 at the LTO as instrument number 092 422 087.

23. At the time Lot 4 sold, ATB was still owed $612,398.31, plus solicitor-client costs and the preservation agent's fees. When Lot 4 sold, the lawyer for ATB received net sale proceeds of $877,327.74 after payment of realtor fees. ATB paid out of these funds as follows:

a)	Realty Taxes on Lot 4	$ 10,872.32
b)	ATB Indebtedness	$612,398.31
c)	Preservation Agent account for Lot 4 and Lot 8	$ 26,846.63
d)	ATB solicitor-client account	$ 16,725.13
e)	ATB solicitor-client account	$ 5,658.49
f)	Balance into Court	$253,376.86

24. The outstanding amount on the 805 mortgage on Lot 4 at April 13, 2010 was $387,106.94.

25. The amount outstanding on the Cedar Peaks mortgage on Lot 8 on September 21, 2009 was $796,001.14, and as of June 4, 2010 was $897,516.74.

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1 There is an encumbrance on title by O.K. Tire Stores Inc. registered on Lot 8, but it does not secure any indebtedness and need not be considered as per the advice of Maurice Blain, counsel for O.K. Tire Stores Inc.

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26. The net proceeds of the sale of Lot 8 were $889,334.10.

27. Paragraph 9 of Justice Bielby's September 21, 2009 Order states that the Court will consider an application for:

> ... the distribution of the remaining funds, whether the equitable doctrine of marshalling would apply that would affect the payment or distribution of the net sale proceeds amongst the Subsequent Encumbrancer(s) or would entitle any one or more of the Subsequent Encumbrancer(s) to be subrogated under any of ATB's mortgage security registered against any of the other Lands so as to equitably cause the sale proceeds to be distributed amongst the priority claimants to the Lands.

As of March 22, 2010 all lands described in Justice Bielby's order were sold.

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III. Issues

[4] The issues to be decided are:

(a) Is the Receiver entitled by virtue of the equitable doctrine of subrogation to step into the position of the ATB in regards to the payment of $391,275.17 to the ATB pursuant to the Guarantee given by Hinton Pines to the ATB?

(b) If the answer to the question in sub paragraph (a) above is in the affirmative, then does the equitable doctrines of marshalling or alternatively apportionment operate to defeat the Receiver's right of subrogation *vis-a-vis* any claim by 805, Cedar Peaks, the Lien Holders, the Town of Hinton, or any other secured creditors?

(c) If the answer to the question in sub paragraph (a) above is in the negative, then to what extent does the doctrine of marshalling or alternatively apportionment, apply to the respective claims made by 805, Cedar Peaks, the Lien Holders, the Town of Hinton, or any other secured creditors?

IV. Cases

1. Subrogation

[5] The Receiver argues that he is subrogated to ATB rights because of Hinton Pine's Guarantee of 103's indebtedness to ATB, and which indebtedness was paid and totalled $391,275.17.

[6] Basically speaking, the equitable doctrine of subrogation allows one party to stand in the shoes of another and advance any claims that the original party may have had against another party: ***Alberta (Treasury Branches) v. Alberta (Public Trustee)***, 2002 ABQB 781, 7 Alta. L.R. (4th) 110. Subrogation is simply asking something in the right of another, which in justice and equity, should be accorded to the person asking: ***Goldsmith v. Stewart***, (1885) 45 Ark 149 (C.A.) 154. Application of the doctrine enables:

> ... the substitution of one person in place of another, whether as a creditor, or as the possessor of any other rightful claim so that he who is substituted succeeds to the rights of the other in relation to the debt or claim and its rights, remedies, or securities.
>
> ***Leavitt v. C.P.R.***, (1897) 37 Atl 886, at 888, right column, 90 Maine 153 (C.A.).

[7] Although there is an abundance of Canadian authorities that have considered this doctrine, none appear to have analogous fact situations to this case. For this reason, and as each case is to determined on its own particular facts, a review of the doctrine and the jurisprudence germane to its application is therefore required.

[8] A concise historical overview of the equitable doctrine of subrogation was provided in ***E C & M Electric Ltd. v. Medicine Hat General and Auxiliary Hospital and Nursing Home District No. 69*** (1987), 76 A.R. 281, 35 D.L.R. (4th) 80 (QB) where Lomas J. in discussing the origins of the doctrine of subrogation quoted *Halsbury's Laws of England* (4th ed.) Volume 20 para. 193 and Volume 16 para. 1438:

> 193. **Surety's right of subrogation**. As soon as the surety has paid to the creditor what is due to the creditor under the guarantee, he is entitled, unless he has waived them, to be subrogated ... to all the rights possessed by the creditor in respect of the debt, default or miscarriages to which the guarantee relates.
>
> 1438. **Doctrine of subrogation**. Where one person has a claim against another, in certain circumstances a third person is allowed to have the benefit of the claim and the remedy for enforcing it, even though it has not been assigned to him, and he is then said to be subrogated to the rights of the first person.

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[9] The authors, Meagher, Gummow and Lehane in *Equity: Doctrines and Remedies* (2nd ed.) (Sydney: Butterworth's, 1984) at page 251 quote from ***John Edwards & Co. v. Motor Union Insurance Co. Ltd.*** [1922] 2 KB 249 at 252 discussing the origin of the doctrine:

> It was derived by our English Courts from the system of Roman law...The doctrine has been widely applied in our English body of law, eg to sureties and to matters *of ultra vires* as well as to insurance. In connection with insurance it was recognized ere the beginning of the eighteenth century. In ***Randal v Cockran*** (1748) 1 Ves Sen 98; 27 ER 916, it was held that the plaintiff's insurers after making satisfaction stood in the place of the assured as to goods, salvage, and restitution in proportion for what they paid. As the Lord Chancellor (Lord Hardwicke) said: "The plaintiffs had the plainest equity that could be".

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[10] Goff and Jones in *The Law of Restitution* (2nd ed) (London: Sweet and Maxwell., 1978) note that a contracting party may reserve a right of subrogation or specifically exclude or limit it. However, they note that since the 17th century, the case law has held that subrogation arises independently of, and "not by force of", contract and will be granted if it is just and equitable to do so. They conclude (at page 406):

> Subrogation is the "plainest equity that could be"; its basis is a "principle of natural justice". As Buckley L.J. recently said: "The doc-trine of subrogation does not ... rest on contract at all. It is an equitable doctrine".[2]

[11] More recently, the doctrine of subrogation was addressed by our Court of Appeal in ***Rainbird Sprinkler Manufacturing Co. (Canada) Ltd.* v. *Elpat Holdings Ltd.***) (1996), 187 A.R. 222, 42 Alta. L.R. (3d) 328 (CA) where the Court, in discussing the application of subrogation in terms of the position of a guarantor held that the guarantor, although not the principle debtor, was entitled to be paid as he stepped into the shoes of the creditor and was entitled to pursue its remedies and realize on its security on the basis of equitable principles. The Court went on to quote G.H.L. Fridman, *Restitution*, (2nd ed.) (Scarborough, Ont.: Carswell, 1992) at pp. 402-3 (at para. 12) :

> A surety who pays off the debt to the principal creditor owed by the principal debtor is entitled to succeed to all claims which the principal creditor has against the debtor in order to prevent an unjust enrichment. The surety stands in the place of the creditor not as a matter of contract but by operation of law. Hence, he is entitled to every remedy which the creditor might have enjoyed against the

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[2] See also Maudsley, *Hanbury's Modern Equity* (8th ed.) (London: Stevens & Sons Ltd.,1969) at page 429; Sidney Arthur Taylor Rowlatt, *Rowatt on The Law of Principal and Surety* (4th ed.), (London: Sweet & Maxwell,1982) at page 145; George W. Brandt, *The Law of Suretyship and Guaranty* (3rd ed.) (Chicago : Callaghan & Co., 1905) at page 613.

> debtor. This includes the right by subrogation to enforce every security and all means of payment.
>
> ... Thus mortgage securities held by a creditor under a mortgage must be transferred to the surety on payment of the debt. The surety, when making such payment, is presumed to keep the mortgage alive for his own bene-fit.

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[12] The Court of Appeal continued at para. 13 to quote the *Mercantile Law Amendment Act*, 1856, 19 & 20 Vict., c. 97, s. 5 as also supporting the right. It states:

> Every Person who, being Surety for the Debt or Duty of another, or being liable with another for any Debt or Duty, shall pay such Debt or perform such Duty, shall be entitled to have assigned to him, or to a Trustee for him, every Judgment, Specialty, or other Security which shall be held by the Creditor in respect of such Debt or Duty, whether such Judgment, Specialty, or other Security shall or shall not be deemed at Law to have been satisfied by the Payment of the Debt or Performance of the Duty, and such Person shall be entitled to stand in the Place of the Creditor, and to use all the Remedies, and, if need be, and upon a proper Indemnity, to use the Name of the Creditor, in any Action, or other Proceeding, at Law or in Equity, in order to obtain from the principal Debtor, or any Co-Surety, Co-Contractor, or Co-Debtor, as the case may be, Indemnification for the Advances made and Loss sustained by the Person who shall have so paid such Debt or performed such Duty, and such Payment or Performance so made by such Surety shall not be pleadable in bar of any such Action or other Proceeding by him: Provided always, that no Co-Surety, Co-Contractor, or Co-Debtor shall be entitled to recover from any other Co-Surety, Co-Contractor, or Co-Debtor, by the Means aforesaid, more than the just Proportion to which, as between those Parties themselves, such last-mentioned Person shall be justly liable.

[13] In the case of a mortgage, the doctrine of subrogation applies only in a situation where there is a payment that in effect discharges the earlier mortgage in circumstances where fairness justifies that the payor stand in the shoes of the first mortgagee as if he or she had taken an assignment: ***Investors Group Trust Co. v. Crispino*** (2006), 17 B.L.R. (4th) 282, 147 A.C.W.S. (3d) 1069 (Ont. Sup. Ct. Just.) at para. 35.

[14] Master Laycock in ***Bank of Montreal v. Suitor***, 2009 ABQB 203 addressed subrogation in the context of registered security interests holders' priorities (at paras.14-15):

> Secondly, the plaintiff argues that the plaintiff becomes subrogated to the position of Home Trust as first mortgagee and therefore has priority to the respondent. The Ontario Court of Appeal in ***Midland Mortgage Corp. v. 784401 Ontario Ltd.*** (1997), 34 O.R. (3d) 594, 12 R.P.R. (3d) 14, 102 O.A.C. 226 (Ont. C.A.) discussed the doctrine of subrogation. Firstly the court determined that the doctrine of subrogation applies to the Land Titles system. Next they accepted the

statement of law as contained in ***Crosbie-Hill v. Sayer***, [1908] 1 Ch. 866 (Eng. Ch. Div.) at page 877:

> ... where a third party at the request of a mortgagor pays off a first mortgage with a view to becoming himself a first mortgage of the property, he becomes, in default of evidence of intention to the contrary, entitled in equity to stand, as against the property, in the shoes of the first mortgagee.

Under the doctrine of subrogation the plaintiff has priority to the caveat for the amount advanced to retire the Home Trust mortgage but not the full amount of its advance. To the extent that the plaintiff did not receive an amount equal to the payout of the Home Trust mortgage it is entitled to those funds from the monies currently being held in trust.

[15] Equity will not permit a party to be barred recourse to the doctrine of subrogation on the basis that there may exist some technical prohibition against subrogation. In this respect, in ***Harris, et al. v. Carnegie, et al.***, [1933] O.R. 844; [1933] 4 D.L.R. 760, (C.A.), Davis J.A. held that plaintiffs who acted as solicitors for both the mortgagors and mortgagees and were parties to the mortgage were persons in a position analogous to a surety and were bound, as between themselves and the mortgagees, to pay the taxes on the mortgagors' default. At paras. 5 and 6:

> This is a common example of a compulsory payment to the use of another, and an action lies for moneys so paid by reason of the implied contract of indemnity. The cases are conveniently collected in Halsbury, (2nd ed.), vol. 7, p. 263, para. 365.
>
> Upon the evidence in this case the plaintiffs paid the money under such circumstances as to entitle them to recover the amount as having been paid for the defendants' use. In any event the plaintiffs are entitled to be subrogated to the rights of the mortgagees, and the mortgagees are bound to allow the plaintiffs to use their names to enforce payment of these moneys and, this being a Division Court suit, to be determined by "equity and good conscience" (sec. 55, Division Courts Act, R.S.O. 1927, ch. 95) no technical defect should be allowed to defeat the justice of the claim.

[16] Furthermore, in ***Morrison v. Canadian Surety Co.***, [1954] 12 W.W.R. (N.S.) 57, [1954] 4 D.L.R. 736 (Man.C.A.), Coyne J.A. in discussing a parties' entitlement to subrogation stated at para. 117:

> ***Brooks Wharf and Bull Wharf Ltd. v. Goodman Bros.***, [1937] 1 K.B. 534, 106 L.J.K.B. 437 (C.A.) is a case where an importing firm placed valuable furs in a bonded warehouse from which they were stolen without fault of the warehousemen. The latter were called upon by the revenue authorities to pay the customs duty under the terms of their bond. Having done so, they sued to recover

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the amount from the importers who were primarily liable for the duty. The court held them entitled to succeed. Lord Wright, at 545, says:

> The obligation is imposed by the Court simply under the circumstances of the case and on what the Court decides is just and reasonable, having regard to the relationship of the parties. It is a debt or obligation constituted by the act of the law, apart from any consent or intention of the parties or any privity of contract.

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[17] The doctrine of subrogation came into existence for the express purpose of rendering justice where an injustice would otherwise be permitted. Confirmation of this conclusion can be seen in ***Morrison v. Canadian Surety Co.***, where Coyne J.A. stated at para. 114:

> The term "subrogation", which in ordinary language as well as in legal parlance means "substitution", has appeared in English law for a long period. First it was applied at common law in favour of an insurer in a policy of indemnity and gradually extended to other fields. It had a wider reach in Equity. It was invented as a means to avoid injustice by enabling a person, not previously entitled, to sue in law or equity by giving him a status to assert against a person or property a claim recognized as fair and just but not maintainable as a contractual or tortious claim. It was a device necessary to avoid injustice, by imposing on the unjust, as a matter of law or equity, an obligation *quasi ex contractu* to do right where no obligation *ex contractu* existed. It was first adopted without realizing the broader conception of *quasi-contract.*

[18] The right of a party to seek equitable relief is always subject to the equitable maxim of "He who comes into equity must come with clean hands". The equitable doctrine of subrogation is no exception. In ***De Jesus v. Shariff***, 2010 BCCA 121, 284 B.C.A.C. 243, Finch C.J.B.C., in discussing the conduct of a party that would justify a refusal by the Court of equitable relief cited I.C.F. Spry in *The Principles of Equitable Remedies*, (6th ed.) (at pp. 169-170) (UK: Sweet & Maxwell, 2001) at para. 86:

> ...it must be shown, in order to justify a refusal of relief, that there is such an "immediate and necessary relation" between the relief sought and the delinquent behaviour in question that it would be unjust to grant that particular relief. ... So it was once emphasised "that general fraudulent conduct signifies nothing; that general dishonesty of purpose signifies nothing; that attempts to overreach go for nothing; that an intention and design to deceive may go for nothing, unless all this dishonesty of purpose, all this fraud, all this intention and design, can be connected with the particular transaction, and not only connected with the particular transaction, but must be made to be the very ground upon which the transaction took place, and must have given rise to this contract".

[19] Furthermore, "under the doctrine of subrogation, all of the circumstances must be balanced, and the Court must be satisfied that no injustice will be done through the substitution of one party in the place of another via a subrogation arrangement", ***Alberta (Treasury Branches) v. Alberta (Public Trustee)***, at para. 50, Cairns J., quoting ***Brown v. McLean***, (1889), 18 O.R. 533 (H.C.J.), at 536.

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[20] Lastly, in ***Coupland Acceptance Ltd. v. Walsh***, [1954] S.C.R. 90, [1954] 2 D.L.R. 129, the Supreme Court of Canada confirmed that the doctrine of subrogation is not confined to matters of priority between mortgages, but applies as well to the relationships between mortgages and other prejudicial instruments such as builders' liens and executions. In this respect, Kellock J., stated (at para. 6):

> While s. 13(1) of *The Mechanics Lien Act*, R.S.O., 1950, c. 227, gives priority to the lien over all payments or advances made under a mortgage after registration of the lien, the section is not to be construed as affecting the right relied upon here by the appellant. The appellant does not rely upon its mortgage for priority as to the moneys here in question but upon the equitable right to stand in the place of the Kerbel mortgagees whose priority to the lien is unquestionable. The position of the lienholder remains the same as it was before the appellant intervened and it would, in my opinion, require more than is to be found in the section to bring about a result so unjust that it would, to paraphrase the language of Parker J., in the ***Crosbie-Hill*** case, permit the lienholder, by a mere accident, to obtain priority at the expense of people who never intended to benefit him. Had the appellant been in fact aware of the registration of the lien, it could have purchased the Kerbel mortgage, in which event no possible question could have arisen.

2. Marshalling

[21] In its simplest form the doctrine of marshalling dictates that if a creditor has two funds to draw upon to satisfy the debt, the Court will require him to take satisfaction from that fund upon which another creditor has no security. In Alberta, the seminal case on the doctrine of marshalling is ***First Investors Corp. v. Veeradon Developments Ltd.*** (1988), 84 A.R. 364, 47 D.L.R. (4th) 446 (Alta. C.A.). In that case, Belzil J.A., in explaining the doctrine of marshalling, noted that the leading formulation of the doctrine of marshalling as a principle of equity is that of Lord Hardwicke in ***Lanoy v. The Duke and Dutchess of Athol*** (1742), 2 Atk. 444. At p. 669 Lord Hardwicke held that if a creditor has two funds, he must take his satisfaction from the fund that has no lien by another creditor. He went on:

> Suppose a person, who has two real estates, mortgages both to one person, and afterwards only one estate to a second mortgagee, who had no notice of the first; the court, in order to relieve the second mortgage, have directed the first to take his satisfaction out of the estate only which is not in mortgage to the second mortgagee, if that is sufficient to satisfy the first mortgage, in order to make room

for the second mortgage, even though the estates descended to two different persons.

[22] Belzil J.A. went on to adopt the formulation in *Snell's Principles of Equity*, (28th Ed), by P.V. Baker and P. St.J. Langan (London : Sweet and Maxwell, 1982) at p. 416, which provides that where there are two creditors of the same debtor, and one creditor has a right to resort to two funds for payment of his debt, and the other a right to resort to one fund only, the court will 'marshal' or arrange the funds so that both creditors are paid as far as possible. The authors of *Snell's* noted that the doctrine has several applications, but marshalling as between mortgagees is perhaps the most usual. *Snell's* continues that the doctrine of marshalling is not allowed to prejudice the first mortgagee. Relying on the Blackacre/ Whiteacre forumla, *Snell's* noted:

> If, for instance, a person having two estates, Blackacre and Whiteacre, mortgages both estates to A, and afterwards mortgages only Blackacre to B, either with or without notice of A's mortgage, the proper course is for A to realise his debt first out of Whiteacre and to take only the balance out of Blackacre, in order to leave as much as possible of Blackacre to satisfy B... A can therefore realise his securities as he pleases, for A is not a trustee for B. But if A pays himself out of Blackacre, B is allowed to resort to Whiteacre to the extent to which Blackacre has been exhausted by A, and to have the same priority against Whiteacre as A had.
>
> ...In the above example, B's right to marshal will be enforced not only against the original mortgagor but also against all persons claiming through him as volunteers, as where the mortgagor dies and Blackacre and Whiteacre pass to different persons. But it is not allowed to prejudice purchasers or mortgagees of one of the estates. Thus if in the above example the mortgagor had created another mortgage of Whiteacre in favour of C. B would have no equity to throw the whole of A's mortgage on Whiteacre, and so destroy C's security."

[23] Belzil J.A. also accepted the definition of marshalling from the judgment of Orde, J. in ***Ernst Brothers Co. v. Canada Permanent Mortgage Corporation*** (1920), 47 O.L.R. 362, affirmed 48, O.L.R., 57 D.L.R. 500 (C.A.) that include the following qualification at para. 22:

> ... This right is always subject to two important qualifications: first, that nothing will be done to interfere with the paramount right of the first mortgagee to pursue his remedy against either of the two estates; and, second, that the doctrine will not be applied to the prejudice of third parties.

[24] Belzil J.A. further noted that these definitions speak of "satisfaction" or "payment of the first mortgage debt out of marshalled "funds". In ***Canada Permanent Trust Company v. King Art Developments Ltd. et al.*** [1984], 4 W.W.R. 587, 54 A.R. 172 (CA) Laycraft, J.A. at para. 45 adopted the following definition of "satisfaction" in *Black's Law Dictionary* (at p. 643):

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> ... the discharge of an obligation by paying a party what is due to him (as on a mortgage, lien or contract), or what is awarded to him by the judgment of a court or otherwise.

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[25] The most important qualification in these definitions is that the application of marshalling cannot prejudice the "paramount" right of the first mortgagee to realize its securities and pursue its remedies as it pleases. That primary right to receive and enforce payment of its debt in money is at its election. The first mortgagee thus may seek a "Rice" order, take the land by final foreclosure, or pursue other courses of action such as simply leaving its security in force. Belzil J.A. noted in ***First Investors Corp. v. Veeradon Developments Ltd.*** that the consequence of this is that if the right is not to be prejudiced, it follows that the prerequisite to applying marshalling to mortgages is that first mortgage properties have all been sold and converted to money funds exceeding the amount due under the first mortgage. He continues:

> In those circumstances, the first mortgagee must pay itself firstly out of the funds derived from the properties not covered by the second mortgage. Equity will not allow the first mortgage to needlessly wipe out the second mortgage by paying itself firstly out of funds derived from the properties covered by both mortgages. The first mortgagee must leave as much as possible for the second mortgagee out of funds derived from properties covered also by the second mortgage. In modern practice, the funds derived from sale will be under control of the court, and the court will marshall by simply directing payment accordingly.

[26] Belzil J.A. further noted that the underlying issue is really between the second mortgagee and the mortgagor and its assigns and there is really no contest between the first and second mortgagees, citing ***Gibson v. Seagrim*** (1855), 20 Beav. 614. The first mortgagee's sole interest is in receiving the money owed to it, and marshalling does not affect that interest. It does not matter to the first mortgagee which fund it receives its money from. Equity, Belzil J.A. says, assumes that a reasonable first mortgagee would want to act honourably, and not capriciously, by leaving as much as possible for the second mortgagee. He quotes North, J. in ***Re Loder's Trusts (a)*** [1886], The Law Times, Vol LV., N.S. 582:

> This is the course which a straightforward man would take.

[27] The doctrine of marshalling is not applied only to mortgagees, and accordingly, I know of no reason why the holder of a builders' lien cannot have resort to the doctrine of marshalling: ***Narduzzi v. Richardson***, 2009 BCSC 588, 54 C.B.R. (5th) 1 (at para. 29 and the cases cited therein at paras. 25-28).

[28] Of further consideration is the principle which is called "marshalling by apportionment". This particular strain of the doctrine of marshaling was aptly explained by Scarth J., in ***Bancorp Investments (Fund 2) Ltd. v. Bhugra Holdings Ltd.***, 2006 BCSC 893, 23 C.B.R. (5th) 108, at para. 25 as follows:

With respect to Apportionment Mr. Justice Burnyeat writes the following at [paragraph] 12:

> Apportionment
>
> 12 In a situation where an owner mortgages both properties in favour of the same first mortgagee but then mortgages the first property to "B" and the second property to "C", the doctrine of "marshalling by apportionment" applies:
>
> > ... where each of the two funds has been assigned or charged by the debtor to a different subsequent claimant, equity interposes so as to secure that the claim of the first claimant is borne by the two funds rateably.
>
> [Halsbury's (4th ed) Vol. 16, p. 785, para. 876.]
>
> As between "B" and "C" in the example noted above, the loss will not lie where the first mortgagee makes it lie. The charge of the first mortgagee will be apportioned rateably between the two properties (according to their value) so that the competing interests of "B" and "C" can be adjusted.

[29] Marshalling by apportionment was further explained in ***Victor Investment Corp. v. Fidelity Trust Co.***, [1975] 1 S.C.R. 251, 41 D.L.R. (3d) 65 as arising in relation to two properties held in separate hands, but subject to the one mortgage debt covering both of them. Thus under apportionment the debt was prorated according to the respective values of the two properties, in the absence of any stipulation that one of the properties would bear the burden or bear it primarily as between the two holders of the equities of redemption.

3. Statute of Elizabeth

[30] 805 submits that this case also involves the principles raised by the *Statute of Elizabeth*. It is clear from the judicial authorities that the *Statute of Elizabeth* is in force in Alberta, ***Goyan v. Kinash***, [1945] 2 D.L.R. 749, [1945] 1 W.W.R. 291 (Alta. S.C.) at 753 in D L.R.

[31] Romaine J. in ***Krumm v. McKay***, 2003 ABQB 437, 342 A.R. 169 provided a concise overview of the application of the ***Statute of Elizabeth***, noting that the purpose of the statute and of the *Fraudulent Preferences Act* is to strike down any conveyances made with the intention to defeat creditors, except for conveyances made for good consideration and *bona fides* to persons not having notice of fraud. She noted that the legislation must be interpreted liberally, and includes any kind of transfers or conveyances made with the requisite intent no matter what the

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form, citing C.R.B. Dunlop, in *Creditor-Debtor Law in Canada* (2d Ed.) (Toronto: Carswell, 1995), at page 598.

[32] Under the *Statute of Elizabeth*, a transfer made for nominal or no consideration is voidable if the debtor intended fraud. There are two categories of fraudulent intent: those in which fraudulent intent is established as a presumption of law and those in which fraudulent intent is established as a fact in evidence: Dunlop at pages 600, 601.

[33] While the *Statute of Elizabeth* includes an exception for *bona fides* transfers for consideration, it is restricted to transferees who do not have knowledge of fraud. Therefore, a creditor attempting to rely on the *Statute of Elizabeth* must establish that the transferor had the necessary fraudulent intention **and** that the transferee was privy to the fraud. (***Krumm*** at para. 15).

[34] The following general principles can be gleaned from the cases:

(a) There is no presumption of fraud in situations of transfer for value;

(b) A creditor must prove an actual intent to defraud;

(c) If the transferee knows that the transferor intends to defraud the creditors, the transfer will be invalidated.

(d) In Canada, a further elaboration of the above points applies so that in cases of a transfer for consideration, there must be a "concurrence of intent" to invalidate a transfer under the *Statute of Elizabeth*. In ***Mulcahy v. Archibald*** (1898), 28 S.C.R. 523 the Supreme Court held that knowing the transferor's intention was found to not be conclusive of bad faith where the transferee did not receive the transfer in order to benefit the transferor. See also Dunlop at pages 607-612.

(e) The following factors have been identified as "badges of fraud" that raise a *prima facie* case:

1) the transfers were made pending the creditors' efforts to obtain judgment;
2) the transfer documents contain false statements as to consideration;
3) the consideration was grossly inadequate;
4) there was unusual haste to make the transfers; and
5) a close relationship exists between the parties to the transfers.

(f) In ***Megbiz v. Osprey Energy Ltd.***, 2006 ABQB 630, 405 A.R. 165, Master Hanebury described a similar list of badges of fraud (at para. 31, relying on Dunlop at p. 613):

(a) the transaction was secret;

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(b) the transfer was made pending the writ;
(c) the deed contained self-serving provisions such as "the gift was made honestly, truly, and bona fide";
(d) the deed contains false statements as to the consideration;
(e) the consideration is grossly inadequate;
(f) there is unusual haste to make the transfer; and
(g) a close relationship exists between the parties to the conveyance

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[35] In ***Krumm*** Romaine J. found that the most persuasive factor leading to a finding of fraud was the relationship between the debtor and the transferee. She applied the evidentiary rule governing cases of close relationship between a transferor and a transferee set out by Davies J. in ***Koop v. Smith*** (1915), 8 W.W.R. 1203 (S.C. C.) (at page 1205) as follows:

> I think the true rule is that suspicious circumstances coupled with a relationship make a case of res ipsa loquitur which the tribunal of fact may and will generally treat as a sufficient *prima facie* case, but that it is not strictly in law bound to do so; and that the question of the necessity of corroboration is strictly a question of fact.

[36] Romaine J. further noted that the types of close relationships covered by this rule include transactions between individuals and corporations that they control, citing ***Burton v. R & M Insurance Ltd.*** (1977), 5 Alta. L.R. (2d) 14, 9 A.R. 589 (T.D.); ***Surkan (Trustee of) v. Niton Junction Holdings Ltd.***, [1979] 3 A.C.W.S. 570, 32 C.B.R. (N.S.) 141 (Alta. Q.B.).

[37] Badges of fraud, and the rebuttable presumptions that arise from them, apply not only where no consideration has been exchanged, but also to situations where there has been a transfer for value: ***Krumm*** at para. 21. There, Romaine J. noted that (at para. 21):

> . . . The "presumption" created by a transfer involving a close relationship is an evidenciary rule, not a presumption of law. It is a rare case where direct evidence of an intention to defraud is available, and given the difficulty of a court "engaging in [a] metaphysical excursion into the debtor's state of mind" (Dunlop, supra at page 601), it is not unreasonable to shift the burden of adducing evidence to rebut a prima facie case to the debtor in circumstances where strong suspicions of a relationship that may give rise to collusion are apparent.

[38] Further, an intent to defraud may be inferred from all the circumstances surrounding a transaction; ***Rogers Realty Ltd. v. Prysiazny*** (1996), 182 A.R. 118, 61 A.C.W.S. (3d) 862 (QB) at para. 18.

[39] Various authorities have held that where the debtor receives some benefit, either direct or indirect, the *Statute of Elizabeth* may be applied to attack the conveyance. ***Canada Life Assurance Co. v. 494708 Alberta Ltd.***, [1996] 1 W.W.R. 21, 173 A.R. 172 (QB) (at para. 76). ***Andersen Lumber Co. v. Canadian Conifer Ltd.*** (1977), 25 C.B.R. (NS) 35, [1977] 5 W.W.R.

41 (Alta C.A.), at pp. 42-43; ***Krumm***, (at para. 32); ***Optical Recording Laboratories Inc. v. Digital Re-cording Corp.*** (1990), 1 O.R. (3d) 131, 75 D.L.R. (4th) 747 (C.A.).

[40] In order to invoke the protection of the *Statute of Elizabeth* a fraudulent transaction must be established. To do so, an intention to defraud must be proven. In this respect, the Court may look to the badges of fraud to determine if the necessary intent existed. In ***Nuove Ceramiche Ricchetti S.p.A. v. Mastrogiovanni*** (1988), 76 C.B.R. (N.S.) 310 (Ont. H.C.J.) Trainor J. quoted Anderson J. in ***Re Fancy***:

> The plaintiff must prove that the conveyance was made with the intent defined in that section. Whether the intent exists is a question of fact to be determined from all of the circumstances as they existed at the time of the conveyance. Al-though the primary burden of proving his case on a reasonable balance of prob-abilities remains with the plaintiff, the existence of one or more of the traditional "badges of fraud" may give rise to an inference of intent to defraud in the absence of an explanation from the defendant. In such circumstances there is an onus on the defendant to adduce evidence showing an absence of fraudulent intent. Where the impugned transaction was, as here, between close relatives under suspicious circumstances, it is prudent for the court to require that the debtor's evidence on bona fides be corroborated by reliable independent evidence.
>
> The "badges of fraud" referred to by Mr. Justice Anderson are those set out in *Re Dougmor Realty Holdings Ltd.*, (1966), 59 D.L.R. (2d) 432:
>
> (1) Secrecy
> (2) Generality of Conveyance
> (3) Continuance in possession by debtor.
> (4) Some benefit retained under the settlement to the settlor.
>
> ...
>
> Control of the assets following the transfer remained with Mr. Mastrogiovanni. He was able to carry on the same business on the same street under almost the same name. Even he confused the names during his testimony. As a consequence, not a day's work was lost nor a day's income and he was able to do this without the burden of the accounts payable that Ceramic had incurred. His explanation, unsupported by evidence that should have been readily available, if his explanation was true, bears little resemblance to reality.

[41] A further discussion of the " badges of fraud" was stated in ***Bank of Montreal v. Peninsula Broilers Ltd.***, [2009] O.J. No. 2129 (Ont. Sup. Ct.J.) where Quinn J., stated at paras. 82 and 93:

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> 82 In cases where there are badges of fraud or suspicious circumstances surrounding a conveyance, "there is no 'onus' shift, but simply a question of legitimate explanation that may be required in circumstances of suspicion": see ***Park v. Bhandari***, [2007] O.J. No. 2237, 2007 CanLII 20981 (On S.C.) at para. 38, aff'd 2008 ONCA 884 (CanLII).
>
> 93 "... the existence of one or more of the traditional 'badges of fraud' may give rise to an inference of intent to defraud in the absence of an explanation from the defendant": see ***Re Fancy***, ibid, followed in ***Ricchetti v. Mastrogiovanni***, ibid, and in ***392278 Ontario Ltd. (c.o.b. Group Three) v. Interopeka S.A., ibid.***

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[42] In ***Convoy Supply Alberta Ltd. v. Apex Insulation 1996 Ltd.***, 2003 ABQB 1, 119 A.C.W.S. (3d) 434, Wilson J., in discussing how the Court could ascertain an intention to defraud stated (at para.19):

> The materials filed by the Plaintiff include the statement that "the credibility of Staples is not in issue." The Defendant takes the position that this puts the matter beyond all argument, that there could not be a fraudulent transaction or intent, as the Defendant Staples denies that she had any such intent. I do not agree... In my opinion, the proper way to assess her real intent is to see what the plain effect of that person's conduct was in the light of circumstances existing at the time. **One would not expect that a witness involved in this kind of a transaction would say that they intended to defraud. These cases usually depend on an examination of the known facts and the situation existing at the time.**
>
> (Emphasis added)

V. Analysis

1. Is the Receiver entitled by virtue of the equitable doctrine of subrogation to step into the position of the ATB in regards to the payment of $391,275.17 made by Hinton Pine to the ATB pursuant to the Guarantee given by Hinton Pine to the ATB?

The Position of the Parties

(a) The Position of the Receiver

[43] The Receiver submits that the right of subrogation arises by reason of the Guarantee between ATB and Hinton Pine entered on May 27, 2009. As a result, the Receiver paid ATB $391,275.17. The Receiver further submits that the only limitation on enforcement of the right of security was contained in paragraph 6 of the Guarantee which provided "until all indebtedness of the Customer to you has been paid in full, the undersigned shall not have any right of

subrogation or to securities held by ATB unless expressly given to the undersigned in writing by the President and CEO, Chief Operating Officer or Chief Credit Officer of ATB".

[44] The Receiver submits that the registration of security interests by 805 under the Personal Property Security Act does not provide it any form of relief, given the fact that registration of that security was not undertaken until March of 2010, following registration of a renewal by 805. At that time, 805 was aware of the Rollover transaction, and the Amending Agreement further provided for additional consideration of $1,250.00 per month payable to the Mortgage holder, presumably as a cost of extension of the term of their Mortgage.

[45] The Receiver further submits that the relative position of both 805 and Cedar Peaks under their respective second Mortgages has not changed, and their ability to collect the full amounts owing under their Mortgages are attributable to general market conditions and the decrease in value of the property, rather than the Rollover Agreements and the transfers of the properties to Hinton Pine and Hinton Leaf.

[46] With respect to the application of the *Statute of Elizabeth* to the Rollover Agreement between 103 and Hinton Pine, the Receiver submits that the title transfers under the Rollover Agreement were done in the normal course of business and for proper consideration. The Receiver further submits that the respective securities held by 805 and Cedar Peaks remained intact and enforceable in the same manner both before and after the transactions that were the subject of the Rollover Agreements. Accordingly, the Receiver submits that by virtue of the right of subrogation, it is entitled to step into the position of ATB in regards to the payment of $391,275.17.

(b) The Position of 805

[47] 805 submits that the Court must consider the effect of the *Statute of Elizabeth* on the Rollover Agreement between Hinton Pine and 103. 805 argues that the net effect of the Rollover Agreement was that at 8:00am on the morning of September 1, 2008, 103 owned Lots 1,2,3 and had equity in those Lots of approximately $630,340.00, (equity which would have been available to the creditors of 103). As a result of the Rollover Agreement by noon on September 1, 2008, 103 no longer owned Lots 1, 2, 3, and had not received from Hinton Pine anything of value, which could then have been available to 103's creditors to apply against what 103 owed them.

[48] 805 further submits that in accordance with the principles of priority contained in the *Personal Property Security Act*, 103 could not cancel that evidence of indebtedness, because this in effect would be 103 giving the funds to Hinton Pine in return for Hinton Pine cancelling the indebtedness which 103 owed for redemption of the 103 shares held by Hinton Pine. Accordingly, 805 argues that this is not allowed under the *Personal Property Security Act* as ATB and Cedar Peaks have priority over Hinton Pine, and as such the $391,275.17 which came into the hands of Hinton Pine would in fact belong to ATB under the General Security agreement and the principle of subrogation does therefor not arise in respect to that amount.

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[49] Lastly, 805 submits that the Rollover transactions that were the subject of the Rollover Agreement between 103 and Hinton Pine was not *bona fides* and that the preferred shares of Hinton Pine were not good and valuable consideration exchanged for the equity in Lots 1,2,3. In this respect, 805 submits that if the owner of a corporation can strip the equity from the corporation by such a Rollover, no ordinary creditor of any corporation will ever again collect anything from a corporation because all the controlling shareholder and the directing mind of the corporation needs to do is incorporate a second company and strip out the assets of the corporation in the manner which was done by Mr. Dorais.

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[50] 805 maintains that this clearly is one of the types of fraud against creditors, which the *Statute of Elizabeth* was designed to deal with and that the statute should be given broad and liberal interpretation. Accordingly, 805 submits that the Rollover transactions that were the subject of the Rollover Agreements are as a result of the *Statute of Elizabeth* invalid, and as such, the Receiver cannot, by virtue of subrogation, step into the position of ATB in regards to the payment of $391,275.17.

(c) The Position of the Lien Holders

[51] The Lien Holders submit that assuming that the doctrine of subrogation applies to the case at bar, such doctrine should only be applied at such time as all secured creditors are paid in full. To do otherwise they submit, would cause an injustice to the duly registered lien holders who are secured creditors. The Lien Holders further submit no right of subrogation would exist on Lot 8 because:

1. the Receiver is claiming the right of subrogation with regard to Guarantee signed for Lot 8; and

2. the ATB indebtedness had been fully repaid by the time Lot 8 sold under judicial sale; and

3. ATB has not realized any of its mortgage debt out of the sale of Lot 8.

[52] As such, the lien holders argue, any right of subrogation exists only on the properties from which the mortgages were realized, and as ATB no longer had any claim against Lot 8, subrogation to their position on that debt would have no effect. The Lien Holders further submit that they, together with the Town of Hinton's caveat, are to be considered as junior creditors by virtue of their registered builders' liens and caveat, as opposed to unsecured creditors. The Lien Holders submit that subrogation within the doctrine of marshalling applies to the junior creditors, and not to third party unsecured creditors, and that the security attaches to the mortgagor's claim which can be satisfied through marshalling the funds received. Accordingly, when the secured first and second mortgages have been paid, the right of subrogation passes to the Lien Holders as the junior creditors, and after the junior creditors have been fully paid, the unsecured creditors can fit within the parameters of marshalling.

(d) Conclusion

[53] The Receiver, as the receiver for Hinton Pine, claims that by virtue of the equitable doctrine of subrogation, the Receiver is entitled to receive from the funds available, the sum of $391,275.17. In order to determine such entitlement, it must first be determined to what extent the right of subrogation arises as a result of the Guarantee by Hinton Pine of 103's indebtedness to ATB.

[54] The Guarantee by Hinton Pine to ATB dated May 27, 2009 is entitled "Continuing Guarantee", without specific reference to a particular parcel of land or as to a stipulated sum. In this respect, the Guarantee merely states that the Guarantee by Hinton Pine is given in consideration of ATB extending credit to 103 or otherwise dealing or continuing to deal with 103. In accordance with such Guarantee, Hinton Pine guaranteed unconditionally and promised to pay to ATB all existing and future debts and liabilities of 103.

[55] Pursuant to the equitable doctrine of subgrogation, absent any intention of fraud, once Hinton Pine was required under the Guarantee to permit the payment of the sum of $391,275.17 to ATB to satisfy the debt of 103 to ATB from the sale proceeds of Lots 1,2,3, Hinton Pine would have the right to step into the shoes of ATB in regards to the $391,275.17.

[56] But, the question now to be addressed is whether there is evidence of fraud; in other words was the Rollover Agreement between 103 and Hinton Pine a valid and enforceable transaction? If it can be established that the Rollover Agreement and the attending transfers of land offends the *Statute of Elizabeth*, the transaction will be declared void, and Hinton Pine will be denied the right of subrogation in regards to the $391,275.17. In order to answer this question, the circumstances surrounding the Rollover Agreement and in particular, the relationship of Mr. Dorais to 103 and Hinton Pine, together with all surrounding circumstances must be reviewed.

[57] Mr. Dorais was the sole controlling shareholder and directing mind of 103 and Hinton Pine. The Receiver argues that the Rollover Agreement which effectively transferred Lots 1,2,3 from 103 to Hinton Pine was done in the normal course of business and for proper consideration, albeit not for cash consideration. What benefit did Hinton Pine derive from the transaction?

[58] The Receiver submits that the Rollover Agreement was required for tax purposes, and presumably to ultimately benefit Mr. Dorais as the sole shareholder of 103 and Hinton Pine. The Receiver further argues that insofar as 805 and Cedar Peaks are concerned, their security as second mortgage holders remained in the same position both before and after the Rollover transaction. If Mr. Dorais had not died and had he continued to make the required payments to ATB, arguably, it could be said that no benefit other than the Receiver's alleged tax benefits would have been obtained by Hinton Pine, 103 and eventually Mr. Dorais himself.

[59] Unfortunately, that is not what happened. Mr. Dorais did pass away, the payments were not made to ATB, and consequently, as a result of the Guarantee and the Court ordered sale of

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Lots 1,2,3, on paper at least, Hinton Pine appears to be entitled to the right of subrogation in regards to the $391,275.17. This would make these funds unavailable to 805 and Cedar Peaks. As such, 805 and Cedar Peaks are not, as suggested by the Receiver, in the same position both before and after the Rollover transaction. If this Court were to permit Hinton Pine to avail itself of subrogation, the net effect would be that Mr. Dorais, as the sole shareholder of both 103 and Hinton Pine would have managed to extricate and protect from the hands of secured and unsecured creditors the $391,275.17.

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[60] As stated previously, in ***Morrison v. Canadian Surety Co.***, the Court confirmed that the doctrine of subrogation came into existence for the purpose of preventing an injustice to a party who is required to pay another's indebtedness, provided that under the circumstances the Court decides it is just and reasonable, having regard to the relationship of the parties.

[61] In this case, the relationship of Mr. Dorais to 103 and Hinton Pine raises in my mind two of the badges of fraud:

1. The consideration is grossly inadequate; and

2. a close relationship exists between the parties to the conveyance; see: ***Megbiz v. Osprey Energy Ltd.***, at para.31.

[62] I therefore find myself in a situation similar to that which existed in ***Krumm***, where Romaine J. concluded that the most persuasive factor that lead to a finding of fraud was the relationship between the parties. Taking into consideration the law as set out by Romaine J. in ***Krumm***, and in particular those cases which involved transactions between individuals and corporations that they controlled, I find that there exists sufficient suspicious circumstances, coupled with a close relationship, to raise a *prima facie* case justifying an inference of an intent to defraud: ***Koop v. Smith***, at page 1205.

[63] This conclusion is arrived at given the absence of a legitimate explanation from the Receiver. As stated previously, the Receiver argues that the Rollover Agreement was done in the normal course of business, for proper consideration, and in particular, for tax reasons. However, the end result of the Rollover Agreement is to permit the primary assets of 103 (Lots 1,2,3) to be removed from the secured and unsecured creditors of 103. As a result, once ATB was aware of the Rollover Agreement, it took immediate steps to obtain the Guarantee from Hinton Pine. To permit Hinton Pine to be subrogated to the $391,275.17 in priority to secured creditors would be inequitable.

[64] For that reason, I find that the Rollover Agreement and the attending transfers of land offends the *Statute of Elizabeth*, with the effect that the transaction is declared void. Hinton Pine is therefore denied the right of subrogation in regards to the $391,275.17.

[65] With respect to the application of Rule 359, as Lots 1,2,3 have been sold pursuant to Court Order any discussion of its application to the case at bar is redundant. Given my

conclusion in regards to Hinton Pine being denied the right of subrogation to the $391,275.17, the provisions of the *Personal Property Security Act* become as well inapplicable to the issue of subrogation.

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[66] As the question contained in subparagraph (a) has been answered in the negative, there is no requirement by this Court to address the issue in subparagraph (b).

2. To what extent does the doctrine of marshalling or alternatively apportionment, apply to the respective claims made by 805, Cedar Peaks, Hinton Plumbing and Heating Ltd, D.C. Electric Ltd., the Town of Hinton, or any other secured creditors?

The Position of the Parties

(a) The Position of the Receiver

[67] With respect to the equitable doctrine of marshalling, the Receiver submits that it need not take a position with respect to the issue of marshalling.

(b) The Position of 805

[68] With respect to the application of the equitable doctrine of marshalling, 805 submits that after Lots 1,2,3, had been sold and ATB had taken all of the money from the sale of Lots 1,2,3 (with the exception of those funds paid to Mr. Dewar), there was remaining owing to ATB, $612,398.31, (this amount was satisfied by ATB out of the sale proceeds of Lot 4), plus the solicitor client costs and the accounts of the Preservation Agent for Lot 4 and Lot 8, (referred to as the "Post Lots 1,2,3 sale ATB indebtedness"). In respect of the 5% payment of $12,257.57 and the Government of Alberta occupancy costs of $31,996.73 collected and held by the Receiver, 805 submits that the doctrine of marshalling should be applied and those amounts should be applied against the ATB indebtedness reducing the Post Lots1,2,3 sale ATB indebtedness to $617,374.26 for the purposes of marshalling by apportionment.

[69] As 805 had a valid registered second mortgage against Lot 4, and Cedar Peaks had a valid registered mortgage against Lot 8, 805 submits that this is a classic case of marshalling by apportionment and that this Court should direct that the Post Lots 1,2,3, sale ATB indebtedness be apportioned between Lot 4 and Lot 8 proportionate to their respective values. 805 submits that the rateable proportions would be that Lot 4 should bear 50.39% of the Post Lots 1,2,3 sale ATB indebtedness and Lot 8 should bear 49.61% of that indebtedness. 805 then submits that this Court should then apportion the Post Lots 1,2,3 sale ATB indebtedness, by apportioning $311,067.72 to Lot 4 and $306,306.47 to Lot 8. The net sale proceeds from the sale of Lot 4 is $915,005.42. 805 submits that if the Court then deducted the $311,067.72 apportioned against Lot 4, this would leave $603,937.70 to satisfy the second mortgage held by 805. The net sale

proceeds from the sale of Lot 8 is $889,334.10. 805 submits that if the Court then deducted the $306,306.47 apportioned against Lot 8, this would leave $583,027.63 to satisfy the second mortgage held by Cedar Peaks, together with any surplus from Lot 4. In this regard, 805's proposal is as follows:

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ATB took from lot 4	$661,628.56
Subtract off the common area costs recovered	$31,996.73
Subtract off the 5% amount recovered	$12,257.57
Notionally ATB took from lot 4	$617,374.26

Apportionment between lots 4 and lots 8 of the ATB amount
Proportionate to the values of lots 4 and lots 8:

Lot 4 proportionate value $\frac{\$980,000}{\$980,000 + \$965,000} = \frac{980,000}{1945,000} = .503856$

Lot 8 proportionate value $\frac{\$965,000}{\$1945,000} = .4961439$

ATB from lot 4	$617,374.26	x .503856 =	$311,067.72
ATB from lot 8	$617,374.26	x .4961439 =	$306,306.47

Net values

Lot 4: $915,005.42 - $311,067.72 =	$603,937.70
Minus 2nd mtge 805251 Alta. Ltd. -	$423,379.00
Surplus	

Lot 8: $889,334.10 - $306,306.47 = available to Cedar Peaks	$583,027.63
Add surplus from lot 4 =	$180,558.70
to Cedar Peaks	$763,586.33

Reconciliation

2nd mtge 805: $423,379 + $763,586.33 to Cedar Peaks = $1,186,965.30 =
Total available funds after ATB paid in full $1,186,965.20

[70] With respect to whether Cedar Peaks would be allowed to prejudice the interest of Hinton in respect of their offsite levy (protected by Caveat registered against title to Lot 4), 805 submits that Hinton is not entitled to take advantage of the principles of marshalling because it filed its

Caveat after the second mortgage had been filed. Under the Alberta Torrens system, Hinton should then be subordinate to such second mortgage.

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[71] With respect to the builders' liens filed by the Lien Holders against Lot 8, 805 submits that these builders' liens are not entitled to take advantage of the principles of marshalling, because there are insufficient funds to satisfy the two second mortgages on Lot 4 and Lot 8 and the builders' liens will receive nothing from the sale proceeds of Lot 8.

(b) The Position of the Lien Holders

[72] The Lien Holders submit that in order to ensure the most equitable division of the monies realized by the sale of the subject properties, the doctrine of marshalling should be applied. Further, they submit that as the doctrine is an equitable one and cannot be used to garner inequitable results, all of the funds available from the sale of all three properties should be used to pay off firstly, ATB, secondly, the 2nd mortgages, and thirdly, the Lien Holders. Further, the Lien Holders concede that as lien holders, they cannot be treated on par with a mortgage holder, and it is therefore not their argument that their respective builders' liens would have any priority over the mortgage holders. However, they submit that as registered lien holders, they are entitled to, in a secondary position, have the funds marshalled in a way that ensures that as many of the secured creditors as possible can take advantage of the monies received by the court.

[73] With respect to the doctrine of apportionment, the Lien Holders submit that such doctrine is a sub-issue of the doctrine of marshalling, and is an equitable remedy which cannot be used to achieve an inequitable result. Accordingly, the Lien Holders submit that it is unnecessary to apply the doctrine of apportionment as all primary and second mortgagors can be fully repaid without using apportionment. The Lien Holders submit that if the monies were apportioned as suggested by 805, an inequitable result would occur in that the lien and caveat holders would be left with no recourse or payment. The Lien Holders further submit that if the doctrine of marshalling is applied without apportionment, there will be more proceeds for those who only have recourse in the proceeds of Lot 8, and that the doctrine of marshalling will create excess funds in the sale of Lots 1, 2, 3 and Lot 4. Therefore to be equitable, the Lien Holders submit that the excess funds must be used to satisfy the secured creditors of Lot 8 before they are distributed to the Receiver on behalf of the unsecured creditors.

[74] With respect to unsecured creditors, the Lien Holders submit that the doctrine of marshalling does not apply in favour of an unsecured creditor. The Lien Holders further submit that as their respective builders' liens represent work done by the Lien Holders to increase the value of the properties this unpaid work is reflected in the amount received from the sale. Accordingly, to allow the Receiver to receive funds on behalf of unsecured creditors ahead of the secured Lien Holders would be inequitable.

(c) Conclusion

[75] The present case represents a classic situation warranting judicial intervention and application of the equitable principles of marshalling by apportionment. In this respect, the present fact situation fits squarely within the example of marshalling by apportionment quoted by Scarth J. in ***Bancorp investments (Fund 2) Ltd. v. Bhugra Holdings Ltd.*** (at para. 25):

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> In a situation where an owner mortgages both properties in favour of the same first mortgagee but then mortgages the first property to "B" and the second property to "C", the doctrine of "marshalling by apportionment" applies:
>
> > ... where each of the two funds has been assigned or charged by the debtor to a different subsequent claimant, equity interposes so as to secure that the claim of the first claimant is borne by the two funds rateably.
> >
> > [Halsbury's (4th ed) Vol. 16, p. 785, para. 876].
>
> As between "B" and "C" in the example noted above, the loss will not lie where the first mortgagee makes it lie. The charge of the first mortgagee will be apportioned rateably between the two properties (according to their value) so that the competing interests of "B" and "C" can be adjusted.

[76] With respect to the Lien Holders' claims and their right to avail themselves of marshalling, I recognize that equitable doctrines are not restricted to mortgagees, and in the appropriate circumstances marshalling applies to holders of a builders' liens: ***Narduzzi v. Richardson***. Furthermore, it must be remembered that marshalling is subject to two important qualifications: first, that nothing can interfere with the paramount right of the first mortgagee to pursue his remedy against either of the two estates; and, second, that the doctrine will not be applied to the prejudice of third parties: ***Ernst Brothers Co. v. Canada Permanent Mortgage Corporation*** at 367-8.

[77] In ***Narduzzi v. Richardson***, Burnyeat J. said (at para. 26):

> I also take into account the decision in ***807933 Ontario Inc. v. Allison (Trustee of)*** (1998), 38 O.R. (3d) 337 (Ont. C.A.), where the court stated that there were two criteria to be met before marshalling would be available:
>
> > The first criteria is that there must be a creditor or mortgagee who has access to two properties of a debtor to which he or she can resort for payment of the amount owing. ... The second criteria is that there must be a creditor ranking behind or inferior to another creditor or mortgagee of a common debtor with a claim against one of the properties available to the superior creditor or mortgagee. Such an inferior creditor can invoke the assistance of equity to cause or marshal the superior creditor or mortgagee to satisfy the

> mortgage debt from the property against which the inferior creditor has no recourse so that the property will be available to the inferior creditor, or if this is impossible, or unfair to the superior creditor, equity may allow the inferior creditor to stand as the superior creditor in relation to the property against which the inferior creditor otherwise has no recourse.

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[78] I cannot accept the Lien Holders' argument that the doctrine of marshalling with apportionment should not be applied. They argue that it is unnecessary to apply apportionment because all primary and second mortgagees can be fully repaid without using it. If you calculate the combined net sale proceeds from the sale of the properties, less the combined totals of ATB, 805 and Cedar Peaks indebtedness, the end result is that, whether by marshalling or marshalling with apportionment, there is simply not enough monies available from such sales to satisfy the mortgagees, let alone, the mortgagees plus the lien and caveat holders.

[79] In order to apply the equitable doctrines of marshalling and apportionment, this Court must give full recognition of the Torren's system of land registration, as incorporated into the *Land Titles Act*. That being so, because the interests of the Lien Holders and Hinton were registered after the second mortgages of 805 and Cedar Peaks, it would be wrong to permit a subsequent encumbrancer to share equally with all prior encumbrancers other than the primary creditor, ATB. If this were a situation where all secured creditors could be paid from the proceeds of the sale of the subject properties, or the interests of the Lien Holders and Hinton were the only secured creditors registered on title to such properties, then, it would be appropriate to apply the doctrine of marshalling. However that is not the case here.

