Tab 26

Re

Maple City Ford Sales (1986) Limited
Bank of Montreal v. Maple City Ford Sales (1986) Limited et al.
[Indexed as: Maple City Ford Sales (1986) Ltd. (Re)]

39 O.R. (3d) 702

[1998] O.J. No. 2714

Court File Nos. 35-044093 and 5234

Ontario Court (General Division)

Browne J.

June 18, 1998

Bankruptcy -- Creditors -- Rule against double proof -- Guarantors of bankrupt seeking authority under s. 38 of Bankruptcy and Insolvency Act to sue principal creditor for trespass and wrongful conversion when trustee in bankruptcy refusing to pursue action -- Respondents disputing that guarantors having status as creditors entitled to relief under s. 38 -- Rule against double proofs not applicable -- Guarantors of bankrupt having status as creditors -- Application under s. 38 granted nunc pro tunc -- Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38.

M Ltd. was indebted to the Bank of Montreal and First City Trust Co., and Mc and M had guaranteed repayment of the indebtedness. The Bank petitioned M Ltd. into bankruptcy, but before having done so, the Bank had commenced an action against M Ltd. and against Mc and M as guarantors. The Bank sued for the deficiency in its recovery of M Ltd.'s indebtedness. In that action, M Ltd. delivered a counterclaim claiming damages for trespass and wrongful conversion. After the receiving order was granted, the trustee in bankruptcy indicated that it did not have funds to pursue the counterclaim, which was a potential asset of the estate. The trustee refusing to act, Mc and M applied under s. 38 of the Bankruptcy and Insolvency Act for an order authorizing them to proceed with the counterclaim in their own names, at their own expense and risk. An order under s. 38 being available only to a creditor of the bankrupt, the respondents disputed that Mc and M had the status of creditors and relied upon the rule against double proofs which precludes a guarantor from filing a provable claim when the principal creditor has filed a claim.

Held, the application should be granted.

Mc and M had acquired the status of creditors and for the purposes of an application under s. 38 it was not necessary to determine precisely the amount of their claim. While exactitude would be required for the purpose of determining voting or dividend rights, the exact amount of their provable claim could be determined later, if required. It was not necessary to make a valuation decision at this time and it followed that the rule against double proofs was not violated as there was no risk of double counting. The application under s. 38 should be granted, and with the civil action having been commenced before any of the bankruptcy proceedings, it was appropriate to make the order nunc pro tunc to the date of the bankruptcy.

Cases referred to

Coughlin & Co. (Re) (1923), 4 C.B.R. 294, [1923] 4 D.L.R. 971, [1923] 3 W.W.R. 177 (Man. C.A.); Degroote v. Canadian Imperial Bank of Commerce (1996), 45 C.B.R. (3d) 132 (Ont. Gen. Div.), affd (1998), 37 O.R. (3d) 651, 2 C.B.R. (4th) 45 (C.A.) (sub nom. Re Montego Forest Products Ltd.); Film House Ltd. (Re) (1974), 19 C.B.R. 231 (Ont. S.C.) [vard (1974), 19 C.B.R. (N.S.) 231 (Ont. S.C.)]; McCrie v. Gray (1940), 22 C.B.R. 390 (Ont. S.C.); Polar Products Inc. v. Hong Kong Bank of Canada (1992), 14 C.B.R. (3d) 225 (B.C.S.C.); Rizzo & Rizzo Shoes Ltd. (Re) (1995), 32 C.B.R. (3d) 96 (Ont. Gen. Div.)

Statutes referred to

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 37, 38 Business Corporations Act, R.S.O. 1990, c. B.16. ss. 245, 246

Rules and regulations referred to

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, Rule 11

APPLICATION for an order pursuant to s. 38 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

James Fisher, for Trustee in Bankruptcy.
Anthony J.G. Van Klink, for plaintiff, Bank of Montreal.
H. Richard Bennett, for defendants, David Brock McKeand and Malger Leasing Ltd.

BROWNE J.: -- David Brock McKeand ("McKeand") and Malger Leasing Ltd. ("Malger") claim as creditors of Maple City Ford Sales (1986) Limited (the "Bankrupt") seeking certain relief. The status of McKeand and Malger as creditors is in dispute. The relief sought is in the alternative firstly for relief pursuant to s. 38 of the Bankruptcy and Insolvency Act of Canada, R.S.C. 1985, c. B-3 ("BIA"). In the alternative, relief further to s. 37 BIA. In the further alternative, leave to continue the civil action 5234/91 as a derivative action pursuant to ss. 245 and 246 of the Business Corporations Act, R.S.O. 1990, c. B.16 ("BCA"). Relief is also sought further to Rule 11 of the Rules of Civil Procedure granting leave to continue action 5234/91. The relief sought is on a nunc pro tunc basis.

There is a cross-motion by the Bank of Montreal (the "Bank") in action 5234/91 requesting that the counterclaim with the exception of one paragraph be dismissed. Certain of the relief sought in the Bank's motion has been adjourned sine die. It is agreed that if the applicants McKeand and Malger are successful that result will dispose of the Bank's motion for the relief as described.

The bankrupt is indebted to the Bank and to First City Trust Company. Those debts have been guaranteed by McKeand and Malger. The primary debtors have filed proofs of claim with the trustee. Neither McKeand nor Malger have filed proofs of claim with the trustee.

June 19, 1991 was a day of much activity. The civil action was commenced. There was on the same date a demand made by the Bank of Montreal and also on the same date, outside of bankruptcy proceedings, an ex parte order appointed a receiver. On July 25, 1991 all four defendants filed a statement of claim and counterclaim.

On October 15, 1991 a petitioner for a receiving order was filed.

The civil action continued through discoveries, setting down for trial and on March 18, 1993, a decision was rendered dismissing the plaintiff's motion against the three personal defendants for summary judgment. On the same date the statement of defence and the counterclaim were amended. The action was pre-tried on November 28, 1996 and scheduled for trial in January 1997 which trial was adjourned. There was a further adjournment of the trial in June 1997.

As an aside, in the material before me are filed three pre-trial memoranda. I questioned the appropriateness of that material being before me and refused to consider any of the pre-trial material.

The petition was disputed. There was a hearing in July 1992 with reasons being released in August 1992 [reported 14 C.B.R. (3d) 188]. In the result a receiving order was issued. That decision was appealed to the Ontario Court of Appeal, which appeal was dismissed October 10, 1996 [reported 41 C.B.R. (3d) 181]. Leave to appeal that decision was refused by the Supreme Court of Canada June 26, 1997.

By letter dated December 6, 1996 solicitors on behalf of certain named parties including the applicants wrote in their capacity as creditors of the bankrupt requesting the trustee to continue the counterclaim against the Bank of Montreal. As a result of that letter the trustee wrote to the creditors of the bankrupt on December 10, 1996, which letter includes the following:

> On June 19, 1991, Bank of Montreal ("Bank") appointed Ernst & Young Inc. as Receiver and Manager of Maple City Ford Sales (1986) Limited ("Company") pursuant to security it held which encumbered all assets of the Company. After realizing on the Company's assets, the Bank incurred a significant shortfall. On October 15, 1991, the Bank filed a Petition for a Receiving Order against the Company appointing Ernst & Young Inc. as Trustee in Bankruptcy. The Receiving Order was issued on July 30, 1992 and a creditor meeting was held on September 17, 1992 at which time Ernst & Young Inc.'s appointment as Trustee was affirmed. No Inspectors were appointed at the meeting. The Company filed an appeal of the Receiving Order and on October 10, 1996 the appeal was dismissed.
>
> Prior to October 15, 1991, the date of bankruptcy, the Bank commenced a legal action against the Company and the guarantors of the Company's indebtedness for recovery of

> its shortfall, In response, the Company filed a counterclaim against the Bank claiming damages of $5,000,000 for trespass and wrongful conversion.
>
> The counterclaim against the Bank may represent a potential asset for the estate. As Trustee, we have no funding available within the estate to investigate the merits of the counterclaim or seek a legal opinion as to the likelihood of success should the counterclaim be pursued. As a result of the lack of funding it is the Trustee's intention to abandon any further action in this regard. Accordingly, we hereby give notice that the creditors of the estate have the right to make application to the Court pursuant to Section 38 of the Bankruptcy and Insolvency Act to commence and prosecute proceedings in their own name and at their own expense and risk regarding this matter.

By October 1997 the position of the trustee was to question the authority of the applicants to follow the procedure of s. 38 unless directed to do so by the court. In other words the trustee took the position the applicants were not creditors or even if creditors, were not for other reasons entitled to rely upon s. 38.

Section 38 includes the following:

> 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 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.

The applicants' position is that they are creditors and having the status of creditors, they are entitled to relief provided in s. 38.

The responding position is that the applicants are not creditors and that they cannot therefore avail themselves of s. 38. The further responding position relies upon a rule described as the rule against double proofs which is said to be applicable where a principal creditor has filed a claim a guarantor has no provable claim and cannot file a double proof with the trustee.

In Re Film House Ltd. (1974), 19 C.B.R. 231 (Ont. S.C.) at p. 233, Houlden J. considered the position of a guarantor who had not been called upon to pay the principal debtor. The issue before the registrar and on appeal involved a creditor's voting rights, if any. From p. 233 the registrar comments as follows:

> Now it is quite clear from Re Froment; Alta. Lumber Co. v. Dept. of Agriculture, Alta., 5 C.B.R. 765, [1925] 2 W.W.R. 415, [1925] 3 D.L.R. 377 (Alta.), that the contingent liability of a guarantor, who has not been called upon to pay or who has not in fact paid, is a debt provable in bankruptcy of the debtor.

The registrar was dealing with the valuation of a liability at a point in time for the purpose of voting. On p. 233 the registrar comments as follows:

> In a sense there is a valuation for purposes of filing a claim, for purposes of voting and for other purposes and a valuation for the purpose of receiving a dividend.

On the facts of this case the principal creditor had chosen not to file a proof of claim for the purpose of voting. Houlden J. at p. 234 provided that:

> If the principal creditor had elected to vote the claim, then the surety would have had no right to vote.

In Polar Products Inc. v. Hong Kong Bank of Canada (1992), 14 C.B.R. (3d) 225 (B.C.S.C.) at p. 227, the facts were quite similar to the case at bar. The applicants therein had requested the trustee to commence an action. With the trustee refusing to launch the action, a motion was brought for relief pursuant to s. 38. The applicants had not filed proofs of claim and in the first instance, relief was not granted for failure to qualify as creditors because of the failure to file proofs of claim. They were given leave to renew the application. After filing proofs of claim the matter again came before the court. In the material before the court it was not possible to quantify the claim at that particular point in time. The court comments at p. 227 as follows:

> I conclude that the applicants have established on a balance of probabilities that they are creditors of the bankrupt in a substantial amount but that the precise amount of indebtedness is unproven and is probably incapable of being proved except by an extensive (and no doubt expensive) accounting and perhaps after a trial of the issue.

The court quotes s. 38 and addresses as a first question whether the applicants are creditors within the section. At p. 228 that issue is discussed as follows:

> Section 2, the definition section, defines "creditor" as meaning "a person having a claim, preferred, secured or unsecured, provable as a claim under this Act".
>
> The word "creditors" appears in many sections of the Act. It has been held that the statutory definition can be satisfied only by "claims proven to the satisfaction of the trustee and/or the court": Re Currell (1985), 57 C.B.R. (N.S.) 173 (Ont. S.C.). That decision dealt with the interpretation of "creditors" in s. 115 of the Act [R.S.C. 1970, c. B-3], which deals with the bankrupt's entitlement to any surplus remaining after payment in full of "his creditors". In that context, it is clear that a claim could be considered proven only if proved as to its amount as well as its existence. But the same degree of precision is not required at this stage in order to deal with the issue raised under s. 38(1) although, if the creditor succeeds in effecting a recovery, the amount of his claim will have to be established precisely in order to apply s. 38(3):

> (3) [Benefits belong to creditor] 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.
>
> I therefore hold that the claims are sufficiently proven to qualify the applicants as creditors for the purposes of s. 38(1).

(Emphasis added)

In DeGroote v. Canadian Imperial Bank of Commerce (1996), 45 C.B.R (3d) 132 (Ont. Gen. Div.), Lax J. was considering s. 38 and the status of a corporation claiming to be a creditor. In the result she concluded at p. 136:

> On balance, I am satisfied that [the corporate applicant] has a claim "provable" in bankruptcy which is all that is required to bring itself within the broad definition of "creditor" under the Act. Whether or not the claim is ultimately proved is irrelevant to the issue I am asked to consider.

It is clear that there are different times and different values within the bankruptcy process for claims to be considered. At the end of the day there must be precision with reference to the figures used for dividend purposes. Before that time, there may be no need for that exactitude. Exactitude would be required for the purpose of voting. In my view exactitude is not required to establish status as a creditor. I am satisfied that the applicants herein have at this stage the required status as creditors even though they ultimately may or may not be entitled to a dividend, if there are any dividends. It is my conclusion that at this time the claim of the applicant now exists as a provable claim the exact amount of which can be determined later, if required.

In the appeal from Lax J.'s decision by endorsement February 4, 1998 [reported 37 O.R. (3d) 651], the appeal was dismissed. The court provided [at p. 654]:

> It is not every case that will lend itself to the granting of a s. 38 order nunc pro tunc and circumstances alter cases: the facts presented in many cases may not engage the discretion of the court to make such an order, whereas the facts presented in others may invite the exercise of that discretion.

In Re Coughlin & Co. (1923), 4 C.B.R. 294, [1923] 4 D.L.R. 971 (Man. C.A.), the headnote includes the following:

> A surety for the whole debt with a limit on his liability is a creditor under sec. 44 of The Bankruptcy Act after he has paid the amount of the limited liability; but he may nevertheless be postponed in ranking on the assets by reason of the rule against double proofs so that his claim shall not rank in opposition to the claim of the creditor whose debt was the subject of the guarantee but who was not paid in full because of the stipulated limit to the surety's liability.
>
> At p. 299 the court provides as follows:

> It is to be noted that it is the "debt" which is provable. There may be several claimants in respect of the "debt," but there is only one debt, and double proof in respect to it is not permitted.

The respondent bank's position is that where there is a guarantee for a whole debt even if limited in amount the guarantor cannot prove a claim in bankruptcy until the time that the principal creditor is paid in full.

The principles involved for the above position were considered by Urquhart J. in McCrie v. Gray (1940), 22 C.B.R. 390 (Ont. S.C.). On the facts in this case the creditor took the position that he was liable as a surety to a bank. The bank had not filed a claim in the bankruptcy estate nor had it made a claim against the surety but a claim against the surety was anticipated. Urquhart J. comments at p. 394 as follows:

> . . . if the Bank of Montreal makes a claim upon the estate and receives its dividend, it is obvious that the creditor, even though he must pay the balance, cannot succeed in a claim against the estate. For example, assuming that twenty cents on the dollar be paid, if the Bank of Montreal makes its claim and receives twenty per cent, and then claims against the creditor for the remaining eighty per cent, the creditor could not rank against the estate for the remainder and get twenty per cent of the eighty per cent because that would have the effect of this debt bearing a dividend of close to forty per cent at any rate considerably more than other creditors' claims would bear. There cannot be two claims for the one debt. In re Coughlin & Co., 4 C.B.R. 294, [1923] 3 W.W.R. 1177, 33 Man. R. 499, 3 Can. Abr. 779.
>
> If, however, the Bank of Montreal does not see fit to claim for its debt but compels payment of the debt from the surety the applicant creditor is subrogated to the rights of the Bank of Montreal and can make a claim therefor.

On the facts of the above case the claim was allowed and valued at the full amount due upon the surety. Most similar cases deal with an attempt to quantify amounts for voting purposes or for dividend payment purposes. It is in my view not necessary to make a valuation decision at this point in time. The rule dealing with double proofs is not violated as it follows that there is but one debt for each of the two principal creditors, their debts being separate from each other. In the result I find the applicants to have status as creditors within s. 38. Their claims are provable at this time in an amount unascertained. There is no violation by their contingent claims upon the rule against doubt proofs of a single debt. There would at this stage be no risk of double counting. The risk of double counting appears to be the mischief to which the rule pertaining to double proofs is directed and I find there to be no mischief in fact to date for the purposes of s. 38.

The civil action against the three personal defendants will continue whatever the decision made upon this application may be.

With the civil action being commenced before any of the bankruptcy proceedings it is in my view appropriate that relief be nunc pro tunc to the date of bankruptcy namely, October 15, 1991.

Having found that relief is available further to s. 38, s. 37 does not apply: see Re Rizzo & Rizzo Shoes Ltd. (1995), 32 C.B.R. (3d) 96 (Ont. Gen. Div.). Again, in my view having found that relief is available under s. 38 relief under the BCA is not available.

Section 38 provides that relief may be granted on such terms and conditions as the court may direct.

The material to which I was referred raises serious questions as to amounts due for debt to the bankrupt from the applicants and raises the question of the applicants' ability to conduct the proceedings at their "own risk and expense".

As I have indicated earlier, the relief granted will be on a nunc pro tunc basis. The relief granted includes the following. The applicants are entitled to file forthwith and as a precondition to the balance of relief proofs of claim, in the bankrupt estate. An order shall go further to Rule 11 of the Rules of Civil Procedure granting the applicants and/or Maple City leave to continue to prosecute the counterclaim in action 5234/91. The applicants may at their risk and expense on notice to other creditors and giving of security for costs as hereinafter provided continue the counterclaim as hereinbefore provided. The trustee may continue the civil action further to s. 38 upon satisfaction of the preconditions, namely, filing proof of claim, giving of notice, paying of security for costs, receive an assignment and transfer by the trustee of all right, title and interest in the chose in action subject to s. 38(3) and/or such accounting as may be required.

Estimates for the length of trial are estimated between two weeks to eight weeks. I accept on the basis of a balance of probabilities that the estate has claims provable against the applicants in an amount or amounts which I am unable to ascertain with any degree of confidence at this stage in the proceedings. I was asked to consider that there be security for such indebtedness. I declined to accept that invitation. However, in the context of the risks and costs of prosecuting the counterclaim, I require that the applicant pay into court in the civil action as a precondition to the relief herein, the sum of $55,000 to be held subject to such order as may be made within that action.

If leave is required in the civil action for the plaintiff to continue to prosecute the claim against the bankrupt, such leave is granted.

The motion brought on behalf of the Bank other than as adjourned is dismissed.

Order to go in favour of the applicants pursuant to these reasons.

If the parties cannot agree upon costs, written submissions may be submitted within 30 days from the date of release of these reasons.

Application granted.

Tab 27

Case Name:
Cuchuran v. Dubitz

[1945] A.J. No. 66

[1945] 3 W.W.R. 541

ALBERTA DISTRICT COURT

BOYD MCBRIDE D.C.J.

Judgment: November 16, 1945

(16 paras.)

Counsel:

J. Decore, for plaintiff.

H. S. Hurlburt, K.C., for defendant.

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1 BOYD MCBRIDE, D.C.J. -- This action is for an amount which plaintiff pleads he "was obliged to pay" to the Canadian Bank of Commerce arising out of the fact that several years ago he backed defendant at the bank.

2 The controversy between the parties raises a number of points of some importance under *The Farmers' Creditors Arrangement Act, 1934*, ch. 53 (now 1943-44, ch. 26) (Dom.), and the *Bankruptcy Act*, R.S.C., 1927, ch. 11, which statutes the defendant invokes as affording him a complete answer to the claim. On these points I have had the assistance of able argument by both counsel.

3 The facts are briefly as follows:

> On November 28, 1929, defendant, being on good terms with plaintiff, requested plaintiff to assist him in securing a loan from the bank, plaintiff to do so by lending his name as an accommodation party to a promissory note. Plaintiff

> agreed and the parties went together to the bank's Willingdon branch. The characteristics of such a transaction, and the nature of the liability being incurred, apparently were familiar to both. At the bank they signed a note for the amount of the loan, $309.80, and this amount was thereupon advanced and paid to defendant. The note runs "I promise to pay," and was signed by each party as a maker. It was the joint and several obligation of each: Secs. 55 and 179 (2) the *Bills of Exchange Act*, R.S.C., 1927, ch. 16. Defendant defaulted on his implied covenant with plaintiff to provide funds to pay the note at maturity. As a result, periodic renewals, each running "I promise to pay," were signed and delivered by both parties to the bank.

4 On October 4, 1935, the amount owing to the bank stood at $373.70, and on that date a further renewal, payable May 1, 1936, was signed and delivered by both parties. The series of notes evidencing the debt has been filed as Ex. 1. In the meantime Parliament had enacted *The Partners' Creditors Arrangement Act, 1934*, ch. 53 (now 1943-44, ch. 26).

5 Some time prior to June, 1936, defendant, asserting himself to be an insolvent farmer and unable to meet his liabilities, made a proposal to his creditors for a composition, extension of time or scheme of arrangement under *The F.C.A. Act, 1934*: Sec. 6 (1); see also Part II of the *Bankruptcy Act*. The creditors refused approval and the Board of Review then intervened at defendant's written request and formally recognized his insolvency by formulating a proposal for him. It is important to note that his proposal became binding an all creditors (sec. 12 [6]) and that the board based it "upon the present and prospective capability of the debtor to perform the obligations prescribed:" Sec. 12 (8). The proposal, Ex. 3, is dated June 12, 1936. In broad outline it prescribed substantial reductions in defendant's secured and unsecured liabilities, and as to the obligation which we now have under consideration it provided in par. (1):

> "That the claim of The Canadian Bank of Commerce in respect of a promissory note made by the Applicant and endorsed by one George Cuchuran, be fixed at the sum of $188.43 as of the first day of December, 1935, which said sum shall bear interest at the rate of 5% per annum from the said date, and shall be payable as follows: One-fifth of the principal sum, and interest on the unpaid balance at the rate aforesaid, payable on the first day of December in each of the years 1936 to 1940, both inclusive."

6 I disregard the erroneous statement in this paragraph that the plaintiff was an endorser when in fact he was a maker of the note. It makes no difference in the issues before me: Sec. 55 of the *Bills of Exchange Act*. It is not disputed that the bank had the right, as it did, to prove for the full amount of the debt. I was satisfied an the evidence that defendant duly paid the bank the amount of his reduced liability, the above-mentioned $188.43, with 5 per cent interest, and the bank, having no further recourse against him, then made demand an plaintiff to pay the unpaid balance of the note, namely, $171.58, and he did so.

7 In these circumstances and by reason of having made this payment, plaintiff advances the proposition that there was Thereby created the relationship of debtor and creditor between defendant and himself arising at and from the moment of payment to the bank, which in point of time was admittedly long after the crucial date, May 1, 1935 (sec. 19, *F.C.A. Act*); he points out that he, plaintiff, did not concur under that section; he argues that in consequence *The F.C.A. Act* and the *Bankruptcy Act* do not apply, and he submits he is entitled to a judgment of this Court against defendant. The latter puts forward two main defences: First, that it was the debt itself which the Board of Review cut, not simply defendant's liability in respect of it, and that plaintiff was not required to pay the balance of the note, being under no legal liability for that amount, and, second, as an insolvent farmer who has paid the reduced amounts required of him by the Board of Review in settlement of his liabilities, he, defendant, cannot now be called upon to pay anything further, and that *The F.C.A. Act* and the *Bankruptcy Act* discharge him not only of the original obligation but also of the claim now put forward. Defendant's counsel puts this submission succinctly when he says: "If the plaintiff was legally bound to pay the bank it is his loss; in law such a payment furnishes no cause of action against defendant." I must determine which of these conflicting views is entailed to prevail.

8 It is directly in point to recall that *The F.C.A. Act* was enacted by Parliament 11 years ago during a period of severe agricultural depression in Canada, see its preamble, and that because its constitutional validity had been impeached a reference was made to the Supreme Court of Canada which held, [1936] S.C.R. 384, at 393, 17 C.B.R. 359, Cannon, J. dissenting, that the Act was a valid exercise by Parliament of its exclusive legislative authority extending to the subjects "Bankruptcy and Insolvency," head No. 21, sec. 91, of *The B.N.A. Act, 1867*, which majority judgment was subsequently affirmed by the Privy Council, [1937] 1 W.W.R. 320, [1937] A.C. 391, 106 L.J.P.C. 67, 18 C.B.R. 217. By its express terms *The F.C.A. Act*, except as therein otherwise provided, is to be read and construed as one with the *Bankruptcy Act*, and the *Bankruptcy Act* and Rules are made applicable: Sec. 2 (2).

9 During the course of argument it became clear that the second defence constituted the main problem. Before dealing with it, it is desirable that I dispose shortly of defence No. 1. I hold the proposition there advanced to be unsound. Plaintiff was a surety for defendant, the principal debtor, and there is no evidence or suggestion that the bank agreed to defendant's composition as formulated, or impliedly released any part of his debt or did anything else which might weaken its position or derogate from its rights. The liability of the parties, as already pointed out, was joint and several. The bank held no security on any property *of the defendant* and hence was an unsecured creditor, notwithstanding the accommodation party's obligation held by it, when defendant came under *The F.C.A. Act: Rowlatt on Principal and Surety*, 3rd ed., at pp. 5, 7 and 311; sec. 2 (*ii*), the *Bankruptcy Act* (as amended by 1932, ch. 39, sec. 2i [1]); *In re Coughlin & Co.; Guar. Co. of North America's Claim* [1923] 3 W.W.R. 1177, at the foot of p. 1183, 33 Man. R. 499. Furthermore under sec. 5A of *The F.C.A. Act* [added by 1935, ch. 20, sec. 2] and sec. 148 of the *Bankruptcy Act*, it seems clear that there is expressly preserved to a creditor the liability of "any person who was a surety or in the nature of a surety" and such person is not released. The Board of Review, I must

take it, did not overlook sec. 5A and it was in fact fully aware of plaintiff's liability to the bank when it came to deal with defendant's application. It only however had before it and it dealt only with the liabilities of the defendant. It could not, on defendant's application, deal with or reduce plaintiff's liability and it did not purport to do so. Support for the view I have taken on this first branch of the defence is I think to be found in the unanimous judgment of the Court of Appeal in Manitoba in *Int. Loan Co. v. Kostinuk* [1936] 3 W.W.R. 481, 44 Man. R. 387, 18 C.B.R. 80, where a similar question as to a guaranteed mortgage debt was under consideration, and the mortgagor of the land had had his liability reduced after coming under *The F.C.A. Act*, and also in the unanimous judgment of the Court of Appeal of Saskatchewan in *Drummond v. Hutchinson* [1942] 1 W.W.R. 123, 23 C.B.R. 168. It follows that where the maker of a promissory note is discharged of his liability by virtue of the provisions of *The F.C.A. Act* the liability of an accommodation party (to whatever extent the note remains unpaid) is not thereby affected.

10 I turn now to the main defence, and success on it must I think necessarily rest on two propositions: (1) That there existed in plaintiff a contingent claim against defendant prior to May 1, 1935; and (2) That by reason of the bank having filed and proved a claim under *The F.C.A. Act* for its unsecured debt, plaintiff's contingent claim--which otherwise might have been susceptible of proof--was debarred by the rule against double proof. Plaintiff's action seems prompted by or predicated to a large extent upon the supposition that the definition of "creditor" in sec. 2 (*d*) of *The F.C.A. Act* excludes from our consideration sec. 104 of the *Bankruptcy Act*. If that were sound, plaintiff's action might be well founded, as certainly he did not pay the bank until after May 1, 1935. But in my view it is an untenable argument running contrary to the whole trend of the authorities, and I reject it. Indeed the very fact that *The F.C.A. Act* nowhere sets out expressly or impliedly what creditors hold provable debts against the estate of an insolvent farmer, in my opinion, requires me to turn to sec. 104 and it becomes an important, if not the governing, provision, for our present purpose. This section makes express provision in regard to contingent claims, and this is consistent with the whole object and intention of Parliament as early laid down by James, L.J. in a well-known passage in his judgment in *Ex parte Llynvi Coal & Iron Co.; In re Hide* (1871) L.R. 7 Ch. 28, 41 L.J. Bk. 5, where speaking of the English *Bankruptcy Act, 1869*, ch. 71, he says at p. 32:

> " * * * the broad purview of the Act is that the bankrupt is to be a freed man, freed not only from debts, but from contracts, liabilities, engagements and contingencies of every kind."

11 See also the discussion of the history of bankruptcy and insolvency and the meaning of these words in the recent judgment of the Privy Council delivered by Viscount Maugham in *Reference re Debt Adjustment Act, 1937; Atty.- Gen. for Alta. v. Atty.-Gen. for Can.* [1943] 1 W.W.R. 378, [1943] A.C. 356, at 371, 112 L.J.P.C. 17, 24 C.B.R. 129; and while there was a gap from the time the former general bankruptcy law of Canada was repealed in 1880 until the coming into force of the new Act in 1919, it is elementary that the then existing English Act of 1914 was the prototype of our Act, and that since 1919 the English authorities have been continuously approved and applied

by Canadian Courts. An Alberta authority almost directly in point is to be found in *In re Froment; Alta. Lbr. Co. Ltd. v. Department of Agriculture, Alta.* [1925] 2 W.W.R. 415, 5 C.B.R. 765, where Tweedie, J. holds it to be established law that the contingent liability of a surety who has not been called upon to pay, or has not in fact paid, forms a debt provable in the bankruptcy of the principal debtor (p. 423) this being of course subject to the rule against double proof. In this case, in contrast to the case at bar, the Bank of Montreal refrained from filing proof. See also *Duncan & Reilley's Bankruptcy in Canada*, 2nd ed., p. 551, with authorities cited in footnotes; and *In re Oriental Commercial Bank; Ex parte European Bank* (1871) L.R. 7 Ch. 99, at 103, 41 L.J. Ch. 217. Again in *In re Melton; Milk v. Towers* [1918] 1 Ch. 37, 87 L.J. Ch. 18, where a surety had given a bank a joint and several guarantee on a printed form, covering another's overdraft, and the. other became bankrupt, I find the Court of Appeal is unanimous, and that Swinfen Eady, L.J. has this to say against a surety proving in competition with the principal creditor, at p. 47:

> "There can be no double proof against the estate; and the rule against double proof has regard to the substance of the transaction, not to the form. It may well be that technically there are * * * two separate liabilities of the debtor arising out of the transaction. One is to * * * the bank for the money he owed. The other, which is a separate liability arising out of the contract of guarantee, is the debtor's liability to indemnify the sureties in respect of their liability to the principal creditor. Technically they are two separate liabilities, but in substance they are the same; and in respect of that liability there could not be a double proof against the estate. The creditor could not prove for the amount of the debt and the surety bring in a proof for part of the same amount."

12 Reference may also be made to the unanimous judgment of the Court of Appeal in Manitoba in *In re Coughlin & Co., supra*, in 1923, where some of the authorities are reviewed and part of the above passage is quoted and approved.

13 At this point it should be noted that there is nothing in the evidence before me to suggest that plaintiff made any attempt at any time to prove a claim, contingent or otherwise, against defendant's estate. Returning to the foregoing authorities and to the principles so fully discussed and enunciated in them I feel I may usefully add two observations applicable to the present case. Firstly it was the plaintiff's obligation to pay the Canadian Bank of Commerce on maturity of the original note when defendant defaulted. If he had done so he would have stood in the bank's shoes on defendant's insolvency and would undoubtedly have suffered some loss on the formulation of the proposal. I cannot see how plaintiff can expect to be placed in a higher position and to be relieved entirely of loss simply because he too defaulted. Secondly, if every surety could come in later and sue, as in the case at bar, then an insolvent debtor who had furnished no sureties would be in a much more fortunate position than for example one who had provided sureties for most of his liabilities; or if the principal creditor and surety could both prove claims for the same obligation then, to provide for these two claims, the composition payable to the farmer's remaining creditors would require unfairly to be reduced. Any such state of affairs in my opinion would violate the whole underlying

principles of bankruptcy and insolvency, and demonstrates how sound is the rule against double proof.

14 I hold therefore that here there was an existing contingent claim provable in bankruptcy and insolvency, and vested in plaintiff prior to May 1, 1935, but that immediately the Canadian Bank of Commerce filed proof of its claim against defendant in respect of the same obligation the rule against double proof came into play, operating against plaintiff to prevent him filing proof of his contingent claim, and that in the result defendant is thereby discharged of the contingent claim and plaintiff deprived of all right of action in respect of it.

15 Although what I have already said in my opinion disposes of this action, there remains for consideration one further point. As it was strongly argued by defendant's counsel I feel I should not overlook it, namely, that defendant on payment of his composition was discharged by virtue of the provisions of *The F.C.A. Act*, in the sense that the term discharge is used in part VI of the *Bankruptcy Act*. I do not think I am required to make a decision on this point and I do not do so. It is one which may arise directly in another and more appropriate case. Nevertheless if a decision be necessary for a proper and final disposition of the case at bar, then without extended search for authority, I would hold that defendant is so discharged. It is on this question of discharge and the correlated rights of parties that we find the most distinctive divergence between *The F.C.A. Act* and the *Bankruptcy Act*. Under *The F.C.A. Act* the *cessio bonorum* appears temporary only (sec. 11 [2]) and Parliament's whole purpose manifestly is to provide the insolvent farmer an opportunity to re-establish himself an the same farm free of the burden of overwhelming debts incurred during the depression, and to enable him to carry on in the meantime with as little interference or supervision as possible. There is no trustee in whom his property vests, and the divergence appears to be accentuated by secs. 141 *et seq.* of the *Bankruptcy Act*. As compared with an authorized assignor or a debtor against whom a receiving order has been made, our 'farmer is subject to little or no disability in the continuation of his farming business. No questions appear to arise, for example, of paying 50 cents on the dollar, nor of subsequent earnings, nor of after-acquired property. Practically the farmer's sole obligation is to pay the amount of the composition, usually by instalments, as fixed by the proposal, to his respective creditors within the extended time allowed. When he has done so these creditors no longer have any right of action against him. *The F.C.A. Act* makes no provision for applying for a formal discharge. My view is that a farmer who has faithfully performed the terms imposed on him in his proposal is discharged by *The F.C.A. Act* as fully and effectually of all provable debts as under an order of discharge granted pursuant to the *Bankruptcy Act*. If I should be wrong in this, then I see nothing to prevent an application under the *Bankruptcy Act* being made for such an order.

16 Plaintiff's action is dismissed with costs.

Tab 28

Case Name:

Re COUGHLIN & Co.

[1922] M.J. No. 42

[1923] 1 D.L.R. 632

Manitoba King's Bench

Macdonald, J.

Judgment: December 4, 1922

(13 paras.)