VI. Conclusion

[80] Accordingly, the proposal by 805 for application of the doctrine of marshalling with apportionment as above stated, is acceptable and is to be implemented. The Receiver is hereby ordered to pay into Court the 5% payment and the Government of Alberta occupancy costs collected and held by the Receiver. The total of these funds shall be considered as having been already collected by ATB and are to be considered as proceeds of the sale of Lot 4 and Lot 8. Should counsel require further direction in regards to the implementation of this proposal, and the relevant calculations, they may come back for further direction.

[81] If the parties cannot agree on costs, costs may be spoken to within sixty (60) days of this decision.

Heard on the 4th day of June, 2010.

Dated at the City of Edmonton, Alberta this 3rd day of September, 2010.

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Don J. Manderscheid
J.C.Q.B.A.

Appearances:

Gregory C. Empson
Gregory C. Empson Professional Corp.
For Anthony Ford Gerrow

Brian Doherty
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Robert Bishop
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Johnson McClelland Murdoch
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Maurice Blain
Nikitiuk & Blain
for O.K. Tire Stores Inc.

TAB 6

Ontario Supreme Court
N'Amerix Logistix Inc. (Re)
Date: 2001-12-07

In the matter of the Bankruptcy of N'Amerix Logistix Inc.

Superior Court of Justice, Spence J. December 7, 2001

Michael R. Kestenberg, for Perry Krieger & Associates Inc.

Harvey G. Chaiton, for Express Business Funding of Canada Inc.

[1] SPENCE J.:—By this motion, the trustee in Bankruptcy for N'Amerix Logistix Inc. ("N'Amerix"), Perry Krieger & Associates Inc. (the "Trustee") requests that this court declare that any interest that the respondent, Express Business Funding of Canada Ltd. ("EBF") may have with respect to the accounts receivable of the Bankrupt including, but not limited to, those more particularly described in Schedule "A" to the Notice of Motion (the "Factored Receivables") is subordinate to the interest of the Trustee therein as EBF failed to perfect its security interest in the Factored Receivables or any collateral of the Bankrupt by registration in accordance with the terms and provisions of the *Personal Property Security Act,* R.S.O. 1990, c. P.10 (the "*PPSA*" or the "Act") prior to N'Amerix's Assignment in Bankruptcy.

Background

[2] On August 31, 2001, N'Amerix filed an Assignment in Bankruptcy after its principal determined that it could not make a viable proposal further to a Notice of Intention to Make a Proposal filed August 17, 2001.

[3] Some months earlier, in February 2001, the Bankrupt's Banker, the Bank of Nova Scotia ("BNS"), issued demand requiring that the Bankrupt repay the sum of approximately $400,000 within 45 days.

[4] The Bankrupt's efforts to obtain financing or an injection of capital from institutional lenders or private individuals were unsuccessful, and it sought financing from a factor EBF to permit N'Amerix to operate and to repay BNS.

[5] On or about March 27, 2001, N'Amerix entered into an agreement in writing with EBF to factor some of its accounts receivable (the "Factoring Agreement"). This agreement was part

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of the arrangement that was made between BNS, N'Amerix and EBF which is dealt with further below.

[6] The Factoring Agreement expressly contemplates EBF registering its security interest. The Factoring Agreement provides, at para. 3(j), as follows:

> (j) in order to secure EBF with respect to Sellers representations, warranties, obligations and covenants under this Section 3 Seller hereby grants to EBF a security interest and a lien upon all of Seller's right, title and interest in and to all of Seller's existing and future accounts receivable and contract rights, together with all replacements thereof and proceeds therefrom. Seller hereby specifically agrees to execute a Uniform Financing Statement (PPSA) which shall be filed by EBF to perfect the security interest granted by Seller herewith and such additional financing statements and/or documents as EBF may require.

[7] Review of the Factoring Agreement and associated documents, including the corporate resolution, shows the name of the Bankrupt to be "N'Amerix Logistix Inc.".

[8] The Trustee's review of the books and records of the Bankrupt indicates that as at the close of business August 30, 2001, $383,355.53 of the accounts receivable of N'Amerix were pledged to EBF.

[9] On August 20, 2001 (the Monday following N'Amerix's filing of a Notice of Intention to Make a Proposal), the Trustee obtained a certified copy of *PPSA* business debtor search for N'Amerix Logistix Inc. (the "First *PPSA* Search") which did not indicate a registration by EBF against the Factored Receivables or any receivables or other collateral of the Bankrupt.

[10] An electronic business debtor search under the *PPSA* respecting N'Amerix Logis*tix* Inc. (emphasis added), conducted on August 30, 2000, reflects the same results as the First *PPSA* Search and did not indicate any registration by EBF of an interest in the Factored Receivables or any receivables or other collateral of the Bankrupt under the *PPSA.*

[11] Subsequent to the Assignment in Bankruptcy, the Trustee's counsel delivered correspondence via facsimile and overnight courier to EBF advising that:

a. Perry Krieger had been appointed on August 31, 2001 as Trustee in Bankruptcy for N'Amerix;

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b. review of the *Personal Property Security Act* search revealed that the Factoring Agreement had not been registered under the *Personal Property Security Act* with respect to the receivables factored to EBF by N'Amerix;

c. that EBF's interest in the accounts receivable was subordinate to the interest of the Trustee pursuant to s. 20 of the *PPSA*;

d. no efforts should be made by EBF to collect the Bankrupt's accounts receivable; and

e. should EBF dispute the position taken by the Trustee, that there was a forum for doing so, and further advising that the funds would be available if EBF were successful in any such challenge.

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[12] In response, EBF forwarded documentation by which it asserted that it had perfected a security interest in the accounts receivable; however, this documentation indicates that EBF registered a financing statement against "N'Amerix Logis*tics* Inc." which is not the correct legal name of the Bankrupt.

[13] Despite the Trustee's advice that EBF should not take any steps to attempt to collect accounts receivable so as to not confuse the Bankrupt's customers, on the afternoon of August 31, 2001, EBF sent letters to N'Amerix's customers advising that upon receipt of the notice "you are required to remit any and all payments owing to N'Amerix Logistix's Inc to [EBF]."

[14] The Bankrupt did not obtain financing by factoring accounts receivable with EBF on and after August 17, 2001.

[15] Some of the customers with whom the Bankrupt continued to do business on and after August 17, 2001 are the same customers with whom accounts receivable had been factored with EBF, and EBF demanded payment of moneys respecting matters it did not finance and to which it has no legitimate claim.

[16] An electronic business debtor search against N'Amerix Logis*tix* Inc. under the PPSA conducted by the Trustee's counsel on September 5, 2001 (the "Third *PPSA* Search"), indicates that EBF filed a Financing Change Statement on September 4, 2001 to amend the business debtor name from "N'Amerix Logis*tics* Inc." to "N'Amerix Logis*tix* Inc.".

[17] By virtue of EBF's filing of a financing change statement after the Bankruptcy (to correct the name of the debtor) which, on its face, indicated the same file number as EBF's earlier incorrect registration against N'Amerix Logis*tix* Inc., the Third *PPSA* Search showed EBF's registration as against N'Amerix Logis*tics* Inc. This search result arises because the financing change statement against the Bankrupt's correct legal name, made on September 4, 2001, referenced the same "file number" as the earlier registration made against the incorrect name and the two statements were thereafter "linked" in the computer system for retrieval and reporting in response to a business debtor search of N'Amerix Logis*tix* Inc.

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Issues

[18] The Trustee raised issues with respect to the allegedly defective registration of the Factoring Agreement. The Trustee's position is that by reason of the defective registration, EBF does not hold a perfected security interest in respect of the Factoring Agreement.

[19] EBF, in its submissions, asserted only one position, which was that EBF is entitled to be subrogated to the perfected security interest of BNS in the accounts receivable of N'Amerix as a result of EBF paying to BNS the indebtedness of N'Amerix on its operating loan.

[20] Accordingly, these reasons address only the issue of subrogation.

Law

[21] Section 20(1)(*b*) of the *PPSA* provides as follows:

> 20(1) Except as provided in subsection (3), until perfected, a security interest,
>
> (*b*) in collateral is not effective against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a trustee in Bankruptcy.

[22] Section 72 of the *PPSA* provides as follows:

> Except in so far as they are inconsistent with the express provisions of this Act, the principles of law and equity, including the law merchant, the law relating to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake and other validating or invalidating rules of law, shall supplement this Act and shall continue to apply.

[23] Ziegel and Denomme, in their text on the *PPSA,* comment as follows:

> Subrogation as an available remedy is explicitly recognized in s. 63(11) of the *Ontario Act* [*i.e.* the *PPSA*], and is implicitly recognized in s. 72 of the Act preserving the general

principles of common law. Subrogation is a broad and flexible remedy seemingly available, to prevent unjust enrichment, where a person makes payment to a creditor at the debtor's request or guarantees payment at the creditor's request, or where the payment is made to a creditor to protect the legitimate interest of the payor. The latter species is certainly broad enough to confer subrogational rights on a junior secured party which pays off the senior secured party where the debtor is in default.

Ziegel and Denomme, *The Ontario Personal Property Security Act Commentary and Analysis,* 2nd ed. (Markham, Ont.: Butterworths, 2000), para. 30.8.

Preliminary Considerations

[24] Based on Mr. Paatz' affidavit, para. 15, as to EBF having required that it be in a first position on receivables, and paras. 16 to 18 of that affidavit as to the dealings with CIT and BNS, it was part of the arrangement that EBF required that it have priority via BNS in respect of the receivables charged to BNS, and BNS agreed to this arrangement, so EBF cannot be said to be a volunteer. So it is not disqualified on that basis from seeking to be subrogated to the perfected security interest of BNS in the receivables of N'Amerix.

[25] As noted in the Ziegel text, subrogation is implicitly recognized in s. 72 of the *PPSA*. The Ziegel text speaks of subrogation as a "remedy" and it speaks of "subrogational rights".

[26] The Trustee submits that s. 20(1)(*b*) of the *PPSA* provides an express provision inconsistent with s. 72 in respect of the claim made by EBF here, because EBF does not have a perfected security interest as required by that provision. EBF does not rely on the security or other interest constituted by the Factoring Agreement of March 27, 2001 between N'Amerix and EBF. EBF relies on the perfected security that BNS acquired and in respect of which EBF claims that it is entitled to be subrogated.

[27] It is not disputed that there is a perfected security interest in favour of BNS.

[28] Paragraph 19 of Mr. Paatz' affidavit states that "EBF and N'Amerix agreed to pay the Bank out on the operating line from monies to be advanced by EBF in return for the Bank subordinating its position as above." This refers to the statement in para. 18 of the affidavit that "the Bank would agree to provide priority to EBF over receivables."

[29] Paragraph 18 of the affidavit refers to the fax text set out in Exhibit F, in which the Bank stated to EBF:

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> Upon receiving payment in full of the operating facility, the Bank is prepared to release its General Assignment of Book Debts and provide priority over receivables held under its General Security Agreement.

[30] The intent of the arrangements referred to in the two preceding paragraphs must be that EBF, N'Amerix and BNS agreed that, upon N'Amerix paying the operating facility in full, EBF would have the benefit of the security which BNS held over the receivables of N'Amerix presumably in the amount advanced by EBF to pay the operating facility.

[31] By Bank draft dated May 18, 2001, EBF advanced to the N'Amerix account at the Bank $275,940.27 to pay out the operating loan.

Subrogation

[32] The term "subrogation" is defined as:

> The substitution of one person in the place of another with reference to a lawful claim, demand or right, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities.

Black's Law Dictionary, as approved in *Midland Mortgage Corp. v. 784401 Ontario Ltd.,* [1993] O.J. No. 2671 (Gen. Div.).

[33] The doctrine of subrogation has been applied in priority disputes similar to claims under the *PPSA.* The doctrine of subrogation has allowed a third-party to obtain priority by way of mortgage over a lien registered under the *Mechanic's Lien Act.* The Supreme Court of Canada in *Coupland Acceptance Ltd. v. Walsh* (1953), [1954] S.C.R. 90, [1954] 2 D.L.R. 129 approved of the English Court of Chancery decision in *Crosbie-Hill v. Sayer* in which Parker J. stated the doctrine of subrogation as follows:

> Where a third party at the request of a mortgagor pays off the first mortgage with a view of becoming himself a first mortgagee of the property, he becomes, in default of evidence of intention to the contrary, entitled in equity to stand, as against the property, in the shoes of the first mortgagee.

[34] As the Ontario Court of Appeal stated in *Mutual Trust Co. v Creditview Estate Homes Ltd.* (1997), 34 O.R. (3d) 583 [at p. 583 O.R., headnote], [1997] O.J. No. 3258 (C.A.):

> The fundamental principle underlying the doctrine is one of fairness in the light of all the circumstances. In this case, the arrangement was that, in the absence of subrogation, a lender would be denied the priority for which it had bargained and the plaintiff would receive a windfall in the form of a higher priority than for which it had bargained. The doctrine of subrogation was not precluded by the negligence of the party claiming subrogation...

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[35] Based on the material, EBF has paid an obligation of N'Amerix to BNS with the knowledge and approval of all parties on the understanding that EBF would thereby obtain a first priority position over the accounts receivable of N'Amerix charged in favour of BNS. Subject to what is said below, this arrangement meets the criteria for subrogation by EBF to the position of BNS to the extent of the funds advanced by EBF to pay out the operating loan of N'Amerix.

Whether s. 20(1)(b) of the PPSA Affects the Claim of Subrogation

[36] Section 20(1)(*b*) provides that, until perfected, a security interest is not effective against a trustee in Bankruptcy.

[37] It is not disputed that BNS holds a perfected security interest against N'Amerix. BNS is not a party to this motion. There were no submissions as to whether BNS could itself assert a claim under its perfected interest against N'Amerix for the amount paid by EBF to BNS on account of the N'Amerix account.

[38] Approaching the matter analytically, there is also a question (which was not addressed in submissions) as to what kind of "interest" is constituted by an entitlement to claim subrogation. If the entitlement [in] itself is security interest, as defined in the *PPSA*, then to the extent that it is to be asserted by EBF directly against the trustee in Bankruptcy, as is the case here (rather than by EBF against the Bank), it would seem to be arguable that the entitlement to subrogation must be perfected by registration in order to be effective against the trustee in Bankruptcy. Under s. 1(1) of the *PPSA,* "security interest" means "an interest in personal property that secures payment or performance of our obligation…".

[39] Having regard to the definition of subrogation from *Black's Law Dictionary* set out above, it would seem at least arguable that the correct analysis is that, in the present case, there is one relevant "security interest", and that is the interest created by the security instruments of the BNS and that subrogation does not create a new security interest but rather determines who may exercise and/or receive the benefit of the security interest. On this analysis, an entitlement to subrogation would not be affected by s. 20(1)(*b*) and the effective preservation of the subrogation entitlement by s. 72 would operate without restriction by s. 20(1)(*b*).

[40] From the cases mentioned above, it is clear that the fundamental principle underlying the doctrine of subrogation is one of fairness in the light of the circumstances. The example given

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by counsel is helpful. The Bank advances $400,000 to N'Amerix. EBF advances $275,000 to the Bank on account of the N'Amerix operating account. If EBF may now assert a subrogated claim for the $275,000 against N'Amerix and the Bank can assert a claim only for the remaining $125,000, the total amount that can be claimed against N'Amerix is $400,000 which is the amount that was originally loaned to and remains unpaid by N'Amerix. So it is fair as between EBF and N'Amerix that EBF should be able to assert the claim, and if EBF could not do so, there would be a windfall to N'Amerix.

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[41] The situation is not different in principle when a trustee in Bankruptcy is introduced into the situation in place of N'Amerix, for the interests in question are now those of the creditors of the estate of N'Amerix, and they have no basis to expect that the amount that can be asserted under the Bank's perfected security should be less than the amount that could be asserted against N'Amerix itself.

[42] It is clear that a perfected security interest existed by reason of the filing by BNS, under which EBF seeks to claim by way of subrogation. Section 20 of the *PPSA* does not require that the interest be recorded in the name of the person who seeks to claim the benefit of the interest, but only that the security interest itself must be perfected. In other words, s. 20 looks to the status of the security interest itself as distinct from the holder of or other party interested in the security interest. This matter is considered in greater detail below.

[43] No submissions were made about requirements under the *PPSA* relating to the filing of a notice of change in respect of security interests. Subrogation rights are perhaps different from other kinds of succession to interests in that in a subrogation case such as the present one, the subrogation claimant does not necessarily claim the entire benefit of the amount owed to the principal obligee but only a portion and does not assert that the principal obligee is no longer in the nexus with the obligor but rather that the nexus exists, at least in part, for the benefit of the subrogation claimant.

Relevant Provisions of PPSA

[44] In s. 1(1), "secured party" is defined as "a person who holds a security interest for the person's own benefit or for the benefit of any other person and includes a trustee where the holders of obligations... under a security agreement are represented by a trustee as the holder of the security interest...".

[45] When this provision is considered in conjunction with [the] definition of "security interest", it appears that, in the scheme of the Act, a security interest is distinct from its holder and any other person who may be entitled to benefit from the security interest. Also, it is the "holder" of the security interest that is the "secured party", and that is so whether the holder holds for its own benefit or for the benefit of others.

[46] In order for a security interest to be perfected, a financing statement in respect of the security interest must (subject to other provisions not applicable in this case) be registered: s. 45.

[47] The Act provides that financing change statements *may* be registered for various purposes. Section 47 provides that a financing charge statement may be registered where a security interest has been perfected by registration and the secured party has assigned the secured party's interest in all or part of the collateral, and upon such registration, the assignee becomes a secured party of record. The Act does not require such registration but permits it so as to enable the assignee to become a secured party. It was not suggested that the interest of EBF by reason of its right of subrogation constituted it an assignee and I doubt that such a suggestion would be sound.

[48] No reference was made to any provision of the Act that requires registration of a subrogation right in respect of a perfected secured interest in order for the subrogation claimant to benefit from that secured interest.

[49] Based on the above considerations, for purposes of the Act, the BNS security is a perfected security interest and BNS, as the holder of BNS security, is the "secured party" in respect of that security interest. Nothing in the Act requires the subrogation right of EBF to be perfected by registration in order for the BNS security interest to be regarded as perfected.

[50] Accordingly, s. 20(1)(*b*) does not impede the recognition under s. 72 of the subrogation right of EBF.

[51] The Act contains various provisions relating to enforcement by the secured party. BNS is not a party to this motion. No submission was made that BNS, as the secured party, is required to be a party in order for the subrogation claim of EBF to be asserted, so it is in order to determine the matter without regard for that consideration.

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Unjust Enrichment

[52] The trustee submits that the claim of subrogation is founded on the doctrine of unjust enrichment which has no application where there is a juristic reason for the deprivation or detriment, and here adequate juristic reason is afforded by s. 20(1)(*b*) of *PPSA*. EBF submits that the basis for subrogation is the concern in the courts of equity for fairness, and not the doctrine of unjust enrichment. It is not necessary to decide the point. Even if subrogation were only available to avoid unjust enrichment, s. 20(1)(*b*) would not constitute adequate juristic reason because, on the analysis set out above, s. 20(1)(*b*) would not preclude the assertion of a subrogation claim.

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Clean Hands

[53] It was submitted that subrogation, as an equitable right, is subject to the requirement that the person asserting the right must have clean hands, and EBF does not. EBF made efforts to obtain payment of receivables, including some receivables not included in the scope of its subrogation claim in respect of the BNS security, after the appointment of the Trustee and after notice from the Trustee requiring payments to be made to it.

[54] EBF submits that the clean hands doctrine applies to the conduct of the party with regard to the matter that gave rise to the right and that matter was its advancing of funds pursuant to its arrangement with N'Amerix and BNS, as to which there is no allegation of improper conduct.

[55] In the materials on subrogation provided by counsel, a distinction is sometimes made between rights and remedies. The point was not pursued in submissions. It would seem reasonable in principle to say that EBF should not be able to request the court to grant the equitable remedy of subrogation if that would put the debtor in a position that would be worse by reason of improper conduct on the part of EBF, for example, the collection by it of receivables not included in the BNS security and intended to be available to EBF. On the submissions, I am not satisfied there is any claim that that has happened. If there is such a claim and it is supported then, in principle, it would be proper to require any amounts so collected to be reimbursed or set-off against the amount otherwise payable under the subrogation claim. Subject to any submissions that may be made in that regard, the alleged

conduct of EBF does not provide a basis for disentitling it to the amounts it seeks to recover by way of subrogation.

Conclusion

[56] For the reasons given above, EBF is entitled to assert its claim for subrogation pursuant to the perfected security interest held by BNS.

[57] Counsel may consult me about costs.

Order accordingly.

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TAB 7

NOVA SCOTIA COURT OF APPEAL

Citation: *White v. E.B.F. Manufacturing Ltd.*, 2005 NSCA 167

Date: 20051230
Docket: CA 238176
Registry: Halifax

2005 NSCA 167 (CanLII)

Between:

E.B.F. Manufacturing Limited

Appellant/Respondent
by Cross-Appeal

- and -

Eric White

Respondent/Appellant
by Cross-Appeal

- and -

ElectroBraid Fence Ltd.

Intervenor

Judge(s): Bateman, Freeman & Saunders, JJ.A.

Appeal Heard: September 29, 2005, in Halifax, Nova Scotia

Held: Appeal and Cross-Appeal dismissed, as per reasons for judgment of Saunders, J.A.; Bateman & Freeman, JJ.A. concurring.

Counsel: George W. MacDonald, Q.C. & C. Peter McLellan, Q.C., Solicitors for the Appellant/Respondent by Cross-Appeal, and the Intervenor
David P. S. Farrar, Q.C. & Colin D. Piercey, Solicitors for the Respondent/Appellant by Cross-Appeal

Reasons for judgment:

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[1] This appeal calls into question a trial judge's interpretation of certain contractual terms which resulted in the payment of royalties for a very profitable invention, and a finding that because the contract had not been repudiated, it remains valid and enforceable.

Background

[2] The case arises out of a contract and business dispute between the parties to this appeal. EBF Manufacturing Limited (EBF) is a Nova Scotia company which manufactures and markets braided electrical fencing. ElectroBraid Fence Limited ("FENCE") is a Nova Scotia company which markets and sells EBF's product.

[3] The respondent, Eric White, ("White") is the inventor, and holder of a patent in a product known commercially as "ElectroBraid," a braided polyester rope interwoven with conductive copper wire that is used for the rail component of a fence. When an electric current is applied to ElectroBraid, it becomes a charged electrical fence, designed to pen or contain animals. This dispute centres mainly upon the method of calculating royalties to White on sales of Electrobraid and related products.

[4] On January 29, 1988, White granted EBF an irrevocable and exclusive licence to all patents and patents pending related to the manufacture of "braided electrical fencing."

[5] E. David Bryson ("Bryson") is the sole shareholder, officer and director of EBF and FENCE. Initially Bryson, White and White's wife Jennifer Fried, were all shareholders in EBF. Subsequently, White exercised a shotgun provision in EBF's shareholder agreement, and Bryson bought all of the shares held by White and Fried. White commenced an action against EBF claiming unpaid royalties and seeking a declaration that the licence agreement had been repudiated. McDougall, J. dismissed the claim for repudiation but found that royalties were due to White based on the sales of both FENCE and EBF.

[6] Following trial, by order dated January 7, 2005, McDougall, J. ordered EBF to have an independent accountant calculate the past royalties due and owing to White. EBF was obliged to make payment within 60 days of receipt of the accountant's report. The accountant's report was received March 29, 2005. Calculations revealed that with past royalties, together with additional amounts of interest, costs and disbursements, EBF owed White a total of $241,255.87.

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[7] On January 6, 2005 EBF appealed the trial judge's decision. On January 20, 2005 EBF applied for a stay of that decision until this appeal could be heard. That application for a stay was dismissed by a member of this court in chambers on January 26, 2005.

[8] After discovering that White had incorporated a new company known as White Rhino Inc. and had begun to compete with EBF and FENCE, those latter two companies applied for a further stay of McDougall, J.'s decision pending the hearing of this appeal. That application for a stay was dismissed by another member of this court in chambers on June 29, 2005.

[9] In addition to the matters leading to the within appeal, the parties have commenced other proceedings, both in the Nova Scotia Supreme Court against White and White Rhino Inc. seeking damages and a permanent injunction with respect to that competition, and in the Federal Court of Canada. The issues complained of, and the status of those other proceedings need not concern us here.

[10] In appealing Justice McDougall's decision, EBF submits that he was wrong to involve FENCE by forcing that company to open its books to inspection, or requiring it to include its gross revenue when calculating royalty payments to White.

Issues

[11] The grounds of appeal in the main appeal may be succinctly stated:

> ***(i) Did the trial judge err in finding that in calculating the royalty payments owed to White by EBF, the gross revenue of FENCE was to be included?***

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> *(ii)* ***Did the trial judge err in ordering FENCE to make its books and records available for review by an accounting professional for the purposes of calculating the royalty payments owing to White by EBF?***

[12] For his part White has cross-appealed claiming that the trial judge seriously erred in finding that the agreement had not been repudiated by the actions and conduct of the appellants, and that as a consequence their agreement continues to bind them to it.

[13] The single ground of appeal advanced in the cross-appeal may be simply stated:

> *(i)* ***Did the trial judge err in determining that the Licence Agreement was not repudiated, and remains "valid and enforceable"?***

[14] Whereas, to a certain extent, the issues on appeal and cross-appeal involve different matters arising from the evidence, different legal principles, and different standards of review, I propose to deal with the appeal and the cross-appeal separately in this judgment.

THE APPEAL

Standard of Review

[15] In **Housen v. Nikolaisen**, [2002] 2 S.C.R. 235, the Supreme Court of Canada considered the standard of review on appeal from a trial court. Iacobucci and Major J.J., writing for the majority, summarized the standard as follows:

> (a) The standard of review for a question of law is one of correctness (¶ 8);
>
> (b) The standard of review for findings of fact is one of "palpable and overriding error," meaning that the error must be readily or plainly seen (¶ 10);

(c) Factual inferences from underlying findings of fact are subject to a "palpably wrong" test as well (¶ 25);

(d) The standard of review for mixed questions of fact and law can vary depending on the circumstances. An incorrect application of the legal standard can expose the mixed question of fact and law to a correctness standard of review (¶ 31).

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[16] The interpretation of an agreement is a matter of law. The standard for appellate review is one of correctness. Here the trial judge was obliged to apply proper legal principles when interpreting the contract between the parties. However, contractual agreements are not examined in a vacuum. As part of the exercise, the trial judge was required to carefully review the evidence and make certain findings of fact. When considering the trial judge's reasons while he was in the fact finding mode, the standard for appellate review is one of "palpable and overriding error." The standard of review applicable to inferences drawn from fact is no less and no different than the standard applied to the trial judge's findings of fact. Again, such inferences are immutable unless shown to be the result of palpable and overriding error. If there is no such error in establishing the facts upon which the trial judge relies in drawing the inference, then it is only when palpable and overriding error can be shown in the inference drawing process itself that an appellate court is entitled to intervene. Thus, we are to apply the same standard of review in assessing Justice McDougall's findings of fact, and the inferences he drew from those facts. **Housen**, supra; **H.L. v. Canada (Attorney General)**, [2005] 1 S.C.R. 401, 2005 S.C.C. 25; and **McPhee v. Gwynne-Timothy** (2005) N.S.C.A. 80.

[17] An error is said to be palpable if it is clear or obvious. An error is overriding if, in the context of the whole case, it is so serious as to be determinative when assessing the balance of probabilities with respect to that particular factual issue. Thus, invoking the "palpable and overriding error" standard recognizes that a high degree of deference is paid on appeal to findings of fact at trial. See, for example, **Housen**, supra, at ¶ 1 - 5. Not every misapprehension of the evidence or every error of fact by the trial judge will justify appellate intervention. The error must not only be plainly seen, but be "overriding and determinative." **Delgamuukw v. British Columbia**, [1997] 3 S.C.R. 1010 at ¶ 78 and 80.

<u>**Issue No. 1**</u>

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(i) Did the trial judge err in finding that in calculating the royalty payments owed to White by EBF, the gross revenue of FENCE is to be included?

[18] At the hearing before us counsel for EBF characterized the Licence Agreement as "fundamentally important to the case," the principal document that "had to be interpreted" by the trial judge, and that it was the "very reason for this lawsuit" since it "forms the basis of the royalties payable to White." EBF says the entire agreement between the parties is contained in the Licence Agreement and therefore it was improper for McDougall, J. to look outside the document in deciding its meaning.

[19] In complaining that the judge erred when he referred to extrinsic evidence in order to interpret the agreement between the parties, EBF was especially critical of Justice McDougall for relying upon the evidence of Mr. Douglas Reid, FCA, the regional managing partner of the accounting firm KPMG, and an opinion Mr. Reid had prepared for Bryson at Bryson's request dated November 12, 1999. Counsel criticized what they described as the "musings of Mr. Reid" and says his evidence ought not to have been received, let alone relied upon, since no attempt had been made to qualify Mr. Reid to present expert evidence at trial.

[20] The thrust of EBF's complaint is that the License Agreement was clear on its face and that it ought to have been given its plain meaning by the trial judge. The appellant says there was no need for the trial judge to stray beyond the text of the document in order to interpret its terms. Specifically, counsel for the appellant state in their factum:

> 28. The plain words of the License Agreement provide that a royalty is to be paid to White equal to 2% of the Company's gross revenues. The recitals to the License Agreement refer to the Shareholders Agreement and in particular article 4.02 which refers to the granting by White of an exclusive license to the Company. The Company is clearly EBF.
>
> . . .
>
> 30. The Learned Trial Judge relied on a letter written by Mr. Reid some two years after the License Agreement was executed to amend the unambiguous provisions of the License Agreement. [Underlining mine]

Counsel then refer to leading authorities for what are said to be the rare and special circumstances which limit the application of the parol evidence rule and the admittance of extrinsic evidence, none of which - it is argued - arose here.

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[21] With respect, it does not behoove the appellant to now allege, on appeal, that the trial judge erred in applying the parol evidence rule or in looking to extrinsic evidence to interpret the agreement between the parties, or in considering and attaching some weight to the evidence of Mr. Reid, when he was invited by EBF's trial lawyer to do precisely that during final arguments at the end of the trial.

[22] While not part of the appeal book, we as a panel or any member of the public for that matter, have access to submissions made by counsel in open court as part of the public record. Often considerable insight is gleaned by comparing the manner in which the theories of the parties were presented at trial or the way in which particular issues were (if at all) put before the trial judge for resolution, to the way in which the case is argued on appeal. This exercise can be especially illuminating where, as here, different counsel take the matter on appeal than those who acted at trial.

[23] In his final arguments following trial, EBF's then lawyer, properly, I would suggest, acknowledged ambiguity in the License Agreement by encouraging Justice McDougall to look beyond the document in order to interpret the agreement and ascertain what the parties to it had decided. In that same submission EBF's trial counsel specifically referred to Mr. Reid and his *viva voce* and documentary evidence, commending it to the attention of the trial judge as being credible and independent and - so counsel argued - tending to corroborate Bryson's version of events. For example, at one point in his submissions, counsel said in part:

> . . . The first question which I think is one of the most important questions is when was the royalty payment to commence and as you know, Mr. Bryson's testimony is that it was to commence at the time that the patent was issued. Mr. White's testimony was that it was to start being payable as a monthly payment on a monthly basis starting in October of 1997. Now if you look at the License Agreement itself . . . what does this agreement say about timing of payment? Well, Ms. Brennan in her letter to the parties when she sent the draft, the agreement doesn't have a date. Mr. Bryson says . . . that clearly royalty payments are not to start until there's a patent because there is to be a royalty in respect of each patent. And Mr. White, of course, takes the view that notwithstanding the

> silence of the agreement, there were discussions between the parties to say it was going to be on a monthly basis. Well, I think, My Lord, that the licensing agreement is vague on the point . . . if it was specific it would have had a clause that says royalty payments are to be made on a monthly basis . . . It could have said royalty payments are to be commenced upon the issuance of a patent . . . So the licensing agreement is vague on the point which means that you do need to look beyond the licensing agreement to see what the parties had decided. And I think when you look at what was happening, you look at the objective evidence, you try to assess what the reasonable parties would have been thinking at the time. . . . this interpretation that royalties were not to be paid until after the patent was issued, it wasn't something new that Mr. Bryson came up with this legal maneuvering that started occurring in 2000. This wasn't a change in position. This was the view that he held throughout and I can illustrate that for you by talking about the evidence of Doug Reid. Mr. Reid is obviously a professional. He is independent of the parties. His evidence is certainly credible and it is also supported by documentation . . .
>
> (Underlining mine)

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[24] Having been urged by the appellant's trial counsel to look beyond the four corners of the License Agreement, and in interpreting the document take into account extrinsic evidence in order to fathom what the parties had decided, the appellant cannot now suggest that the same trial judge erred by applying the parol evidence rule and by looking to other extrinsic evidence so as to give meaning to any ambiguity in the same agreement.

[25] In any event - and quite apart from this background to the appellant's contradictory submissions - I see no error in the manner in which he interpreted the agreement between the parties. It is vague, in certain respects. As Ms. Brennan, the lawyer who drafted it in the first place acknowledged in her file materials and correspondence to her clients, she was not a patent lawyer, and the date for commencement of royalty payments had not been stipulated. This was one of the principal questions put before the trial judge in this litigation to resolve. He had no choice but to look beyond the document. To interpret the agreement he had every reason to consider evidence beyond its text. He made no error in principle in deciding to do so. That decision was correct.

[26] The question then becomes whether any of the factual findings made by the trial judge reveal palpable and overriding error, such that his determinations with

respect to the calculation of royalties, and authorizing a review of FENCE's accounting records for the purposes of calculating royalties, ought to be reversed.

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[27] In his decision, McDougall, J. was certainly alert to the issues that now give rise to this appeal. He carefully reviewed and summarized the material evidence that had been presented over the course of the eight day trial and then, as he was bound to do, made certain critical findings leading ultimately to his disposition and order. He said in part:

> [15] This license agreement dated the 29th day of January, 1998 was signed by White, Fried and Bryson both in their personal capacity and on behalf of EBFML It is interesting to note that the exclusive license was granted only to EBFML. However, on the same day the shareholders' agreement was signed -- September 4, 1997 -- White, Fried and Bryson had also signed another one-page agreement that made reference to clause 4.02 of the shareholders' agreement. In the second paragraph of this one-page agreement it was stated:
>
> > In that event we agree promptly to form another company, with identical voting common shares as EBF Manufacturing Limited, to which Eric White will grant a similar exclusive license.
>
> The event referred to was the insolvency of EBFML or any other company that might possibly be granted such an exclusive license in the event EBFML actually did become insolvent.
>
> [16] The license agreement was drafted by a lawyer retained by EBFML. In the cover letter sent to the three principals of EBFML enclosing a draft of the license agreement counsel wisely suggested two things:
>
> > ... As discussed with you, I do not have experience with patents and it would be prudent to have the document reviewed by your patent lawyer. Also, you may want to add further details - for example, paragraph 4 does not specify when royalty payments are to be made, including the commencement date for such payments.
>
> One other interesting comment in this letter (which was tendered as an exhibit without calling the author) is:

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> My understanding is that all of the equipment is to be owned by E.B.F. (by E.B.F. she meant E.B.F. Manufacturing Limited - my comment) and that Electrobraid (by Electrobraid she meant ElectroBraid Fence Limited - my comment) simply acts as an agent on behalf of E.B.F. I have prepared the document on this basis.

[17] The manner in which royalty payments were to be calculated and the timing of those payments, formed the basis of this law suit.

. . .

ISSUES TO BE DECIDED

. . .

(2) Based on the agreements between the parties (both the shareholders' agreement and the license agreement) when and how should royalties be calculated?

. . .

[23] Although the term "gross revenues" was not defined, there is nothing to suggest that it should not be given its ordinary accounting definition. This was even suggested to Mr. E.C. Harris, Q.C. in correspondence sent to him by Mr. Douglas Reid, C.A. on the 12th day of November 1999. That definition states:

> 'Gross revenues' represents the total sales, net of sales discounts, of the Company. They will be reported on the financial statements of the Company as 'sales', or 'revenue'.
>
> The corporate structure that the Company currently operates within raises an issue. In our view it is reasonable that the agreements contemplated 'gross revenues' to be sales to the consumer, or third

> party sales. The current management structure sees the Company selling the product to Electrobraid Fence Limited, a company with identical ownership to the Company, at a price that may not be representative of the sales made to the third party purchaser.
>
> Therefore, we believe the parties to the agreement should clarify that 'gross revenues' be the gross sales, net of sales discounts, as reported by Electrobraid Fence Limited, using generally accepted accounting principles.

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[24] Both Messrs. Harris and Reid had been called upon at one time or another to provide professional legal and/or accounting advice to the companies and its shareholders.

[25] It is interesting to note that the lawyer who had previously drafted the license agreement identified some shortcomings in the agreement related to the timing of royalty payments but she did not express any concerns about the method of calculation. It is 2% of gross revenues defined as the total sales or revenue to third party buyers. If the sale was made either by EBFML or ElectroBraid Fence directly to the end user or discounted to an agent of the companies then that is the amount that should be used in calculating gross revenues. It should not be some potentially arbitrary transfer price from EBFML to ElectroBraid Fence. Sales to end-users or the discounted price offered to company agents, as long as it reflects fair market value, should not be open to manipulation that could potentially harm the patent(s) owner.

[26] . . . In order to determine the gross revenues of the companies for purposes of calculating the total amount of royalties owing to Mr. White, EBFML and ElectroBraid Fence will be required to hire a qualified accounting professional to review the financial records of the companies since they began operations in or about September of 1997. All sales of the companies products to end users or the discounted prices given to agents of the companies, for both patented and patent pending products, should be included in the calculation of this amount.

. . .

[41] I also earlier indicated that a proper review of the companies' financial records should be conducted in order to calculate total gross revenues from the

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> time the companies first began operations. If the parties cannot agree on who to appoint for this purpose, the court will select a qualified individual or firm after hearing further submissions from counsel. The process of selecting the appropriate individual or firm should be completed within 60 days of the date of this decision. White is also entitled to interest on all unpaid royalties at a rate equal to the average interest that EBFML would have had to pay on any monies borrowed from its bank during the period from its inception in September, 1997 up to the present day. Interest is not to be compounded.
>
> . . .
>
> [43] All future royalty payments should be paid by EBFML/ElectroBraid Fence to White on a monthly basis in the manner described herein unless the parties mutually agree to some other arrangement.

(Underlining mine)

[28] There was ample evidence to support the interpretation and disposition of the trial judge. In no way can it be said that his findings are the result of palpable and overriding error. I will review, in some detail, the evidence supportive of the judge's interpretation.

[29] The first formal written contract that makes reference to royalties is the Shareholders' Agreement of September 4, 1997. The preamble specifically states that EBF was incorporated for the purpose of manufacturing and marketing ElectroBraid Fence products. A second company, FENCE, was incorporated simultaneously and with the same share ownership structure as EBF, to market the products. As the business developed, EBF did not "market" products to third parties but "transferred" ElectroBraid to FENCE at a wholesale price.

[30] Clause 4.01 of the Shareholders' Agreement states that the nature of the business of the company shall consist of manufacturing and selling braided fencing and associated products. FENCE was to be responsible for selling associated products.

[31] In September 1997, for whatever reason, the parties never turned their minds to drafting a separate shareholders' agreement for FENCE. Therefore, by preparing the Shareholders' Agreement, it cannot be said that the parties intended to clearly delineate the roles of EBF as manufacturer and FENCE as marketer. At the time the Shareholders' Agreement was prepared, as I have already pointed out, the parties were dealing, generally, with the manufacturing and distribution of ElectroBraid. As matters developed they incorporated FENCE to do the end selling. For whatever reason the parties never turned their minds to drafting a separate shareholders' agreement for FENCE. The fact that the agreement that was prepared does not refer to FENCE, cannot be interpreted to mean that the royalties were payable only on EBF's "sales."

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[32] In the fall of 1998, more than one year after the preparation of the Shareholders' Agreement, the parties signed a letter agreement indicating that the Shareholders' Agreement for EBF applied equally to FENCE. A separate formal written contract with distinct terms was not prepared for FENCE.

[33] White argued that royalties should be calculated based on sales to arm's length third parties, whether they be wholesalers, end users, fence installers, sales agents, sales partners or whatever. This strikes me as a commercially reasonable position to have taken. Evidently, so did the trial judge.

[34] Bryson argued that royalties should be calculated based on a wholesale transfer price between two companies with the same sole shareholder, officer and director. Obviously the potential exists to manipulate the transfer price between the two, thereby disentitling White from a royalty at fair market value. In my view this is not commercially reasonable nor, according to the trial judge's assessment of the evidence, in accordance with what the parties intended. As he determined, the royalty should be based upon sales to third parties thereby subject to the demands of the marketplace and "not open to manipulation that could potentially harm the patent(s) owner."

[35] The behaviour of EBF, FENCE and Bryson subsequent to the executing of the Agreement clearly support the trial judge's finding that Bryson's understanding (as well as White's) was that the royalties be based on sales to third parties by

FENCE. For example, the fiscal years ended September 30, 1999 and September 30, 2000 show the royalties were carried on the books of FENCE, not EBF. The two royalty cheques of May and June of 1999, in the amount of $10,000 each, (signed by Bryson well before the involvement of KPMG) were both drawn on the account of FENCE. If FENCE had no responsibility to pay royalties, why were cheques for royalties being drawn on the account of FENCE?

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[36] Similarly, the January 25, 2002 letter from the appellant's trial counsel enclosed two cheques for royalties, drawn on the account of FENCE, not EBF.

[37] The management and ownership structure of both EBF and FENCE is identical. EBF sells *exclusively* to FENCE. Bryson sets the price at which EBF sells ElectroBriad to FENCE. Surely the parties did not intend that White would receive royalties based only on the sales from EBF to FENCE. For example, Bryson could sell ElectroBriad FENCE to FENCE for $1, and yet set the price for the consumer at $200. White would only receive royalties on that $1. This is not only inconsistent with the evidence of the parties' intention, it is not commercially reasonable.

[38] The appellant argues that "Company" in the License Agreement is clearly EBF. There is no definition of the term "Company" in the January 29, 1998 License Agreement. "Company" is defined in the September 4, 1997 Shareholders' Agreement to mean EBF. At no time was a separate shareholders' agreement prepared with respect to FENCE. Again the parties subsequently agreed in September 1998 that the Shareholders' Agreement for EBF would apply equally to FENCE.

[39] EBF emphasizes that the License Agreement does not name FENCE as a party thereto. However, one cannot ignore the fact that Bryson is personally named as a party to the document. In other words, Bryson is bound thereby, and cannot circumvent the terms of the License Agreement. Bryson has 100% control of both companies, and as the trial judge inferred, he cannot be permitted to circumvent a commercially reasonable interpretation of the License Agreement by paying royalties only on a wholesale transfer price between EBF and FENCE, a price which is entirely within his control.

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[40] Further, all parties testified that the basic agreement between them with respect to royalties had been concluded by June 30, 1997. In particular, Bryson agreed on cross-examination that the Shareholders' Agreement and License Agreement did not change any of the terms of the agreement on royalties that had been concluded by the parties by June 30, 1997. In June 1997, the parties were only premising their discussions on the February 1997 Business Plan of EBF as prepared by White and Fried without reference or regard to the existence of FENCE.

[41] In summary, there was ample evidence in the record to support the trial judge's findings that although FENCE:

> . . . never became party to the shareholders' agreement, nor was a separate shareholders' agreement even created for it, its share structure mirrored that of EBF . . . FENCE would be used to sell the product and act as a buffer between "EBF and its customers". This would be particularly important when the company began marketing its products in the United States . . . as a shield against any law suits that might arise in what the shareholders perceive to be a more litigious market. Although sales of "EBF" products were made by both companies most of the sale to end-users were eventually funneled through "FENCE".

[42] In **Investors Compensation Scheme Ltd. v. West Bromwich Building Society**, [1998] 1 W.L.R. 896 (H.L.), at page 913, Lord Hoffman summarises the principles of interpretation of a written contract. He says:

> (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
>
> . . .
>
> (4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words.

> The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax: see Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd. [1997] A.C. 749.

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[43] In **Kentucky Fried Chicken Canada v. Scott's Food Services Inc.**, 1998 CarswellOnt 4170 (C.A.) at ¶ 27, the Court states:

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity [FN1]. Rather, the document should be construed in accordance with sound commercial principles and good business sense [FN2]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

[44] I concur with those observations and statement of principles. In my view they were clearly in the mind of the trial judge in disposing of this aspect of the case as he did. I see no error in the manner in which he handled it, and would dismiss this ground of appeal.

Issue No. 2

(ii) Did the trial judge err in ordering FENCE to make its books and records available for review by an accounting professional for the purposes of calculating the royalty payments owing to White by EBF?

[45] Here EBF and FENCE argue that in ordering that FENCE's gross revenue be included in the calculation of royalties to be paid to White, the judge erred in law by not recognizing that FENCE was not a party to the agreement, or the litigation,

and that being a separate and distinct legal entity, the judge was wrong to lift the corporate veil so as to grant White the relief he sought.

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[46] I disagree. First, I do not accept the appellant's characterization that FENCE is not a party to either the Shareholders' Agreement or the License Agreement. As previously noted, "Company" is defined in the Shareholders' Agreement to be EBF, which in turn is incorporated into the License Agreement. However, the parties confirmed by way of a letter agreement dated September 29, 1998 that the Shareholders' Agreement applied equally to FENCE. Thus, on these facts, FENCE ought to be considered a party to both the Shareholders' Agreement and the License Agreement.

[47] In any event and even assuming that FENCE is not a party, nor intended to be a party to the agreements, it is my opinion that it was appropriate for the trial judge in these unique circumstances to lift the corporate veil, and make the order he did.

[48] The concept that corporations are separate legal entities, despite the fact they may have the same shareholders, has been fundamental to the common law since the House of Lords decision in **Salomon v. Salomon & Co.**, [1897] A.C. 22 (H.L.). A more recent commentary on this principle can be found in the Supreme Court of Canada decision in **Kosmopoulos v. Constitution Insurance Co. of Canada**, [1987] 1 S.C.R. 2, where Wilson, J. stated at ¶ 12:

> As a general rule a corporation is a legal entity distinct from its shareholders: Salomon v. Salomon & Co., [1897] A.C. 22 (H.L.). The law on when a court may disregard this principle by "lifting the corporate veil" and regarding the company as a mere "agent" or "puppet" of its controlling shareholder or parent corporation follows no consistent principle. The best that can be said is that the "separate entities" principle is not enforced when it would yield a result "too flagrantly opposed to justice, convenience or the interests of the Revenue": L.C.B. Gower, *Modern Company Law* (4th ed. 1979) at p. 112. I have no doubt that theoretically the veil could be lifted in this case to do justice, as was done in American Indemnity Co. v. Southern Missionary College *supra,* cited by the Court of Appeal of Ontario. But a number of factors lead me to think it would be unwise to do so.

[Underlining mine]

[49] At the hearing before us counsel for the appellant and intervenor urged that the corporate veil ought not to be lifted except in the most serious of cases where fraud, or deceit, or use of a corporation for an improper purpose is both pleaded and proved. With respect, I think that submission invites a far too restrictive approach, implying that only the most egregious or criminally unlawful circumstance will entitle a court to lift the corporate veil. I do not understand that to be the law.

[50] In **Littlewoods Mail Order Stores Ltd. v. Inland Revenue Commissioners**, [1969] 1 W.L.R. 1241 (C.A.) Lord Denning declared at page 1255:

> . . . The doctrine laid down in Salomon v. Salomon & Co. [1897] A.C. 22, has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. . . .

[51] In **Le Car GmbH v. Dusty Roads Holdings Ltd.**, 2004 CarswellNS 138 (S.C.), Murphy, J. accurately identified three situations where courts have lifted the corporate veil:

(a) where failure to do so would be unfair and lead to a result "flagrantly opposed to justice";

(b) where representations are made or activities undertaken for a fraudulent or other objectionable, illegal or improper purpose to facilitate doing something that would be illegal or improper for an individual to do personally; and

(c) where the corporation is merely acting as the controlling shareholder's agent.

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[52] Courts will often pierce the corporate veil where the company is an agent or the mere alter-ego of the controlling shareholder or parent company. There was certainly evidence before McDougall, J. to support a conclusion that FENCE was merely the alter-ego of Bryson and EBF. In **Aluminum Co. of Canada v. Toronto (City)**, 1944 CarswellOnt 71 (S.C.C.), at ¶ 15-16, Rand, J., referred to the Court's earlier decision in the case of **Toronto v. Famous Players Canadian Corp.**, [1936] 2 D.L.R. 129 as having:

> 15 . . . settled that the business of one company can embrace the apparent or nominal business of another company where the conditions are such that it can be said that the second company is in fact the puppet of the first; when the directing mind and will of the former reaches into and through the corporate façade of the latter and becomes, itself, the manifesting agency.
>
> . . .
>
> 16 The question, then, in each case, apart from formal agency which is not present here, is whether or not the parent company is in fact in such an intimate and immediate domination of the motions of the subordinate company that it can be said that the latter has, in the true sense of the expression, no independent functioning of its own.

[53] EBF and FENCE are inextricably linked. EBF is the manufacturing arm of the enterprise and FENCE is the distributing arm. In his testimony Bryson agreed that FENCE was a "mere sales station." He agreed it had no employees, very little assets other than its inventory, and limited capitalization.

[54] The evidence at trial established that Bryson is the sole shareholder, director and officer of both companies. When FENCE was created, it was decided that EBF would own all the business assets and FENCE would be used to sell the product and act as a buffer between EBF and its customers. FENCE has no independent functioning. The directing mind of EBF (Bryson) penetrates the corporate facade so that FENCE becomes the agent of EBF. Indeed in her covering letter referring to the License Agreement, Ms. Marcia Brennan, the

parties' corporate lawyer who drafted the documentation, states that FENCE is an agent of EBF and that she drafted the License Agreement on that basis.

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[55] EBF manufactures ElectroBraid Fence. Its only customer is FENCE, a company controlled and operated by the same individual. Though FENCE does sell other products other than ElectroBraid, these products are all part of the ElectroBraid fencing system. Without ElectroBraid, FENCE would not be able to function. FENCE is a mere agent of EBF.

[56] In my opinion all of these unique circumstances confirm the soundness of the trial judge's decision. I see no error in his treating EBF and FENCE - for the purpose of calculating the royalties to which White was entitled - as being, essentially, one and the same thing. More fundamentally, however, the appellant's and intervenor's submission that the judge erred in failing to separate the two corporate entities ignores the position asserted on their behalves at trial. A key issue is whether the royalties would be calculated on the "sales" to EBF or those of FENCE. At no time did the appellant suggest to the trial judge that FENCE should be made a formal party to the action, or that FENCE was not properly before the court, or that he was not entitled to conclude that royalties be calculated on the sales of FENCE. Throughout the trial all parties conducted the proceeding as if FENCE and EBF were parties to the litigation.

[57] Lastly, the appellant has argued that the trial judge erred by considering Mr. Reid's interpretation of gross revenues. Whether or not Mr. Reid was qualified as an "expert" at trial is irrelevant, as Mr. Reid's "opinion" is a commercially reasonable interpretation that the agreements between the parties can bear.

[58] The appellant now seeks to distance itself from the opinion of Mr. Reid, when that opinion was sought at the behest of Bryson. Bryson was apparently satisfied with Mr. Reid's opinion for a period of time, since - as I have already explained - he reflected royalties on the financial statements of FENCE, and drew the payments from the accounts of FENCE. In these circumstances I see no error on the part of the trial judge in directing that EBF and FENCE make their corporate financial records available for inspection "in order to calculate total gross revenues from the time the companies first began operations" and thereby

determine the amount of royalties to which White was entitled. I would dismiss this ground of appeal.

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Disposition: The Appeal

[59] For all of these reasons I see no error on the part of the trial judge in finding that in order to calculate the royalties owed to White by EBF the gross revenue of FENCE ought to be included, or in compelling FENCE to make its records available for review to complete that calculation. I would dismiss the appeal with costs to the respondent, White.

THE CROSS-APPEAL

Standard of Review

[60] Here too there are mixed standards of review to be applied. When deciding, as he did, that the License Agreement had not been repudiated, the trial judge was obliged to apply proper legal principles. In that sense the standard for our review on appeal, to that segment of his decision making, is one of correctness. However, in arriving at that conclusion he was also obliged to carefully consider the evidence and make certain key findings. Such findings are reviewable on a palpable and overriding error basis, as discussed earlier.

Analysis

Issue No. 1: ***Did the trial judge err in determining that the License Agreement was not repudiated?***

[61] White contends that the refusal of EBF to pay royalties resulted in a repudiation of the licence agreement. He attacks the trial judge's dismissal of his cross-appeal on a number of fronts. Owing to their variety and specificity I feel obliged to address them in some detail.

[62] White says the trial judge erred in finding that there had never been a denial by EBF of his entitlement to receipt of eventual royalties. In his decision McDougall, J. said:

> [35] Based on the evidence presented before me I do not find that there has been a repudiation of the agreement. The parties might not have agreed on exactly when royalty payments should have begun but clearly there has never been a denial of White's entitlement to receipt of eventual payment.

[Underlining mine]

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[63] White argues that EBF took the position, on February 7, 2000, in a letter from its lawyer on that date, that royalties were not yet due and owing. This - so it is argued - constituted a denial of White's entitlement to the receipt of eventual royalties and it is at this point that White says the repudiation of the agreement "crystalized."

[64] I share the trial judge's view that some significance ought to be attached to the fact that White's plea that EBF had repudiated the contract was not advanced in his first statement of claim filed in May, 2000. At that point in the litigation - notwithstanding the fact that this pleading was filed some three months after the repudiation is said to have taken place - the claim was restricted to royalties said to be owing for patents and patents pending invented by White and utilized by EBF.

[65] In the alternative White says that "the repudiation crystalized when EBF defended the action in its first defence filed May 30, 2000." I note parenthetically that the words "repudiate" or "repudiation" do not appear in either pleading at this stage of the litigation.

[66] The defence put forward by EBF at that time was that under the terms of their agreements, royalties to White would not commence unless and until he was granted a patent related to the technologies described in those agreements. Thus, EBF pled that since White had not obtained any such patents, he was not entitled to

any royalty payments. EBF counterclaimed for damages said to have been caused by White's conduct in delaying and frustrating all attempts to secure patent protection.

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[67] It wasn't until White filed an amended statement of claim on March 28, 2001 that any relief for repudiation was asserted. White alleged, *inter alia*:

> 13. As a result of the failure of EBF Manufacturing Limited to make payments pursuant to the Licence Agreement, EBF Manufacturing Limited has repudiated the agreement and, as of May 3, 2000, was no longer entitled to a licence for the use of certain patents and patents pending owned by White. EBF Manufacturing Limited has continued to manufacture and distribute its products using White's patents and patents pending without permission to use White's intellectual property.
>
> . . .
>
> 15. White therefore claims:
>
> . . .
>
> iv. a declaration that the Licence Agreement has been repudiated by EBF Manufacturing Limited, is now null and void and White is relieved from any further obligations thereunder;
>
> [Underlining in original]

[68] EBF filed an amended defence and counterclaim on June 6, 2001. In response to White's claim of repudiation, EBF responded in particular as follows:

> 6. The Plaintiff knew or ought to have known that the Defendant interpreted the Agreements as not requiring payment to the Plaintiff prior to granting of a patent. The Plaintiff was in agreement or acquiesced to the non-payment by the Defendant pursuant to the Agreements. In the alternative, the Plaintiff engaged in conduct which reasonably led the Defendant to believe that he was acquiescing to the non-payment of royalties pursuant to the Agreements. In the event that the

Agreements entitled the Plaintiff to payment prior to granting of a patent, which is not admitted but specifically denied, then the Plaintiff is estopped from relying on such non-payment as a breach of the Agreements.

[Underlining in original]

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[69] White also complains that the judge erred in finding that White "did very little to demand payment of what he claims is being withheld from him." On the contrary, the appellant by cross-appeal says he asked for his first royalty payment in December 1997 (not December 1998 as found by the judge). He argues that the evidence of both Bryson and himself was that a $5,000 payment was made to him in December 1997, and that Bryson simply disagreed that this sum constituted a royalty payment. White argues that the evidence given by Mr. Currie, a CGA hired by Bryson as the company's accountant provided independent corroboration of White's claim. In conducting his review of the books to reconcile business expenses and royalty payments Mr. Currie prepared a memo dated April 21, 1999 in which he identified one royalty payment of *$5,000 from April 30, 1998 or before*. Mr. Currie testified that he ascertained this to be a royalty payment from his review of the books of the companies. Mr. Currie's evidence was not challenged at trial. Thus, in the circumstances, White argues that the trial judge made a palpable and overriding error of fact in concluding that White's first demand for royalties occurred in December 1998 as opposed to 1997.

[70] Further, while it is true that he did not place his demands in writing, White testified that he continually made verbal demands throughout late 1998 and early 1999 for payment of his royalties. The constant excuse he received from Bryson was that royalties could not be paid as the books had not been brought up to date.

[71] White says his actions in first demanding royalty payments in December 1997 and then continuously throughout 1999 cannot be fairly characterized (as did the judge) as doing "very little to demand payment."

[72] White says the judge's finding that a "misunderstanding" had developed is seriously in error. The evidence is compelling - White argues - that this is not a case where there had been a misunderstanding or confusion between the parties.

Rather, Bryson knew that royalties were due and owing, but simply conjured up excuses to avoid paying.

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[73] Whatever the interpretation - whether a failure to demand, or a refusal to pay - it is clear that EBF failed to pay any royalties between June 1999 and March 2001. Although not put forward as an alternative argument, White says that this non-payment constituted a fundamental breach entitling him to terminate the agreement. **Anne of Green Gables Licencing Authority Inc. v. Avonlea Traditions Inc.**, [2000] O.J. No. 740 (S.C.); and **Neostyle Envelope Co. v. Barber-Ellis Ltd.**, [1914] O.J. No. 598 (S.C.A.D.).

[74] Repudiation has two parts: an unambiguous demonstration by one party that it intends to default, and a clearly communicated acceptance of that default by the innocent party. If either element is missing, repudiation has not been made out. It is a well recognized principle that if a repudiation has occurred, the non-defaulting party must indicate acceptance of that repudiation in order to treat the contract as at an end. Thus, if there had been a repudiation of the agreement by EBF, White was required to indicate his acceptance of that repudiation in order to treat their contract as terminated. **Canada Egg Products Ltd. v. Canadian Doughnut Co.**, [1955] S.C.R. 398.

[75] White argues that if one were to conclude that the correspondence between the parties or subsequently between their counsel was insufficient to declare White's acceptance of the repudiation by EBF, then relying upon the Supreme Court of Canada's decision in **Canada Egg**, supra, service of the statement of claim may be sufficient notice of the election to treat the contract as at an end. White argues that the trial judge erred in failing to consider **Canada Egg**, supra, and whether service of the statement of claim in this case constituted sufficient notice of White's election to treat the contract as at an end.

[76] Finally, White says the trial judge seriously erred in looking at factors said to be entirely irrelevant when concluding that Bryson's actions did not constitute repudiation. McDougall, J. said:

> [40] To order the declarative relief now being sought by White would, in effect, put EBF . . . and . . . Fence out of business. This would strip Bryson of any benefit he should have received under the shot-gun provisions of the shareholders' agreement which was used to buy out White and Fried's shares in the companies. . . . If EBF . . . could not rely on the exclusive license it held over White's patent(s), what would it manufacture and sell? For the reasons previously stated I do not think the actions of Bryson as president of EBF . . . amounted to a repudiation of the license agreement. It is therefore still valid and enforceable.

These factors clearly motivated the judge in his conclusion that Bryson's actions as president of EBF did not amount to a repudiation. However, White argues that such considerations were entirely irrelevant to decide - as a matter of law, whether a repudiation had occurred, and if it had, with what consequence.

[77] In summary, and regardless of how one characterizes his actions in 1999, White says formal demands for payment were clearly made in writing once his counsel had been retained, as early as February 2000. Whatever the case, White says a formal demand for payment of royalties was not required. White says the judge erred in faulting him for a "failure" to adequately demand payment. The agreement stipulated that future royalties should be paid on a monthly basis - and that in fact is what the trial judge found. Consequently it was not necessary for White to demand payment of his royalties, and the non-payment thereof was sufficient to effect a repudiation.

[78] In support of his submissions White refers to ***The Law of Contracts, S. M. Waddams, 4th ed. (1999, Canada Law Book: Toronto)*** the following appears:

> [599] Another question is whether the party not in breach is required to warn the other before terminating. As a general rule performance is due without request. The debtor must seek out the creditor.[73] Consequently, if performance is substantially defective, the other party may terminate, even if ignorant of the deficiency at the time of termination.[74] It may, however, be a harsh result for a party in breach to lose the whole benefit of the contract, and in some cases a duty to warn has evolved. A buyer of goods is obliged, if no delivery date is fixed, to take delivery within a reasonable time, but a seller is not allowed quietly to let a reasonable time elapse and then terminate without warning.[75] The seller must give notice requiring the buyer to take delivery before terminating. Where, under a

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> land sale agreement, no closing date is fixed, or the original date has passed, either party may fix a new closing date by giving reasonable notice.[76] Where a condition is waived, the party waiving it may resume strict rights, but only on reasonable notice.[77] Similarly, where an employee might not realize that work is seriously deficient, an employer must give a warning before summary dismissal.[78] These cases appear to be instances of a limited right to "cure" defective performance, a right more widely recognized in American jurisdictions.[79]

(Citations omitted)

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[79] In response, EBF says there is no merit to White's plethora of complaints. The trial judge referred to and properly applied the leading jurisprudence on the subject of repudiation and recognized the heavy burden upon a party claiming such a result. White is really attempting to retry the case and replace the judge's finding that the licence agreement remains "valid and unenforceable," with a finding that EBF's conduct was so egregious that it amounted to a repudiation of the agreement by conduct as of May 3, 2000.

[80] In my opinion the cases relied upon by White are distinguishable in that there, the breaching party evinced a clear and continuing unwillingness to be bound by the terms of their agreements, whereas in this case, nothing in the factual findings of McDougall, J. suggest that EBF or Bryson ever reached that level of non-compliance. In fact the trial judge found that the areas which gave rise to the various disputes between Messrs. White and Bryson were largely unprovided for in the agreement between them, and that there was a legitimate dispute as to interpretation. The trial judge found as a fact that the timing and calculation of royalties were left unprovided for in the agreement, and that they were topics of legitimate dispute between the parties. To find that a contract had been repudiated, owing to a legitimate disagreement over interpretation would, in my opinion, be a wholly erroneous conclusion.

[81] Further, as White acknowledges in his submissions, even if there had been such a serious breach as to justify repudiation, that would also require a finding that White had signalled his adoption or acceptance of a repudiation. Relying upon **Canada Egg**, supra, White argues that such an "acceptance" ought to be inferred as found in the service of the originating notice (action) and statement of claim he

filed in May, 2000. In my opinion, **Canada Egg**, supra, does not help the cross-appellant's position.

[82] The circumstances in that case were entirely different. The matter arose following a dispute between the parties under a contract providing for the delivery of a substantial quantity of powdered egg yolk and powdered egg albumen. The respondent brought an action against the appellant for a declaration that a valid contract had been entered into between the parties, and claiming damages for an anticipatory repudiation thereof. In February 1951 the appellant agreed to sell and the respondent agreed to buy one hundred thousand pounds of powdered egg yolk to be delivered on July 15, 1951 and July 31, 1951, and ten thousand pounds of powdered egg albumen, delivery to be made as required to March 31, 1952. About the middle of April, the appellant, either because of an inability to buy sufficient eggs, or because it could not purchase eggs at a suitable price, decided it would not carry out its obligations under the contract. The appellant's representatives intimated this likelihood to the respondent during some preliminary discussions and finally on May 7, 1951 declared to the respondent that a valid contract had not been concluded, and that in any event the appellant could not make its deliveries as required. The parties continued to hold without prejudice discussions in May and June 1951 in an attempt to reach an amicable settlement. Ultimately the respondent determined that future negotiations with the appellant would be futile and that it would, as in fact it did, go to the marketplace and buy whatever egg products it could find. However, the respondent did not make known to the appellant, either expressly or by appropriate conduct, that it did not intend to negotiate further, or to go into the market. The respondent issued its statement of claim on June 25, 1951.

[83] Among the several issues to be determined by the Court, the one most central to this case, was whether on June 25, 1951, when the respondent issued its writ, it was open to the respondent to adopt the appellant's repudiation; and if so, did the issuance of the writ on that date constitute an adoption? When Kerwin, C.J.C., declared at ¶ 6:

> Once it is found that the repudiation was still alive, the respondent was not obliged to say in so many words, orally or in writing, that it treated the

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> repudiation as putting an end to the contract, but it was sufficient to bring this action while the matter remained in that position.

the phrase "this action" must surely have been intended to refer to an action alleging repudiation of the contract, by conduct. In this case there was neither an allegation of repudiation by conduct, nor an acceptance of repudiation, pleaded in the original statement of claim filed on May 9, 2000. As noted earlier in these reasons, there was no reference to either circumstance in the defence filed a few weeks later.

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[84] White's alternative submission that correspondence mentioning potential litigation can somehow amount to a repudiation just as effectively (even as counsel prepares, files and serves a statement of claim which pointedly omits to allege repudiation) is unsupported by any authority of which I am aware.

[85] In this case there was no action alleging repudiation until after the issuance of the patent on March 28, 2001, and the amended statement of claim which followed. As is noted in the concurring opinion of Estey, J., in **Canada Egg**, supra, the acceptance of the repudiation must be made "with every reasonable dispatch." In my view, alleging and purporting to accept repudiation in March 2001 in respect of breaches said to have occurred and continued since 1997 or 1998 does not meet such a standard.

[86] Certain scholars treat repudiation as a *type* of anticipatory breach, or discuss fundamental breach, anticipatory breach, and repudiation as being synonymous terms. See, for example, **Chitty on Contracts**, 28th ed. (London: Suite & Maxwell, 1999), Vol. 1; and **G.H.L. Fridman**, ***The Law of Contract in Canada,*** 4th ed. (Toronto: Carswell, 1999). See, as well, the dissenting opinion of MacKeigan, C.J.N.S. in **Canso Chemicals Ltd. v. Canadian Westinghouse Co.** (1974), 54 D.L.R. (3d) 517. This conjunction, as it were, of terms is how it was pitched to the trial judge during counsel's final arguments. For example, EBF's trial counsel said this when dealing with this issue in his final submissions:

> Now, my lord, the next area I was going to get into dealt with the law on fundamental breach . . . Repudiation, my lord, really is a question, as we indicated

> in our brief, of fundamental breach . . . If you decide that royalty payments were due at some point before the issuance of the patent, then what Mr. White will say to you is you then (sic) to say that EBF has demonstrated an intention not to be bound by the terms of that agreement such that they have repudiated and I have elected to treat the contract at an end. That's the contract language for what the issue is before you. On the issue of the calculation of payment . . . that can't possibly be an issue of fundamental breach . . . The only question that is material at all to that is the timing in our submission . . . but not a question of fundamental difference that would justify terminating the contract. So when you look at the time periods during 1997, 1998, 1999 and the year 2000, was EBF, you have to ask yourself, engaged in practice that would demonstrate an intention not to be bound by the contract. Clearly not. They were continuing to move ahead . . . They were making advances to Mr. White. Is that the actions of someone who is snubbing their nose at a contract and saying I'm not going to be bound by this license? No. . . . That's not a fundamental breach. Mr. Bryson has been consistent in his interpretation of when royalties were to be paid. Maybe he was wrong. Does that mean it's a fundamental breach? No. You have to take the next step and say well, if there's something that demonstrates that EBF had no intention to be bound by the terms of that licence agreement as evidenced by the non-payment. No. There is nothing to demonstrate an intention on them, in fact, just the contrary. Clearly this is a company that intended to live up to obligations under the contract and the only issue, only issue when the payment was to be made . . .

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[87] I do not believe McDougall, J. was led astray by the way in which the point was argued. I prefer to deal with repudiation as a different side to the same coin, that being a specific circumstance in law whereby the conduct of the defaulting party will permit the innocent party to treat the contract as discharged, before performance is due or before it has been fully performed. This distinguishes it from a situation where the defaulting party commits what may be termed a fundamental breach. In the former circumstance the conduct of the parties is key. In the latter circumstance the nature of the promise that has been violated and its consequence take on much more significance. See, for example, **M.P. Furmston, Cheshire, Fifoot & Furmston's *Law of Contract*, 11th ed. (London: Butterworths, 1986).**

[88] Repudiation occurs where a party intimates by words or conduct that he does not intend to honour his obligations when they fall due. Repudiation can be either explicit or implicit. It is implicit "where the reasonable inference from the

defendant's conduct is that he no longer intends to perform his side of the contract." **Furmston**, supra, at p. 522.

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[89] What has to be established is that the defaulting party has made his intention clear beyond a reasonable doubt that he no longer intends to perform his side of the bargain. Proof of such an intention requires an investigation into the nature of the contract, the attendant circumstances, and the motives which prompted the breach. **Furmston**, supra, at p. 523. **Furmston** quotes from the case of **Mersey Steel and Iron Co. v. Naylor Benzon & Co.**, (1884) 9 App Cas 434 at 438-439:

> You have to look at the actual circumstances of the case in order to see whether the one party to the contract is relieved from its future performance by the conduct of the other; you must examine what that conduct is so as to see whether it amounts to a renunciation, to an absolute refusal to perform the contract . . .and whether the other party may accept it as a reason for not performing his part.

(Underlining mine)

[90] In order for repudiation to be established there must be acceptance. As Fridman points out in **The Law of Contract in Canada**, supra, at pp. 647-648:

> "An unaccepted repudiation" said Asquit L.J. in one English case, "is a thing writ in water and of no value to anybody; it confers no legal rights of any sort or kind." Although this graphic expression has said to be limited by the facts of the case in which it occurred, the phrase does have some merit, and does put succinctly an important aspect of the law relating to discharge by repudiation or anticipatory breach. Such repudiation will not effectively terminate the contract unless the innocent party does accept the repudiation, and is prepared to treat the contract as ended. The innocent party, in effect, has an election whether or not to treat the contract as continuing or as ended, once the party has committed an act which, in accordance with what has been said above, can be regarded as repudiating the contract.

[91] As to what constitutes "acceptance" of repudiation, the learned authors of **Chitty on Contracts**, supra, observe at 25-012:

> Where there is an anticipatory breach, or the breach of an executory contract, and the innocent party wishes to treat himself as discharged, he must "accept the repudiation." It is usually done by communicating the decision to terminate the party in default although it may be sufficient to lead evidence of an "unequivocal overt act which is inconsistent with the subsistence of the contract...without any concurrent manifestation of intent directed to the other party." Unless and until the repudiation is accepted the contract continues in existence for "an unaccepted repudiation is a thing writ in water." Acceptance of a repudiation must be clear and unequivocal and mere inactivity or acquiescence will generally not be regarded as acceptance for this purpose. But there may be circumstances in which a continuing failure to perform will be sufficiently unequivocal to constitute acceptance of a repudiation. It all depends on "the particular contractual relationship and the particular circumstances of the case."

(Underlining mine)

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[92] While a more detailed enunciation of the principles that guided him would have been helpful, I am satisfied after reviewing the entire record as well as the submissions made by trial counsel that McDougall, J.'s analysis and application of the law was correct. **Children's Aid Society of Cape Breton-Victoria v. J.C. & A.C.**, 2005 NSCA 161.

[93] It appears to me that McDougall, J. had these principles in mind when reviewing the conduct of both Bryson and White, their motives, the nature of the agreement between the parties, and all of the attendant circumstances. I am not persuaded that he erred in his analysis or his ultimate conclusion that a repudiation had not in fact occurred.

[94] His strong findings that there "was never a refusal to pay;" that "White's own approach to payment might have influenced" Bryson's "position that royalties would only be payable once the patent(s) had been granted"; that "White had ample opportunity to demand payment of royalties he felt he was owed but chose not to"; that the parties "might not have agreed on exactly when royalty payments should have begun but clearly there has never been a denial of White's entitlement to receipt of eventual payment"; that White's "conduct in allowing this to continue was tacit acceptance of the timing of payments . . ."; that Bryson "never denied that royalties would eventually be paid"; that White's own conduct contributed to

the misunderstanding that developed"; leading to the judge's conclusion that he did "not think the actions of Bryson as president of EBF amounted to a repudiation" are entirely inconsistent with White's submission that a repudiation had occurred and that he had effectively communicated his acceptance thereof. In light of the trial judge's strong findings, which find support in the record, I see no merit to the cross-appeal and would dismiss it.

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[95] While my own view of the evidence may have led me to a different conclusion with respect to whether or not the contract had been repudiated, that is not the test. Rather, the question is: has the cross-appellant shown that Justice McDougall's determination that the contract was not repudiated and is therefore enforceable, the result of palpable and overriding error? I am not persuaded that it was. This judge had the distinct advantage of seeing and hearing the parties and their witnesses over the course of an eight day trial. Evidently he was not prepared to characterize Bryson's behaviour in the manner White has suggested, and thereby conclude that Bryson's conduct amounted to repudiation. I am unable to find that the trial judge's conclusions that Bryson "never denied that royalties would eventually be paid," that White's "own conduct contributed to the misunderstanding that developed," or declaring "I do not think the actions of Bryson as president of EBF . . . amounted to a repudiation of the licence agreement" arose from an error in principle or a material and obvious error of fact. Consequently I would not disturb the trial judge's finding that the agreement between the parties is still valid and enforceable.

Disposition: The Cross-Appeal

[96] I would therefore dismiss the cross-appeal with costs to the respondent by cross-appeal, EBF, only. I am not persuaded that there were significant added steps taken, nor independent participation on the part of the intervenor FENCE that would warrant its entitlement to separate costs on the cross-appeal.

Conclusion

[97] For all of these reasons I would dismiss the appeal with costs of $10,000 to the respondent White (40% of the costs he was awarded at trial), together with

disbursements as taxed or agreed. I would dismiss the cross-appeal with costs of $6,000 to the respondent by cross-appeal, EBF only, together with disbursements as taxed or agreed.

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Saunders, J.A.

Concurred in:

Bateman, J.A.

Freeman, J.A.

TAB 8

Court of Queen's Bench of Alberta

Citation: Tirecraft Group Inc. v. High Park Holdings ULC, 2010 ABQB 653

2010 ABQB 653 (CanLII)

Date: 20101014
Docket: 0903 05810
Registry: Edmonton

Between:

Tirecraft Group Inc. by Ernest & Young Inc., Its Court Appointed Receiver and Manager

Applicant

\- and -

High Park Holdings ULC, Metplas Holdings Inc., Tire Industries Inc., Anastasios Votis, and George Votis

Respondents

Memorandum of Decision
of the
Honourable Mr. Justice K.D. Yamauchi

I. INTRODUCTION

[1] Tirecraft Group Inc. by Ernst & Young Inc., its court-appointed receiver and manager (the "Applicant") is the applicant in these proceedings. It seeks an Order requiring the Respondents to respond to certain questions that arose during the examinations for discovery of the Respondents Anastasios Votis and George Votis (collectively, the "Votises"). As well, it seeks to have the Respondents provide undertakings taken under advisement and to provide more adequate and complete responses to undertakings the Respondents did provide.

[2] The Applicant argues that the information it seeks is relevant and material to issues that are in dispute between the parties. The first issue is whether the corporate Respondents are the alter egos or agents of the individual Respondents, Anastasios Votis ("Anastasios") and George

Votis ("George"). The second issue, which was raised by the Respondents in their statement of defence, is whether the Applicant is estopped from raising or relying on the breach of a management fee agreement in establishing its claim against the Respondents.

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[3] The Respondents, on the other hand, argue that the Votises refused to provide the information the Applicant seeks, because the questions and undertakings are not relevant to the issues raised by the pleadings, they constitute a fishing expedition and they are simply a disguised attempt to conduct a pre-judgment examination-in-aid of enforcement.

II. FACTS

[4] The Applicant commenced this action by way of a statement of claim it filed on April 21, 2009 (the "Statement of Claim"). The Respondents filed a statement of defence and counterclaim on May 29, 2009 (the "Statement of Defence and Counterclaim"). The Applicant filed a reply and defence to counterclaim June 16, 2009.

The Statement of Claim alleges, *inter alia*, that:

(a) Anastasios is the sole director and sole controlling shareholder of the Respondents Metplas Holdings Inc. ("Metplas") and Tire Industries Inc. ("Tire Industries");

(b) George is the sole controlling shareholder of the Respondent High Park Holdings ULC ("High Park");

(c) The Votises were directors of Tirecraft Group Inc. ("TGI");

(d) High Park and Anastasios were shareholders of TGI, collectively controlling 53.13% of TGI's voting shares;

(e) On or about June 1, 2005, TGI entered into a management fee agreement with its shareholders, including Tire Industries, High Park and Anastasios (the "Agreement"). In the Agreement, TGI's payment of management fees to its shareholders or their appointees was expressly stated to be conditional on:

(I) TGI being in compliance with the financial covenants and in material compliance with all other covenants set forth in a senior lender credit agreement at the time TGI made such payments; and

(ii) TGI having achieved certain performance targets as defined in the Agreement;

(f) On or about September 17, 2007, through September 19, 2007, at the Respondents' direction and in contravention of the terms of the Agreement, TGI paid

management fees to corporations controlled by the Votises at a time when these individuals were TGI's directors and directly or indirectly controlled TGI's voting shares;

(g) In addition, TGI improperly paid management fees to High Park, Metplas and Tire Industries:

(I) at a time when TGI was insolvent or on the eve of insolvency to the knowledge of TGI and the Respondents;

(ii) with the intent and effect of defeating, hindering, delaying or prejudicing the rights of TGI's creditors; or

(iii) with the intent and effect of preferring certain of the Respondents;

(h) Metplas, Tire Industries and High Park were at all material times the Votises' agents or alter egos. Therefore, the court should pierce the corporate veil and hold the Votises personally liable for repayment of the management fees that were improperly paid to the corporations they controlled.

[5] The Respondents defend this action on, *inter alia*, the following bases, which are contained in the Statement of Defence and Counterclaim:

(a) The management fees that TGI paid to Metplas, Tire Industries and High Park were owing to them and were properly paid pursuant to the Agreement;

(b) Even if the payment of the management fees was a breach of the Agreement, the Applicant is estopped from raising or relying on the breach;

(c) The Respondents repaid, directly or indirectly, the management fees to TGI in the fall of 2007; and

(d) TGI owes the Respondents, in their capacity of plaintiffs by counterclaim $5 million in relation to a series of advances that they provided to TGI between June 1, 2007 and October 31, 2007.

[6] The Applicant examined Anastasios for discovery, in his individual capacity and as the officer for Metplas and Tire Industries, on January 26, 2010. The Applicant examined George for discovery, in his individual capacity and as the officer for High Park., on April 28, 2010

[7] The questions to which the Respondents objected and the undertakings they took under advisement or refused to provide, relate to:

(a) financial information related to Metplas, Tire Industries and High Park;

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(b) what the recipients of the management fees did with the money after they received it;

(c) the identities of parties closely related to the corporate Respondents; and

(d) Metplas's execution of the Agreement.

III. ISSUES

[8] The issues before this Court on this special chambers application are:

(a) whether the questions that the Applicant posed are relevant and material to this action, entitling the Applicant to responses and disclosure of documents; and

(b) whether the responses to the questions and undertakings given are complete.

IV. DISCUSSION

[9] The *Alberta Rules of Court*, Alta. Reg. 390/68 (the "*Rules*"), limit the scope of the questions a person must answer during an examination for discovery, by providing:

> 200 (1.2) During the oral examination under subrule (1), a person is required to answer only relevant and material questions.

[10] The *Rules* also provide us with a description of the terms "relevant and material," when they say:

> 186.1 For the purpose of this Part, a question or record is relevant and material only if the answer to the question, or if the record, could reasonably be expected
>
> (a) to significantly help determine one or more of the issues raised in the pleadings, or
>
> (b) to ascertain evidence that could reasonably be expected to significantly help determine one or more of the issues raised in the pleadings.

[11] Rule 186.1 tells us that the starting point for our determination of the issues before this Court are the pleadings. The Alberta Court of Appeal provided us with further fine-tuning of the meaning of the term "relevant and material" in ***NAC Constructors Ltd. v. Alberta (Capital Region Wastewater Commission***, 2006 ABCA 246, 63 Alta. L.R. (4th) 19 at paras. 12-13, when it said:

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> 12 Oral examination for discovery is now confined to eliciting facts of primary relevance, that is, facts that are directly in issue, or of secondary relevance, that is, facts from which the existence of the primary facts may be directly inferred. Both primary and secondary relevance are determined by reference to the issues raised by the pleadings. Questions seeking information that could reasonably be expected to lead to facts or records of secondary relevance (that is, questions asking for information that is only of tertiary relevance) need no longer be answered.
>
> 13 In addition to being relevant within the meaning of Rule 186.1, information sought on discovery must be material, that is, be reasonably expected to "significantly" help determine one or more of the issues raised in the pleadings. The materiality of evidence refers to its pertinency or weight in relation to the issue it is adduced to prove: *Black's Law Dictionary*, (6th ed. 1990). Facts or documents may be relevant within Rule 186.1, but, either alone or in combination with other evidence, be of no significant help to the examining party in proving or disproving a fact in issue. As Slatter J. observed in *Weatherill Estate v. Weatherill* (2003), 337 A.R. 180, 2003 ABQB 69 (Alta. Q.B.), at para. 17, "... relevance is determined by the pleadings while materiality is more a matter of proof ...". See also *Tolko Industries Ltd. v. Railink Ltd.* (2003), 14 Alta. L.R. (4th) 388, 2003 ABQB 349 (Alta. Q.B.), at para. 6.

[12] It is worthwhile for this Court to provide Justice Slatter's entire quotation from ***Weatherill Estate v. Weatherill*** (2003), 337 A.R. 180, 2003 ABQB 69 at paras. 16-17, as it provides us with considerable guidance when examining the issues before this Court. He said [emphasis added]:

> 16 In determining whether a document is relevant and material, the starting point is the pleadings. The pleadings define the issues, and relevance must be determined with respect to the issues. The pleadings are also relevant with respect to the issue of materiality. However, with respect to materiality one must also have regard to the issue in question. Where does the burden of proof lie? Is the issue something that is capable of direct proof, or is it something like a person's state of mind, which can only be proven indirectly? Does one party essentially have to try and prove a negative? How are cases of this type usually proven at trial? The less amenable a fact is to direct proof, the wider will be the circle of materiality. There are some facts that can only be proven by essentially eliminating all the competing scenarios, thereby leaving the fact in issue as the sole logical inference. When a state of mind is in issue, it can generally only be proven by demonstrating a pattern of conduct of the person whose state of mind it is. In deciding whether a particular document is material, one must take a very pragmatic view, viewing the situation from the perspective of the party who must prove the fact in question. At an interlocutory stage of proceedings, the Court should not measure counsels' proposed line of argument too finely; if counsel can

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> disclose a rational strategy in which the disputed document plays a material part, that should be sufficient. Again it must be remembered that the purpose of the Rule was to avoid abusive, excessive, and unnecessarily expensive discovery, not to cut off legitimate lines of inquiry.
>
> 17 That relevance is determined by the pleadings, while materiality is more a matter of proof can be seen by the wording of the Rule. The Rule talks about records that can "help determine" an issue, or that can "ascertain evidence" that will determine an issue. These are words of proof, and materiality must be determined with that in mind.

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[13] The Applicant argues that it requires the information it requests, so that it may establish a case for the court to "pierce" the various corporate veils that the Votises have established and impose liability on the Votises personally. The concept of a "corporate veil" is very old and well-established, see *e.g.* ***Salomon v. Salomon***, [1897] A.C. 22 (H.L.); ***Lee v. Lee's Air Farming Ltd.***, [1961] A.C. 12 (P.C.). In fact, the *Business Corporations Act*, R.S.A. 200, c. B-9, ss. 16 and 46(1) recognize this concept.

[14] The Applicant cited ***Kosmopoulos v. Constitution Ins. Co. of Canada***, [1987] 1 S.C.R. 2 at para. 12, to support its position that a court may lift the corporate veil when a corporate entity is a "mere 'agent' or 'puppet' of its controlling shareholder or parent corporation." It is important to note the context in which the court made this statement. The court said that, "The law on when a Court may disregard [the separate legal entity principle] ... follows no consistent principle." The court went on to say:

> The best that can be said is that the "separate entities" principle in not enforced when it would yield a result "too flagrantly opposed to justice, convenience or the interests of Revenue": L.C.B. Gower, *Modern Company Law* (4th ed., 1979) at p. 112.

[15] The Applicant also provided this Court with ***Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.***, 1996 CarswellOnt 1699, (1996), 28 O.R. (3d) 423 (Ct. Jus. (Gen Div.)), aff'd 1997 CarswellOnt 3496, [1997] O.J. No. 3754 (C.A.). In that case, Justice Sharpe said, at para 16:

> 16 It was conceded in argument that no case since *Kosmopolous* has applied the preferred "just and equitable" test. In *Kosmopolous* itself, the Supreme Court, including Wilson J., rejected the submission that the corporate veil be lifted. Moreover, it will be noted that Wilson J. does not use the phrase "just and equitable" but rather quotes a passage from an English text which describes the test in must more stringent terms.

[16] The ***Transamerica*** court went on to say at paras. 22-23 [citations excluded]:

> 22 As just indicated, the courts will disregard the separate legal personality of a corporate entity where it is completely dominated and controlled and being used as a shield for fraudulent or improper conduct. The first element, "complete control", requires more than ownership. It must be shown that there is complete domination and that the subsidiary company does not, in fact, function independently ...
>
> 23 The second element relates to the nature of the conduct: is there "conduct akin to fraud that would otherwise unjustly deprive claimants of their rights?" ...

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[17] The ***Transamerica*** court did not find either of these elements and therefore refused to pierce the corporate veil.

[18] The pleadings do not allege fraud on the part of the Votises, although there is reference to "improper conduct." As well, the pleadings use terminology that one finds in the *Fraudulent Preferences Act*, R.S.A. 2000, c. F-24, although the Applicants do not use the term "fraud" or "fraudulent."

[19] A stronger statement that attempts to identify when a court will pierce the corporate veil was made in ***Clarkson Co. Ltd. v. Zhelka*** (1967), 64 D.L.R. (2d) 457 at paras. 83-84 (Ont. H.C.), where the court said:

> 83 If a company is formed for the express purpose of doing a wrongful or unlawful act, or, if when formed, those in control expressly direct a wrongful thing to be done, the individuals as well as the company are responsible to those to whom liability is legally owed.
>
> 84 In such cases, or where the company is the mere agent of a controlling corporator, it may be said that the company is a sham, cloak or alter ego, but otherwise it should not be so termed.

[20] Despite this very strong statement, the ***Zhelka*** court did not find a case for piercing the corporate veil, even though the court said at para. 86, that this case may be "close to the line." It found that the controlling shareholder entered into the impugned transaction with the intention of protecting lands from creditors and others having claims against the corporation in whose name the lands were originally registered.

[21] When will a court find the corporation to be a "sham, cloak or alter ego" and pierce the corporate veil? Courts have found the following factors to be significant:

(a) the shareholder treats itself and the corporation interchangeably, ***Yang v. Overseas Investments (1986) Ltd.*** (1995), 26 Alta. L.R. (3d) 223 (Q.B.);

(b) the corporation is merely created to deflect monies from their proper usage, ***Shillingford v. Dalbridge Group Inc.*** (1996), 197 A.R. 56 at para. 27(Q.B.);

(c) the shareholder intermingles the corporation's affairs with its own, such that the shareholder fails to recognize the corporation's separate identity, ***Pelliccione v. John F. Hughes Contracting & Development Co.*** (1995), 47 C.L.R. (3d) 104 at para. 104 (Ont. S.C.J.)

(d) the shareholder treats corporate property as though it belongs to the shareholders without regard for the interests of those dealing with the corporation, K.P. McGuinness, *The Law and Practice of Canadian Business Corporations* (Toronto: Butterworths, 1999) as reproduced in ***Pelliccione*** at para. 97.

[22] Other cases have found further factors that might be significant when a court assesses whether a corporation is merely the agent or alter ego of its shareholder:

(a) whether the corporation was independent from its shareholders, ***Shillingford*** at para. 28; ***Frankel Structural Steel Ltd. v. Goden Holdings Ltd.***, [1971] S.C.R. 250 at para. 11;

(b) whether the corporation has its own assets, skills or employees, ***Shillingford*** at para. 28; and

(c) whether the corporation has its own bank account, books or records, ***Frankel*** at para. 10.

It should be noted that there are other instances in which the court will pierce the corporate veil, such as when persons hold themselves out to the public without identifying their corporate status, see *e.g.* ***Wolfe v. Moir*** (1969), 69 W.W.R. 70 (Alta S.C.); ***CHED-CKNG FM v. Goose Loonies Inc.*** (1995), 31 Alta. L.R. (3d) 242, 172 A.R. 117 (Master). That situation is not relevant in the case at Bar.

[23] When one parses through the various tests and criteria courts have established to determine whether they will pierce the corporate veil, they all come down to the "persuasive argument" that Justice Wilson provided us in ***Kosmopoulos*** at para. 13, where she said:

> 13 There is a persuasive argument that "those who have chosen the benefits of incorporation must bear the corresponding burdens, so that if the veil is to be lifted at all that should only be done in the interests of third parties who would otherwise suffer as a result of that choice": Gower, *supra*, at p. 138 ...

[24] Our legislation and the common law have allowed persons to incorporate for various reasons, such as tax planning and separating corporate affairs from personal affairs. One could say that the taxing authorities or those who contract with corporations "suffer" as a result of the

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promoter's choice in business structure. The difference, however, is that the taxing authorities, who are, after all a branch of government, and those who contract with corporations, go in with their eyes open. They know that corporations get favourable tax rates and promoters can defer payment of tax on income while that income rests in the corporation. They know that when they contract with a corporation their remedies are limited to corporate assets on a breach and they cannot reach through or pierce the corporate veil.

[25] It is only when the promoter uses the corporate structure as a cloak, sham or alter ego in such a way as to perform a wrongful, unlawful, fraudulent or improper act that causes third parties to suffer, will a court pierce the corporate veil. This is a very narrow opening. Perhaps that is why the courts have established "no consistent principles" since Justice Wilson's *obiter dictum* in ***Kosmopoulos***. Generally, each case differs on its facts and, especially in the case of an interlocutory application, courts simply have not enough information to make a rationale decision. This Court is simply not in a position to make very important findings of fact required to determine whether the Applicants have made out a case for piercing the corporate veil.

[26] However, that is not what the *Rules* require this Court so to do. It requires this Court to determine whether the questions are "relevant and material ... to significantly determine one or more of the issues raised in the pleadings, Rule 186.1. However, this Court must be cautious not to allow the Applicant to go on a fishing expedition to find some evidence to support the allegations it is making, ***Franco v. Hackett***, 2000 ABQB 241 at para. 34. There must be some underlying foundation on which it is basing its allegations in the first place.

[27] The Applicant has broken the questions down into 3 distinct categories and this Court will analyze those questions using those categories. However, the Respondents provided this Court with the actual questions the Applicants posed during the examinations for discovery. This Court finds it useful to list those particular questions under the categories the Applicant provides.

Management Agreement Questions

[28] The questions the Applicants asked of Anastasios, which he refused to answer were:

Whether Anastasios understood that Metplas signed the Agreement.

Whether anyone signed the Agreement on behalf of Metplas.

Whether Metplas was a party to or signatory of the Agreement.

[29] The Applicant alleges that Metplas received management fees from TGI. These questions relate to the technical aspect of whether Metplas signed the agreement and whether Metplas was a party to the agreement. These questions do not relate to any of the issues raised in the pleadings. Even when this Court looks at the Agreement, it sees that Metplas was not a signatory to the Agreement.

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[30] Whether Metplas was an alter ego or agent of Anastasios will not be addressed through responses to these questions. Those issues are better addressed through other evidence. The Respondents need not answer these questions.

Questions Related to the Identity of Certain Individuals or Entities

[31] The questions the Applicant asked of Anastasios, which he refused to answer were:

What were the names of the accountants for Metplas?

What were the names of the Metplas employees other than Anastasios?

[32] The questions the Applicants asked of George, which he refused to answer were:

The names of High Park's accountants, bank, and subcontractors and the name of George's personal accountant.

Whether High Park had contracts other than those dealing with TGI business.

[33] The Applicant argues that it requires this information to determine the true relationship among the various corporations, their shareholders and the Votises. It argues that if the corporate and individual defendants shared accountants, employees and banks, this *may* be relevant and material to determining whether these corporations are mere shells, with no other purpose but to act as the agents or alter egos of the Votises. The Respondents argue that the accountants and employees are irrelevant.

[34] The names of the various parties' accountants are not relevant or material. Entrepreneurs and their respective corporations often use the same accountants, and lawyers, for that matter, for all of their business and personal needs. Assuming one or all of them shared the same accountants, this does not show that they are dong anything improper or fraudulent. One could argue the converse, as well. Just because they had separate accountants, does not mean that they are not doing something improper or fraudulent.

[35] Whether Metplas had other employees besides Anastasios is also neither relevant nor material. In fact the classic case of ***Lee's Air Farming*** involved a case of a single shareholder, director, officer and employee and the court held that the corporation was a separate legal entity from the individual. In ***Shillington*** at para 28, Justice Perras referred to the corporation in that case as having "no assets, skills or employees." These must be taken together. In other words, the corporation in that case had none of these. This factor helped His Lordship determine at para. 27, that the individuals created the corporation as a "vehicle to hide behind as they deflected monies from their proper usage." In other words, third parties "suffered" as a result of this.

[36] The same can be said for subcontractors and contracts other than those dealing with TGI's business. Whether High Park had subcontractors or other contracts is neither material nor

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relevant to the issue of whether the court can pierce the corporate veil. Corporations may simply be a conduit through which a promoter can contract with others and retain earnings. The legislation permits this, as do the taxing statutes. It is only when third parties suffer that a court will step in.

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[37] The banks with which the Respondents conduct their business may be relevant and material. Although this might be better dealt with in the next section, how funds flowed between or among the parties might be relevant and material to the issues set forth in the pleadings. It is not so much the bankers, but the banking statements that will arise from disclosure (or undertakings) that might be of assistance to the trial court. Accordingly, this Court directs that George must answer this question.

Questions Regarding High Park's and Metplas's Financial Information

[38] The Applicant seeks the following:

Metplas's income tax return for 2007 and financial statements for 2005, 2006 and 2007

High Park's income tax returns for 2006 and 2007

A response to the question whether High Park had prepared financial statements for 2005, 2006 and 2007 and an undertaking to provide them

Advice as to what High Park did with the funds it received in 2007 and whether they were declared as income

Advice as to whether High Park declared the management fees as income in 2007.

[39] This is a financial case, in the sense that it has to do with the flow of money. The only way for the trial court to determine whether the Applicant has made out the allegations contained in the Statement of Claim is to look at the flow of money, where it went, to whom and when. Not only does the Applicant want to determine whether monies were properly paid under the Agreement, the Respondents have defended and counterclaimed, based on the flow of money. They say that they repaid, directly or indirectly, the management fees to TGI in the fall of 2007. As well, they claim that TGI owes them, in their capacity of plaintiffs by counterclaim, $5 million in relation to a series of advances that they provided to TGI between June 1, 2007 and October 31, 2007. The trial court will not be in a position to answer these questions without the information the Applicant seeks. Not to allow the Applicant to obtain this information would require the trial court to attempt to guess at the information that is contained in the financial records. All the cases that deal with the issue of piercing the corporate veil say that each case depends on its unique facts. The trial court will need evidence to determine those unique facts in this case and the foundation on which that evidence is built will be that obtained from the examinations for discovery.

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[40] The Applicant has established "that the information which could be obtained from such returns or [statements] is relevant to the pleadings and the relief sought by them," ***Agrios v. Mediavision Inc.*** (1982), 19 Alta. L.R. (2d) 74, [1982] A.J. No. 591 at para. 22 (Q.B.), aff'd without written reasons 22 Alta. L.R. (2d) xxxvi (C.A.). This is not a pre-trial examination-in-aid of enforcement. The flow of funds is the very nature of this action.

[41] The Respondents argue that the Applicant should be estopped from relying on the Agreement, when it attempts to establish its claim. The actual wording of this argument is contained in paragraph 7 of the Statement of Defence and Counterclaim, which says:

> 7. If payment of the management fees was a breach of the Management Fee Agreement, which is denied, the breach was that of TGI and not of any of these Defendants, and TGI and its receiver are estopped from raising or relying upon the breach.

[42] The Applicant argues that for the Respondents to prove estoppel, they must demonstrate: (i) that TGI made a representation or promise that was intended to affect the parties' legal relationship; and (ii) that the Respondents relied on the representation, such that its position was altered, ***Maracle v. Travellers Indemnity Co. of Canada***, [1991] 2 S.C.R. 50. In ***Capital City Oil Well Servicing Co. v. Non-Marine Underwriters, Lloyd's London***, 1959 CarswellAlta 10; 27 W.W.R. 241 at para. 29 (S.C.), Justice Greschuk added the element of "detriment" in the sense that the Respondents, in the case at Bar, must have altered their position to their detriment, quoting ***Greenwood v. Martins Bank Ltd.***, [1933] A.C. 51 at 57, 101 LJKB 622 and ***Morgan v. Boles***, [1946] 1 W.W.R. 1 at 6.

[43] These principles arise from ***Carr v. London and Northwestern Railway Co.***(1875), L.R. 10 C.P. 307 at 316-317, which are as follows:

> One such proposition is, if a man by his words or conduct wilfully endeavours to cause another to believe in a certain state of thing which the first knows to be false, and if the second believes in such state of things, and acts upon his belief, he who knowingly made the false statement is estopped from averring afterwards that such a state of things did not in fact exist ...
>
> Another recognized proposition seems to be that if a man, either in express terms or conduct, makes a representation to another of the existence of a certain state of facts which he intends to be acted upon in a certain way, and it be acted upon in that way, in the belief of the existence of such a state of facts, to the damage of him who so believes and acts, the first is estopped from denying the existence of such a state of facts.
>
> And another proposition is that if a man, whatever his real meaning may be, so conducts himself that a reasonable man would take his conduct to mean a certain representation of facts and that it was a true representation, and that the latter was

> intended to act upon it in a particular way, and he with such belief does act in that way to his damage, the first is estopped from denying that the facts were as represented.

[44] In ***People's Bank of Halifax v. Estey***, 1904 CarswellNB 55, 34 S.C.R. 429 at para. 43, Justice Nesbitt refers to these as the "three celebrated rules" that deal with estoppel.

[45] In the case at Bar, this Court understands the Respondents' argument to be that TGI's conduct in making the payments to the Respondents amounted to a representation that TGI was in a position to make the payments. The Respondents received the payments unconditionally and for their absolute use. The Respondents, relying on that representation, accepted the payments and thereby altered their financial positions. To now require them to repay those monies would be detrimental to the Respondents.

[46] The Respondents argue that if the Applicant wants to determine whether the Respondents altered their position in reliance on TGI's representations, it should "simply ask that question." That gets us no where because, undoubtedly, the Respondents will respond in the affirmative. The trial court will require evidence that supports that response and that evidence will be in the form of the Respondents' financial information, as contained in income tax returns and financial statements. Thus, this information is relevant and material to significantly help the trial court determine the estoppel issue that the Respondents themselves raised.

[47] In ***Capital City*** at para. 31, Justice Greschuk went on to say that when acting on the representation, "the party to whom it is made must alter its position to its prejudice." At this moment, and without the benefit of detailed evidence, this Court finds it difficult to see how the Respondents altered their positions to their prejudice. They have had the use of the funds from the date they received them. If they wrongly received the funds, they will suffer no prejudice by having to return them. This Court, and the trial court that hears this matter, cannot answer any of these questions without further information.

[48] Finally, we must remember that Anastasios and George were directors of TGI and held the majority of TGI's voting shares. The Respondents do not contest this. Thus, it is difficult to see how they could now argue that they are somehow prejudiced by TGI's payment of management fees. Justice Davies in ***People's Bank*** said, at paras. 16-17:

> 16 This is after all only an elaboration of the doctrine laid down by Ashhurst J. in the well known case of *Lickbarrow v. Mason*, 2 T.R. 63 , where he says:
>
>> We may lay it down as a broad general principle that wherever one of two innocent persons must suffer by the acts of a third he who enables such third person to occasion the loss must sustain it.
>
> 17 And see 6 Am. & Eng. Enc., p. 482. In *Henderson & Co. v. Williams*, [1895] 1 Q.B. 521, the present Lord Chancellor, Halsbury, adopts the language of

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Savage C.J. in *Root v. French*, 13 Wend. 570, who in speaking of a *bonâ fide* purchaser who has purchased property from a fraudulent vendee and given value for it, says:

> He is protected in doing so upon the principle just stated that when one of two innocent persons must suffer from the fraud of a third he shall suffer who by his indiscretion has enabled such third person to commit the fraud. A contrary principle would endanger the security of commercial transactions and destroy that confidence upon which what is called the usual course of trade materially rests.

[49] Accordingly, the Votises will respond to these questions and provide the financial information the Applicant seeks.

V. SUMMARY

[50] In summary, the Respondents need not answer any questions concerning:

(a) Metplas's signing of the Agreement or Anastasios's understanding of whether Metplas signed the Agreement;

(b) questions as to the names of Metplas's accountants and employees; or

(c) questions as to the names of High Park's accountants and subcontractors or whether High Park had contracts other than those dealing with TGI business.

[51] However, the Respondents must respond to questions regarding High Park's financial information and Metplas's financial information, including:

(a) what High Park did with the funds it received in 2007 and whether they were declared as income;

(b) whether High Park declared the management fees as income in 2007; and

(c) the name of High Park's bank.

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[52] As well, the Respondents must produce:

(a) Metplas's income tax return for 2007 and financial statements for 2005, 2006 and 2007;

(b) High Park's income tax returns for 2006 and 2007; and

(c) High Park's financial statements for 2005, 2006 and 2007.

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Heard on the day of 5th of October, 2010.
Dated at the City of Edmonton, Alberta this 14th day of October, 2010.

K.D. Yamauchi
J.C.Q.B.A.

Appearances:

Aldo Argento
Macleod Dixon LLP
for the Applicant

Wendy Thiessen
Bishop and MacKenzie LLP
for the Respondents

TAB 9

Apart from the lack of evidence to support the defendant's position, the plaintiffs say that restitution was not pleaded in the counterclaim. Had such a claim been made then the plaintiffs could have anticipated that claim and would have been prepared to meet it through the discovery process.

The plaintiffs' position on both counts is well founded. I accept that the evidence does not show a benefit accrued either to the lands or to the plaintiffs from the defendant's efforts. I also find that, in the absence of pleadings covering the issue, it is too late now to raise the matter of restitution.

In my original reasons I said this [reported 23 R.P.R. (2d) 258 at p. 275, [1992] 4 W.W.R. 357, 66 B.C.L.R. (2d) 146]:

> I direct the defendant to convey the property to the plaintiffs and direct the plaintiff Canada Mortgage and Housing Corporation to discharge the mortgage. This aspect of the order was not canvassed in argument, and if counsel wish to make submissions on the point, I will hear them.

One of the consequences of the order that I did not contemplate, as the matter had not been raised, was the loss to the defendant of property purchase tax ($308,800) which was paid by it at the time of the conveyance. This was paid to another arm of the plaintiff Her Majesty the Queen. When the property is reconveyed to that plaintiff the Crown, as purchaser, will be exempt from paying the tax. If the Crown is not ordered to return that tax, it will be retaining tax recovered from a void transaction. It is fair to order that the Crown return the tax to the defendant, and I do so in this case only because both parties are represented before me and have made submissions on the point.

That is a very different issue to that of property taxes paid by the defendant to the District of North Vancouver. In that case the defendant will have to petition the district for relief. Even if I were inclined to do so, I cannot make a comparable order as the district is not a party to these proceedings.

In conclusion, I direct that in addition to returning the sum of $2 million plus interest to the defendant, the plaintiff Crown will return the property purchase tax of $308,800, together with interest at the Registrar's rates from the date it was paid.

Order accordingly.

Re Canada Deposit Insurance Corp. and Canadian Commercial Bank

[Indexed as: Canada Deposit Insurance Corp. v. Canadian Commercial Bank]

Court File No. 22084

Supreme Court of Canada, La Forest, L'Heureux-Dubé, Gonthier, Cory, McLachlin, Stevenson and Iacobucci JJ. November 19, 1992.*

Debtor and creditor — Priorities — Loan or capital investment — Investors advancing money in attempt to preserve solvency of bank — Agreement that investors to purchase certain assets and to be repaid from assets and from income — Investors having right to purchase shares in bank — Bank becoming insolvent — Investors entitled to rank as creditors.

In an effort to preserve the solvency of the respondent bank, a participation agreement was entered into among the Governments of Canada and Alberta, the Canada Deposit Insurance Corp. and six other banks. The agreement set out a sale by the respondent to the participants of a portfolio of assets comprising loans made by the respondent that were unlikely to be recovered. Repayment was to be made by the respondent out of portfolio assets and out of pre-tax income. It promised an indemnity equal to the price paid, and, in case of insolvency, the indemnity was to be owed as a debt. The participants also had a right to subscribe for shares in the respondent at a named price subject to the approval of shareholders and of the Minister of Finance, and to an amendment of the law. If this aspect of the agreement could not be carried out, interest was payable at the prime rate. The respondent became insolvent and the question arose whether the participants were entitled to rank *pari passu* with the other unsecured creditors. By s. 3 of the *Partnerships Act*, R.S.O. 1990, c. P.5: "The receipt by a person of a share of the profits of a business is proof, in the absence of evidence to the contrary, that the person is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him or her a partner in the business, and in particular, (*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such . . . (*d*) the advance of money by way of loan to a person engaged or about to engage in a business on a contract with that person that the lender is to receive a rate of interest varying with the profits, or is to receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business . . .". By s. 4: "In the event of a person to whom money has been advanced by way of loan upon such a contract as is mentioned in s. 3 . . . the lender of the loan is not entitled to recover anything in respect of the loan . . . until the claims of the other creditors . . . are satisfied."

On an application to determine the question, the judge held that the participants were entitled to their proportionate shares of the money recovered from the portfolio assets, but not to make any claim against the other assets until the other unsecured creditors had been paid in full. The participants appealed successfully to the Alberta Court of Appeal.

* Stevenson J. took no part in the judgment.

On further appeal to the Supreme Court of Canada, **held**, the appeal should be dismissed.

The transaction was, in substance, a loan and not a capital investment, the equity component being incidental to the main features of the transaction. Section 4 of the *Partnerships Act* did not apply since the participants' only entitlement was to repayment of principal and (in one circumstance) interest at the prime rate, and accordingly they were not to receive a rate of interest varying with the profits, or a share of the profits. The word "contract" in s. 4 did not apply to a transaction of the sort described in s. 3, para. 3, cl. (*a*). Even if the court had a general equitable power to subordinate one class of creditors to others, there was no ground for the exercise of such a power in this case.

Cases referred to

Laronge Realty Ltd. v. Golconda Investments Ltd. (1986), 63 C.B.R. (N.S.) 74, 7 B.C.L.R. (2d) 90; *Re Dickie Estate* (1925), 5 C.B.R. 214; *Re Meade*, [1951] 1 Ch. D. 774; *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France*, [1975] 2 All E.R. 390; *Sukloff v. A.H. Rushforth & Co.* (1964), 45 D.L.R. (2d) 510, [1964] S.C.R. 459, 6 C.B.R. (N.S.) 175; *Grace v. Smith* (1775), 2 Black W. 997, 96 E.R. 587; *Waugh v. Carver* (1793), 2 H. Bl. 235, 126 E.R. 525; *Cox v. Hickman* (1860), 8 H.L.C. 268, 11 E.R. 431; *Ex p. Taylor; Re Grason* (1879), 12 Ch. D. 366; *Re Stone* (1886), 33 Ch. D. 541; *Re Hildesheim*, [1893] 2 Q.B. 357; *Re Mason*, [1899] 1 Q.B. 810; *Re Fort; Ex p. Schofield*, [1897] 2 Q.B. 495; *Re Young; Ex p. Jones*, [1896] 2 Q.B. 484; *Re Mobile Steel Co.*, 563 F. 2d 692 (1977); *Re Multiponics Inc.*, 622 F. 2d 709 (1980)

Statutes referred to

Act to Amend the Law of Partnership, 1865 (U.K.), c. 86
Bank Act, S.C. 1980-81-82-83, c. 40
Bank Act, R.S.C. 1985 c. B-1 [repealed by s. 604 of, and replaced by 1991, c. 46], ss. 132, 173, 174, 277
Bankruptcy Act, R.S.C. 1970, c. B-3, s. 98 — now R.S.C. 1985, c. B-4, s. 139
Partnership Act, 1890 (U.K.), c. 39, ss. 2(3)(*d*), 3
Partnership Act, R.S.O. 1990, c. P.5, ss. 3, para. 3, cls. (*a*), (*b*), (*d*), 4
Winding-up Act, R.S.C. 1970, c. W-10
Winding-up Act, R.S.C. 1985, c. W-11, ss. 93 to 95

APPEAL from a judgment of the Alberta Court of Appeal, 69 D.L.R. (4th) 1, 107 A.R. 199, 74 Alta. L.R. (2d) 69, 21 A.C.W.S. (3d) 159, allowing an appeal and dismissing a cross-appeal from a judgment of Wachowich J., 46 D.L.R. (4th) 518, 67 C.B.R. (N.S.) 136, 83 A.R. 122, 56 Alta. L.R. (2d) 244, 8 A.C.W.S. (3d) 53, on an application to determine a question of priorities on the winding-up of the Canadian Commercial Bank.