Counsel:

E. F. Haffner, for the Guarantee Co. of North America.

C. K. Guild, for the assignee.

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1 MACDONALD, J.--This is an appeal from the decision of Salter & Arnold, authorised trustees of the above debtor, disallowing the claim of the Guarantee Company of North America arising in the following manner:--

2 The debtors were engaged in business as commission dealers in cattle and as such were required under the Act respecting livestock being the Live Stock and Live Stock Products Act, 1917 (Can.), ch. 32, sec. 4, to furnish sufficient and satisfactory security for the proper accounting by such commission merchants of the proceeds of any sales received by them and of any money paid to them to effect any purchase.

3 In compliance with this provision the debtors were bonded by the Guarantee Company of North America in the sum of $10,000, themselves joining in the bond as principals and the said guarantee company as surety, the bond being taken to His Majesty the King for the benefit of those coming within the scope of the said sec. 4 (2). The debtors incurred liabilities to various consignors of cattle

by disposing of their cattle, collecting the proceeds, which proceeds were largely in excess of the said sum of $10,000, and failing to account to the owners of the cattle for the proceeds arising from the sale thereof, the said guarantee company was called upon to make good and did make good their guarantee by payment to His Majesty the King of the said sum of $10,000, which amount has been distributed among the owners of the cattle disposed of (to whom I shall refer as special creditors), and the said guarantee company now make claim against the estate of the debtors for the said sum of $10,000, which claim the authorised trustee disallows, and this is an appeal against such disallowance.

4 In the application for the bond the debtors jointly and severally agree to indemnify and hold harmless the said guarantee company from and against any and all loss, damage, expense and costs incurred by it under and by reason of the said bond, and under this indemnity the guarantee company's claim to rank as creditor against the estate of the debtors. The point that I am called upon to decide is whether or not the guarantee company is entitled to rank against the estate as it now stands, irrespective of the unpaid claims due special creditors whose claims arise from the sale by the debtors of their cattle.

5 Under the Bankruptcy Act 1919 (Can.), ch. 36, sec. 44, sub-sec. 2, all debts and liabilities present or future to which the debtor is pledged at the date of the receiving order or the making of the authorised assignment, or to which he may become pledged before his discharge by reason of any obligation incurred before the date of the receiving order or of the making of the authorised assignment, shall be deemed to be debts provable in bankruptcy, or in any proceeding under an authorised assignment.Under this section the guarantee company are clearly creditors, having paid the sum of $10,000 under their bond and for which the debtors agreed to idenmify them; but are they entitled to rank against the estate before the special creditors are fully paid?

6 The bond is given, not to secure a part of any indebtedness that may arise, but is given to secure the full amount of any account incurred by the principals and although the amount of the bond is limited to $10,000, yet it is a guarantee that the principals shall pay in full. It is strongly contended by counsel for the trustee that the special creditors, having proved against the estate of the debtors for the full amount of their claim and having received a dividend thereon, and the guarantee company having subsequent to the payment of such dividends paid the amount of their guarantee, that the guarantee company cannot prove their claim because that would be in contravention of the rule in bankruptcy that there cannot be a double proof against the same estate in respect of the same debt. *Re Oriental Commercial Bank; Ex parte European Bank* (1871), L.K, 7 Ch. 99.

7 The true principle is that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts. That applies to a case of principal and surety. There could not be a double proof in respect of that obligation; *Re Melton, Milk v.Towers*, [1918] 1 Ch. 37, at p. 48.

8 A surety guaranteed a bank the payment of all sums of money which then were or might

thereafter from time to time become due or owing to the bank from their customer S., but nevertheless the total amount recoverable from the surety was not to exceed ú300. The guarantee was to be a continuing security and any dividends which the bank might receive in the bankruptcy of S. were not to prejudice their right to recover from the surety to the full extent of the guarantee any sums which after the receipt of such dividend might remain owing to them by S.

9 S. became bankrupt and the bank after receiving the ú300 from the surety claimed to prove in the bankruptcy to the full amount due to them from S.

10 The trustee in bankruptcy contended that the proof ought to be reduced by the amount the bank had received from the surety.

11 Held that the bank were entitled to prove for their whole debt.

12 When bankruptcy supervened the right of the principal creditor the bank, was to prove for that amount unless there was a surety and that surety was a surety for a part of the debt. In that case if the surety had paid that part then by virtue of that payment the right of proof which would have been the right of proof of the principal creditor becomes *pro tanto* the right of proof of the surety. The surety has a right having paid part of the debt in that way to stand *pro tanto* in the shoes of the principal creditor; and even if the principal creditor has proved and has received the dividend and the surety comes and repays the full amount the principal creditor would then be trustee for the surety of the amount of the dividend which he had so received: *Re Sass; Ex parte National Provincial Bank of England*, [1896] 2 Q.B. 12.

13 Following this case and several other cases cited by counsel I have come to the conclusion that all I have to decide is whether as between Coughlin & Co., and the surety the surety became a surety for the whole of the debt or for part and in my judgment they became surety for the whole, notwithstanding the fact that the amount of the liability is limited, and they in consequence are not entitled to prove against the estate of the debtors, except subject to the prior claims of the special creditors to payment in full of their claims.

Tab 29

Indexed as:

Deco Electric Ltd. v. Republic Building Systems Alberta Ltd.

[1983] A.J. No. 726

25 Alta. L.R. (2d) 347

45 A.R. 325

Action No. 8203-06972

Alberta Court of Queen's Bench
Judicial District of Edmonton

Master Funduk

March 25, 1983.

Counsel:

N. Nichols, for the plaintiff.
S. Noonan, for Lu-Mac Industries (execution creditor).
A. Stacy, for Atco Metal Ltd.

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1 **MASTER FUNDUK**:-- This is an application by the plaintiff for an order that money presently in court be paid to it. Two execution creditors of the defendant appeared on the application and opposed it. The facts are as follows.

2 On March 2, 1982, the plaintiff commenced an action in debt against the defendant. On the same day it obtained an order allowing it to issue a garnishee summons before judgment. Also on the same day it issued a garnishes summons.

3 The amount claimed in the garnishes summons was $10,238.39. The claim of the plaintiff was for $10,218.39, so the amount claimed in the garnishee summons was for the plaintiffs claim, and costs of $20.00.

4 On March 2, 1982, when the plaintiff issued the garnishee summons, there were no subsisting writs of execution with the Sheriff for the Judicial District of Edmonton, so the plaintiff could garnishee only for its claim.

5 About March 12, 1982, the garnishee paid into court the sum of $10,238.39.

6 In April, 1982, the defendant delivered a statement of defence.

7 In May, 1982, an order was obtained directing that out of the money in court the sum of $8,200.00 and costs be paid to the plaintiff and that the balance of the money be held pending the trial of the action. The balance, which is still in court, is $1,723.09.

8 On November 4, 1982, the plaintiff recovered judgment against the defendant for $3,173.04 and costs of $115.00. The plaintiff also obtained from the defendant a consent to payment out to the plaintiff of the balance of the money.

9 The Clerk of the court refused to accept the consent to payment out unless he had a clear Form A or, alternatively, an order of the court. In my view the Clerk was correct in taking that approach.

10 The money was paid into court pursuant to garnishee process. Accordingly, it could be paid directly to the plaintiff only under the aegis of Rule 480. If the plaintiff had been able to provide the Clerk with a clear Form A, the Clerk could have properly paid the money to the plaintiff pursuant to the consent to payment out. Lacking a clear Form A the Clerk could not comply with the consent to payment out.

11 I would note that Rule 480 is solely a procedural rule. Whether, the money be paid to a creditor by consent or by order of the court the overriding limitation is the Execution Creditore Act. Any payment to a creditor pursuant to Rule 480 cannot violate the Execution Creditors Act.

12 The difficulty the plaintiff faced is that by the time it got its judgment and consent to payment out there were three subsisting execution creditors.

13 In its notice of motion the plaintiff asks for "an Order to pay monies held to the credit of this action to the plaintiff". The notice of motion also states:

> AND FURTHER TAKE NOTICE that in support of this application the plaintiff relies on the following grounds and statutory provisions.
>
> 1. When the money was paid into court pursuant to the plaintiff's Garnishee Summons, there were not outstanding writs.
> 2. The Execution Creditors Act, a. 8(1).
> 3. Rule 470 of the Alberta Rules of Court.

14 The first issue is the Interpretation of a. 8(1) of the Execution Creditors Act, R.S.A. 1980, c. E-14. Counsel for the plaintiff submits that the court can order that the money be paid other than in accordance with how it would be distributed as required by the Act. Section 8 reads:

> 8(1) Except in cases where it is otherwise specifically provided by this Act, or where it is otherwise ordered by the court, all money paid into court by virtue of a garnishee summons shall without an order be paid by the clerk of the court to the sheriff of his judicial district,
>
> (a) if the garnishee summons is based on a judgment, immediately after the expiration of the 10th day after service of the summons on the judgment debtor and on the garnishee or after any longer period that may be ordered by the court or judge, or
>
> (b) if the garnishee summons is issued before judgment, immediately on the plaintiff entering judgment against the defendant or at any later time that may be ordered by the court of judge.
>
> (2) Immediately on the receipt by the Sheriff of any money from the clerk of the court
>
> (a) if there are no subsisting writs of execution against the debtor whose debt was garnisheed or against any of the persons entitled to the money, the sheriff shall immediately pay out the money or the part of the money in respect of which he has no subsisting writs of execution either to the persons entitled by law to receive it or to their solicitors, or
>
> (b) if there is a subsisting execution against the debtor or any of the persons entitled by law to receive the money, the sheriff shall retain the money and shall distribute it as money levied under execution among the creditors of the debtor or the person entitled to receive the money, as the case may be. (emphasis added)

15 In my view, the emphasized phrase has nothing to do with how money caught by garnishee process is to be distributed among creditors of the debtor. The phrase is in subs. (1) and relates only to that subsection. Sub-section (1) is only a "transfer" provision, that is, it deals with the transfer of garnishee money by the Clerk to the Sheriff.

16 The Clerk can pay the garnishee money to the Sheriff without an order of the court. There are then two exceptions to that general provision. They are:

(a) where the Act otherwise specifically provides;

(b) where it is otherwise ordered by the court.

The "it" in the phrase in question has regard to the payment by the Clerk to the Sheriff.

17 In my view, it would be an unreasonable interpretation to find the phrase gives jurisdiction to the court to override the scheme of distribution set by the Act.

18 The general scheme of the Act is to provide for a pro rata sharing of execution proceeds between execution creditors of a judgment debtor. The philosophy is that it is more equitable to have a pro rata sharing rather than having execution creditors vying with each other to beat each other to the punch, as it were.

19 Section 2 provides that all property seized or attached by virtue of the processes indicated "shall be deemed to have been attached on behalf of all creditors entitled by this Act to share in any money received by the sheriff by reason of the seizure or attachment". What creditors are "entitled by this Act" to share? The title of the Act gives the answer: execution creditors of the judgment debtor, being those who have subsisting writs of execution filed with the Sheriff.

20 Garnishee is a specialized form of execution designed to attach a particular kind of property (a chose in action) which could not be attached by the ordinary writ of execution. The Act carries this concept forward in s. 8(2)(b) by treating money caught by garnishee, for the purpose of distribution, as if it had been money levied under execution.

21 If the Sheriff had seized an automobile of the defendant, under a writ of execution, and sold it, could the court order that the sale proceeds would go to one only of four execution creditors of equal rank? Could the court order that because at the time of seizure there was only the one writ of execution the sale proceeds should not have to be shared with the other three execution creditors who filed writs of execution after the seizure had been made? To ask the questions is to answer them. As money caught by garnishee must be treated as if it was money levied under execution, for distribution purposes, the same answers apply.

22 Any suggestion that it is "unfair" to the plaintiff that the money in court must be distributed in accordance with the Act is out of place. It is very common for execution creditors to "slip in" between the time of execution or garnishee and the time for distribution. The Act even builds in a waiting period which allows other creditors to file writs of execution and then share in the fruits.

23 For example, a garnishee summons is issued on March 1, 1983, and served on the garnishee on the same day. On that day there are two subsisting writs of execution in the Sheriff's hands. On March 9 the garnishee pays money into court. Between March 1 and March 9 three further writs of execution are filed with the Sheriff. On March 27 the Clerk pays the money to the Sheriff. Between March 9 and March 27 a further writ of execution is filed with the Sheriff. The Sheriff holds the money for 14 days: s. 10. During that 14 days five more writs of execution are filed with the Sheriff. On April 11 the Sheriff distributes the money. He has to distribute pro rata between 11

execution creditors. What started off as two execution creditors has now mushroomed to 11 execution creditors.

24 The first two execution creditors might think it unfair that the other nine execution creditors, who were not execution creditors at the time the garnishee summons was issued, should share in the proceeds. However, as pointed out by Clement, J.A., in Nemethy v. Wilkinson Company Ltd. (1978), 10 A.R. 336; 7 Alta. L.R. (2d) 30, in s. 10 "the legislature has expressed in imperative terms the time for distribution of sale moneys in the sheriff's hands, and the creditors to whom the distribution is to be made".

25 Considering the object of the Act, to provide for an orderly distribution of money realized by any of the processes listed in s. 2, and the scheme of distribution envisaged by the Act, it would be startling to conclude the legislature intended that the court was to have an overriding discretion to interfere with the scheme of distribution.

26 In Coutts & Co. v. Inland Revenue Commissioners, [1953] A.C. 267 (H.L.), Lord Reid states at p. 281:

> ... In general, if it is alleged that a statutory provision brings about a result which is so startling, one looks for some other possible meaning of the statute which will avoid such a result, because there is some presumption that Parliament does not intend its legislation to produce highly inequitable results ...

27 In Artemiou v. Procopiou, [1966] 1 Q.B. 878 (C.A.), Danckwerts, J., states at p. 888:

> An intention to produce an unreasonable result is not to be imputed to a statute if there is some other construction available ...

28 If words in a statute are capable of two or more meanings the approach is:

> ... In deciding which of these two meanings the Legislature intended the section to bear, I think the construction should be adopted which, upon a reading of the Act and its amendments as an entire enactment, appears to better accord with the body of the enactment than does the alternative construction.

per White, J., in R. v. Board of Commissioners (1926), 54 N.B.R. 138, at p. 143 (N.B.C.A.).

29 Words in a statute must be read in the context of the statute:

> ... Every clause of a statute should be construed with reference to the context and the other clauses of the Act, so as, so far as possible, to make a consistent enactment of the whole statute or series of statutes relating to the subject matter ...

per Lord Davy in Canada Sugar Refining Company v. The Queen, [1898] A.C. 735, at 741 (P.C.).

30 In Attorney-General v. Prince Augustus, [1957] A.C. 436 (P.C.), Viscount Simonds states at p. 461:

> ... For words, and particularly general words, cannot be read in isolation: their color and content axe derived from their context. So it is that I conceive it to be my right and duty to examine every word of a statute in its context, and I use "context" in its widest sense, which I have already indicated as including not only other enacting provisions of the same statute, but its preamble, the existing state of the law, other statutes in pari materia, and the mischief which I can, by those and other legitimate means, discern the statute was intended to remedy.

31 I consider s. 8(1) to be solely a procedural matter which deals only with the mechanics of transferring money from the Clerk to the Sheriff. The phrase in question must be interpreted in that context and in the context that the general scheme of the Act is for a pro rata distribution among execution creditors of equal rank.

32 One can think of examples where the court might "otherwise order". For example, if the garnishee pays money into court and files an answer stating that the debt attached belongs or may belong to some third person, Rule 475(1)(d); would it be proper for that to be ignored and the Clerk pay the money to the Sheriff? In such a case the court might well find it necessary to put a "hold" on the money until the matter is cleared up.

33 Another example, which is quite common, is where there are no subsisting writs of execution. The garnisheeing creditor can then obtain an order under Rule 480, supported by a clear Form A, for the Clerk to pay the money directly to him. Such an order does not disturb the scheme of the Act. If there are no subsisting writs of execution and the Clerk pays the money to the Sheriff the Sheriff shall "immediately pay out the money": s. 8(2)(a). In such a case an order under Rule 480 is an alternative to a transfer under s. 8(1)(a) and an immediate payment out under s. 8(2)(a). An order under Rule 480 would be an "otherwise order(ed)".

34 I do not consider the phrase "or where it is otherwise ordered by the court" in s. 8(1) to allow the court to alter the scheme of distribution mandated by the Act. If the phrase is taken out of context it would literally mean the court could not only alter the scheme of distribution between creditors of equal rank but could also alter the scheme of distribution between creditors of different rank.

35 For example, an employee of an execution debtor can get a limited priority by virtue of s. 16. Could the court, under the guise of the phrase in s. 8(1), order that the employee will not receive any priority? Could the court order the employee is to receive a priority for one years wages? I think not.

36 Section 6 of the Act has the same clause as that in s. 8(1). Section 6 provides:

> 6. If money is paid into court under any garnishee proceedings in the court, it shall be available for distribution by the sheriff among the execution creditors of the debtor whose debt is garnisheed except when
>
> (a) the money paid into court is not liable to attachment,
> (b) the amount paid into court does not exceed the sum of $50.00,
> (c) by virtue of any statute or rule of court the money is required to be paid to the debtor as being exempt from attachment, or
> (d) it is otherwise ordered by the court

37 The only reported decision I am aware of that deals with s. 6 is Independent Order of Foresters v. Board of Trustees of Northern Irrigation District and Provincial Treasurer of Alberta, [1943] 3 W.W.R. 297 (Alta. S.C.T.D.); [1944] 1 W.W.R. 206 (Alta. C.A.). The facts are as follows.

38 The plaintiff purchased some debentures of the defendant, thus becoming a creditor of the defendant. The payment of the amounts secured by the debentures was guaranteed by the Crown.

39 There was default by the defendant and the plaintiff obtained judgments against it. The plaintiff garnished and also seized certain bonds. The Crown also obtained a judgment against the defendant.

40 The issue, which was a stated case of law before O'Connor, J., was whether the Crown could, as an execution creditor, share under the Execution Creditors Act with the plaintiff. The issue was generated because the Crown also happened to be surety for the debts which the plaintiff had received judgments against the defendant for. Although the plaintiff had not sued the Crown on the suretyship the suretyship was admitted in the agreed statement of facts.

41 O'Connor, J., in holding that the Crown was not entitled to share with the plaintiff, discussed the "double proof" problem if both the creditor and the surety can rank on the debtors estate. He states at p. 300-01:

> (2) Counsel for the plaintiff contends that it is inequitable to pay the money to the treasurer since the province has guaranteed payment of the debentures.
>
> A surety who compromised, at 4s. on the pound, his liability for his principal's debt, was held not to be entitled to share in a dividend of debentures which the creditor had obtained in the bankruptcy of the principal debtor: Ex parte Corry; in re Fothergill (1876), 3 Ch.D. 445; 45 L.J. Bk. 153. James, L.J., said (p. 155):

> 'In this case, the surety has paid 4s. in the pound. What is his equity against the creditor? If the surety has paid 20s. in the pound, he may exercise whatever right the principal debtor had against the creditor. But the creditor may first require payment of 20s. in the pound, and all that the surety can say is 'You have got something very valuable under the arrangement. I am willing to discharge my obligation to you by paying 20s. in the pound and when I have done that you must hand me over the security.' That seems to me to be the sole equity.'

In in re Coughlin & Co. (1923), 3 W.W.R. 1179, 33 Man. R. 499; 4 C.B.R. 294, Fullerton, J.A., said, p. 1179:

> 'In considering the right of a surety who has made payment to rank upon the estate the cases draw a distinction between two classes of guarantees, one where the contract is to be construed as a security for a part only of the debt and the other where it is to be construed as a security for the whole amount due or to become due with a provision limiting the surety's liability to pay any amount beyond a named sum ... In a case of a guarantee of the latter class the creditor is entitled to rank for the whole amount as the surety cannot be permitted to compete with the creditor for dividends in respect of a debt which the surety himself has guaranteed.'

Dennistoun, J.A., said p. 1182:

> 'It is to be noted that it is the 'debt' which is provable. There may be several claimants in respect to the 'debt'., but there is only one debt., and double proof in respect to it is not permitted.'

The principle is not limited to bankruptcy.

In in re Oriental Commercial Bank; Ex parte European Bank (1872), L.R. 7 Ch. 99; 41 L.J., Ch. 217, Mellish, L.J., said, p. 218:

> 'Upon the main question the case of Rigby v. Macnamara (1795), 2 Cox. Eq. Cas. 415, tends to show that the rule in bankruptcy against double proof applies also in the Court of Chancery, and consequently applies in

case of companies being wound up.'

In Martin v. McMullen (1891), 18 O.A.R. 559, Maclennan, J.A., said, P. 565:

'The cases which have been cited are cases in which the creditor had proved or had obtained dividends on the bankruptcy of the debtor, but the principle involved seems to be a general principle of equity, applicable to all cases of suretyship.'

See also in re Sass; Ex parte National Provincial Bank of England (1896), 2 Q.B. 12; 65 L.J.Q.B. 481. (emphasis added)

42 I pause to note that the judgment the Crown had obtained against the debtor was for some money the Crown had paid to honour its suretyship. There was, accordingly, a "double proof" problem if the Crown could rank with the plaintiff. The money the Crown had paid still left some of the plaintiffs judgments unsatisfied.

43 O'Connor, J., then goes on to deal with the applicability of the above principles in light of the Execution Creditors Act. He states, at pp. 302-03:

(3) Counsel for the plaintiff further contends that if the treasurer is excluded from participation in the moneys attached and the proceeds of the bonds seized, this will save multiplicity of actions, and cites clause (g) of s. 34 of the Judicature Act, R.S.A. 1942, c. 129, in support of the court's jurisdiction to do this. He cites s. 3 of the Execution Creditors Act, 1934, c. 8 (now R.S.A. 1942, c. 122) and, as to the garnishee, s. 6, and, as to the execution, s. 12 of the said Act, which sections are as follows:

'3. Except only in the cases where it is otherwise specifically provided by this Act, all property seized or attached by virtue of any writ of execution, writ of attachment, garnishee proceedings or proceedings in the nature of equitable execution shall be deemed to have been attached on behalf of all creditors who are entitled by this Act to share in any money received by the sheriff by reason of such seizure or attachment; and all moneys realized thereby shall be dealt with and distributed by the sheriff of the district in which such seizure or attachment is made under the provisions of this Act.

6. Where any money is paid into court under any garnishee proceedings in

the Supreme Court of Alberta or any District Court, the same shall be available for distribution by the sheriff amongst the execution creditors of the debtor whose debt is garnished except only in each of the following cases, namely:

(a) When the money paid into court is not liable to attachment;
(b) When the amount paid into court does not exceed the sum of twenty-five dollars;
(c) When by virtue of any statute or Rule of Court the money is required to be paid to the debtor as being exempt from attachment; and
(d) When it is otherwise ordered by a court or judge.

12. When the amount received by the sheriff in respect of an execution is not sufficient to pay the claims of creditors and the executions with costs in full, the sheriff shall firstly retain his fees, and secondly, in the event of any creditor being entitled under the provisions of this Act to priority for costs, the sheriff shall pay such costs to that creditor, and thirdly, shall pay the claim of any person who is entitled to be paid in preference to any other creditor, and fourthly shall distribute the balance (if any) rateably amongst such execution creditors as are entitled to share therein under the provisions of this Act.'

The cases of Tobin v. Commercial Inv't Co. (1916), 10 W.W.R. 123; 22 B.C.R. 481; 34 W.L.R. 23; Knight v. Knight (1734), 3 P. Wms. 334; 24 E.R. 1088, and McGowan v. Middleton (1883), 11 Q.B.D. 464; 52 L.J.Q.B. 355, show that the court will adapt its procedure to prevent multiplicity of actions but the plaintiff's right to prevent the defendant from sharing in the moneys in the hands of the sheriff must depend on substantive law. It is not a question of procedure.

It is contended that s. 6, clause (d), permits the court to do justice between the parties. Counsel for the defendant treasurer argues that clause (d) is intended to permit the court to order payment to a garnishee creditor in cases where it is obvious that the other execution creditors would not be entitled to the money under the Act; for example, where there were no subsisting writs of execution in the sheriff's hands, or where the garnishing creditor was a wage earner or was otherwise entitled to be paid the money in priority to other claims. He relies on Bowerman v. Phillips (1888), 15 O.A.R. 679, in which it was held that the

> Ontario Creditors Relief Act did not permit one creditor to attack the judgment of another if the debt was bona fide.
>
> I find the sections are intended to permit the court to do justice between the parties, according to settled principles of law and equity. (emphasis added).
>
> Secs. 6 and 12 were intended to enable the court to deal with such a case as this according to law.
>
> I find the debenture holders of the irrigation district are exclusively entitled under their charge to the money and bonds of the irrigation district which are now or may hereafter come into the hands of the sheriff.

44 Section 3 of the 1934 Act is ss. 2 and 3 of the present Act. Sections 6 and 12 of the 1934 Act are the same sections in the present Act. The only differences are in the manner the sections are set up.

45 Although he does not so expressly state, it is implicit O'Connor, J., found that the equitable principle that a surety could not compete with the creditor in ranking on the debtors estate had not been altered by the Act.

46 On appeal, Ford, J.A., in delivering the judgment of the court, states at p. 209:

> ... it appeared to counsel for the parties that it might be advisable first to have determined the question as to whether the Crown in the right of the province was entitled to share with the plaintiff in the issue, in moneys realized by garnishee or under writs of execution. For that purpose a special case was agreed upon and signed by solicitors for all three parties to the issue.

After referring to the special case and the trial decision he continues at p. 216:

> ... As summarized in the factum on behalf of the provincial treasurer their submissions are as follows:
>
> (1) The Execution Creditors Act does not permit the court to grant priority to one execution creditor at the expense of another except as provided by the Act;
>
> (2) Alternatively, the plaintiff cannot claim priority in respect of the portion of the judgment which does not represent monies paid under the guarantee;

(3) ...

And at p. 217-218:

> The province of Alberta became surety for the whole debt without limitation. Where a surety is liable to the creditor for the whole amount of the debtor's liability there is a principle running through the cases, sufficient of which are referred to in the judgment appealed from, which does not permit of the surety competing with the creditor in the realization of the assets of the principal debtor. While this principle finds its usual application in bankruptcy it is one of general application, applicable to all cases of suretyship.
>
> There is, in my opinion, nothing in the Execution Creditors Act, R.S.A. 1942, c. 122, the relevant portion of which is set out in the learned trial judge's reasons, which prevents the application of this principle, where, as here, the surety is attempting to compete with the creditor, whose debt has been guaranteed in full, by a judgment obtained ... (by the Crown against the debtor) ...
>
> To give effect, in the present proceeding, to the equities as between the province as surety and the plaintiff as the primary creditor, by answering the question submitted in consonance with the principle stated, does not amount to a setting aside directly or indirectly, or the impeaching of the judgment obtained by the surety, as contended on behalf of the defendants, respondents. The point involved in the question is not whether the judgment was properly obtained but whether the judgment creditor, a surety for the whole debt is entitled, as against the plaintiff, to share in what is realized under the plaintiff's executions and garnishee summonses.
>
> Nor does the giving effect, in the present proceedings, to the equities, as between the surety and the principal creditor, nullify, 'virtually' or at all, the provision of the Execution Creditors Act as also contended on behalf of the defendants.

And at pp. 219-20:

> If both surety and creditor were allowed to share in the sheriff's distribution, there is, I think, no doubt that the creditor would immediately have the right to take proceedings against the surety to recover the balance due him. Indeed in my opinion, the creditors, having a charge thereon, would have the right to claim the very dividend which the surety has received.

> In the way the issues have been brought before the court there is quite as much reason for the court now preventing the surety ranking inequitably in the sheriff's distribution, as against the creditor, as there is to prevent a surety so ranking in bankruptcy or in a distribution for the benefit of creditors. I find nothing in the Execution Creditors Act against the court's power to do so.

47 In effect, what the plaintiff wants is to have a priority over the other subsisting execution creditors. The plaintiff and the other execution creditors are all of equal rank. The plaintiffs claim is not of a nature which the Act, other legislation or law or equity gives a higher status to than the other execution creditors. There are no equities between the plaintiff and the other execution creditors.

48 The plaintiff's position is founded solely on the fact that at the time it garnisheed there were no execution creditors of the defendant. That fact does not support any principle in law or equity to give the plaintiff a priority. except for its costs in accordance with s. 11. Giving a full priority to the garnisheeing creditor in such circumstances would destroy the efficacy of the Act. It would "fix" the time of distribution at when the garnishee was issued. It would eliminate all subsequent execution creditors. I do not believe the legislators could have intended that result in any particular case, especially on the whim of the court. It would literally be at the whim of the court.

49 In my view, the proper approach to s. 6(d) is that set out by O'Connor, J. It is a matter of substantive law, not procedure. There must be a sound principle of law or equity for the court to be able to require a distribution which does not literally follow the mandate of the Act.

50 In my view, there is no principle of law or equity which enables the plaintiff to have a priority over the other subsisting execution creditors.

51 The application to have the money paid directly to the plaintiff is dismissed.

52 The Clerk of the court will transfer the money to the Sheriff for distribution by him in accordance with the Act.

qp/s/rpv/jpn

Tab 30

Case Name:

Isabelle Estate (Trustee of) v. Royal Bank of Canada

Between
A.C. Poirier & Associates Inc., as Trustee for the Estate of André Isabelle, appellant, and The Royal Bank of Canada, respondent

[2008] N.B.J. No. 345

2008 NBCA 69

299 D.L.R. (4th) 727

169 A.C.W.S. (3d) 697

47 C.B.R. (5th) 159

336 N.B.R. (2d) 332

2008 CarswellNB 463

No. 137/07/CA

New Brunswick Court of Appeal

J.T. Robertson, B.R. Bell and K.A. Quigg JJ.A.

Heard: April 16, 2008.
Judgment: September 25, 2008.

(62 paras.)

Bankruptcy and insolvency law -- Creditors and claims -- Creditors -- Appeal by Isabelle for leave to commence action under s. 38 of Bankruptcy and Insolvency Act allowed -- Isabelle was shareholder of bankrupt company -- As guarantor, Isabelle was a creditor within the meaning and scope of s. 38 of the Act -- This was a proper case for granting Isabelle the right to initiate a lawsuit against the Bank with respect to any breach of legal obligations it may have owed the bankrupt company -- Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38.

Appeal by the Isabelle from the dismissal of his motion for an order authorizing him to bring an action against the Bank for wrongdoing tied to events surrounding the bankruptcy of Heritage Flooring. A bankruptcy court judge had found the Bank guilty of exercising certain remedies against Heritage. The trustee had not proceeded with an action on behalf of bankrupt. Isabelle was a guarantor and minority shareholder of the bankrupt company, Heritage Flooring. The guarantee was given to the respondent, Royal Bank, as partial security for the $2 million revolving line of credit which the Bank had extended to Heritage. The other respondent, A.C. Poirier & Associates, was the trustee in bankruptcy of the bankrupt company. Isabelle's motion was dismissed on the ground that, as a shareholder of Heritage, he was not a creditor within the meaning of s. 38 of the Bankruptcy and Insolvency Act. On appeal, Isabelle argued that the motion judge erred because the motion was premised on Isabelle's status as guarantor and not as shareholder.

HELD: Appeal allowed and motion judge's decision set aside. As guarantor, Isabelle was a creditor within the meaning and scope of s. 38 of the Act. This was a proper case for granting Isabelle the right to initiate a lawsuit against the Bank with respect to any breach of legal obligations it may have owed Heritage. A potential defendant who was also a creditor of the bankrupt had no right to bring a s. 38 application for the purpose of ensuring that no other creditor obtained an order authorizing the other creditor to initiate a proceeding against the potential defendant.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38, s. 50.4(1), s. 69, s. 120, s. 187(11), s. 193(a), s. 193(c), s. 193(e)

Bankruptcy and Insolvency General Rules, C.R.C., c. 368, Rule 3, Rule 13, Rule 31(2)

New Brunswick Rules of Court, Rule 13.01, Rule 15.02(1), Rule 62.08

Appeal From:

On appeal from a judgment of the New Brunswick Court of Queen's Bench, September 4, 2007.

Court Summary:

History of Case:

Decision under appeal: 2007 NBQB 287.

Preliminary or incidental proceedings: N/A.

Counsel:

For the appellant: Lee McKeigan-Dempsey.

For the respondent: Hugh J. Cameron.

THE COURT: The respondent's motion to quash the appeal is dismissed and, correlatively, the appellant's motion for leave to appeal is granted, *nunc pro tunc*. The appellant is entitled to costs of $3,500 with respect to these motions.

The appeal is allowed and the decision of the motion judge is set aside. The appellant is entitled to the order sought under s. 38 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. It follows that the respondent's motions of April 2 and 3, 2007 are dismissed, except with respect to the decision to grant the Bank intervener status. The appellant is entitled to costs of $8,500 on the appeal.

The respondent's post-hearing motion is dismissed with costs of $5,000 to the appellant.

Costs are payable forthwith.

The judgment of the Court was delivered by

J.T. ROBERTSON J.A.:--

I. Introduction

1 Both parties are seeking to acquire a "chose in action" belonging to a bankrupt company. The property in question is the bankrupt company's right to sue its banker for wrongdoing. The right is presently vested in the bankrupt's trustee. However, once the trustee decides not to pursue the action, a creditor of the bankrupt may apply for a court order authorizing that creditor to pursue the action in its own name and at its own expense and risk. This right is provided for under s. 38 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("the *Act*"). Once the order issues, the trustee is required to transfer to the creditor title to the chose in action. Any benefit derived from the lawsuit is applied against the amount owing to the creditor and the costs of litigation. Any surplus belongs to the bankrupt's estate.

2 André Isabelle was a guarantor and minority shareholder of the bankrupt company, Plancher Héritage Ltée/Heritage Flooring Ltd. The guarantee was given to the respondent, The Royal Bank of Canada, as partial security for the $2 million revolving line of credit which the Bank had extended to Heritage Flooring. The other respondent, A.C. Poirier & Associates, is the trustee in bankruptcy of the now bankrupt company. Following the hearing of this appeal, Mr. Isabelle also fell into bankruptcy and once again A.C. Poirier & Associates was appointed trustee. Hence, the style of cause has been amended to reflect this reality. However, for clarity's sake, and unless otherwise noted, I refer to Mr. Isabelle as though he were the appellant.