Charles P. Russell, for appellant.
James Rout, Q.C., for respondent, Her Majesty the Queen in right of Alberta.
Colin L. Campbell, for respondent banks.
Earl A. Cherniak, Q.C., and *Robert J. Morris*, for general body of creditors.

The judgment of the court was delivered by

IACOBUCCI J.:—In September of 1985, the Canadian public witnessed what fortunately has been an infrequent occurrence in Canadian banking. Early that month, a chartered bank known as the Canadian Commercial Bank ("C.C.B.") became insolvent and was ordered to be wound up pursuant to the provisions of the *Winding-up Act*, R.S.C., 1985, c. W-11 (formerly R.S.C. 1970, c. W-10). This appeal concerns the characterization of the unique and complex financial arrangement entered into by the Governments of Canada and of Alberta, six major Canadian financial institutions, the Canadian Deposit Insurance Corporation ("C.D.I.C.") and C.C.B. in the spring of 1985 in an attempt to prevent its winding-up. The main issue is whether, in substance, the $255 million advanced to C.C.B. under this arrangement was in the nature of a loan, in which case the "lenders" thereof would rank *pari passu* with the other unsecured creditors of C.C.B., or whether it was in the nature of a capital investment in the business of C.C.B., in which case such unsecured creditors would have priority over the "investors". If the former characterization is adopted, as I believe it should be, subsidiary issues concerning the postponement of claims under s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P.5, and the doctrine of equitable subordination are also raised.

I
FACTS

Although they are relatively uncomplicated, the facts of this case are rather extensive and warrant a full review. C.C.B. was a chartered bank involved primarily in commercial lending. In early 1985, C.C.B. faced a solvency crisis owing to a sharp deterioration in its loan portfolio. Many of its outstanding loans had become non-performing. On March 14, 1985, C.C.B.'s chief executive officer reported this crisis to the Office of the Inspector General of Banks and announced the inability of C.C.B. to continue in operation without outside assistance. At the request of the Governor of the Bank of Canada, a government and banking industry funded support initiative was undertaken to assist C.C.B. and to avoid the loss of public confidence in Canada's banking system.

On March 24, 1985, a support group comprising Her Majesty in right of Canada ("Canada"), Her Majesty in right of Alberta ("Alberta"), C.D.I.C. and what I shall sometimes refer to as the Bank Group ("Bank Group"), consisting of the Royal Bank of Canada, the Bank of Montreal, the Toronto-Dominion Bank, the Bank of Nova Scotia, the Canadian Imperial Bank of Commerce,

and the National Bank of Canada, entered into a memorandum of intent to provide the "emergency financial assistance" requested by C.C.B. "on certain terms".

In essence, Canada, Alberta, C.D.I.C. and the Bank Group, collectively referred to as the Participants ("Participants"), agreed to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in a portfolio of assets held by C.C.B. consisting of loans and related security having a nominal value, on the books of C.C.B., of over $500 million ("Portfolio Assets"). The participation interest of each Participant was proportional to its own financial contribution and was to be evidenced by participation certificates issued by C.C.B. The parties also agreed in principle that the Participants would receive from C.C.B. on a proportionate basis, and until such a time as the Participants received the amount they paid for their participation certificates, a portion of the money received on account of each Portfolio Asset as well as 50% of C.C.B.'s pre-tax income, or alternatively 100% of C.C.B.'s pre-tax income plus interest. In other words, it was agreed that the $255 million advanced by the Participants would be repaid by C.C.B. After repayment, the payments from the Portfolio Assets and from C.C.B.'s pre-tax income would cease.

Under the memorandum of intent, C.C.B. undertook to indemnify each Participant against any loss experienced under the support program up to the amount paid by them to C.C.B. It was agreed that in the event of the insolvency or winding-up of C.C.B., any amount remaining unpaid "shall constitute indebtedness of C.C.B. to the members of the Support Group". Finally, the parties agreed in principle that each Participant would receive from C.C.B., on a proportionate basis, transferable rights or warrants to purchase common shares of C.C.B. at a price of $0.25 per share. The warrants were to expire 10 years after the day that C.C.B. had repaid the full amount advanced for the participation certificates.

On March 25, 1985, the Department of Finance issued a press release announcing a joint agreement involving "an infusion of capital with repayment provisions . . . designed to provide the Canadian Commercial Bank with sufficient funds to ensure solvency following a recent and sharp deterioration in its U.S. loan portfolio". The agreement was described as resulting in the "purchase by the support group of a package of nonperforming loans", leaving C.C.B. "in a strong position of solvency in order to support its deposit base". After setting out the general terms of the support program, the Minister of State (Finance) said she had "full confidence" that this program "involving Canada's largest chartered banks and the two Governments will permit the Canadian Commercial Bank to continue its active and important role in the growing economy of Western Canada". The Minister concluded that the support program represented "a strong collective vote of confidence in the health of the economy of Western Canada".

In order to carry out the letter and spirit of the memorandum of intent, the Participants and C.C.B. were to execute, among other documents, a Participation Agreement ("Participation Agreement") (also referred to as "P.A."), an Equity Agreement ("Equity Agreement") (also referred to as "E.A.") and an Amending and Subordination Agreement ("Amending and Subordination Agreement"). These agreements, which incorporate and refine the general principles agreed to earlier in the memorandum of intent, were ultimately entered into as of April 29, 1985. The Participation Agreement and the Equity Agreement formed the core of the support program. There are no relevant inconsistencies between these documents and the memorandum of intent. I will, however, review in closer detail the former documents as their provisions are of crucial importance to the resolution of the issues raised by this appeal.

Section 2 of the Participation Agreement provided for the Participants to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in 255 million units in the Portfolio Assets of C.C.B. Each Participant's interest was proportional to its financial contribution. For example, C.D.I.C. advanced $75 million and received a participation interest in 75 million units. The total participation in the Portfolio Assets was divided into 529,798,627 units, with the portion of 255 million units purchased by the Participants commonly referred to as the Syndicated Portion ("Syndicated Portion"). C.C.B. retained beneficially an undivided participation interest in the remaining 274,798,627 units which comprised the aggregate of the C.C.B. Portion ("C.C.B. Portion") of the Portfolio Assets.

Under s. 5 of the Participation Agreement, C.C.B. warranted that the C.C.B. Portion for each Portfolio Asset represented its "best estimate of the amount likely to be recovered from or with respect to that Portfolio Asset". Thus, as found by the learned chambers judge, the Participants purchased, in essence, a portfolio of bad loans or that portion of a loan not likely to be recovered.

C.C.B. was appointed and authorized to act as agent to administer the Portfolio Assets (P.A., s. 6(*a*)). Pursuant to s. 9 of the Participation Agreement, all money received by C.C.B. on account of each Portfolio Asset, whether principal, interest or otherwise, was first to be retained by C.C.B. until the C.C.B. Portion of that

Portfolio Asset was completely recovered; then to be paid to the Participants (except C.D.I.C.) proportionately to reduce or retire their respective advances; then to be paid to C.D.I.C. to reduce or retire its proportionate share; and finally to be retained by C.C.B. Each Participant was entitled to receive these proceeds up until such time as it received an amount which, when taken together with all amounts received by that Participant from C.C.B.'s pre-tax income pursuant to s. 10, was equal to the price paid by that Participant for its participation certificate.

In addition to proceeds from C.C.B.'s Portfolio Assets, the Participants were entitled to receive proportionately from C.C.B., on a quarterly basis, an amount equal to 50% of C.C.B.'s pre-tax income (P.A., s. 10). C.C.B.'s "pre-tax income" was defined in s. 10 of the Participation Agreement as C.C.B.'s "net income . . . before making any allowance for the payments to be made pursuant to this section, accrued interest on any presently existing bank debenture of CCB or any provision for income taxes payable to Canada, the United States of America and any political division of either". Again, C.C.B.'s obligation to make such payments would terminate after each Participant received an amount pursuant to ss. 9 and 10 equal to the price paid by such Participant for its participation certificate (P.A., s. 10).

Under s. 11 of the Participation Agreement, if C.C.B. failed by October 31, 1985, to obtain the shareholder and regulatory approval necessary for it to increase its authorized capital to the extent required for it to perform the Equity Agreement, as discussed below, then s. 10 of the Participation Agreement would be deemed to have been amended and would be construed as requiring C.C.B. to pay to the Participants 100% of C.C.B.'s pre-tax income. This obligation would continue until such time as the total amount received by each Participant from the Portfolio Assets and C.C.B.'s pre-tax income satisfied the amount paid by that Participant for its participation certificate, together with interest at prime rate. It should be noted that this was the only circumstance under which C.C.B. was to pay interest to the Participants.

Section 8 of the Participation Agreement provided that C.C.B. indemnified each Participant against any loss suffered by it by reason of the amounts realized from the Portfolio Assets and from 50% of C.C.B.'s pre-tax income failing to equal the price paid by that Participant for its participation certificate. This indemnity was to be paid only by payments of the amount and source described in ss. 10 and 11, with one important exception: "if CCB becomes insolvent or is wound up, any amount remaining unpaid and required to be paid in order to indemnify that Participant completely in accordance with the foregoing indemnity, shall constitute indebtedness of CCB, to which the provisions of section 13 shall apply."

The relevant parts of s. 13 of the Participation Agreement read as follows:

> 13. *Priorities on Insolvency*
>
> (*a*) *Notwithstanding the provisions of section 277 of the Bank Act* [which otherwise gives Canada and a province a first and second charge respectively on the assets of an insolvent bank] or any other rule of law, each of the Participants agrees that, in the case of the insolvency or winding-up of CCB:
>
> (i) neither Canada, CDIC nor Alberta shall, in connection with any money owing to it under this agreement, claim any charge on the assets of CCB;
>
> (ii) *the right of each of the Participants other than CDIC* to money owing to it under this agreement *shall rank pari passu with the right of the depositors* of CCB to payment in full of the deposit liabilities of CCB;
>
> (iii) the right of CDIC to money owing to it by CCB, under this agreement but not by reason of the subrogation of CDIC to the claims of depositors of CCB (if any) shall be subordinate in right of payment to the prior payment in full of all money owing to the other Participants under this agreement and to the depositors of CCB, but shall rank in priority to any outstanding bank debentures of CCB.
>
> *Each of Canada, CDIC and Alberta acknowledges that it has waived, as set out above, any priority to which it would otherwise be entitled.* Each Participant agrees that this *section 13 is intended to benefit the depositors of CCB*, and to enure to the benefit of the successors of CCB and any curator, liquidator or receiver that may be appointed to supervise or to wind up the business of CCB.

(Emphasis added.) Moreover, s. 13 provided that each Participant would rank *pari passu* with each other except C.D.I.C. and that each would, as necessary, redistribute payments received by it in order to achieve this ranking.

Pursuant to s. 12 of the Participation Agreement, C.C.B. could not, without the consent of the Participants, declare or pay any dividend or reduce its issued capital until such time as C.C.B. paid to each Participant its purchase price, and any additional amount (interest at prime rate) payable under s. 11. Moreover, the Participants required as a condition to their purchase, *inter alia*: (1) the execution of an Amending and Subordination Agreement; (2) the execution of the Equity Agreement; and (3) the opinion of the Inspector General of Banks that C.C.B would be solvent following the purchase (P.A., ss. 14 and 16). Finally, the parties expressly declared that the Participants were not partners or joint venturers with each other (P.A., s. 18(j)) and that the law governing the

agreement would be the law applicable in the Province of Ontario (P.A., s. 18(d)).

The Equity Agreement (C.O.A., at pp. 154-74) gave the Participants warrants providing for the right to subscribe to a total of 24,062,517 common shares of C.C.B. at a price of $0.25 per share, on a basis proportionate to each Participant's participation interest (E.A., ss. 2, 3, 5 and 6). At the date of the agreement, C.C.B. had an authorized capital of 10 million common shares with a par value of $10 each, of which 6,529,768 were issued and outstanding (E.A., s. 4). If all outstanding employee stock options to purchase common shares were exercised and all issued convertible preferred shares were converted into common shares, the issued capital of C.C.B. would consist of a total of 8,020,839 common shares (E.A., s. 4). Thus, if the warrants were fully exercised, the Participants would own 75% of C.C.B.'s common shares.

Shareholder and regulatory approval were required to increase C.C.B.'s authorized capital from its current level of 10 million common shares to the 32.1 million required in order to give full effect to the Equity Agreement. Pursuant to s. 15 thereof, C.C.B. had to first obtain shareholder approval no later than October 31, 1985, and next had to apply to the Minister of Finance pursuant to the *Bank Act*, R.S.C., 1985, c. B-1 (formerly S.C. 1980-81-82-83, c. 40), for the necessary change in its authorized capital. If such an application was not made by October 31, 1985, the provisions of s. 11 of the Participation Agreement (100% pre-tax income plus interest) were triggered. In s. 8 of the memorandum of intent, Canada had agreed that "an application for such alteration in capital when made shall be approved for purposes of the Bank Act".

The limited authorized capital of C.C.B. was not the only obstacle to the issuance of common shares to the Participants. Under present law, the chartered banks which were Participants could not legally exercise their right to subscribe to common shares of C.C.B. This was recognized by the parties in para. (d) of the preamble to the Equity Agreement as well as in s. 10 of the agreement. Under s. 8 of the Equity Agreement, the warrants were made fully assignable and it was the declared intention of the Participants, as recorded in the preamble, "that unless the present law is materially changed, they shall assign such rights".

The Participants' right to purchase these shares was to continue for a period of 10 years after the date on which each Participant had been repaid the full amount it had advanced under the terms of the Participation Agreement (E.A., ss. 1 and 12). Again, this agreement would be governed by and construed in accordance with the law applicable in the Province of Ontario (E.A., s. 19).

Finally, under the Amending and Subordination Agreement, the holders of all outstanding subordinated debentures issued by C.C.B. pursuant to s. 132 of the *Bank Act* (*i.e.*, Canada, British Columbia, Alberta and the Workers' Compensation Board of British Columbia), agreed to postpone the repayment of the amounts represented by their debentures until such time as C.C.B. had paid to each Participant an amount equal to the price paid by that Participant for its participation certificate.

To summarize, the Participants were to receive in return for the $255 million advanced under the support program, proportionally to their own financial contribution and up to that amount: (1) payments from the Portfolio Assets; (2)(a) 50% of C.C.B.'s pre-tax income and warrants to buy up to 75% of C.C.B.'s common shares, or (b) 100% of C.C.B.'s pre-tax income, with interest on the amount contributed; and (3) an indemnity for any losses caused. Under these agreements, the Participants could receive a return which was greater than their contribution only in two ways, namely, by exercising or assigning their warrants up to 10 years after full repayment (however, this option was contingent on shareholder, regulatory and legislative approval) or, if these warrants could not be granted, by receiving interest on the amount advanced at the prime rate.

C.C.B. was advised by the Office of the Inspector General of Banks, by a letter dated April 24, 1985, as to the appropriate accounting treatment to be applied to these transactions. Following these guidelines, C.C.B. wrote down its loan assets by $255 million, charged the write-down to tax-allowable appropriations for contingencies and credited the $255 million received from the Participants to tax-paid appropriations for contingencies. C.C.B. was not specifically directed by the Inspector General of Banks to record its indemnity towards the Participants as a liability, nor did C.C.B. do so. By effectively "selling" that portion of its loan portfolio not likely to be recovered and by not recording its indemnity obligation under the Participation Agreement to repay the $255 million as a liability, C.C.B. was able to restore a position of solvency on its books, thereby allowing it to remain in business, which was, after all, the raison d'être of the support program.

Despite this financial assistance, C.C.B.'s financial status continued to deteriorate. For reasons beyond the scope of this appeal, the support program was unsuccessful in ensuring C.C.B.'s long-term solvency. By an order made September 3, 1985, on a petition by

C.D.I.C., Wachowich J. of the Alberta Court of Queen's Bench ordered C.C.B. to be wound up pursuant to the *Winding-up Act*, R.S.C. 1970, c. W-10. At that point, none of the Participants had exercised or assigned (or even been granted) any of their warrants under the Equity Agreement as the preliminary conditions of shareholder and regulatory approval, for the authorization and issuance of additional common shares had not been fulfilled. Price Waterhouse Limited was appointed, and remains, the sole Liquidator of C.C.B. ("Liquidator").

As of August 18, 1987, the Liquidator had recovered approximately $112 million on account from C.C.B.'s Portfolio Assets, of which $5 million was attributable to the portion thereof beneficially owned by the Participants (namely, the Syndicated Portion). The Liquidator brought an application before Wachowich J. for advice and direction as to the interpretation of the support agreements. In particular, the Liquidator sought to determine the validity and ranking of the claims of the Participants pursuant to the Participation Agreement.

In a judgment rendered on December 7, 1987, Wachowich J. held the Participants to be entitled to the repayment of sums recovered by the Liquidator on the Syndicated Portion of the Portfolio Assets (the $5 million), but otherwise not entitled to recover their advances until after all ordinary creditors, including unsecured creditors, were paid in full. Wachowich J. interpreted the injection of funds by the Participants to have been a capital investment. The Participants, apart from Canada and C.D.I.C., the respondents in this appeal, successfully appealed the latter part of this judgment. The Alberta Court of Appeal disagreed with Wachowich J., preferring to characterize the advance of $255 million as a loan. The Court of Appeal concluded that the Participants were entitled to rank *pari passu* with C.C.B.'s unsecured creditors for all moneys advanced to C.C.B. pursuant to the Participation Agreement and not repaid by moneys recovered from the Syndicated Portion of the Portfolio Assets.

On an application by the Liquidator, Wachowich J. directed the Liquidator to present an application to this court for leave to appeal from the Court of Appeal's decision. Wachowich J. further ordered that Lerner & Associates be appointed as Legal Representative ("Legal Representative") of C.C.B.'s general body of creditors, other than the Participants, for purposes of the application for leave to appeal and further on the appeal. Leave to appeal to this court was granted on March 14, 1991. The Liquidator, as an officer of the court and as the representative of all the creditors of C.C.B., takes no position in this appeal. The Bank Group and

Alberta, the respondents before this court, made separate written and oral submissions.

II

JUDGMENTS IN THE COURTS BELOW

A. *Alberta Court of Queen's Bench*, 46 D.L.R. (4th) 518, 67 C.B.R. (N.S.) 136, 83 A.R. 122

On the initial application, the Participants took the position that they were entitled under the terms of the support agreements: (1) to receive their proportionate shares of the moneys received by the Liquidator or C.C.B. on account of the Portfolio Assets; and (2) to rank *pari passu* with all the other unsecured creditors of C.C.B. for any amounts not recovered from the Portfolio Assets and still owing to them pursuant to the Participation Agreement. Wachowich J. agreed with the first proposition but rejected the second.

According to Wachowich J., the Participants' first submission involved a consideration of the validity of the Participation Agreement. The learned chambers judge confessed it was a "difficult task" to determine the position of the Participants with respect to C.C.B.'s estate given the "extraordinary nature of the agreement" involved (at p. 523). He noted there were no precedents dealing with similar commercial agreements. In his view, the Participation Agreement in question was not prohibited by ss. 173 and 174 of the *Bank Act*. While the agreement did not relate to business in which a bank would normally or commonly engage, he noted that "given the unique circumstances and the stated purpose of the Participation Agreement as a whole, one can hardly regard this as an invalid transaction" (at p. 524). He found it was a valid contractual document binding on all parties and held that the Participants were entitled to receive their proportionate share from moneys recovered by the Liquidator from the Portfolio Assets, in the manner provided for in s. 9 of the Participation Agreement (*i.e.*, to the extent such recoveries exceed the C.C.B. Portion).

Next, Wachowich J. turned to a consideration of the ranking of the Participants with the general body of creditors of C.C.B. for any amounts not recovered from the Syndicated Portion of the Portfolio Assets, and still owing pursuant to the Participation Agreement. He noted that the Participants would have "valid claims" under the terms of the Participation Agreement for such amounts (at p. 525). However, whether they could rank *pari passu* with other unsecured creditors depended on the interpretation of the agreement taken as a whole and a determination of the "real basis upon which the $255 million was paid to C.C.B." (at p. 525).

In Wachowich J.'s view, the essence of the Participation Agreement was not the creation of a mere purchase and sale of assets with an added indemnity as to the value of those assets. Rather, the transaction reflected an investment of capital into C.C.B. (at p. 528):

> The agreement, as evidenced by all the surrounding circumstances, was really to effect an infusion of capital into C.C.B. whereby the participants would be risking their moneys in hope that the C.C.B. would continue as a viable and profitable business. If this in fact had occurred, the support group participants stood to gain a healthy return on their investments.

The learned chambers judge found support for his characterization in the following: (1) the portion of the Portfolio Assets purchased by the Participants was of little value; (2) s. 2 of the Participation Agreement masked the true nature of the transaction, that is, the investment of working capital into C.C.B.; (3) the indemnity provision and repayment structure set up by the agreement were directly connected to the profits and income of C.C.B.; (4) the repayment of the purchase price was to come not only from the Portfolio Assets, but mainly from C.C.B.'s pre-tax income; (5) if C.C.B.'s business was successful, the Participants would benefit not only in recovering their purchase price, but as well by purchasing common shares in C.C.B. under the Equity Agreement; (6) "[w]hile the transaction may not be a typical investment situation, where for example there is an outright purchase of shares, it is difficult to ignore the investment features of the agreement" (at p. 529); (7) while the accounting treatment had to be looked at with caution, the fact there was no liability to the Participants recorded on the balance sheet of C.C.B., as created by the indemnity provisions of the agreement, supported the conclusion that the transaction was an investment; (8) the cases of *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 63 C.B.R. (N.S.) 74, 7 B.C.L.R. (2d) 90 (C.A.) ("*Laronge Realty*"); *Re Dickie Estate* (1925), 5 C.B.R. 214 (N.S.S.C.), and *Re Meade*, [1951] 1 Ch. D. 774, "stand for the general proposition that advances of moneys will be classed as capital investments where the moneys were used in the business and the business was carried on for the joint benefit of the parties involved" (at pp. 529-30), and (9) the Participants here did have a stake in the continued profitability of C.C.B. in that (a) the repayment of the money advanced would come from the income of C.C.B. and (b) their warrants allowed them to "continue to share in the profits of C.C.B." (at p. 530).

Thus, according to Wachowich J., the Participants could not rank *pari passu* with the ordinary creditors of C.C.B., including

unsecured creditors, for the amounts not recovered from the Portfolio Assets. In so doing, he applied the principle that "if a person contributes capital to a business, even though that person is not a partner in the business and may have received no share of the profits, they cannot prove their claim in bankruptcy in competition with the creditors of the business" (at p. 131): 2 Hals., 3rd ed., p. 495; *Laronge Realty*, *supra*, and *Re Beale* (1876), 4 Ch. D. 246.

In concluding, Wachowich J. held the provisions of the Participation Agreement which attempt to rank the Participants *pari passu* and to create a debt on insolvency are ineffective to alter the "existing legal nature of their relationship" with C.C.B. These provisions would be void as they are an attempt to alter insolvency laws through a private agreement: *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France*, [1975] 2 All E.R. 390 (H.L.).

B. *Alberta Court of Appeal*, 69 D.L.R. (4th) 1, 107 A.R. 199, 74 Alta. L.R. (2d) 69

The respondents (the Participants apart from Canada and C.D.I.C.) appealed from Wachowich J.'s conclusion with respect to their ranking on insolvency, whereas the then Legal Representative cross-appealed from the conclusion that the Participants could receive funds from the Syndicated Portion of the Portfolio Assets. Harradence J.A. (writing for the Court of Appeal) began by stating that the learned chambers judge had erred in law in his interpretation of the decisions in *Laronge Realty*, *supra*; *Re Dickie Estate*, *supra*, and *Re Meade*, *supra* (at p. 10):

> I have examined closely the cases relied upon as well as others to which I have been referred and the inescapable conclusion to be reached is that the proposition as stated [by Wachowich J.] can only be correct where one implies into the term "moneys were used in the business" a necessary condition that the investor has not expressly stipulated a requirement for the repayment of moneys advanced. A failure to imply this term into the proposition results in a misstatement of the appropriate test and, further, is inconsistent with the decision of the Supreme Court of Canada in *Sukloff v. A.H. Rushforth & Co.* (1964), 45 D.L.R. (2d) 510, [1964] S.C.R. 459, 6 C.B.R. (N.S.) 175.

Harradence J.A. reviewed the cases cited by Wachowich J. and noted that, unlike the case at bar, none of them involved transactions where provisions for the repayment of the money advanced had been included by the parties. Turning specifically to *Sukloff v. A.H. Rushforth & Co.* (1964), 45 D.L.R. (2d) 510, [1964] S.C.R. 459, 6 C.B.R. (N.S.) 175. ("*Sukloff v. Rushforth*"), Harradence J.A. said that while it was "difficult to glean" from that case the exact reason for concluding that the transaction under considera-

tion therein was a loan rather than a capital investment, "the only reasonable conclusion to be reached is that the provision for repayment was determinative of the nature of the transaction" (at p. 13). He concluded his review of the jurisprudence by stating (at p. 14): "where, as in this case, the evidence indicated that moneys advanced to a business are to be repaid, and particularly when the terms of repayment are specified, the transaction is classified as a loan".

Harradence J.A. next turned to the interpretation of the Participation Agreement. He noted at the outset the rule prohibiting extrinsic evidence from contradicting express contractual terms. He reviewed a number of factors favouring interpreting the agreement as a loan, namely: (1) there is nothing in the express terms of the agreement which supports a conclusion that the money was advanced as an investment; (2) there are express provisions pointing to the opposite conclusion, including provisions for repayment and for an indemnity that full repayment will be made; (3) pursuant to the Participation Agreement, upon insolvency or winding-up, any amount remaining unpaid was to constitute indebtedness and, in such circumstances, the Participants were to rank *pari passu* with other creditors; and (4) the intention of the Participants was consistent with a "loan" characterization. He did not find it necessary to determine whether the accounting treatment was consistent with an investment, holding that such a factor is not determinative of the legal relationship of the parties.

Harradence J.A. found that repayment of the money advanced was intended and was coupled with express repayment provisions. Thus, relying on *Sukloff v. Rushforth*, *supra*, and the other cases cited, he concluded that the $255 million advanced was not to be characterized as an investment in capital but rather as a "loan coupled with a purchase agreement to C.C.B." (at p. 16).

The observation made by the learned chambers judge that the business of C.C.B. was carried on for the "joint benefit" of C.C.B. and the Participants, because (1) repayment was to come from the income of C.C.B. and (2) the warrants, if exercised, would allow the Participants to continue to share in the profits of C.C.B., was next addressed. With respect to the first factor, Harradence J.A. held that Wachowich J. erred in considering the *source of the funds for repayment* in concluding that the Participants would be sharing in C.C.B.'s profits. His comments warrant citation (at p. 16):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the support group participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of "joint benefit". Since the sums to be received by the participants were limited to repayment of moneys advanced, with a contingent right to interest, the source of the repayment moneys is not relevant and, with respect, the learned chambers judge erred in concluding the Participants were "sharing in profits" in this respect.

As for the second factor, Harradence J.A. summarily rejected it as an *indicium* of investment and "joint benefit" mainly because of the *contingent nature* of the warrants in question, as recognized by both the Participation Agreement and the Equity Agreement. He added: (at pp. 16-17): "Had shares actually been issued or even approval obtained, or if there was an obligation to purchase or if a purchase had been made, then the 'joint benefit' argument might have some merit and it would have been necessary to fully address this issue."

Finally, Harradence J.A. considered whether repayment to the respondents was nevertheless postponed pursuant to what are now s. 139 of the *Bankruptcy Act*, R.S.C., 1985, c. B-3, and s. 4 of the *Partnerships Act*. In his view, the application of these provisions was precluded by his earlier conclusion that the Participants were not to receive a rate of interest varying with the profits of C.C.B. or a share in the profits of C.C.B.

Thus, the appeal was allowed and it was ordered that the respondents were entitled to rank *pari passu* with the ordinary creditors of C.C.B. for all moneys advanced to C.C.B. pursuant to the Participation Agreement and not repaid by moneys recovered from the Portfolio Assets. In view of this result, the cross-appeal brought by the then Legal Representative, alleging an inconsistency in Wachowich J.'s conclusions, was dismissed.

III
ISSUES

There are many ways of characterizing the issues raised by this appeal. As I see it, the three main questions which need to be addressed are:

> (1) Was the Court of Appeal correct in characterizing the advance of $255 million by the Participants to the C.C.B. as a loan, as opposed to an investment in capital, thereby creating a debtor-creditor relationship between the parties?
>
> (2) If the true legal nature of this transaction is indeed a loan, does this loan come within the postponement provision found in s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P5?

(3) If the *Partnerships Act* does not apply, should the respondents' claim for the money loaned under the Participation Agreement nonetheless be postponed to the claims of the general body of C.C.B. unsecured creditors, other than the Participants, based on the United States doctrine of equitable subordination?

The Legal Representative raises a subsidiary issue concerning the portion of the moneys recovered attributable to the Syndicated Portion of the Portfolio Assets:

(4) Was the Court of Appeal correct in upholding the conclusion of the learned chambers judge that the Participants are entitled to receive from the Liquidator, pursuant to the Participation Agreement, the sums recovered on the Syndicated Portion of the Portfolio Assets?

For the reasons that follow, it is my view that the first and fourth questions should be answered in the affirmative while the second and third should be answered in the negative. In summary, the words chosen by the parties in their agreements clearly support the Court of Appeal's conclusion that the assistance program involved, in substance, a loan of $255 million and not a capital investment. The surrounding circumstances provide additional support for, rather than detract from, this conclusion. Although the transaction did have an equity component (the warrants), this aspect alone does not, in the circumstances of this case, transform the essential nature of the advance from a loan to an investment. Put another way, while it is true that this transaction does have "investment features", these features were incidental to the debt features of the arrangement and do not alter the substance of the debtor-creditor relationship that was created by the parties with respect to the $255 million advanced by the Participants to C.C.B. Moreover, the fact that C.C.B.'s pre-tax income was the main source for repayment does not affect this characterization as the amount to be repaid from this source was limited to the sum advanced to C.C.B., plus a contingent interest at prime rate. Thus, the respondents are creditors of C.C.B. and, as such, are entitled to what may be called a *"prima facie" pari passu* ranking with the other unsecured creditors of C.C.B. in the distribution of C.C.B.'s assets.

In the circumstances of this case, this *prima facie* ranking is not altered by the principles of law and equity relied upon by the Legal Representative. Indeed, the loan in question does not fall within the ambit of the Ontario *Partnerships Act* (ss. 3, para. 3 cl. (*d*), 4) as the Participants were to receive neither a "rate of interest varying with the profits" of C.C.B. nor a "share of the profits arising from carrying on the business" of C.C.B. In my view, the principles of equitable subordination have no application to the facts of this

case. Finally, in light of these conclusions, the Legal Representative's subsidiary issue concerning the moneys recovered on the Syndicated Portion of the Portfolio Assets must also fail. Accordingly, I would dismiss the appeal.

IV
RELEVANT STATUTORY PROVISIONS

Winding-up Act:

Distribution of Assets

93. The property of the company shall be applied in satisfaction of its debts and liabilities, and the charges, costs and expenses incurred in winding-up its affairs.

94. All costs, charges and expenses properly incurred in the winding-up of a company, including the remuneration of the liquidator, are payable out of the assets of the company, in priority to all other claims.

95. The court shall distribute among the persons entitled thereto any surplus that remains after the satisfaction of the debts and liabilities of the company and the winding-up charges, costs and expenses, and unless otherwise provided by law or by the Act, charter or instrument of incorporation of the company, any property or assets remaining after the satisfaction shall be distributed among the members or shareholders according to their rights and interests in the company.

Partnerships Act:

3. In determining whether a partnership does or does not exist, regard shall be had to the following rules:

. . . . .

3. The receipt by a person of a share of the profits of a business is proof, in the absence of evidence to the contrary, that the person is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him or her a partner in the business, and in particular,

(*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such;

. . . . .

(*d*) the advance of money by way of loan to a person engaged or about to engage in a business on a contract with that person that the lender is to receive a rate of interest varying with the profits, or is to receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such, provided that the contract is in writing and signed by or on behalf of all parties thereto;

. . . . .

4. In the event of a person to whom money has been advanced by way of loan upon such a contract as is mentioned in section 3, or of a buyer of the

goodwill in consideration of a share of the profits of the business, becoming insolvent or entering into an arrangement to pay his or her creditors less than 100 cents on the dollar or dying in insolvent circumstances, the lender of the loan is not entitled to recover anything in respect of the loan, and the seller of the goodwill is not entitled to recover anything in respect of the share of profits contracted for, until the claims of the other creditors of the borrower or buyer, for valuable consideration in money or money's worth, are satisfied.

V
Analysis

A. *Characterization of the $255 million advanced: capital investment or loan?*

The first and foremost issue in this appeal concerns the determination of the true nature of the transaction in question between the Participants and C.C.B. Was the $255 million advanced by the Participants in the nature of a loan, as found by the Court of Appeal, or in the nature of an investment of capital, as found by the learned chambers judge? If the Court of Appeal was correct in describing the transaction as a loan, it follows that the Participants are creditors of C.C.B. and as such, pursuant to both the Participation Agreement and ss. 93 to 95 of the *Winding-up Act*, they would be entitled, subject to the statutory (s. 4 of the *Partnerships Act*) and equity ("equitable subordination") principles raised by the Legal Representative, to rank *pari passu* with the other ordinary creditors of C.C.B. in the distribution of C.C.B.'s assets. If, however, Wachowich J.'s characterization is to be preferred, then, relying on an old common law principle, it is argued the Participants would not be creditors entitled to an equal ranking with C.C.B.'s true creditors: *Re Beale, supra*; *Re Meade, supra*; *Laronge Realty, supra*; and 3(2) Hals., 4th ed., p. 315. Under this approach, it is said the Participants would have an equitable right to share in the distribution of the assets of C.C.B., but only at such time as the ordinary creditors have been paid in full.

The principal argument raised by the Legal Representative in favour of finding the transaction to have been that of a capital infusion is the potential for unlimited returns and control over C.C.B. by reason of the warrants granted to the Participants under the Equity Agreement. Other *indicia* of capital investment are also suggested. First, C.C.B.'s accounts did not show their obligation to the Participants as a liability. It is submitted that, if the financial statements could have led creditors, including depositors, to believe that there was adequate capitalization, this should be taken into consideration in determining the rights of the ordinary creditors and the respondents. Secondly, it is argued that the Court

of Appeal's interpretation of ss. 8 and 13 of the Participation Agreement fails to recognize that the rights of differing classes of people who provide funds for the use of a business crystallize prior to insolvency and cannot be altered by an agreement. It is argued that the Court of Appeal erred in assuming that the characterization by the Participants and C.C.B. of their rights and obligations *inter se* should be determinative of the relative priority of the claims of the Participants and the ordinary creditors of C.C.B. According to the Legal Representative, "[s]ection 13 should be disregarded by the Courts, as being a self-serving attempt by the Participants to enhance their position for distribution purposes in the event of insolvency". Finally, the Legal Representative argues that the Court of Appeal erred in its interpretation of *Sukloff v. Rushforth, supra*, which, according to him, stands for the proposition that, if someone has an interest in a business, in the sense that his or her potential for return is unlimited except by the enterprise's actual ability to generate profits, that person may not rank as a creditor if the business becomes insolvent. The key, according to the Legal Representative, is the right or potential to an unlimited return, not the right to repayment.

The respondent Alberta, on the other hand, submits that the advance was a loan and offers the following arguments: (1) the agreement for the advance contained no express provision that the advance was an investment in capital but did contain express provisions to the contrary, including provisions for repayment and an indemnity for that repayment; (2) the parties intended the advance to be repayable; (3) C.C.B. was contingently liable to pay interest; (4) in its financial statements C.C.B. accounted for the advance as being a debt by disclosing the outstanding balance of the advance at the opening, repayments during, and the obligation for the outstanding balance at the closing of each reporting period; (5) Mr. Justice Estey considered the advance to be a loan in the Report of the Inquiry into the Collapse of the CCB and Northland Bank 1986 ("Estey Report"), at pp. 115, 118 and 125; (6) the Participants could not and did not invest in C.C.B.'s equity capital; (7) the decision of this court in *Sukloff v. Rushforth, supra*, as correctly demonstrated by the Court of Appeal, supports the conclusion that the advance to C.C.B. was a loan; and (8) according to *Sukloff v. Rushforth, supra*, and other decisions, an advance of money which is to be repaid, without more, is a loan and not an investment in equity capital or the supply of capital for the business of the recipient for the joint benefit of the advancer of money and the recipient, even if it is described as an investment of capital or if the person advancing the money is to share the profits

or to receive shares of the recipient or if the advance is repayable when funds are available or out of profits. Alberta also takes issue with the Legal Representative's characterization of s. 13 of the Participation Agreement. It submits that this is a common provision in loans and, rather than enhance the Participants' ranking on insolvency, has the effect of reducing the otherwise priority ranking of Canada, Alberta and C.D.I.C.

For their part, the Bank Group note that the agreements in question represent a unique response to a unique situation, and thus, cannot be perceived as a normal investment in a business. For the reasons given therein, they commend the Court of Appeal's characterization of the advances as a loan in the form of a purchase of doubtful assets. Specifically, they submit that Harradence J.A. was correct in finding that, because of the contingent nature of the warrants, the support agreements did not provide a right to share in profits or for a rate of interest that varied with profits. They characterize the Equity Agreement as a mere "sweetener". The Bank Group submits that the cases, including *Sukloff v. Rushforth*, *supra*, do not support the conclusion that a contingent right to profits in circumstances like the case at bar can represent an interest in the business. With respect to the accounting issue, they argue that they should be considered on a basis different from the other Participants because they were prohibited from controlling or attempting to control C.C.B. Indeed, they had no control over how C.C.B. showed its obligations to them in its financial statements. Further, such a factor should not determine the nature of the legal relationship between the parties to the agreement.

For my part, I agree in essence with the position advanced by Alberta and the Bank Group. Briefly put, the words chosen by the parties in their agreements strongly support the Court of Appeal's conclusion that the financial assistance program involved, in substance, a loan of $255 million rather than a capital investment and there is nothing in the surrounding circumstances which distracts from this characterization. On the contrary, the surrounding circumstances offer additional support for the Court of Appeal's conclusion. As noted by Wachowich J. and the Legal Representative, the transaction did indeed have an equity component (the warrants) and did involve a repayment scheme linked to the profits of C.C.B. However, for reasons which I shall elaborate, these aspects are insufficient to justify the conclusion reached by Wachowich J. Similarly, the other *indicia* of capital investment put forward by the Legal Representative, such as the accounting treatment given to the advance, do not affect the substance of this transaction.

As in any case involving contractual interpretation, the characterization issue facing this court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.

In the case at bar, it should be noted that the circumstances surrounding the financial arrangements between C.C.B. and the Participants, and the agreements themselves, are somewhat unique. At the heart of this matter is the attempted rescue of a Canadian chartered bank. Recourse to emergency measures in order to preserve the solvency of a bank is, fortunately, relatively rare in our country. I say this not because financial support programs are harmful (quite the contrary), but because the events surrounding the C.C.B. rescue in the mid-1980s infrequently arise. Part of the result, however, is that the task of ascertaining the intention of the Participants and of C.C.B. with respect to the advance of $255 million is not particularly simple. Indeed, the learned chambers judge described the Participation Agreement as a "unique document based on a unique set of facts" as well as an "extraordinary transaction", and he found it "most difficult" to characterize (at pp. 531 and 523). Similarly, Harradence J.A. said that "[t]he unique situation of C.C.B. and the Participants resulted in novel and complex documentation, the interpretation and characterization of which is a challenging and difficult task" (at p. 10).

It is evident from reviewing the agreements in question that characteristics associated with both debt and equity financing are present. The most obvious examples are, on the one hand, ss. 8 and 13 of the Participation Agreement pertaining to C.C.B.'s indemnity towards the Participants and their ranking in the event of a winding-up and, on the other hand, the provisions of the Equity Agreement concerning the warrants granted by C.C.B. to the Participants. Such a duality is apparently quite common in loan participation agreements. Indeed, in an article entitled "Characterization of Loan Participation Agreements" (1988), 14 C.B.L.J. 336, Professor Jacob S. Ziegel uses the heterogeneity in some loan participations to explain, in part, the divergence of judicial and academic opinion in the United States on the proper characterization of a participation agreement (at p. 337):

> This issue [the characterization of the participation agreement] has provoked a large body of case law and textbook and periodical literature, most

of it American, and the conclusions are not always the same. At one time or another one or more of the following descriptions have been applied to a participation agreement: a simple debtor-creditor relationship, with or without the benefit of security; an agency agreement; a partnership or joint venture; a trust; and, finally, a sale or assignment of an undivided interest in the loan.

It is easy to see why there should be this divergence of opinion. As with any agreement, the parties are free to verbalize it as they see fit and ambiguous or neutral language may reflect their unwillingness to answer hard questions, perhaps in the hope that the need to do so may never arise. Frequently, the several parts of a participation agreement lend themselves to different characterizations and the agreement is really a composite of cumulative legal elements. Finally, there is a significant overlap between such flexible concepts as a secured loan or trust and the sale or assignment of an undivided share of a loan, and the language of the agreement may be consistent with more than one of them. Faced with such ambiguity, the job of the adjudicator, when a dispute arises, is to find the characterization that best seems to fit the parties' intentions as derived from the total agreement and all the surrounding circumstances.

As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeon-hole the entire agreement between the Participants and C.C.B. in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to coexist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

The weight to be given to one aspect of the support agreements over another in assessing the true intention of the parties underlies the difference in opinion between the learned chambers judge and the Court of Appeal's characterization of the transaction. Wachowich J. emphasized both the fact that the recovery by the Participants of their contribution was dependent upon the income generated by C.C.B. and the Participants' potential to share in the future success of C.C.B. by the warrants, even after having been repaid, as evidencing that the essence of the transaction was that of a capital investment. The Court of Appeal, however, largely dismissed the relevance of the Equity Agreement because of its contingent nature and emphasized instead that the Participants were only entitled to receive from C.C.B. the amount advanced to it and that the parties had included specific provisions in the Participation Agreement referring to debt; all of which amounted to a very strong *indicium* of a loan.

In the circumstances of this case, it is my view that the learned chambers judge and the Legal Representative give far too much weight to the equity features associated with the Equity Agreement in characterizing the overall nature of the advance of $255 million. It is true the Participants received warrants to purchase common shares of C.C.B. through the Equity Agreement. It is also true, at least in theory, that by fully exercising their warrants the Participants would own 75% of the common shares issued by C.C.B. However, it is evident on the face of the record that this possibility was not only a mere hypothesis, but it was unlikely to occur. As noted by the respondents and the Court of Appeal, shareholder and regulatory approval was required to permit an increase in C.C.B.'s authorized capital and, unless the warrants were assigned, an amendment to the *Bank Act* was necessary before the Participants who are chartered banks could fully exercise their rights to purchase shares. It is not without significance that none of the Participants ever exercised any of their warrants nor did they assign them. In these circumstances, I agree with the Court of Appeal that the true effectiveness of the Equity Agreement was highly contingent and that the learned chambers judge erred in not considering the warrants for what they really were, namely, so-called "sweeteners" or "kickers" with respect to the advance of $255 million which were simply additional features to the underlying loan arrangement between the parties. Undoubtedly, the warrants are an equity feature of the transaction supporting a conclusion that the advance was an investment. However, in the facts of this case, only minimal weight

should be given to this factor in the overall characterization of the agreement. Alone, the highly contingent warrants are surely insufficient to tip the scales when faced with the strong *indicia* of debt present here as identified by the Court of Appeal.

Wachowich J. also erred in concluding that the Participants would be "sharing in the profits" of C.C.B. under the support agreements. The Participation Agreement simply *referred to* C.C.B.'s profits (*i.e.*, pre-tax income) as one of the *sources* for repayment. The other source for repayment, the moneys recovered on the Syndicated Portion of the Portfolio Assets, was not linked with C.C.B.'s profits. While full repayment from the Portfolio Assets alone was unlikely, the fact remains that the amount of money to be paid to the Participants from both sources was fixed at the amount advanced by each for their participation certificate. Regardless of where the repayments were coming from, they remained mere repayments for moneys advanced. Of course, the Participants would benefit from the success of C.C.B.'s business; however, this benefit would be capped by the amount of the advance. I shall examine in greater detail the "sharing in profits" argument of the Legal Representative when I deal with s. 4 of the *Partnerships Act*. For now, it is sufficient to state that, in the circumstances of this case, the source from which C.C.B. was to repay the advance made does not carry any weight in favour of a finding that said advance was an investment in capital rather than what it appears to be on the face of the agreements, namely, a loan of $255 million coupled with an equity "sweetener" or "kicker".

Another error committed by the learned chambers judge relates to his reliance on the decisions of *Laronge Realty*, *supra*, and *Re Meade*, *supra*. The latter case together with *Re Beale*, *supra*, are said to have established the common law principle applied in *Laronge Realty* and upon which Wachowich J. relied in order to deny ranking the Participants *pari passu* with C.C.B.'s unsecured creditors other than the Participants. This principle is stated as follows in 3(2) Hals., 4th ed., p. 315:

> If a person advances money to another, not by way of loan but as a contribution to the capital of a business carried on for their joint benefit, the person who has made the advance, even though he is not a partner in the business and has received no share of the profits as such, is debarred from proving in the bankruptcy of the recipient of the money in competition with the creditors of the business.

Briefly, I agree with Harradence J.A.'s conclusion that none of the agreements at issue in the cases relied upon by Wachowich J. contained express provisions for the repayment of the money advanced and that such a factor was crucial to the conclusions

reached therein. I also agree that the express repayment scheme set out in the Participation Agreement clearly distinguishes the case at bar from those in which the common law rule relied upon by Wachowich J. has been applied.

This rule was referred to, but *not* applied, by this court in *Sukloff v. Rushforth*, *supra*, a case upon which the Legal Representative strongly relies. There, Ritchie J. declined to apply the common law rule since he found that the money advanced by Mr. Sukloff was more in the nature of a loan, thereby creating a debtor-creditor relationship between the parties. Indeed, just after citing the above excerpt, Ritchie J. stated (at p. 517): "As I have indicated, I do not construe Mr. Sukloff's role as that of one who was supplying capital for a business carried on for the joint benefit of himself and the two limited companies." Earlier, he had specifically agreed with the trial judge's finding that Mr. Sukloff's relationship with the companies in question "was confined to that of a *lender or financier* who had a right to share in the profits, if any, of the undertakings of these companies" (at p. 516) (emphasis added). This "share in the profits" aspect was later used by Ritchie J. in order to postpone part of the money advanced by Mr. Sukloff (the unsecured $10,000 upon which the Legal Representative asks this court to focus) under what was then s. 98 (now s. 139) of the *Bankruptcy Act*, a provision similar to s. 4 of the *Partnerships Act*. However, this aspect had no effect whatsoever on the characterization of the true nature of the transaction involved and on the application of the common law rule set out in *Re Beale*, *supra*, and *Re Meade*, *supra*, and applied in *Laronge Realty*, *supra*. As found on the evidence, the advances in *Sukloff v. Rushforth*, *supra*, amounted to a loan.

As observed by Harradence J.A. in the case at bar, it is somewhat difficult to discern what specific evidence Ritchie J. was referring to when he agreed with the finding of the trial judge in *Sukloff v. Rushforth*, *supra*. However, I would note, as did Harradence J.A., that the agreements involved therein contained express repayment provisions similar to those contained in the Participation Agreement. It is not unreasonable to suggest that these provisions played an important role in the characterization of the advances as a loan. In any event, what is most important for our purposes is the fact that *none* of the moneys advanced by Mr. Sukloff was "postponed" under the common law principle advanced by Wachowich J. and the Legal Representative. The only part which was indeed postponed (the $10,000), was done so under the *Bankruptcy Act* and not following *Re Meade*, *supra*. I will explain in the context of my analysis of s. 4 of the *Partnerships Act* why,

contrary to *Sukloff v. Rushforth*, *supra*, such statutory postponement has no application to the facts of this case (namely, because there is no profit-sharing in the case at bar, simply a repayment out of profits). Suffice it here to say that, contrary to the Legal Representative's submissions, *Sukloff v. Rushforth*, *supra*, has no bearing on the characterization issue facing this court.

Similarly, contrary to the Legal Representative's submissions, the accounting treatment is not by itself of great weight in the characterization of the advance. I agree with the learned chambers judge that this "evidence" should be "looked at with caution" (at p. 529). I say this for the following interrelated reasons. First, C.C.B. was following the express directives given by the Office of the Inspector General of Banks, who is not a party to any of the agreements, in using the accounting methods it did. Secondly, as noted by the Bank Group, the accounting methods used by C.C.B. were beyond the control of many of the Participants. Thirdly, the Legal Representative is really asking us to look at the conduct of one party, after an arrangement has been signed, in order to discern the common intention of all contracting parties at the time of signing. This type of unilateral and after the fact "evidence" is clearly of little relevance and reliability with respect to the issues before this court. Fourthly, as previously noted, the accounting treatment used and the success of the support program were closely linked and it is unwise to draw inferences on the legal relationship of the parties therefrom. For all these reasons, I would not place much weight on the accounting treatment used by C.C.B. in determining the true nature of the advance of $255 million. In so concluding, I do not wish to say that there may not be other cases where the accounting treatment could be helpful in determining the nature of a given transaction.

Finally, I cannot agree with Wachowich J. about the relevance to the characterization issue of the fact that the portion of the Portfolio Assets purchased by the Participants was of little value. Even assuming that courts are entitled to weigh the value of the consideration given for a particular promise when characterizing an agreement, there was more to the support agreements than the mere purchase of participations in bad loans. Regardless of the true value of the Syndicated Portion, the Participants were to be *repaid* the entire $255 million they had advanced to purchase their participation certificates. The source of this repayment was also the profits of C.C.B. and the parties agreed that any amount remaining unpaid upon insolvency would be considered an indebtedness by C.C.B. towards the Participants.

On the other hand, the factors noted by the Court of Appeal of Alberta and the respondents as providing *indicia* of the "loan" nature of the advance of $255 million are clearly relevant to the characterization issue and they strongly support such a conclusion. I have already referred to these factors in summarizing the reasons of Harradence J.A. and the submissions made by Alberta and the Bank Group. To repeat the most important ones: (1) there is nothing in the express terms of the agreements which supports a conclusion that the money was advanced as an investment; and (2) there are express provisions supporting a characterization of the advance as a loan, including provisions for repayment (P.A., ss. 9 to 11), for an indemnity should full repayment not be made from the sources contemplated (P.A., s. 8), and for equal ranking with the ordinary creditors of C.C.B. (P.A., s. 13).

It is interesting to note that my conclusion that the $255 million advance was a loan also accords with the views of Mr. Justice Estey in his report. The relevant passages are found at pp. 115, 118 and 125 of the Estey Report:

> The $255M reduced the bank's debt to the Bank of Canada, but itself became an obligation to be retired by collections on the Support Package loans or on liquidation, out of the assets of the bankrupt bank. The receipt of the $255M therefore is irrelevant to the presence or absence of solvency. Whatever state the bank was in at that time remained unaffected by the receipt of the Support Package moneys. The Inspector General, therefore, was in error in finding the bank to be solvent upon receipt of the $255M. It should be borne in mind that the $255M, by the terms of the interim and final agreements, remains an obligation in debt of the CCB.
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> The Support Package should have classified these moneys as an unrecoverable purchase price, as a capital grant of some nature or as a subordinated loan, repayable out of earnings only. What CCB needed at this time of crisis was a loan without recourse in the nature of a capital grant repayable only from future profits and not a loan which would retain that characteristic and revive when the bank ran into further difficulties.
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> The object of this Support Program therefore was to replace lost income and thereby protect and renew capital. The banks could not in law contribute equity capital, and the government agencies likewise were not in a position, either legally or practically, to do so. Resort was had to what amounted to a long-term loan repayable out of the prospects of collections from bad debts and future earnings. The money infused, therefore, could not be treated as capital, but only serve to reduce liquidity advances.

Contrary to the Legal Representative's submissions, s. 13 of the Participation Agreement is not an attempt to enhance the ranking of the Participants upon C.C.B.'s insolvency. As evidenced by the

passages from this clause which I earlier emphasized, the main purpose and effect of s. 13 is to reduce, rather than enhance, the ranking of certain of the Participants (Canada and Alberta) upon insolvency as the parties agreed to do away with s. 277 of the *Bank Act.* As for the other Participants, there is nothing in s. 13 other than a confirmation that the ordinary principles of common law and of ss. 93 to 95 of the *Winding-up Act* apply upon insolvency, namely, the Participants, as unsecured creditors of C.C.B., are entitled to rank *pari passu* with the other ordinary creditors of C.C.B.

For all the foregoing reasons, I find that the Court of Appeal did not err in characterizing the advance of $255 million to C.C.B. as being, in substance, a loan rather than an investment of capital. While *indicia* supporting both conclusions are present, the overall balance clearly tilts in favour of the characterization put forward by the respondents. Accordingly, I would dismiss this first ground of appeal.

B. *Postponement under s. 4 of the Partnerships Act*

In the alternative, the Legal Representative submits that, even if the advance of $255 million was properly characterized as a loan, the Court of Appeal erred in declining to postpone, under existing statutory and common law principles, the respondents' claims for the moneys not repaid until the claims of the other ordinary creditors of C.C.B. were satisfied. Relying on ss. 3, para. 3, cl. (*d*) and 4 of the *Partnerships Act*, he argues that, where a lender advances money to a business borrower under a contract providing that the lender shall "participate in the profits of that business", and the borrower subsequently becomes insolvent, the lender is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied. It is submitted that the support agreements in question are contracts of such a nature because the Participants contracted to be repaid their advances out of C.C.B.'s pre-tax income (either 50% or 100% plus interest, depending on whether the Equity Agreement could be carried out), and because of the potential for profits inherent in the warrants granted to the Participants under the Equity Agreement.

As noted earlier, the Alberta Court of Appeal rejected a similar argument on the grounds that, notwithstanding the source for repayment and the warrants, the Participants were not to receive under the agreements a "rate of interest varying with the profits" or a "share of profits" (at p. 16). In other words, the loan in question was not one to which s. 4 of the *Partnerships Act* applied. The respondents before this court adopt a similar position on this issue.

Alberta argues, persuasively in my view, that a lender does not receive a "share of the profits" within the meaning of ss. 3, para. 3, cl. (*d*) and 4 of the Ontario *Partnerships Act* unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan. It is submitted that a lender does not share in profits merely by having a contingent right to acquire or possibly even by having the right to acquire or by owning shares of the borrower. In the case at bar, Alberta submits that all amounts which the Participants were entitled to be paid were to be applied only in repayment of the principal amount due and hence they were not entitled to and did not share in C.C.B.'s profits. As for the Bank Group, it is submitted that in the case of the insolvency of a bank, the *Winding-up Act* and not the *Partnerships Act* or the *Bankruptcy Act* determine the priority of claims. Moreover, they argue that the transaction at hand is not one to which the *Partnerships Act* applies because the Participation Agreement referred to profits only as a means of determining the source of the Participants' right to repayment, and because any alleged "share of the profits" would stop when the sum advanced was repaid.