3 This appeal stems from Mr. Isabelle's unsuccessful application (hereafter "motion") for an order authorizing him to initiate a lawsuit against the Bank for wrongdoing tied to events surrounding the bankruptcy of Heritage Flooring. In an earlier decision, another bankruptcy court judge found the Bank guilty of exercising certain remedies against Heritage in contravention of s. 69 of the *Act*. That decision was not appealed to this Court. On the understanding that a guarantor qualifies as a creditor under the *Act*, Mr. Isabelle filed his s. 38 motion, but only after the trustee elected not to pursue the action on behalf of Heritage Flooring. This explains why the Bank sought intervener status and opposed the motion. It does not explain why the Bank brought its own motion under s. 38 with a view to becoming both the plaintiff and defendant in the action that Heritage Flooring could have brought against the Bank but for the assignment in bankruptcy. All of the motions were heard together. While the Bank was granted standing, the motion judge reasoned that it was unnecessary to deal with its request for a s. 38 order because of the dismissal of Mr. Isabelle's motion. The decision under appeal is reported as *Re Plancher Héritage ltée/Heritage Flooring Ltd. (Bankrupt)* (2007), 320 N.B.R. (2d) 76, [2007] N.B.J. No. 324 (QL), 2007 NBQB 287.

4 Mr. Isabelle's motion was dismissed on the ground that, as a "shareholder" of Heritage Flooring, he is not a creditor within the meaning of s. 38 of the *Act*. Mr. Isabelle argues that the motion judge erred because the motion was premised on Mr. Isabelle's status as "guarantor" and not as "shareholder". The Bank reluctantly concedes that a guarantor qualifies as a creditor at law. However, the Bank insists that Mr. Isabelle fails to qualify as a creditor within the meaning and scope of s. 38 of the *Act* for no fewer than six reasons, some of which were neither pleaded nor argued in the court below. As well, the Bank opposes the appeal on procedural grounds. It asks for summary dismissal because of Mr. Isabelle's failure to seek and obtain leave to appeal as contemplated by s. 193(e) of the *Act*. With respect to this issue, Mr. Isabelle counters that leave was not required and, if mistaken, asks for leave to be granted *nunc pro tunc*. Mr. Isabelle points out that his Notice of Appeal contains a request for leave as is provided for under Rule 31(2) of the *Bankruptcy and Insolvency General Rules*, C.R.C., c. 368 ("the *BIA Rules*").

5 In my view, leave to appeal should have been sought and obtained prior to the appeal hearing. But I also hold this omission is not fatal and leave should be granted *nunc pro tunc*. As to the Bank's standing, I am of the view that a motion judge retains a narrow discretion to decide whether a creditor and potential defendant should be granted the right to oppose an application brought under s. 38 of the *Act*. This is not to suggest that a potential defendant has an unfettered right to meddle in the affairs of another creditor seeking an order under s. 38. Indeed, these reasons for judgment will stand in the way of those who believe it is permissible for a creditor to be both the plaintiff and defendant in the same action (the so-called "hermaphroditic litigant"). Section 38 was never intended to be used as a litigation tactic for short-circuiting the need to defend a valid cause of action. As to whether the motion judge erred in granting the Bank intervener status, I hold that in the circumstances of this case it is too late to undo what has been done. To revoke the Bank's standing at this late stage would work an injustice on Mr. Isabelle. For this reason, I am not prepared to set aside the motion judge's decision to grant the Bank standing. As to the ultimate issue on appeal, I conclude that, as guarantor, Mr. Isabelle is a creditor within the meaning and scope of s.

38 and that none of the Bank's arguments represents an impediment to granting the order sought. In short, this is a proper case for granting Mr. Isabelle the right to initiate a lawsuit against the Bank with respect to any breach of legal obligations it may have owed Heritage Flooring. This includes not only statutory breaches, such as those tied to s. 69 of the *Act*, but also contractual breaches and breaches of obligations imposed at law or in equity. It follows that the Bank's s. 38 motion to acquire the chose in action must be dismissed.

6 One other matter of contention arises on this appeal and attests to the Bank's unbridled resolve in seeking immunity for breaches of any legal obligations. Fifteen days after the hearing of the present appeal, Mr. Isabelle made an assignment in bankruptcy. Immediately after, while the decision on appeal was still under reserve, and without first discussing the matter with Mr. Isabelle's trustee in bankruptcy or Mr. Isabelle's counsel on appeal, the Bank wrote to this Court informing us that, pursuant to Rule 13.01 of the *Rules of Court*, the matter was "automatically stayed" because of the assignment in bankruptcy. The Court was then asked "to confirm" this understanding, otherwise the Bank "would be required to seek a date for the hearing of a motion in that regard." I shall address this unorthodox litigation tactic more fully below. For the moment, it is sufficient to note that the Court declined the invitation to provide the Bank with legal advice. After pursuing other litigation tactics without success, the Bank did in fact bring a motion asking that our pending decision be permanently stayed or, alternatively, that we grant an order for security for costs as against Mr. Isabelle's trustee. We dismissed the motion with reasons to follow. The promised reasons commence at para. 51 of these reasons.

7 Frankly, once the facts of this case are laid bare, one must seriously question whether the Bank's litigation strategy is premised on a "scorched earth" policy. The highway to this appeal is littered with too many motions, frivolous arguments and the citation of irrelevant case law with one singular objective: to guarantee the Bank's immunization from lawsuit by anyone who seeks damages for its wrongful conduct. Otherwise, why would the Bank refuse to consent to an order granting a one-day extension of time for perfecting the within appeal and force Mr. Isabelle to pursue a motion in this Court so as to obtain the required extension? In my view, the answer is self-evident.

II. Background

8 Mr. Isabelle was one of four persons who gave a limited guarantee ($150,000) to the Bank with respect to the debts of Plancher Héritage Ltée/Heritage Flooring Ltd., a company in which he was also a minority shareholder. The guarantee was a condition precedent to the Bank granting Heritage Flooring a revolving line of credit. On February 2, 2004, the Bank demanded full payment of the outstanding indebtedness within 15 days. On February 11, 2004, Heritage filed a Notice of Intention to Make a Proposal, pursuant to s. 50.4(1) of the *Act*. With the filing of the Notice of Intention, Heritage Flooring was automatically entitled to a stay, pursuant to s. 69 of the *Act*, with respect to a creditor exercising any remedies. Notwithstanding the prohibition, the Bank subsequently removed all of the monies in Heritage's operating accounts ($205,000) and capped Heritage's credit limit

significantly below the amount permitted under the terms of their agreement. In proceedings reported as *Re Heritage Flooring Ltd.* (2004), 279 N.B.R. (2d) 1, [2004] N.B.J. No. 286 (QL), 2004 NBQB 168, a judge of the Court of Queen's Bench found that the Royal Bank had unilaterally exercised remedies in breach of s. 69 of the *Act.* As stated earlier that decision was not appealed to this Court. On March 24, 2004, Heritage Flooring filed an assignment in bankruptcy. A.C. Poirier & Associates was appointed trustee in bankruptcy. Subsequently the Bank appointed a receiver under its security agreement. The Bank liquidated more than $2 million in inventory and accounts receivable for less than $900,000. As for the $400,000 left owing, the Bank issued demands for payment to all four guarantors.

9 On April 11, 2005, the Bank commenced an action against all four guarantors. In his Statement of Defence and Counterclaim, Mr. Isabelle pleaded that Heritage Flooring had valid claims against the Bank for breaches of contractual and statutory obligations. Mr. Isabelle also indicated his intention to join Heritage Flooring as a party to the action. The Bank was successful in having several paragraphs of Mr. Isabelle's Statement of Defence struck and, as well, his Counterclaim. The Counterclaim hinged on Mr. Isabelle obtaining an order under s. 38 of the *Act* authorizing him to sue the Bank. Subsequently, Mr. Isabelle filed an Amended Statement of Defence. However, the Bank successfully challenged the amended paragraphs. The motion judge compared the proposed amendments with the paragraphs originally struck and concluded that, as there was no material difference, the amending paragraphs could not stand. Once this occurred, Mr. Isabelle had no defence to the action on the guarantee. Thus, the Bank was granted summary judgment against Mr. Isabelle for the amount of the guarantee plus interest ($175,343.76). We are told that the judgment with interest has climbed to half a million dollars. The summary judgment decision is reported as *Royal Bank of Canada v. Profor Kedgwick Ltd., André Isabelle, Gérard Charest and Marcel Gauthier*, [2008] N.B.J. No. 65 (QL), 2008 NBQB 78.

10 Rather than appealing the summary judgment, Mr. Isabelle sought leave to appeal the decision to strike the paragraphs of the Amended Statement of Defence that would have provided Mr. Isabelle with a defence to the action. The application for leave to appeal was dismissed: *Royal Bank of Canada v. Profor Kedgwick Ltee.*, [2008] N.B.J. No. 110 (C.A.) (QL). It is a question of fact whether the amending paragraphs were, in essence, the same as those originally struck. At the same time, I am not prepared to endorse the summary judgment decision lest it be cited as authority in subsequent cases. Let me explain my concern.

11 As I read the summary judgment decision, the motion judge concluded that Mr. Isabelle had no valid defence to the action for two reasons. The first rests on the rule in *Foss v. Harbottle* (1843), 2 Hare 460, 67 E.R. 189. However, that case has nothing to do with guarantors. It addresses whether a shareholder can bring a derivative action on behalf of a company that has endured wrongdoing at the hands of third party. Second, the motion judge concluded that any wrongdoing on the part of the Bank could only be addressed by the trustee in bankruptcy of Heritage Flooring. This understanding of the law is correct if one is seeking damages from the Bank for wrongful conduct. There is no doubt that Mr. Isabelle was seeking damages under his counterclaim which in turn was premised on

obtaining an order under s. 38 of the *Act*. But Mr. Isabelle was also attempting to raise valid defences to the Bank's demand for payment under the contract of guarantee. Cases such as *Northland Bank* v. *Roine Estate* (1992), 11 C.B.R. (3d) 133 (BCSC), [1992] B.C.J. No. 380 (QL), support the notion that a guarantor such as Mr. Isabelle may have a valid defence to a demand for payment made by the creditor of the principal debtor. In that case, the creditor breached a loan agreement with the principal debtor by an unauthorized use of loan proceeds and the unauthorized withholding of a loan disbursement. In the present case, we have a wrongful appropriation of moneys from a bank account and a wrongful withholding of credit. Yet in *Northland Bank* the wrongful conduct resulted in the discharge of the guarantor of his obligation to the creditor under the contract of guarantee. Whether or not Mr. Isabelle would have been discharged under his contract of guarantee with the Bank is one issue. But to deny him the right to defend the action on the guarantee and to grant summary judgment to the Bank is, with great respect, not a precedent I wish to see cited in this Court.

12 On March 2, 2007, prior to the summary judgment issuing, Mr. Isabelle requested the trustee of Heritage Flooring to commence an action against the Bank. On March 23, 2007, the trustee advised Mr. Isabelle that the inspectors of the bankrupt estate declined the invitation to commence proceedings. On April 2, 2007, Mr. Isabelle filed a "motion" with the Registrar of Bankruptcy seeking authorization to commence an action against the Bank as provided for under s. 38 of the *Act*. In response, and on the same day, the Bank filed a motion asking for an order enjoining the trustee from transferring any cause of action to any creditor, except the Bank. The Bank pleaded that under its security agreement with Heritage Flooring, the Bank was the owner of all of Heritage's after-acquired property including any right of action Heritage possessed as against the Bank. On this basis, the Bank sought the s. 38 order that would have rendered it both plaintiff and defendant in the same action. As well, the Bank pleaded that as an inspector of the bankrupt estate, Mr. Isabelle was prohibited from acquiring the right to sue the Bank because of s. 120 of the *Act*. As well, the Bank asked that all motions be referred to a judge of the Court of Queen's Bench. On the following day, April 3, 2007, the Bank filed yet another motion for leave to intervene with respect to Mr. Isabelle's motion and sought other ancillary relief intended to thwart Mr. Isabelle's motion. On April 4, the Registrar referred all of the motions to the judge whose decision is now under appeal. The motion judge dismissed Mr. Isabelle's motion for the reason noted above, but declined to rule on the Bank's motions. The motion judge was of the view that they were moot having regard to the dismissal of Mr. Isabelle's motion. What the motion judge failed to appreciate was that the Bank was also seeking to acquire Heritage Flooring's right of action against the Bank.

III. The Need for Leave to Appeal

13 Prior to the hearing of the scheduled appeal, the Bank brought a motion seeking an order to quash the appeal on the ground that the appellant failed to seek and obtain leave to appeal from a judge of this Court, as contemplated by s. 193 of the *Act*. Since the motion to quash was brought only a few weeks before the scheduled hearing, the motion was referred to the full panel and heard together with the scheduled appeal. Section 193 reads as follows:

> Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:
>
> (a) if the point at issue involves future rights;
> (b) if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings;
> (c) if the property involved in the appeal exceeds in value ten thousand dollars;
>
> (d) from the grant of or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed five hundred dollars; and
>
> (e) in any other case by leave of a judge of the Court of Appeal.

14 Mr. Isabelle contends that leave was not required as his appeal falls within s. 193(a) and (c). The Bank contends otherwise and argues that the appeal falls within s. 193(e). I shall first deal with Mr. Isabelle's arguments.

A. *Future Rights - s. 193(a)*

15 Mr. Isabelle argues the underlying issue involves a future right within the meaning of s. 193(a) of the *Act*. According to his argument, Heritage Flooring's right to proceed against the Bank is currently vested in the trustee in bankruptcy, and it is only through a successful s. 38 application that Mr. Isabelle would be able to pursue such an action. Thus, according to Mr. Isabelle, since his ability to proceed would only come into existence once the s. 38 order issues, the appeal is one which involves a "future right". In support, counsel for Mr. Isabelle cites *Houlden & Morawetz Bankruptcy and Insolvency Analysis*, s. 34(1), which cites *Re J. McCarthy & Sons Co. of Prescott Ltd.* (1916), 38 O.L.R. 3 at 7 (S.C.A.D.), [1916] O.J. No. 4 (QL) for the proposition that "[t]he words 'future rights' should be given a wide and liberal interpretation." The Bank relies heavily on two cases to argue that future rights are not involved in the present appeal. The first in time is *Re Catalina Exploration & Development Ltd. Elias and Catalina Exploration & Development Ltd. v. Hutchison* (1981), 27 A.R. 1 (C.A.), [1981] A.J. No. 896 (QL), which involved an action against the trustee in bankruptcy that could not be commenced without leave. At paragraphs 15-16 and 22-24, Chief Justice McGillivray acknowledged the lack of clarity concerning "future rights" in rejecting the *McCarthy* analysis:

> I confess to difficulty in perceiving what exactly Parliament sought to do by providing for an appeal without leave in a case involving future rights while requiring leave in cases which do not involve future rights. Indeed, I find the authorities leave me in a state of uncertainty as to what a future right is at all, leave alone what there is about a future right that would require a treatment of

> cases involving future rights different from cases that do not involve future rights. [...]
>
> In the *McCarthy* case, it was said that future rights were involved in giving a creditor leave to sue instead of proving its claim in the bankruptcy. The court said that mode of trial *i.e.* by jury or otherwise, or unrestricted rights of appeal were future rights. If future proceedings involve "future rights" within the meaning of the *Bankruptcy Act*, it is difficult to think of any case in which it could not be said that future rights were involved. I am unable to agree with the decision in the *McCarthy* case.
>
> [...]
>
> A right in a legal sense exists when one is entitled to enforce a claim against another or to resist the enforcement of a claim advanced by another. A present right exists presently; a future right is inchoate in that while it does not exist, it may arise in the future. For the adjective "future" to have any meaning, it cannot refer to that which presently exists. Does the claim alleged against the trustee presently exist? It is a current allegation of existing facts though they may be procedurally blocked by a need to obtain leave to assert the claim.
>
> To give "future" the meaning that includes that which a litigant may obtain by success in litigation in the future is to say that a right of appeal exists in all cases. Any claim advanced is, in that sense, a future right to a judgment which does not yet exist. It would seem to me for clause (a) of section 163 [now 193] to have any meaning that it must refer to rights which could not at the present time be asserted but which will come into existence at a future time.
>
> It is sufficient to say that in my opinion a presently existing right to seek leave to sue a trustee in respect of presently existing facts is not a future right and the appellant does not bring the case within [that subsection].

16 Although the alleged "future right" in this case relates to a cause of action vested in the trustee, rather than to a cause of action against the trustee as in *Elias*, a similar analysis should apply. The s. 38 assignment would not result in a new right "com[ing] into existence at a future time", but would rather assign the trustee's present right. Such was the conclusion in *Re Zammit* (1998), 3 C.B.R. (4th) 193 (Ont. C.J. (Gen. Div.)), [1998] O.J. No. 604 (QL), the other case which the Bank cites. Registrar Ferron elaborated on this point at para. 7 of *Zammit*:

> The creditor still advances, not his or her own action but the trustee's claim. If it were otherwise the relief afforded by the section would be substantially curtailed. For example, a proceeding to set aside a fraudulent preference under section 95(1) of the *Bankruptcy and Insolvency Act* is an action reserved to the trustee. The proceeding provides that certain conveyances, payments etc., made under the circumstances set out in the section "be deemed fraudulent and void as against the trustee in bankruptcy". Obviously, no creditor can advance that proceeding unless authorized by section 38. Section 38 does not create a cause of action in the creditor but merely allows the creditor standing in the trustee's place to advance a proceeding vested in the trustee which the trustee for whatever reason declines to take.

17 At the hearing of the appeal, Mr. Isabelle countered with *Re Braich* (2007), 250 B.C.A.C. 53, [2007] B.C.J. No. 2847 (QL), 2007 BCCA 641. At para. 8 of that decision, Tysoe J.A., in Chambers, expressed "some reservations about the narrowness" of the *Elias* interpretation of the term "future rights", although he admitted that it was unnecessary to settle on the precise scope of "future rights". The same is true in the present case. Suffice it to say, the weight of authority supports the view that a cause of action that presently exists is not a "future right" merely because a court order is required to pursue it. For this reason, Mr. Isabelle's submission with respect to s. 193(a) fails.

B. *Property over $10,000 - s. 193(c)*

18 In his Notice of Appeal, Mr. Isabelle states that "[t]he refusal to grant the Appellant's s. 38 motion prevents the Appellant from pursuing a claim against the Bank for damages suffered by the bankrupt in excess of $10,000, as contemplated by subsection 193(c) of the [*Act*]." While Mr. Isabelle advanced little argument on this point, he did submit an excerpt from *Houlden & Morawetz Analysis* that referred to cases that appear to support his position. The most recent of these cases is *Re Galaxy Sports Inc.* (2003), 183 B.C.A.C. 192, [2003] B.C.J. No. 1271 (QL), 2003 BCCA 322, which found that an appeal as of right existed under s. 193(c) for similarly remote amounts of money. In that case, Galaxy's proposal to its creditors was approved as required by s. 54(2)(d) of the *Act*, but certain of the chair's decisions with respect to admitting or rejecting proofs of claim for the purpose of voting were appealed pursuant to s. 108(1). Concurrently, the trustee sought court approval of the proposal. The motion judge reserved approval of the proposal until the "threshold issue of requisite creditor approval" was resolved. Directions were sought as to whether an appeal as of right existed under s. 193(a) or (c) of the *Act*, or whether leave was required. A key term of the proposal was an action against Galaxy's suppliers for fraudulent misrepresentation and breach of fiduciary duty. The trustee expressed the opinion that the creditors stood to recover $584,000 under the proposal, compared to $62,000 if Galaxy fell into bankruptcy. The Chambers judge, relying on *McNeill v. Roe, Hoops & Wong* (1996), 39 C.B.R. (3d) 147 (B.C.C.A.), [1996] B.C.J. No. 284 (QL), endorsed the following as the applicable test under s. 193(c): "the 'property involved in the appeal'... may be determined by comparing the order appealed against the remedy sought in the

notice of appeal". Since the speculative difference was greater than $10,000, an appeal as of right existed. This determination was not challenged before a full panel of the Court in *Re Galaxy Sports Inc.* (2003), 45 C.B.R. (4th) 42, [2003] B.C.J. No. 1744 (QL), 2003 BCCA 418. By the same logic, Mr. Isabelle would have an appeal as of right if the property ultimately in jeopardy exceeded $10,000; the immediate award on appeal would not itself need to exceed $10,000.

19 In response to Mr. Isabelle's argument, the Bank refers to Houlden, Morawetz & Sarra, *Bankruptcy and Insolvency Law of Canada*, looseleaf (Toronto: Thomson Carswell, 2007) at s. 34 for the proposition that there is no right of appeal under s. 193(c) of the *Act* if the remedy sought is not "appreciable in money." In *Elias,* McGillivray C.J.A., also rejected the appellant's argument that an appeal as of right existed under this subsection, quoting at para. 27 from Justice Rinfret in the expropriation case of *Gatineau Power Company and Freeman F.T. Cross*, [1929] S.C.R. 35; [1928] S.C.J. No. 73 (QL):

> Thus, the whole matter in controversy, even if traced back to the Commission - and we do not think it should be - is merely the right to have that body entertain an application for authority to expropriate. Such right is not appreciable in money. Still less so is the right of appeal to the Court of King's Bench which is the sole matter in controversy on the projected appeal here. The consequence of the authorization by the Commission might result in a proceeding in which the amount involved would exceed two thousand dollars; but the ultimate award on the expropriation is not the matter in controversy in this appeal; and, as was said in *Lachance v. La Societe de Prets et de Placements de Quebec*, 26 S.C.R. 200:
>
> > 'our jurisdiction does not depend on the possible consequences of a possible judgment'.

20 A similar result obtained in *Simonelli v. Mackin* (2003), 320 A.R. 330, [2003] A.J. No. 142 (QL), 2003 ABCA 47, at para. 24: "... if Simonelli's appeal is successful, the claim will be struck. If it is not, the matter will be heard and decided. Therefore, the "loss" resulting from refusing the application to strike is not an award exceeding $10,000 in value. Rather, the loss is the risk of a determination on the merits."

21 In my respectful view, this Court should follow the lead of *Elias* and *Simonelli.* The purposive analysis in *Elias* with respect to s. 193(a) of the *Act* is equally applicable to s. 193(c): it is difficult to think of a case involving a corporate bankrupt in which the amount ultimately in issue would not exceed $10,000. Consequently, there would be little utility to the other four subsections under s. 193 if such cases were subject to an appeal as of right. Since the issue on appeal in this case does not directly involve an amount in excess of $10,000 there can be no appeal as of right under s. 193(c). The central issue in this case is whether or not the motion judge erred by failing to consider whether the appellant, as a guarantor, is a creditor of the bankrupt. Since the issue on appeal does not

involve an amount in excess of $10,000, there can be no appeal as of right under s. 193(c).

C. *Seeking Leave - A Bifurcated process? Yes*

22 The fact that Mr. Isabelle failed to seek and obtain leave prior to perfecting his appeal does not mean that the appeal should be automatically quashed. It must be decided whether the legislative scheme demands a bifurcated process for dealing with leave applications: that is to say, whether the application for leave to appeal must be dealt with in a separate proceeding and prior to the hearing of the appeal on its merits. The alternative is to permit the leave application to be heard together with the merits of the appeal, as happened in the present case, and as is true of certain appeals launched under the *Criminal Code*. Mr. Isabelle assumed that the alternative procedure was the correct one. In his Notice of Appeal, he asked "for a determination as to whether he may appeal the decision as of right, pursuant to ss. 193(a) and (c) of the [*Act*], and should it be determined that the Appellant cannot appeal the decision as of right, the Appellant seeks leave to appeal the decision pursuant to s. 193(e) of the [*Act*]". In short, Mr. Isabelle filed a Notice of Appeal which also included a request for leave in the event it was determined that an appeal did not exist as of right. Intuitively, however, one would think that a separate hearing on the leave application is required. Yet there is evidence that suggests otherwise. Let me explain.

23 The procedural route Mr. Isabelle followed would appear to be sanctioned by Rule 31(2) of the *Bankruptcy and Insolvency General Rules*. Rule 31(2) provides that where an appeal is brought under s. 193(e) of the *Act* (that is to say with leave of a judge of this Court), "the notice of appeal must include the application for leave to appeal." Rule 31(2) of the *BIA Rules*, C.R.C., c. 368, prescribes the procedure to follow on an appeal under s. 193(e):

> (2) If an appeal is brought under paragraph 193(*e*) of the Act, the notice of appeal must include the application for leave to appeal.

24 Moreover, the Registrar of Bankruptcy for New Brunswick (who is also the Registrar of this Court) has issued a practice directive stating that the Notice of Appeal should contain sufficient particulars to allow a determination as to whether leave is required. The Registrar's Directive is dated February 10, 2004 and titled "Appeals in Bankruptcy". All of this suggests that the leave application and the appeal can be heard together. On the other hand, s. 193(e) of the *Act* speaks unequivocally of the need to obtain "leave from a judge of the Court of Appeal."

25 In my view, a bifurcated process for dealing with leave applications and appeals is mandated by the *Act* and to be preferred over one that sees both proceedings being dealt with contemporaneously. There is an obvious reason to justify this approach. On the hearing of most leave applications it is impossible for the applicant not to address the merits of the appeal when arguing the existence of valid grounds for doubting the correctness of the impugned decision. In truth, the arguments made in support of and in opposition to the leave application are the very same arguments to be pursued on the appeal. It is for these reasons that I am prepared to follow the lead of the Ontario Court of Appeal in *Re 518494 Ontario Ltd. (c.o.b. Petrochem)* (1985), 12 O.A.C.

392, [1985] O.J. No. 239 (QL) and adopt a general rule requiring leave applications to be dealt with independently of the hearing of the appeal. An appellant who is proceeding on the assumption that leave to appeal is not required should move for leave to appeal before a single judge of this Court as soon as the respondent raises the issue of whether leave to appeal is required. In future, this is the safe procedure to be followed; it would prevent a respondent's motion to quash an appeal without a hearing on the merits. I hasten to add that the onus is on the respondent to bring to the Court's attention the appellant's failure to first seek the requisite leave. Otherwise, the court will normally proceed on the basis that leave is not required.

D. *The Failure to Seek Leave - Is it fatal? No*

26 The question we must now address is whether Mr. Isabelle's failure to obtain leave prior to the hearing of the within appeal is fatal and, hence, the Bank's motion to quash the appeal should be allowed. In support, the Bank cites *Petrochem* and *Re Hrebecka* (1999), 12 C.B.R. (4th) 47 (C.A.), [1999] O.J. No. 2782 (QL). *Re Hrebecka* involved a motion to quash before a full panel of the Ontario Court of Appeal and states as follows, in its entirety: "The evidence discloses that the amount in issue is under $10,000, an amount requiring leave pursuant to s. 193 of the *Bankruptcy Act*. No such leave was sought or obtained. The motion is accordingly granted and the appeal is quashed with costs." It appears from this brief decision that the appellant in that case failed to invoke s. 193(e) as was done in this case. *Petrochem* is slightly more detailed, although still distinguishable. The instructive paragraph is the fourth of five:

> In this case the appellant combined its notice of appeal and application for leave as required [by the *Rules*]; but, instead of applying to a single judge for leave, it brought its application for leave and its appeal before a full panel of this Court. This was wrong. The appellant should first have moved before a single judge for leave. It is only if leave to appeal is granted that the appellant can proceed with its appeal. In the future this is the procedure that is to be followed where leave is required under s. 163(e) [now 193(e)].

27 It bears noting that the only ground of appeal involved in *Petrochem* was subsection (e), and that the Court went on to decide the application for leave rather than automatically quashing it for procedural deficiency. In my view, this Court retains the discretion to whether the appeal should be quashed because of the failure to obtain leave. Section 187(9) of the *Act*, under the heading Authority of the Courts, mandates a flexible approach to procedural error:

> (9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

28 This Court also has the authority, under s. 187(11) of the *Act*, to extend time "either before or after the expiration thereof on such terms, if any, as it thinks fit to impose." These provisions are

consistent with the approach described in New Brunswick's *Rules of Court* for other types of proceedings, in order to secure "the just, least expensive and most expeditious determination of every proceeding on its merits" (Rule 1.03(2)). The Bank has had sufficient notice of the matters on appeal, so it cannot be said that injustice has resulted from any irregularity. For these reasons, the motion to quash the appeal for failing to obtain leave prior to the hearing of the appeal is dismissed.

E. *Should Leave Be Granted, Nunc Pro Tunc? Yes*

29 Having regard to the introductory paragraphs of these reasons, it can come as no surprise that I am prepared to grant the required leave. Nonetheless, for the sake of completeness, I will deal with this issue as though no ruling had been made on the merits of the appeal. The case law reveals a number of factors that should be considered, or possible grounds for granting leave: (1) whether the appeal raises an arguable ground, often referred to as a serious issue; (2) whether there is reason to doubt the correctness of the decision; (3) whether the impugned decision raises a question of importance; (4) whether there is conflicting jurisprudence on the point; and (5) whether the granting of leave will unduly delay pending proceedings. It is self-evident that this appeal raises several issues of significance to bankruptcy law and for this reason alone leave should be granted. This would be true even if I had formed the opinion that the motion judge was correct in dismissing Mr. Isabelle's motion. Moreover, the granting of leave does not lead to delay as there can be no underlying proceedings until such time as Mr. Isabelle is granted a s. 38 order. For these reasons, I would grant the requisite leave to appeal, *nunc pro tunc*.

IV. The Issue of Standing - The Bank as Intervener - The Hermaphroditic Litigant

30 The motion judge referred to Rule 3 of the *BIA Rules* and Rule 15.02 of the *Rules of Court* in support of his holding that the Bank should be permitted to intervene. Rule 3 of the *BIA Rules* effectively states that in cases not provided for under the *Act* or *BIA Rules*, the court's practice in civil matters is to be followed. Rule 15.02(1) of the New Brunswick *Rules of Court* provides for "Leave to Intervene" in cases where a person has an interest in the subject matter of the proceeding or may be adversely affected by a judgment in a proceeding. On this basis, the motion judge ruled that he possessed the jurisdiction to grant the Bank intervener status. Regrettably, in a subsequent paragraph of his decision (para. 31), the motion judge goes on to dismiss the request for intervener status when dealing with a number of the Bank's motions that he felt did not need to be addressed as they were no longer germane. In my view, this was a "slip" and, therefore, the contradictory reference must be ignored.

31 Before turning to the question of whether the motion judge retains the discretion to grant intervener status with respect to s. 38 proceedings, I wish to note that there is a difference in law between someone who is granted status as intervener and one who obtains status as a party (see *United Brotherhood of Carpenters and Joiners of America, Local 1386 v. Bransen Construction Ltd. et al.* (2002), 249 N.B.R. (2d) 93, [2002] N.B.J. No. 114 (QL), 2002 NBCA 27). For purposes of deciding this appeal, however, I am going to ignore the distinction and focus on the issue of

whether the motion judge erred in granting the Bank standing to oppose Mr. Isabelle's motion for a s. 38 order. My understanding of the law is as follows.

32 Generally, only the trustee need be served with notice of motion (often referred to as an application) brought under s. 38 of the *Act*. Specifically, there is no need to serve the proposed or potential defendant with notice, unless the order is one that would impose an obligation on that party. Otherwise, the creditor need only show that the trustee has refused or neglected to proceed with the lawsuit (see cases collected in Houlden, Morawetz & Sarra, at Cs. 46). The law goes on to provide that even if the potential defendant has notice of the s. 38 application, he or she has no standing to appear on the application, nor can the potential defendant cross-examine on the material filed in support of the application. Inevitably, *Re Nesi Energy Marketing Canada Inc.* (1998), 233 A.R. 347, [1998] A.J. No. 1203 (QL), 1998 ABQB 912, is cited in support of these propositions.

33 The general rule is inapplicable when the potential defendant is also a creditor of the bankrupt. The law accepts that notice of the s. 38 application must be given to all creditors so that they have the opportunity to join in the lawsuit, but for a limited purpose and subject to one important condition precedent. Where the defendant in the proposed lawsuit is also a creditor, he or she is entitled to participate in the s. 38 proceedings for the limited purpose of preserving his or her right to share rateably in the spoils of the action, provided the creditor is willing to share in the expense of the proceedings including costs: *Re B. Donovan Interiors Ltd.* (1990), 3 C.B.R. (3d) 196 (N.S.S.C.), [1990] N.S.J. No. 447 (QL). It is only within this contrived context that the creditor be both plaintiff and defendant in the same s. 38 lawsuit (see Houlden, Morawetz & Sarra, at Cs. 46 and Cs. 49). Interestingly, there is no requirement to notify the creditors in advance of the application for an order. It is only important that they be given a reasonable opportunity to decide whether or not to participate in the proposed lawsuit (see Houlden, Morawetz & Sarra, at Cs. 46). Above all else the potential defendant cannot be a full plaintiff in the proposed lawsuit.

34 In summary, the law of bankruptcy does not recognize the right of a potential defendant (and creditor of the bankrupt) to become both the plaintiff and the defendant in the same action. For this reason, the concept of the "hermaphroditic litigant" is a misnomer. This understanding of the law is reinforced in an article that counsel for the Bank provided to us on the hearing of the appeal and yet the Bank persisted with its argument that the law fully accepts the concept of the hermaphroditic litigant: David R.M. Jackson "The Hermaphrodite Litigant: Suing Yourself Under Section 38 of the BIA", (2002) 17:2 Nat. Creditor/Debtor Rev. 21. That article does point out that there is some debate among the courts as to the extent to which a potential defendant and creditor of the bankrupt may influence litigation decisions, but none of the cases cited recognize the right of the potential defendant/creditor to acquire the chose in action or to take full control of the litigation.

35 Regrettably, some seem to believe that it is permissible for a potential defendant and creditor of a bankrupt to become the plaintiff in order to eliminate another creditor's right to obtain an assignment of the chose in action from the trustee in bankruptcy. This could be accomplished in one of two ways: either the potential defendant attempts to gain standing in the other creditor's s. 38

application or, in the alternative, the potential defendant brings his or her own s. 38 motion and asks that both motions be heard together. Bluntly stated, these litigation tactics constitute an abuse of legal process. Unfortunately, that reality does not seem to deter some potential defendants.

36 In the present case, the Bank's April 2, 2007 motion was brought under s. 38 and claims the contractual right to be both the plaintiff and the defendant in the lawsuit that would otherwise have been brought by Heritage Flooring against the Bank. This is true notwithstanding the above noted article which clearly states that a creditor/defendant's participation in the underlying lawsuit is severely restricted. But the Bank is not the first potential defendant to engage in such foolish thinking. There is also an unreported New Brunswick decision in which the potential defendant (and creditor of the bankrupt) attempted to acquire intervener status on a s. 38 application brought by another creditor. The potential defendant was seeking to acquire the chose in action for $250,000, thereby preventing the other creditor from pursuing an action for breach of a franchise agreement in which the damages to be claimed were in the "millions". The motion judge rightly refused to hear from the potential defendant (who had not even made a formal motion for intervener status) let alone grant it standing. The application for leave to appeal to this Court was dismissed (see *Toner and Toner v. KPMG Inc.*, (2008) February 20, No. 12749, leave to appeal dismissed [2008] N.B.J. No. 111 (QL)).