I have already found that the Court of Appeal was correct in characterizing the advance of $255 million under the support program as a loan. In order to determine the applicability of s. 4 of the *Partnerships Act* to the facts of this case, a provision which may apply regardless of whether a partnership exists, the general question to be answered is whether this loan was made "upon such a contract as is mentioned in section 3" of the Act. If so, then, subject to any constitutional arguments not made herein, the respondents would not be entitled to recover anything in respect of the loan until the claims of the other ordinary creditors of C.C.B. are satisfied.

The only provisions in s. 3 of the *Partnerships Act* which make specific reference to a "contract" are s. 3, para. 3, cls. (*b*) and (*d*). Section 3, para. 3, cl. (*b*) is clearly irrelevant to this appeal. Thus, at least at first glance, the contracts in the case at bar must fall within the ambit of s. 3, para. 3, cl. (*d*) of the *Partnerships Act* in order to trigger the application of s. 4. The specific question then becomes whether or not the support agreements provided that the Participants were to receive a "rate of interest varying with the profits" of C.C.B., or a "share of the profits arising from carrying on the business" of C.C.B. While the Legal Representative originally structured his s. 4 argument exclusively around the wording

in s. 3, para. 3, cl. (*d*) of the *Partnerships Act*, he expanded this argument during oral submissions to include s. 3, para. 3, cl. (*a*). He submitted that, even if the transaction does not fall within the ambit of the former subsection, it clearly falls within the latter. Accordingly, another specific question to be considered is whether s. 4 of the *Partnerships Act* can be triggered by "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business" which does not involve a contract of the sort described in s. 3, para. 3, cl. (*d*). I will deal with both of these questions in turn.

Sections 3, para. 3, cl. (*d*) and 4 of the *Partnerships Act* originate from the now repealed 1865 *Act to Amend the Law of Partnership* (U.K.), c. 86 ("*Bovill's Act*"). The intent of what is now s. 3 of the *Partnerships Act* was evidently to mitigate the harshness of the old common law rule, which was that any person who shared in the profits of the partnership was deemed to be a partner, and so liable for any debts of the partnership on insolvency: *Grace v. Smith* (1775), 2 Black W. 997, at p. 1001, 96 E.R. 587 at p. 588, *per* De Grey C.J.: "[e]very man who has a share of the profits of a trade ought also to bear his share of the loss"; and *Waugh v. Carver* (1793), 2 H. Bl. 235, 126 E.R. 525.

The old common law rule was first modified by the decision in *Cox v. Hickman* (1860), 8 H.L.C. 268, 11 E.R. 431, which in some respects was very similar on the facts to the present case. The company of Smith and Son fell into financial difficulties and was unable to pay its creditors. The Smiths entered into an arrangement with five of its creditors assigning the company to them (as trustees for all of the creditors), for a term of 21 years. During that period, the trustees were to carry on the business of the company "and to pay the net income, after answering all expenses; which net income was always to be deemed the property of the two Smiths, among [all] the creditors of the Smiths" (at p. 269). In other words, the creditors "were to be paid their debts out of the profits of their debtors' business": Nathaniel Lindley, *Lindley on the Law of Partnership*, 15th ed., by Ernest H. Scamell and R.C. I'Anson Banks (London: Sweet & Maxwell, 1984), at p. 104. The most significant fact for our purposes is that the repayment was to be only to the extent of the debts; when all the debts had been paid, the trustees were to hold the estate in trust for the Smiths. Financial troubles continued under the new management, and the company once again became unable to pay its debts.

Since at that time the law was thought to be that a person who shared in the profits was liable as a partner, the question in *Cox v. Hickman*, *supra*, was not, as here, whether those creditors who were being paid out of profits were to be ranked equally with subsequent creditors, but whether the former group were to be themselves liable as partners to subsequent creditors. In deciding that they were not so liable, the House of Lords is considered to have established, amongst other things, that receipt of a share of the profits is not conclusive proof of a partnership as was previously thought (*Lindley on the Law of Partnership*, *supra*, at p. 104).

However, it is interesting to note one excerpt of the opinion of Wightman J. (one of the judges who came to advise the House of Lords in *Cox v. Hickman*) who, instead of modifying the old common rule, would simply have not applied it to the facts of the case (at p. 296 H.L.C., p. 443 E.R.):

> It is said that a person who shares in net profits is a partner; that may be so in some cases, but not in all; and it may be material to consider in what sense the words, "sharing in the profits" are used. In the present case, I greatly doubt whether the creditor, who merely obtains payment of a debt incurred in the business by being paid the exact amount of his debt, and no more, out of the profits of the business, can be said to share the profits. If in the present case, the property of the Smiths had been assigned to the trustees to carry on the business, and divide the net profits, not amongst those creditors who signed the deed, but amongst all the creditors, until their debts were paid, would a creditor, by receiving from time to time a rateable proportion out of the net profits, become a partner? I should think not.

In my view, the undesirability of the result foreseen by Wightman J. is equally compelling in the context of ss. 3, para. 3, cl. (*d*) and 4 of the *Partnerships Act*.

Historically, s. 3, para. 3, cl. (*d*) of the *Partnerships Act* appears to refer to loans similar to those involved in *Sukloff v. Rushforth*, *supra*, namely, loans in which the creditor advances money to the debtor on the terms that it shall be repaid with interest, and in addition the creditor is to receive a share of the profits over and above any payments on principal until the amount is paid off, as opposed to loans such as those in the present case where the share of the profits is used solely to repay the principal. In other words, s. 3, para. 3, cl. (*d*) applied to loans which had no cap or limit on the amount to be paid to the creditor from the profits of the debtor's business or which had a cap unrelated to the principal owing on the debt.

It is not entirely clear in *Sukloff v. Rushforth*, *supra*, whether the lender actually received any of the profits of the company via the arrangement for 50% of the profits. However, in many older cases it is clear that the lender did receive interest and the stated share of the profits for a period, and then claimed for the *entire amount* of the principal on bankruptcy of the debtor. In these cases

ss. 2(3)(*d*) and 3 of the *Partnership Act*, 1890 (U.K.), c. 39 (similar to ss. 3, para. 3, cl. (*d*) and 4 of the *Partnerships Act*), were applied to subordinate the claims: see *Ex p. Taylor; Re Grason* (1879), 12 Ch. D. 366 (C.A.); *Re Stone* (1886), 33 Ch. D. 541; *Re Hildesheim*, [1893] 2 Q.B. 357; *Re Mason*, [1899] 1 Q.B. 810; and *Re Fort; Ex p. Schofield*, [1897] 2 Q.B. 495 (C.A.). These sections of the *Partnership Act, 1890* essentially repeated *Bovill's Act* so it seems reasonable that this was the specific situation envisaged by the Act.

Contrary to the oral submission of the Legal Representative, *Re Young; Ex p. Jones*, [1896] 2 Q.B. 484, is not inconsistent with the distinction I am drawing. There, Mr. Jones lent money to Mr. Young which was to be used to pay the expenses of Mr. Young's business. The terms of the agreement provided that, in return for the use of this sum, Jones was to be paid a fixed weekly sum out of the profits of the business. When Young became insolvent, Jones claimed for the entire amount of principal, without making allowance for the amounts received by virtue of the weekly payments. In other words, the weekly sum received by Jones out of profits was not for the purpose of repaying the principal sum on the debt. Thus, *Re Young* is clearly distinguishable from the facts of this case and should not be seen as foreclosing the interpretation of s. 3, para. 3, cl. (*d*) that I am advancing.

In addition, s. 3, para. 3, cl. (*a*) of the *Partnerships Act* provides strong support for the distinction between profits as the source of repayment, and a share in the profits, with any repayment of a fixed debt falling into the former category. Indeed, it provides that:

> (*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such;

This seems to preclude any reading of s. 3, para. 3, cl. (*d*) which would catch debts which are to be repaid "out of profits". In this respect, it is interesting to note that the authors of *Lindley on the Law of Partnership* are of the view that the equivalent of s. 3, para. 3, cl. (*a*), not s. 3, para. 3, cl. (*d*), applies to cases such as *Cox v. Hickman*, *supra*, where, as we have seen, an arrangement similar to the one at bar was involved (at p. 108).

For the foregoing reasons, I would conclude that any fixed debt to be repaid out of profits does not in itself constitute a "share of the profits" within the meaning of s. 3, para. 3, cl. (*d*) of the *Partnerships Act*. As argued by Alberta, a lender does not receive a "share of the profits" under this provision unless he or she is

entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan.

Having said this, the question of whether the support agreements provided that the Participants were to receive a "rate of interest varying with the profits" of C.C.B., or a "share of the profits arising from carrying on the business" of C.C.B., as to trigger s. 4 of the *Partnerships Act*, may be readily answered. Clearly, the Participants were not to receive in return for the advance of $255 million a rate of interest varying with C.C.B.'s profits. The rate of interest to be paid was fixed according to the prime rate and was contingent on whether or not the Equity Agreement could be carried out. As for C.C.B.'s profits, they merely represented the source from which the Participants were to be repaid their advance. In this respect, I entirely agree with the following excerpt taken from the reasons of Harradence J.A. in the case at bar (at p. 16):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the support group participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of "joint benefit". Since sums to be received by the participants were limited to repayment of moneys advanced, with a contingent right to interest, the source of the repayment moneys is not relevant and, with respect, the learned chambers judge erred in concluding the participants were "sharing the profits" in this respect.

The Participants had a fixed debt which would be repaid in part by the moneys received from the Syndicated Portion of the Portfolio Assets and in part by C.C.B.'s pre-tax income. With the exception of the contingent interest at prime rate, under no circumstance were the payments from the pre-tax income to be applied to anything but the repayment of the loan. All amounts that the Participants were entitled to be paid were to be applied only in repayment of the principal amount of the loan. Once the loan was fully repaid, all payments from C.C.B.'s pre-tax income were to stop. Accordingly, I find that the Participants were not to receive a "share of the profits" of C.C.B. within the meaning of s. 3, para. 3, cl. (*d*) of the *Partnerships Act* by virtue of the repayment scheme for the $255 million advance. I also do not accept that the contemplated granting of warrants under the highly contingent circumstances of this case alters this conclusion.

The question then is whether s. 4 of the *Partnerships Act* can be triggered by an arrangement falling under s. 3, para. 3, cl. (*a*). Indeed, as previously noted, the Legal Representative takes the

alternative position that, even if s. 3, para. 3, cl. (*d*) does not apply, the transaction in this case is surely one contemplating "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business". While one cannot seriously dispute this proposition, the fact remains that s. 4 cannot apply unless "money has been advanced by way of loan upon such a contract as is mentioned in section 3". The first point to note is that s. 3, para. 3, cl. (*a*) of the *Partnerships Act* makes no reference whatsoever to a "contract" and thus appears to be beyond the realm of s. 4. Clearly, the legislature could have chosen a more general term than "contract" in s. 4 had it wished this postponement provision to apply to every transaction described in s. 3. The same could also be said about the absence of the word "loan" in s. 3, para. 3, cl. (*a*). It is not without significance that we were not presented with any jurisprudence in which a person who had a fixed debt to be paid out of profits (*i.e.*, who would fall under s. 3, para. 3, cl. (*a*) and not s. 3, para. 3, cl. (*d*)) was subordinated under the Act.

Further, if the policy on which s. 4 of the *Partnerships Act* is based is that a person who reaps the rewards of profits must share some risk, then this would not apply to a creditor with a fixed debt, notwithstanding that the fund or source of repayment is profits, because his or her total return will not vary with the profitability of the company.

From the above, I conclude that s. 4 of the *Partnerships Act* cannot be triggered by what is described in s. 3, para. 3, cl. (*a*) as "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business", which does not involve a contract of the sort described in s. 3, para. 3, cl. (*d*). The present case may very well fall within s. 3, para. 3, cl. (*a*) of the Act. However, that section only deals with a guideline for determining whether or not a partnership has been created, an issue which is not raised in this appeal. Contrary to s. 3, para. 3, cl. (*d*) of the *Partnerships Act*, s. 3, para. 3, cl. (*a*) does not have the added function of triggering the postponement provision of the Act. As the Participants were not to receive a "rate of interest varying with the profits" of C.C.B. or a "share of the profits arising from carrying on the business" of C.C.B., their claims for the return of the moneys advanced cannot be postponed under s. 4.

Accordingly, I would dismiss this ground of appeal. The Court of Appeal did not err in declining to postpone the respondents' claims under s. 4 of the *Partnerships Act*.

C. *Equitable subordination*

In the further alternative, the Legal Representative submits that even if the transaction in question is a loan and the *Partnerships Act* does not apply, the Participants' claims should be subordinated on equitable grounds based on the United States doctrine of "equitable subordination".

More specifically, it is argued that the equitable jurisdiction of superior courts gives them authority in insolvency matters to subordinate claims that, while valid as against the insolvent's estate, arise from or are connected with conduct prejudicial to the interests of other creditors. While the Legal Representative does not assert that the conduct of the Participants was fraudulent or worthy of censure, he argues that the Participants acted to the detriment of the ordinary creditors of C.C.B. in ways (which I shall outline below) that should invoke this equitable jurisdiction. Both the Bank Group and Alberta challenge the proposition that equitable subordination is available under Canadian law in insolvency matters. In addition, the respondents argue that the facts of this case do not call for the application of equitable principles.

This issue does not appear to have been raised before Wachowich J. or the Court of Appeal and consequently this court does not have the benefit of any findings of fact as to the actual or potential prejudice suffered by C.C.B.'s depositors and other creditors as a result of the conduct of the Participants. In this respect, the evidence presented to this court by the Legal Representative is limited to certain excerpts of the Estey Report, incorporated by reference in the affidavit of Mr. Allan Taylor of the Royal Bank of Canada (C.O.A. at pp. 236-41). The excerpts in question are those found at pp. 114-21 of the Estey Report under the heading "Flaws in the Support Program".

This court also does not have the benefit of the insight of the courts below as to whether or not, in the first place, the doctrine of equitable subordination should become part of Canadian insolvency law. As I see the matter, however, it is not necessary in the circumstances of this case to answer the question of whether a comparable equitable doctrine should exist in Canadian law and I expressly refrain from doing so. Assuming, for the sake of argument only, that Canadian courts have the power in insolvency matters to subordinate otherwise valid claims to those of other creditors on equitable grounds relating to the conduct of these creditors *inter se*, this court has been presented with insufficient grounds to justify the exercise of such a power in the case at bar.

Briefly put, the reasons and limited evidence advanced by the Legal Representative before this court disclose neither inequitable conduct on the part of the Participants nor injury to the ordinary creditors of C.C.B. as a result of the alleged misconduct.

As I understand it, in the United States there are three requirements for a successful claim of equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute: see *Re Mobile Steel Co.*, 563 F. 2d 692 (5th Cir., 1977) at p. 700; *Re Multiponics Inc.*, 622 F. 2d 709 (5th Cir., 1980); A. DeNatale and P. B. Abram, "The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors" (1985), 40 Bus. Law. 417 at p. 423; and L. J. Crozier, "Equitable Subordination of Claims in Canadian Bankruptcy Law" (1992), 7 C.B.R. (3d) 40 at pp. 41-2. Even if this court were to accept that a comparable doctrine to equitable subordination should exist in Canadian law, I do not view the facts of this case as giving rise to the "inequitable conduct" and ensuing "detriment" necessary to trigger its application.

In this regard, the actions cited by the Legal Representative as being detrimental to the ordinary creditors of C.C.B., thereby giving rise to equitable subordination, come down to two elements: (1) the press release of March 25, 1985, issued by the Department of Finance announcing to the general public that the support program would leave C.C.B. "in a strong position of solvency" and that sufficient funds were being advanced "to ensure solvency"; and (2) the flaws in the support program outlined in the Estey Report and described by the Legal Representative as: (a) the inadequacy of the support program to ensure C.C.B.'s solvency; (b) the accounting treatment disguised the fact that the Participation Agreement required the entire amount advanced to be repaid; (c) the accounting treatment used by the Bank Group gave rise to tax benefits not available to ordinary depositors; (d) the Participation Agreement allegedly obliged C.C.B. to apply all amounts received on the Syndicated Portion of the Portfolio Assets to the Participants; (e) the warrants would have the effect of prohibiting C.C.B. from raising funds in the equity market since they would enable the Participants to acquire 75% of the common shares of C.C.B. up to 10 years after the advances had been paid in full; and (f) after making their advances and receiving their participation certificates, the Bank Group ceased dealing with C.C.B. in the normal manner.

At the outset, I note that many of the actions relied on by the Legal Representative cannot be attributable to the Participants. For example, the press release was not issued by the respondents and the accounting treatment given by C.C.B. to the advance of $255 million simply followed the instructions given by the Office of the Inspector General of Banks. Thus, even if some inequitable connotation could be given to these actions, they would not represent misconduct on the part of the respondents to whom the ordinary creditors of C.C.B. are now attempting to rank in priority.

Another difficulty with the Legal Representative's submission, however, is that I fail to see anything remotely inequitable in the conduct complained of. With respect to the press release, the evidence does not show that the Participants were necessarily of a different opinion from that set out in the press release. Certainly, they advanced the funds on the condition that the Inspector General of Banks provide them with an opinion letter confirming the solvency of C.C.B. on the infusion of the proposed funds. As for the flaws in the support program, there is nothing to show that the Participants' plans were other than well-intentioned. As stated at the beginning of these reasons, it is beyond the scope of this appeal to engage in a detailed review of the reasons which led to the failure of the support program. Suffice it to say that the assertions of the Legal Representative in substance do not show wrongdoing or unfairness on the part of the Participants, but merely show that the support program did not work, and perhaps with hindsight, offer some explanations as to why.

In any event, it does not appear to have been suggested at any time in the courts below nor was any evidence led to suggest that any creditor of C.C.B. was misled by any of the above actions or that the press release, accounting treatment or any flaw in the support program operated to cause any creditor to act to its detriment. Thus, even if this court were to find that the Participants acted in an inequitable manner in their dealings with C.C.B. and its depositors and other creditors, we do not have a shred of evidence upon which to conclude that the improper conduct resulted in actual harm to the ordinary creditors of C.C.B. now before this court. One can only speculate that depositors and other creditors relied on the press release or accounting treatment and thereby suffered damages. We have been offered no United States' decision in which mere speculation of harm to other creditors has been found sufficient to meet the second requirement of the doctrine of equitable subordination. Of course, the ordinary creditors of C.C.B. who appear before this court have, to a varying extent, suffered from the winding-up of C.C.B., just as any creditor

(including the Participants) suffer following an insolvency or bankruptcy. The Legal Representative has not shown, however, that these ordinary creditors have suffered identifiable prejudice attributable specifically to the alleged misconduct of the Participants.

Accordingly, I would reject this alternative ground of appeal. Even if equitable subordination is available under Canadian law, a question which I leave open for another day, the facts of this case do not call for an intervention with the *pari passu* ranking of the respondents in the name of equity.

D. *The $5 million attributable to the Syndicated Portion of the Portfolio Assets*

The last matter to be addressed pertains to the moneys recovered from the Portfolio Assets and attributable to the Syndicated Portion thereof. In his oral submissions, the Legal Representative argued that the learned chambers judge erred in allowing the Participants to recover funds from the Syndicated Portion of the Portfolio Assets. A similar submission was made in the Alberta Court of Appeal but was summarily rejected (at p. 16). As I understand it, the argument is one of inconsistency between the treatment given, on the one hand, to the respondents' claim for their portion of the moneys recovered from the Portfolio Assets and, on the other hand, to the respondents' claim for all moneys advanced to C.C.B. pursuant to the Participation Agreement and not repaid by moneys recovered from the Portfolio Assets. According to the Legal Representative, these two claims stem from the same financial arrangement and cannot be given different legal effects. It is argued that, if the advance of $255 million is really an investment of capital, as found by Wachowich J., then it is wrong to rank the respondents behind the ordinary creditors of C.C.B. only with respect to the claim for what is not repaid by moneys recovered from the Portfolio Assets. Similarly, if the transaction is really a loan but the loan is one to which s. 4 of the *Partnerships Act* applies, then both claims ought to be postponed.

This submission has already been answered by my conclusion that the advance of $255 million to C.C.B. was substantially in the nature of a loan and that the *Partnerships Act* does not apply to postpone the loan.

VI

DISPOSITION

For the foregoing reasons, I would dismiss the appeal with costs here and in the courts below. As found by the learned chambers

judge and upheld by the Court of Appeal, the Participants are entitled to their proportionate share of the moneys recovered from the Portfolio Assets of C.C.B. in the manner set out in the Participation Agreement, that is, to the extent such recoveries exceed the C.C.B. Portion of each of the Portfolio Assets. Moreover, as found by the Court of Appeal, the respondents are entitled to rank *pari passu* with the ordinary creditors of C.C.B. for all moneys advanced pursuant to the Participation Agreement and not repaid by moneys recovered from the Portfolio Assets.

Appeal dismissed.

Dawson et al. v. Richards et al.

[Indexed as: Dawson v. Richards (Guardian of)]

Court File No. 13139

Alberta Court of Appeal, Harradence, Kerans and Major JJ.A.
November 12, 1992.

Motor vehicles — Accident claims fund — Liability — Deductions — Claimant entitled to "no fault" benefits under spouse's insurance policy — Fund not liable — Motor Vehicle Accident Claims Act, R.S.A. 1980, c. M-21, s. 12.

By s. 12 of the *Motor Vehicle Accident Claims Act*, R.S.A. 1980, c. M-21, a person injured by an uninsured motorist cannot recover from the fund "in respect of an amount paid or payable by an insurer by reason of the existence ... of a contract of insurance, other than life insurance". The plaintiff was injured by an uninsured motorist. She was entitled to certain "no fault" benefits under her husband's automobile insurance policy. The claim against the fund for the amount of the benefits having been dismissed, the plaintiff appealed to the Alberta Court of Appeal.

Held, the appeal should be dismissed. The plaintiff had a valid claim for the amount of the benefits against her husband's insurer, and, accordingly the liability of the fund was excluded.

Cases referred to

Wells v. Metropolitan Insurance Co. (1989), 39 C.C.L.I. 291, [1989] I.L.R. ¶1-2437, 94 A.R. 209, 13 A.C.W.S. (3d) 372

Statutes referred to

Motor Vehicle Accident Claims Act, R.S.A. 1980, c. M-21, ss. 11(7) [am. 1981, c. 74, s. 1; 1988, c. 31, s. 12], 12

APPEAL by the plaintiff from a judgment against the Administrator of the Motor Vehicle Claims Fund.

J.A. Middleton, for appellants.
L.H. Merryweather, for respondents and Motor Vehicle Accident Claims Fund.

TAB 10

Re Blue Range Resource Corporation, 2000 ABQB 4

Date: 20000110
Action No. 9901-04070

IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL DISTRICT OF CALGARY

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C. C-36, AS AMENDED

AND IN THE MATTER OF BLUE RANGE RESOURCE CORPORATION

2000 ABQB 4 (CanLII)

APPEARANCES:

R.J. (Bob) Wilkins/Gary Befus of Walsh Wilkins
for Big Bear Exploration Ltd.

A. Robert Anderson/Bryan Duguid of Blake Cassels & Graydon
for Enron Trade & Capital Resources Canada Corp.

Glen H. Poelman of Macleod Dixon
for the Creditors' Committee

Virginia A. Engel of Peacock Linder & Halt
for MRF 1998 II Limited Partnership

REASONS FOR JUDGMENT
of the
HONOURABLE MADAM JUSTICE B.E. ROMAINE

INTRODUCTION

[1] This is an application for determination of three preliminary issues relating to a claim made by Big Bear Exploration Ltd. against Blue Range Resource Corporation, a company to which the Companies' Creditors Arrangement Act, R.S.C. 1985, c.C-36, as amended, applies. Big Bear is the sole shareholder of Blue Range, and submits that its claim should rank equally with claims of unsecured creditors. The preliminary issues relate to the ranking of Big Bear's claim, the scope of its entitlement to pursue its claim and whether Big Bear is the proper party to advance the major portion of the claim.

[2] The Applicants are the Creditors' Committee of Blue Range and Enron Canada Corp., a major creditor. Big Bear is the Respondent, together with the MRF 1998 II Limited Partnership, whose partners are in a similar situation to Big Bear.

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FACTS

[3] Between October 27, 1998 and February 2, 1999, Big Bear took the following steps:
(a) it purchased shares of Blue Range for cash through The Toronto Stock Exchange on October 27 and 29, 1998;
(b) it undertook a hostile takeover bid on November 13, 1998, by which it sought to acquire all of the issued and outstanding Blue Range shares;
(c) it paid for the Blue Range shares sought through the takeover bid by way of a share exchange: Blue Range shareholders accepting Big Bear's offer received 11 Big Bear shares for each Blue Range share;
(d) it issued Big Bear shares from treasury to provide the shares used in the share exchange.

[4] The takeover bid was accepted by Blue Range shareholders and on December 12, 1998, Big Bear acquired control of Blue Range. It is now the sole shareholder of Blue Range.

[5] Big Bear says that its decision to undertake the takeover was made in reliance upon information publicly disclosed by Blue Range regarding its financial situation. It says that after the takeover, it discovered that the information disclosed by Blue Range was misleading, and in fact the Blue Range shares were essentially worthless.

[6] Big Bear as the sole shareholder of Blue Range entered into a Unanimous Shareholders' Agreement pursuant to which Big Bear replaced and took on all the rights, duties and obligations of the Blue Range directors. Using its authority under the Unanimous Shareholders' Agreement, Big Bear caused Blue Range to apply for protection under the CCAA. An order stipulating that Blue Range is a company to which the CCAA applies was granted on March 2, 1999.

[7] On April 6, 1999, LoVecchio, J. issued an order which provides, in part, that:
(a) all claims of any nature must be proved by filing with the Monitor a Notice of Claim with supporting documentation, and
(b) claims not received by the Monitor by May 7, 1999, or not proved in accordance with the prescribed procedures, are forever barred and extinguished.

[8] Big Bear submitted a Notice of Claim to the Monitor dated May 5, 1999 in the amount of $151,317,298 as an unsecured claim. It also filed a Notice of Motion on May 5, 1999, seeking an order lifting the stay of proceedings granted by the March 2, 1999 order for the purpose of filing a statement of claim against Blue Range. Big Bear's application for leave to file its statement of claim was denied by LoVecchio, J. on May 11, 1999.

[9] On May 21, 1999, the Monitor issued a Notice of Dispute disputing in full the Big Bear claim. Big Bear filed a Notice of Motion on May 31, 1999 for:
(a) a declaration that the unsecured claim of Big Bear is a meritorious claim against Blue Range; and

(b) an order directing the expeditious trial and determination of the issues raised by the unsecured claim of Big Bear.

[10] On October 4, 1999, LoVecchio, J. directed that there be a determination of two issues in respect of the Big Bear unsecured claim by way of a preliminary application. On October 28, 1999, I defined the two issues and added a third one.

[11] Big Bear's Notice of Claim sets out the nature and amount of its claim against Blue Range. The amount is particularized by the schedule attached to the Notice of Claim, which identifies the claim as being comprised of the following components:

(a) the price of shares acquired for cash on October 27 and 29, 1998 ($724,454.91);
(b) the value of shares acquired by means of the share exchange of Big Bear treasury shares for Blue Range shares held by Blue Range shareholders ($147,687,298); and
(c) "transaction costs," being costs incurred by Big Bear for consultants, professional advisers, filings, financial services, and like matters incidental to the share purchases generally, and the takeover bid in particular ($3,729,498).

ISSUE #1

[12] With respect to the alleged share exchange loss, without considering the principle of equitable subordination, is Big Bear:

(a) an unsecured creditor of Blue Range that ranks equally with the unsecured creditors of Blue Range; or
(b) a shareholder of Blue Range that ranks after the unsecured creditors of Blue Range.

[13] At the hearing, this question was expanded to include reference to the transaction costs and cash share purchase damage claims in addition to the alleged share exchange loss.

Summary of Decision

[14] The nature of the Big Bear claim against Blue Range for an alleged share exchange loss, transaction costs and cash share purchase damages is in substance a claim by a shareholder for a return of what it invested *qua* shareholder. The claim therefore ranks after the claims of unsecured creditors of Blue Range.

Analysis

[15] The position of the Applicants is that the share exchange itself was clearly an investment in capital, and that the claim for the share exchange loss derives solely from and is inextricably intertwined with Big Bear's interest as a shareholder of Blue Range. The Applicants submit that there are therefore good policy reasons why the claim should rank after the claims of unsecured creditors of Blue Range, and that basic corporate principles, fairness and American case law support these policy reasons. Big Bear submits that its claim is a tort claim, allowable under the

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CCAA, and that there is no good reason to rank the claim other than equally with unsecured creditors. Big Bear submits that the American cases cited are inappropriate to a Canadian CCAA proceeding, as they are inconsistent with Canadian law.

[16] There is no Canadian law that deals directly with the issue of whether a shareholder allegedly induced by fraud to purchase shares of a debtor corporation is able to assert its claim in such a way as to achieve parity with other unsecured creditors in a CCAA proceeding. It is therefore necessary to start with basic principles governing priority disputes.

[17] It is clear that in common law shareholders are not entitled to share in the assets of an insolvent corporation until after all the ordinary creditors have been paid in full: *Re: Central Capital Corp.* (1996), 132 D.L.R. (4th) 223 (Ont. C.A.) at page 245; *Canada Deposit Insurance Corp. v. Canadian Commercial Bank* (1992), 97 D.L.R. (4th) 385 (S.C.C.) at pages 402 and 408. In that sense, Big Bear acquired not only rights but restrictions under corporate law when it acquired the Blue Range shares.

[18] There is no doubt that Big Bear has exercised its rights as a shareholder of Blue Range. Pursuant to the Unanimous Shareholders' Agreement, it authorized Blue Range to file an application under the CCAA "to attempt to preserve the equity value of [Blue Range] for the benefit of the sole shareholder of [Blue Range]" (Bourchier November 1, 1999 affidavit). It now attempts to recover its alleged share exchange loss through the claims approval process and rank with unsecured creditors on its claim. The issue is whether this is a collateral attempt to obtain a return on an investment in equity through equal status with ordinary creditors that could not be accomplished through its status as a shareholder.

[19] In *Canada Deposit Insurance* (supra), the Supreme Court of Canada considered whether emergency financial assistance provided to the Canadian Commercial Bank by a group of lending institutions and government was properly categorized as a loan or as an equity investment for the purpose of determining whether the group was entitled to rank *pari passu* with unsecured creditors in an insolvency. The court found that, although the arrangement was hybrid in nature, combining elements of both debt and equity, it was in substance a loan and not a capital investment. It is noteworthy that the equity component of the arrangement was incidental, and in fact had never come into effect, and that the agreements between the parties clearly supported the characterization of the arrangement as a loan.

[20] *Central Capital* (*supra*) deals with the issue of whether the holders of retractable preferred shares should be treated as creditors rather than shareholders under the CCAA because of the retraction feature of the shares. Weiler, J.A. commented at page 247 of the decision that it is necessary to characterize the true nature of a transaction in order to decide whether a claim is a claim provable in either bankruptcy or under the CCAA. She stated that a court must look to the surrounding circumstances to determine "whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability."

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[21] The court in *Central Capital* found that the true nature of the relationship between the preferred shareholders and the debtor company was that of shareholders. In doing so, it considered the statutory provision that prevents a corporation from redeeming its shares while insolvent, the articles of the corporation, and policy considerations. In relation to the latter factor, the court commented that in an insolvency where debts will exceed assets, the policy of federal insolvency legislation precludes shareholders from looking to the assets until the creditors have been paid (*supra*, page 257).

[22] In this case, the true nature of Big Bear's claim is more difficult to characterize. There may well be scenarios where the fact that a party with a claim in tort or debt is a shareholder is coincidental and incidental, such as where a shareholder is also a regular trade creditor of a corporation, or slips and falls outside the corporate office and thus has a claim in negligence against the corporation. In the current situation, however, the very core of the claim is the acquisition of Blue Range shares by Big Bear and whether the consideration paid for such shares was based on misrepresentation. Big Bear had no cause of action until it acquired shares of Blue Range, which it did through share purchases for cash prior to becoming a majority shareholder, as it suffered no damage until it acquired such shares. This tort claim derives from Big Bear's status as a shareholder, and not from a tort unrelated to that status. The claim for misrepresentation therefore is hybrid in nature and combines elements of both a claim in tort and a claim as shareholder. It must be determined what character it has in substance.

[23] It is true that Big Bear does not claim recission. Therefore, this is not a claim for return of capital in the direct sense. What is being claimed, however, is an award of damages measured as the difference between the "true" value of Blue Range shares and their "misrepresented" value - in other words, money back from what Big Bear "paid" by way of consideration. Although the matter is complicated by reason that the consideration paid for Blue Range shares by Big Bear was Big Bear treasury shares, the Notice of Claim filed by Big Bear quantifies the loss by assigning a value to the treasury shares. A tort award to Big Bear could only represent a return of what Big Bear invested in equity of Blue Range. It is that kind of return that is limited by the basic common law principal that shareholders rank after creditors in respect of any return on their equity investment. Whether payment of the tort liability by Blue Range would affect Blue Range's stated capital account is irrelevant, since the shares were not acquired from Blue Range but from its shareholders.

[24] In considering the question of the characterization of this claim, it is noteworthy that Mr. Tonken in his March 2, 1999 affidavit in support of Blue Range's application to apply the CCAA did not include the Big Bear claim in his list of estimated outstanding debt, accounts payable and other liabilities. The affidavit does, however, set out details of the alleged mispresentations.

[25] I find that the alleged share exchange loss derives from and is inextricably intertwined with Big Bear's shareholder interest in Blue Range. The nature of the claim is in substance a claim by a shareholder for a return of what it invested *qua* shareholder, rather than an ordinary tort claim.

[26] Given the true nature of the claim, where should it rank relative to the claims of unsecured

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creditors?

[27] The CCAA does not provide a statutory scheme for distribution, as it is based on the premise that a Plan of Arrangement will provide a classification of claims which will be presented to creditors for approval. The Plan of Arrangement presented by CNRL in the Blue Range situation has been approved by creditors and sanctioned by the Court. Section 3.1 of the Plan states that claims shall be grouped into two classes: one for Class A Claimants and one for Class B Claimants, which are described as claimants that are "unsecured creditors" within the meaning of the CCAA, but do not include " a Person with a Claim which, pursuant to Applicable Law, is subordinate to claims of trade creditors of any Blue Range Entities." The defined term "Claims" includes indebtedness, liability or obligation of any kind. Applicable Law includes orders of this Court.

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[28] Although there are no binding authorities directly on point on the issue of ranking, the Applicants submit that there are a number of policy reasons for finding that the Big Bear claim should rank subordinate to the claims of unsecured creditors.

[29] The first policy reason is based on the fundamental corporate principle that claims of shareholders should rank below those of creditors on an insolvency. Even though this claim is a tort claim on its face, it is in substance a claim by a shareholder for a return of what it paid for shares by way of damages. The Articles of Blue Range state that a holder of Class A Voting Common Shares is entitled to receive the "remaining property of the corporation upon dissolution in equal rank with the holders of all other common shares of the Corporation". As pointed out by Laskin, J. in *Central Capital (supra* at page 274):

> Holding that the appellants do not have provable claims accords with sound corporate policy. On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies.

[30] Although what is envisaged here is not that Blue Range will pay out funds to retract shares, the result is the same: Blue Range would be paying out funds to the benefit of its sole shareholder to the prejudice of third-party creditors.

[31] It should be noted that this is not a case, as in the recent restructuring of Eatons under the CCAA, where a payment to the shareholders was clearly set out in the Plan of Arrangement and approved by the creditors and the court.

[32] As counsel for Engage Energy, one of the trade creditors, stated on May 11, 1999 during Big Bear's application for an order lifting the stay order under the CCAA and allowing Big Bear to file a statement of claim:

> We've gone along in this process with a general understanding in our mind as to what the creditor pool is, and as recently as middle of April, long after the evidence will show that Big Bear was identifying in its own mind the existence of this claim, public statements were continuing to be made, setting out the creditor pool, which did not include this claim. And this makes a significant difference in how people react to supporting an ongoing plan...

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[33] Another policy reason which supports subordinating the Big Bear claim is a recognition that creditors conduct business with corporations on the assumption that they will be given priority over shareholders in the event of an insolvency. This assumption was referred to by Laskin, J. in *Central Capital (supra)*, in legal textbooks (Hadden, Forbes and Simmonds, Canadian Business Organizations Law Toronto: Butterworths, 1984 at 310, 311), and has been explicitly recognized in American case law. The court in *In the Matter of Stirling Homex Corporation*, 579 F. 2d 206 (1978) U.S.C.A. 2nd Cir. at page 211 referred to this assumption as follows:

> Defrauded stockholder claimants in the purchase of stock are presumed to have been bargaining for equity type profits and assumed equity type risks. Conventional creditors are presumed to have dealt with the corporation with the reasonable expectation that they would have a senior position against its assets, to that of alleged stockholder claims based on fraud.

[34] The identification of risk-taking assumed by shareholders and creditors is not only relevant in a general sense, but can be illustrated by the behaviour of Big Bear in this particular case. In the evidence put before me, Big Bear's president described how, in the course of Big Bear's hostile takeover of Blue Range, it sought access to Blue Range's books and records for information, but had its requests denied. Nevertheless, Big Bear decided to pursue the takeover in the absence of information it knew would have been prudent to obtain. Should the creditors be required to share the result of that type of risk-taking with Big Bear? The creditors are already suffering the results of misrepresentation, if it occurred, in the inability of Blue Range to make full payment on its trade obligations.

[35] The Applicants submit that a decision to allow Big Bear to stand *pari passu* with ordinary creditors would create a fundamental change in the assumptions upon which business is carried on between corporations and creditors, requiring creditors to re-evaluate the need to obtain secured status. It was this concern, in part, that led the court in *Stirling Homex* to find that it was fair and equitable that conventional creditors should take precedence over defrauded shareholder claims (*supra* at page 208).

[36] The Applicants also submit that the reasoning underlying the *Central Capital* case (where the court found that retraction rights in shares do not create a debt that can stand equally with the debt of shareholders) and the cases where shareholders have attempted to rescind their shareholdings after a corporation has been found insolvent is analogous to the Big Bear situation, and the same result should ensue.

[37] It is clear that, both in Canada and in the United Kingdom, once a company is insolvent, shareholders are not allowed to rescind their shares on the basis of misrepresentation: *McAskill v. The Northwestern Trust Company*, [1926] S.C.R. 412 at 419; *Milne v. Durham Hosiery Mills Ltd.,* [1925] 3 D.L.R. 725 (Ont. S.C.A.D.); *Trusts and Guarantee Co. v. Smith* (1923), 54 O.L.R. 144 (Ont. S.C.A.D.); *Re: National Stadium Ltd.* (1924), 55 O.L.R. 199 (Ont. S.C.); *Oaks v. Turquend* [1861-73] All E.R. Rep. 738 (H.L.) at page 743-744.

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[38] The court in *McAskill (supra* at page 419) in obiter dicta refers to a claim of recission for fraud, and comments that the right to rescind in such a case may be lost due to a change of circumstances making it unjust to exercise the right. Duff, J. then refers to the long settled principle that a shareholder who has the right to rescind his shares on the ground of misrepresentation will lose that right if he fails to exercise it before the commencement of winding-up proceedings, and comments:

> The basis of this is that the winding-up order creates an entirely new situation, by altering the relations, not only between the creditors and the shareholders, but also among the shareholders *inter se*.

[39] This is an explicit recognition that in an insolvency, a corporation may not be able to satisfy the claims of all creditors, thus changing the entire complexion of the corporation, and rights that a shareholder may have been entitled to prior to an insolvency can be lost or limited.

[40] In the Blue Range situation, Big Bear has actively embraced its shareholder status despite the allegations of misrepresentation, putting Blue Range under the CCAA in an attempt to preserve its equity value and, in the result, holding Blue Range's creditors at bay. Through the provision of management services, Big Bear has participated in adjudicating on the validity of creditor claims, and has then used that same CCAA claim approval process to attempt to prove its claim for misrepresentation. It may well be inequitable to allow Big Bear to exercise all of the rights it had arising from its status as shareholder before CCAA proceedings had commenced without recognition of Blue Range's profound change of status once the stay order was granted. Certainly, given the weight of authority, Big Bear would not likely have been entitled to rescind its purchase of shares on the basis of misrepresentation, had the Blue Range shares been issued from treasury.

[41] Finally, the Applicants submit that it is appropriate to take guidance from certain American cases which are directly on point on this issue.

[42] The question I was asked to address expressly excludes consideration of the principle of "equitable subordination". The Applicants submit that the principle of equitable subordination that is excluded for the purpose of this application is the statutory principle codified in the U.S. Bankruptcy Code in 1978 (Bankruptcy Code, Rules and Forms (1999 Ed.) West Group, Subchapter 1, Section 510 (b)). This statutory provision requires notice and a full hearing, and relates to the ability of a court to subordinate an allowed claim to another claim using the principles of equitable subordination set out and defined in case law. The Applicants submit,

however, that I should look to three American cases that preceded this statutory codification and that dealt with subordination of claims by defrauded shareholders to the claims of ordinary unsecured creditors on an equitable basis.

[43] The first of these cases is *Stirling Homex (supra)*. The issue dealt with by the United States Court of Appeals, Second Circuit, is directly on point: whether claims filed by allegedly defrauded shareholders of a debtor corporation should be subordinated to claims filed by ordinary unsecured creditors for the purposes of formulating a reorganization plan. The court referred to the decision of *Pepper v. Litton* (308 U.S. 295 at page 305, 60 S.Ct. 238, 84 L. Ed. 281 (1939)) where the Supreme Court commented that the mere fact that a shareholder has a claim against the bankrupt company does not mean it must be accorded *pari passu* status with other creditors, and that the subordination of that claim may be necessitated by principles of equity. Elaborating on this, the court in *Stirling Homex* (*supra* at page 213) stated that where the debtor corporation is insolvent, the equities favour the general creditors rather than the allegedly defrauded shareholders, since in this case, the real party against which the shareholders are seeking relief is the general creditors whose percentage of realization will be reduced if relief is given to the shareholders. The court quotes a comment made by an earlier Court of Appeals (*Newton National Bank v. Newbegin*, 74 F. 135, 140 (8th Cir. 1896):

> When a corporation becomes bankrupt, the temptation to lay aside the garb of a stockholder, on one pretense or another, and to assume the role of creditor, is very strong, and all attempts of that kind should be viewed with suspicion.

[44] Although the court in *Stirling Homex* refers to its responsibility under US bankruptcy law to ensure that a plan of reorganization is "fair and equitable" and to the "absolute priority" rule of classification under US bankruptcy principles, it is clear that the basis for its decision is the general rule of equity, a "sense of simple fairness" (*supra*, page 215). Despite the differences that may exist between Canadian and American insolvency law in this area, this case is persuasive for its reasoning based on equitable principles.

[45] If Big Bear's claim is allowed to rank equally with unsecured creditors, this will open the door in many insolvency scenarios for aggrieved shareholders to claim misrepresentation or fraud. There may be many situations where it could be argued that there should have been better disclosure of the corporation's declining fortunes, for who would deliberately have invested in a corporation that has become insolvent. Although the recognition that this may greatly complicate the process of adjudicating claims under the CCAA is not of itself sufficient to subordinate Big Bear's claim, it is a factor that may be taken into account.

[46] The Applicants also cite the case of *In re U.S. Financial Incorporated* 648 F. 2d 515 (1980)(U.S.C.A. 9th Cir.). This case is less useful, as it was decided primarily on the basis of the absolute priority rule, but while the case was not decided on equitable grounds, the court commented that support for its decision was found in the recognition of the importance of recognizing differences in expectations between creditors and shareholders when classifying claims (*supra* at page 524). The court also stated that although both creditors and shareholders had

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been victimized by fraud, it was equitable to impose the risks of insolvency and illegality on the shareholders whose investment, by its very nature, was a risky one.

[47] The final case cited to me on this issue is *In re THC Financial* 679 F. 2d 784 (1982) (U.S.C.A. 9th Cir.), where again the court concluded that claims of defrauded shareholders must be subordinated to the claims of the general creditors. The court commented that the claimant shareholders had bargained for equity-type profits and equity-type risks in purchasing their shares, and one such risk was the risk of fraud. As pointed out previously, Big Bear had an appreciation of the risks of proceeding with its takeover bid without access to the books and records of Blue Range and took the deliberate risk of proceeding in any event.

[48] In *THC Financial*, the claimants argued that since they had a number of possible causes of action in addition to their claim of fraud, they should not subordinated merely because they were shareholders. The court found, however, that their claim was essentially that of defrauded shareholders and not as victims of an independent tort. All of the claimants' theories of recovery were based on the same operative facts - the fraudulent scheme.

[49] Big Bear submits that ascribing some legal impediment to a shareholder pursuing a remedy in tort against a company in which it holds shares violates the principle set out in *Salomon v. Salomon and Company, Limited* [1897] A.C. 22 (H.L.) that corporations are separate and distinct entities from their shareholders. In my view, this is not in issue. What is being sought here is not to limit a tort action by a shareholder against a corporation but to subordinate claims made *qua* shareholder to claims made by creditors in an insolvency situation. That shareholder rights with respect to claims against a corporation are not unlimited has already been established by the cases on rescission and recognized by statutory limitations on redemption and retraction. In this case, the issue is not the right to assert the claim, but the right to rank with creditors in the distribution of the proceeds of a pool of assets that will be insufficient to cover all claims. No piercing of the corporate veil is being suggested or would result.

[50] Counsel for Big Bear cautions against the adoption of principles set out in the American cases on the basis that some decisions on equitable subordination require inequitable conduct by the claimant as a precondition to subordinating a claim, referring to a three-part test set out in a number of cases. This discussion of the inequitable conduct precondition takes place in the broader context of equitable subordination for any cause as it is codified under Section 510 of the US Bankruptcy Code. In any event, it appears that more recent American cases do not restrict the use of equitable subordination to cases of claimant misconduct, citing, specifically, that stock redemption claims have been subordinated in a number of cases even when there is no inequitable conduct by the shareholder. "Stock redemption" is the term used for cases involving fraud or misrepresentation: *U.S. v. First Truck Lines, Inc.* (1996) 517 U.S. 535; *SPC Plastics Corporation et al v. Griffiths et al* (1998) 6th Circuit Case No. 88-21236. Some of the American cases draw a distinction between cases where misconduct is generally required before subordination will be imposed and cases where "the claim itself is of a status susceptible to subordination, such as...a claim for damages arising from the purchase ... of a security of the debtor": *U.S. v. First Truck Lines, Inc. (supra,* at paragraph 542).

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[51] The issue of whether equitable subordination as codified in Section 510 of the U.S. Bankruptcy Code should form part of the law in Canada has been raised in several cases but left undecided. Big Bear submits that these cases establish that if equitable subordination is to be part of Canadian law, it should be on the basis of the U.S. three-part test which includes the condition of inequitable conduct. Again, I cannot accept this submission. It is true that Iacobucci, J. in *Canada Deposit Insurance Corp.*, while he expressly refrains from deciding whether a comparable doctrine should exist in Canada, refers to the three-part test and states that he does not view the facts of the *Canada Deposit Insurance Corp.* case as giving rise to inequitable conduct. It should be noted, however, that that case did not involve a claim by a shareholder at all, since the lenders had never received the securities that were an option under the agreements, and that the relationship had at this point in the case been characterized as a debtor/creditor relationship.

[52] At any rate, this case, together with *Olympia and York Developments Ltd. v. Royal Trust Co.* [1993] O.J. No. 181 (Ont. G.D.) and *Unisource Canada Inc. v. HongKong Bank of Canada* [1998] O.J. No. 5586 (Ont. H.C.) all refer to the doctrine of equitable subordination codified in the U.S. Bankruptcy Code which is not in issue here. The latter two cases appear to have accepted the erroneous proposition that inequitable misconduct is required in all cases under the American doctrine.

[53] Big Bear also submits that the equitable principles that exist in U.S. law which have led the courts to ignore separate corporate personality in the case of subsidiary corporations are related to equitable principles used to subordinate shareholder claims. The basis for this submission appears to be a reference by the British Columbia Court of Appeal in *B.G. Preeco I (Pacific Coast) Ltd. v. Bon Street Holdings Ltd. et al* (1989) 43 B.L.R. 68 (1989) to the *Pepper v. Litton* case (*supra*) and the so-called "Deep Rock doctrine" under American law. I do not see a link between the comments made in *Pepper v. Litton* and referred to in *B.C. Preeco* on an entirely different issue and comments concerning the court's equitable jurisdiction in the case of claims by shareholders against insolvent corporations.

[54] I acknowledge that caution must be used in following the approach taken in American cases to ensure that the principles underlying such approach do not arise from differences between U.S. and Canadian law. However, I find that the comments made by the American courts in these cases relating to the policy reasons for subordinating defrauded shareholder claims to those of ordinary creditors are persuasive, as they are rooted in principles of equity that are very similar to the equitable principles used by Canadian courts.

[55] American cases are particularly useful in the areas of commercial and insolvency law given that the larger economy in the United States generates a wider variety of issues that are adjudicated by the courts. There is precedent for the use of such cases: Laskin, J. in *Central Capital Corp.* (*supra*) used the analysis set out in American case law on whether preferred shareholders can claim as creditors in an insolvency to help him reach his conclusion.

[56] The three American cases decided on this direct issue before the 1978 statutory

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codification of the law of equitable subordination are not based on a doctrine of American law that is inconsistent with or foreign to Canadian common law. It is not necessary to adopt the U.S. absolute priority rule to follow the approach they espouse, which is based on equitable principles of fairness and policy. There is no principled reason to disregard the approach set out in these cases, which have application to Canadian business and economy, and I have found them useful in considering this issue.

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[57] Based on my characterization of the claim, the equitable principles and considerations set out in the American cases, the general expectations of creditors and shareholders with respect to priority and assumption of risk, and the basic equitable principle that claims of defrauded shareholders should rank after the claims of ordinary creditors in a situation where there are inadequate assets to satisfy all claims, I find that Big Bear must rank after the unsecured creditors of Blue Range in respect to the alleged share exchange loss, the claim for transaction costs and the claim for cash share purchase damages.

ISSUE #2

[58] Assuming (without admitting) misrepresentation by Blue Range and reliance on it by Big Bear, is the alleged share exchange loss a loss or damage incurred by Big Bear and, accordingly, is Big Bear a proper party to advance the claim for such a loss?

Summary of Decision

[59] As the alleged share exchange loss is not a loss incurred by Big Bear, Big Bear is not the proper party to advance this claim.

Analysis

[60] The Applicants submit that negligence is only actionable if a plaintiff can prove that it suffered damages, as the purpose of awarding damages in tort is to compensate for actual loss. This is a significant difference between damages in tort and damages in contract. In order for a plaintiff to have a cause of action in negligent misrepresentation, it must satisfy the court as to the usual elements of duty of care and breach thereof, and it must establish that it has sustained damages from that breach.

[61] The Applicants argue that Big Bear did not suffer any damages arising from the share exchange. The Big Bear shares used in the share exchange came from treasury: Big Bear did not use any corporate funds or corporate assets to purchase the Blue Range shares. As the shares used in the exchange did not exist prior to the transaction, Big Bear was essentially in the same financial position pre-issuance as it was post-issuance in terms of its assets and liabilities. The nature and composition of Big Bear's assets did not change as the treasury shares were created and issued for the sole purpose of the share exchange. Therefore, Big Bear did not sustain a loss in the amount of the value of the shares. The Applicants submit that the only potential loss is that of the pre-takeover shareholders of Big Bear, as the value of their shares may have been diluted as a

result of the share exchange. However, even if there was such a loss, Big Bear is not the proper party to pursue such an action. Just as shareholders may not bring an action for a loss which properly belongs to the corporation, a corporation may not bring an action for a loss directly incurred by its shareholders.

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[62] Big Bear claims that it is entitled to recover the value of the Big Bear shares that were issued in furtherance of the share exchange. It says that it can prove all the elements of negligent misrepresentation: there was a special relationship; material misrepresentations were made to Big Bear; those representations were made negligently; Big Bear relied on those representations; and Big Bear suffered damage.

[63] It submits that damages for negligent misrepresentation are calculated as the difference between the represented value of the shares less their sale value. Big Bear contends that it matters not that the consideration for the Blue Range shares was Big Bear shares issued from treasury. As long as the consideration is adequate consideration for legal purposes, its form does not affect the measure of damages awarded by the courts for negligent misrepresentation. Big Bear says that it bargained for a company with a certain value, and, in doing so, it gave up its own shares worth that value. Therefore, Big Bear submits that it clearly incurred a loss.

[64] Big Bear submits that it is the proper party to pursue this head of damages. While the corporation has met the test for negligent misrepresentation, the shareholders likely could not, as the representations in questions were not made to them. In any event, Big Bear indicates that it does not claim for any damages caused by dilution of the shares. It also notes that a claim for dilution would not be the same as the face value of the shares issued in the share exchange, which is the amount claimed in the Notice of Claim.

[65] Big Bear's claim is in tort, not contract. This is an important distinction, as the issue at hand concerns the measure of damages. The measure of damages is not necessarily the same in contract as it is in tort.

[66] It is a first principle of tort law that a person is entitled to be put in the position, insofar as possible, that he or she was before the tort occurred. While the courts were historically loath to award damages for pure economic loss, this position was softened in ***Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.*, [1964] A.C. 465 (H.L.)** where the court confirmed that damages could be recovered in this type of case. When assessing damages for negligent misrepresentation resulting in pure economic loss, the goal is to put the party who relied on the misrepresentation in the position which it would have been in had the misrepresentation not occurred. While the parties to this application appear to agree on this principle, it is the application thereof with which they disagree.

[67] The proper measure of damages in cases of misrepresentation is discussed in **S.M. Waddams, *The Law of Damages* (Toronto: Canada Law Book Inc., Looseleaf, Dec. 1998)**, where the author states:

> The English and Canadian cases have consistently held that the proper measure [with respect to fraudulent misrepresentation] is the tortious measure, that is the amount of money required to put the plaintiff in the position that would have been occupied not if the statement had been true but if the statement had not been made. The point was made clearly in *McConnel v. Wright*, [1903] 1 Ch. 546 (C.A.):
>
> > It is not an action for breach of contract, and, therefore, no damages in respect of prospective gains which the person contracting was entitled by his contract to expect come in, but it is an action of tort - it is an action for a wrong done whereby the plaintiff was tricked out of certain money in his pocket; and therefore, prima facie, the highest limit of his damages is the whole extent of his loss, and that loss is measured by the money which was in his pocket and is now in the pocket of the company. That is the ultimate, final, highest standard of his loss. (at 5-19, 5-20)
>
> ...
>
> Since the decision of the House of Lords in 1963 in *Hedley Byrne Ltd.* v. *Heller & Partners Ltd.,* [1964] A.C. 465 (H.L.) it has been established that an action lies for negligent misrepresentation causing economic loss. It naturally follows from acceptance of out-of pocket loss rather than the contractual measure as the basic measure of damages for fraud, that the same basic measure applies to negligent misrepresentation. (at 5-28).