37 Bluntly stated, a potential defendant who is also a creditor of the bankrupt has no right to bring a s. 38 application for the purpose of ensuring that no other creditor obtains an order authorizing that other creditor to initiate a proceeding against the potential defendant. This is why the Bank's April 2, 2007 motion should have been dismissed to the extent that it sought to invoke s. 38 as a basis for asserting the Bank's right to be both plaintiff and defendant in an action that could only be vigorously and honestly pursued by someone adverse in interest to the Bank.

38 To this point, it seems clear that the Bank has no right to standing on Mr. Isabelle's s. 38 motion. But what of the case in which the potential defendant wishes to argue that the applicant is not, for example, a creditor within the meaning and scope of s. 38 and, therefore, the order sought should not issue. If the potential defendant is not given notice of the s. 38 proceedings, and the trustee does not oppose the order, then presumably the potential defendant has the right to raise the issue on a preliminary motion once the lawsuit is filed. This is because the doctrine of "issue estoppel" is inapplicable as the potential defendant, now defendant, was not a party to the s. 38 proceedings. But I am still left with the question whether the law should recognize the right of a motion judge to exercise a narrow discretion and to grant the potential defendant intervener status.

39 In my view, there may be cases in which the potential defendant should be permitted to oppose the granting of the applicant's s. 38 motion rather than deferring the matter until after the action is commenced. Why? Because the potential defendant might well avoid the need to defend a lawsuit that should never have been commenced in the first place. These are the cases in which the potential defendant raises a discrete and genuine issue of law that if decided in favour of the potential defendant might well avoid the need to defend a lawsuit that should never have been

commenced in the first place. For this reason, I am prepared to accept that a motion judge should retain a "narrow discretion" to decide whether a potential defendant should be granted standing on the s. 38 motion brought by a creditor. Thus, for example, where a potential defendant contends that the applicant for the motion does not qualify as a creditor within the meaning and scope of s. 38, it makes sense for the potential defendant to intervene in circumstances where there is no other party opposing the s. 38 motion. However, I want to reemphasize that the discretion to grant intervener status is a narrow one and is not to be abused. If there is a scintilla of evidence to suggest that the potential defendant is simply engaging in a litigation tactic intended to wear down the s. 38 applicant, the motion judge should refuse to grant the potential defendant standing. However, if standing is granted, it will be necessary for the motion judge to specify the extent of the intervener's participation (*e.g.* cross-examination on affidavits).

40 Returning to the case at hand, the question is whether the motion judge erred in granting the Bank standing. Had I been the motion judge, I would not have granted the requisite standing. The Bank did more than raise a discrete legal issue. It raised frivolous issues and cited countless cases with one objective in mind - to ensure that the Bank remained immune from liability with respect to alleged and established wrongdoing and at any cost. But I cannot undo what has already been done. It is simply too late to decide whether the motion judge erred in granting the Bank standing. The Bank has already participated fully in the proceedings and nothing is achieved by striking it as a party at this late stage. Indeed, if we were to strike the Bank as a party, there could be no order as to costs. For these reasons, I am not prepared to set aside the motions judge's decision to grant the Bank standing.

A. *Is the Guarantor of a Debt of the Bankrupt a Creditor of the Bankrupt? Yes*

41 The motion judge did not answer the question posed above. Rather, he held that a "shareholder" of a corporate debtor and bankrupt does not qualify as a creditor within the meaning of s. 38 of the *Act*. Given *Re Grandview Ford Lincoln Sales Ltd.*, (2001) 22 C.B.R. (4th) 210 (Ont.Gen.Div.), [2001] O.J. No. 251 (QL), no one challenges the motion judge's ruling. Mr. Isabelle argues, however, that the motion judge erred in failing to appreciate that the motion was premised on his status as "guarantor". The Bank now recognizes the motion judge's error and concedes that, as a general proposition, a guarantor qualifies as a creditor of the bankrupt. This is true under common law principles even if the principal debtor has made no demand for payment or, once a valid demand has been made on the guarantor, no money has been paid pursuant to it. In short, a contingent liability entitles a guarantor to claim status as a creditor: *Bank of Nova Scotia v. Holland* (1979), 32 C.B.R. (N.S.) 153 (Ont. S.C. (H.C.J.)), [1979] O.J. No. 1190 (QL). Moreover, the law is equally clear that the guarantor's contingent claim is a debt provable in bankruptcy, whether or not the guarantor has been called on to pay or has paid. On this point, see generally *Re Froment*, 5 C.B.R. 765, [1925] 3 D.L.R. 377 (Alta.S.C.), [1925] A.J. No. 60 (QL); *B.N.R. Holdings Ltd. v. Royal Bank* (1992) 14 C.B.R. (3d) 233, [1992] B.C.J. No. 198 (QL) and *Re Maple City Ford Sales (1986) Ltd.* (1998), 39 O.R. (3d) 702 (Gen. Div.), [1998] O.J. No. 2714 (QL).

42 In summary, a guarantor of the debt of a bankrupt qualifies as a creditor. However, this finding does not answer the question of whether Mr. Isabelle qualifies as a creditor within the meaning and scope of s. 38 of the *Act* and is therefore entitled to an order authorizing him to commence an action against the Bank. In short, this Court must decide whether the s. 38 order sought should issue.

B. *Should the Section 38 Order Issue? Yes*

43 My analysis begins with some general comments about the conditions precedent to a creditor obtaining an order under s. 38 of the *Act*. The primary requirement is that the creditor must request the trustee to pursue the action and the trustee must neglect or refuse to do so. In the present case, that condition precedent has been satisfied. There is also discussion in the jurisprudence whether the applicant must establish that the proposed lawsuit has merit. In some cases, the threshold test is stated in terms of establishing a "*prima facie*" case. I am not confident that the law should require anything more than the applicant demonstrate "serious issue". It is for the plaintiffs to decide whether they believe they have a valid cause of action that is worth the time and money required. Moreover, to allow the potential defendant to argue on the motion that a *prima facie* case has not been established would undermine the purpose of s. 38 and offend the understanding that the right to intervene is a limited one. In any event, whatever the threshold be, it is clear that it has been met in this case because of the finding of Bank wrongdoing made in other bankruptcy proceedings. The fact of the matter is that by breaching s. 69 of the *Act*, the Bank opened itself to a lawsuit in which the damages, whether compensatory, punitive or both, might well exceed the indebtedness of Mr. Isabelle and Heritage Flooring combined. This is not to suggest that, in an ensuing action between these parties, the allegations of wrongdoing must be tied to the breaches of s. 69. In fact, they may extend to all breaches whether they are contractual, statutory or common law in nature (*e.g.*, insufficient time for repayment).

44 The Bank insists that Mr. Isabelle is not a creditor within the meaning or scope of s. 38 of the *Act* for six reasons. First, the Bank argues that Mr. Isabelle is not entitled to claim status as a creditor because he failed to file a Proof of Claim as required under s. 124(2) and, second, he was prohibited from doing so because of the rule against "double proof". The Bank insists that only if a guarantor has paid the principal creditor in full is that guarantor entitled to prove his or her claim in the bankruptcy of the debtor. Third, the Bank asserts that, pursuant to a separate contract ("Postponement of Claim"), Mr. Isabelle has no right to pursue the cause of action in his own name as any such right is vested in the Bank. Fourth, the Bank insists that Mr. Isabelle's application under s. 38 should be dismissed for want of "specificity". Fifth, the Bank advances the bold argument that there is no property (chose in action/cause in action) to be transferred to Mr. Isabelle. According to the Bank, because of its security agreement (the "after-acquired-property" clause) with Heritage Flooring any property that would otherwise form part of the bankrupt's estate, including any cause of action that Heritage has as against the Bank, instead belongs to the Bank. Sixth, the Bank invokes s. 120(1) of the *Act*. That provision states that no "inspector" is entitled to acquire for himself any property of the bankrupt estate without the prior approval of the court. The Bank argues that Mr.

Isabelle, as an inspector, is not entitled to the order sought.

45 Of the six arguments noted above, only the fifth and sixth are found in the documentary record filed in this Court. Arguments one through four, inclusive, were raised for the first time in the respondent Bank's written submission to this Court. Since appellants submit written argument first, Mr. Isabelle understandably failed to deal with these issues. Moreover, even if the Bank had argued these four points before the motion judge, the Bank should have filed a Notice of Contention as provided for under Rule 62.08 of the *Rules of Court*. Furthermore, even if the Bank had argued these points before the motion judge, on the appeal to this Court, the Bank should have filed a Notice of Contention to the effect that he reached the correct result for reasons that he failed to consider. This was not done to the prejudice of Mr. Isabelle. Understandably, his written submission to this Court, as appellant, failed to deal with these issues. Much time was spent addressing the many issues surrounding the need for leave to appeal. Moreover, Mr. Isabelle cannot be faulted for failing to ask for the right to submit a supplemental submission. There was need to do so in light of the Bank's failure to file a Notice of Contention.

46 While this Court is under no obligation to deal with the four issues not properly raised, I must dispel any perception that they might have altered the outcome of this appeal. The plea of lack of "specificity" is frivolous as is the plea of the rule against "double proof". I have already outlined the general nature of the claim against the Bank. The specifics of the claim will be outlined in the Statement of Claim. As to the rule against double proof, it has no application. That common-sense rule is intended to prevent both the guarantor and the principal debtor from sharing in the proceeds of the estate with respect to a single debt. Those are not the facts of our case. Mr. Isabelle does not seek to be enriched at the expense of other creditors. In any event, had the issue of "Proof of Claim" been properly raised, it would have been a simple matter for this Court to exercise its jurisdiction under s. 187(9) and permit Mr. Isabelle (his trustee in bankruptcy) to file such before commencing his s. 38 action against the Bank. As it presently stands, no objection to Mr. Isabelle's motion was made before the motion judge on this technical ground. The Bank's argument based on the "Postponement of Claim" contract has no application with respect to the liabilities of the Bank to Heritage Flooring. The postponement contract essentially provides that if Heritage Flooring owes money to both the Bank and Mr. Isabelle, the Bank gets paid first. It also provides that all of the liabilities of Heritage Flooring to Mr. Isabelle and all sums payable by the former to the latter are assigned to the Bank. The contract says nothing about monies the Bank may owe to Heritage Flooring for breach of its statutory and contractual obligations and the right of Mr. Isabelle to obtain an assignment of any right of action now vested in the trustee in bankruptcy. Note that if Mr. Isabelle's action against the Bank were to succeed, Heritage Flooring would not be indebted to Mr. Isabelle, the Bank would.

47 Finally, the Bank must recognize that its failure to properly raise the four issues outlined above is not an invitation to raise them in subsequent proceedings. As the Bank sought and obtained legal standing in the court below, that was the proper time for raising the issues and, hence, the Bank is forever foreclosed from raising them in any subsequent proceedings taken pursuant to the

order granted under s. 38.

48 The Bank is left with only two arguments in support of its position that a s. 38 order may not issue to Mr. Isabelle. First, the Bank contends that any right Heritage Flooring may have to sue the Bank is the Bank's property, not the trustee's, by virtue of the Bank's "General Security Agreement" with Heritage Flooring dated January 30, 2001. But for a valid security agreement, all property owned by the bankrupt is vested in the trustee pursuant to s. 71 of the *Act*. But it is equally true that the interest of a secured creditor in the property of the bankrupt never becomes the property of the trustee unless the trustee pays out the claim of the secured creditor. The effect of the pertinent statutory provisions is that the interest of the secured creditor in the bankrupt's property never loses its priority over the claims of other creditors: *MacKesey v. Royal Bank* (1991) 86 D.L.R. (4th) 637 (Sask. C.A.), [1991] S.J. No. 572 (QL). Heritage Flooring did execute a security agreement in favour of the Bank, charging all of Heritage's present and after acquired property to the Bank, including all choses in action. From here, the Bank asks us to make a quantum leap by accepting that any right of action that Heritage Flooring acquired against the Bank with respect to the latter's wrongdoing comes within the ambit of the after-acquired-property clause. In other words, the Bank maintains that it owns the right to sue itself. Obviously this cannot be so. If we were to accept the Bank's argument, no debtor would be able to sue a secured creditor for breaching the parties' security agreement, or other legal obligations, so long as that security agreement contained an after-acquired-property clause. I shall say no more of this issue except that a contractual provision drafted with that objective might be struck on the ground of being offensive to public policy.

49 The Bank's other argument is tied to s. 120(1) of the *Act*. That provision states that no "inspector" is entitled to acquire any property of the bankrupt estate without the prior approval of the court. The Bank then argues that: "[i]t is clear that Andre Isabelle is attempting, in his position as Inspector, to act for himself and not for the benefit of the general body of creditors." With great respect, it is not clear to me that Mr. Isabelle is not acting in the best interests of the other creditors. They still have a right to participate in the lawsuit and share in the spoils. Quite properly, Mr. Isabelle points out that if successful against the Bank, in whole or part, Heritage Flooring would be claiming damages (compensatory and punitive) which may well exceed the amount that Heritage owes the Bank. In my view, there is nothing improper about Mr. Isabelle seeking an order under s. 38 even though he is an inspector under the *Act*. Wisely, counsel for Mr. Isabelle notes that court approval may be sought, even at this late stage in the proceedings, having regard to the powers of the court set out in s. 187(9) of the *Act*. If necessary, I would grant the requisite approval, *nunc pro tunc*.

50 In conclusion, the motion judge erred in refusing to grant Mr. Isabelle the order sought under s. 38 of the *Act*. Therefore, the appeal should be allowed and the decision below set aside. The appellant is entitled to an order under s. 38 of the *Act* authorizing him to commence an action for damages against the Bank with respect to any breaches of any legal obligations which the Bank owed Heritage Flooring. This includes not only statutory breaches, such as those tied to s. 69 of the *Act*, but as well contractual breaches and breaches of obligations imposed at law or in equity (*e.g.*,

insufficient time to repay loan). It necessarily follows that the Bank's motions aimed at acquiring the same cause of action must be dismissed.

C. *The Post-Hearing Motion*

51 As noted at the outset, 15 days after the hearing of the present appeal, Mr. Isabelle made an assignment in bankruptcy. Immediately following this event and while the decision on appeal was still under reserve, and without first discussing the matter with Mr. Isabelle's trustee in bankruptcy or Mr. Isabelle's counsel on appeal, counsel for the Bank wrote to the Court informing us, that pursuant to Rule 13.01 of the *Rules of Court*, the matter was "automatically stayed" because of the assignment. Rule 13.01 states, in part, that where at any stage of a "proceeding" the interest or liability of a party is transferred to another party, the proceeding shall be stayed until an order to continue issues. Quaere: Is a decision under reserve a proceeding? The Court was then asked "to confirm" this understanding of the law, otherwise the Bank "would be required to seek a date for the hearing of a motion in that regard." In response, the Court declined the invitation to provide the Royal Bank with legal advice. The Bank should have first discussed the matter with the trustee and Mr. Isabelle's counsel rather than simply forwarding them a copy of its letter, so the parties could decide what course of action to follow. This was not done. Instead, the correspondence from the Bank to the Registrar reads as a letter of intimidation which brought about the opposite effect. Mr. Isabelle's trustee in bankruptcy and his counsel on appeal each responded with a letter, in what amounts to an informal submission, addressed to the Registrar. Each disputed the Bank's understanding of the law, cited relevant authorities and then asked that this Court deliver its decision in the usual manner. In response, the Bank forwarded an affidavit together with an *ex parte* order to the Registrar of this Court, purportedly drafted in conformity with Rule 13 of the *Rules of Court*.

52 Rule 13 provides that where at any stage of a proceeding the interest or liability of a party is transferred to another person (*e.g.*, the trustee in bankruptcy), the proceeding is stayed until an order to continue issues. Should the party with carriage of a proceeding fail to obtain such an order within 30 days of the transfer, an interested party may do so. In the present case, 30 days had passed since Mr. Isabelle fell into bankruptcy and, hence, the Bank had the right to seek the continuance order. However, the order provided to the Registrar would have given the carriage of the proceedings to the Bank such that it would be both the appellant and respondent. The Registrar refused to sign the order and rightly so. Eventually an order was signed directing that the proceeding be continued with "A.C. Poirier & Associates Inc. as Trustee for the Estate of André Isabelle as appellant". As the Bank did not obtain the order it sought, it brought a motion to permanently stay the rendering of our decision or, alternatively, an order for security of costs. We dismissed both requests with costs and reasons to follow. Here are our reasons.

53 In support of its many arguments, the Bank cites no less than 10 decisions. Only one decision is relevant to the motion for the permanent stay and that decision is contradicted by two others that the Bank failed to bring to our attention. However, the three cases deal with the question of

whether, in the absence of a continuance order, a decision under reserve is automatically stayed once one of the parties becomes bankrupt. Since a continuance order issued in this case, it is unnecessary to address the jurisprudence (see *Adams-Eden Furniture Ltd. (c.o.b. Whitehorse Furniture Ltd.) v. Kansa General Insurance Inc.*, [1995] M.J. No. 314 (QL) aff'd [1995] M.J. No. 258 (QL) and compare with *Hunter Douglas Ltd. v. Kool Vent Awnings Ltd.* (1957), 37 C.B.R. 154 (Que. S.C., in Bankruptcy), [1958] C.C.S. No. 127 (QL) and *Rea v. Patmore* (1999) 253 A.R. 363, [1999] A.J. No. 1288 (QL), 1999 ABQB 1069).

54 The Bank had no option but to abandon its argument that the decision under reserve was automatically stayed pursuant to Rule 13.01 of the *Rules of Court*. Any stay that did exist, and this is by no means a given, was lifted with the granting of the continuance order. The Bank then argued that the permanent stay rested on ss. 67(1) and 71 of the *Act*. Section 67(1)(d) states that the property of the bankrupt shall comprise such powers over property as might have been exercised by the bankrupt for his or her own benefit. Section 71 states that the property of the bankrupt passes to the trustee and that the bankrupt ceases to have the capacity to deal with his or her property. It should be readily apparent that these provisions do not operate to prevent this Court from rendering its decision on appeal. This is not to deny that once this Court concludes that a s. 38 order should issue, the right to pursue an action against the Bank then vests in Mr. Isabelle's trustee.

55 The Bank's next argument is that the release of our decision should be stayed on the ground of "mootness". The Bank advanced two reasons. First, it points out that in a document entitled "Statement of Affairs" prepared by Mr. Isabelle with the assistance of his trustee, the value of the s. 38 application is stated as "$0". The Bank seizes upon this fact to argue that the decision under appeal is worthless even if Mr. Isabelle is successful and, hence, there is no live issue between the parties. In his response affidavit, the trustee points out that in those cases where the value of an asset or liability is unknown with any reasonable certainty, it is necessary for the bankrupt to use "$1" or "$0" for the estimated realizable value. This makes good sense and renders the Bank's argument frivolous as is its next argument. The Bank argues that if Mr. Isabelle was a creditor of Heritage Flooring at the time the appeal was heard, he is no longer a creditor as any debt owed to him by Heritage Flooring is an asset in his bankruptcy and has been assigned to his trustee by operation of law. Clearly, Mr. Isabelle does not lose his status as creditor because he is now bankrupt. It just means that his trustee is the one vested with the right to decide what further action should be taken with respect to all of his assets.

56 Next, the Bank argues that a stay should issue because Mr. Isabelle's trustee has not indicated whether he is interested in pursuing an action against the Bank should Mr. Isabelle's appeal succeed. The Bank cites two cases in support of its argument. For the sake of completeness, I will canvass the cases even though they do not remotely support the argument presented. The first decision is *Hall-Chem Inc. v. Vulcan Packaging Inc.* (1994), 21 O.R. (3d) 89 (Ont. C.A.), [1994] O.J. No. 2692 (QL). In that case "V" had obtained judgment against "B" for $338,000. B appealed but was ordered to give security. B moved to vary the order but while the motion and appeal were pending he filed an assignment in bankruptcy. B's trustee took the position that both proceedings were stayed under

s. 69.3(1) of the *Act*. When the motion came before the Ontario Court of Appeal, the Court held that s. 69.3(1) was not applicable. The applicable section was s. 71(2) which vested B's cause of action in the trustee and it was for the trustee to advise B's counsel and for B's counsel to seek instructions as to whether the trustee intended to abandon or proceed with the appeal. Finally, the Court held that the trustee should have sought an order for continuance as provided for under the equivalent of our Rule 13.02 of the *Rules of Court*.

57 The present case is clearly distinguishable from *Hall-Chem*. In that case, the trustee had to decide whether to pursue the motion and the appeal pending before the Court of Appeal. In the present case, the motion and appeal were already heard prior to Mr. Isabelle falling into bankruptcy. Until our decision issues there is nothing his trustee can do. The trustee is entitled to await the decision of this Court to determine whether it should proceed to sue the Bank based on the totality of the surrounding circumstances. Without knowing the reasons underscoring our decision to grant the order Mr. Isabelle sought, it would be unwise for his trustee to make a decision in the abstract.

58 The Bank also insists that *Mann v. Northern B.C. Enterprises Ltd.* (2005), 46 C.C.E.L. (3d) 253, [2005] B.C.J. No. 1485 (QL), 2005 BCCA 367 is a pivotal case. The essential facts involve a trial judge who had allowed an undischarged bankrupt to represent his company in an action for damages for wrongful dismissal in circumstances where the bankrupt's trustee, who held the shares, was not prepared to take any steps to have the company represented at trial. However, I am unable to appreciate how *Mann* is analogous to the case under appeal. Mr. Isabelle is not a shareholder attempting to represent Heritage Flooring in an action against the Bank. Nor is Mr. Isabelle pursuing the present appeal contrary to the wishes of his trustee. The trustee is simply awaiting a decision of this Court in order to determine what action should be taken. Armed with an order under s. 38 of the *Act*, the trustee must decide whether to exercise Mr. Isabelle's right to sue the Bank. Until that decision is made and until the trustee applies for the order granted on this appeal there are no proceedings pending before any court.

59 It is worth reminding all litigators that effective advocacy does not include the indiscriminate proliferation of issues supported by a plethora of case law. It is not the intended role of an appellate court to sift through countless issues and case law to see whether there is something which "sticks". Such litigation tactics obfuscate the true issues and may ultimately undermine the credibility of all advocates and their client's interests. More often than not, the indiscriminate recitation of cases is looked on as an ineffective means of strengthening a weak case. This is why it is important for counsel to be as judicious in their selection of the case law to be cited in support of an argument as it is important to isolate those issues that legitimately advance the interests of their client.

60 Ultimately, the Bank conceded that the granting of a stay is a discretionary decision but asked that it be exercised in favour of the Bank because of the prejudice it would suffer should it succeed on the appeal and be awarded costs. Of course, the Bank's argument presumes the trustee will be unable to pay any cost award. In the alternative, the Bank asked for an order for security of costs under Rule 58.10 of the *Rules of Court*. Knowing that my colleagues endorse my reasons for

judgment with respect to the disposition of the main appeal, the issues of prejudice and costs are truly moot. That said the law in this Province is clear: (1) an order for security for costs may only issue when it is in the "interests of justice"; and (2) "impecuniosity" is not a sufficient ground for granting such an order (see *Re Dugas Estate (Bankrupt)* (2003), 261 N.B.R. (2d) 99 (C.A.), [2003] N.B.J. No. 230 (QL) and *HSBC Bank Canada v. Elm City Chrysler Ltd. et al.* (2007), 323 N.B.R. (2d) 137, [2007] N.B.J. No. 346 (QL)).

61 For these reasons, we dismissed the Bank's post-appeal hearing motion. As the motion was conceived in desperation and nurtured by heaps of irrelevant case law and frivolous arguments, the cost award must reflect these realities. Accordingly, the trustee is entitled to costs of $5,000 on this motion.

VIII. Conclusion

62 In conclusion, I would dismiss the respondent's motion to quash the appeal because of the appellant's failure to obtain leave as required under s. 193(e) of the *Act*. Instead, I would allow the application for leave to appeal, *nunc pro tunc*. As the respondent's motion involved the preparation of extensive written submissions, distinct from those submitted on the main appeal, I would award the appellant costs of $3,500 on this motion. I would also allow the appeal and set aside the motion judge's decision dismissing the appellant's motion brought under s. 38 of the *Act*. The appellant is entitled to an order under s. 38 of the *Act* authorizing him to commence an action for damages against the Bank with respect to a breach of any legal obligation which the Bank owed Heritage Flooring. This includes not only statutory breaches, such as those tied to s. 69 of the *Act*, but as well contractual breaches and breaches of obligations imposed at law or in equity. It necessarily follows that the Bank's motions of April 2, 2007 should be dismissed and the same is true with respect to its motion of April 3, 2007, except with respect to the decision to grant the Bank intervener status. I would award costs of $8,500 to the appellant on the appeal. With respect to the post-hearing motion, the appellant is entitled to costs of $5,000 for the reasons discussed above. In sum, costs of $17,000 are payable forthwith.

J.T. ROBERTSON J.A.
We concur:
B.R. BELL J.A.
K.A. QUIGG J.A.

cp/e/qlrxc/qlpxm/qlrxg/qlcas/qlhcs/qlrxg/qlaxr

Tab 31

Indexed as:

Riddler (Re)

IN THE MATTER of The Proposal of Alan Wayne Riddler

[1991] B.C.J. No. 36

3 C.B.R. (3d) 273

24 A.C.W.S. (3d) 1052

Vancouver Registry Nos. 150692 and 1097/85

British Columbia Supreme Court
Vancouver, British Columbia
(In Chambers)

Campbell C.J.S.C.

Heard: September 18, 1990
Judgment: January 9, 1991

Bankruptcy -- Creditors -- Pre-proposal and post-proposal claims -- Proof of claim -- Rule against double proof.

Appeal from the trustee's order of disallowance. An executor misappropriated funds from an estate of which he was sole executor. He subsequently filed a proposal for bankruptcy. The new executrix commenced an action against the bankrupt, his banker and solicitors for misappropriation of trust funds. She also filed a claim with the trustee as a secured creditor in respect of the funds. The trustee disallowed the claim and the executrix appealed, seeking an order to set aside the trustee's disallowance and allowing her claim as ordinary creditor. The claim included funds allegedly misappropriated before the filing of the bankruptcy proposal by the first executor and interest accruing thereafter. The original action was settled by the other named defendants except the bankrupt.

HELD: Appeal allowed in part. The effective date of determining a claim in a proposal is the date it is filed. Thus the appellant could not claim any sum accruing by way of interest or litigation cost after that date. The appellant had provided adequate proof of her claim against the bankrupt. However, she would not be allowed to claim for an amount equal to the settlement moneys since this would offend the rule against double proof.

STATUTES, REGULATIONS AND RULES CITED:

Bankruptcy Act, R.S.C. 1985, c. B-3, ss. 69, 124, 125, 135.

Counsel for the Creditor; P.D. Le Dressay.
Counsel for the Trustee: K.S. Campbell.

CAMPBELL C.J.S.C.:-- The creditor, Joy Armstrong, Executrix of the estate of James T. Riddler, deceased, ("the applicant") appeals pursuant to s. 135(4) of the Bankruptcy Act, R.S.C. 1985, c. B-3 ("the Act") from the Trustee's disallowance of her claim filed in these bankruptcy proposal proceedings. She seeks an order setting aside the disallowance and allowing her claim as an ordinary creditor in the amount of $131,353.40.

The facts as revealed by the material filed are somewhat complicated.

James T. Riddler died November 18, 1975 having on October 15, 1975 executed his will which appointed Alan Wayne Riddler as Executor. Letters probate in favour of Alan Wayne Riddler as sole Executor of the deceased's estate were granted to Alan Wayne Riddler ("A.W. Riddler") on February 12, 1980.

In August 1980, A.W. Riddler withdrew $60,000.00 from the estate bank account and transferred it into his personal account. He then purchased a term deposit receipt for $60,000.00 in his own name and pledged it to the Bank of Montreal as security for personal advances. The term deposit was redeemed by the bank and applied against his personal indebtedness.

On February 2, 1983, A.W. Riddler borrowed $60,000.00 from the Bank of Montreal to reinstate the term deposit receipt apparently in an attempt to replenish the deceased's estate. This was also redeemed by the bank and applied to reduce A.W. Riddler's personal indebtedness. A.W. Riddler in an affidavit filed herein September 13, 1988, says that this was done without his knowledge or consent.

On July 18, 1985, A.W. Riddler made a proposal in bankruptcy, The proposal lists assets totalling $105,240.00. The liabilities listed include: $86,000.00 owing to secured creditors; $6,973.94 owing to preferred creditors and $36,696.67 owing to unsecured creditors. The estate of James T. Riddler is not listed as a creditor.

The Registrar was directed by an order of Taylor J. on September 12, 1985 to take the accounts of A.W. Riddler as Executor of the estate of James T. Riddler. One Registrar's Report covering the accounts for the period from November 18, 1979, to March 31, 1984, dated November 3, 1986, shows the amount owed by A.W. Riddler to the estate as of March 31, 1984 to be $69,158.00. A second Registrar's Report filed November 20, 1986, shows that A.W. Riddler owed the estate $139,415.00 as of November 3, 1986. I have no evidence of how the indebtedness increase between March 31, 1984 and November 3, 1986 is calculated. It also seems unusual that the indebtedness as of March 31, 1984 of $69,158.00 would increase as of the proposal date, July 18, 1985, to $131,353.00 the amount, as will appear later the Trustee was subsequently, subject to certain condi-

tions, prepared to accept. This calculation is purportedly explained in the letter of November 10, 1988, which is exhibit 10 to the affidavit of John Bottom.

On December 12, 1986, the court removed A.W. Riddler as the Executor of the estate and appointed Joy Armstrong, a beneficiary and mother of the deceased, as Executrix.

An action was commenced on November 13, 1987 by Joy Armstrong in her capacity as Executrix of the estate, against A.W. Riddler for misappropriation of trust funds ("the 1987 litigation"). Other defendants named in the action included the Bank of Montreal, A.W. Riddler's former solicitors and his former accountants. That action was commenced without the leave of this court as required by s. 69 of the Bankruptcy Act. Subsequently, that leave was obtained from Gibbs J. on August 11, 1988.

On February 19, 1988, the Trustee sent notice to the applicant to prove any claim against the proposer within 30 days, failing which the Trustee stated he intended to distribute the estate of A.W. Riddler ("the proposer") without regard for any such claim.

On March 4, 1988, a proof of claim was submitted by the applicant. It claimed a secured interest in the amount of $139,415.00 on the "basis of trust and tracing". The Trustee disallowed this proof of claim on the ground that it claimed a priority position that did not exist under the Act. A second proof of claim claiming a proprietary interest in the proposal estate was submitted by the applicant on May 9, 1988. This was disallowed by the Trustee on the basis of insufficient evidence. The applicant appealed both disallowances to this court and both were upheld by Gow J. on October 4, 1988.

A third proof of claim, the subject of this application, was filed by the applicant as an ordinary creditor on October 14, 1988. This was for $135,702.36. No statement of account, as required by the Bankruptcy Act, was included to show how this amount was calculated. The Registrar's report earlier referred to which showed that as of November 3, 1986, the proposer was indebted to the applicant in the amount of $139,415.00 subject to his entitlement to a ten per cent share of the net distribution of the James T. Riddler estate was attached to the Proof of Claim. There is no indication in the Registrar's report as to how much, if any, of the amount claimed to be owing by the proposer arose between July 18, 1985 (the effective date of the proposal) and November 3, 1986, nor of the value of his ten per cent interest in the James T. Riddler estate to be set off against his debt.

The Trustee's solicitor pointed out these deficiencies in a letter dated October 25, 1988, to the applicant's solicitor.

In a letter dated November 10, 1988, referred to earlier as exhibited to the Bottom affidavit, the solicitor for the applicant wrote to the Trustee's solicitor purporting to give details of the calculation of the claim and included an interest schedule. According to this, as of July 18, 1985, the date of the proposal, the proposer owed the applicant $131,353.40 plus costs ordered by Taylor J. on a solicitor/ client basis totalling $7,483.20 making a total indebtedness of $138,836.60. The Trustee through his solicitor then advised he was prepared to accept the applicant's proof of claim "as wholly unsecured for the amount of $131,353.40" subject to a full and general release of the Trustee and the estate of the proposer from the applicant and the estate of James Riddler. This offer was not accepted by the applicant.

On or about December 12, 1989, the 1987 litigation settled by all defendants except the proposer. The Bank of Montreal ("the bank") paid $106,000.00 to settle the claim against it. The remaining defendants, apart from the proposer, paid a further amount of $22,000.00. All but the bank waived

entitlement to claim against the proposer. The proposer was not a party to the settlement agreement, nor has the proposer been a party to any such agreement with the bank.

Robert Dresser', solicitor for the Trustee, in his affidavit sworn September 18, 1990, states that he was informed by counsel for the bank that the bank would not prove a claim against the proposal estate for the amount paid by the bank under settlement. The bank, however, did not assign its right to claim against the proposer to the applicant.

After protracted correspondence and discussions between the solicitor for the Trustee and for the applicant after the filing of the Proof of Claim on October 4, 1988, the Trustee, on July 19, 1990, gave Notice of Disallowance of that claim. This application followed.

In that correspondence and those discussions subsequent to the settlement of the 1987 litigation, the applicant has taken the position that she is entitled to invoke the rule in Clayton's Case. Accordingly, she has purported to apply the funds received from the settlement to her post-proposal claims, first for costs and interest incurred in the 1987 litigation, second against the proposer's debt for solicitor/client costs incurred subsequent to the proposal, and third in respect of interest.

In a letter to the applicant's solicitor dated October 5, 1988, the Trustee's solicitor's stated:

> "Although the Registrar's report should provide evidence of the claim, you must bear in mind that toe claim is provable only for the debt as it stood as at the date of the filing of the proposal. You may not prove a claim for interest thereafter or for any costs of other charges which may have been incurred subsequent to the filing of the proposal."

In several subsequent letters to and discussions with the applicant's solicitors the Trustee's solicitors have objected to the form and content of the proof of claim and have sought an accounting from the applicant as to the means by which the claimed amount is calculated and the amount claimed owing as of the effective proposal date of July 18, 1985.