[68] Big Bear claims to be entitled to the difference between the actual value and the exchange value of the shares. The flaw in this assertion is that it focuses on what Big Bear bargained for as opposed to what it actually received, which is akin to a contractual measure of damages. Big Bear clearly states that it is not maintaining an action in contract, only in tort. Damages in tort are limited to the losses which a plaintiff *actually incurs* as a result of the misrepresentation. Thus, Big Bear is not entitled to recover what it expected to receive as a result of the transaction; it is entitled to be compensated only for that which it actually lost. In other words, what did Big Bear have before the loss which it did not have afterwards? To determine what losses Big Bear actually sustained, its position after the share exchange must be compared with its position prior to the share exchange.

[69] The situation at hand is unique. Due to a negligent misrepresentation, Big Bear was induced to give up something which, although it had value, was of substantially no cost to the corporation, and in fact did not even exist but for the misrepresentation. Big Bear created shares which had a value for the purpose of the share exchange, in that Blue Range shareholders were willing to accept them in exchange for Blue Range shares. However, outside of transaction costs, those shares had no actual cost to Big Bear, as compared to the obvious costs associated with a payment by way of cash or tangible assets. Big Bear cannot say that after the share exchange, it had lost approximately $150 million dollars, because the shares essentially did not exist prior to the transaction, and the cost of creating those shares is not equivalent to their face value. Big Bear retains the ability to issue a limitless number of shares from treasury in the future; any loss in this regard would not be equivalent to the actual value of the shares. Therefore, all that is required to return Big Bear to its pre-misrepresentation position is compensation for the actual costs associated with issuing the shares.

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[70] That Big Bear has not incurred a loss in the face value of the exchanged shares is demonstrated by comparing the existing facts with hypothetical situations in which such a loss may be found. Had Big Bear been required to pay for the shares used in the exchange, for instance, by purchasing shares from existing Big Bear shareholders, there would have been a clear loss of funds evidenced in the Big Bear financial statements. Big Bear's financial position prior to the exchange would have been significantly better than its position afterwards. However, no such difference results from the mere exchange of newly-issued shares. If there had been evidence that Big Bear was or could be compelled to redeem or retract the new shares at the value assigned to them at the time of the share exchange, Big Bear may have a loss in the amount of the exchange value of the shares. However, there is no evidence of such a redemption or retraction feature attaching to these shares.

[71] In sum, Big Bear's position prior to the share exchange is that the Big Bear shares issued as part of the exchange did not exist. As a result of the alleged misrepresentation, Big Bear issued shares from treasury. These shares would not have been issued but for the misrepresentation. All that is required to put Big Bear back into the position it was in prior to the negligent misrepresentation is compensation for the cost of issuing the shares, which is not the same as the exchange value of those shares. Although this is somewhat of an anomalous situation, it is consistent with the accepted tort principle that, except in cases warranting punitive damages, damages in tort are awarded to compensate for actual loss. A party may not recover in tort for a loss of something it never had. Indeed, if Big Bear was awarded damages for the share exchange equal to what it has claimed, it would be in a better position financially than it was prior to the exchange. To the extent that shareholders would indirectly benefit, they would not only be Big Bear's pre-exchange shareholders, who may have suffered a dilution loss, but a new group of shareholders, including former Blue Range shareholders who participated in the exchange.

[72] Big Bear submits that it incurred other losses as a result of the misrepresentation. Transaction costs incurred in the share exchange may be properly characterized as damages in tort, as those costs would not have been incurred but for the negligent misrepresentation. The same is true for the Big Bear claim for cash expended to purchase Blue Range shares prior to the share exchange. However, as I have indicated in my decision on Issue #1, Big Bear's claim for transaction costs and for cash share purchase damages ranks after the claims of other unsecured creditors. There may also be losses such as loss of ability to raise equity. There was no evidence of this before me in this application, and I have addressed Big Bear's ability to advance a claim for this type of loss in the decision relating to Issue #3.

[73] Finally, there may also be a loss in the form of dilution of the value of the Big Bear shares. However, as Big Bear admits in its submissions, no such claim is made by the corporation, and any loss relating to a diluted share value would not be the same amount as the exchange value of the shares.

[74] In the result, I find that Big Bear is not the proper party to pursue a claim for the alleged share exchange loss.

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ISSUE #3

Is Big Bear entitled to make or advance by way of argument in these proceedings the claims represented by the heads of damage specified in the draft Statement of Claim set out at Exhibit "F" to the affidavit of A. Jeffrey Tonken dated June 25, 1999?

[75] In addition to claims for damages for negligent misrepresentation, the claims that are set out in the draft Statement of Claim are claims for remedies for oppressive and unfairly prejudicial conduct and claims for loss of opportunity to pursue valuable investments and endeavours and loss of ability to raise equity.

Summary of Decision

[76] Given the orders made by LoVecchio, J. on April 6, 1999 and May 11, 1999, Big Bear is not entitled to advance the claims represented by the heads of damage specified in the draft Statement of Claim other than as set out in its Notice of Claim.

Analysis

[77] Big Bear submits that it is clear that, in an appropriate case, a complex liability issue that arises in the context of CCAA proceedings may be determined by a trial, including provision for production and discovery: *Algoma Steel Corp. v. Royal Bank of Canada* [1992] O.J. No. 889 (Ont. C.A.). Big Bear also submits that the court has the jurisdiction to overlook technical complaints about the contents of a Notice of Claim. The CCAA does not prescribe a claim form, nor set the rules for completion and contexts of a claim form, and it is common ground that in this case, the form used for the "Notice of Claim" was not approved by any order of the court. At any rate, Big Bear submits that it is not seeking to amend its claim to add new claims or to claim additional amounts.

[78] It makes that assertion apparently on the basis that the major parties concerned with CCAA proceedings in the Blue Range matter were aware of the nature of Big Bear's additional claims by reason of the draft Statement of Claim attached to Mr. Tonken's May 5, 1999 affidavit, although that affidavit was filed in support of an application to lift the stay imposed under the CCAA, an application which was dismissed by LoVecchio, J. on May 11, 1999.

[79] Big Bear characterizes the issue as whether it must prove the exact amount claimed in its Notice of Claim or otherwise have its claim barred forever. It submits that the bare contents of the Notice of Claim cannot be construed as a fixed election barring a determination and assessment of an unliquidated claim for tort damages, and that it would be inequitable to deny Big Bear a hearing on the substance of its claim based on a perceived technical deficiency in the contents of the Notice of Claim.

[80] In summary, Big Bear asks that the court direct an expedited trial for the hearing of its

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claim as outlined in the draft Statement of Claim.

[81] The Applicants submit that, by attempting now to make claims other than the claims set out in the Notice of Claim, Big Bear is attempting to indirectly and collaterally attack the orders of LoVecchio, J. dated April 6, 1999 and May 11, 1999, specifically:

a) by adding claims for alleged heads of damage other than those specified in the Notice of Claim contrary to the claims bar order of April 6, 1999; and
b) by attempting to include portions of the draft Statement of Claim relating to other alleged heads of damage in the Notice of Claim contrary to the May 11, 1999 order dismissing leave to file the draft Statement of Claim.

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[82] While it is true that a court has jurisdiction to overlook technical irregularities in a Notice of Claim, the issue is not whether the court should overlook technical non-compliance with, or ambiguity in, a form, but whether it is appropriate to do so in this case where previous orders have been made relating to these issues. Here, Big Bear chose to pursue its claims through two different routes. It filed a Notice of Claim alleging damages for a share exchange loss, transaction costs and the cost of shares purchased before the takeover bid, all damage claims that can reasonably be identified as being related to an action for negligent misrepresentation. At about the same time, it brought an application to lift the stay granted under the CCAA and file a Statement of Claim that alleged other causes of action. That application was dismissed, and the order dismissing it was never appealed. This is not a situation as in *Re Cohen* (1956) 19 W.W.R. 14 (Alta. C.A.) where a claim made on one basis was later sought to be made on a different basis, nor an issue of Big Bear lacking the necessary information to make its claim, although quantification of damage may have been difficult to determine. Given the previous application by Big Bear, this is a collateral or indirect attack on the effectiveness of LoVecchio, J.'s orders, and should not be allowed: *Wilson v. The Queen* (1983) 4 D.L.R. (4th) at 599). The effect of the two orders made by LoVecchio, J. is to prevent Big Bear from advancing its claim other than as identified in its Notice of Claim, which cannot reasonably be interpreted to extend beyond the claims for damages for negligent misrepresentation.

[83] It is true that the Notice of Claim form is not designed for unliquidated tort claims. I do not accept, however, that it was not possible for Big Bear to include claims under other heads of damages in the claim process by, for example, attaching the draft Statement of Claim to the Notice of Claim, or by incorporating such claims by way of schedule or appendix, as was done with respect to the claims for damages for negligent misrepresentation.

[84] I note that LoVecchio, J. issued a judgment after this application was heard relating to claims for relief from the impact of the claims procedure established by the court by a number of creditors who filed late or wished to amend their claims after the claims bar date of May 7, 1999 had passed. Although LoVecchio, J. allowed these claims, and found that it was appropriate in the circumstances to grant flexibility with respect to the applications before him, he noted that total amount of the applications made to him would be less than 1.4 million dollars, and the impact of allowing the applications was minimal to the remaining creditors. The applications before him do not appear to involve issues which had been the subject of previous court orders, as in the current

situation, nor would they have the same implication to creditors as would Big Bear's claim. The decision of LoVecchio, J. in the circumstances of the applications before him is distinguishable from this issue.

DATED at Calgary, Alberta this 10th day of January, 2000.

J.C.Q.B.A.

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TAB 11

',1995 113589

IN THE SUPREME COURT OF NOVA SCOTIA

BETWEEN:

S-MARQUE INC.

PLAINTIFF AND DEFENDANT BY COUNTERCLAIM

-and

HOMBURG INDUSTRIES LIMITED

DEFENDANT AND PLAINTIFF BY COUNTERCLAIM

AND

1995 S.H.113762

IN THE SUPREME COURT OF NOVA SCOTIA

BETWEEN:

S-MARQUE INC.

PLAINTIFF

-and

RICHARD HOMBURG, FRANK MATHESON, RON NELSON
OCEAN REALTY CONSULTANTS LIMITED, STAT ENTERPRISES
LIMITED, NEWEDGE TECHNOLOGIES INCORPORATED and
DOVER CAPITAL CORPORATION

DEFENDANTS

AND

1995 S.H.116298

IN THE SUPREME COURT OF NOVA SCOTIA

BETWEEN:

STAT ENTERPRISES LIMITED, OCEAN REALTY CONSULTANTS LMITED and DOVER CAPITAL CORPORATION

PLAINTIFFS

- and

S-MARQUE INC.

DEFENDANT

DECISION

HEARD: in Halifax, Nova Scotia before the Honourable Suzanne M. Hood
on March 2, 3, 4, 5, 6 and 10

DECISION: September 2, 1998

COUNSEL: Stanley W. MacDonald and Mark A. David for S-Marque Inc.
Colin D. Bryson for all other parties

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HOOD, J.:

When Mahon's Stationery went bankrupt, it owed $2.152 million to S-Marque. A group of companies controlled directly or indirectly by Richard Homburg, related companies to Mahon's, were either shareholders of Mahon's, lenders to it or its landlord. In the months preceding its assignment in bankruptcy, Mahon's entered into a number of transactions with these related companies. As well, there were ongoing negotiations with S-Marque about Mahon's outstanding accounts.

ISSUES

1. Whether the conveyance of 70 Akerley Boulevard was for consideration conspicuously less than its fair market value (s. 100 Bankruptcy and Insolvency Act, R.S.C. 1985 c. B-3).

2. Payment by Mahon's for paving at 70 Akerley Boulevard:

(a) Whether it was a settlement (s. 91 Bankruptcy and Insolvency Act);

(b) Whether it was made contrary to the Statute of Elizabeth (1570) Imp. 13; or

(c) Whether it constituted a fraudulent preference (s. 4 of the Assignments and Preferences Act, R.S.N.S. 1989, c.25).

3. Transfer of computer inventory:

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(a) Whether the consideration was conspicuously less than the fair market value (s. 100 BIA);

(b) Whether the transaction constituted a settlement (s. 91 BIA);

(c) Whether the transaction is fraudulent and void (s. 95 BIA);

(d) Whether the payment offended against the Statute of Elizabeth; or

(e) Whether the transaction constituted a fraudulent preference (s. 4 Assignments and Preferences Act).

4. Transfer of furniture and equipment:

(a) Whether the consideration was conspicuously less than fair market value (s. 100 BIA);

(b) Whether the transaction constituted a settlement (s. 91 BIA);

(c) Whether the payments offended against the Statute of Elizabeth; or

(d) Whether the transaction constituted a fraudulent preference (s. 4 Assignments and Preferences Act).

5. What is the status of the Dover Capital Corporation security and the balance of $148,000.00 owing to Dover?

6. Whether there was a guarantee by Homburg Industries Limited of $100,000.00 of Mahon's indebtedness to S-Marque.

7. Whether S-Marque made fraudulent misrepresentations.

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STATUTORY PROVISIONS

The relevant sections of the statutes are as follows:

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

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91. (1) Any settlement of property made within the period beginning on the day that is one year before the date of the initial bankruptcy event in respect of the settlor and ending on the date that the settlor became bankrupt, both dates included, is void against the trustee.

(2) Any settlement of property made within the period beginning on the day that is five years before the date of the initial bankruptcy event in respect of the settlor and ending on the date that the settlor became bankrupt, both dates included, is void against the trustee if the trustee can prove that the settlor was, at the time of making the settlement, unable to pay all the settlor's debts without the aid of the property comprised in the settlement or that the interest of the settlor in the properly did not pass on the execution thereof.

(3) This section does not extend to any settlement made

(a) before and in consideration of marriage;

(b) in favour of a purchaser or incumbrancer in good faith and for valuable consideration; or

(c) on or for the spouse or children of the settlor of property that has accrued to the settlor after marriage in right of the settlor's spouse or children.

95. (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 or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in the 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 or under pressure and evidence of pressure shall not be admissible to support the transaction.

(2.1) Subsection (2) does not apply in respect of a margin deposit

made by a clearing member with a clearing house.

(3) In this section,

`creditor includes a surety or guarantor for the debt due to the creditor;

100. (1) Where a bankrupt sold, purchased, leased, hired, supplied or received property or services in a reviewable trans-action within the period beginning on the day that is one year before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, the court may, on the application of the trustee, inquire into whether the bankrupt gave or received, as the case may be, fair market value in consideration for the property or services concerned in the transaction.

(2) Where the Court in proceedings under this section finds that the consideration given or received by the bankrupt in the reviewable transaction was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, the court may give judgment to the trustee against the other party to the transaction, against any other person being privy to the transaction with the bankrupt or against all those persons, for the difference between the actual consideration given or received by the bankrupt and the fair market value, as determined by the court, of the property or services concerned in the transaction.

(3) In making an application under this section, the trustee shall state what in his opinion was the fair market value of the property or services concerned in the transaction and what in his opinion was the value of the actual consideration given or received by the bankrupt in the transaction, and the values on which the court makes any finding pursuant to this section shall be the values so stated by the trustee unless other values are proven.

Assignments and Preferences Act. R.S.NLS. 1989. c.25

4 (1) Every transfer of property made by an insolvent person

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(a) with intent to defeat, hinder, delay or prejudice his creditors, or any one or more of them; or

(b) to or for a creditor with intent to give such creditor an unjust preference over other creditors of such insolvent person, or over any one or more of such creditors,

shall as against the creditor or creditors injured, delayed, prejudiced or postponed, be utterly void.

(2) If any transfer to or for a creditor .has the effect of giving such creditor a preference over the other creditors of such insolvent person, or over any one or more of them, the transfer shall

(a) in and with respect to any action or proceeding which is brought, had or taken to impeach or set aside such transfer within 60 days after the giving of the same; or

(b) if such insolvent person makes an assignment for the benefit of his creditors within 60 days from the giving of such transfer,

be presumed to have been made with intent to give such creditor an unjust preference as aforesaid, and to be an unjust preference, whether such transfer was made voluntarily or under pressure.

5 Nothing in Section 4 shall apply to

(b) any *bona fide* sale or payment made in the ordinary course of trade or calling to innocent purchasers or parties;

(c) any payment of money to a creditor; or

(d) to any *bona fide* gift, conveyance, assignment, transfer or delivery over of any property which is made in consideration of any present actual *bona fide* payment in money, or by way of security for any present actual *bona fide* advance of money, or which is made in consideration of any present actual *bona fide* sale or deliver of property...

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FACTS

Mahon's Stationery Limited made an assignment into bankruptcy on February 15, 1994. S-Marque Inc., the plaintiff, its major creditor, was owed $2.152 million. Its business was as a buying group for stationery and office supply companies. Mahon's was a member of that buying group.

Stat Enterprises Limited owned Mahon's, having purchased its shares in June 1992. Thirty-five percent (35%) of Stat's common shares are held by Richard Homburg and the remaining sixty-flue percent (65%) by Jim McCallion, Ron Nelson and Kevin Russell. Richard Homburg also held sufficient preferred shares, which, if exercised pursuant to their default provisions, would have given him fifty-one percent (51 %) voting control of Stat.

Dover Capital Corporation was a lender to Mahon's. Ocean Realty Consultants Limited was a preferred shareholder of Stat Enterprises Limited and also purchased land from, and leased it back to, Mahon's. Newedge Technologies Incorporated is a computer company which grew out of the computer division of Mahon's.

Homburg Industries Limited is a company owned and controlled by Richard Homburg.

Ocean, Dover, Newedge and Homburg Industries were related companies pursuant

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to the **Bankruptcy and Insolvency Act ("BIA"),** which provides in sections 3 and 4:

3. (1) For the purposes of this Act, a person who has entered into a transaction with another person otherwise than at arm's length shall be deemed to have entered into a reviewable transaction.

(2) It is a question of fact whether persons not related to one another within the meaning of section 4 were at a particular time dealing with each other at arm's length.

(3) Persons related to each other within the meaning of section 4 shall be deemed not to deal with each other at arm's length while so related.

4. (1) In this section:

`related group' means a group of persons each member of which is related to every other member of the group;

`unrelated group' means a group of persons that is not a related group.

(2) For the purposes of this Act, persons are related to each other and are 'related persons' if they are

(a) individuals connected by blood relationship, marriage or

adoption;

(b) a corporation and

(i) a person who controls the corporation, if it is controlled

by one person,

(ii) a person who is a member of a related group that controls the corporation, or

(iii) any person connected in the manner set out in paragraph (a) to a person described in sub- paragraph (i) or (ii); or

(c) two corporations

(i) controlled by the same person or group of persons,

(ii) each of which is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation,

(iii) one of which is controlled by one person and that person is related to any member of a related group that controls the other torpor-ation,

(iv) one of which is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,

(v) one of which is controlled by a related group a member of which is related to each member of an unrelated group that controls the other corporation, or

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(vi) one which is controlled by an unrelated group each member of which is related to at least one member of an unrelated group that controls the other corporation.

(3) For the purposes of this section,

(a) where two corporations are related to the same corporation within the meaning of subsection (2), they shall be deemed to be related to each other;

(b) where a related group is in a position to control a corporation, it shall be deemed to be a related group that controls the corporation whether or not it is part of a larger group by whom the corporation is in fact controlled;

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Ocean, Dover, Newedge and Homburg Industries were either controlled by Richard Homburg or by a company controlled by him.

Stat admits that it is related to the other defendant companies; therefore, Stat is a related company to all the defendant companies. Pursuant to s. 3 (3) of the BIA, related companies are deemed not to deal with each other at arms length.

Richard Homburg was, for all or part of the relevant times:
- Chairman, Secretary, Treasurer and a Director of Dover;

- a Director of Stat and, later, its President

- President, Secretary and a Director of Ocean

- Chairman and a Director of Newedge

- Chairman and a Director of Homburg Industries.

Frank Matheson is an employee of the Homburg Group. For all or part of the relevant times, he was:

- President and a Director of Dover
- Secretary and a Director of Stat
- Secretary, President and a Director and, later, Secretary and a Director only, of Newedge
- Registered Agent of Ocean
- President of Homburg Industries.

Ronald Nelson was a Vice-President of Mahon's and a shareholder in Stat. He later became President and a Director of Newedge.

Mahon's was in financial difficulty in 1992 and its then directors approached Richard Homburg, with the end result that Stat bought the shares of Mahon's.

During 1993, there were discussions between Richard Homburg and officers of SMarque about converting $650,000.00 of Mahon's debt to S-Marque into preferred shares of Stat. In the fall of 1993, there were discussions between S-Marque and Richard Homburg about a guarantee to S-Marque of $100,000.00 of Mahon's current debt to SMarque.

On February 15, 1994, Dover purchased Mahon's indebtedness to the Royal Bank of Canada, in the amount of $1.8 million, for $880,570.03. The Royal Bank then assigned to Dover its security, including a $5 million debenture, which formed a first charge on the assets and undertakings of Mahon's.

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On the same day, Mahon's made an assignment into bankruptcy.

Also on that day, Dover gave notice of its intention to enforce its security under the debenture and appointed a receiver under the debenture.

The goods and undertakings of Mahon's were sold for $1,700,001.00 (before expenses) by Dover to Mahon's Warehouse (1994) Limited, a newly incorporated company. Its President was Jim McCallion.

S-Marque has commenced action against Richard Homburg, Frank Matheson, Ron Nelson, Ocean Realty Consultants Limited, Stat Enterprises Limited, Newedge Technologies Incorporated and Dover Capital Corporation under s. 38 of the BIA. That section allows a creditor to take proceedings in its own name for its own benefit and at its own risk where the trustee does not do so. In the bankruptcy action, S-Marque alleges that five transactions between Mahon's and one or more of the defendants were settlements, preferences, fraudulent conveyances and/or reviewable transactions under the **BIA, the Assignments and Preferences Act** and/or the **Statute of Elizabeth.**

The defendants admit that two of the transactions were preferences although, in the case of one of those two, they deny the amount involved. They deny that the other three offend any of those statutes.

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Dover says, if anything is to be repaid to the estate of the bankrupt company, that to the extent of $148,000.00.00, the proceeds belong to Dover because of the shortfall of its recovery under its security documentation.

S-Marque also sues Homburg Industries on a guarantee. Homburg Industries counterclaims for negligent misrepresentation by S-Marque. Stat, Ocean and Dover also sue S-Marque for misrepresentation with respect to the $650,000.00 debt to share conversion:

The three actions are consolidated for trial.

AGREEMENTS

The parties agree that Mahon's was insolvent from June 1993 until its assignment into bankruptcy on February 15, 1994.

The parties also agree that $20,000.00 paid by Mahon's to the former shareholders of Mahon's was caught by the Assignments and Preferences Act and the BIA.

The parties also agree that the equipment seizure by Dover was improper because it was done pursuant to security that was void. The parties dispute the value of the goods seized. That issue will be dealt with below.

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Property at 70 Akerley Boulevard

When Stat purchased the shares of Mahon's in June 1992, Mahon's owned the land and building at 70 Akerley Boulevard in Dartmouth. At the time it purchased Mahon's, Stat agreed to sell the property to Ocean for a "price to be agreed upon but not to exceed" (Tab 13 of Exhibit 1) $1.050 million. The land was secured by a first mortgage in the amount of $850,000.00 and a fixed $5 million debenture.

In June 1993, Ocean agreed to purchase the land and building for $804,000.00, the outstanding balance on the first mortgage. The Royal Bank of Canada, holder of the debenture, agreed to the conveyance on condition that: Ocean pay $150,000.00 for renovationsrmprovements to the property; the Bank maintain a fixed second charge in the amount of $250,000.00; and Ocean lease the property back to Mahon's.

The BIA provides that the sale of this property by Mahon's to Ocean is reviewable because the sale was to another person other than in an arm's length transaction as defined in sections 3 and 4 of the BIA.

Section 100 of the BIA provides that the court may inquire into a reviewable transaction if the transaction occurs within twelve months of the bankruptcy. In this case, the transaction occurred 7% months prior to the bankruptcy. The court's inquiry is as to whether the bankrupt received fair market value for the property.

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S-Marque says that the conveyance of this property to Ocean was for consideration conspicuously less than the fair market value of the property, pursuant to s. 100 (2) of the BIA.

Eric M. Piccott, AACI, prepared an appraisal report of 70 Akerley Boulevard (Tab 223 of Exhibit 1) and testified for S-Marque. His conclusion was that the market value of the property was $1.050 million as of June 30, 1993. It is upon the basis of this report that S-Marque claims that the sale to Ocean for $804,000.00 was for conspicuously less than the fair market value of the property.

Ocean and Homburg say that either the value of $804,000.00 is the fair market value of the property at the time of sale or, in the alternative, that the sale was subject to a fixed charge to the Royal Bank of $250,000.00 and that illustrates that the property must be worth $1.054 million ($804,000.00 mortgage plus $250,000.00 debenture).

I do not find that the fixed charge to the Royal Bank is in any way determinative of the market value of the property. The consideration which Mahon's received on the conveyance of the property is what the court must consider pursuant to s.100 of the BIA. There is no evidence that Mahon's debt to the Royal Bank was lessened as a result of this transaction. In fact, the evidence is to the contrary: Mahon's debentures in favour of the Royal Bank were not reduced in amount.

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14 I do not accept the conclusion of the appraisal report that the property had a value of $1.050 million on June 30, 1993.

In his appraisal report, Mr. Piccott used three approaches to provide estimates of value: the Direct Comparison Approach, the Cost Approach and the Income Approach.

The appraisal report had a number of flaws in it, beginning with its lack of compliance with the *Uniform Standards of Professional Appraisal Practice (USPAP)* (Exhibit 5). In particular, USPAP Rule 2-2 provides that the appraiser must in his report:

> (viii) describe the information considered, the appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions;

Mr. Piccott failed to do so in the following ways:

1. In the Cost Approach, he:

a) gave no information in the report about which costing manual he used to determine the building costs in s. 12.0 of his report. Only in his testimony in court did he state that he used the Boeckh's manual;

b) used a depreciation rate of 20% in the report with no explanation of how he arrived at that figure.

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15 2. He increased the sate prices of the comparables used in the Direct Comparison Approach by 40% on the basis that they were forced sales but gave no explanation in the report about how he arrived at that percentage.

3. In the Income Approach, he:

a) listed at p. 27 of his report net rents for various locations but gave no breakdown of the proportion of space used in those locations for office and warehouse; no information about the terms of the leases, including whether there were rent inducements, etc.; and gave no information about the differences among the various buildings;

b) gave no explanation of why he chose to use a net rent of $5.25 based upon the rental survey contained on p. 27;

c) gave no explanation as to why he chose a vacancy and bad debt allowance of 5%;

d) did not explain how he arrived at a capitalization rate of 11.25%.

In addition to lack of compliance with USPAP, there are other reasons why I do not accept the valuation of Mr. Piccott.

On cross-examination, Mr. Piccott said that he assumed the three comparables, in the Direct Comparison Approach he used, were "forced sales" because the vendors were

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16 financial institutions but that he made no specific inquiries about the circumstances of those sales.

In Montreal Trust Co. of Canada v. Grab and Kohl (1994), 235 N.S.R. (2d) 41; 386 A.P.R. 41 (N.S.S.C.), Bateman, J. (as she then was), says at p. 47:

> Mr. Kempton holds the view that sales by financial institutions are forced sales and thus not reflective of market value, as there is an undue stimulus on the price. Thus, concludes Mr. Kempton, the price of comparable sales by financial institutions should be accorded less weight. Mr. Ingrain testified that in the nonrecessionary market he would generally agree with Mr. Kempton. We are, however, in a recessionary market. In such 'a market, where a significant number of sales are by financial institutions, those sales impact on overall price and the market must be defined to include those sales, not as anomalies, but as reflective of the market. Mr. Picott agreed with Mr. Ingrain. I find Mr. Ingram's argument logical and persuasive.

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Forced sales are part of the market. Mr. Piccott's rationale for increasing these sale prices by 40%, even if they were forced sales", to arrive at a unit value of $27.50 to apply to 70 Akerley Boulevard is therefore unsupported.

In addition, there were some errors in the building areas Mr. Piccott used. He admitted on cross-examination that he used the wrong gross building area for Comparable #3. The actual area is that shown in Exhibit 8, that is, 34,000.00 square feet. This decreases the Residual Building Value per square foot to $17.06.

With respect to Comparable #1, Mr. Piccott used a gross building area of 15,589

17 square feet. The listing broker, Verna Turner, testified that she used 17,575 square feet as the area. This is shown in Exhibit 14 and on the Multiple Listing Service Sheet (Exhibit 6). That would reduce the Residual Building Value to $18.16.

As well, in both the Direct Comparison and Cost Approaches, Mr. Piccott used as the land value a value of $3.50 per square foot based upon the regulated land prices for sales by the City of Dartmouth's Burnside Industrial Commission. However, in the comparables he listed, the land values varied from $1.75 per square foot to $2.25 per square foot. On cross-examination, Mr. Piccott admitted that the price of $3.50 per square foot was for land on Akerley Boulevard above Bumside Drive. The comparables and 70 Akerley Boulevard are below Burnside Drive.

Exhibit 6, Burnside Business Park Land Sale Transactions, 1968 -1995/6, sets out on page 13 in Section 3.3 three land sales in 1993/94 in the Burnside Industrial Park. These are sales at $2.00, $2.95 and $0.20 per square foot. One of these was for property on Akerley Boulevard below Burnside Drive. On cross-examination, Mr. Piccott said that these would be relevant but that that was not the way he did it.

Based upon these two factors, I conclude that the value attributed to the land at 70 Akerley was overstated.

Mr. Piccott included in his gross building area for 70 Akerley an area of 3,000 square feet of mezzanine storage. Lloyd Digdon, a real estate broker who tried to sell or

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18 lease the property and who had an office in the building for two years, tested that the mezzanine area would be hard to sell or lease because there were no stairs to it and the sides of the space were so sloped that one could not stand up at the sides. He treated the building area as 24,562 square feet as a result. Frank Matheson said that the only access to that mezzanine space was by a ladder or forklift.

Assuming that the *Boeckh's Manual* cost for this building is correct as stated by Mr. Piccott in his report, his Cost Approach value is still too high. The land value, as I have said above, is overstated. Furthermore, there is no support in the report for a 20% depreciation rate. It might be more (or less likely, it might be less).

Mr. Piccott used a building area that is greater than the saleable building area because he included the mezzanine storage which can be reached only by ladder of forklift and at the sides of which a person cannot stand up. The gross building area should be reduced by 3000 square feet to 24,302 square feet.

The unit price arrived at by Mr. Piccott was based upon a 40% increase in the sale prices of the comparables to account for "forced sales". In addition, there were errors in the building areas used for two of the three comparables. The unit values should be $18.16, $12.33 and $17.09.

If one uses the highest of the three unit prices and applies it to 24,302 square feet, the reduced area of 70 Akerley Boulevard, the building value is $441,324.00. Adding to

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19 that Mr. Piccott's land value of $300,563.00 (which I have concluded is high), results in a valuation of only $741,324.00. This is an amount less than the stated value at which the building was sold in 1993 to Ocean.

In the Income Approach, if one substitutes any of the lower rents from p. 27 of the report, then the valuation is reduced.

The value of $1.050 million set out in the appraisal report is not substantiated by the report. The onus is upon S-Marque to satisfy the court that the sale was for conspicuously less than the fair market value of the property. The appraisal report put forward on its behalf does not satisfy me of this.

Paving

Part of the deal for the conveyance of 70 Akerley Boulevard to Ocean was that Ocean would do renovations/improvements to the property. One of these was the paving of the parking lot.

Tab 63 of Exhibit 1 is a letter dated June 1, 1993 from Homburg International Limited to Mahon's, signed by Frank Matheson. In that letter, Mr. Matheson says that "as the owner of the property we will do the following": including "pave the parking lot". He goes on to say: "It is estimated that our total commitment will be $150,000." (My emphasis)

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Tab 82 of Exhibit 1 is a letter dated June 21, 1993 from the Royal Bank to Jim McCallion of Mahon's. The Bank in that letter approves of the sale of 70 Akerley to Ocean upon various conditions which include "the renovations/improvements for $150,000 being done by Ocean".

On September 27, 1993 Jim McCallion faxed a memo (Tab 98 of Exhibit 1) to Doug Gillett, the commercial property manager for the Homburg companies. That memo deals with the quote Mr. McCallion received for the paving.

The paving work was done and a Mechanic's Lien was filed by the contractor in December 1993. Mahon's paid the contractor $13,750.00 in December 1993 and $13,750.00 in January 1994.

Ocean says that any cost for work beyond $150,000.00 was to be the obligation of Mahon's. Frank Matheson testified that the paving was for the benefit of Mahon's. Mr. Matheson said that Ocean would pay up to $150,000.00, but that it was originally anticipated that that would include the paving. He also said that Doug Gillett of the Homburg companies was only involved to get the best price for the paving.

Jim McCallion testified that the understanding was that if the cost of renovations exceeded $150,000.00 that Mahon's would pay the excess. He said that by the time $150,000.00 was spent the paving still was not done and that it had to be done to entice retail clientele. As he put it: "the building was A-1, the parking lot was not." He said that

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21 the management shareholders therefore decided to have the paving done. He testified that the quote was sent to Doug Gillett at the Homburg companies because it was expected that Ocean would pay for it. He also testified that the paving benefitted the property and that by the time the paving was paid for he knew Mahon's would not survive.

Although there may have been an understanding between Mahon's and Ocean that Ocean would pay only-up to $150,000.00, there is no documentation of this. The letter from Frank Matheson, on behalf of Ocean, to Mahon's committed Ocean to do certain work including the paving. The **letter gave an estimate** of the cost, but said nothing about Mahon's being responsible in the event of cost overruns.

Furthermore, the letter from the Royal Bank to Mahon's gave approval to the sale of 70 Akerley Boulevard conditional upon Ocean paving the parking lot. It is clear from that letter that the Bank anticipated that Ocean would be paying for that work.

As well, there is a memorandum dated August 9, 1993 from Jim McCallion to Frank Matheson which refers to the cost of the improvements (Tab 96 of Exhibit 1). It is apparent from that memo that there were cost overruns on the capital improvements because the memo sets out a total of $191,000.00 in improvement costs at that time. However, there is no distinction drawn between those over and those under the $150,000.00 mark, nor any mention that the paving contract would be treated any differently than the other work. Following this, there is the fax (Tab 98) from Jim McCallion to Doug Gillett about the quote for the paving work, in which Jim McCallion says: "Will endeavour to negotiate down to

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22 $32M area...".

It is true that improvements to leased property can be for the benefit of a tenant such as Mahon's. However, at the time the letters from Ocean to Mahon's and from the Royal Bank to Mahon's were written the commitment to do the paving was that of Ocean. Notwithstanding that, payment was subsequently made by Mahon's. According to the testimony of both Jim McCallion and Frank Matheson, it created a big problem for the Homburg companies when a lien was filed. As Frank Matheson put it: 'We had never had a lien filed against us.' He testified that he told Mr. McCallion to deal with it and he did. He admitted on cross-examination that Mr. McCallion would take that direction from him because he was speaking on behalf on Richard Homburg.

The payment made by Mahon's for the cost of the paving was made in satisfaction of Ocean's obligation. It was made on the instruction of Frank Matheson of Ocean who spoke for the Homburg companies and for Richard Homburg.

Since the two companies are related within the meaning of the BIA, the payment by Mahon's for the benefit of Ocean results in a settlement within the meaning of s. 91 of the BIA as it was not made for valuable consideration.

Ocean raises the issue of whether the fee simple interest of Ocean was lienable. S-Marque says that the lien refers to Ocean. The **Mechanic's Lien Act** provides that a

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23 lien may be filed against anyone benefitting from the work. Ocean is the owner of the land and it must show that the work did not benefit it. Since that was not done, the lienability issue raised by Ocean does not persuade me that this is not a settlement benefitting Ocean.

As a result, this payment is to be reimbursed by Ocean on whose behalf it was made.

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Computer Inventory

Mahon's operated a computer division called Computers To Go. By late 1993, Mahon's decided to set the division up as a separate corporate entity. A new company, Newedge Technologies Incorporated, was set up to be run by Ron Nelson.

Dover had loaned $100,000.00 to Mahon's on November 24,1993 with the intent that it be secured by a debenture on Mahon's computer inventory. Dover believed it had a valid debenture. It did not: the debenture was never executed. In January 1994, Frank Matheson gave instructions to seize computer inventory from Mahon's pursuant to the debenture and equal to the debt. This was done and the inventory ultimately became part of Newedge's inventory for sale at its new location.

Because of the mistaken belief in the existence of the debenture and the consequent belief that the goods were taken pursuant to that debenture, no payment was made by Dover or Newedge to Mahon's for that inventory. Dover does not dispute that the

24 inventory was taken in error. The only issue in dispute between the parties is the value of the computer inventory taken.

Mahon's had done an inventory in early January, 1994. A subsequent inventory done approximately two months after Mahon's assignment in bankruptcy, showed that there was a shortfall of computer inventory.

McCuaig & Company Inc., the Trustee in Bankruptcy for Mahon's, prepared a report (Tab 231 of Exhibit 1) concluding that there was a shortfall in the computer inventory of Mahon's in the amount of $199,000.00. Dover says that the goods taken were valued at $110,790.00 as shown at Tab 211 of Exhibit 1. That is an invoice from Dover to New Edge containing a list of products and their costs.

The McCuaig report purports to be an opinion pursuant to s.100 (3) of the BIA. However it states:

> I have reviewed discovery transcripts and information we have in our files and in the company's records and offer the following comments:" (my emphasis)

The report concludes:

> Keeping in mind the foregoing assumptions with respect to the company's inventory records, we believe that the value of the shortfall in Information Processing Machine inventory is approximately $199,000.00.

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On cross-examination, Mr. McCuaig admitted that his report is not really an opinion but his observations. With respect to the variances between the computer print-out (Tab 174 of Exhibit 1) and the Dover list (Tab 211 of Exhibit 1), he admitted that there could be a number of reasons possible for those differences. These include the possibility of shoddy book-keeping, goods removed from inventory, errors, recording sales to the wrong department or even theft.

Mr. McCuaig admitted that he did not do any investigation nor an inventory. What he did was compare the computer print-outs (Tab 174) to the Dover list (Tab 211) to confirm if the prices on the two were consistent. He testified that he could not find all the items but that for those he did find that the pricing was consistent on both lists. He said that he assumed that the book value on the print-out was current and accurately reflected the value.

Jim McCallion testified about his role in the removal of the computer inventory from Mahon's. He said that he would have been sure the list prepared then was accurate because there was a guarantee to the Royal Bank and because, as he put it: "I do things right." Mr. McCallion said that he did not prepare the list but that Ron Nelson and one of his staff did it. He said his purpose for being there was to ensure that only inventory worth the proper amount was taken and nothing more. He says he was satisfied that $110,000.00 in inventory was removed.

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Mr. McCallion admitted on cross-examination that the computer print-out (Tab 174) might be inaccurate because of Ron Nelson's system for computer inventory, which was not the same as the system for the rest of the inventory of Mahon's. In fact, he said that he was aware of instances of records of Computers to Go not being accurate and that he went to them about it because it was part of the Mahon's operation and he was therefore responsible for it. He testified that those concerns were one of the reasons why the computer division became a separate company.

Ron Nelson testified that he worked with Jim McCallion and Kevin Russell and the controller for Mahon's to select the computer inventory and record it. He said that everyone had a copy of the list and that was what the document at Tab 211 was created from. He said that the list at Tab 211 is dated March of 1994 because the original list was handwritten and it was only typed up in March.

His explanation for the differences between the Mahon's list (Tab 174) and the Dover list (Tab 211) is that his system was more accurate than Mahon's. He said that he had no doubt that the list from his system was accurate.

Section 100 (3) of the BIA provides that an opinion of the trustee of the value of goods is to be accepted by the court unless another value is proven. It is on the basis of this provision of the BIA and the McCuaig report that S-Marque claims that the computer inventory taken should be valued at $199,000.00. There are two problems with this. The

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27 first is that Mr. McCuaig stated in his testimony that his report is more a series of observations than an opinion. From that, I conclude that it is not an opinion of value as contemplated by s. 100 (3).

Secondly, even if it were such an opinion, it can be displaced by proof of another value. That is what Tab 211 purports to be. 1 would have concern about its date in March if it were not for the testimony of Jim McCallion which I accept.

I found Jim McCallion to be an extremely credible witness, forthright and sincere. Where there are inconsistences between his testimony and that of other witnesses, I accept his evidence. Even Michael Sweett of S-Marque testified that Jim McCallion "had a degree of integrity".

Mr. McCallion testified that he would have made sure that the inventory taken was $110,000.00 and no more because he does things right and because there was a guarantee to the Royal Bank. When he says that, I accept his testimony. I am therefore satisfied that, although he does not have a copy of the list which Ron Nelson said he had, he took steps to ensure that no more than $110,000.00 worth of computer inventory left Mahon's. I am therefore satisfied that the value of computer inventory taken is as stated in Tab 211.

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Chattels

In conjunction with the establishment of Newedge as a corporate entity separate from Mahon's, Ira MacInnis, C.A. was retained. He is a chartered accountant with Doane Raymond and acts for the Homburg companies.

His time records (Exhibit 9) show that he met with Ron Nelson, subsequently with Jim McCallion and Ron Nelson and later with Frank Matheson and Ron Nelson. He also had a number of telephone conversations with Frank Matheson and with Ron Nelson. As a result, he prepared a document with respect to the steps to be taken to organize Newedge (Tab 148 of Exhibit 1). In that document, he stated the assets of Newedge to be:

Software (Delta system)	$ 5,000.00
Furniture and fixtures (excluding .	) $ 5,000.00
Store fixtures (	) $20,000.00
Show booth (	) $20,000.00
	$50,000.00

He noted that: "Mahon's Stationery will provide documentation and invoices to substantiate the values at which the assets were transferred.*

The information in this document also appears in Exhibit 10 which Mr. MacInnis says is his handwritten file notes.

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Mr. MacInnis testified that he asked for the fair market value of the assets and explained that to Ron Nelson. He said that he believes he prepared Exhibit 10 during a meeting he had with Ron Nelson.

On January 24,1994 Mahon's passed a Special Resolution authorizing the transfer of certain assets to Newedge for $50,000.00 (Tab 155 of Exhibit 1). The resolution provided that Newedge was to pay the purchase price by issuing 50,000 common shares with a par value of $1.00 each to Mahon's. A Bill of Sale (Tab 159 of Exhibit 1) was executed by Frank Matheson on behalf of Mahon's which listed the assets transferred as:

Display Booth
Racking, shelving, fixtures
Software (Delta Business Vision Systems)

The shares were issued to Mahon's. Tab 224 of Exhibit 1 shows that 50,001 shares were acquired by Mahon's. However, on the following day they were transferred to Homburg Industries Limited (25,501 shares) and Armchair Investments Limited (24,500).

Tab 165 of Exhibit 1 was described by Mr. MacInnis as a breakout of the $50,000.00 value. It is signed by both Jim McCallion and Ron Nelson and was used by Ira MacInnis as the basis of the opening Balance Sheet. The Opening Balance Sheet (Exhibit 11) of New Edge Technologies Incorporated shows "Fixed assets, at cost" of $50,000.00. It is made up of: $5,000.00 for software and $45,000.00 for furniture and fixtures. The auditors

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30 report at p. 1 of Exhibit 11 says that audits are done to "obtain reasonable assurance whether the financial statement is free of material misstatement". It then concludes:

> In our opinion, this financial statement presents fairly, in all material respects, the financial position of the company ..., in accordance with generally accepted accounting principles.

Mr. MacInnis said that for the value of the chattels he relied upon the fact that the two parties (McCallion and Nelson) had agreed. He said that he was not concerned about the valuations in the financial statement.

Jim McCallion testified about the values placed on the chattels transferred to Newedge. He said that the items had only nominal value to Mahon's and the software had no value to Mahon's. He testified that there were "tons" of shelving available in Metro and that if $10.00 was paid for it, it was only worth 5 cents. He also testified that he had no part in arriving at the $50,000.00 valuation but that he had no problem with it as the items had no value to Mahon's. He said he questioned how they were valued at $50,000.00. He testified on cross-examination that he knew it would be shown to a bank for financing purposes, but that in his view a banker would make his own assessment. He admitted that an audited financial statement would have been "good enough" for him.

Frank Matheson testified that the values used were to "prop up" the balance sheet, but that a lender would discount it and that it was not the basis for the financing in any event.

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Ron Nelson said that the $50,000.00 was an "arbitrary" number and that in retrospect he realizes it was too high. He said that it could be argued that the chattels were worth $10,000.00 or $50,000.00 and that if one were "creative" it could be $50,000.00. He too admitted that he knew that the figures would be relied upon by the financing institution. He said that the chattels would be traded for equity in Stat.

The defendants dispute that this is a settlement under s. 91 of the BIA or that it is caught by s. 100. However, this must be viewed in the context of the entire transaction.

The steps to incorporate New Edge are set out in Ira MacInnis' letter of January 19, 1994 to Frank Matheson of Dover Capital Corporation (Tab 148 of Exhibit 1). Step 1 is for Mahon's to transfer listed assets to New Edge in exchange for 50,000 common shares of New Edge.

Then, in Step 4, Mahon's is to sell its shares to Homburg Industries Limited and Armchair Investments Limitd for $50,000.00, which is then to be paid by Mahon's to Stat "as a partial repayment of the intercorporate loans". (Step 6).

The effect of this series of transactions is that Mahon's transferred away assets and received nothing for them. Because of this, the entire transaction constitutes a settlement.

The defendants also question the value the plaintiffs attribute to these chattels. Newedge says that the value is $15,000.00. This was the evidence of its witnesses, in

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32 spite of the fact that the Financial Statement of Newedge showed the assets valued at $50,000.00.

Jim McCallion's only concern was with Mahon's. He was not a director or otherwise a part of Newedge. It appears from the evidence that there were problems within the Computers To Go division of Mahon's and between Jim McCallion and Ron Nelson. These problems were to be resolved by the incorporation of Newedge, its establishment outside the Mahon's premises and the transfer of equipment and inventory to allow Newedge to begin operating.

Jim McCallion signed a memo (Tab 165 of Exhibit 1) dated January 26, 1994 from Mahon's to Newedge which states that the chattels are worth $50,000.00. As a former banker and an honest person, Mr. McCallion was clearly uncomfortable during his testimony with having signed that memo. He tested that he had doubts about the value but no reason to question it because the chattels were surplus to Mahon's and had no value to Mahon's.

Frank Matheson referred to "propping up" the balance sheet of Newedge. Ron Nelson referred to the figure as an "arbitrary" one and being "creative" to get the figure to $50,000.00.

Based upon the evidence before me, I conclude that these chattels were worth $15,000.00.

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$148.000.00 owed to Dover

The Royal Bank had loaned money to Mahon's which was secured by a debenture. By the end of January, 1994, the Bank was contemplating calling its loan.

On January 31, 1993 (sic 1994), Michael Sweett wrote to Richard Homburg (Tab 166 of Exhibit 1). In that letter he thanks for Mr. Homburg for advising him of the "status of Mahon's relationship with the Royal Bank." He goes on to say:

> As I understand the situation from you, Mahon's bank may be preparing to call their loan.

At Tab 167 is a copy of the letter the Royal Bank wrote to S-Marque on February 1, 1994. B. W. (Brian) Anderson, Account Manager of the Royal Bank said:

> We hereby notify you it is the Bank's intention on February 2, 1994, to make demand on Mahon's Stationery Limited for repayment of all funds owed.

The demands were made on Mahon's and its guarantors on February 2, 1994. The amount outstanding at the time was $1.8 million (Tab 186 of Exhibit 1).

On February 10, 1994, Mahon's Directors passed a resolution that: "The Company make a voluntary assignment in bankruptcy ...." (Tab 178 of Exhibit 1).

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Richard Homburg wrote to Brian Anderson at the Royal Bank on February 10, 1994 (Tab. 177 of Exhibit 1). In that letter he refers to "our discussions of yesterday and our subsequent agreement". The terms of the transaction whereby Dover would acquire the bank's security are set out in a letter dated February 11, 1994 from the Royal Bank to Dover, Mahon's and Stat (Tab 179 of Exhibit 1). It is signed by all parties. They include payment by Dover to the Royal Bank of $875,000.00 and transfer and assignment to Dover of the Royal Bank's security.

On February 15, 1994 (Tab 184), the date the assignment in bankruptcy was made, Dover wrote to S-Marque to advise that the Bank had on that date appointed a Receiver. The letter advised S-Marque:

> Pursuant to the enforcement of the security by the Bank, Dover Capital Corporation Limited has agreed to acquire the Mahon's business-and assets and the security which will continue to be enforced.

Dover purchased the Royal Bank debenture and took an assignment of the Royal Bank security. Dover paid the Royal Bank $875,000.00, which is close to the amount of $888,000.00 at which the Receiver for the Royal Bank had appraised the assets according to a letter from its lawyer (Tab 199 of Exhibit 1).

As a result, Mahon's became indebted to Dover for $1.8 million and Dover had a first charge upon Mahon's assets. Mahon's assets, seized pursuant to the Bank security assigned to Dover, were sold to a new company for $1,700,001.00 ($1.652 million net,

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35 after expenses of sale). This resulted in a shortfall of $148,000.00 on Doves realization on its $1.8 million security. Dover says that its security is still in existence and is still enforceable. It says that if additional funds fall into the estate of the bankrupt company, it is a secured creditor with respect to the amount of $148,000.00.

S-Marque says firstly that Dover has realized on its security and is an unsecured creditor for the shortfall. Secondly, it says that Dover's claim should be disallowed because Dover has taken no steps to realize upon its security against Ocean, which is a related company. It submits,' in the third alternative, that even if Dover's claim that it is a secured creditor for $148,000.00 is valid it should be subordinated to that of S- Marque by application of the doctrine of equitable subordination.

Dover does not admit that it has realized upon its security and is unsecured for the balance outstanding. However, there is a letter from Willard Strug dated April 19, 1994 (Tab 217 of Exhibit 1) to the Trustee in Bankruptcy in which Mr. Strug says:

> As you know Dover has enforced and realized on its security and we are filing the Proof of Claim based on your request. There is a balance of debt outstanding after realization on the security, you have been advised of the particulars of the amount. To the extent of this balance, Dover is an unsecured creditor.

Dover says this is a gratuitous comment by Mr. Strug. I disagree. This is Dover's own lawyer filing a Proof of Claim as an unsecured creditor for $148,000.00 still owing after

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36 it has realized upon its security.

Even if that were not the case, two questions remain: Has Dover realized upon its security? If so, then is it unsecured for the balance outstanding?

Dover bought the debenture from the Royal Bank of Canada and took an assignment of its security. It then made a demand under the debenture, seized assets pursuant to the demand and subsequently resold them.

The BIA provides in s. 127:

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

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

Pursuant to subsection (2), the security is turned over to the trustee for the benefit of all creditors, not just the secured creditor. In that case, the secured creditor proves his entire claim.

This is to be contrasted with subsection (1) in which the secured creditor "realizes his security°. In that case, he can only prove the balance due after deducting what has been realized.

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The clear intent of subsection (2) is that the secured creditor gives up his secured position by turning the security over to the trustee for the "general benefit of the creditors°. If I accept Dover's argument, a secured creditor, acting under subsection (1) would be in a better position with respect to a deficiency than he would be for his entire claim if he acted under subsection (2). This interpretation would make section 127 internally inconsistent.

As well, this interpretation is inconsistent with the nature of the secured creditor's secured position. Once the security is realized upon, the property which was the security for the loan is gone. In the case of a debtor who is not bankrupt, the deficiency can become the subject of a judgment, but that judgment is unsecured. It would be unfair to other creditors if a secured creditor's position with respect to a deficiency were enhanced by the bankruptcy of the debtor.

A number of bankruptcy decisions support this interpretation.

In Re Tuxedo Silver Limited (1961), 4 C.B.R. (ICS.) 95 (Man. Q.B. in bankruptcy), a secured creditor who had a total claim of $122,364.68 but who had recovered $37,695.00 on its security, was allowed an unsecured claim for the balance.

Similarly, in Re Levesque Auto Inc.; Compagnie Financiers Canadienne v. Gagnon (1978), 26 C.B.R.(N.S.) 234 (Que. S.C.) Lalande, J. allowed a claim for a balance

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38 owing after the secured creditor had realized upon its security, but only as an unsecured creditor ("creanciere ordinaire") (at p. 239).

Dover, however, says that it has not realized entirely upon its security. It says that if further assets come into the hands of the trustee as the result of reviewable transactions being voided they are assets which would have been seized by it under the debenture if they had been there at the time of the seizure.

Dover says that the decision in **Re J. K. Campbell Sz Associates Limited** (1989), 67 Alta. L. R. (2d) 142 (Q.B. in Bankruptcy) supports its argument that it can claim as a secured creditor for the balance owing of $148,000.00.

In that case, both the trustee in bankruptcy and the receiver appointed under a debenture believed that certain transactions entered into by the bankrupt company were preferences under the BIA. Each wished to commence action to recover the payments made but the trustee did not wish to do so if the recovery would benefit the secured creditor ahead of the other creditors.

The receiver/manager was appointed just over one month before the trustee in bankruptcy was appointed.

The bankruptcy court determined at p. 149 that:

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> ... the bank as debenture holder had a right of property from the date of execution of the debenture and not only from the date of crystallization of the debenture. The bank has, therefore, been a secured creditor of the bankrupt company at all material times, and pursuant to s. 69 (2) of **Bankruptcy Act** it is entitled to "realize or otherwise deal" with its security.

Registrar Quinn then concluded at p. 149 that:

> ... the trustee does not have the required status to commence such actions in the circumstances under consideration here.

The effect of this decision is that in a dispute between a receiver/manager and a trustee in bankruptcy about which can seek to set aside preferences, the receiver/manager has the first right to do so.

In this case, there is no dispute about who will take the action. The receiver did not seek to set aside reviewable transactions. The dispute is only about who is entitled to the moneys recovered as a result of the action to set aside transactions. The **J.K. Campbell** decision does not answer the question about entitlement as between the receiver and the trustee to moneys recovered.

All that Registrar Quinn said (at p. 149) was:

> ... I would not make a declaration that the proceeds from the preference actions commenced by the trustee against creditors of the bankrupt shall vest in the trustee free and clear of the receiver of the bankrupt company.

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40 This was said in the context of the registrars decision that the trustee could not act under the BIA and that if he did act under the Fraudulent Preferences Act that the proceeds 'would not vest in the trustee free and clear of the receiver ....'

This is scarcely an endorsement of the position taken by Dover. The Registrar had already decided that action could be taken by the receiver-manager not the trustee, "in the circumstances under consideration here."

Dover's position is inconsistent as well with a line of cases beginning in 1935.

In **Re Yagerphone Ltd.,** [1935] All E.R. 803 (Ch. D.), Justice Bennett says at p. 805:

> The right to recover a sum of money from a creditor who has been preferred is conferred for the purpose of benefiting the general body of creditors and ... the sum of money ... did not become part of the general assets of Yagerphone, Ltd., but was a sum of money received by the liquidators impressed in their hands with a trust for those creditors amongst whom they had to distribute the assets of the company.

Yagerphone was cited in Re Maybank Foods Inc. (1990), 78 C.B.R. 79 (Ont. S.C. in Bankruptcy), where Saunders, J. says at p. 81:

> It is conceded by the respondent that the moneys recoverable by a trustee from a creditor who has been preferred do not become part of the general assets of the bankrupt estate subject to the claims of secured creditors, but

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> rather are received by the trustee subject to a trust in favour of the creditors represented by the trustee: Re Yagerphone Ltd . ....

The Supreme Court of Canada recognized this principle in Ramgotra (Trustee of) v. North American Life Assurance Co., [1996] 3. W.W.R. 457. In that case, Gonthier, J. says at p. 480:

> If a settlement is declared void against the trustee, then the settled property reverts back to the bankrupt's estate, and falls into the possession of the trustee in bankruptcy.

In Canadian Imperial Bank of Commerce v. Canotek Development Corporation (1997), 35 O.R. (3d) 247 (Ont. C.A.), McKinlay, J.A. says at p. 256:

> Section 95 renders a fraudulent preference void as against the trustee in bankruptcy; it does not render it void as against a secured creditor.

Furthermore, in Bank of Montreal v. Bray (1997), 36 O.R. (3d) 99 (Ont. C.A.), Justice Rosenberg says at p. 106:

> There is little ambiguity in s. 2 of the (Fraudulent Conveyances) Act Transactions made with intent to defraud creditors are void as against those creditors. There is nothing in s. 2 that renders the transaction void as against the parties to the transaction.

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Although that case dealt with another statute, there is little difference between the language of the Fraudulent Conveyances Act and the BIA. The effect of all these decisions is that overturning a fraudulent preference puts the property back in the hands of the trustee. The transaction is void as against the trustee in bankruptcy. The property does not, however, revert to the bankrupt to be available as part of the security over which a secured creditor has rights of seizure.

Sections 127 to 134 of the BIA deal with claims by secured creditors. In The 1998 *Annotated Bankruptcy and InsolvencyAct* (Houlden and Morawetz, Carswell, Toronto), the authors say in their commentary on these sections, at p. 384:

> A secured creditor may realize his or her security and prove a claim as an unsecured creditor. s. 127 (1). Similarly, if the secured creditor is required by the trustee pursuant to s. 128 (1) to file a proof of security and to assess the value of his or her security, the secured creditor will be an unsecured creditor for the balance due after deducting the assessed value of the security: s. 128 (2). If, after valuing the security, a secured creditor realizes the security, the net amount realized is substituted for the prior valuation, and the secured creditor will be an unsecured creditor for.the balance due after deducting the amount of the realization: s. 131.

Section 128 (2) says:

> 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.

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43 Section 133 says:

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

Sections 148 to 154 of the BIA deal with dividends. The wording of these sections provide that dividends are paid only to unsecured creditors. Accordingly, when sections of the Act refer to a secured creditor being paid a dividend, as sections 128 (2) and 133 do, it is clear that the secured creditor receives a dividend only with respect to his unsecured claim as an unsecured creditor.

In addition, S-Marque says that because it is acting under s. 38 of the BIA it has a claim to the property of the bankrupt which supersedes any other claim including that of a secured creditor because that recovery is only for the benefit of s. 38 creditors.

Section 38 of the BIA provides:

> 38. (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.
>
> (2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose

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in action or subject-matter of the proceeding, including any document in support thereof.

(3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

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In **Re Garage Causapscal Limitee, Traders Finance Corporation Ltd.** v. Levesque (1960), 26 D.L.R. (2d) 384 (S.C.C.), the position of a s. 38 creditor was considered by the Supreme Court of Canada. In that case, the court had to consider whether a s. 38 creditor was an assignee of the trustee in bankruptcy. In his reasons for judgment, Fauteux, J. says at p. 390:

> ... s. 16 (now s. 38) grants the prompt creditor who wishes to sue in his own name and at his own risk and expense, exclusive preference to the extent of his claim and expenses. It is this preferential right which the respondent is asserting in his proceedings. This right is conferred on him by the law and not by the Trustee. It differs, moreover, essentially from that which the Trustee, acting for the creditors as a whole, could have asserted for the benefit of the estate.
>
> Section 16 (38) of the new Act upholds this preferential right, but provides that the action to assert it must be taken by the creditor personally and not by the Trustee. It is for that reason that Parliament, by s. 16 (38), has obliged the latter to assign and hand over to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding ... upon the order authorizing the creditor to sue being given. This obligation is a consequence and not a condition of the preferential right and of the right to sue to assert it.

45 The General Division of the Ontario Court of Justice says in Penfold v. Provenzano (1996), 42 C.B.R. (2d) 148, at p. 155, that the interpretation of s. 38 should be:

... large and liberal, in favour of its intended purposes and beneficiaries.

The Supreme Court of Canada again dealt with s. 38 in Employers' Liability Assurance Corp. Ltd. v. Ideal Petroleum (1959) Ltd. (1977), 75 D.L.R. (3d) 63. In that case, Justice de Grandpre says at p. 65:

In the lower courts, s. 38 has been considered as well. In Re Ontario Metal Importers Ltd. (1992), 15 C.B.R. (3d) 8 (Ont. C.J., Gen. Div.) (In Bankruptcy), Registrar Ferron says at p. 10:

The proceeds of a successful recovery as result of an action commenced under the authority of s. 38 are not "proceeds realized from the property of the bankrupt", as that phrase is used in (s. 136 of the Bankruptcy Act) and accordingly the section has no application to such distribution .

... The moving party's preferred status given in the Bankruptcy Act cannot be imported into s. 38.

In Toyota Canada Inc. v. Imperial Richmond Holdings Ltd. (1993), 20 C.B.R. (3d) 102, Justice Miller says at p. 115:

It would make sense that only those creditors who wished to take the risk of

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the action on would benefit from any fruits the action may bring. Therefore, s. 38 (3) clarifies this point exactly. Instead of the benefits accruing to the estate of the bankrupt, the benefits will first accrue to those creditors who chose to take the risk.

At p. 118, he continued:

The assignment is not a condition of the creditors acquired right to take the action, but merely a consequence of it.

In the **Penfold** case, Justice Whalen says at p. 157:

Therefore, an assignment executed pursuant to Section 38 of the Act is neither the foundation of the action nor the manner by which the claimant acquires his right and status. These are personal to the creditor and are founded upon or accorded by the section itself, not the assignment. Although the Supreme Court of Canada did not discuss the reason for requiring the assignment, the purpose is apparent. By assigning his right and interest in the subject matter of the claim, the trustee exhausts his residuary interest in the matter ....

Accepting this analysis and law (as I must), I also accept that a s. 38 assignment by the trustee is not a condition precedent to the remedy extended by the section. Rather, it is a consequence.

To the contrary is Re: **Lawrason's Chemicals Ltd.** (October 8, 1997, O.C.J. File No. 31-204441-T). It says that the proceeds of impugned transactions return to the estate of the bankrupt and that the security of a secured creditor with a deficiency is revived and

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47 has priority. It also says that this applies even to transactions set aside in an action by a creditor acting pursuant to s. 38. This is a decision in direct conflict with those cited above; however, it is on appeal.

In any event, based upon the decisions in Garage Causapscal and Employers' Liability Assurance, both of which are decisions of the Supreme Court of Canada and also based upon Re Ontario Metal Importers, Toyota and Penfold, I conclude that when a creditor undertakes an action pursuant to s. 38 of the BIA that there is no residuary interest in the trustee on bankruptcy. Accordingly, any recovery made pursuant to an action undertaken by a creditor is for the benefit of that creditor. The recovery does not fall into the hands of the trustee, whose powers are exhausted with respect to that claim. There is therefore no fund to which any secured creditor can assert priority.

The effect of s. 38 is that only those who pursue can benefit.

At the time Dover made its seizure under the debenture, part of the security it had was a second ranking on the building at 70 Akerley Boulevard which had been conveyed by Mahon's to Ocean. Ocean is a related company to Dover. Frank Matheson of Dover testified that they did not try to realize upon this security because he said it had no value beyond the amount of the mortgage.

However, there is no indication in the evidence before me that an appraisal was

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48 done by or for Dover nor is there evidence of the principal outstanding on the mortgage eight months after the conveyance had been made. If mortgage payments were being made, and there is no evidence of default by Ocean on the mortgage, the principal should have been reduced. Furthermore, more than $150,000.00 in renovations had been done to the property after it was conveyed to Ocean. Ocean paid for $150,000.00 in improvements and as discussed above, the paving was paid for by Mahon's in the amount of $27,500.00. Those improvements may have increased the property value and therefore Ocean's equity in the property.

Dover cannot make a claim for a deficiency when it has not exhausted all remedies available to it under its security documentation. However, because it did seize assets in February, 1994 and has not made any attempt to realize upon its security against 70 Akerley Boulevard, I conclude that it has realized upon its security in its entirety.

Dover also says that there is provision in the BIA for it to revalue its security. Section 132 (1) says:

> 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.

There are only two situations where a creditor can revalue its security. The first is

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49 where it made a good faith but mistaken estimate. In this case, Dover says that since transactions with companies related to it have been overturned, it can revalue because its earlier valuation of its security was mistaken, although made in good faith. The very fact that transactions with companies related to Dover have been overturned in itself says that the earlier valuation by Dover was not made "in good faith on a mistaken estimate".

The other situation in which a revised valuation can be made is where the security has "diminished or increased in value since its previous valuation." Dover is saying that this applies where there is now additional security which it wishes to value for the first time. I reject Dover's argument on this point. The intent of this section is for a secured creditor to place a value upon the items it originally said were its security. It is not to be used to add security, especially when that additional security, if that is in fact what it is, is available because of the efforts of a s. 38 creditor who has overturned transactions involving companies related to Dover.

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Equitable Subordination

S-Marque argues in the further alternative that the doctrine of equitable subordination should be invoked. Dover says that the doctrine does not apply in Canada and that I should not write it into the legislation. Dover further says that there was nothing inequitable about the way in which acquired and exercised on the security.

The doctrine has been codified in the *United States Bankruptcy Code.* It is not a

50 part of the BIA.

The doctrine has been considered in the following Canadian cases. In AEVO Co. v. D & A MacLeod Co. (1991), 7 C.B.R. (3d) 33 (Ont. Ct. Gen. Div.) (In Bankruptcy), Chadwick, J. said at p. 38:

> ... I cannot agree that the doctrine of equitable subordination has any application in Canadian bankruptcy law.
>
> The **Bankruptcy Act** itself provides how claims are to be identified and how the estate is to be distributed.
>
> To incorporate the doctrine of equitable subordination into the **Bankruptcy Act** would create chaos and lead to challenges of security agreements based upon the conduct of the secured creditor.
>
> If the Parliament of Canada felt that this doctrine had some application, I am confident that in their wisdom they would have incorporated similar provisions into our statute.

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In the British Columbia Court of Appeal, the possibility of such a doctrine was not entirely foreclosed. It was argued in Laronge Realty Ltd. v. Golconda Investments Ltd. et al. (1986), 7 B.C.L.R. 90 C.A.) at p. 96 that:

> When the Supreme Court of British Columbia sits as a Bankruptcy Court, it is a court of equity and as such is bound to give equitable relief to applicants entitled.

", Esson, J.A. said at pp. 96-7:

The authority mainly relied on is a decision of the Supreme Court of the United States, **Pepper v. Litton,** 308 U.S. 295, 84 L. Ed. 281 (1939), which is said to establish the principle that, where a claimant in bankruptcy has violated the rules of fair play and good conscience, the claim may be disallowed.

I find it unnecessary to reach any firm view as to whether that doctrine is part of Canadian law. I point out that s. 153 of the **Bankruptcy Act,** which confers bankruptcy jurisdiction on the Supreme Court of British Columbia and on other courts in other provinces, confers upon them "such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy..."

The respondent has referred to some cases which appear to have applied the rules of equity but, in view of the conclusion I have reached on the first two grounds, I prefer to say no more than that it should not be inferred that there is no such jurisdiction available. I would not wish to say anything which would encourage the view that the court does not have a long arm to prevent the kind of grossly unjust results which I think would have been achieved had the appellants succeeded in the position they took.

The Supreme Court of Canada has, since the date of those decisions, rendered its decision in Canada Deposit Insurance Corp. v. Canadian Commercial Bank (1992), 16 C.B.R. (3d) 154. In that decision, Iacobucci, J. dealt with the doctrine of equitable subordination as an alternate argument. He says at p. 191:

> ... it is argued that the equitable jurisdiction of superior courts gives them authority in insolvency matters to subordinate claims that, while valid as against the insolvent's estate, arise from or are connected with conduct prejudicial to the interests of other creditors.
>
> This issue does not appear to have been raised before Wachowich J. or the Court of Appeal and consequently this court does not have the benefit of any findings of fact as to the actual or potential prejudice suffered ....

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This court also does not have the benefit of the insight of the courts below as to whether or not, in the first place, the doctrine of equitable subordination should become part of Canadian insolvency law.

Iacobucci, J. reviews the three requirements for its application in the United States.

He then goes on to say at p. 192:

Even if this court were to accept that a comparable doctrine to equitable subordination should exist in Canada, I do not view the facts in this case as giving rise to the "inequitable conduct" and ensuring (sic) "detriment" necessary to trigger its application.

He concludes at p. 193:

Accordingly, I would reject this alternative ground of appeal. Even if equitable subordination is available under Canadian law, a question which I leave open for another day, the facts of this case do not call for an intervention with the pan passu ranking of the respondents in the name of equity.

Following that decision, Chadwick, J. again had an equitable argument raised before

him in **Re/Max Metro-City Realty Ltd. v. Baker (Trustee of)** (1993), 16 C.B.R. (3d) 308

(Ont. C.J. (Gen. Div.) (In Bankruptcy). He refers to the CDIC case and says at p. 313:

Although his comments are obifer and apply to the winding-up legislation, he appears to leave the door open for its application in appropriate cases in the

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53 future.

Chadwick, J. then declines to apply the doctrine in the case before him.

Is this an appropriate case? The principles set out by Iacobucci, J. in CDIC at pp. 191-92 are:

> ... (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute ....

In the cases before Chadwick, J. the creditor seeking the application of the doctrine was seeking to use it to raise his claim from one of unsecured creditor to secured creditor. In **AEVO,** a creditor was seeking an order requiring the trustee in bankruptcy to pay it moneys pursuant to a general security agreement. In **Matticks v. B & M Construction Inc.** (Trustee of) (1992), 15 C.B.R. (3d) 224 (Ont. CA (Gen. Div.) [In Bankruptcy], a guarantor sought payment by the trustee of the balance of funds held by him. Chadwick, J. says at pp. 227-28:

> ... Karen Matticks has an equitable charge against the lands in question, but she did not take an assignment of the security .... The guarantor had the opportunity of paying out Central Guaranty Trust and taking the assignment of the mortgage security .... The fact that she has made a number of monthly payments ... does not make her a secured creditor ....

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In **Re/Max,** Chadwick, J. says at p. 313:

> The statutory provisions of the **Bankruptcy Act** does (sic) not go so far as making an unsecured creditor secured or providing one creditor with a preference over another by application of equitable principles.

In those cases, a creditor was trying to use equitable principles to raise itself above other creditors. In this case, a creditor who has acted under s. 38 invokes the equitable principle to prevent a company, related to those against whom it has been successful in its s. 38 action, from taking the benefit of that action by asserting its rights as a secured creditor.

S-Marque has acted under s. 38 of the BIA to have transactions reviewed and declared void. The moneys or other assets that are affected are available for the benefit of only those who pursue them under s. 38. A situation where a creditor who is related to parties to the voided transactions will benefit from the action by S-Marque brings this case within the three principles for application of the doctrine of equitable subordination in the United States. The inequitable conduct is the conduct that has resulted in the voiding of the transactions. In one case, Dover itself would be prevented from recovery except after all other creditors pursuant to s. 137 of the BIA. That section provides:

> 137. (1) A creditor who entered into a reviewable transaction with a

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debtor at any time prior to the bankruptcy of the debtor is not entitled to claim a dividend in respect of a claim arising out of that transaction until all claims of the other creditors have been satisfied unless the transaction was in the opinion of the trustee or of the court a proper transaction.

In other cases, it is the conduct of other companies that has resulted in the voiding of the transaction. These companies are related to Dover within the meaning of the BIA. If Dover gets the benefit of the s. 38 action, then it will result in injury to S-Marque and will confer an unfair advantage upon Dover. In my view, to invoke the principles of equity to subordinate the claim of Dover in these circumstances is not inconsistent with the provisions of the BIA. The Act already provides for a kind of subordination in s. 137. The intent of that section is to prevent a creditor who has entered into a reviewable transaction from benefitting from the voiding of that transaction. It is a limited and equitable extension of that section to prevent a creditor who is related to a creditor who has entered into a reviewable transaction from benefitting either.

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It is this conduct, that is the conduct resulting in the entering into of reviewable transactions which have now been declared void, that is the inequitable conduct, not, as Dover suggests, its conduct in acquiring and exercising on its security.

If I am wrong in concluding that Dover is only an unsecured creditor for the balance of its claim and unable to share in the s. 38 benefit because it did not participate in the s. 38 action, then I would invoke the principles of equity to prevent Dover from benefitting from the reversal of transactions that were improperly entered into by companies related

56 to it within the meaning of the BIA.

Guarantee

Richard Homburg testified that he would never have given a guarantee without it being part of a deal to convert $650,000.00 of Mahon's debt to S-Marque into preferred shares of Stat (the "Debt to Equity Conversion") . He testified that he has never given a third party guarantee. He also testified that there was only an agreement in principle and that it was up to the lawyers to work out the terms.

Michael Sweett, on the other hand, said that his understanding was that the guarantee was with respect to the current accounts receivable and not related to the Debt to Equity Conversion, which was with respect to long overdue accounts receivable. He said that the wording of the guarantee was to be put in legal terms but that the deal had been finalized between the parties and there were to be no further negotiations. He said in his testimony that the deal was "fairly clear-cut" when he signed the letter dated October 17, 1993 (Tab 122 of Exhibit 1; also in Exhibit 2, the Guarantee Exhibit Book at Tab 24.). That letter was also signed by Richard Homburg and each page initialled by him.

The letter was originally sent by Michael Sweett to Richard Homburg. It was marked *"DRAFT"* (Tab 23 of Exhibit 2). The letter begins:

> This document is intended to finalize the deal reached between S-Marque Inc.,
>
> yourself and Mahon's Stationery Limited during our conference call of

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October 15, 1993. This document will also attempt to deal with a few miscellaneous issues of minor significance not covered in our call as well as the practical method of handling some elements of the agreement. By covering off all these items in this document there need be no misunderstanding between ourselves and Mahon's management at a later date.

Section A is entitled: "Amounts Owing". Under that heading there are five subheadings after the phrase: "There are five amounts that must be dealt with as part of this deal".

The first one listed is "Current Accounts Payable Mahon's to S-Marque.

In the original letter (Tab 23 of Exhibit 2), S-Marque proposes that the amounts owing will be paid according to the following schedule:

$ 50,000.00	Immediately
$150,000.00	October 31 st
$ 12,500.00	Weekly after October 31st (Postdated cheques to be provided)

Michael Sweett's letter was edited and then faxed by Richard Homburg back to Mr. Sweett on November 9, 1993 with the covering message to: "Please call when you have received this fax."(Tab 24 of Exhibit 2) There is a handwritten note on the fax cover sheet: "Signed as requested" followed by Michael Sweett's initials.

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In the final version signed by all (Tab 24), this schedule changed to the following:

$100,000.00 Immediately

$ 12,500.00 Weekly after November 10t' (Postdated cheques to be provided)

Below that an arrow was drawn to the bottom of the page on which there is, in Richard Homburg's hand-writing, the words: "with $100,000 balloon payment at maturity, such payment to be guaranteed by Homburg Industries Limited."

It is on the basis of this signed letter that IS-Marque now claims that Homburg Industries Limited must pay it the sum of $100,000.00.

In *The Law of Guarantee* (2"ded. Carswell), Kevin P. McGuiness says at p. 107:

> 4.2 The requisites of a binding guarantee are essentially the same as the requisites for any legally binding contract. Briefly stated, in order for a guarantee obligation to have come into existence, it is necessary for there to have been an offer and acceptance, sufficient certainty of terms for the courts to be able to determine the nature and scope of the obligation that has been assumed, valid consideration to support to (sic) the contract, a voluntary assumption of obligations by the parties to the agreement accompanied by an intention to enter into a legally binding agreement, and compliance with the formal requirements that arise under the **Statute of Frauds.** Once these requirements have been satisfied, then any guarantee, like any other contract entered into between mentally competent persons of full age, will be enforceable by the parties to it ... provided it is neither illegal, immoral nor contrary to public policy.

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59 There is nothing in the Letter Agreement between the parties that contemplates that it will be embodied in a formal written document. Accordingly, no question arises in this case about whether the parties in so providing considered the contract incomplete or whether they intended the formal document to be merely a solemn record of an agreement already made.

Is the Letter Agreement sufficiently certain in its terms to be a contract? S-Marque says that it is.

In Hillas and Co. Limited v. Arcos Limited (1932), L.T. 503 (H.L.), Lord Wright said at p. 514:

The document of the 213' May 1930 cannot be regarded as other than inartistic, and may appear repellant to the trained sense of an equity draftsman. But it is clear that the parties both intended to make a contract and thought they had done so. Business men often record the most important agreements in crude and summary fashion; modes of expression sufficient and clear to them in the course of their business may appear to those unfamiliar with the business far from complete or precise. It is accordingly the duty of the court to construe such documents fairly and broadly, without being too astute or subtle in finding defects; but, on the contrary, the court should seek to apply the old maxim of English law, venba *ita sunt intelligenda ut ryes magis valeat quam pemat.* That maxim, however, does not mean that the court is to make a contract for the parties, or to go outside the words they have used, except in so far as there are appropriate implications of law ....

The Hillas decision was cited with approval both by the Court of Queen's Bench in Saskatchewan (in Rychjohn Investments Ltd. v. Hunter (1979), 100 D.L.R. (3d) 652) and

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60 the Ontario Court of Appeal (in Canada Square Corp. Ltd. v. **Versafood Services Ltd.** et al (1981), 130 D.L.R. (3d) 205). Morden J.A., at p. 216 of the Canada Square decision, says:

> *Corbin on Contracts, vol.* I (1963), at p. 93, observes that "[t]he fact that [the parties] have ... acted [by rendering some substantial performance or by taking other material action in reliance upon their existing expressions of agreement] is itself a circumstance bearing upon the question of completeness of their agreement."
>
> He continued at p. 217:
>
> ... the parties by their words and actions following October 14, 1969, conducted themselves in a way which showed that it was more probable than not that from that date forward they regarded their relationship as being of a binding nature rather than one of two parties still engaged in negotiation.

Prior to the Letter Agreement, S-Marque had been discussing with Mahon's on a regular basis its concern about Mahon's current account with S-Marque. It had threatened on a number of occasions to stop further shipments of inventory to Mahon's because of these concerns. This is illustrated by the memo from Michael Sweett to Richard Homburg of October 1, 1993 (Tab 105 of Exhibit 1), where he says:

> As Jim McCallion rightly states in his letter I cannot authorize further shipments to him until the payment due September 301 is made.

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After the Letter Agreement was signed, there was no further correspondence of that nature.

On the other side, the terms of the payment schedule were carried out. The payment of $100,000.00 was made and weekly payments of $12,500.00 began. The first weekly payment and the $100,000.00 payment were made on November 10, 1993 (Tab 227 of Exhibit 10), the day after the execution of the Letter Agreement.

Both parties therefore acted on the deal as if it had been finalized not as if it were still to be negotiated.

However, there remains the issue of whether the subsequent correspondence between the lawyers for the parties resulted in the original agreement being rescinded and a new deal being negotiated. Waddams in The Law of Contracts, V ed. (Toronto: Canada Law Book Inc., 1993) says at paragraph 30:

> Where there appears to be a firm agreement at one stage, but subsequently negotiations resume, the facts are susceptible of at least two analyses. There may be an agreement that remains intact, with subsequent negotiations on a supplementary agreement, the failure of which is irrelevant to the enforceability of the prior agreement, or the subsequent negotiations may show that there is no agreement, either because, looked at as a whole, events show a rescission of the earlier agreement, or sets up an estoppel. The latter analysis seems appropriate where one party in negotiating for better terms, leads the other to believe that there is not yet any firm agreement at all ... On the other hand, if both parties know, or should know, that the negotiations look to supplement to an existing firm agreement, there is a strong case for permitting enforcement of that agreement when the supplementary negotiations fall through.

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In *Chitty on Contract,* 26' edition, the authors say at paragraph 54:

> Negotiations with a view to contracting may be long and complicated; and in such cases it may be hard to tell when (if at all) an offer has been made and accepted. The court then has to look at the whole course of the negotiations and to determine at what point (if any) the parties reached agreement. The parties may of course continue their negotiations after this point has been reached; but this fact will not affect the existence of the contract between them unless the continuing negotiations can be regarded as an agreement to rescind the original contract.

In Bellamy v. Debenham (1890), 45 Ch. D. 481, North, J. said at pp 493 94:

> The question, therefore, is, whether subsequent negotiations can be looked at, merely for the purpose of preventing that which would otherwise be a complete contract from being so. In my opinion, when once it is shewn that there is a complete contract, it is impossible that further negotiations between the parties can, without the consent of both, get rid of what I may call the crystallized contract already arrived at, and as, in the present case, contained in the letters . ... The question is really one of fact; ....

That case was cited in **Cumberland Realty Group Limited v. Braaten et al** (1983),

27 Sask. R. 50 (Sask. Q.B.) where Halvorson, J. said at pp. 53-4:

> In circumstances such as here exist, where an enforceable contract is said to arise from letters passing between the parties, the court must take into consideration not only those letters but all the correspondence prior and subsequent to the letters. As well, in my view, the conduct of the parties is important as is the time frame of the correspondence.

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The question to be asked in the present instance is: does the conduct of the parties and all the relevant correspondence between them establish that the May 25th letter was a binding contract and not simply a proposal or step in the negotiations?

Viewing the problem from this perspective I am satisfied the offer and acceptance in the May 25th letter did constitute a binding mortgage renewal. That the parties intended this result is evident from the fact I mentioned earlier of the defendant commencing payments on the mortgages according to the terms of the letter and the plaintiff accepting same.

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There is nothing in the correspondence between the lawyers for the parties which leads me to conclude that the original agreement in the Letter Agreement was rescinded and that a new deal was being negotiated. The delay in finalization of the Guarantee document centred around how the amount owing by Mahon's on July 15, 1994 would be calculated. There were two considerations: (1) credits for rebates owing to Mahon's and (2) the guarantee being limited to $100,000.00 even if Mahon's owed more on that date. Late in the correspondence a concern about the date the guarantee of payment would take effect was raised. The parties then discussed whether, if the debt had not been reduced to $100,000.00 by the weekly payments and if the weekly payments continued, the guarantee would take effect at the later date.

With respect to the rebates, the Letter Agreement (Tab 24 of Exhibit 2) provides that: "This amount less any rebates ... will be paid in full between now and July 15, 1994 ...." The rebates were dealt within the original agreement and formed one of its terms. The parties were not negotiating anything new about it, only wording to reflect the agreement about rebates which had already been made.

The Letter Agreement refers to a Guarantee of $100,000.00 in the following words: "with $100,000.00 balloon payment at maturity, such payment to be guaranteed by Homburg Industries Limited." This is a clear provision that $100,000.00 is what is guaranteed. There is, in my view, no ambiguity about its meaning, such that further negotiations would be required.

With respect to the proposed amendment about the timing of the guaranteed payment, this was a new term, not raised previously. It was first raised in a telephone conversation of January 6,1994 between Willard Strug and Jodi Nieman. The notes of this conversation are in Tab 44 of Exhibit 2. This was six weeks after the initial correspondence between the lawyers and almost two months after the Letter Agreement was signed on November 9, 1993. One can only speculate that by that time there may have been concern about whether Mahon's could continue the $12,500.00 weekly payments on schedule. It is also to be noted that this was only 19 days before the January 25, 1994 memo (Tab 160) from Jim McCallion to Richard Homburg in which Mr. McCallion says: "It is obvious that Mahon's is bankrupt."

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This provision about timing was a new term which Homburg Industries sought to add to the deal already made. As was said in Bellamy v. Debenham, this cannot "get rid of ... the crystallized contract already arrived at ...."

Jim McCallion testified that he did not recall that Richard Homburg ever told him that the guarantee was conditional upon the successful completion of the Debt to Equity

Conversion. He did say, however, that it was given in the context of the dealings between S-Marque and Mahon's and that it was an understanding. He also admitted on crossexamination, however, that if it was a condition it could have been stated explicitly.

After the November 9, 1993 exchange of faxes, there followed a letter from SMarque's lawyer, Elizabeth Fisher, to Willard Strug dated November 19, 1993 (Tab 34 of Exhibit 2). In that letter, Ms. Fisher refers to her discussions with Michael Sweett about the share subscription. There is no reference in that letter to the Guarantee. Nor is there in the reply from Willard Strug dated November 22, 1993 (Tab 35). Three days later, on November 25, 1993 a letter (Tab 36) is sent by Jodi Nieman, a lawyer in the same firm as Ms. Fisher, to Willard Strug in which Ms. Nieman says:

> I am enclosing at the request of Elizabeth Fisher a Guarantee of Homburg Industries Limited, which we have prepared in accordance with the letter *agreement* dated October 17, 1993. (My emphasis)

In his reply, dated November 29, 1993 (Tab 38 of Exhibit 2), Mr. Strug says:

> I have now received instructions with respect to the Guarantee and would advise as follows:

There is no mention of the guarantee being conditional upon completion of the conversion, about which Mr. Strug and Ms. Fisher had been corresponding a matter of days previously.

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The November 29 letter from Mr. Strug concludes: "Once the Guarantee has been amended, it is acceptable to the Guarantor."

In the succeeding series of correspondence between the two lawyers (Tabs 39, 40, 43, 48, 49, 50, 52, 54 and 55 of Exhibit 2), there is never any reference to the Debt to Equity Conversion nor to any other conditions upon which the guarantee hinged. The January 18, 1994 letter from Willard Strug to Jodi Nieman (Tab 52 of Exhibit 2) says:

> Homburg Industries Limited is guaranteeing this last $100,000.00 payment. In the event of a default in the weekly payments, Homburg Industries is guaranteeing the $100,000 final payment.

From the. evidence, I conclude that Homburg did give a guarantee which was unconditional. The deal was a deal already made being reduced to writing, as set out in the October 17, 1993 letter as amended and not a deal to be finalized.

Section 7 of the **Nova Scotia Statute of Frauds, R.S.N.S.** 1989, c. **442** provides:

7 No action shall be brought

(b) whereby to charge any person upon any special promise to answer for the debt, default or miscarriage of another person;

unless the promise, agreement or contract upon which the action is brought, or some memorandum or note thereof, is in writing, signed by the person

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sought to be charged therewith or by some other person thereunto by him lawfully authorized.

The Letter Agreement satisfies the requirement that the particulars of the guarantor's obligation be certain. The formality or informality of the document is not important as long as the other conditions are met, as I find they are in this case.

In The *Law of Guarantee,* Kevin McGuinness says at pp. 127-28:

> In general, the same rules respecting written evidence apply in the case of a guarantee given by a corporation as in the case of a guarantee given by an individual. Because a corporation is an artificial person, it must of necessity act through its agents and, as we have seen, agents may act only as authorized. However, the laws of agency, insofar as they apply to corporate agents such as directors and officers, have now been substantially modified by statute. Thus, a corporation may not defend against a guarantee given in its name on the grounds that a person held out by it as being a director or one of its officers or agents was not duly appointed, or on the grounds that the director, officer or agent lacked the power to exercise the authority or perform the duties that are customary for such person to possess in the business of the corporation, or are usual for the director, officer or agent. Furthermore, a corporation is prohibited from asserting that a document is not valid or genuine if it was issued by any director, officer or agent who has or would normally have the authority to issue that document.

The parties who signed the Letter Agreement are Michael Sweett, Richard Homburg and Jim McCallion. Michael Sweett sent the original correspondence on S-Marque letterhead as President of S-Marque Inc. Although it was addressed to Richard Homburg personally, the return fax was covered by a cover sheet with the logo of the Homburg companies and from the fax number of "Homburg Dover".

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More importantly, Richard Homburg was acknowledged by all witnesses as the operating mind of the Homburg companies. He himself testified that he "gets involved when things don't go right". There is no doubt that things were not "going right" with Mahon's at the time of the Letter Agreement. He also said, when asked if he had close control of the business operations of his companies, "I know what's going on." When asked the same question about Mr. Homburg, Frank Matheson replied that Richard Homburg had close control.

I have no doubt that Richard Homburg was acting as the authorized agent of Homburg Industries Limited when he signed the agreement. I am therefore satisfied that the proper officers of the corporations involved in the Guarantee signed the Letter Agreement.

Homburg Industries says there was no consideration for the guarantee because, as it was part only of the entire restructuring agreement and the conversion did not occur, the overall agreement failed.

S-Marque says that the guarantee stood alone. It says that the consideration was that S-Marque would continue to provide product to Mahon's and increase its account receivable with Mahon's. It also says that the guarantee was given in consideration of SMarque foregoing the payment of $100,000.00 of the $200,000.00 owed at the end of October.

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I am satisfied that the guarantee was a separate deal from the Debt to Equity Conversion. I am also satisfied that there was consideration for the guarantee in the form of the continuation of supply of product to Mahon's and in Mahon's having to pay only $100,000.00 not $200,000.00 at the end of October.

S-Marque says that the doctrine of frustration applies because of the actions of the Royal Bank and because the guarantee was part of the entire restructuring deal, which was not completed. However, first, I have concluded that the guarantee was not a part of the overall conversion deal. Secondly, I have concluded that the guarantee was set out in the Letter Agreement of November 9, 1993. It was in effect when the Royal Bank demanded payment, the contract was not frustrated and the guarantee is enforceable by S-Marque.

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Homburg Industries must pay S-Marque the $100,000.00 pursuant to the guarantee set out in the Letter Agreement.

Misrelaresentation

Homburg Industries counterclaims against S-Marque for misrepresentation. In a separate action, Stat, Dover and Ocean claim against S-Marque for misrepresentation. The alleged misrepresentation, in both cases, is with respect to S-Marque's promise to subscribe for equity in Stat in exchange for debt owed by Mahon's.

Homburg Industries says that it would not have offered the guarantee if S-Marque had not indicated that it would and could complete the Debt to Equity Conversion. Dover

70 says it lent $100,000.00 to Mahon's for the purchase of inventory in reliance upon SMarque completing the debt to equity conversion. Ocean says that it invested $150,000.00 in Mahon's on the strength of S-Marque's representations about the conversion. Both say they would not have done so otherwise and that they have lost that money as a result of S-Marque's misrepresentations.

Richard Homburg testified that Jim Dillon and Michael Sweett told him they had the authority to make a deal for S-Marque, but did not follow through. He said that later they seemed to be backing out and the Royal Bank lost patience. Mr. Homburg said that Mr. Dillon and Mr. Sweett misled them into believing that they were "driving the business" and did not disclose their inability to deal. He says the deal between them is as set out in the letter dated March 11, 1993 from Jim Dillon and Michael Sweett at S-Marque to Jim McCallion and Ron Nelson at Mahon's (Tab 30 of Exhibit 1).

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That letter is signed by Mr. Dillon and Mr. Sweett, initialled by Richard Homburg on each page and has Richard Homburg's hand-written note on the last page: "Agreed upon the terms" followed by his signature and the date, March 11. There is no reference in that letter to Board approval or Bank approval. The letter says in paragraph two:

> After considering your response and discussion with Mahon's other major investor Mr. Richard Homburg we present the following as a reasonable revised proposal for S-Marque participation in Mahon's reorganization.

Item 1 in that letter is as follows:

> 1. S-Marque agrees to conversion of $650,000 of its debt to preferred shares on the same terms and conditions as a $650,000 preferred share investment to be held by the Homburg Group.

The only condition referred to in the letter is set out in Item 3:

> 3. Our acceptance of any deal and willingness to go along with the proposed transaction is contingent upon our not becoming materially exposed relative to our current position and only accepting courses of action which have the minimum risk to our position. To this end our support will be continent upon Elizabeth Fisher, our council [sic], having full access to yourselves and your lawyers as well as full advance knowledge of all aspects of any restructuring arrangement contemplated. Obviously we are not lawyers and while we support your initiatives form [sic] a business perspective, we will also appropriately weigh the opinion of our legal representatives.

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The letter concludes on page 5, after enumerating a total of 20 points, with the following words:

> Please bear in mind that preceding represents our ability to participate combined with an appropriate response to Mahon's performance to date. We will look forward to moving forward on this matter as soon as possible.

Michael Sweett admitted that there is no reference in the March 11, 1993 letter to Board and Bank approval.

Jim McCallion testified that it was a concern that for all that Jim Dillon and Michael Sweett could speak for S-Marque. He testified that it was very clearly said at their March 10, 1993 meeting and thereafter that there was no need for other approvals. I accept his

72 testimony in this regard.

Ron Nelson testified that Jim Dillon projected an entrepreneurial spirit that he could do the Debt to Equity Conversion and that he could get the necessary approvals.

Richard Homburg said that he would not have paid the sum of $90,000.00 if the debt to equity conversion was not to be done; this was a payment made on October 1, 1993, part of the $150,000.00 paid by Ocean.

Jim Dillon is no longer an employee of S-Marque and evidence on its behalf was given by Michael Sweett, at the relevant times S- Marque's Vice-President Finance and M.LS. Jim Dillon was its President and C.E.O. at the relevant times. Mr. Sweett is now the President of Basics Office Products Limited (to which S-Marque changed its name in 1995).

Michael Sweet testified that, although Richard Homburg may have thought the conversion deal was done, as far as S-Marque was concerned it needed Board and Bank approval. He said that these conditions were implied in all their correspondence and that Richard Homburg knew this since Mahon's was a shareholder of S-Marque.

He also testified that the only reason the conversion did not occur is that the Homburg Group failed to five up to the commitment that the preferred share position of SMarque and the Homburg Group in Mahon's would be equal in all respects.

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The correspondence between the lawyers of the two parties is at Tabs 34-36, 51-52, 56, 59, 94, 99-100, 124, 127, 129 and 176 of Exhibit 1. The memorandum attached to the first piece of correspondence between the lawyers is dated April 6, 1993 (Tab 34). The letter is from Willard Strug, Q.C., solicitor for Mahon's, to Elizabeth Fisher, solicitor for SMarque. It says in Item 3:

> These shares will be the same shares and terms as the Homburg Group preferred shares.

A subsequent letter from W. Strug to E. Fisher (Tab 51) dated May 13, 1993 says on p. 2:

> It was my understanding that the shareholdings between Homburg Group and S-Marque was [sic] to be equivalent with respect to the preferred shareholdings.

The response from S-Marque's lawyer on May 14, 1993 (Tab 52) says:

> S-Marque's subscription ... was expressed to be conditional on the matching investment by the Homburg Group .... S-Marque considers that this situation is not in accordance with the terms agreed upon ....

On May 18, 1993 (Tab 56), Willard Strug wrote to Elizabeth Fisher:

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Obviously, the Homburg Group will not invest its $90,000.00.00 unless these issues can be resolved.

In his November 10, 1993 letter (Tab 124) to Elizabeth Fisher, Mr. Strug says:

Ocean has advanced the sum of $110,000.00 which has been invested in Stat Enterprises Limited. The transaction will take the form of a transfer of preferred shares from the individual principals of Mahons to Ocean Realty for amount payable on the shares, ie. $100,000.00. This amount has in turn been paid to the Company as the subscription price for the 150 Preference Shares.

This leaves an additional $10,000.00 which has been invested and for which preference shares would be issued. I understand from our discussion that there may be some concern that Ocean will have more preference shares per dollar invested than S-Marque. If this is a concern, we will endeavor to have the number of preference shares issued to Ocean reflect the pro rata investment. '

In reply, Elizabeth Fisher in her letter of November 19, 1993 (Tab 127) says:

I would appreciate it if you would confirm that this is indeed intended to be a change to the original deal.

Also, in reply to your letter, I would confirm that S-Marque is expecting to receive the same number of preference shares per dollar as Ocean.

The final letter on this subject exchanged between the parties is that from Willard Strug to Elizabeth Fisher dated February 10, 1994 (Tab 176), just days before Mahon's assignment into bankruptcy, in which Mr. Strug says:

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> As you can appreciate it is essential that the status of the capital reorganization of Stat be completed...
>
> Although an attempt was made to issue the preferred shares to S-Marque last year, the terms of issue, share terms, and the proportion of holdings were never agreed upon. Furthermore, S-Marque did not pay for the shares .
>
> ... we must conclude that the attempt to reorganize the capital of Stat has been unsuccessful and is therefore terminated.

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The issuance of preferred shares to S-Marque was not completed. Mahon's made an assignment into bankruptcy on February 15, 1994.

Tab 73 of Exhibit 1 contains a memorandum from S-Marque to Jim McCallion at Mahon's. It refers to a resolution passed by the S-Marque Board which approves not a debt to equity conversion but an increased postponement of Mahon's debt to S-Marque. Michael Sweett testified that the passing of the resolution and his memo to McCallion was not an attempt to back out of the conversion but only an attempt to do the deal another way.

Michael Sweett testified that after the memo was sent Richard Homburg called him and said: "You have started World War III." Mr. Sweett said that thereafter it was agreed that they would proceed with the original deal. His letter to that effect is at Tab 75 of Exhibit 1, where he states:

1. S-Marque will proceed to convert a portion of its debt to $650,000 in preferred shares to match an equal preferred share holding by The Homburg Group. The shares held by The Homburg Group and S-Marque Inc. will be equal in all respects.

Mr. Sweett admitted in cross-examination that there is no mention in his letters of May 19, 1993 (Exhibit 3) or July 8, 1993 (Exhibit 4) to S-Marque's bank of the debt to equity conversion. His response was that he "needed to warm the Bank up" to that proposal.

He also tested that there was no link between the payments the Homburg companies made to Mahon's and the debt to equity conversion. He said that the two (the conversion and the current dealings) were completely separate issues.

I conclude that the course of action by S-Marque from the start was to benefit itself and only incidentally to keep Mahon's in business. If Mahon's could be fumed around and kept in business that would benefit S-Marque in that it would recover its Accounts Receivable and keep its market share in the stationery business since Mahon's was a large buyer in the buying group.

The matters I have considered in coming to this conclusion are the following:

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7) *The correspondence from S-Marque to Mahon's suppliers without the knowledge of Mahon's.*

S-Marque sent letters to Mahon's suppliers just as the new shareholders and management took over at Mahon's. An example of these is at Tab 10 of Exhibit 1. In it, Michael Sweett of S-Marque, on May 26, 1992, tells Hallmark Cards about the new ownership and management at Mahon's and S-Marque's postponed receivables. He then says on p. 2:

> As S-Marque's exposure on it's [sic] postponement equals the receivables we would normally cant' on Mahon's, we simply cannot afford to double our normal exposure. Therefore, for the next 24 months from the date of closing we would like our suppliers to accept the receivable risk of sales to Mahon's through S-Marque and provide all regular allowances and terms.

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This letter and others like it were written at the same time as S-Marque representatives, including Michael Sweett, were meeting and corresponding with the new owners and managers and trying to work out a deal to keep the Royal Bank from putting Mahon's into receivership. In Jim Dillon's letter of May 14, 1992 to Jim McCallion and the Royal Bank (Tab 7 of Exhibit 1) he says:

> Based upon our exposure we have suggested and others have suggested for us how we might be prepared to participate in a potential purchase of Mahon's Stationery Limited. Any participation on our part will be weighed against our net receivable exposure and our desire to maintain our market presence in Halifax.

After setting our various proposals which had been put forward and rejected by one party or the other and a final proposal by S-Marque, he concludes by setting out the alternative:

> S-Marque will take no action and attempt to reduce its losses through a combination of supplier support and offsets. Estimated net loss of $00,000 on current accounts receivable of $630,000. We hope this document clearly sets out our position to all parties.

Jim McCallion testified about his reaction to the letters to the suppliers. He said that he was not aware of them at the time and did not find out about them until after the purchase had closed. He said that then he found out that they had no credit privileges with some suppliers. Mr. McCallion testified that he called Jim Dillon about the letters. He also said that he was "not happy" that this had arisen less than one month into the deal.

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2) S-Marque's dealings with its own bank.

S-Marque had committed to enter into the Debt to Equity Conversion, which it says was contingent upon its bank's approval. However, after the commitment was made, Michael Sweett wrote twice to his bank without mentioning the conversion (Exhibits 3 and 4, dated May 19, 1993 and July 8, 1993 respectively). In fact, in the May 19, 1993 letter (two months after the March 11, 1993 commitment to do the conversion), he addresses the accounts receivable owed to S-Marque. Not only does he not mention the conversion, he continued to refer to postponement of debt. He says:

> Although S-Marque's debt will not increase, there is a question as to how much of the existing debt should be postponed. Any increase from our current postponement of $475,000 would be matched by additional investment by the Homburg group. This issue is by no means finalized and we will keep you abreast of the discussion.

In his July 8, 1993 letter, he still does not mention the conversion, even though he had written to Richard Homburg on June 17, 1993 confirming S-Marque's intent to do the conversion (Tab 75 of Exhibit 1). In the July 8 letter to the bank, Mr. Sweett says the following about the accounts receivable debt (of.Mahon's and others):

> ... we have taken the overdue portion of their payable to S-Marque Inc. and segregated them [sic] from our regular A/R report to allow us to control the level of their indebtedness and put in place an organized schedule for paydown of those amounts.
>
> An S-Marque Inc. board conference call is scheduled for July 191' to discuss the Mahon's situation and obtain the boards [sic] approval on the direction of this account, interest charges, paydown schedule and any other issues.

Mr. Sweett's response in his testimony was that he was "warming them up" to the idea may well be true but shows him being less than forthright with his bank about the proposal to convert debt to equity.

3) S-Marque let it be thought its bank had been told about the conversion.

Jim McCallion testified that he believed that S-Marque had told its bank about the

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Debt to Equity Conversion. He says he inferred this from the letter Michael Sweett wrote to him on May 19, 1993 (Tab 57 of Exhibit 1). That letter says:

> The issue at hand is not our desire to go along with what was originally agreed to but rather our ability to present the entire situation as a saleable package to our bank. As always, everything we do is subject to their approval .... You also know that the bank is currently uncomfortable with the Mahon's situation let alone the restructured situation. From their perspective our position with Mahon's had deteriorated ... which makes them very nervous.
>
> We feel if the bank is to go along with our preferred share purchase we have to show them movement on the remaining debt.

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Jim McCallion said that he had concerns about Michael Sweett's integrity after seeing the Consolidated Balance Sheet for S-Marque prepared for its bank (Tab 45 of Exhibit 1). It showed Long Term Receivables of $894,000.00, including those owed by Mahon's, which had been postponed, and which showed a Tangible Net Worth position for S-Marque of $2.126 million which included those postponed receivables.

I am not, however, satisfied that these actions by S-Marque amounted to misrepresentation on its part. In any event, even if misrepresentation by S-Marque were proven, I conclude that it was not the cause of the failure of the Debt to Equity Conversion.

Although it is not clear from the evidence that S-Marque's bank ever did give its approval, there is some indication that the Board resolution approving of the conversion was sent to the bank. This is contained at page two of Michael Sweett's letter to the bank

81 dated August 8, 1993 (Tab 95) where he says: "the attached resolution was passed by SMarque's directors." The resolution, however, is not attached to the Exhibit. It is unclear whether it was attached to the letter and, if so, whether it was the resolution approving the conversion or the earlier resolution approving only an increase in postponed debt.

It is clear, however, that the S-Marque Board gave its approval to the conversion. Tab 91 of Exhibit 1 is a copy of a resolution of the S-Marque Board of Directors which says:

> S-Marque will convert $650,000.00 of it's [sic] postponed debt and overdue A/R with Mahon's Stationery to preferred shares of Stat Enterprises Limited.

Ultimately, however, it was the refusal of the Homburg Group to give S-Marque an equal position with respect to the preferred shares that scuttled the Debt to Equity Conversion. Therefore, although Ocean and Dover may well have invested their money on the strength of the conversion taking place, it was not the fault of S-Marque, and the less than straightforward dealings by Michael Sweett on its behalf, that the conversion failed. Had there been an equality of preferred share position, the Debt to Equity Conversion may well have occurred.

In any event, the $100,000.00 loaned by Dover to Mahon's was loaned for purchase of computer inventory. Dover believed it had put security in place for that loan. As discussed above (under the heading: Computer Inventory), the security was not executed. If it had been executed, Dover would have been secured for this loan. I conclude that this is inconsistent with a claim that Dover would not have loaned the $100,000.00 without the

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82 assurance by S-Marque that it would conclude the conversion.

With respect to the investment of $90,000.00 by Ocean on October 1, 1993, it was made when Jim McCallion of Mahon's had advised S-Marque that day that Mahon's could not pay its September 30, 1993 billing (Tab 105 of Exhibit 1). If Mahon's failed to pay that amount, it would have had no further product shipped to it. This impasse was resolved by a payment to Mahon's that day by Ocean and a memo from Jim McCallion to Michael Sweett that the $90,000.00 payment would be made immediately and that "our account with S-Marque Inc. is considered current." (Tab 106 of Exhibit 1). That payment, accordingly, was made to solve an immediate problem about supply of product, part of the short-term debt owed by Mahon's to S-Marque.

The same can be said of the $60,000.00 payment made to S-Marque on October 29, 1993. It was made to keep the product supply coming into Mahon's to keep it operating.

Even after the date of those payments by Ocean there was correspondence between the lawyers of the two parties about the inequality of preferred share position between the Homburg companies and S-Marque. As late as November 19, 1993 Elizabeth Fisher wrote to Willard Strug (Tab 127) saying:

> I would appreciate it if you would confirm that this is indeed intended to be a change to the original deal .
>
> ... I would confirm that S-Marque is expecting to receive the same number of preference shares per dollar invested as Ocean.

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Because the Debt to Equity Conversion failed due to the actions of the defendants, not S-Marque, the claim and counter-claim against S-Marque for misrepresentation are not proven.

CONCLUSION

1. Value of 70 Akerley Boulevard

S-Marque does not succeed. Claim dismissed.

2. Paving

S-Marque succeeds. The transaction whereby Mahon's paid $27,500.00 for the paving at 70 Akerley Boulevard is voided. This payment was made for the benefit of Ocean; therefore, Ocean must pay S-Marque $27,500.00.

3. Computer Inventory

The defendants concede that this transaction is void as against Mahon's creditors. S-Marque has not succeeded in proving a value of $199,000.00. The value is $110,000.00 as set out in Tab 211 of Exhibit 1. Dover must pay this amount to S-Marque. By virtue of

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84 s. 100 (2), judgment is also given in favour of S-Marque against those who are privy to this transaction.

4. *Office Equipment and Furniture*

This transaction was a settlement. S-Marque succeeds. However, S-Marque has not satisfied me that the value of these chattels is $50,000.00. Judgment is entered against Newedge for $15,000.00.

5. *Debt of $748,000.00 owed to Dover*

Dover does not have priority to this sum from the transactions overturned.

6. *Guarantee*

S-Marque succeeds. Homburg Industries Limited is to pay S-Marque $100,000.00.

7. *Misrepresentation*

The counter-claim of Homburg Industries and the claims of Stat, Dover and Ocean are dismissed.

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COSTS

The parties have not addressed the issue of costs. If they cannot agree, I will accept written submissions.

I note the following:

1. S-Marque was originally seeking a total of $642,500.00 and has been awarded $272,500.00;

2. The defendants agreed that one transaction, a payment of $20,000.00 to the former owners of Mahon's, was a preference;

3. The defendants also agreed that the transfer of the computer inventory was a preference and were successful in satisfying me that its value was $110,000.00 not $199, 000.00;

4. S-Marque successfully defended the misrepresentation claim and counterclaim made against it, totaling $350,000.00;

5. S-Marque successfully defended Dover's claim for $148,000.00 of the moneys recovered;

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6. S-Marque has succeeded on four issues and the defendants on three.

These are factors which the parties should consider in trying to come to an agreement on costs, and which I will consider if submissions are made to me on costs.

Hood, J.

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TAB 12

IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR
TRIAL DIVISION

Citation: *Oppenheim v. J.J. Lacey Insurance Limited*, 2009 NLTD 148
Date: 20091008
Docket: 19940116856

2009 NLTD 148 (CanLII)

IN THE MATTER of an Appeal by M.J. Oppenheim, Attorney in Fact in Canada for Lloyd's Non-Marine Underwriters, from the allowance of a claim of Hiland Insurance Limited by the Trustee of the Estate in Bankruptcy of J.J. Lacey Insurance Ltd.

BETWEEN:

M.J. OPPENHEIM, Attorney in Fact in Canada For LLOYD'S NON-MARINE UNDERWRITERS

PLAINTIFF

AND:

J.J. LACEY INSURANCE LIMITED

FIRST DEFENDANT

AND:

HILAND INSURANCE COMPANY LIMITED

SECOND DEFENDANT

Before: The Honourable Mr. Justice Robert M. Hall

Place of hearing: St. John's, Newfoundland and Labrador

Heard: February 12, 13, 14, 15, 18, 19, 20 and 21, 2008; May 28, 29, and 30, 2008; June 2 and 5, 2008

Appearances:

Philip J. Buckingham	Counsel for M.J. Oppenheim, Attorney in Fact in Canada for Lloyd's Non-Marine Underwriters
Neil L. Jacobs	Counsel for the Trustee in Bankruptcy of J.J. Lacey Insurance Limited
D. Mark Pike	Counsel for the Provisional Liquidator of Hiland Insurance Company Limited

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Authorities Cited:

CASES CONSIDERED: Kosmopoulos v. Constitution Insurance Co., [1987] 1 S.C.R. 2; **Bow Valley Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd.** (1995), 130 Nfld. & P.E.I.R. 92 (N.L.S.C.(T.D.)); **Salomon v. A. Saloman & Co.**, [1897] A.C. 22 (H.L.); **Clarkson Co. Ltd. v. Zhelka et al.**, [1967] 2 O.R. 565 (H. Ct. J.); **Re Lifschultz Fast Freight**, 132 F.3d 339 at 349 (7th Cir. 1997); **Taylor v. Standard Gas and Electric**, 306 U.S. 307 (1939); **Pepper v. Litton**, 308 U.S. 295 (1939); **Re Mobile Steel**, 563 F.2d 692 (5th Cir. 1977); **Laronge Realty Ltd. v. Golconda Investments Ltd.** (1986), 7 B.C.L.R. (2d) 90 (C.A.); **Canada Deposit Insurance Corp. v. Canadian Commercial Bank**, [1992] 3 S.C.R. 558; **AEVO Co. v. D & A Macleod Co.** (1991), 4 O.R. (3d) 368 (Gen. Div.); **Matticks v. B & M Construction Inc.** (1992), 11 O.R. (3d) 156 (Gen. Div.); **Re/Max Metro-City Realty Ltd. v. D & A MacLeod Co.** (1993), 16 C.B.R. (3d) 308 (Ont. Ct. J. (Gen. Div.)); **S-Marque Inc. v. Homburg Industries Ltd.**, [1998] N.S.J. No. 550 (S.C.).