In addition, they requested that the applicant file an amended proof of claim to take into account the funds received pursuant to the 1987 litigation settlement. The applicant has not adjusted her claim and "stands by" the proof of claim as currently presented and further contends that the settlement of the 1987 litigation has nothing to do with the bankruptcy.

The pre-proposal claim would be comprised of the principal amount of the claim which appears to be $60,000.00 plus interest. The post-proposal claim would appear to consist of interest accruing since July 18, 1985, and the applicant's costs in the 1987 litigation.

It appears the costs of the 1987 litigation are in excess of $68,000.00. Interest accruing since the date of the proposal was $79,824.25 as of March 1990.

The first issue is whether the applicant can make a claim in the proposal estate for matters arising after the effective date of the proposal.

Section 62 of the Act is unequivocal in stating that the effective date for determining claims in a proposal is the date it is filed. That section provides:

> 62. (1) Where an insolvent person makes a proposal, the trustee shall file a copy thereof with the official receiver and the time of the filing of the proposal shall constitute the

time for the determination of the claims of the creditors and for all other purposes of this Act.

(2) A proposal accepted by the creditors and approved by the court is binding on all the creditors with claims provable under this Act and affected by the terms of the proposal but does not release the debtor from the debts and liabilities referred to in section 178, unless the creditor assents thereto.

The proposal here was filed July 18, 1985. Clearly then the applicant cannot include in her proof of claim any amount for interest arising after July 18, 1985, nor can she claim the costs of the 1987 litigation since these were incurred after the effective date of the proposal. Thus, she can only claim the principal amount of her claim against the proposer, together with whatever interest had accrued on it to the effective date of the proposal. Equally clearly, the proof of claim filed includes postproposal amounts, including interest.

Thus, the applicant is only entitled to file a proof of claim as of July 18, 1985. This eliminates the interest and costs of the 1987 litigation and all other matters arising subsequent to that date.

The next issue is whether the applicant has provided adequate proof of her claim against the proposer.

The relevant provisions of the Act are sections 124(1)(2)(4) (5), 125 and 135(1)(2)(4). These state:

124. (1) Every creditor shall prove his claim, and a creditor who does not prove his claim is not entitled to share in any distribution that may be made.

(2) A claim shall be proved by delivering to the trustee a proof of claim in the prescribed form.

(4) The proof of claim shall contain or refer to a statement of account showing the particulars of the claim and any counter-claim that the bankrupt may have to the knowledge of the creditor and shall specify the vouchers or other evidence, if any, by which it can be substantiated.

(5) The proof of claim shall state whether the creditor is or is not a secured or preferred creditor.

125. Where a creditor or other person in any proceedings under this Act files with the trustee a proof of claim containing any wilfully false statement or wilful misrepresentation, the court may, in addition to any other penalty provided in this Act, disallow the claim in whole or in part as the court in its discretion may see fit.

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

> (2) Where the trustee considers a claimant is not entitled to rank on the estate of the bankrupt, or is not entitled to rank for the full amount of his claim, or if directed by a resolution passed at any meeting of creditors or inspectors, he may disallow the claim in whole or in part, and in that case shall give to the claimant a notice of disallowance, and the notice shall contain the reasons for disallowance.

> (4) The disallowance referred to in subsection (2) is final and conclusive unless, within thirty days after the service or mailing of the notice or such further time as the court may on application made within the same thirty days allow, the claimant appeals to the court in accordance with the General Rules from the trustee's decision.

Section 124 is mandatory in its terms. A creditor filing a proof of claim must append a statement of account showing full particulars of the claim, failing which the trustee has the discretion to disallow the claim in whole or in part: ss. 124(4), 125 and 135(4). The claimant must, in a statement of accounts, show the particulars of the claim, specify vouchers or any other evidence by which the claim can be substantiated. Thus, the proof of claim should be sufficient to enable the trustee to make an informed decision on the merits: Re Corduroy's Unlimited Inc. (1962), 4 C.B.R. (N.S.) 250 (Que.S.C.); Re Norris (1988), 57 C.B.R. (N.S.) 246 (Ont.S.C.) and Re Rix (1984), 53 C.B.R. (N.S.) 67 at pp. 72-74 (B.C.S.C.).

Counsel for the Trustee submits that the creditor's obligation to provide reliable, accurate information extends to any and all events after the initial filing of the proof of claim which affect the amount of the claim. He also submits that the rule against double proofs is premised upon this obligation and relies on the following authorities in support of this proposition: Re Film House Ltd. (1974), 19 C.B.R. (N.S.) 231 (Ont.S.C); Re Hammond Organs Studio of Kelowna Ltd, (1981), 40 C.B.R. (N.S.) 293 (B.C.S.C.); Re Tuxedo Silver Ltd. (1961), 4 C.B.R. (N.S.) 95 (Man.Q.B.); and Re Rix, supra. (The rule against double proofs will be discussed infra.)

Counsel for the Trustee also submits that on an application under s. 135 for review of a disallowance by the Trustee, the creditor will not be permitted to recast or reformulate the claim. It is contended that the application must stand or fall on the basis of the material leading to the notice of disallowance.

Counsel for the applicant says that there has been a proper accounting and contends that the Trustee's objections to the arithmetical calculations are immaterial. It is his position that the indebtedness of the proposer was fixed by an order of the Registrar of the Court as being $139,415.00 as of November 3, 1986. He further relies on the decision of the B.C. Court of Appeal in Hill v. Hill (1966), 56 W.W.R. 260 to argue that the amount of the indebtedness is res judicata. This decision is cited for the following proposition:

> "For the purposes of estoppel by res judicata, a judgment on merits stands for every point, whether of assumption or admission, which was in substance the ratio of and fundamental to the decision." (Per Tysoe J.A. at p. 268)

I question whether the proposer's indebtedness is in fact res judicata within the meaning of Hill v. Hill. As stated earlier, the Registrar's Report dated November 20, 1986, indicates the proposer was indebted to the estate in the amount of $139,415.00 as of November 3, 1986, subject to his entitle-

ment to a ten per cent share of the net distribution of the estate. There is no indication in the Registrar's Report as to how much, if any, of the amount said to be owing arose between July 18, 1985 (the effective date of the proposal) and November 3, 1986. Nor is there an indication of the value of the ten per cent interest in the estate to be set off against the debt. Thus, it cannot be said that the Registrar's report provides conclusive proof of the statement of accounts.

It was also argued that the applicant provided detailed calculations of the interest and costs for this claim in a letter dated November 10, 1988. This letter showed that as of July 18, 1985, the proposer owed $135,353.40 plus costs ordered on a solicitor/client basis totalling $7,483.20. However, there was no reference made to the value of the proposer's ten per cent interest in the estate as an amount to be set off against his overall debt.

On the other hand, counsel for the Trustee submits that no basis has been provided by which the applicant's claim can be determined. He points out that the applicant failed to provide a full and proper accounting with the proof of claim despite numerous requests for such information and that the value assigned to the claim has changed repeatedly since it was first presented and that none of these valuations have been supported by an accounting the Trustee can properly rely upon. Thus, he says, the Trustee was well within its discretion to disallow the claim pursuant to s. 135.

The difficulty with that position is that the Trustee was prepared to accept the applicant's proof of claim as wholly unsecured in the amount of $131,353.40 subject to a full and general release. This offer is evidence of the Trustee's willingness to accept the amount in the applicant's proof of claim and thus negates his arithmetical objections. The applicant on the other hand was willing to have the claim accepted in this amount but was unwilling to provide the release required by the Trustee.

In these circumstances it seems appropriate to accept the proof of claim in the amount of $131,353.40 less a credit of the ten per cent entitlement of the proposer in the Estate of James T. Riddler, deceased, and subject to the considerations to which I now turn.

As stated earlier, the applicant takes the position that she is entitled to invoke the rule in Clayton's Case and, accordingly has applied the funds received from the settlement of the 1987 litigation to her post-proposal claims.

Her counsel submits that she is under no duty whatsoever to account to the Trustee for funds received in settlement of the 1987 litigation from the defendants other than the proposer and says there is no evidence that the settlement funds were paid or accepted on the basis of any joint liability or indebtedness of the proposer. He submits that the settlement funds thus relate to a separate claim. However, he adds that, assuming that the settlement funds relate to the entire claim, the creditor is not bound to attribute the settlement funds to any part of the claim. He relies on Clayton's Case, 1 M.E.R. 571 as authority for the proposition that absent a specific appropriation being made by the payor, the creditor may appropriate the payment as he sees fit.

The modern restatement of this rule is found in Corey Bros. & Co. Ltd. v. The "Mecca", [1887] A.C. 286 (H.L.). Lord MacNaghten stated:

> "... if the debtor does not make any appropriation at the time when he makes the payment the right of application devolves in the creditor .... But it has long been held and it is now quite settled that the creditor has the right of election up to the very last moment,' and he is not bound to declare his election in express terms. He may declare it by bringing an action or in any other way that makes his

> meaning and intention plan .... The presumed intention of the creditor may no doubt be gathered from a statement of account, or anything else which indicates an intention one way or the other and is communicated to the debtor, provided there are no circumstances pointing in an opposite direction. But so long as the election rests with the creditor, and he has not determined his choice, there is no room, as it seems to me, for the application of rules of law such as the rule of civil law, reasonable as it is, that if the debts are equal the payment received is to be attributed to this debt first contracted. (at pp. 293-294)

This passage was affirmed in Waisman & Ross v. Crown Trust, [1970] S.C.R. 553.

Thus, it is argued that since the defendant payors in the 1987 litigation made no specific appropriation with respect to the settlement funds, the election is with the applicant and her appropriation, express or implied, will govern the application of the funds. In this case, the applicant clearly indicated in her solicitor's letter to the Trustee's solicitor dated March 20, 1990, that the settlement funds were not being applied to the preproposal indebtedness of the proposer.

In my view, Clayton's Case is distinguishable from the case at bar. The payments in this case were not made by the debtor (i.e. the proposer) rather the payments were made by co-defendants in settlement of the 1987 litigation. Clayton's Case also involved a current account between the debtor and creditor. Here, we have a claim against the proposer and a personal action against him and the other co-defendants. I agree with counsel for the Trustee in his submission that authorities such as Clayton's Case anticipate a single, global claim against a single defaulting debtor. In this case, the proposal estate is a distinct person from A.W. Riddler. Counsel suggests that the question is not how claims as against a single person ought to be allocated, but rather how a single credit ought to be allocated between two separate "persons" having separate debts.

While there seems to be no authority directly on this point, he suggests that those cases which deal with the allocation between bankruptcy estates and subsequent creditors may be of some assistance. For example, in Re Anderson (1978), 21 O.R. (2d) 539 (Ont.C.A.), after acquired assets were allocated to those claims arising first in time. He suggests that this would be consistent with the well-known accounting principle of "first in - first out". While counsel conceded that there is also a general accounting principle that payments are to be allocated first to interest and then to principal, he submits that this general rule cannot be applied where, as here, the obligation in issue should be divided into two distinct debts.

Finally, counsel submitted that the "first in - first out" approach, would cause no prejudice to the applicant. She still has the full amount paid by the bank, plus the unrestricted ability to continue to pursue the proposer in the 1987 litigation for whatever she believes is owed after making any and all proper discounts or deductions. Accordingly, the submission is that if the applicant's claim is to be allowed, it ought to be restricted to the amount she is able to prove on the basis of material already provided to the Trustee, net of whatever settlement funds she has already received.

In the unique circumstances of this case these submissions of counsel for the Trustee are logical, sensible and fair.

Counsel for the Trustee also made extensive submissions based on the "rule against double proofs", i.e. where there is one debt with several claimants to that debt, the debt may only be proved once in bankruptcy: In Re Coughlin & Co.; Guaranty Co. of North America's Claim, [1923] 3

W.W.R. 1177 (Man.C.A.) cited in Re Tuxedo silver Ltd. (1961), 4 C.B.R. 95 (Man.Reg.). This rule appears to emerge from the law relating to surety.

Two additional cases were cited by counsel for the Trustee on this point. Both deal with guarantors He relies on these authorities in support of his submission that the settlement amounts should be deducted from the proof of claim. First, in Re Hammond Organ Studios of Kelowna Ltd. (1981), 40 C.B.R. (N.S.) 293 (B.C.S.C.), the bank was ordered to account in its claims against the estate the amount paid by the guarantors instead of claiming the full amount of the debt. It was reasoned that this would give the bank an unfair advantage over other creditors since there would be a duplicated claim for the amount paid by the guarantors. Second, in Re Film House Ltd. (1974), 19 C.B.R. (N.S.) 231 (Ont.S.C.), the court held, inter alia, that the surety in this case was only entitled to vote at a creditor's meeting after giving credit for the value of any security held by the creditor.

Of those defendants in the 1987 litigation who settled all but the bank have waived their entitlement to a claim in the proposal estate. The bank has not assigned its right to claim in the proposal estate to the applicant. .However, the bank has apparently agreed that it will not file a proof of claim against the proposer for the amount it paid under the settlement.

While the circumstances here do not involve a guarantor or surety, it is logical that the reasoning in the cases cited be extended to the unique circumstances of this case. Accordingly, the applicant ought to deduct the settlement amounts from the proof of claim. To hold otherwise is tantamount to allowing the applicant to collect twice on the same debt. This, in turn, would operate to the detriment of the other creditors of the proposer.

I conclude that the applicant should not be entitled to claim for an amount equal to the settlement moneys since this would offend the rule against double proofs.

Thus, the proof of claim will be allowed in the amount due July 15, 1985, which on the material before me is $131,353.40, less the ten per cent of the James T. Riddler estate due the proposer and less the amounts totalling $128,000.00 received by the applicant in her settlement of the 1987 litigation.

Counsel did not address the issue of costs. Nevertheless the conclusion I have reached gives technical success to the applicant in that her proof of claim has been allowed, subject to deductions. However, the practical result is that the Trustee has been successful in that the claim as allowed is for what will be a nominal amount. In these circumstances it is appropriate that each party bear their own costs.

CAMPBELL C.J.S.C.

Tab 32

Case Name:

Labarre (Syndic de)

IN THE MATTER OF THE BANKRUPTCY OF GAETAN LABARRE, Bankrupt
LA BANQUE TORONTO-DOMINION, Petitioner
Vs.
ST-GEORGES, HEBERT INC., Respondent

[2004] Q.J. No. 13895

No.: 500-11-019569-025

Quebec Superior Court
District of Montreal

The Honourable Dionysia Zerbisias, J.S.C.

Heard: January 21 and June 8, 2004.
Judgment: June 29th, 2004.

(23 paras.)

Counsel:

Claude Savoie (Savoie & Savoie), attorney for Petitioner.
Jean El Masri (El Masri Dugal), attorney for Respondent.

JUDGMENT

1 Petitioner appeals from the disallowance by the Trustee of its proof of claim as a non-secured creditor in the estate of the Bankrupt.

2 The circumstances are as follows.

3 On January 10, 2003, Petitioner filed a proof of claim in the amount of $50,107.19 (capital $43,491.68; interest $6,615.51) as an unsecured creditor in the estate of the Bankrupt Gaétan Labarre.

4 In support of its claim, Petitioner filed the following documents:

A) statement of interest calculations;
B) statement of collocation setting out the distribution of funds from the judicial sale of an immoveable property owned by the Bankrupt, situated at 180 Domaine Caché, Laval, Quebec;
C) a Deed of Sale executed on June 12, 1995 between Les Constructions Marc Picard Inc. and the Bankrupt wherein the Bankrupt assumed repayment of the balance due under a loan made by Petitioner to Les Constructions Marc Picard Inc.; the balance assumed was $86,719.00 bearing interest at 8.375% per annum;
D) copy of the Declaration in an action instituted by Petitioner against the Bankrupt and Les Constructions Marc Picard Inc. on April 9, 2001, for the amount of $43,491.68 plus interest, which declaration sets out the details of the Bank's claim.

5 Nowhere in the Proof of Claim, nor in the supporting documents is there any mention that in addition to the proceeds from the judicial sale in the amount of $61,683.60 received by Petitioner, that Petitioner had also received from Canada Mortgage and Housing Corporation (hereinafter the CMHC) two payments, on November 11, 2000 and February 2001, in the amounts of $34,236.15 and $3,583.37 respectively on account of the same loan.

6 Mr. Labarre had filed an assignment in bankruptcy, on December 28, 2002, after payment of these sums from CMHC to Petitioner but prior to judgment being rendered in the Petitioner's action against him. Mr. Labarre was subsequently discharged from his bankruptcy on September 29, 2003.

7 On February 17, 2003 the Trustee disallowed the claim filed by Petitioner on the grounds that it was inaccurate and contained false information; that there was nothing due and outstanding to Petitioner itself; that Petitioner was acting as the undeclared representative of a third party, CMHC; and that having received payment from CHMC, it had no further interest as a creditor against the estate.

8 Petitioner appealed from the disallowance on March 19, 2003 on the grounds that

A) it is the authorized agent of CMHC under Canada Mortgage and Housing Corporation Act, R.S.C. 1985, c. C-7 and the National Housing Act, R.S.C. 1985, c. N-11.
B) it has been designated an approved lender under these laws and that as such, it is subrogated, pursuant to those laws and to Article 2474 C.C.Q. in the rights of and can take action on behalf of the C.M.H.C.

9 With the greatest respect, I cannot agree with the Petitioner's position.

10 The Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3 (hereinafter BIA) sets out the rules regarding the filing of proof of claims at Sections 121 and following. Sections 124 and 125 stipulate how and who may file a proof of claim, and the penalties for false claims:

> 124.(1) [Creditors shall prove claims] Every creditor shall prove his claim, and a creditor who does not prove his claim is not entitled to share in any distribution that may be made.

(2) [Proof by delivery] A claim shall be proved by delivering to the trustee a proof of claim in the prescribed form.

(3) [Who may make proof of claims] The proof of claim may be made by the creditor himself or by a person authorized by him on behalf of the creditor, and, if made by a person so authorized, it shall state its authority and means of knowledge.

(4) [Shall refer to account] The proof of claim shall contain or refer to a statement of account showing the particulars of the claim and any counter-claim that the bankrupt may have to the knowledge of the creditor and shall specify the vouchers or other evidence, if any, by which it can be substantiated...

> 125.[Penalty for filing false claim] Where a creditor or other person in any proceedings under this Act files with the trustee a proof of claim containing any wilfully false statement or wilful misrepresentation, the court may, in addition to any other penalty provided in this Act, disallow the claim in whole or in part as the court in its discretion may see fit.

11 Form 31 BIA provides the form whereby claims must be made. The proof of claim fyled herein, complies with that form. In it, Petitioner affirms the debt due on the date of the bankruptcy, and that the debt is still outstanding on the date of the claim.

12 Since proof of claims are generally filed by laypersons it is an accepted principle of law that a liberal approach must be used in the examination of these claims: technicalities are to be avoided, and clerical errors to be overlooked. On the other hand, the proof of claim must be as accurate as possible and must provide supporting documents and sufficient details, failing which the claim is deemed not to have any standing.

13 Amendments of claims should be allowed where an honest error has been made. The Court, in the exercise of its general authority, has the power to excuse formal defects and irregularities under s.187(9) BIA which provides that proceedings in bankruptcy should not be invalidated by any formal defect or irregularity, unless a substantial prejudice or injustice, which cannot be remedied by an order of the Court, has been caused.

14 Petitioner's position cannot be maintained on either of the grounds invoked.

15 Under s. 5(1) of the Act to Amend the National Housing Act and The Canada Mortgage and Housing Corporation Act, S.C., 1999, c. C-66 Petitioner has been designated as an approved lender.

16 Section 10 provides that where CMHC pays one of its approved lenders an insured loan, it is CMHC which is subrogated in the rights of the lender:

> "(1) The Corporation may make payments to approved lenders or to holders of insured loans, and may make loans or payments to borrowers or their assignees, for the purpose of avoiding or curing, in whole or in part, default under insured loans or facilitating variation of the terms of payment of insured loans, or for any other purposes that the Corporation considers appropriate to protect its interest as an insurer.

(2) If the Corporation makes a payment to an approved lender or holder of an insured loan under subsection (1), the Corporation is subrogated, to the extent of the amount of the payment, to all the rights and interests of the lender or holder in respect of that amount, and may maintain an action in respect of those rights and interests in the name of the lender or holder or in the name of the Corporation. Any money recovered by the lender or holder must first be applied against money owing to the lender or holder on account of the insured loan.

(3) The Corporation may waive the right of subrogation referred to in subsection (2)."

(Underlining added)

17 Section 20 provides that CMHC may designate an approved lender to act as its agent:

20. "The Corporation may authorize an approved lender to act as agent for the Corporation in the exercise of any of its powers or functions under this Part, including in a situation involving a loan made or administered by the lender."

18 In both these instances therefore, either the Petitioner has lost its rights to the extent of the payment it has received from CMHC, the latter being subrogated in the lender's right against the Borrower, or, if Petitioner has been appointed the agent of CMHC, the mandate must be disclosed.

19 Furthermore, Article 2474 Civil Code of Quebec, S.Q. 1991, c.64, provides that whenever there is payment by an insurer to an insured, there is subrogation or a transfer of rights from the insured to the insurer:

2474. "The insurer is subrogated to the rights of the insured against the person responsible for the loss, up to the amount of indemnity paid. The insurer may be fully or partly released from his obligation towards the insured where, owing to any act of the insured, he cannot be so subrogated."

20 In the present instance, it is the Petitioner, the insured or payee, who is attempting to invoke the rights of CMHC, the insurer or payor. However, under Art. 2474 C.C.Q by the operation of the law itself, there has been a transfer of rights from Petitioner in favour of CMHC to the extent of the payment received from it: Trépanier vs Plamondon, [1985] R.D.J. 277 (C.A.Q.). Since every person must exercise their civil rights under the name assigned to them, (Art. 5 C.C.Q.), and no person can plead in the name of another (Article 59 C.C.P.), Petition is precluded from acting on behalf of CMHC, save as may be provided under the BIA which specifies that representatives must declare their authority when fyling proofs of claim on behalf of others.

21 In any case, Petitioner has not complied with the requirement of the law by indicating pursuant to s. 124(3) BIA on whose behalf and by what authority it is acting.

22 This is not a question of a mere technicality or formality, but one of substance. A trustee must be furnished with sufficient accurate information to permit him to evaluate the claim against the bankrupt. The other creditors must have sufficient information to contest those claims. Finally there is the rule against double proof which is designed to assure the distribution of a bankrupt's assets on a pro-rata basis among unsecured creditors by insuring that the trustee does not pay two dividends on what is essentially the same claim: Re. Olympia and York Developments Ltd (1998), 4 C.B.R. (4th) 189 (Ont. Gen. Div.).

23 FOR THESE REASONS THEREFORE, THE COURT:

A) DISMISSES the Appeal;
B) RESERVES the right of Petitioner and/or CMHC to file their claims in the proper form within fifteen days of the present judgment;
C) ORDERS that no distribution of dividends be made in the estate until such time as the claims have been fyled, or, upon the expiry of the delay, whichever first occurs;
D) THE WHOLE WITH COSTS in favour of Respondent-Trustee.

DIONYSIA ZERBISIAS, J.S.C.

cp/i/qlspt

Tab 33

Indexed as:
Olympia & York Developments (Re)

IN THE MATTER OF the Bankruptcy of Olympia & York Developments Limited, a corporation incorporated under the laws of the Province of Ontario and having its principal place of business in the City of Toronto, in the Municipality of Metropolitan Toronto

[1998] O.J. No. 4903

80 O.T.C. 369

4 C.B.R. (4th) 189

84 A.C.W.S. (3d) 15

Court File No. 97-CL-000161

Ontario Court of Justice (General Division)
In Bankruptcy

Blair J.

November 26, 1998.

(30 pp.)

[Ed. note: A Corrigendum was released by the Court December 17, 1998 and the correction has been made to the text.]

Bankruptcy -- Claims provable -- What constitutes -- Creditors -- Rights, effect of bankruptcy of debtor -- Claims -- Severability -- Practice -- Evidence and proof -- Appeals -- From registrar's decision, nature of appeal -- Double proof.

Appeal by the Trustee in Bankruptcy of Olympia and York Developments Limited from a decision by the Registrar that a claim by York's creditor, A&G Lenders, and the claim of the Olympia and York Resources Credit Corporation did not constitute a double proof. Both of these claims arose out of a jumbo loan transaction. Resources had been incorporated for the sole intent of giving effect to the Jumbo Loan. The Registrar found that Resources had a separate corporate existence from York, that a genuine debtor and creditor relationship did exist between York and Resources, and that one

payment would not discharge both claimants' claims against York. The Trustee argued that allowing both claims amounted to a double proof. It was admitted that the A&G Lenders comprised substantially all of the creditors of Resources. However, the Trustee for Resources had filed a proof of claim in the York bankruptcy. York's Trustee was prepared to acknowledge one claim, either by Resources or the A&G Lenders, and argued that there was in substance only one debt. The respondents argued that the claim by Resources on the York debt and the claim of the A&G Lenders on the guarantee of the Resources debt were not claims in relation to the same debt.

HELD: Appeal allowed. The order of the Registrar was set aside. An order was granted directing that the claims of the A& G Lenders and of Resources against the estate of York constituted a double proof against the estate. There was a declaration that the A&G Lenders and Resources were entitled to rank for payment of one dividend out of the estate of York. The loan from the A&G Lenders to Resources and the continuing loans of the same funds from Resources to York were in substance the same debt. There was an inseparable nexus between the obligation of Resources to pay the A&G Lenders and the obligation of York to make payments to Resources. The Registrar erred in law by finding that the existence of a separate corporate entity and a debtor and creditor relationship between the parent and the subsidiary meant that the same-debt-in-substance test could not be met.

Statutes, Regulations and Rules Cited:

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

Counsel:

Geoffrey B. Morawetz and Benjamin T. Glustein, for Pricewater-house Coopers Inc. (formerly Coopers & Lybrand Limited), in its capacity as the trustee in bankruptcy of Olympia & York Developments Limited.
Benjamin Zarnett, PricewaterhouseCoopers Inc., (fomerly Coopers & Lybrand Limited, in its capacity as the trustee in bankruptcy of Olympia & York Developments Limited.
John A. MacDonald and Arthur Peltomaa, for Credit Lyonnais Canada, in its capacity as security agent for the A&G Lenders, and Deloitte & Touche, in its capacity as trustee in bankruptcy of Olympia & York Resources Credit Corporation.

BLAIR J.:--

I. OVERVIEW AND BACKGROUND

Overview

1 The issues on this appeal turn on what is known as the rule against double proof in bankruptcy matters.

2 Olympia & York Developments Limited ("OYDL") and Olympia & York Resources Credit Corporation ("OYRCC") are bankrupt corporations.[1] OYRCC is a wholly owned subsidiary of OYDL created for the single purpose of receiving the sum of US $2.5 billion by way of what was

termed a "Jumbo Loan" from a syndicate of lenders known as the "A&G Lenders". Immediately upon receipt, the monies were advanced by OYRCC to OYDL, which gave back a Promissory Note and entered into a Repayment Agreement with OYRCC. OYDL also guaranteed the OYRCC indebtedness to the A&G Lenders.

3 It is admitted that the A&G Lenders comprise substantially all of the creditors of OYRCC. In fact, they are the only creditors who have filed proofs of claim in the OYRCC bankruptcy. All of the inspectors in that bankruptcy are representatives of the A&G Lenders.

4 Deloitte & Touche, the trustee in bankruptcy for OYRCC, has filed a proof of claim in the OYDL bankruptcy for the principal amount of the loan -- which remained outstanding in full at the time of the insolvency proceedings -- together with interest. At the same time, the A&G Lenders have also filed a proof of claim in the OYDL bankruptcy, based upon the OYDL guarantee of the OYRCC indebtedness, together with interest.

5 OYDL's Trustee disallowed the claims on the ground that they constitute a double proof of claim against the estate for the same debt. It was, and is, prepared to acknowledge one claim, by either OYRCC or the A&G Lenders. The amount the Trustee is prepared to acknowledge is the sum of $1,759,108,979 (Cdn), representing the outstanding principal on the Jumbo Loan less the sum of $1,281,281,018 (Cdn) recovered by the A&G Lenders on security pledged to it to guarantee the Jumbo Loan by certain OYRCC subsidiaries.[2]

6 Both the A&G Lenders and the Trustee in Bankruptcy of OYRCC appealed the disallowances to the Registrar in Bankruptcy. On May 21, 1998, Registrar Ferron allowed the appeals, Re Olympia and York Developments Ltd., [1998] O.J. No. 2114. OYDL's Trustee now appeals from the decision of Registrar Ferron, and seeks,

(a) an Order setting aside the decision of the Registrar;
(b) an Order that the claims of the A&G Lenders and of OYRCC against the estate of OYDL ("the Claims") constitute a double proof against the estate;
(c) a declaration that the A&G Lenders and OYRCC may rank for payment of one dividend out of the estate of OYDL based on a claim in the sum of $1,759,108,979 (Cdn); and,
(d) costs.

Background

7 In December 1988, OYDL and the A&G Lenders began negotiations in respect of what was to become the $2.5 billion (U.S.) loan facility. A commitment letter from Credit Lyonnais to OYDL, dated December 1988, set out the initially proposed terms. The borrower for purposes of the loan facility was to be a wholly owned subsidiary of OYDL and OYDL was to guarantee the Loan. The proposal was that the Loan Agreement and other documents would contain covenants and other provisions "as are usual in Olympia & York loan agreements". The commitment letter concluded by saying that Credit Lyonnais was "very pleased to have this opportunity to provide this facility to Olympia & York and [looked] forward to the continuation of [their] mutually beneficial relations".

8 The negotiations eventually ripened into the Jumbo Loan transaction -- or, more accurately, series of transactions.[3] Except for US $500 million which was remitted directly to OYDL by one of the lenders upon the direction of OYRCC, the funds were advanced by the A&G Lenders to

OYRCC. OYRCC, in turn and on the same day, "onloaned" the monies to OYDL. At the end of the day, OYDL had a loan facility of US $2.5 billion.

9 In exchange, OYDL (a) gave its guarantee of the OYRCC indebtedness to the A&G Lenders (the "OYDL Guarantee") not just as guarantor but also as principal debtor, (b) agreed to maintain a current value net worth of at least US $2.5 billion throughout the life of the facility, (c) executed a Promissory Note in the principal amount of US $2.5 billion in favour of OYRCC, and (d) entered into a Repayment Agreement in that regard with OYRCC. Apart from the OYDL Guarantee, the central underlying security which the A&G Lenders received from the Jumbo Loan consisted of a pledge of the shares that OYDL held (indirectly through subsidiaries) in Abitibi Price Inc. ("Abitibi") and in Gulf Canada Resources Limited ("Gulf").

10 The Jumbo Loan arrangements were somewhat complex, and had their business and tax driven aspects. For a schematic representation of the transaction, reference may be made to the diagram which is attached as Schedule "A" to these Reasons. In narrative terms, the specific arrangements were as follows:[4]

(a) the shares of Abitibi and Gulf, formerly held by a number of corporations in the O&Y Group would be transferred to Olympia & York Forest Holding Limited ("Forest") and Olympia & York Energy Holdings Limited ("Energy"), respectively;
(b) the shares of Forest and of Energy would be wholly owned by A&G Resources Corporation ("A&G Resources");
(c) the shares of A&G Resources would be wholly owned by OYRCC;
(d) the shares of OYRCC would be wholly owned by OYDL;
(e) all existing loans secured prior to that date by Abitibi and Gulf shares owned by the O & Y Group would be repaid in an amount sufficient to release those shares from existing security;
(f) the A&G Lenders would advance the Jumbo Loan;
(g) the A&G Lenders would take indirect security over the Abitibi and Gulf shares by taking a pledge of the shares of A&G Resources from OYRCC;
(h) A&G Resources would (i) guarantee OYRCC's obligations to the A&G Lenders, (ii) provide a negative pledge in respect of the Abitibi and Gulf shares held by Forest and Energy respectively, and (iii) pledge the shares of Forest and Energy in favour of the A&G Lenders;
(i) OYDL would obtain the use of the funds advanced; and,
(j) OYDL would guarantee the obligations of OYRCC to the A&G Lenders.

11 In accordance with the agreements, OYRCC and its wholly owned subsidiary, A&G Resources, and its wholly owned subsidiaries, Forest and Energy, were all incorporated under the Business Corporations Act (Ontario). OYRCC is a single purpose subsidiary of OYDL, incorporated for the sole intent of giving effect to the Jumbo Loan. It has no source of income other than a 1/16th percentage spread on the interest rate paid by OYRCC to the A&G Lenders. Its only asset, apart from the shares of A&G Resources (which were pledged to the A&G Lenders as security for the Jumbo Loan), is its claim against OYDL. The A&G Lenders, as I have already noted, are substantially the only creditors of OYRCC.

12 The terms of the Jumbo Loan, as between OYRCC and the A&G Lenders are set out in four separate Term Loan Agreements (one for each applicable lender or syndicate of lenders), and, symmetrically, OYDL provided four separate guarantees of OYRCC's obligations under the Jumbo Loan (collectively, "the OYDL Guarantee"). As between OYRCC and OYDL, the transactions are evidenced by the Promissory Note and the Repayment Agreement.

13 The Term Loan Agreements reflect the loan transaction as between the Borrower, OYRCC, and the particular lender or syndicate of lenders in question. They do not refer specifically to the back-to-back loan from OYRCC to OYDL. However, their provisions do reflect a connection with the OYDL Guarantee and with the security afforded by the pledge of the A&G Resources shares (and, indirectly, the pledge of the Abitibi and Gulf shares). These provisions include,

* cross-default clauses (a default under the OYDL Guarantee is a default under the Term Loan Agreements; the insolvency of OYDL is a default under the Terms Loan Agreements);
* a term that the Lenders must consent in writing to any amendment or waiver of any provision not only of the Term Loan Agreements but also of any document referred to therein (e.g., the OYDL Guarantee) and, in addition, must consent in writing to "any departure by the Borrower or any other O&Y Corporation"[5] which is a party to such a document from the terms of such a document; and, in this latter connection specifically, includes,
* a clause requiring written Lender consent to any agreement "to a reduction in the Required Net Worth (as that term is defined in the [OYDL] Guarantee").

14 The "Required Net Worth (as that term is defined in the [OYDL] Guarantee") is a reference to the covenant of OYDL that its net worth would not fall below US $2.5 billion, i.e. the amount of the Jumbo Loan advance.

15 The contractual arrangements between OYRCC and OYDL reflect an integration with the Term Loan Agreements. The Repayment Agreement, the Promissory Note and the Term Loan Agreements are all dated on March 21, 1989, the same day the back-to-back loans were advanced. A reading of the Repayment Agreement and the Promissory Note together demonstrates that payments by OYDL under the Promissory Note and payments by OYRCC under the Term Loan Agreements are interrelated. For instance, the preamble to the Repayment Agreement states:

> AND WHEREAS it is the intention of OYDL and [OYRCC] that the unpaid principal amount of the Note shall at all relevant times be equal to the aggregate unpaid principal amounts of the Reference Tranches (as defined in the Note)[6].

16 The Promissory Note provides that the interest rates payable and the timing of the interest payments by OYDL, to OYRCC under the Promissory Note are a function of the interest rates payable by OYRCC under the Term Loan Agreements. The interest rate payable by OYDL to OYRCC is 1/16th% greater than the rate payable by OYRCC to the A&G Lenders. Moreover, the Note also stipulates that OYDL is obligated to pay additional sums to OYRCC that OYRCC itself may be required to pay under the Term Loan Agreements for such things as additional interest owing on ac-

count of late payments of principal or amounts owing with respect to an indemnity given to the A&G Lenders by OYRCC for costs incurred as a result of default.

17 Most significantly for purposes of the Appellant's argument here, sections 3 and 4 of the Repayment Agreement specify that:

> 3. If it becomes known to [OYRCC] that the whole or any part of the principal amount of any Reference Tranche will be paid by it or will become or has become due and payable by it pursuant to [certain provisions in the Term Loan Agreements], then [OYRCC] shall so notify OYDL to the extent that notice of the particulars of such event has not already been given by it pursuant to [another provision of the Term Loan Agreement].
> 4. OYDL shall make payments of principal under the Note to [OYRCC] at such time or times and in such amounts as payments of principal are made by [OYRCC] under the Term Loan Agreements. (emphasis added)

The Registrar's Decision

18 Registrar Ferron held that the two claims did not constitute a double proof. In doing so, he focussed on the following factors as of particular importance (with the results indicated):

> (a) whether "a resulting genuine debtor/creditor relationship between OYDL and OYRCC in fact exist[ed] or whether, having regard to the close corporate relationship which existed between the parent and the subsidiary, the circumstances surrounding the genesis of the credit facility, the terms of repayment and the evidence of the loan, such a relationship could not have arisen" (the Registrar found that a genuine debtor/creditor relationship did exist);
> (b) whether one payment would discharge both claimants' debts against OYDL (he held it would not);
> (c) whether OYRCC had a separate corporate existence (he found that it did).

19 With respect to his finding on the last factor, the Registrar relied on an English decision, Re Polly Peck International plc (in administration) [1996], 2 All E.R. 433 (Ch. Div.) ("Polly Peck"), a case with facts similar to the case at bar.

Positions of the Parties

20 The Respondents argue that the interrelationship which OYDL and OYRCC have set up between the Repayment Agreement, the Promissory Note and the Term Loan Agreements is irrelevant to the proof of claim issue and of no Concern to the A&G Lenders. They contend that there were two separate loans and thus, there are two separate debts. They argue that the Registrar correctly applied the rule against double proof in bankruptcies by concluding that the rule did not apply because the claim of OYRCC (on the OYDL debt) and the claim of the A&G Lenders (on the guarantee of the OYRCC debt) are not claims in relation to the same debt. Furthermore, he properly relied upon and applied the principles set out in Polly Peck.

21 The Trustee of OYDL submits that the Registrar erred in concluding that the OYRCC claim and the A&G claim did not amount to claims for the same debt twice over, thereby constituting a double proof. He says the Registrar misconstrued or failed to consider the constating documents re-

lating to the Jumbo Loan and in particular, the provisions of the Promissory Note and the Repayment Agreement cited earlier in these Reasons. The Registrar erred in requiring a finding that OYRCC had no real separate corporate existence or that there was no genuine debtor/creditor relationship between OYDL and OYRCC before he could find that the claims were based on the same debt. The Trustee states that the substance of the transaction, not the form counts and here there is in substance only one debt, namely the US $2.5 billion Jumbo Loan.

II. LAW AND ANALYSIS

Standard of Review

22 An appeal from the Registrar in Bankruptcy is a true appeal, and not a hearing de novo. The appellant must satisfy this Court that the Registrar arrived at an incorrect result in law. Rosenberg J. summarized this standard of review in the following fashion, in Re Kenny (1997), 149 D.L.R. (4th) 508 (Ont. Gen. Div.), at pp. 514-515:

> An appeal under s. 192(4) of the BIA from an "order" of a Registrar is a true appeal and not a hearing de novo. Accordingly, the appellant must satisfy the court that the Registrar erred in principle or in law in the way he has applied or exercised his discretion or that he omitted the consideration of, or misconstrued some fact (citations omitted).

The Rule Against Double Proof

23 The rule against double proof in bankruptcy matters prohibits two proofs of claim in the same estate for the same debt. That the two claims may be based on separate contracts is of no matter, provided they are in respect of the same debt. Sir G. Mellish L.J. put the concept very succinctly in Re Oriental Commercial Bank; Ex parte European Bank (1871), 7 L.R. Ch. App. 99, where he stated (at pp. 103-104):

> [T]he true principle is, that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts. (Emphasis added)

24 See also, Barclays Bank Ltd. v. TOSG Trust Fund Ltd., [1984] 1 All E.R. 628 (C.A.), at pp. 636-637, affirmed on different grounds [1984] 1 All E.R. 1060 (H.L.); Houlden & Morawetz, Bankruptcy and Insolvency Law of Canada 3rd ed., at paragraph G-40; Re Melton; Milk v. Towers [1918] 1 Ch 37, at p. 47.

25 There is a reason for this rule. It was developed to ensure the pari passu distribution of the assets of the bankrupt on a pro rata basis amongst the unsecured creditors -- the central tenet of bankruptcy legislation.[7] In the words of Oliver L.J. in Barclays Bank, supra, at p. 653:

> p. 653 ... The purpose of the rule is, of course, to ensure pari passu distribution of the assets comprised in the estate of an insolvent in pro rata discharge of his liabilities. The payment of more than one dividend in respect of what is in substance the same debt would give the relevant proving creditors a share of the available assets larger than the share properly attributable to the debt in question.

26 The Parties do not disagree as to the foregoing statement of the rule against double proof, or as to the rationale underlying it. They simply disagree as to its application in the circumstances of this case.

The Authorities

27 Whether or not a "double proof" has been lodged with respect to what is in substance the same debt is a matter to be determined on the facts of each individual case. From my understanding of the authorities, the underlying principles which should frame this analysis in group corporate insolvency situations may be summarized as follows. First, where the interests of different creditors of the various corporate entities come into play, the courts should be careful to respect the axiom regarding separate corporate existence enunciated by the House of Lords in Salomon v. Salomon [1897] A.C. 22. At the same time, however, the courts should strive to give effect to the ethic of pari passu distribution and to the fundamental underlying principle of justice as between all creditors. Balancing these sometimes competing principles calls for a consideration of the true nature of the transaction, and the relationship between, and the presumed common intention of the parties. Finally, in seeking a just solution in novel situations the court may engage in an analysis which, while not ignoring the separate corporate being of the members of the corporate group, nonetheless transcends the mere legal fact of that existence. See in particular, as to the foregoing summary, Ford & Carter Ltd. v. Midland Bank Ltd. (1979) 129 NLJ 543, per Lord Wilberforce at p. 544; Polly Peck, supra, at pp. 444-445; and Barclays Bank, supra, per Kerr L.J., at pp. 645 and 647-648, and per Oliver L.J. at pp. 636 and 640.

28 In insolvency cases -- as in, for example, tax cases -- the court will not allow technicalities to obscure the essence of the transaction. This includes, in my opinion, not being either too dazzled or too immobilized by intricate corporate footwork which is designed to accomplish legitimate business and tax purposes, but which may not be as directly dispositive in resolving insolvency cases. This point was emphasized by Oliver L.J. in Barclays Bank at pp. 640 and 636:

> p. 640: This argument is perfectly intelligible, and indeed almost unanswerable if one regards the payment of those customers who were paid to TOSG as an entirely separate transaction isolated from any other arrangement made with the agency, but to my mind it ignores the reality. If one is to look for analogies, it is, I think, essential first to analyse what the total effect of the arrangements was and the reasoning behind them. All the cases stress that in relation to the rule against double proofs it is the substance and not the form that is to be regarded (see eg Re Melton, Milk v. Towers [1918] 1 Ch 37, at 60, [1916-17] All ER Rep 672 at 683, Re Oriental Commercial Bank (1871) LR 7 Ch App 99). (emphasis added)
>
> p. 636: I accept the submission of counsel for TOSG and the agency that the rule ought more properly to be styled the rule against double dividends, for its object is to absolve the liquidator from paying out two dividends on what is essentially the same debt ... (emphasis added)
>
> Second, it is, I think, a fallacy to argue ... that, because overlapping liabilities result from separate and independent contracts with the debtor, that, by itself, is determinative of whether the rule can apply. The tests is in my judgment a much broader one which transcends a close jurisprudential analysis of the per-

sons by and to whom the duties are owed. It is simply whether the two competing claims are, in substance, claims for payment of the same debt twice over. (Italics in original; underlining added)

Application of the Rule in the Circumstances of this Case

29 To adopt the language of Oliver L.J., then, what is "the total effect of the arrangements ... and the reasoning behind them" in the circumstances of this case? In my view, a careful reading of all of the documentation including in particular, the Repayment Agreement, supports the conclusion that the "loan" from the A&G Lenders to OYRCC and the "on-loaning" of the same funds from OYRCC to OYDL are in substance the same debt.

30 Notwithstanding the complex structure of the arrangement from a commercial/corporate/tax perspective, the economic and financial reality of the Jumbo Loan deal -- its substance, if you will -- is simple and clear: a US $2.5 billion loan facility was lent by the A&G Lenders to OYDL on the strength of (a) the OYDL covenant and, (b) the security of the Abitibi and Gulf shares. In my opinion, in the particular circumstances of this case, the legal substance of the transaction is to he same effect[8].

31 The documents in this case demonstrate that, from the perspective of the A&G Lenders, the loan facility was backed by the OYDL covenant and by the security of the Abitibi and Gulf shares. Moreover, while the funds were being advanced, technically, to OYRCC, it is clear from the Credit Lyonnais commitment letter that the lenders were providing the facility to OYDL. The A&G Lenders were not privy to the internal fashion in which the Olympia & York corporations structured the deal. Nevertheless, the structure suggests a closely intended connection between the obligation of OYDL to make payments to OYRCC and the obligation of OYRCC to make payments to the A&G Lenders.

32 In this latter regard, particular reference may be made to the requirement in the Repayment Agreement that payments of principal under the Note are to be made "at such time or times and in such amounts as payments of principal are made by [OYRCC] under the Term Loan Agreements". Furthermore,

* The funds were initially advanced by the A&G Lenders and "on-loaned" to OYDL on the same date that the Term Loan Agreements, the Promissory Note, the Repayment Agreement were executed;

* OYRCC was incorporated for the sole purpose of receiving the funds from the A&G Lenders and forwarding those funds to OYDL, and, apart from the receipt of the 1/16th% spread on the interest rate, OYRCC did not transact any other business;

* the timing and rate of interest payments under the Promissory Note were directly tied to the interest payments to be paid by OYRCC under the Term Loan Agreements;

* OYDL agreed under the Promissory Note to pay additional sums to OYRCC that may be payable by OYRCC to the A&G Lenders in certain circumstances such as default in interest; and, finally,

* the Repayment Agreement states in its recitals that it was the intention of OYDL and OYRCC that the unpaid principal amount of the Promissory Note would be equal to the aggregate unpaid principal amounts under the Term Loan Agreements.

33 There is thus an "inseparable nexus"[9] between the obligation of OYRCC to pay the A&G Lenders and the obligation of OYDL to make payments to OYRCC. The agreements contemplate the former will occur before the latter are called for. The circle is closed, it seems to me, with OYDL's agreement to be bound as principal debtor and by the fact that, for all practical purposes, the A&G Lenders are the only creditors of OYRCC.

34 To my mind these circumstances lead to the inescapable inference that the parties intended that there would be a single US $2.5 billion loan facility made available to OYDL on the strength of the OYDL covenant and the security of the Abitibi and Gulf shares, and that the A&G Lenders would look to OYDL ultimately and primarily, if not solely, for payment. It was not the common intention of the parties that in the event of the bankruptcy of both OYDL and OYRCC, the A&G Lenders would be able to recover a dividend based upon 200% of their claim, which would be the effect if the claims put forward by ARCH and the A&G Lenders are both allowed to stand.

The Registrar's Decision and the "Genuine Debtor-Creditor", "Separate Corporate Existence", and "Group Enterprise" Issues

35 Registrar Ferron concluded that there existed a genuine debtor-creditor relationship between OYDL and OYRCC and that there was nothing in the circumstances which would allow him to disregard the separate corporate existence of OYRCC. In my view, these conclusions are simply mirror images of each other. Registrar Ferron said:

> If one acceded to the position taken by the trustee of OYDL and concluded that OYRCC's loan to its parent company was of no significance, the transaction involving the loan from the A&G Lenders would have to be seen as something of a sham and that [the] A&G Lenders were misled in loaning funds to OYRCC which until this point no one denied. [OYRCC] had a corporate existence separate and distinct from its parent including the capacity to borrow and loan funds.

36 While the latter observation is accurate, it is not conclusive; and, in my respectful view, the learned Registrar erred in law in deciding that once he found the existence of a separate corporate entity and a debtor-creditor relationship between parent and subsidiary, the same-debt-in-substance test could not be met. The case law illustrates that the existence of separate and distinct claims or liabilities is not determinative of the double proof issue. The crucial question is whether or not the separate and distinct claims relate in substance to the same debt. For the reasons that I have outlined, I am satisfied that they do.

37 In concluding that a separate corporate existence was dispositive of the double proof issue, the Registrar relied heavily upon the decision of the English Court of Chancery in Polly Peck. This decision warrants careful consideration, although in the end I am satisfied that it is distinguishable from the circumstances of this case and, in any event, not dispositive or the issues to be determined.

38 The factual situation in Polly Peck, on the surface, is remarkably similar to this case. It involved a large multi-national group of companies (the "PPI Group"), the use of a special purpose subsidiary as a financial vehicle for the raising of funds for the Group ("PPIF"), a resulting intra-corporate indebtedness with the initial loan to the special purpose subsidiary being guaranteed by the parent ("PPI") and the funds being "on-loaned" to the parent by the subsidiary. It also involved the insolvency of both the parent company and the special purpose subsidiary. Robert Walker J. reviewed all of the arguments which have been put forward in this case. He rejected the argument that the special purpose subsidiary had no separate corporate existence and was in effect an agent or nominee of the parent, or, that it was a mere façade, on the basis of the well-known principles of separate legal identity established in Salomon v. Salomon, supra. He also rejected the argument that in circumstances such as these, a closely-integrated group of companies should be considered as a single economic unit -- saying that he found those submissions of counsel "most persuasive", but concluding that he was "not ultimately persuaded by them": supra, p. 447. His reasons in this regard are carefully considered, and I quote them in full (supra, pp. 447-448):

> The arguments for considering a closely-integrated group of companies as a single economic unit were fully considered (principally in the context of corporate presence as founding jurisdiction) in Adams v. Cape Industries plc [1991] 1 All ER 929 at 965, [1990] Ch 433 at 476-477, both by Scott J and, with a full citation of authority, in the judgment of the Court of Appeal (see [1991] All ER 929 at 1016-1020, [1990] Ch 433 at 532-537). Both passages merit careful study. The Court of Appeal concluded that --
>
> > 'save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of Salomon v. Salomon & Co Ltd, [1897] AC 22, [1895-9] All ER Rep 33 merely because it considers that justice so requires.' (See [1991] 1 All ER 929 at 1019, [1990] Ch 433 at 536.
>
> Mr. Kosmin seeks to add to these exceptions (turning on particular statutes or contracts) a further exception where a rule of law founded in public policy (the rule against double proof) would be frustrated by ignoring the economic reality of the single group. In that submission Mr. Kosmin can and does call in aid the words of Oliver LJ in Barclays Bank Ltd. v. TOSG Trust Fund Ltd [1984] 1 All ER 628 at 636-7, [1984] AC 626 at 636 that the test is 'a much broader one which transcends a close jurisprudential analysis of the persons by and to whom the duties are owed'.
>
> Nevertheless I am not persuaded by the argument. I can accept that as a matter of economic reality the bondholders (whose presumed intentions may be material) must have intended to rely on the credit-rating and covenant of PPI, whether as guarantor or (after substitution) as principal obligor. It is doubtful whether even the most farsighted of them can have calculated that in the event of a crash, PPIF might have fewer unsecured creditors than PPI, and a claim against PPI on the loan. It was perfectly possible, consistently with each prospectus, that the proceeds of some or all of the bond issues would be loaned on, not to PPI, but

> to other group subsidiaries. It is also possible, though less likely, to imagine a situation in which PPIF lent on to another subsidiary, with PPI guaranteeing that borrowing also, and the second subsidiary then lending on to PPI. Each of those sequences of events would be likely to produce a different result in the event of a crash of the whole group, whether or not the rule against double proof has any application. The possibility of there being subsidiaries which were not wholly owned subsidiaries adds to the range of imaginable variations.
>
> Were I to accede to Mr. Kosmin's submission it would create a new exception unrecognised by the Court of Appeal in Adams v. Cape Industries plc and that is not open to me. Moreover I think that Mr. Kosmin is in one sense assuming what he seeks to prove, since the unjust or inequitable result which he asserts does not occur unless the group is recognised as being in substance a single economic entity, whose constituent members' internal rights and obligations are to be disregarded. But the authorities to which I have already referred show that substance means legal substance, not economic substance (if different), and that legal existence of group companies is particularly important when creditors become involved. Injustice may be in the eye of the beholder, but I do not perceive any obvious injustice -- certainly not such as the court can remedy -- the unpredictable consequences that may follow from the unforeseen insolvency of a large international group of companies such as the Polly Peck group.

39 Polly Peck is distinguishable from this case in a number of ways, however. In Polly Peck, Robert Walker J. specifically noted the exception alluded to in Adams v. Cape Industries plc, supra, involving "cases which turn on the wording of particular statutes or contract". In that case, there was no evidence of an inseparable legal nexus between the two loans in the structure of the transaction. Thus, the parent's obligation to pay under the "onloaned" transaction was not dependent upon the subsidiary's payments being made under the underlying transaction structured between the lender and the subsidiary, which is the situation in this case. Additionally, while in Polly Peck the parent had the option of substituting itself as a principal obligor, it was not obliged to do so. Here OYDL had committed itself as a principal obligor in the Jumbo Loan, and accordingly, as a matter of law it had become a "full-fledged principal debtor with all of the duties and obligations that term implies": Manulife Bank of Canada v. Carlin, supra, pp. 436-437. Finally -- and significantly -- the lenders in Polly Peck were not the only substantial creditors of the subsidiary corporation, PPIF, whereas in this case, under the structure of the transaction, the A&G Lenders would only ever be the substantial creditors of OYRCC.

40 In my view, it is not necessary to be overly concerned in this case about "piercing the corporate veil", "separate corporate entity", or whether concepts such as a "group enterprise theory" or a "single economic unit" theory should be considered. The case does not fall to be decided on any of these bases. It falls squarely into one of the recognized exceptions to the principle of Salomon v. Salomon. It is a case which turns on the wording of a particular contract, or contracts.

41 Moreover, the reality flowing from the fact that the A&G Lenders are the only creditors of OYRCC for these purposes (and for practical purposes would only ever be) is that the A&G Lenders will recover a dividend in the OYDL bankruptcy on the basis of 200% of the debt owing to them whereas other creditors of OYDL will be obliged to accept solace on the basis of only the amount of

their claims. This result is fundamentally contrary to the foremost underlying principal of bankruptcy legislation, and should be resisted. It is in reality, a double proof, and accordingly cannot be allowed.

42 Notwithstanding that this motion may be determined on the particular wording of the overall governing contractual documentation, I do not hesitate to say that in my view it is appropriate for the Court to have regard to the intra-corporate group aspects of the Jumbo Loan for purposes of assessing the overall nature of the transaction from a legal perspective. This is not a case of piercing the corporate veil, of arguing agency or sham, or of denying the existence of separate corporate vehicles in the same group enterprise. It is not a question of attempting to fasten some corporate entity with a liability attributable on Salomon v. Salomon principles to some other corporate entity simply because they both belong to the same enterprise of economic unit. It is simply a question of looking at the total picture in order to determine "total effect of the arrangements", or, to put it another way, to determine the legal substance of the transaction.

43 This approach is well accepted, for instance, in tax cases, where it is necessary for the Court to sort out what is the essence of a transaction: see, for example, De Salaberry Realties Ltd. v. Minister of National Revenue (1974), 46 D.L.R. (3d) 100 (Fed.Ct., T.D.); Alberta Gas Ethylene Co. v. R. (1988), 41 B.L.R. 117 (Fed.Ct., T.D.). In the latter case, where the facts were strikingly similar to those here, Reed J., in refusing to ignore the separate corporate entity of a subsidiary made the following observation:

> ... I do not interpret the jurisprudence as ignoring the existence of subsidiary corporations per se. Rather, it seems to me that the jurisprudence proceeds on the basis that in certain circumstances, consequences will be drawn despite the legal existence of separate subsidiary corporations. (Emphasis added)

44 I agree. Here, at least for purposes of assessing proofs of claim in the parent company's bankruptcy, the consequences of the circumstances as they exist -- the "total effect of the arrangements" -- are that the Jumbo Loan is a same debt transaction "despite the legal existence" of the separate subsidiary, OYRCC.

Other Issues

One Payment for Discharge of Both Debts

45 In Barclays Bank, supra, Oliver L.J. postulated, as a test for determining whether there was a double proof, "the question whether two payments are being sought for a liability which, if the company were solvent, could be discharged as regards both claimants by one payment". (Emphasis added)

46 Registrar Ferron considered this test for determining whether the rule against double proof had been contravened, and concluded that the test was not met on the facts of this case. He said:

> If OYDL were to pay the A&G Lenders under the guarantee this could not affect the loan due to OYRCC under its note. Similarly, if OYDL were to pay OYRCC and thus discharge the Promissory Note, the obligation under the guarantee would still exist and be enforceable. One payment would not discharge both claimants' debts against OYDL and accordingly, on the test suggested by Oliver, L.J. the rule is not offended.

47 I respectfully disagree. The Registrar's conclusion flows from a misunderstanding of the constating documents which frame the Jumbo Loan deal. Suppose, for example, that OYDL remained solvent, but that OYRCC had become insolvent and unable to pay the A&G Lenders. One payment by OYDL to the A&G Lenders would satisfy its liability on the OYDL Guarantee, and would eliminate the liability as between the A&G Lenders and OYRCC. There would accordingly be no further payments to be made by OYRCC under the Term Loan Agreements; and, since OYDL's obligation under the Note is to pay interest on the principal at the times provided in the Term Loan Agreements, and under the Repayment Agreement is "to make payments of principal under the Note to [OYRCC] under the Term Loan Agreements", OYDL could have no more liability to OYRCC under the Promissory Note. Thus, one payment would discharge both debts, having regard to the total contractual framework of the arrangement.

48 Working the single payment analysis from the other direction, namely by means of a payment by OYDL to OYRCC on the Note is a little less clear and more cumbersome. From a practical point of view, however, the effect would have been the same. No payment of principal was called for by OYDL to OYRCC until, and to the extent that, OYRCC had made payments on the loan. Accordingly, the liability of OYDL to the A&G Lenders on the OYDL Guarantee would have been reduced in the same amount. Even though OYDL technically had the right to prepay OYRCC under the terms of the Promissory Note and there is nothing specific in the agreements requiring OYRCC to remit payment to the A&G Lenders in return in such event, one payment would unquestionably discharge all debts if made by OYDL via the A&G Lender route, as I have indicated, and that, in my view, is sufficient to meet the "same debt" test. I see nothing in the decision in Barclays Bank mandating a contrary conclusion.

Creating a 'Double Proof' in the OYRCC Bankruptcy?

49 The Respondents argue that to accede to the "double proof" submissions of OYDL's Trustee would be to sanction a double proof situation in the OYRCC bankruptcy. This would be so because OYDL would in effect be receiving full credit for its indebtedness down to its subsidiary, OYRCC. This would deprive OYRCC's creditors (including those other than the A&G Lenders) of a right to share in that asset of OYRCC; and, at the same time, it would unjustifiably advantage OYDL's creditors by providing more money for them at the parent level.

50 The short answer to this submission is that it is premised on the proposition OYRCC had or might have had other creditors. However, that is not the case. The A&G Lenders are the only creditors of OYRCC, for these purposes. Given the contractual framework established for the Jumbo Loan, there would never be any other creditors of OYRCC with claims of any significance relative to those of the A&G Lenders, since OYRCC was limited in its ability to create further indebtedness which would exceed 1% of the Jumbo Loan. Thus, in the circumstances of this case, the "double proof" lies in the OYDL estate and not in the OYRCC estate.

Reduction of Claims on Account of Recoveries from Third Parties

51 The A&G Lenders have recovered the sum of $1,281,281,018 (Cdn) through their efforts to realize on the security pledged in relation to the Abitibi and Gulf shares. On a motion for directions which resulted in orders made on February 13 and April 14, 1997, Farley J. required the A&G Lenders to deduct such amounts from their claims on the OYDL Guarantee. His orders were affirmed on appeal. It is therefore accepted that these sums must be deducted from the A&G Lenders side of the claim in the OYDL bankruptcy.

52 The Respondents submit, however, that if the claim of OYRCC in the OYDL estate is permitted to proceed -- even if the A&G Lender claim on the OYDL Guarantee is not -- it should be permitted to proceed without any similar deduction being made. This result might well follow, I think, if the view to be taken of the matter were that expressed by the learned Registrar. For the reasons I have outlined above, however, I am respectfully of the opinion that the view of the Registrar constituted an error in law and reflected a misapprehension of the factual and contractual basis underlying this case.

53 Because the amount still owing to the A&G Lenders has been reduced by the amount of the recovery on its other security, OYRCC's obligations to the A&G Lenders have been reduced by a similar amount. Under the Repayment Agreement, OYRCC is only able to call upon OYDL to make payments under the Promissory Note when, and to the extent that, it has itself made payments under the Jumbo Loan. In the circumstances now existing, it cannot be called upon to make payments which have already been made in the form of recovery on other security. Thus, it cannot have a claim against OYDL for more than what remains as the outstanding amount of the Jumbo Loan.

54 Therefore, in my view, to the extent that the OYRCC Claim in the OYDL bankruptcy is put forward it must be reduced by the amounts recovered by the A&G Lenders on their other security.

III. CONCLUSION

54a Accordingly,

a) the order of the Registrar is set aside;
b) an order is granted directing that claims of A&G Lenders and of OYRCC against the estate of OYDL constitute a double proof against the estate;
c) a declaration is granted that the A&G Lenders and OYRCC may rank for payment of one dividend out of the estate of OYDL based on a claim in the sum of $1,759,108,979.00 (Cdn.); and,
d) the Appellant is entitled to its costs of the appeal and of the proceeding before the Registrar.

[The Court did not number this paragraph. QL has assigned the number 54a.]

BLAIR J.

[Editor's note: Schedule "A" could not be reproduced online.]

cp/s/aaa/mjb/DRS/qlsxs

1 The bankruptcies followed an earlier re-structuring of OYDL and some 28 of its directly and indirectly owned subsidiaries, under the Companies' Creditors Arrangement Act (the "CCAA").

2 In separate proceedings and by Orders dated February 13 and April 14, 1997, Farley J. held that the A&G Lenders were required to deduct the sums recovered on such security from the amount of their claim. His Orders were upheld by the Court of Appeal in a decision released

on September 1, 1998, Olympia & York Developments Ltd. (trustee of) v. National Bank of Canada, [1998] O.J. No. 3482 (C.A.).

3 The lending syndicate was comprised of the following lenders, to the extent of the following advances: Credit Lyonnais and other European lenders (US $1.25 billion); Hongkong and Shanghai Banking Corporation (US $ 750 million); Dai-Ichi Kango Bank, Ltd. (US $250 million); Royal Bank of Canada (US 250 million).

4 Summary taken from the admitted recitation of facts in the Appellant's factum.

5 A defined term in the Term Loan Agreement, meaning OYDL, or any of its subsidiaries, or any successor guarantors (or their subsidiaries).

6 Reference Tranches" as defined in the Note are portions of the advances made under the Term Loan Agreements.

7 As contemplated in section 141 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended (the "BIA").

8 See, Polly Peck, supra, at p. 444 and Tokyo Ltd. v. Karoon [1986] 3 All ER 468 at p. 486, for the general proposition that courts are concerned the law and not with economics when looking at the substance of matters.

9 To borrow a phrase used by Gonthier J. in Husky Oil Operations Ltd. v. M.N.R. [1995] 3 S.C.R. 453, at p. 491, albeit in a slightly different context. Husky Oil was a constitutional case, but Gonthier J. drew upon "double proof" concepts in considering the claims of a creditor and a statutory surety, who had made payments to the creditor on behalf of the debtor, against the estate of a principal debtor. The particular question he addressed was whether the statutory suretyship created a joint and several liability as between the debtor and the statutory surety for the debt (he concluded it did not).

Tab 34

Case Name:
Ravelston Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF a plan of Compromise or Arrangement of the Ravelston Corporation Limited and Ravelston Management Inc. AND IN THE MATTER OF the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended, and the Courts of Justice Act, R.S.O. 1990, c. C.43, as amended

[2005] O.J. No. 3802

14 C.B.R. (5th) 207

142 A.C.W.S. (3d) 18

2005 CarswellOnt 4267

Court File No. 05-CL-5863

Ontario Superior Court of Justice
Commercial List

J.M. Farley J.

Heard: August 25, 2005.
Judgment: August 26, 2005.

(7 paras.)

Creditors and debtors law -- Legislation -- Debtors' relief -- Companies' Creditors Arrangement Act -- Application for approval of settlement allowed on basis that settlement was fair and commercially reasonable.

Application by the Receiver for the Ravelston Corporation Limited for approval of a settlement between the Receiver and the creditor, Canwest Global Communications Corporation -- Ravelston, CanWest and the National Post had entered a Management Services Agreement -- Ravelston gave notice of termination the day before it filed for protection under Companies' Creditors Arrangement

Act -- Parties became involved in a dispute as to the termination fee owing under the agreement -- Reached settlement whereby CanWest would pay $12.75 million to the Receiver, representing 50 per cent of the claim -- Creditor Hollinger Incorporated did not support approval of settlement -- HELD: Application allowed -- Settlement on 50 per cent basis fell within the range of acceptability on a fair and commercially reasonable basis.

Statutes, Regulations and Rules Cited:

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

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

Courts of Justice Act, R.S.O. 1990, c. C.43

Counsel:

Alex MacFarlane, for RSM Richter Inc. in its capacity as Receiver, Interim Receiver, and Monitor of The Ravelston Corporation Limited, Ravelston Management Inc., Argus Corporation Limited, 509643 N.B. Inc., 509644 N.B. Inc., 509645 N.B. Inc., 509646 N.B. Inc., 509647 N.B. Inc.

Matthew Gottlieb, for Hollinger Inc.

Robert W. Staley and Derek J. Bell, for Hollinger International Inc.

Lyndon Barnes and Nancy Roberts, for CanWest Global Communications Corporation

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ENDORSEMENT

1 **J.M. FARLEY J.** (endorsement):-- These are the short reasons promised yesterday where I approved the settlement between the Receiver of Ravelston and CanWest concerning the dispute between them as to the termination fee owing under the Management Services Agreement dated November 15, 2000 between Ravelston, CanWest and National Post. As I pointed out, the business efficacy of the Management Services Agreement may well be questioned; however what was to be decided by me was not that, but rather the issue of the termination arrangements.

2 The Receiver and CanWest - the day before the hearing of this dispute reached a settlement, subject to court approval, whereby the parties would exchange mutual releases and CanWest would pay the Receiver $12.75 million. This amounted to 50% of the amount the Receiver was claiming pursuant to the notice of termination which Ravelston gave CanWest the day before Ravelston filed for protection pursuant to the CCAA (with the Receiver being the monitor under the CCAA proceedings) and for the appointment of the Receiver as the court appointed receiver of Ravelston. The two Hollinger companies, Inc. and International, were not happy with the amount of the settlement, although it appears that both were content with a settlement at a higher amount being paid the Receiver. Inc. did not support the approval of the settlement but did not oppose it. International actively opposed the settlement; its position was that the Receiver ought to have obtained a settlement in the 75% range. Both Inc. and International assert that they ought to have been more involved with the settlement process as they assert a special relationship owing to claimed security interests in the claim and its proceeds. One could well posit a situation where the process of settlement could

have been improved by more involvement of Inc. and International. However, what we are concerned with is not perfection, but rather has there been material and relevant prejudice so as to taint the process to the degree that the court ought not to entertain the settlement. However, in this situation, Mr. Gottlieb for Inc. volunteered that Inc. had been alerted to the settlement prior to its being entered into, albeit just immediately prior (where in my view it would have been better to have alerted Inc. that settlement discussions were to be actively engaged in and then given progress reports at meaningful times along the way). International was kept more abreast of the situation; the Receiver and its Canadian counsel dialogued with International's counsel, Mr. Staley, including a meeting on June 7, 2005 which, inter alia, dealt with International's view concerning the dispute with CanWest. The Receiver of course had the benefit of the active participation of International leading up to the hearing scheduled for August 17th including a detailed factum by International opposing the CanWest position that it owed nothing. On August 15th, Mr. Staley was advised that the Receiver would be meeting with CanWest's counsel the next day to see if a settlement could be reached. While Mr. Staley was otherwise engaged on the 16th, he did indicate that a settlement would be preferable to having the matter litigated. International did not ask that another lawyer be allowed to participate in or observe the settlement discussions, nor did it indicate that a floor amount should be achieved in order that International would be supportive of a settlement.