STATUTES CONSIDERED: *Insurance Adjusters, Agents and Brokers Act*, R.S.N.L. 1990, c. I-9; *Insurance Companies Act*, R.S.N.L. 1990, c. I-10; *Corporations Act*, R.S.N.L. 1990, c. C-36; *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11; *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

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TEXTS CONSIDERED: L.C.B. Gower, *Gower's Principles of Modern Company Law*, 5th ed. (London: Sweet & Maxwell, 1992); Kevin Patrick McGuinness, *The Law and Practice of Canadian Business* (Vancouver: Butterworths, 1999); Thomas G.W. Telfer, "Transplanting Equitable Subordination: The New 'Free-Wheeling' Equitable Discretion in Canadian Insolvency Law?" (2002) 36 Can. Bus. L.J., 36; P.V. Baker & P. St. J. Langan, *Snell's Principles of Equity*, 29th ed. (London: Sweet & Maxwell, 1990).

REASONS FOR JUDGMENT ON AN APPEAL BY LLOYD'S FROM THE ALLOWANCE OF A CLAIM BY HILAND BY THE TRUSTEE OF THE ESTATE IN BANKRUPTCY OF LACEY

HALL, J.:

BACKGROUND

[1] J.J. Lacey Insurance Limited ("Lacey") was a body corporate incorporated under the laws of Newfoundland and Labrador and licensed as an insurance broker under the *Insurance Adjusters, Agents and Brokers Act*, R.S.N.L. 1990, c. I-9 (the "IAABA") and Hiland Insurance Company Limited ("Hiland") was a body corporate incorporated under the laws of Newfoundland and Labrador and licensed as an insurance company under the *Insurance Companies Act*, R.S.N.L. 1990, c. I-10. I am satisfied Lacey and Hiland were affiliates of each other as that term is defined in sections 2, 7 and 8 of the *Corporations Act*, R.S.N.L. 1990, c. C-36, which sections read as follows:

> 2.(b) "affiliate" means an affiliated body within the meaning of section 7;
>
> ...
>
> **Affiliated corporations**
>
> 7. (1) One body corporate is affiliated with another body corporate where 1 of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person.

(2) Where 2 bodies corporate are affiliated with the same body corporate at the same time, they are affiliated with each other.

Control of a body corporate

8. A body corporate is controlled by a person where shares of the body corporate carrying voting rights sufficient to elect a majority of the directors of the body corporate are held, directly or indirectly, except by way of security only, by or on behalf of that person.

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[2] Attached as Schedule "A" to this judgment is a chart showing the affiliated relationship of Lacey to Hiland as well as the relationship of both Hiland and Lacey to Mr. Clayton Gillingham ("Gillingham") in whom I am satisfied control of these corporations was vested, as well as control of A & P Realty Limited, The Porte Village Limited, Central Insurance Services Limited ("Central"), C.W.G. Enterprises Limited and P & G Realty Limited. Neither the solicitor for the Trustee in Bankruptcy of Lacey nor the solicitor for the provisional liquidator of Hiland took any exception in this proceeding to the argument that all of the corporations shown in Schedule "A" attached to this judgment were affiliated with each other and were controlled by Gillingham, who was either president or a director or controlling shareholder (directly or indirectly) of each of those corporations.

[3] In September 1994, pursuant to section 30 of the IAABA and section 74 of the *Insurance Companies Act*, the Superintendent of Insurance ("the Superintendent") for the Province of Newfoundland and Labrador ordered an examination of the accounts of Lacey and Hiland as well as those of Central. The results of that investigation, in so far as they relate to Central, are not relevant in this matter.

[4] As a result of irregularities discovered by the staff of the Superintendent during the course of this examination, Hiland's license as an insurance company was cancelled on October 3, 1994, and Coopers and Lybrand Limited were

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appointed as provisional liquidator of Hiland, pursuant to the provisions of the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11. Additionally, the provisional liquidator of Hiland successfully petitioned for the bankruptcy of Lacey and Central and on December 30, 1994, Peat Marwick Thorne Inc. (currently KPMG Inc.) was appointed Trustee in Bankruptcy of Lacey. Lacey had acted as an insurance broker and agent on behalf of the Plaintiff herein ("Lloyd's") and subsequently as broker and agent for Hiland. Hiland was incorporated in December of 1992 and received its license as an insurance company late in January of 1993. Prior to the incorporation of Hiland, Lacey carried on business as agent and broker of automobile and property and casualty insurance, principally on behalf of Lloyd's, but it also acted for some other insurers. Due to the relationship of Lacey as broker or agent for Hiland, and the apparent receipt by Lacey of funds which constituted premiums for insurance and thus trust funds in the hands of Lacey pursuant to the IAABA, the provisional liquidator of Hiland filed a proof of claim (property) pursuant to section 81(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA") in the amount of $1,647,939 and a further unsecured claim in the amount of $2,910,459 for a total claim of Hiland in the bankruptcy of Lacey in the amount of $4,558,398. Ultimately, the claim of Hiland in the bankruptcy of Lacey was accepted by the trustee at $3,258,961.16. The trustee paid two dividends, firstly in the amount of $149,545.10 on March 1, 1996, and secondly in the amount of $523,374.00 on July 6, 1999, recognizing these dividends as payment of trust funds received by Lacey as agent and broker on behalf of Hiland. This left a net claim in the bankruptcy of Hiland in the amount of $2,586,042.06 accepted by the trustee as owing to Hiland on which a dividend of $56,066.40 was paid to Hiland and a superintendent's levee of $2,803.32 levied thereon, leaving at present a net claim by Hiland in the bankruptcy of Lacey of $2,529,975.66.

[5] Lloyd's is an unsecured creditor of Lacey and it appealed the decision of the trustee of Lacey to allow the proof of claim of Hiland in the bankruptcy of Lacey. After much delay, pursuant to an interlocutory application heard December 18, 2007, I ordered that Lloyd's appeal to this Court seeking a disallowance of the claim of Hiland in the bankruptcy of Lacey should proceed by way of a *trial de novo* and that fresh evidence over and above that produced by Lloyd's to that date would be allowed, either by *viva voce* evidence or through any other appropriate evidentiary process. As a result, a statement of claim was issued by Lloyd's as

plaintiff, which was subsequently amended by an amended statement of claim filed December 6, 2007. In its statement of claim Lloyd's states that from January 1, 1992, until December 31, 1992, Lacey as cover holder had two Binding Authority Agreements under which it was authorized to sell automobile and residential insurance for Lloyd's. The persons authorized under the 1992 Binding Authority Agreements were Gillingham and an employee and subsequent wife of Gillingham, namely Carol Scott. Lloyd's claims that between June 1, 1991, and December 31, 1992, certain insurance policies were entered into by Lacey in the name of certain underwriters at Lloyd's but these policies were either not reported to Lloyd's or Lacey failed to remit the premiums to Lloyd's in accordance with the terms of the Binding Authority Agreements as referenced herein, or both. It was later during the same time period that Gillingham had applied for a provincial insurance company license for Hiland under the *Insurance Companies Act*.

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[6] Lloyd's claimed that during these periods the Defendants, by their directors, officers, servants and agents, unduly, unlawfully and maliciously and lacking *bona fides* conspired and agreed together, one with the other, or with persons unknown to:

1) submit false, inaccurate and misleading information to Lloyd's for the purposes of obtaining, without authorization, and to convert to their own use or the use of directors, officers or shareholders, the benefit of premiums otherwise due and owing to Lloyd's on policies issued pursuant to the Binding Authority Agreements;

2) submit false, inaccurate and misleading information to Lloyd's, the purpose of which was to mislead, misstate and otherwise mislead Lloyd's as to the true nature of the potential exposure to Lloyd's from the issuance of insurance policies pursuant to the Binding Authority Agreements;

3) misled Lloyd's as to the premiums written and the potential exposure incurred as a result of the generation of policies of insurance pursuant to the Binding Authority Agreements aforesaid; and

4) conceal from Lloyd's a true reflection of the insurance risks that Lloyd's, by operation of law, was otherwise obliged to provide cover notwithstanding the failure of the Defendants to remit the premiums.

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[7] Lloyd's claimed in its amended statement of claim that the Defendants were motivated to conspire and that their predominant purpose and concern was to obtain capital generated by the premiums for the operation of one or other Defendant, or for the use of the directors, officers or directing minds thereof for their own use and benefit, either jointly or in part. Lloyd's claims that this scheme was designed in the manner and fashion to conceal from Lloyd's material facts necessary in order for Lloyd's to properly provide for the underwriting in relation to the policies written and thus was in violation of the Binding Authority Agreements. This resulted in denying to Lloyd's the ability to use the premiums that had been converted by the Defendants.

[8] Lloyd's says that because of this scheme, under the common law of the Province of Newfoundland and Labrador, the Defendants are liable both for their own acts and for the acts or omissions of their subsidiaries and/or directors, officers or shareholders in as much as the Defendants operated their corporate entities as one entity with the sole and singular purpose of defrauding the Plaintiff of its lawful entitlement to the premiums collected. Lloyd's pleads that these activities, both intra-company (as between Hiland and Lacey) and inter-company (between Hiland and Lacey), were such as to deny the Defendants any reliance on the basic principles of corporate law to suggest that Hiland and Lacey should be treated as separate operating enterprises. Lloyd's says that to treat Hiland and Lacey as separate operating enterprises will unjustly deprive Lloyd's of its rights by means of the Defendant's very own misconduct and, in particular, would result in the allowance of the Hiland claim against the estate of Lacey to the detriment not only of Lloyd's but to the detriment of all legitimate creditors of the bankrupt estate of Lacey. Lloyd's claims that at all material times the Defendants were not operating as separate corporations but were essentially one and the same under the directing mind of Gillingham and that Gillingham directly controlled the day-to-day operations of Hiland and Lacey through common offices and common management

and that he oversaw, directed, managed and coordinated all operations and developed the scheme by which Lloyd's was denied its lawfully entitled premiums.

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[9] As the result of the fraud committed against Lloyd's by the Defendants, Hiland and Lacey, either acting in concert through their directors, officers or shareholders or as a result of the activities and/or the directing mind of Gillingham, Lloyd's requests that the Court pierce the corporate veils of Hiland and Lacey, and Lloyd's further requests that the notice of claim filed with the Trustee in Bankruptcy by Hiland against the Estate of Lacey, be deemed invalid and be disallowed and the declaratory relief of the Plaintiff's claim be granted.

DEFENSE OF LACEY

[10] Counsel for Lacey filed a defense pleading that the allegations of Lloyd's with respect to failure to notify Lloyd's by Lacey of the writing of policies and the failure to remit premiums for those policies to Lloyd's, had no bearing on the matter which is presently under appeal i.e., the trustee's decision to allow the Hiland proof of claim. In particular, Lacey pleads that the alleged conspiracy between Lacey and Hiland, are matters which were not under appeal and are new matters arising in the bankruptcy estate and that the Plaintiff is out of time in raising these issues, some thirteen years after the receiving order was issued. Lacey's counsel claims that the only matter under appeal is fraud of Hiland and that the trustee of Lacey takes a position that, in determining whether to pierce the corporate veil of Hiland, the Court should restrict itself to considering whether Hiland was created as a sham to defraud Lloyd's and should determine what the effect of such a decision would be upon the legitimate creditors of Hiland. With respect, I disagree with these positions of the counsel for the trustee of Lacey. I am satisfied that in appealing the decision of the trustee, Lloyd's is saying that the trustee did not investigate the claim of Hiland but simply relied upon the evidence provided by the provisional liquidator. In this regard, the trustee of Lacey did not have the evidence of fraud and/or conspiracy on the part of Hiland, Lacey and Gillingham. Indeed, normal estate administration practice and procedure under the BIA would not see such an investigation taking place by the trustee. I am of the

view that Lloyd's should not be prejudiced in having the fraud, conspiracy and lifting of the corporate veil arguments made before this Court even though there has been a very significant lapse of time. As indicated in my earlier judgment in this matter filed January 24, 2008, in relation to converting this matter to a *trial de novo*, I was of the view that efficacy, expedition and concerns over extra expense and delay or increased formality should not be allowed to trump fairness and should certainly not allow the claims determination process to constitute a *de facto* "good housekeeping seal of approval" upon activities surrounding which there is a serious allegation of criminality.

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[11] The provisional liquidator for Hiland likewise asserts that the notice of appeal from the allowance of the claim of Hiland only asserted that there was a fraud committed by Hiland as against Lloyd's. Hiland denies that any fraud took place and put Lloyd's to strict proof thereof. It denies that there was any grand scheme of deception or conspiracy such as to give rise to the remedy sought by Lloyd's, which would defeat the interest of the legitimate creditors of Hiland and that the appeal of the allowance of the claim of Hiland should only be based on grounds advanced by Lloyd's at the time of the decision of the trustee and not upon new and extended grounds raised by Lloyd's in its statement of claim.

[12] With respect, I similarly disagree with this position. Lloyd's cannot know and was not privy to the information which the trustee used in arriving at his decision to allow the claim of Hiland. The somewhat abridged process under which claims in bankruptcy are evaluated by a trustee cannot, in my view, be used as a shield to protect a fraudulent creditor from making a claim against a bankrupt corporation. I repeat my earlier comments that efficacy, expedition and concerns over extra expense and delay and increased formality should not be permitted to trump the fairness of the claims evaluation process where there is serious allegation of criminality.

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FRAUD PERPETRATED AGAINST LLOYD'S

[13] The investigation initiated by the Superintendent of the affairs of Lacey and Hiland revealed that a number of policies were written by Lacey on the policy forms provided to Lacey by Lloyd's, that these policies appear not to have been reported to Lloyd's, and that the premiums paid thereon by the insureds were not remitted to Lloyd's. A preliminary sample list of policies was prepared by Karen Legge, C.A., (who had conducted this portion of the investigation on behalf of the Superintendent) and submitted by her to Lloyd's. Lloyd's confirmed that the listed policies had not been reported and the premiums not remitted. This resulted in the furthering of the Superintendent's examination of the affairs of Lacey in this regard.

[14] Under the contractual arrangements in place between Lloyd's and Lacey, all policies written for Lloyd's were to have a numeric identification number, i.e., no letters of the alphabet were to be used in the policy number. However, the policies written on Lloyd's forms and not reported to Lloyd's all had an alpha identifier inserted in the policy number.

[15] Additionally, any claims which arose under these alpha policies were assigned a claim file number using an "x" in that claim number. This practice was different from what it was with respect to policies which had been reported to the insurers. All of the "x"-numbered claim files were administered directly by Gillingham and did not go through the normal claims process at Lacey, as agreed with Lloyd's under the Binding Authority Agreements.

[16] I am satisfied from the evidence of Karen Legge, C.A. that the claims made by insureds against these alpha policies (not reported to Lloyd's) were paid out of the retained premiums, which had not been remitted by Lacey to Lloyd's. Only one exception was the policy related to one Freake where an alpha policy was cancelled after a claim was received and a new policy written properly on Lloyd's forms but dated prior to the claim. The policy and claim were then sent to Lloyd's.

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There was no compelling evidence to rebut the existence of these alpha policy files and "x" claim files and I am satisfied that this practice was extensively carried out by Lacey at the direction of Gillingham. I accept the evidence of Karen Legge, C.A. that her investigation indicated that policies earning a total of $3,110,100 in premiums were written in this manner between November of 1991 and December 31 of 1992 and were not reported to Lloyd's. On December 31, 1992, the Binding Authority Agreements between Lloyd's and Lacey expired. I am satisfied on the evidence that such activities constituted a fraud upon Lloyd's by Lacey and that the directing mind in the planning, organization and carrying out of that fraud was Gillingham. In her evidence, Carol Scott, the common law spouse of Gillingham, who had been a claims supervisor at Lacey's, confirmed that these alpha policies were managed by, and "x" file claims under them resolved, directly by Gillingham. In meetings held early on in the Superintendent's investigation of Hiland and Lacey, Gillingham confirmed to Karen Legge, C.A. that claims against the alpha policies were paid out of the premiums retained by Lacey and which were payable to Lloyd's on policies not reported to Lloyd's. In his evidence at trial Gillingham did not rebut this evidence of Ms. Legge, which evidence she had recorded contemporaneously with Gillingham making the statements to her. I therefore accept the quantum established by Ms. Legge in her investigation as to the amount of policy fraudulently written by Lacey on Lloyd's paper and the premiums resulting therefrom as $3,110,100.

HILAND - INCORPORATION AND ROLE IN FRAUD UPON LLOYD'S

[17] Hiland was incorporated at the end of December 1992. It did not receive its license to carry on business as an insurance company under the *Insurance Companies Act* until late January 1993.

[18] Lloyd's had advised Lacey several months prior to the incorporation of Hiland that Lloyd's would not be writing any more automotive and property policies in Newfoundland and Labrador after the expiry of the Binding Authority Agreements then in place between Lloyd's and Lacey. These agreements expired December 31, 1992. Gillingham had expected to receive approval for the

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licensing of Hiland as an insurance company prior to these agreements expiring. This was important as Lloyd's was the major insurance company for which Lacey had authority to sell. Loss of the Lloyd's account was to be a serious loss to Lacey. Additionally, Gillingham was confident that Hiland, as an insurance company controlled by him, would be profitable as he would be able to write insurance through Hiland for customers to whom he had previously issued Lloyd's policies.

[19] However, there existed in Lacey the problem of the unreported Lloyd's policies. Gillingham wanted to get these policies into Hiland. The vehicle he chose was simply to cancel these policies and reissue them in Hiland's name for the balance of the policy terms originally issued through Lloyd's. He did this without the consent of either Lloyd's or the named insureds in the policy. This provided a means of covering up the illegally issued Lloyd's policies and the fraud perpetrated by Lacey and Gillingham upon Lloyd's and additionally to get premium money into Hiland. These transfers all occurred after Hiland had received its license to sell insurance in January of 1993 and after all of the unreported Lloyd's policies had been written.

[20] The parties opposed to Lloyd's appeal in this matter argue that Hiland could not have been a party to the fraud occasioned by the unreported policies, as its corporate existence did not occur until after the initial fraud upon Lloyd's by Lacey had occurred. I cannot accept this argument. The cover up of the fraud was aided and abetted by Hiland by way of the rewriting of the Lloyd's policy in Hiland's name without the consent of either the insureds or Lloyd's. Thus the fraud process continued with the involvement of Hiland. Hiland received the proportionate share of the premiums on these policies which should have gone to Lloyd's. Hiland therefore benefited by receiving part of Lloyd's book of business and its premium revenue. In my view, this makes it every bit a party to the fraud as were Lacey and Gillingham.

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LIFTING THE CORPORATE VEIL

[21] In its statement of claim Lloyd's asserts that at all material times Hiland and Lacey, as well as the affiliated companies and persons set out in the organizational chart of Hiland, and those companies set out in paragraph 2 hereof, as well as the directors and officers thereof, shared a common purpose of designing and putting into place the plan of action so as to deny Lloyd's of their lawful entitlement to the premiums collected on insurance policies generated pursuant to the Binding Authority Agreements. Lloyd's contends that under the common law of Newfoundland and Labrador the Defendants are liable both for their own acts and the acts and/or omissions of their subsidiaries and/or directors, officers or shareholders, in as much as the Defendants operated their corporate entities as one entity with the sole and singular purpose of defrauding the Plaintiff of its lawful entitlement to premiums collected pursuant to policies of insurance issued under those Binding Authority Agreements. Lloyd's further asserts that Gillingham as the sole owner of a hundred issued common shares of Hiland and *de facto* sole owner of Lacey, at all times material hereto controlled the day-to-day operations of both Hiland and Lacey and in particular directed the staff of one or both of these corporate entities and/or affiliates to set in place this fraudulent scheme.

[22] It is the position of Lloyd's that these fraudulent activities are such as to deny Lacey and Hiland any reliance on the basic principles of corporate law to suggest that Hiland and Lacey should now be treated as separate operating entities, as to do so will unjustly deprive Lloyd's of its rights by means of the Defendant's very own misconduct and, in particular, would result in allowance of the claim against the estate of Lacey by Hiland to the detriment not only of Lloyd's but as against all legitimate creditors of Lacey.

DOES THE LAW SUPPORT LIFTING THE CORPORATE VEIL OF HILAND AND LACEY?

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[23] The Supreme Court of Canada in **Kosmopoulos v. Constitution Insurance Co.**, [1987] 1 S.C.R. 2, dealt with a case of a fire loss in a leather goods business. The respondent Andreas Kosmopoulos had incorporated his leather goods business and became the sole shareholder and director of the company. Virtually all of the documentation required in the business continued to refer to it as being a sole proprietorship and made no reference to the company. The lease in which the business was carried on continued in Kosmopoulos' personal name and the landlord's approval to assign the lease to Kosmopoulos' company was not obtained. The fire insurance policies all showed the insured as being the sole proprietor Kosmopoulos, even though the insurance agency was well aware of the fact that the business was being carried on by the incorporated company. A fire in the adjoining premises damaged the company's assets and the rented premises. The insurance companies refused payment on proof of loss and Kosmopoulos and his corporation sued. One of the arguments made was that the Court should lift the corporate veil as between Kosmopoulos personally and his corporation to find that he personally had an insurable interest. Wilson, J. on behalf of the Court at paragraphs 12 and 13 considered this argument as followed:

> 12 As a general rule a corporation is a legal entity distinct from its shareholders: Salomon v. Salomon & Co., [1897] A.C. 22 (H.L.). The law on when a court may disregard this principle by "lifting the corporate veil" and regarding the company as a mere "agent" or "puppet" of its controlling shareholder or parent corporation follows no consistent principle. The best that can be said is that the "separate entities" principle is not enforced when it would yield a result "too flagrantly opposed to justice, convenience or the interests of the Revenue": L.C.B. Gower, Modern Company Law (4th ed. 1979) at p. 112. I have no doubt that theoretically the veil could be lifted in this case to do justice, as was done in American Indemnity Co. v. Southern Missionary College, supra, cited by the Court of Appeal of Ontario. But a number of factors lead me to think it would be unwise to do so.
>
> 13 There is a persuasive argument that "those who have chosen the benefits of incorporation must bear the corresponding burdens, so that if the veil is to be lifted at all that should only be done in the interests of third parties who would

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> otherwise suffer as a result of that choice": Gower, supra, at p. 138. Mr. Kosmopoulos was advised by a competent solicitor to incorporate his business in order to protect his personal assets and there is nothing in the evidence to indicate that his decision to secure the benefits of incorporation was not a genuine one. Having chosen to receive the benefits of incorporation, he should not be allowed to escape its burdens. He should not be permitted to "blow hot and cold" at the same time.

[24] The Newfoundland and Labrador Court of Appeal in **Bow Valley Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd.** (1995), 130 Nfld. & P.E.I.R. 92 (N.L.S.C.(T.D.)), dealt *inter alia* with whether the corporate veil should be lifted in a situation where a single enterprise joint venture corporation had been incorporated by two of the principle actors in the matter. The Court considered the equities of the matter concerning the real relationship between the joint venture partners. The appellants however advocated the traditional approach, one consistent with the view that a corporation is a separate legal personality from its shareholders and that those shareholders were liable for the undertakings of the corporation or the acts of its servants, agents or employees. In this regard, the Court cited **Salomon v. A. Saloman & Co.**, [1897] A.C. 22 (H.L.). At paragraphs 39 and 40 the Court of Appeal noted that there were exceptions to this traditional rule and stated:

> 40 One circumstance where the corporate veil is lifted is where it is established that the corporation is an instrument for fraud or improper conduct by the shareholder. There is no such allegation here. .... BVHB was established for a valid business reason: to obtain financing of a certain type. It was not incorporated to create a false impression.

[25] At paragraph 41 the Court of Appeal cited with approval *Gower's Principles of Modern Company Law*, 5th ed. (London: Sweet & Maxwell, 1992) as follows:

> 41 L.C.B. Gower, in Gower's Principles of Modern Company Law 5th ed. (London: Sweet & Maxwell, 1992), concludes, at page 133, that there are only three circumstances where the corporate veil may be lifted:
>
> (1) When the court is construing a statute, contract or other document;

(2) When the court is satisfied that a company is a "mere façade" concealing the true facts;

(3) When it can be established that the company is an authorised agent of its controllers or its members, corporate or human.

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[26] In *The Law and Practice of Canadian Business* (Vancouver: Butterworths, 1999) the author Kevin Patrick McGuinness, commencing at page 28, deals with piercing or lifting the corporate veil. At paragraphs 1.47 and 1.48 he states as follows:

1.47 Thus the courts are generally unwilling to pierce the corporate veil and will normally do so only where required to do so by statute or where extraordinary circumstances exist. Cases falling within the latter category are confined within a narrow compass. Taking advantage of the limited liability of a corporation *per se* is not improper. If a person chooses to deal with a corporation, then he or she is limited in recourse to whatever assets the corporation may itself own. The occasional judgment suggests that courts are particularly unwilling to pierce the corporate veil where the corporation concerned has been in business for a considerable period of time, it is solvent, and there is no evidence of dishonesty relating to the conduct of its business or affairs. The courts are also unwilling to lift the corporate veil where to do so would contravene the express terms of a contract entered into by the party who is seeking to have it lifted. However, the weight of these facts and the circumstances when they will apply are not at all clear.

1.48 Indeed, it is difficult to discern any general principle that the courts have followed in the handling of such cases. The situations in which a court will pierce the veil are based on no principle of universal application, save perhaps the one unifying thread that the separate personality of a corporation will not be respected where the corporation is being used as a cover for deliberate wrong-doing. In addition, the courts will ignore the separate personality of a company in the following situations:

(1) where it is expressly authorized to do so by statute – many such situations are specified under tax legislation, but some are found in the corporate context, as where the company fails to describe itself as a "limited" company;

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(2) where the company may correctly be characterized as having acted as an agent;

(3) where it is necessary to determine the residence of the company;

(4) where the company has been used as a cloak for fraud or manifestly improper conduct – although in such cases there is no need to lift the corporate veil in order to affix liability on the shareholder who perpetrated the fraud, as the shareholder will be personally liable for the fraud as a co-party;

(5) where there is a trust relationship;

(6) where the company is involved in criminal activity directed by its shareholders;

(7) in the interest of defence or national security;

(8) where to recognize the veil would be contrary to public policy.

FINDING RE LIFTING CORPORATE VEIL

[27] I am satisfied on the evidence that frauds were perpetrated jointly by Lacey, Gillingham and Hiland and included the use of monies from Hiland to purchase an asset in the name of an affiliated company, P & G Realty Limited, a cash advance from Hiland of $135,000 to Gillingham, and a cash advance of $17,000 to an affiliated company, CWG Enterprises, and a mortgage loan of $135,000 to another affiliated company, The Porte Village Limited. These transfers appear to have impaired the assets of Hiland as well as did other monies funneled directly to the account of Nesbitt Thompson, an investment broker, with whom Lacey, Hiland, Gillingham and related companies had funneled money. These transactions point to the use of Hiland as a corporate vehicle to further wrongful acts. Gillingham in his evidence stated that premiums of insurance paid to Hiland included premiums not reported to Lloyd's. It is therefore likely that at least part of the monies used by Hiland was lawfully that of Lloyd's and I am satisfied on the evidence that Hiland was used by Gillingham and Lacey as a façade to conceal the true facts, namely the non-reporting of premiums to Lloyd's and the non-reporting of policies issued in Lloyd's name, both actions constituting a fraud upon Lloyd's by Lacey,

Gillingham and Hiland. Gillingham had the ability to bind Lloyd's and he did so through Lacey. The Hiland replacement policies were used to cover this deception. The guiding hand in all of this deception was Gillingham and, as such, Hiland knew of this because Gillingham was the sole directing mind of Hiland, just as Gillingham was the sole directing mind of Lacey. They were in effect all one and the same entity. In **Clarkson Co. Ltd. v. Zhelka et al**, [1967] 2 O.R. 565 (H. Ct. J.), the trustee in bankruptcy of one Zhelka sought a declaration that certain lands in North York, Ontario were held by the defendants or one of them as trustee for the plaintiff and that a certain mortgage thereon from the defendant Zhelka to the defendant Industrial Sites & Locations Ltd. as mortgagee did not constitute a valid charge. The Ontario High Court of Justice stated:

> 80 If a company is formed for the express purpose of doing a wrongful or
>
> 81 unlawful act, or, if when formed, those in control expressly direct a wrongful thing to be done, the individuals as well as the company are responsible to those to whom liability is legally owed.
>
> [emphasis added]

[28] Having stated the above principle, however, the Ontario High Court of Justice found that the evidence fell short of establishing whether there was any fraud upon Zhelka's personal creditors perpetrated by the operation of the company and Zhelka's conduct with relation thereto.

[29] Lloyd's has argued, and I agree, that the initial appointment of the provisional liquidator can not cleanse the activities of Hiland which was previously used as a vehicle to perpetuate fraud upon Lloyd's, nor can the appointment of the provisional liquidator bestow a legitimacy on what were *ab initio* fraudulent acts by Lacey, Hiland and Gillingham acting in my view as one entity.

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EQUITABLE SUBORDINATION OF HILAND CLAIM IN LACEY'S BANKRUPTCY

[30] Having concluded that Lacey, Gillingham and Hiland were one and the same entity in perpetrating the frauds upon Lloyd's previously described in this judgment, the question now arises as to what use can be made of that conclusion.

[31] The claim for relief contained in paragraphs 23 and 24 of the statement of claim of Lloyd's issued in this matter asks this Court to pierce the corporate veil of Hiland and Lacey as a consequence of the frauds committed against Lloyd's by Hiland and Lacey and, as a result of having so found, to deem the claim filed with the Trustee in Bankruptcy of Lacey by the provisional liquidator of Hiland against the estate of Lacey invalid and to disallow it.

[32] No evidence was presented to me as to the nature of the debts existing between Lacey as debtor and Hiland as creditor. I must, therefore, in the absence of evidence assume that the claim of Hiland in the bankruptcy of Lacey is for legitimately incurred debt owing from Lacey to Hiland. Therefore, I can not absolutely disallow that debt. The question therefore arises: notwithstanding the assumed position that the debt existing from Lacey to Hiland is a legitimate debt, can this debt can be postponed in favour of the debts of the other creditors of Lacey until these creditors receive their full entitlement in the Lacey bankruptcy? Such full payment is unlikely to occur, particularly with respect to the unsecured creditors. This then brings us to the question of whether the codified scheme of distribution of the assets of a bankrupt, under the BIA, can be modified by a court on the basis of equitable principles, in particular the proposed notion of equitable subordination. Professor Thomas G.W. Telfer of the University of Western Ontario has published an extensive article entitled "Transplanting Equitable Subordination: The New Free-Wheeling Equitable Discretion in Canadian Insolvency Law?" (2002) 36 Can. Bus. L.J., 36. At page 36 of his article, Professor Telfer adopts the following definition of equitable subordination as it appears in the decision of the Seventh Circuit Court of the United States **Re Lifschultz Fast Freight**, 132 F.3d 339 at 349 (7th Cir. 1997), quoting from D.

Skeel, "Markets, Courts, and the Brave New World of Bankruptcy Theory" [1993] Wisc. L. Rev. 465 at 506 as follows:

> Equitable subordination relies on courts' peering behind the veil of formally unimpeachable legal arrangements to detect the economic reality beneath. This task by nature "require[s] the court to make extremely subjective judgments as to whether a party has acted opportunistically".

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[33] Professor Telfer indicates that in the United States most academic commentators trace the origins of the use of equitable powers in United States bankruptcy matters to the "seminal cases" of **Taylor v. Standard Gas and Electric**, 306 U.S. 307 (1939) and **Pepper v. Litton**, 308 U.S. 295 (1939). In **Taylor** Douglas, J. firmly based his decision upon the Court's broad equitable powers as a "court of equity". Bankruptcy courts have invoked equitable powers "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done."

[34] According to Professor Telfer these rulings began a long debate over the meaning of these highly abstract concepts and he observed that one author had suggested that it was impossible to extract from the decision in **Pepper** a basic rule that could be followed consistently.

[35] At page 42 of the article, Professor Telfer points out that in 1977 the Fifth Circuit Court in **Re Mobile Steel**, 563 F.2d 692 (5th Cir. 1977), distilled the principles of the earlier case law and developed a three-part test for equitable subordination. Professor Telfer describes that test as follows:

> Before exercising the power of equitable subordination, a court must be satisfied that:
>
> (ii) The claimant must have engaged in some type of inequitable misconduct;

(iii) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant;

(iv) Equitable subordination of the claim must not be inconsistent with the provisions of the *Bankruptcy Act.*

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[36] Professor Telfer goes on to discuss United States' limitations on judicial discretion to alter priorities on insolvency and at page 48 states:

> While the **Mobile Steel** three-part test has been influential in setting out the broad parameters of the doctrine, in many respects the doctrine continues to operate under the rubric of an open-ended standard. Judicial attempts to further define or elaborate upon the meaning of misconduct, for example, "substitute equally vague terms for the root concept". The open-ended nature of the doctrine has sparked a debate in the United States over the merits of granting the judiciary the power to alter statutory priorities. … this part examines a recent trend in the United States jurisprudence to curtail Douglas J.'s abstract notions "rules of fair play and good conscience". In interpreting the principles of equitable subordination, courts have focused the inquiry on the contractual rights of the parties and recognized the importance of not altering legislative policy choices on any kind of a categorical basis.

[37] At pages 49 and 50 Professor Telfer discusses several techniques which have been used to mark off or set boundaries for the operation of equitable subordination and comments at page 50 as follows:

> Some American courts have adopted a restrictive approach, or what one author has called the "formalist contract-rights presumption", for cases involving non-management creditors.

[38] At page 51 Professor Telfer discusses arguments propounded by A. DeNatale and P. Abram in their article "The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors" (1985), 40 Bus. Lawyer 417, with respect to the third element from the **Re Mobile Steel** test. He states:

DeNatale and Abram argue that the third element from the **Mobile Steel** test (equitable subordination must not be inconsistent with the provisions of the bankruptcy statute) "acknowledges that the equitable powers of the bankruptcy court may not be used to alter the statutory scheme but rather must be used only to conform the results of a particular case to the statutorily mandated bankruptcy results. The United States Supreme Court in **Noland** recently adopted the following statement from these two authors as the rationale supporting the third element:

> Simply stated, the third criterion is a reminder to the bankruptcy court that although it is a court of equity, it is not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable. (see DeNatale and Abram footnote 40 at pages 427-428)
>
> [emphasis added]

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[39] At page 53 of his article, before embarking upon the discussion of whether equitable subordination is available is part of Canadian law, Professor Telfer proposes the following as the question to be answered:

> If equitable subordination is available as a matter of Canadian law, a question for the Canadian courts is whether these two major limitations upon the doctrine are acceptable policy limits upon a broad discretionary remedy.

EQUITABLE SUBORDINATION IN CANADIAN LAW

[40] Professor Telfer states that there is no statutory provision in the BIA that expressly permits the application of equitable subordination. However, he points out that under section 183 of the BIA courts exercising jurisdiction in Canada are "invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy".

[41] At page 55 of his article Professor Telfer summarizes the conflicting positions in Canadian legal commentary regarding the doctrine. He states:

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> Beyond the precise legal authority for the doctrine, Canadian commentators have also taken up the normative debate of whether such judicial intrusion into commercial affairs is desirable. Some authors assert that there are instances "where the facts are so compelling that fairness dictates some adjustment of priorities".[citation omitted] Bankruptcy courts require the discretion in equity "to subordinate the claim of a creditor whose conduct prejudiced an estate".[citation omitted] On a general level, the failure to intervene with an equitable remedy may "permit conduct which is morally offensive to go unpunished and, indeed to be rewarded."[citation omitted]
>
> Poised against the argument in favour of intervention stands the need for commercial certainty in commercial lending. Departure from the legal scheme of priorities "in favour of a discretionary scheme simply aggravates the uncertainty of result".[citation omitted] If courts resorted to equitable remedies, including equitable subordination, the effect would be to alter the priority scheme of the provincial personal property security legislation. This would subvert the PPSAs' purpose, which is to provide a statutory scheme to give certainty and predictability to secured transactions. The introduction of a discretionary regime, it is argued, would create costly litigation, drive up the cost of credit and make reorganizations more difficult as parties jockey to alter legal priorities.

[42] Prior to 1992 three Canadian decisions were divided on the issue as to whether the doctrine equitable subordination existed in Canada. In 1992 the Supreme Court of Canada expressly refrained from providing an answer on the issue. In 1986 the British Columbia Court of Appeal in **Laronge Realty Ltd. v. Golconda Investments** (1986), 7 B.C.L.R. (2d) 90 (C.A.), dealt with a case where a creditor sought to have certain shareholder loans postponed. While the court ultimately ruled in favour of the creditor on other grounds, it did consider whether there existed an equitable jurisdiction to subordinate the loans. It was argued on behalf of the creditor that when the court sat as a bankruptcy court it was a court of equity and as such was bound to give equitable relief. The Respondent relied upon the United States Supreme Court decision in **Pepper** and argued that **Pepper** "is said to establish the principle that, where a claim in bankruptcy has violated the rules of fair play in good conscience, the claim may be disallowed". The British Columbia Court of Appeal, however, declined to rule on this point and stated that it was unnecessary to reach any firm views as to whether the doctrine was part of Canadian law. Referring to the fact that the then *Bankruptcy Act* conferred upon the courts "such jurisdiction at law and at equity as well enable them to exercise

original, auxiliary and ancillary jurisdiction in bankruptcy" the court continued as follows:

> 29 The respondent has referred to some cases which appear to have applied the rules of equity but, in view of the conclusion I have reached on the first two grounds I prefer to say no more than that it should not be inferred that there is no such jurisdiction available. I would not wish to say anything which would encourage the view that the court does not have a long arm to prevent the kind of grossly unjust results which I think would have been achieved had the appellants succeeded in the position they took.

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[43] Professor Telfer at page 59 of his article describes this dictum as having "been characterized by one author as 'embrac[ing] the doctrine of equitable subordination'."[citation omitted]

[44] Continuing at page 60 of his article, however, Professor Telfer points out two Ontario judgments prior to 1992 and the **Canada Deposit Insurance Corp. v. Canadian Commercial Bank**, [1992] 3 S.C.R. 558, decision of the Supreme Court, which two cases clearly expressed the view that equitable subordination did not form part of the Canadian law. In **AEVO Co. v. D & A Macleod Co.** (1991), 4 O.R. (3d) 368 (Gen. Div.), Chadwick J. set out the accepted three-part test for equitable subordination established by American case law but concluded that he could not agree that the doctrine of equitable subordination has any application in Canadian law. He states at page 372:

> [t]he *Bankruptcy Act* itself provides how claims are to be identified and how the estate is to be distributed.
>
> To incorporate the doctrine of equitable subordination into the *Bankruptcy Act* would create chaos and lead to challenges of security agreements based on the conduct of the secured creditor.
>
> If the Parliament of Canada felt that this doctrine had some application I am confident that in their wisdom they would have incorporated similar provisions into our statute.

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[45] Subsequent to his decision in **AEVO**, Chadwick J. in **Matticks v. B & M Construction Inc.** (1992), 11 O.R. (3d) 156 (Gen. Div.), referred to his earlier ruling in **AEVO**. Although equitable subordination was not directly relevant to that case at hand, he stated at paragraph 11 in **Matticks** that the *Bankruptcy Act* "provided a specific code for the determination of bankruptcy matters. There was no room in the interpretation of the Act for that equitable doctrine". In 1992 the question of equitable subordination came before the Supreme Court of Canada in the **Canadian Commercial Bank** ("the **CCB**") case. Before CCB was wound up, the governments of Canada and Alberta, the six major Canadian banks and the Canada Deposit Insurance Corporation entered into a complex financial arrangement in an attempt to prevent the demise of the CCB. The characterization of the monies advanced by the parties was crucial to the determination of how the proceeds of the liquidation of the assets of CCB were to be distributed. The Supreme Court of Canada had first to determine whether or not $255,000,000 advanced by these parties was in the nature of a loan or in the nature of an investment of capital. If the transaction was to be characterized as a loan, these parties were creditors of CCB and would be entitled to rank on an equal footing with the other ordinary creditors in the distribution of CCB's assets. The court concluded that the transaction was in fact a loan, thus giving rise to the issue of whether the doctrine of equitable subordination ought to be applied to postpone that loan in favour of the other creditors. It is not necessary here for the purposes of this decision to set out in detail the considerations of the Supreme Court of Canada in that regard. Suffice to say the Supreme Court of Canada did not accept the formulation of a broad equitable jurisdiction and refused to decide whether the United States doctrine of equitable subordination was a part of Canadian insolvency law. Without referring to the earlier conflicting Canadian authorities on this issue, as set out above, Iacobucci J. stated:

> 90 ... As I see the matter, however, it is not necessary in the circumstances of this case to answer the question of whether a comparable equitable doctrine should exist in Canadian law and I expressly refrain from doing so. ...

[46] The Supreme Court of Canada then went on to say in paragraph 96 that it was leaving a ruling on applicability of the doctrine of equitable subordination for "another day". Despite not making a clear ruling on whether a comparable

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doctrine existed in Canada, Iacobucci, J. did refer to American authorities which set out the general parameters of equitable subordination in the United States. He stated:

> 91 As I understand it, in the United States there are three requirements for a successful claim of equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

[47] Subsequent to the **CCB** decision in the Supreme Court of Canada, the issue has not come back before that Court. However, it has been considered in numerous decisions subsequently, in virtually all cases in contests between secured creditors or as between an unsecured creditor and a secured creditor.

[48] In **Re/Max Metro-City Realty Ltd. v. D & A MacLeod Co.** (1993), 16 C.B.R. (3d) 308 (Ont. Ct. J. (Gen. Div.)), Chadwick, J. at page 313 acknowledged that the "*Bankruptcy Act* itself requires application of equitable consideration in dealing with various claims and classes of claims." However, Chadwick, J. denied the claim for equitable setoff in this case, remaining firm to his earlier rulings in **AVEO** and **Matticks** to refuse to allow equitable principles to upset the statutory form of distribution stating, "The statutory provisions of the *Bankruptcy Act* do not go so far as making an unsecured creditor secured or providing one creditor with a preference over another by application of equitable principles".

[49] In other cases, such as **S-Marque Inc. v. Homburg Industries Ltd.**, [1998] N.S.J. No. 550 (S.C.) Hood, J. of the Nova Scotia Supreme Court in a decision described by Professor Telfer as "one of the clearest applications of the doctrine of equitable subordination by a trial court" dealt with a dispute with respect to the proceeds of transactions that had been successfully set aside by a creditor in an action pursuant to section 38 of the BIA. S-Marque Inc., the successful section 38 applicant, sought to rely upon the doctrine of equitable subordination to preclude a

secured creditor from having recourse to the proceeds of the transactions. Dover Capital Corporation, the secured creditor and a related party to the defendants in the section 38 action, argued that any funds that became available as a result of the transactions being set aside were assets which would have been seized by it under a debenture held by it, if they had been there at the time of the seizure. On the principle issue of whether Dover Capital Corporation had any rights to the funds, the authorities clearly indicated that where a transaction is overturned the property does not become available for the benefit of a secured creditor. Notwithstanding that legal position Hood, J. concluded that if Dover Capital Corporation had a valid secured claim to the proceeds, it was to be equitably subordinated. Hood, J. stated that if he was wrong on his finding that the secured creditor had no claim to the funds, then he would invoke the principles of equity to prevent Dover Capital Corporation from benefiting from the reversal of transactions that were improperly entered into by companies related to it within the meaning of the BIA. Hood, J. applied the three-part test set out in **CCB** and concluded that the relevant inequitable conduct was the conduct resulting in reviewable transactions which have now been declared void. With respect to one such transaction, the Court found that it was the very conduct of Dover Capital Corporation that lead to the setting aside of the transfer by the debtor company. In other cases, it was the conduct of the companies related to Dover Capital Corporation that had lead to the wording of the transactions. Here the misconduct was considered by the court as resulting in injury to S-Margue Inc. and conferred an unfair advantage upon Dover Capital Corporation (see paragraph 184 of **S-Marque Inc.**).

CONCLUSIONS RE APPLICABILITY OF EQUITABLE SUBORDINATION DOCTRINE

[50] As can be seen by my brief consideration of the various Canadian authorities respecting equitable subordination, it is clear that the history of Canadian trial courts applying this doctrine, or the doctrine being accepted by courts of appeal, has been sketchy. Professor Telfer's article deals in far greater detail than I have with respect to the approximately 20 subsequent cases on this doctrine as of the time of his article in 2002. This sketchy record has continued subsequent to Professor Telfer's article.

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[51] In considering the three requirements of a successful claim of equitable subordination, as considered by Iacobucci, J. in **CCB**, I am satisfied as follows:

1) That Hiland together with Gillingham and Lacey clearly engaged in a form of inequitable conduct. Lacey illegally appropriated the premium revenue of Lloyd's and either directly or indirectly funneled that premium revenue to Hiland which accepted it;

2) This conduct resulted in injury to Lloyd's and conferred an unfair advantage on Hiland.

[52] The important question in this matter, I having found that the first two branches of the three-part **CCB** test have been met, is whether to allow equitable subordination in this fact situation would be inconsistent with the provisions of the BIA. Were we not dealing with an insolvency situation, I am more than satisfied that the common law of equity would subordinate the claim of Hiland to the claim of Lloyd's as against Lacey. In P.V. Baker & P. St. J. Langan, *Snell's Principles of Equity*, 29th ed. (London: Sweet & Maxwell, 1990), page 57 sets out situations where the authors explain the circumstances in which a holder of *prima facie* priority can lose it as follows:

> A person with a prima facie claim to priority for his interest may lose it through his own misconduct. The owner of a legal interest may be postponed to a subsequent equitable interest owing to his fraud, or by estoppel, or through his gross negligence; and the owner of a prior equitable interest may be postponed if his conduct is inequitable.

[53] Would I, by equitably subordinating the claim of Hiland to the claim of Lloyd's as against the bankrupt estate of Lacey, be doing something inconsistent with the provisions of the BIA? Sections 136-141 of the BIA set out the scheme of distribution of the assets of a bankrupt and section 141 specifies that subject to the BIA all claims proved in a bankruptcy shall be paid rateably. This means that the priority of claims set out in section 136 and following sections will have priority over general creditors. However, general creditors are to be paid rateably. By

applying equitable subordination to the unsecured claim of Hiland in the bankruptcy of Lacey, would I be doing something which is inconsistent with the provisions of the Bankruptcy statute? Clearly by subordinating the claim of one unsecured creditor to the claims of all other unsecured creditors, I would not be bringing into bankruptcy matters the chaos envisaged by Chadwick, J. in **AVEO** or **Matticks**. While indeed the scheme of distribution in the BIA may have as objects the avoidance of litigation and promotion of expeditious distribution, in my view equitable subordination of the claim of Hiland in this particular matter does not interfere significantly with these objects nor does it have the effect of challenging or interfering with secured creditors because we are dealing only with the rights of unsecured creditors relative to each other. It is true that by allowing the doctrine of equitable subordination to apply to unsecured creditors *inter se* that litigation about postponing the claims of unsecured creditors would result in the delay of the distribution of dividends from the bankrupt estate to such disputing creditors. However, it would only delay distribution to the creditor who is sought to be found subordinate. All other unsecured creditors would receive their dividends as they would have received them in the ordinary course of events. Trustees in bankruptcy would simply determine their preliminary distributions based upon the challenged unsecured claim not being subordinated but would not distribute the dividend to that impugned unsecured creditor but would distribute to all other unsecured creditors their rateable share. After the subordination challenge was litigated a trustee could simply adjust payouts in accordance with the result of the subordination litigation. If the subordination argument were unsuccessful, the harm caused to the creditors sought to be subordinated could be mitigated by solicitor and client costs and interest at the statutory rate from the time of the initial dividend, such interest being chargeable against the creditor seeking the subordination. None of the chaos envisaged by Chadwick, J. would result in such a situation.

CONCLUSION

[54] I am therefore satisfied that the three-part test for equitable subordination as postulated by Iacobucci, J. in **CCB** is appropriate to be applied in the circumstances of this matter and conclude that the claim of Hiland in the

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bankruptcy of Lacey is to be subordinated until all other unsecured claims have been satisfied. In doing so I see no inequity being caused. It has been argued that to allow equitable subordination would punish the creditors of the insolvent estate of Hiland, principally policy holders. In my view, this is not an appropriate consideration. The creditors of Hiland have no status in the bankruptcy of Lacey. The creditor of Lacey is Hiland itself, not the creditors of Hiland. Hiland the corporation participated in a fraud against Lloyd's. The creditors of Hiland should not be indirectly rewarded by the criminal activity of the Hiland corporation. Thus, I see no inequity in postponing the claim of Hiland to the other unsecured creditors of Lacey. I acknowledge that there is difficulty in limiting the scope of equitable subordination but I cannot defer from finding unfair conduct simply because such conduct is generally difficult to define. In the case at bar, it is not at all difficult to find unfair, unconscionable and criminal activity on the part of Hiland, Gillingham and Lacey. Difficulty in limiting the scope of the doctrine should not stop courts from expanding the law so that the law responds to those clear cases where right-thinking persons can clearly and easily discern oppressive unfairness as having occurred.

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[55] Lloyd's shall be entitled to its costs in this matter as against the estate of Lacey and the provisional liquidator of Hiland.

[56] Additionally, Lloyd's sought an order that the provisional liquidator of Hiland return to the trustee of Lacey a dividend paid as of December 23, 1996, in the amount of $56,066.40. There was no evidence before me as to whether the provisional liquidator was in possession of any funds to effect this repayment or any part of it. In light of the fact that the dividend was paid to the provisional liquidator in 1996, there is a real chance it does not possess funds sufficient to make such repayment. I will therefore reserve judgment on whether I will order such repayment pending further evidence and argument.

ROBERT M. HALL
Justice

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SCHEDULE "A"

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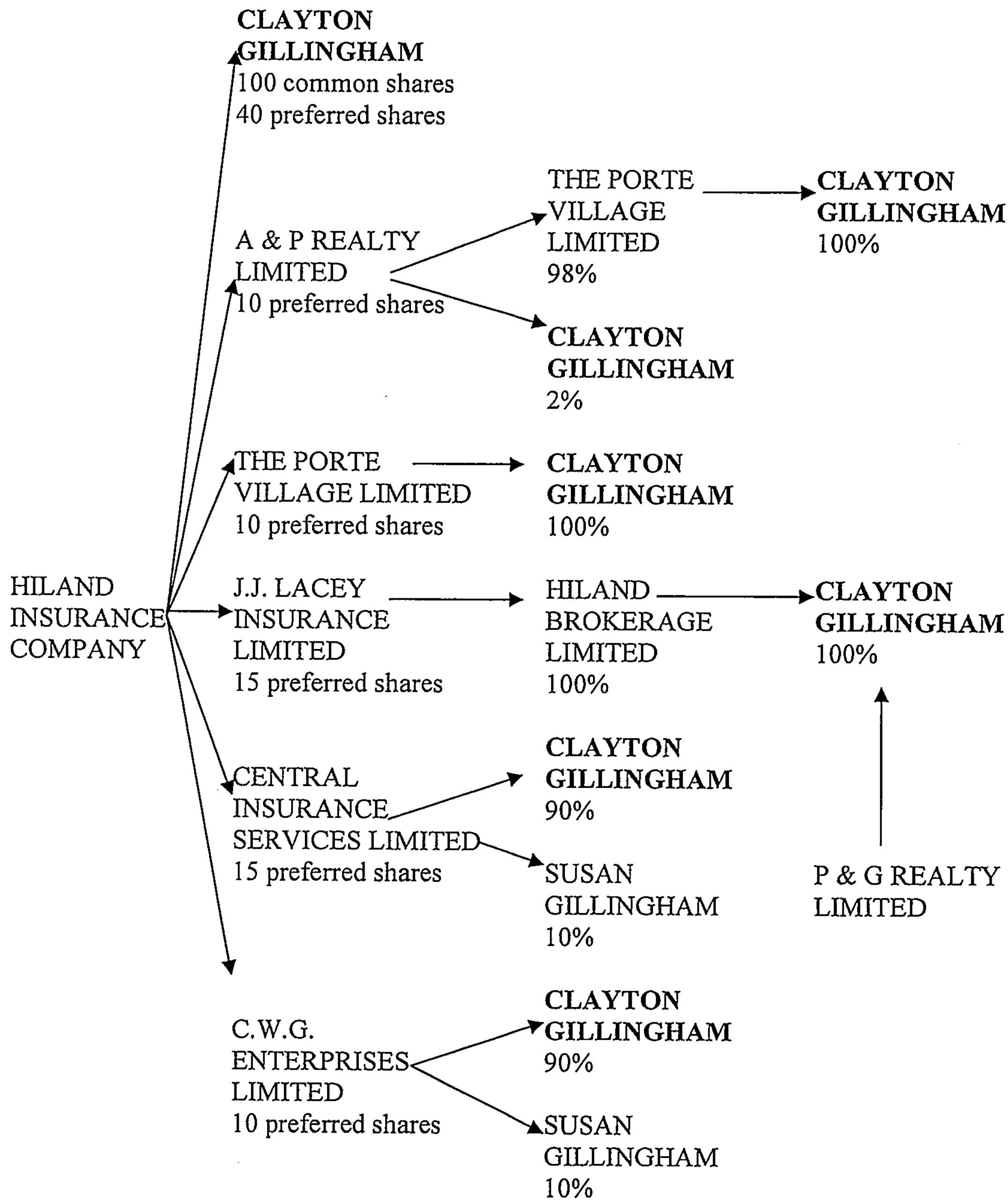

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

And in the Matter of a Plan of Compromise or Arrangement of Indalex Limited, Indalex Holdings (B.C.) Ltd., 6326765 Canada Inc. and Novar Inc.

Court File No. CV-09-8122-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at TORONTO

RESPONDING BOOK OF AUTHORITIES OF THE UNITED STEELWORKERS
(Motion Returnable July 24, 2013)

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