3 The Receiver submitted that a motion to approve a settlement entered into by a court-appointed receiver is analogous to a motion to approve a sale of assets by a court-appointed receiver so that the 4 part set of principles/considerations of Royal Bank v. Soundair Corp. (1991), 4 O.R. (3d) 1 (C.A.) at para. 16 would come into play. See Re Bakemates International Inc., [2003] O.J. No. 3191 (S.C.J.), affirmed [2004] O.J. No. 2463, 2004 CarswellOnt. 2339 (C.A.). However, it seems to me that there is a subtle distinction to make between reliance on a receiver's commercial expertise concerning a recommended sale and the receiver's expertise in regards to a settlement of a legal dispute (while of course taking into account that such a receiver will have had appropriate legal advice from its own counsel). That distinction is based on the fact that the court is the "expert" in respect of the law and will generally be in a better position to assess the law involved in a situation than it would be as to the commercial aspects of a sale of property. In this regard, one may wish to consider the analogous situation of expert opinions as discussed in R. v. Mohan, [1994] 2 S.C.R. 9. Thus it seems to me that the court, with the assistance of counsel (both counsel supporting the approval of a settlement and counsel opposing), should conduct an analysis of the strengths and weaknesses of the case, including the general vagaries of litigation plus the benefits of certainty and the avoidance of delay concerning possible appeals, sufficient for the court to conclude that the proposed settlement fell within the range of what was fair and commercially reasonable. The case here involved an all or nothing result if the case went on to a court decision.

4 I have had the benefit of reviewing in detail the material for the August 17th hearing immediately prior to being advised that the Receiver and CanWest had reached a settlement, subject to court approval. In my view there was much to be said for the merits of each side's position. There was much to be said about the pros and cons -- and it was carefully detailed in that material and so was said. I have now had as well the benefit of the material filed and argued concerning the approval of the settlement as concerns the merits of the dispute which was to have been heard on August 17th. If the case had not settled, then I would have had to make a decision, a decision on an all or nothing basis. I would have made that decision - but I cannot predict now what it would have been, nor could I predict how the Court of Appeal would have decided, given the fact that inevitably my decision would have been appealed. It would have been an interesting decision to write. There cer-

tainly was no slam-dunk either way, nor nothing approaching that certainty of result. In my view, the settlement on a 50% basis falls within the general range of acceptability on a fair and commercially reasonable basis. I therefore have approved the settlement.

5 Allow me to observe that in the fact circumstances of this case and the law as eventually argued in the respective factums, I agree that it is highly likely that attempts to negotiate a settlement before almost reaching the court house steps would have been premature. It was indeed necessary and appropriate that each side reflect on its own strengths and weaknesses once it had the benefit of refined argument on the strengths of the other side.

6 Mr. Gottlieb makes a fair request in my view where he asks on behalf of Inc. for advance notice of any intention to deal with the proceeds of this settlement. I leave it to the Receiver in consultation with International and Inc. to deal with the issue of proceeds disposition and notice generally.

7 Order approving settlement to issue as per my fiat.

J.M. FARLEY J.

cp/e/qw/qljxh/qlkjg/qlrme

Tab 35

Case Name:
Angiotech Pharmaceuticals, Inc. (Re)

**IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
AND IN THE MATTER OF a Plan of Compromise or Arrangement of Angiotech Pharmaceuticals, Inc. and the other Petitioners Listed on Schedule "A", Petitioners**

[2011] B.C.J. No. 648

2011 BCSC 450

76 C.B.R. (5th) 210

2011 CarswellBC 841

Docket: S110587

Registry: Vancouver

British Columbia Supreme Court
Vancouver, British Columbia

P.W. Walker J.
(In Chambers)

Heard: April 6, 2011.
Oral judgment: April 6, 2011.

(15 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Proposals -- Meetings of shareholders -- Sanction by court -- Application for order sanctioning plan proposed by petitioners and approved by monitors and creditors allowed -- Proper notice of plan given and no objections made -- Plan enabled petitioners to operate, facilitate continued employment, allowed creditors to derive greater benefit than they would in event of bankruptcy or liquidation and permitted important medical products to continue be available -- Requirement for shareholders' meeting dispensed with as holding it would give those that no

longer had economic interest in company a veto -- Plan met statutory criteria, was fair and in best interests of creditors and public.

Statutes, Regulations and Rules Cited:

Business Corporations Act, SBC 2002, CHAPTER 57,

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 6(2), s. 6(8), s. 61

Counsel:

Counsel for Angiotech Pharmaceutics, Inc.: J. Dacks, M. Wasserman, D. Gruber, R. Morse.

U.S. Counsel for Angiotech Pharmaceutics, Inc. appearing by telephone: S. Jones.

Counsel for Alvarez & Marsal Canada Inc.: J. Grieve, K. Jackson.

Counsel for Consenting Noteholders: R. Chadwick, L. Willis.

Counsel for U.S. Bank National Association: M. Buttery.

Oral Reasons for Judgment

1 **P.W. WALKER J.** (orally):-- The application before me is for an order to sanction the plan (as amended) proposed by the petitioners and approved by the monitor in the Angiotech CCAA proceeding.

2 I find that the proposed plan has several purposes, which include:

(a) effecting a compromise, settlement, and payment of all affected claims;
(b) implementing a recapitalization of subordinated notes; and
(c) enabling the petitioners to sustain sufficient current and future liquidity in order to enhance their short and long term viability.

3 The plan was unanimously approved at a plan approval meeting of the creditors ("creditors' meeting") held and conducted by the monitor in Vancouver on April 4, 2011. I am satisfied that notice of the plan, the amended plan, and the creditors' meeting was widely disseminated in accordance with my previous orders.

4 The total value of the notes held by subordinated noteholders is approximately $266 million. It is noteworthy that the noteholders which held subordinated notes having a value of approximately $234 million voted in favour of the plan at the creditors' meeting.

5 No objection to the plan has been taken by any employee, past or present, or the existing common shareholders whose interests will be extinguished by the plan.

6 The plan as amended contains the following key elements, which are set out in the affidavit of K. Thomas Bailey sworn on March 31, 2011 at para. 31:

(a) New Common Shares will be issued to Affected Creditors with Distribution Claims who have not made valid Cash Elections or Liquidity Elections (as defined below) and distributions of cash will be made to Convenience Class Creditors and Affected Creditors that have made valid Liquidity Elections;
(b) the Subordinated Notes, the Subordinated Note Indenture and all Subordinated Note Obligations will be irrevocably and finally cancelled and eliminated except for the limited purposes provided in section 4.5 of the Plan;
(c) all Affected Claims will be discharged and released;
(d) the Existing Shares and options and the Shareholder Rights Agreement will be cancelled without any liability, payment or other compensation to Existing Shareholders in respect thereof;
(e) Angiotech US will repay to Wells Fargo and the DIP Lender, as applicable, any and all outstanding Secured Lender Obligations;
(f) Angiotech will make payment to the KEIP Participants of amounts owing under the KEIP at the time specified and in accordance with the terms of the KEIP;
(g) Angiotech will make grants of New Common Shares and options to acquire New Common Shares pursuant to the terms of the MIP;
(h) Angiotech's Notice of Articles will be amended to, among other things, create an unlimited number of New Common Shares in order to provide flexibility for the recapitalized Angiotech on a going forward basis;
(i) Angiotech will transfer to the Monitor the aggregate of all Cash Elected Amounts and Liquidity Election Payments (as defined below) to be held in escrow in one or more separate interest-bearing accounts for distributions to Convenience Class Creditors and Affected Creditors that have made valid Liquidity Elections, as applicable;
(j) the Board of Directors of Angiotech will be replaced by a new Board of Directors; and
(k) the Petitioners, the Monitor, Blackstone, the Subordinated Note Indenture Trustee, the Advisors, Wells Fargo, the DIP Lender, the Subordinated Noteholders and, among others, present and former shareholders, affiliates, subsidiaries, directors, officers and employees of the foregoing will be granted a release and discharge from liability in connection with, among other things, the CCAA proceeding and the Plan.

7 I am satisfied from my review of the evidence that the plan, if implemented, would:

(a) enable the petitioners to continue to operate as going concerns;
(b) facilitate and promote continued employment of a substantial number of the petitioners' employees;
(c) allow creditors and other persons with an economic interest in the petitioners to derive a far greater benefit than would result from a bankruptcy or liquidation; and
(c) permit important medical products sold and distributed by the petitioners to continue to be made available to the public worldwide.

8 The amendments to the plan that now contemplate distribution of newly issued common shares in an aggregate amount of 3.5% afford greater benefit to all affected creditors who choose to and are qualified to take them.

9 As well, the amendments to the plan calling for a liquidity election provide greater benefits to creditors who are not able, or choose not, to participate in the share offering.

10 I am also satisfied that the Court has jurisdiction to dispense with the calling of a meeting of existing shareholders in order to amend the articles of the Canadian petitioner. I am satisfied that I have that jurisdiction pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*") and the *Business Corporations Act*, S.B.C. 2002, c. 57. I say that because I am of the view that s. 6(8) of the *CCAA* prohibits a plan that calls for a distribution to pay an equity claim where non-equity claims cannot be paid in full: *Re Canadian Airlines Corp.*, 2000 ABQB 442 at paras. 143 and 145, aff'd at 2000 ABCA 238. The evidence discloses that this is not possible in this case.

11 Even if it could be said that the combined effect of ss. 6(8) and 6(2) of the *CCAA* do not remove the requirement for a shareholders' meeting, I am satisfied that the requirement should be dispensed with in the circumstances of this case. To do otherwise, so that a meeting is held, would cause persons who no longer have an economic interest in the company to acquire a functional veto: *Re Xillix Technologies Corp. et al* (21 June 2007), Vancouver No. S066835 (S.C.).

12 I am also satisfied that the proposed release contained in the plan is rationally connected to the purpose of the plan, it is necessary for the implementation of the plan, and it meets the tests set out in *Re Muscletech Research and Developments Inc.*, (2006) 25 C.B.R. (5th) 231 (Ont. S.C.J.); *Re Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 92 O.R. (3d) 513 (C.A.); and *Re Canwest Global Communications Corp.*, 2010 ONSC 4209.

13 The creditors who are protected by the release were instrumental in facilitating the reorganization of the petitioners' affairs as a going concern. Further, their efforts led to the development of a plan that meets the objectives set out in the *CCAA*.

14 The reorganization facilitated by those creditors provides greater benefits to all of the creditors than would otherwise be realized if the petitioners had been liquidated.

15 In conclusion, I am satisfied that the plan should be sanctioned because:

(a) it meets the statutory criteria set out in s. 61 of the *CCAA*;
(b) it is fair and reasonable; and
(c) it is in the best interests of the creditors and the public.

P.W. WALKER J.

cp/e/qlrds/qlvxw/qlced/qlana

Tab 36

Case Name:

Kitchener Frame Ltd. (Re)

IN THE MATTER OF the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended
IN THE MATTER OF the Consolidated Proposal of Kitchener Frame Limited and Thyssenkrupp Budd Canada, Inc., Applicants

[2012] O.J. No. 486

2012 ONSC 234

86 C.B.R. (5th) 274

212 A.C.W.S. (3d) 631

2012 CarswellOnt 1347

Court File No. CV-11-9298-00CL

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

February 3, 2012.

(93 paras.)

Bankruptcy and insolvency law -- Proposals -- Court approval or rejection -- Protection of creditors' interests -- Motion by Kitchener Frame and Thyssenkrupp Budd Canada for an order sanctioning an amended consolidated proposal allowed -- Kitchener and Thyssenkrupp were inactive entities with no operating assets and no material liquid assets -- The motion was unopposed and the consolidated proposal was unanimously supported by the affected creditors -- The release contained in the consolidated proposal benefited the creditors generally -- Furthermore, the alternative was bankruptcy, a scenario which would significantly erode recoveries for the unsecured creditors -- Bankruptcy and Insolvency Act, ss. 59(2), 62(3).

Motion by Kitchener Frame and Thyssenkrupp Budd Canada for an order sanctioning an amended consolidated proposal. Kitchener and Thyssenkrupp were inactive entities with no operating assets

and no material liquid assets. Although affiliates of Thyssenkrupp had been providing funding for pension and non-pension post-employment benefit obligations to former employees, the status quo was unsustainable. The motion was unopposed and the consolidated proposal was unanimously supported by the affected creditors. Kitchener and Thyssenkrupp took the position that the requested relief was reasonable and that it benefited the general body of creditors.

HELD: Motion allowed. The release contained in the consolidated proposal was approved as full and adequate disclosure of the release and its effect had been provided. The release benefited the creditors generally and the alternative was bankruptcy, a scenario which would significantly erode recoveries for the unsecured creditors. It was therefore appropriate to grant the sanction order.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 50(14), s. 54(2)(d), s. 59(2), s. 62(3), s. 136(1), s. 178(2), s. 179, s. 183

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.1

Excise Tax Act, R.S.C. 1985, c. E-15,

Counsel:

Edward A. Sellers and Jeremy E. Dacks, for the Applicants.

Hugh O'Reilly, Non-Union Representative Counsel.

L. N. Gottheil, Union Representative Counsel.

John Porter, for Ernst & Young Inc., Proposal Trustee.

Michael McGraw, for CIBC Mellon Trust Company.

Deborah McPhail, for Financial Services Commission of Ontario.

ENDORSEMENT

1 **G.B. MORAWETZ J.**:-- At the conclusion of this unopposed motion, the requested relief was granted. Counsel indicated that it would be helpful if the court could provide reasons in due course, specifically on the issue of a third-party release in the context of a proposal under Part III of the *Bankruptcy and Insolvency Act* ("*BIA*").

2 Kitchener Frame Limited ("KFL") and Thyssenkrupp Budd Canada Inc. ("Budd Canada"), and together with KFL, (the "Applicants"), brought this motion for an order (the "Sanction Order") to sanction the amended consolidated proposal involving the Applicants dated August 31, 2011 (the "Consolidated Proposal") pursuant to the provisions of the *BIA*. Relief was also sought authorizing the Applicants and Ernst & Young Inc., in its capacity as proposal trustee of each of the Applicants (the "Proposal Trustee") to take all steps necessary to implement the Consolidated Proposal in accordance with its terms.

3 The Applicants submit that the requested relief is reasonable, that it benefits the general body of the Applicants' creditors and meets all other statutory requirements. Further, the Applicants submit that the court should also consider that the voting affected creditors (the "Affected Creditors") unanimously supported the Consolidated Proposal. As such, the Applicants submit that they have met the test as set out in s. 59(2) of the *BIA* with respect to approval of the Consolidated Proposal.

4 The motion of the Applicants was supported by the Proposal Trustee. The Proposal Trustee filed its report recommending approval of the Consolidated Proposal and indicated that the Consolidated Proposal was in the best interests of the Affected Creditors.

5 KFL and Budd Canada are inactive entities with no operating assets and no material liquid assets (other than the Escrow Funds). They do have significant and mounting obligations including pension and other non-pension post-employment benefit ("OPEB") obligations to the Applicants' former employees and certain former employees of Budcan Holdings Inc. or the surviving spouses of such former employees or others who may be entitled to claim through such persons in the *BIA* proceedings, including the OPEB creditors.

6 The background facts with respect to this motion are fully set out in the affidavit of Mr. William E. Aziz, sworn on September 13, 2011.

7 Affiliates of Budd Canada have provided up to date funding to Budd Canada to enable Budd Canada to fund, on behalf of KFL, such pension and OPEB obligations. However, given that KFL and Budd Canada have no active operations, the *status quo* is unsustainable.

8 The Applicants have acknowledged that they are insolvent and, in connection with the *BIA* proposal, proceedings were commenced on July 4, 2011.

9 On July 7, 2011, Wilton-Siegel J. granted Procedural Consolidation Orders in respect of KFL and Budd Canada which authorized the procedural consolidation of the Applicants and permitted them to file a single consolidated proposal to their creditors.

10 The Orders of Wilton-Siegel J. also appointed separate representative counsel to represent the interests of the Union and Non-Union OPEB creditors and further authorized the Applicants to continue making payments to Blue Cross in respect of the OPEB Claims during the *BIA* proposal proceedings.

11 On August 2, 2011, an order was granted extending the time to file a proposal to August 19, 2011.

12 The parties proceeded to negotiate the terms of the Consolidated Proposal, which meetings involved the Applicants, the Proposal Trustee, senior members of the CAW, Union Representative Counsel and Non-Union Representative Counsel.

13 An agreement in principle was reached which essentially provided for the monetization and compromise of the OPEB claims of the OPEB creditors resulting in a one-time, lump-sum payment to each OPEB creditor term upon implementation of the Consolidated Proposal. The Consolidated Proposal also provides that the Applicants and their affiliates will forego any recoveries on account of their secured and unsecured inter-company claims, which total approximately $120 million. A condition precedent was the payment of sufficient funds to the Pension Fund Trustee such that when such funds are combined with the value of the assets held in the Pension Plans, the Pension Fund Trustee will be able to fully annuitize the Applicants' pension obligations and pay the commuted

values to those creditors with pension claims who so elected so as to provide for the satisfaction of the Applicants' pension obligations in full.

14 On August 19, 2011, the Applicants filed the Consolidated Proposal. Subsequent amendments were made on August 31, 2011 in advance of the creditors' meeting to reflect certain amendments to the proposal.

15 The creditors' meeting was held on September 1, 2011 and, at the meeting, the Consolidated Proposal, as amended, was accepted by the required majority of creditors. Over 99.9% in number and over 99.8% in dollar value of the Affected Creditors' Class voted to accept the Consolidated Proposal. The Proposal Trustee noted that all creditors voted in favour of the Consolidated Proposal, with the exception of one creditor, Canada Revenue Agency (with 0.1% of the number of votes representing 0.2% of the value of the vote) who attended the meeting but abstained from voting. Therefore, the Consolidated Proposal was unanimously approved by the Affected Creditors. The Applicants thus satisfied the required "double majority" voting threshold required by the *BIA*.

16 The issue on the motion was whether the court should sanction the Consolidated Proposal, including the substantive consolidation and releases contained therein.

17 Pursuant to s. 54(2)(d) of the *BIA*, a proposal is deemed to be accepted by the creditors if it has achieved the requisite "double majority" voting threshold at a duly constituted meeting of creditors.

18 The *BIA* requires the proposal trustee to apply to court to sanction the proposal. At such hearing, s. 59(2) of the *BIA* requires that the court refuse to approve the proposal where its terms are not reasonable or not calculated to benefit the general body of creditors.

19 In order to satisfy s. 59(2) test, the courts have held that the following three-pronged test must be satisfied:

(a) the proposal is reasonable;
(b) the proposal is calculated to benefit the general body of creditors; and
(c) the proposal is made in good faith.

See *Mayer (Re)* (1994), 25 CBR (3d) 113; *Steeves (Re)*, 25 CBR (4th) 317; *Magnus One Energy Corp. (Re)*, 53 CBR (5th) 243.

20 The first two factors are set out in s. 59(2) of the *BIA* while the last factor has been implied by the court as an exercise of its equitable jurisdiction. The courts have generally taken into account the interests of the debtor, the interests of the creditors and the interests of the public at large in the integrity of the bankruptcy system. See *Farrell (Re)* 2003, 40 C.B.R. (4th) 53.

21 The courts have also accorded substantial deference to the majority vote of creditors at a meeting of creditors; see *Lofchik, Re* [1998] O.J. No. 332 (Ont. Bktcy). Similarly, the courts have also accorded deference to the recommendation of the proposal trustee. See *Magnus One, supra.*

22 With respect to the first branch of the test for sanctioning a proposal, the debtor must satisfy the court that the proposal is reasonable. The court is authorized to only approve proposals which are reasonable and calculated to benefit the general body of creditors. The court should also consider the payment terms of the proposal and whether the distributions provided for are adequate to meet the requirements of commercial morality and maintaining the integrity of the bankruptcy system. For a discussion on this point, see *Lofchik, supra*, and *Farrell, supra.*

23 In this case, the Applicants submit that, if the Consolidated Proposal is sanctioned, they would be in a position to satisfy all other conditions precedent to closing on or prior to the date of the proposal ("Proposal Implementation Date").

24 With respect to the treatment of the Collective Bargaining Agreements, the Applicants and the CAW brought a joint application before the Ontario Labour Relations Board ("OLRB") on an expedited basis seeking the OLRB's consent to an early termination of the Collective Bargaining Agreements. Further, the CAW has agreed to abandon its collective bargaining rights in connection with the Collective Bargaining Agreements.

25 With respect to the terms and conditions of a Senior Secured Loan Agreement between Budd Canada and TK Finance dated as of December 22, 2010, TK Finance provided a secured creditor facility to the Applicants to fund certain working capital requirements before and during the *BIA* proposal proceedings. As a result of the approval of the Consolidated Proposal at the meeting of creditors, TK Finance agreed to provide additional credit facilities to Budd Canada such that the Applicants would be in a position to pay all amounts required to be paid by or on behalf of the Applicants in connection with the Consolidated Proposal.

26 On the issue as to whether creditors will receive greater recovery under the Consolidated Proposal than they would receive in the bankruptcy, it is noted that creditors with Pension Claims are unaffected by the Consolidated Proposal. The Consolidated Proposal provides for the satisfaction of Pension Claims in full as a condition precedent to implementation.

27 With respect to Affected Creditors, the Applicants submit that they will receive far greater recovery from distributions under the Consolidated Proposal than the Affected Creditors would receive in the event of the bankruptcies of the Applicants. (See Sanction Affidavit of Mr. Aziz at para. 61.)

28 The Proposal Trustee has stated that the Consolidated Proposal is advantageous to creditors for the reasons outlined in its Report and, in particular:

(a) the recoveries to creditors with claims in respect of OPEBs are considerably greater under the Amended Proposal than in a bankruptcy;
(b) payments under the Amended Proposal are expected in a timely manner shortly after the implementation of the Amended Proposal;
(c) the timing and quantum of distributions pursuant to the Amended Proposal are certain while distributions under a bankruptcy are dependent on the results of litigation, which cannot be predicted with certainty; and
(d) the Pension Plans (as described in the Proposal Trustee's Report) will be fully funded with funds from the Pension Escrow (as described in the Proposal Trustee's Report) and, if necessary, additional funding from an affiliate of the Companies if the funds in the Pension Escrow are not sufficient. In a bankruptcy, the Pension Plans may not be fully funded.

29 The Applicants take the position that the Consolidated Proposal meets the requirements of commercial morality and maintains the integrity of the bankruptcy system, in light of the superior coverage to be afforded to the Applicants' creditors under the Consolidated Proposal than in the event of bankruptcy.

30 The Applicants also submit that substantive consolidation inherent in the proposal will not prejudice any of the Affected Creditors and is appropriate in the circumstances. Although not expressly contemplated under the *BIA*, the Applicants submit that the court may look to its incidental, ancillary and auxiliary jurisdiction under s. 183 of the *BIA* and its equitable jurisdiction to grant an order for substantive consolidation. See *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006) 22 CBR (5th) 126 (Ont. S.C.J.) (Commercial List). In deciding whether to grant substantive consolidation, courts have held that it should not be done at the expense of, or possible prejudice of, any particular creditor. See *Ashley, supra.* However, counsel submits that this court should take into account practical business considerations in applying the *BIA*. See *A & F Baillargeon Express Inc. (Trustee of) (Re)* (1993), 27 CBR (3d) 36.

31 In this case, the Applicants submit that substantive consolidation inherent in the Consolidated Proposal is appropriate in the circumstances due to, among other things, the intertwined nature of the Applicants' assets and liabilities. Each Applicant had substantially the same creditor base and known liabilities (other than certain Excluded Claims). In addition, KFL had no cash or cash equivalents and the Applicants are each dependant on the Escrow Funds and borrowings under the Restated Senior Secured Loan Agreement to fund the same underlying pension and OPEB obligations and costs relating to the Proposal Proceedings.

32 The Applicants submit that creditors in neither estate will be materially prejudiced by substantive consolidation and based on the fact that no creditor objected to the substantial consolidation, counsel submits the Consolidated Proposal ought to be approved.

33 With respect to whether the Consolidated Proposal is calculated to benefit the general body of creditors, TK Finance would be entitled to priority distributions out of the estate in a bankruptcy scenario. However, the Applicants and their affiliates have agreed to forego recoveries under the Consolidated Proposal on account of their secured and unsecured inter-company claims in the amount of approximately $120 million, thus enhancing the level of recovery for the Affected Creditors, virtually all of whom are OPEB creditors. It is also noted that TK Finance will be contributing over $35 million to fund the Consolidated Proposal.

34 On this basis, the Applicants submit that the Consolidated Proposal is calculated to benefit the general body of creditors.

35 With respect to the requirement of the proposal being made in good faith, the debtor must satisfy the court that it has provided full disclosure to its creditors of its assets and encumbrances against such assets.

36 In this case, the Applicants and the Proposal Trustee have involved the creditors pursuant to the Representative Counsel Order, and through negotiations with the Union Representative Counsel and Non-Union Representative Counsel.

37 There is also evidence that the Applicants have widely disseminated information regarding their *BIA* proposal proceedings through the media and through postings on the Proposal Trustee's website. Information packages have also prepared by the Proposal Trustee for the creditors.

38 Finally, the Proposal Trustee has noted that the Applicants' conduct, both prior to and subsequent to the commencement of the *BIA* proposal proceedings, is not subject to censure in any respect and that the Applicants' have acted in good faith.

39 There is also evidence that the Consolidated Proposal continues requisite statutory terms. The Consolidated Proposal provides for the payment of preferred claims under s. 136(1) of the *BIA*.

40 Section 7.1 of the Consolidated Proposal contains a broad release in favour of the Applicants and in favour of certain third parties (the "Release"). In particular, the Release benefits the Proposal Trustee, Martinrea, the CAW, Union Representative Counsel, Non-Union Representative Counsel, Blue Cross, the Escrow Agent, the present and former shareholders and affiliates of the Applicants (including Thyssenkrupp USA, Inc. ("TK USA"), TK Finance, Thyssenkrupp Canada Inc. ("TK Canada") and Thyssenkrupp Budd Company), as well as their subsidiaries, directors, officers, members, partners, employees, auditors, financial advisors, legal counsel and agents of any of these parties and any person liable jointly or derivatively through any or all of the beneficiaries of the of the release (referred to individually as a "Released Party").

41 The Release covers all Affected Claims, Pension Claims and Escrow Fund Claims existing on or prior to the later of the Proposal Implementation Date and the date on which actions are taken to implement the Consolidated Proposal.

42 The Release provides that all such claims are released and waived (other than the right to enforce the Applicants' or Proposal Trustee's obligations under the Consolidated Proposal) to the full extent permitted by applicable law. However, nothing in the Consolidated Proposal releases or discharges any Released Party for any criminal or other wilful misconduct or any present or former directors of the Applicants with respect to any matters set out in s. 50(14) of the *BIA*. Unaffected Claims are specifically carved out of the Release.

43 The Applicants submit that the Release is both permissible under the *BIA* and appropriately granted in the context of the *BIA* proposal proceedings. Further, counsel submits, to the extent that the Release benefits third parties other than the Applicants, the Release is not prohibited by the *BIA* and it satisfies the criteria that has been established in granting third-party releases under the *Companies' Creditors Arrangement Act* ("*CCAA*"). Moreover, counsel submits that the scope of the Release is no broader than necessary to give effect to the purpose of the Consolidated Proposal and the contributions made by the third parties to the success of the Consolidated Proposal.

44 No creditors or stakeholders objected to the scope of the Release which was fully disclosed in the negotiations, including the fact that the inclusion of the third-party releases was required to be part of the Consolidated Proposal. Counsel advises that the scope of the Release was referred to in the materials sent by the Proposal Trustee to the Affected Creditors prior to the meeting, specifically discussed at the meeting and adopted by the unanimous vote of the voting Affected Creditors.

45 Counsel also submits that there is no provision in the *BIA* that clearly and expressly precludes the Applicants from including the Release in the Consolidated Proposal as long as the court is satisfied that the Consolidated Proposal is reasonable and for the general benefit of creditors.

46 In this respect, it seems to me, that the governing statutes should not be technically or stringently interpreted in the insolvency context but, rather, should be interpreted in a manner that is flexible rather than technical and literal, in order to deal with the numerous situations and variations which arise from time to time. Further, taking a technical approach to the interpretation of the *BIA* would defeat the purpose of the legislation. See *NTW Management Group (Re)* (1994), 29 C.B.R. (3d) 139; *Olympia & York Developments Ltd. (Re)* (1995), 34 C.B.R. (3d) 93; *Olympia & York Developments Ltd. (Re)* (1997), 45 C.B.R. (3d) 85.

47 Moreover, the statutes which deal with the same subject matter are to be interpreted with the presumption of harmony, coherence and consistency. See *NAV Canada c. Wilmington Trust Co.*, 2006 SCC 24. This principle militates in favour of adopting an interpretation of the *BIA* that is harmonious, to the greatest extent possible, with the interpretation that has been given to the *CCAA*.

48 Counsel points out that historically, some case law has taken the position that s. 62(3) of the *BIA* precludes a proposal from containing a release that benefits third parties. Counsel submits that this result is not supported by a plain meaning of s. 62(3) and its interaction with other key sections in the *BIA*.

49 Subsection 62(3) of the *BIA* reads as follows:

> (3) The acceptance of a proposal by a creditor does not release any person who would not be released under this Act by the discharge of the debtor.

50 Counsel submits that there are two possible interpretations of this subsection:

> (a) It prohibits third party releases - in other words, the phrase "does not release any person" is interpreted to mean "cannot release any person"; or
>
> (b) It simply states that acceptance of a proposal does not automatically release any party other than the debtor - in other words, the phrase "does not release any person" is interpreted to mean "does not release any person without more"; it is protective not prohibitive.

51 I agree with counsel's submission that the latter interpretation of s. 62(3) of the *BIA* conforms with the grammatical and ordinary sense of the words used. If Parliament had intended that only the debtor could be released, s. 62(3) would have been drafted more simply to say exactly that.

52 Counsel further submits that the narrow interpretation would be a stringent and inflexible interpretation of the *BIA*, contrary to accepted wisdom that the *BIA* should be interpreted in a flexible, purposive manner.

53 The *BIA* proposal provisions are designed to offer debtors an opportunity to carry out a going concern or value maximizing restructuring in order to avoid a bankruptcy and related liquidation and that these purposes justify taking a broad, flexible and purposive approach to the interpretation of the relevant provisions. This interpretation is supported by *Ted Leroy Trucking Ltd. (Re)*, 2010 SCC 60.

54 Further, I agree with counsel's submissions that a more flexible purposive interpretation is in keeping with modern statutory principles and the need to give purposive interpretation to insolvency legislation must start from the proposition that there is no express prohibition in the *BIA* against including third-party releases in a proposal. At most, there are certain limited constraints on the scope of such releases, such as in s. 179 of the *BIA*, and the provision dealing specifically with the release of directors.

55 In the absence of an express prohibition against including third-party releases in a proposal, counsel submits that it must be presumed that such releases are permitted (subject to compliance with any limited express restrictions, such as in the case of a release of directors). By extension, counsel submits that the court is entitled to approve a proposal containing a third-party release if the court is able to satisfy itself that the proposal (including the third-party release) is reasonable and

for the general benefit for creditors such that all creditors (including the minority who did not vote in favour of the proposal) can be required to forego their claims against parties other than the debtors.

56 The Applicants also submit that s. 62(3) of the *BIA* can only be properly understood when read together with other key sections of the *BIA*, particularly s. 179 which concerns the effect of an order of discharge:

> 179. An order of discharge does not release a person who at the time of the bankruptcy was a partner or co-trustee with the bankrupt or was jointly bound or had made a joint contract with the bankrupt, or a person who was surety or in the nature of a surety for the bankrupt.

57 The order of discharge of a bankrupt has the effect of releasing the bankrupt from all claims provable in bankruptcy (section 178(2) *BIA*). In the absence of s. 179, this release could result in the automatic release at law of certain types of claims that are identified in s. 179. For example, under guarantee law, the discharge of the principal debt results in the automatic discharge of a guarantor. Similarly, counsel points out the settlement or satisfaction of a debt by one joint obligor generally results in the automatic release of both joint obligors. Section 179 therefore serves the limited purpose of altering the result that would incur at law, indicating that the rule that the *BIA* generally is that there is no automatic release of third-party guarantors of co-obligors when a bankrupt is discharged.

58 Counsel submits that s. 62(3), which confirms that s. 179 applies to a proposal, was clearly intended to fulfil a very limited role - namely, to confirm that there is no automatic release of the specific types of co-obligors identified in s. 179 when a proposal is approved by the creditors and by the court. Counsel submits that it does not go further and preclude the creditors and the court from approving a proposal which contains the third-party release of the types of co-obligors set out in s. 179. I am in agreement with these submissions.

59 Specific considerations also apply when releasing directors of a debtor company. The *BIA* contains specific limitations on the permissible scope of such releases as set out in s. 50(14). For this reason, there is a specific section in the *BIA* proposal provisions outlining the principles governing such a release. However, counsel argues, the presence of the provisions outlining the circumstances in which a proposal can contain a release of claims against the debtor's directors does not give rise to an inference that the directors are the only third parties that can be released in a proposal. Rather, the inference is that there are considerations applicable to a release or compromise of claims against directors that do not apply generally to other third parties. Hence, it is necessary to deal with this particular type of compromise and release expressly.

60 I am also in agreement with the alternative submissions made by counsel in this area to the effect that if s. 62(3) of the *BIA* operates as a prohibition it refers only to those limitations that are expressly identified in the *BIA*, such as in s. 179 of the *BIA* and the specific limitations on the scope of releases that can benefit directors of the debtor.

61 Counsel submits that the Applicants' position regarding the proper interpretation of s. 62(3) of the *BIA* and its place in the scheme of the *BIA* is consistent with the generally accepted principle that a proposal under the *BIA* is a contract. See *Metcalfe & Mansfield Alternative Investments II Corp. (Ltd.)*, 2008 ONCA 587; *Employers' Liability Assurance Corp. v. Ideal Petroleum (1953)*

Ltd., [1978] 1 S.C.R. 230; and *Society of Composeurs, Authors & Music Publishers of Canada v. Armitage* (2000), 20 C.B.R. (4th) 160 (C.A.). Consequently, counsel submits that parties are entitled to put anything into a proposal that could lawfully be incorporated into any contract (see *Air Canada (Re)* (2004), 2 C.B.R. (5th) 4) and that given that the prescribed majority creditors have the statutory right under the *BIA* to bind a minority, however, this principle is subject to any limitations that are contained in the express wording of the *BIA*.

62 On this point, it seems to me, that any provision of the *BIA* which purports to limit the ability of the debtor to contract with its creditors should be clear and explicit. To hold otherwise would result in severely limiting the debtor's ability to contract with its creditors, thereby the decreasing the likelihood that a viable proposal could be reached. This would manifestly defeat the purpose of the proposal provisions of the *BIA*.

63 The Applicants further submit that creditors' interests - including the interests of the minority creditors who do not vote in favour of a proposal containing a third-party release - are sufficiently protected by the overriding ability of a court to refuse to approve a proposal with an overly broad third-party release, or where the release results in the proposal failing to demonstrate that it is for the benefit of the general body of creditors. The Applicants submit that the application of the *Metcalfe* criteria to the release is a mechanism whereby this court can assure itself that these preconditions to approve the Consolidated Proposal contained in the Release have been satisfied.

64 The Applicants acknowledge that there are several cases in which courts have held that a *BIA* proposal that includes a third-party release cannot be approved by the court but submits that these cases are based on a mistaken premise, are readily distinguishable and do not reflect the modern approach to Canadian insolvency law. Further, they submit that none of these cases are binding on this court and should not be followed.

65 In *Kern Agencies Ltd. (No. 2) (Re)* (1931), 13 CBR 11, the court refused to approve a proposal that contained a release of the debtor's directors, officers and employees. Counsel points out that the court's refusal was based on a provision of the predecessor to the *BIA* which specifically provided that a proposal could only be binding on creditors (as far as relates to any debts due to them from the debtor). The current *BIA* does not contain equivalent general language. This case is clearly distinguishable.

66 In *Mister C's Ltd. (Re)*, (1995) 32 C.B.R. (3d) 242, the court refused to approve a proposal that had received creditor approval. The court cited numerous bases for its conclusion that the proposal was not reasonable or calculated to benefit the general body of creditors, one of which was the release of the principals of the debtor company. The scope of the release was only one of the issues with the proposal, which had additional significant issues (procedural irregularities, favourable terms for insiders, and inequitable treatment of creditors generally). I agree with counsel to the Applicants that this case can be distinguished.

67 *Re Cosmic Adventures Halifax Inc.* (1999) 13 C.B.R. (4th) 22 relies on *Kern* and furthermore the Applicants submit that the discussion of third-party releases is technically *obiter* because the proposal was amended on consent.

68 The fourth case is *C.F.G. Construction Inc. (Re)*, [2010] J.Q. no 12249, 2010 CarswellQue 10226 where the Quebec Superior Court refused to approve a proposal containing a release of two sureties of the debtor. The case was decided on alternate grounds - either that the *BIA* did not permit a release of sureties, or in any event, the release could not be justified on the facts. I agree with the

Applicants that this case is distinguishable. The case deals with the release of sureties and does not stand for any broader proposition.

69 In general, the Applicants' submission on this issue is that the court should apply the decision of the Court of Appeal for Ontario in *Metcalfe*, together with the binding principle set out by the Supreme Court in *Ted Leroy Trucking*, dictating a more liberal approach to the permissibility of third-party releases in *BIA* proposals than is taken by the Quebec court in *C.F.G. Construction Inc.* I agree.

70 The object of proposals under the *BIA* is to permit the debtor to restructure its business and, where possible, avoid the social and economic costs of liquidating its assets, which is precisely the same purpose as the *CCAA*. Although there are some differences between the two regimes and the *BIA* can generally be characterized as more "rules based", the thrust of the case law and the legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible, encouraging reorganization over liquidation. See *Ted Leroy Trucking*.

71 Recent case law has indicated that, in appropriate circumstances, third-party releases can be included in a plan of compromise and arrangement that is approved under the *CCAA*. See *Metcalfe*. The *CCAA* does not contain any express provisions permitting such third-party releases apart from certain limitations that apply to the compromise of claims against directors of the debtor company. See *CCAA* s. 5.1 and *Allen-Vanguard Corporation (Re)*, 2011 ONSC 733.

72 Counsel submits that although the mechanisms for dealing with the release of sureties and similar claimants are somewhat different in the *BIA* and *CCAA*, the differences are not of such significance that the presence of s. 62(3) of the *BIA* should be viewed as dictating a different approach to third-party releases generally from the approach that applies under the *CCAA*. I agree with this submission.

73 I also accept that if s. 62(3) of the *BIA* is interpreted as a prohibition against including the third-party release in the *BIA* proposal, the *BIA* and the *CCAA* would be in clear disharmony on this point. An interpretation of the *BIA* which leads to a result that is different from the *CCAA* should only be adopted pursuant to clear statutory language which, in my view, is not present in the *BIA*.

74 The most recent and persuasive example of the application of such a harmonious approach to the interpretation of the *BIA* and the *CCAA* can be found in *Ted Leroy Trucking*.

75 At issue in *Ted Leroy Trucking* was how to resolve an apparent conflict between the deemed trust provisions of the *Excise Tax Act* and the provisions of the *CCAA*. The language of the *Excise Tax Act* created a deemed trust over GST amounts collected by the debtor that was stated to apply "despite any other Act of Parliament". The *CCAA* stated that the deemed trust for GST did not apply under the *CCAA*, unless the funds otherwise specified the criteria for a "true" trust. The court was required to determine which federal provision should prevail.

76 By contrast, the same issue did not arise under the *BIA*, due to the language in the *Excise Tax Act* specifically indicating that the continued existence of the deemed trust depended on the terms of the *BIA*. The *BIA* contained a similar provision to the *CCAA* indicating that the deemed trust for GST amounts would no longer apply in a *BIA* proceeding.

77 Deschamps J., on behalf of six other members of the court, with Fish J. concurring and Abella J. dissenting, held that the proper interpretation of the statutes was that the *CCAA* provision

should prevail, the deemed trust under the *Excise Tax Act* would cease to exist in a *CCAA* proceeding. In resolving the conflict between the *Excise Tax Act* and the *CCAA*, Deschamps J. noted the strange asymmetry which would arise if the *BIA* and *CCAA* were not in harmony on this issue:

> Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

78 It seems to me that these principles indicate that the court should generally strive, where the language of both statutes can support it, to give both statutes a harmonious interpretation to avoid the ills that can arise from "statute-shopping". These considerations, counsel submits, militate against adopting a strained reading of s. 62(3) of the *BIA* as a prohibition against third-party releases in a *BIA* proposal. I agree. In my opinion, there is no principled basis on which the analysis and treatment of a third-party release in a *BIA* proposal proceeding should differ from a CCAA proceeding.

79 The Applicants submit that it logically follows that the court is entitled to approve the Consolidated Proposal, including the Release, on the basis that it is reasonable and calculated to benefit the general body of creditors. Further, in keeping with the principles of harmonious interpretation of the *BIA* and the *CCAA*, the court should satisfy itself that the *Metcalfe* criteria, which apply to the approval of a third-party release under the CCAA, has been satisfied in relation to the Release.

80 In *Metcalfe*, the Court of Appeal for Ontario held that the requirements that must be satisfied to justify a third-party release are:

> (a) the parties to be released are necessary and essential to the restructuring of the debtor;
> (b) the claims to be released are rationally related to the purpose of the Plan (Proposal) and necessary for it;
> (c) the Plan (Proposal) cannot succeed without the releases;
> (d) the parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan (Proposal); and
> (e) the Plan (Proposal) will benefit not only the debtor companies but creditors generally.

81 These requirements have also been referenced in *Canwest Global Communications Corp. (Re),* 70 C.B.R. (5th) 1 and *Angiotech Pharmaceuticals Inc. (Re)* 76 C.B.R. (5th) 210.

82 No single requirement listed above is determinative and the analysis must take into account the facts particular to each claim.

83 The Applicants submit that the Release satisfies each of the *Metcalfe* criteria. Firstly, counsel submits that following the closing of the Asset Purchase Agreement in 2006, Budd Canada had no operating assets or income and relied on inter-company advances to fund the pension and OPEB requirements to be made by Budd Canada on behalf of KFL pursuant to the Asset Purchase Agreement. Such funded amounts total approximately $112.7 million in pension payments and $24.6 million in OPEB payments between the closing of the Asset Purchase Agreement and the Filing Date. In addition, TK Finance has been providing Budd Canada and KFL with the necessary funding to pay the professional and other costs associated with the *BIA* Proposal Proceedings and will continue to fund such amounts through the Proposal Implementation Date. Moreover, TK Canada and TK Finance have agreed to forego recoveries under the Consolidated Proposal on account of their existing secured and unsecured inter-company loans in the amount of approximately $120 million.

84 Counsel submits that the releases provided in respect of the Applicants' affiliates are the *quid pro quo* for the sacrifices made by such affiliates to significantly enlarge recoveries for the unsecured creditors of the Applicants, particularly the OPEB creditors and reflects that the affiliates have provided over $135 million over the last five years in respect of the pension and OPEB amounts and additional availability of approximately $49 million to allow the Applicants to discharge their obligations to their former employees and retirees. Without the Releases, counsel submits, the Applicants' affiliates would have little or no incentive to contribute funds to the Consolidated Proposal and to waive their own rights against the Applicants.

85 The Release in favour of Martinrea is fully discussed at paragraphs 121-127 of the factum. The Applicants submit that the third-party releases set out in the Consolidated Proposal are clearly rationally related, necessary and essential to the Consolidated Proposal and are not overly broad.

86 Having reviewed the submissions in detail, I am in agreement that the Released Parties are contributing in a tangible and realistic way to the Consolidated Proposal.

87 I am also satisfied that without the Applicants' commitment to include the Release in the Consolidated Proposal to protect the Released Parties, it is unlikely that certain of such parties would have been prepared to support the Consolidated Proposal. The releases provided in respect of the Applicants' affiliates are particularly significant in this regard, since the sacrifices and monetary contributions of such affiliates are the primary reason that the Applicants have been able to make the Consolidated Proposal. Further, I am also satisfied that without the Release, the Applicants would be unable to satisfy the borrowing conditions under the Amended and Restated Senior Secured Loan Agreement with respect to the Applicants having only certain permitted liabilities after the Proposal Implementation Date. The alternative for the Applicants is bankruptcy, a scenario in which their affiliates' claims aggregating approximately $120 million would significantly erode recoveries for the unsecured creditors of the Applicants.

88 I am also satisfied that the Releases benefit the Applicants and creditors generally. The primary non-affiliated Creditors of the Applicants are the OPEB Creditors and Creditors with Pension Claims, together with the CRA. The Consolidated Proposal, in my view, clearly benefits these Creditors by generating higher recoveries than could be obtained from the bankruptcies of the Applicants. Moreover, the timing of any such bankruptcy recoveries is uncertain. As noted by the Proposal Trustee, the amount that the Affected Creditors would receive in the event of the bankruptcies of the Applicants is uncertain both in terms of quantum and timing, with the Applicants' funding of OPEB Claims terminating on bankruptcy, but distributions to the OPEB Creditors and other Creditors delayed for at least a year or two but perhaps much longer.

89 The Applicants and their affiliates also benefit from the Release as an affiliate of the Applicants may become enabled to use the net operating losses (NOL) following a series of transactions that are expected to occur immediately following the Proposal Implementation Date.

90 I am also satisfied that the Applicants have provided full and adequate disclosure of the Releases and their effect. Full disclosure was made in the proposal term sheet circulated to both Representative Counsel in early August 2011. The Release was negotiated as part of the Consolidated Proposal and the scope of the Release was disclosed by the Proposal Trustee in its Report to the creditors on the terms of the Consolidated Proposal, which Report was circulated by the Proposal Trustee to the Applicants' known creditors in advance of the creditors' meeting.

91 I am satisfied that the Applicants, with the assistance of the Proposal Trustee, took appropriate steps to ensure that the Affected Creditors were aware of the existence of the release provisions prior to the creditors' meeting.

92 For the foregoing reasons, I have concluded that the Release contained in the Consolidated Proposal meets the *Metcalfe* criteria and should be approved.

93 In the result, I am satisfied that the section 59(2) *BIA* test has been met and that it is appropriate to grant the Sanction Order in the form of the draft order attached to the Motion Record. An order has been signed to give effect to the foregoing.

G.B. MORAWETZ J.

cp/e/qlafr/qlvxw/qlana/qlhcs

Tab 37

Case Name:
Nortel Networks Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
AND IN THE MATTER OF a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, Applicants

[2010] O.J. No. 1232

2010 ONSC 1708

63 C.B.R. (5th) 44

81 C.C.P.B. 56

2010 CarswellOnt 1754

Court File No. 09-CL-7950

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: March 3-5, 2010.
Judgment: March 26, 2010.

(106 paras.)

Bankruptcy and insolvency law -- Property of bankrupt -- Pensions and benefits -- Motion by the applicant Nortel corporations for approval of a settlement agreement dismissed -- The settlement agreement contained a clause that stating that no party was precluded from arguing the applicability of any amendment to the Bankruptcy and Insolvency Act that changed the priority of claims -- The clause was not fair and reasonable -- The clause resulted in an agreement that did not provide certainty and did not provide finality of a fundamental priority issue -- Companies' Creditors Arrangement Act, s. 5.1(2).

Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Sanction by court -- Motion by the applicant Nortel corporations for approval of a settlement agreement dismissed -- The settlement agreement contained a clause that stating that no party was precluded from arguing the applicability of any amendment to the Bankruptcy and Insolvency Act that changed the priority of claims -- The clause was not fair and reasonable -- The clause resulted in an agreement that did not provide certainty and did not provide finality of a fundamental priority issue -- Companies' Creditors Arrangement Act, s. 5.1(2).

Motion by the applicant Nortel corporations for approval of a settlement agreement. The settlement agreement provided for the termination of pension payments and the termination of benefits paid through Nortel's Health and Welfare Trust (HWT). The applicants were granted a stay of proceedings on January 14, 2009, pursuant to the Companies' Creditors Arrangement Act, but had continued to provide the HWT benefits and had continued contributions and special payments to the pension plans. The opposing long-term disability employees opposed the settlement agreement, principally as a result of the inclusion of a release of Nortel and its successors, advisors, directors and officers, from all future claims regarding the pension plans and the HWT in the absence of fraud. The Official Committee of Unsecured Creditors of Nortel Networks Inc. ("UCC"), and the informal Nortel Noteholder Group (the "Noteholders") opposed Clause H.2 of the settlement agreement. Clause H.2 stated that no party was precluded from arguing the applicability of any amendment to the Bankruptcy and Insolvency Act that changed the priority of claims. The Monitor supported the Settlement Agreement, submitting that it was necessary to allow the Applicants to wind down operations and to develop a plan of arrangement. The CAW and Board of Directors of Nortel also supported the settlement agreement.

HELD: Motion dismissed. Cause H.2 was not fair and reasonable. Clause H.2 resulted in an agreement that did not provide certainty and did not provide finality of a fundamental priority issue. The third party releases were necessary and connected to a resolution of the claims against the applicants, benefited creditors generally and were not overly broad or **offensive to public policy.**

Statutes, Regulations and Rules Cited:

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

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.1(2)

Counsel:

Derrick Tay, Jennifer Stam and Suzanne Wood, for the Applicants.

Lyndon Barnes and Adam Hirsh, for the Nortel Directors.

Benjamin Zarnett, Gale Rubenstein, C. Armstrong and Melaney Wagner, for Ernst & Young Inc., Monitor.

Arthur O. Jacques, for the Nortel Canada Current Employees.

Deborah McPhail, for the Superintendent of Financial Services (non-PBGF).

Mark Zigler and Susan Philpott, for the Former and Long-Term Disability Employees.

Ken Rosenberg and M. Starnino, for the Superintendent of Financial Services in its capacity as Administrator of the Pension Benefit Guarantee Fund.

S. Richard Orzy and Richard B. Swan, for the Informal Nortel Noteholder Group.

Alex MacFarlane and Mark Dunsmuir, for the Unsecured Creditors' Committee of Nortel Networks Inc.

Leanne Williams, for Flextronics Inc.

Barry Wadsworth, for the CAW-Canada.

Pamela Huff, for the Northern Trust Company, Canada.

Joel P. Rochon and Sakie Tambakos, for the Opposing Former and Long-Term Disability Employees.

Robin B. Schwill, for the Nortel Networks UK Limited (In Administration).

Sorin Gabriel Radulescu, In Person.

Guy Martin, In Person, on behalf of Marie Josee Perrault.

Peter Burns, In Person.

Stan and Barbara Arnelien, In Person.

ENDORSEMENT

G.B. MORAWETZ J.:--

INTRODUCTION

1 On January 14, 2009, Nortel Networks Corporation ("NNC"), Nortel Networks Limited "(NNL"), Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation (collectively, the "Applicants") were granted a stay of proceedings pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") and Ernst & Young Inc. was appointed as Monitor.

2 The Applicants have historically operated a number of pension, benefit and other plans (both funded and unfunded) for their employees and pensioners, including:

(i) Pension benefits through two registered pension plans, the Nortel Networks Limited Managerial and Non-Negotiated Pension Plan and the Nortel Networks Negotiated Pension Plan (the "Pension Plans"); and

(ii) Medical, dental, life insurance, long-term disability and survivor income and transition benefits paid, except for survivor termination benefits, through Nortel's Health and Welfare Trust (the "HWT").

3 Since the CCAA filing, the Applicants have continued to provide medical, dental and other benefits, through the HWT, to pensioners and employees on long-term disability ("Former and LTD

Employees") and active employees ("HWT Payments") and have continued all current service contributions and special payments to the Pension Plans ("Pension Payments").

4 Pension Payments and HWT Payments made by the Applicants to the Former and LTD Employees while under CCAA protection are largely discretionary. As a result of Nortel's insolvency and the significant reduction in the size of Nortel's operations, the unfortunate reality is that, at some point, cessation of such payments is inevitable. The Applicants have attempted to address this situation by entering into a settlement agreement (the "Settlement Agreement") dated as of February 8, 2010, among the Applicants, the Monitor, the Former Employees' Representatives (on their own behalf and on behalf of the parties they represent), the LTD Representative (on her own behalf and on behalf of the parties she represents), Representative Settlement Counsel and the CAW-Canada (the "Settlement Parties").

5 The Applicants have brought this motion for approval of the Settlement Agreement. From the standpoint of the Applicants, the purpose of the Settlement Agreement is to provide for a smooth transition for the termination of Pension Payments and HWT Payments. The Applicants take the position that the Settlement Agreement represents the best efforts of the Settlement Parties to negotiate an agreement and is consistent with the spirit and purpose of the CCAA.

6 The essential terms of the Settlement Agreement are as follows:

(a) until December 31, 2010, medical, dental and life insurance benefits will be funded on a pay-as-you-go basis to the Former and LTD Employees;

(b) until December 31, 2010, LTD Employees and those entitled to receive survivor income benefits will receive income benefits on a pay-as-you-go basis;

(c) the Applicants will continue to make current service payments and special payments to the Pension Plans in the same manner as they have been doing over the course of the proceedings under the CCAA, through to March 31, 2010, in the aggregate amount of $2,216,254 per month and that thereafter and through to September 30, 2010, the Applicants shall make only current service payments to the Pension Plans, in the aggregate amount of $379,837 per month;

(d) any allowable pension claims, in these or subsequent proceedings, concerning any Nortel Worldwide Entity, including the Applicants, shall rank *pari passu* with ordinary, unsecured creditors of Nortel, and no part of any such HWT claims shall rank as a preferential or priority claim or shall be the subject of a constructive trust or trust of any nature or kind;

(e) proofs of claim asserting priority already filed by any of the Settlement Parties, or the Superintendent on behalf of the Pension Benefits Guarantee Fund are disallowed in regard to the claim for priority;

(f) any allowable HWT claims made in these or subsequent proceedings shall rank *pari passu* with ordinary unsecured creditors of Nortel;

(g) the Settlement Agreement does not extinguish the claims of the Former and LTD Employees;

(h) Nortel and, *inter alia*, its successors, advisors, directors and officers, are released from all future claims regarding Pension Plans and the HWT, provided that nothing in the release shall release a director of the Applicants

from any matter referred to in subsection 5.1(2) of the CCAA or with respect to fraud on the part of any Releasee, with respect to that Releasee only;

(i) upon the expiry of all appeals and rights of appeal in respect thereof, Representative Settlement Counsel will withdraw their application for leave to appeal the decision of the Court of Appeal, dated November 26, 2009, to the Supreme Court of Canada on a with prejudice basis;[1]

(j) a CCAA plan of arrangement in the Nortel proceedings will not be proposed or approved if that plan does not treat the Pension and HWT claimants *pari passu* to the other ordinary, unsecured creditors ("Clause H.1"); and

(k) if there is a subsequent amendment to the *Bankruptcy and Insolvency Act* ("BIA") that "changes the current, relative priorities of the claims against Nortel, no party is precluded by this Settlement Agreement from arguing the applicability" of that amendment to the claims ceded in this Agreement ("Clause H.2").

7 The Settlement Agreement does *not* relate to a distribution of the HWT as the Settlement Parties have agreed to work towards developing a Court-approved distribution of the HWT corpus in 2010.

8 The Applicants' motion is supported by the Settlement Parties and by the Board of Directors of Nortel.

9 The Official Committee of Unsecured Creditors of Nortel Networks Inc. ("UCC"), the informal Nortel Noteholder Group (the "Noteholders"), and a group of 37 LTD Employees (the "Opposing LTD Employees") oppose the Settlement Agreement.

10 The UCC and Noteholders oppose the Settlement Agreement, principally as a result of the inclusion of Clause H.2.

11 The Opposing LTD Employees oppose the Settlement Agreement, principally as a result of the inclusion of the third party releases referenced in [6h] above.

THE FACTS

A. Status of Nortel's Restructuring

12 Although it was originally hoped that the Applicants would be able to restructure their business, in June 2009 the decision was made to change direction and pursue sales of Nortel's various businesses.

13 In response to Nortel's change in strategic direction and the impending sales, Nortel announced on August 14, 2009 a number of organizational updates and changes including the creation of groups to support transitional services and management during the sales process.

14 Since June 2009, Nortel has closed two major sales and announced a third. As a result of those transactions, approximately 13,000 Nortel employees have been or will be transferred to purchaser companies. That includes approximately 3,500 Canadian employees.

15 Due to the ongoing sales of Nortel's business units and the streamlining of Nortel's operations, it is expected that by the close of 2010, the Applicants' workforce will be reduced to only 475 employees. There is a need to wind-down and rationalize benefits and pension processes.

16 Given Nortel's insolvency, the significant reduction in Nortel's operations and the complexity and size of the Pension Plans, both Nortel and the Monitor believe that the continuation and funding of the Pension Plans and continued funding of medical, dental and other benefits is not a viable option.

B. The Settlement Agreement

17 On February 8, 2010 the Applicants announced that a settlement had been reached on issues related to the Pension Plans, and the HWT and certain employment related issues.

18 Recognizing the importance of providing notice to those who will be impacted by the Settlement Agreement, including the Former Employees, the LTD Employees, unionized employees, continuing employees and the provincial pension plan regulators ("Affected Parties"), Nortel brought a motion to this Court seeking the approval of an extensive notice and opposition process.

19 On February 9, 2010, this Court approved the notice program for the announcement and disclosure of the Settlement (the "Notice Order").

20 As more fully described in the Monitor's Thirty-Sixth, Thirty-Ninth and Thirty-Ninth Supplementary Reports, the Settlement Parties have taken a number of steps to notify the Affected Parties about the Settlement.

21 In addition to the Settlement Agreement, the Applicants, the Monitor and the Superintendent, in his capacity as administrator of the Pension Benefits Guarantee Fund, entered into a letter agreement on February 8, 2010, with respect to certain matters pertaining to the Pension Plans (the "Letter Agreement").

22 The Letter Agreement provides that the Superintendent will not oppose an order approving the Settlement Agreement ("Settlement Approval Order"). Additionally, the Monitor and the Applicants will take steps to complete an orderly transfer of the Pension Plans to a new administrator to be appointed by the Superintendent effective October 1, 2010. Finally, the Superintendent will not oppose any employee incentive program that the Monitor deems reasonable and necessary or the creation of a trust with respect to claims or potential claims against persons who accept directorships of a Nortel Worldwide Entity in order to facilitate the restructuring.

POSITIONS OF THE PARTIES ON THE SETTLEMENT AGREEMENT

The Applicants

23 The Applicants take the position that the Settlement is fair and reasonable and balances the interests of the parties and other affected constituencies equitably. In this regard, counsel submits that the Settlement:

(a) eliminates uncertainty about the continuation and termination of benefits to pensioners, LTD Employees and survivors, thereby reducing hardship and disruption;

(b) eliminates the risk of costly and protracted litigation regarding Pension Claims and HWT Claims, leading to reduced costs, uncertainty and potential disruption to the development of a Plan;
(c) prevents disruption in the transition of benefits for current employees;
(d) provides early payments to terminated employees in respect of their termination and severance claims where such employees would otherwise have had to wait for the completion of a claims process and distribution out of the estates;
(e) assists with the commitment and retention of remaining employees essential to complete the Applicants' restructuring; and
(f) does not eliminate Pension Claims or HWT Claims against the Applicants, but maintains their quantum and validity as ordinary and unsecured claims.

24 Alternatively, absent the approval of the Settlement Agreement, counsel to the Applicants submits that the Applicants are not required to honour such benefits or make such payments and such benefits could cease immediately. This would cause undue hardship to beneficiaries and increased uncertainty for the Applicants and other stakeholders.

25 The Applicants state that a central objective in the Settlement Agreement is to allow the Former and LTD Employees to transition to other sources of support.

26 In the absence of the approval of the Settlement Agreement or some other agreement, a cessation of benefits will occur on March 31, 2010 which would have an immediate negative impact on Former and LTD Employees. The Applicants submit that extending payments to the end of 2010 is the best available option to allow recipients to order their affairs.

27 Counsel to the Applicants submits that the Settlement Agreement brings Nortel closer to finalizing a plan of arrangement, which is consistent with the sprit and purpose of the CCAA. The Settlement Agreement resolves uncertainties associated with the outstanding Former and LTD Employee claims. The Settlement Agreement balances certainty with clarity, removing litigation risk over priority of claims, which properly balances the interests of the parties, including both creditors and debtors.

28 Regarding the priority of claims going forward, the Applicants submit that because a deemed trust, such as the HWT, is not enforceable in bankruptcy, the Former and LTD Employees are by default *pari passu* with other unsecured creditors.

29 In response to the Noteholders' concern that bankruptcy prior to October 2010 would create pension liabilities on the estate, the Applicants committed that they would not voluntarily enter into bankruptcy proceedings prior to October 2010. Further, counsel to the Applicants submits the court determines whether a bankruptcy order should be made if involuntary proceedings are commenced.

30 Further, counsel to the Applicants submits that the court has the jurisdiction to release third parties under a Settlement Agreement where the releases (1) are connected to a resolution of the debtor's claims, (2) will benefit creditors generally and (3) are not overly broad or **offensive to public policy.** See *Re Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 92 O.R. (3d) 513 (C.A.), [*Metcalfe*] at para. 71, leave to appeal refused, [2008] S.C.C.A. No. 337 and *Re Grace* [2008] O.J. No. 4208 (S.C.J.) [*Grace 2008*] at para. 40.

31 The Applicants submit that a settlement of the type put forward should be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all the circumstances. Elements of fairness and reasonableness include balancing the interests of parties, including any objecting creditor or creditors, equitably (although not necessarily equally); and ensuring that the agreement is beneficial to the debtor and its stakeholders generally, as per *Re Air Canada*, [2003] O.J. No. 5319 (S.C.J.) [*Air Canada*]. The Applicants assert that this test is met.

The Monitor

32 The Monitor supports the Settlement Agreement, submitting that it is necessary to allow the Applicants to wind down operations and to develop a plan of arrangement. The Monitor submits that the Settlement Agreement provides certainty, and does so with input from employee stakeholders. These stakeholders are represented by Employee Representatives as mandated by the court and these Employee Representatives were given the authority to approve such settlements on behalf of their constituents.

33 The Monitor submits that Clause H.2 was bargained for, and that the employees did give up rights in order to have that clause in the Settlement Agreement; particularly, it asserts that Clause H.1 is the counterpoint to Clause H.2. In this regard, the Settlement Agreement is fair and reasonable.

34 The Monitor asserts that the court may either (1) approve the Settlement Agreement, (2) not approve the Settlement Agreement, or (3) not approve the Settlement Agreement but provide practical comments on the applicability of Clause H.2.

Former and LTD Employees

35 The Former Employees' Representatives' constituents number an estimated 19,458 people. The LTD Employees number an estimated 350 people between the LTD Employee's Representative and the CAW-Canada, less the 37 people in the Opposing LTD Employee group.

36 Representative Counsel to the Former and LTD Employees acknowledges that Nortel is insolvent, and that much uncertainty and risk comes from insolvency. They urge that the Settlement Agreement be considered within the scope of this reality. The alternative to the Settlement Agreement is costly litigation and significant uncertainty.

37 Representative Counsel submits that the Settlement Agreement is fair and reasonable for all creditors, but especially the represented employees. Counsel notes that employees under Nortel are unique creditors under these proceedings, as they are not sophisticated creditors and their personal welfare depends on receiving distributions from Nortel. The Former and LTD Employees assert that this is the best agreement they could have negotiated.

38 Representative Counsel submits that bargaining away of the right to litigate against directors and officers of the corporation, as well at the trustee of the HWT, are examples of the concessions that have been made. They also point to the giving up of the right to make priority claims upon distribution of Nortel's estate and the HWT, although the claim itself is not extinguished. In exchange, the Former and LTD Employees will receive guaranteed coverage until the end of 2010. The Former and LTD Employees submit that having money in hand today is better than uncertainty going forward, and that, on balance, this Settlement Agreement is fair and reasonable.

39 In response to allegations that third party releases unacceptably compromise employees' rights, Representative Counsel accepts that this was a concession, but submits that it was satisfac-

tory because the claims given up are risky, costly and very uncertain. The releases do not go beyond s. 5.1(2) of the CCAA, which disallows releases relating to misrepresentations and wrongful or oppressive conduct by directors. Releases as to deemed trust claims are also very uncertain and were acceptably given up in exchange for other considerations.

40 The Former and LTD Employees submit that the inclusion of Clause H.2 was essential to their approval of the Settlement Agreement. They characterize Clause H.2 as a no prejudice clause to protect the employees by not releasing any future potential benefit. Removing Clause H.2 from the Settlement Agreement would be not the approval of an agreement, but rather the creation of an entirely new Settlement Agreement. Counsel submits that without Clause H.2, the Former and LTD Employees would not be signatories.

CAW

41 The CAW supports the Settlement Agreement. It characterizes the agreement as Nortel's recognition that it has a moral and legal obligation to its employees, whose rights are limited by the laws in this country. The Settlement Agreement temporarily alleviates the stress and uncertainty its constituents feel over the winding up of their benefits and is satisfied with this result.

42 The CAW notes that some members feel they were not properly apprised of the facts, but all available information has been disclosed, and the concessions made by the employee groups were not made lightly.

Board of Directors

43 The Board of Directors of Nortel supports the Settlement Agreement on the basis that it is a practical resolution with compromises on both sides.

Opposing LTD Employees

44 Mr. Rochon appeared as counsel for the Opposing LTD Employees, notwithstanding that these individuals did not opt out of having Representative Counsel or were represented by the CAW. The submissions of the Opposing LTD Employees were compelling and the court extends it appreciation to Mr. Rochon and his team in co-ordinating the representatives of this group.

45 The Opposing LTD Employees put forward the position that the cessation of their benefits will lead to extreme hardship. Counsel submits that the Settlement Agreement conflicts with the spirit and purpose of the CCAA because the LTD Employees are giving up legal rights in relation to a $100 million shortfall of benefits. They urge the court to consider the unique circumstances of the LTD Employees as they are the people hardest hit by the cessation of benefits.

46 The Opposing LTD Employees assert that the HWT is a true trust, and submit that breaches of that trust create liabilities and that the claim should not be released. Specifically, they point to a $37 million shortfall in the HWT that they should be able to pursue.

47 Regarding the third party releases, the Opposing LTD Employees assert that Nortel is attempting to avoid the distraction of third party litigation, rather than look out for the best interests of the Former and LTD Employees. The Opposing LTD Employees urge the court not to release the only individuals the Former and LTD Employees can hold accountable for any breaches of trust. Counsel submits that Nortel has a common law duty to fund the HWT, which the Former and LTD Employees should be allowed to pursue.

48 Counsel asserts that allowing these releases (a) is not necessary and essential to the restructuring of the debtor, (b) does not relate to the insolvency process, (c) is not required for the success of the Settlement Agreement, (d) does not meet the requirement that each party contribute to the plan in a material way and (e) is overly broad and therefore not fair and reasonable.

49 Finally, the Opposing LTD Employees oppose the *pari passu* treatment they will be subjected to under the Settlement Agreement, as they have a true trust which should grant them priority in the distribution process. Counsel was not able to provide legal authority for such a submission.

50 A number of Opposing LTD Employees made in person submissions. They do not share the view that Nortel will act in their best interests, nor do they feel that the Employee Representatives or Representative Counsel have acted in their best interests. They shared feelings of uncertainty, helplessness and despair. There is affidavit evidence that certain individuals will be unable to support themselves once their benefits run out, and they will not have time to order their affairs. They expressed frustration and disappointment in the CCAA process.

UCC

51 The UCC was appointed as the representative for creditors in the U.S. Chapter 11 proceedings. It represents creditors who have significant claims against the Applicants. The UCC opposes the motion, based on the inclusion of Clause H.2, but otherwise the UCC supports the Settlement Agreement.

52 Clause H.2, the UCC submits, removes the essential element of finality that a settlement agreement is supposed to include. The UCC characterizes Clause H.2 as a take back provision; if activated, the Former and LTD Employees have compromised nothing, to the detriment of other unsecured creditors. A reservation of rights removes the finality of the Settlement Agreement.

53 The UCC claims it, not Nortel, bears the risk of Clause H.2. As the largest unsecured creditor, counsel submits that a future change to the BIA could subsume the UCC's claim to the Former and LTD Employees and the UCC could end up with nothing at all, depending on Nortel's asset sales.

Noteholders

54 The Noteholders are significant creditors of the Applicants. The Noteholders oppose the settlement because of Clause H.2, for substantially the same reasons as the UCC.

55 Counsel to the Noteholders submits that the inclusion of H.2 is prejudicial to the non-employee unsecured creditors, including the Noteholders. Counsel submits that the effect of the Settlement Agreement is to elevate the Former and LTD Employees, providing them a payout of $57 million over nine months while everyone else continues to wait, and preserves their rights in the event the laws are amended in future. Counsel to the Noteholders submits that the Noteholders forego millions of dollars while remaining exposed to future claims.

56 The Noteholders assert that a proper settlement agreement must have two elements: a real compromise, and resolution of the matters in contention. In this case, counsel submits that there is no resolution because there is no finality in that Clause H.2 creates ambiguity about the future. The very object of a Settlement Agreement, assert the Noteholders, is to avoid litigation by withdrawing claims, which this agreement does not do.

Superintendent

57 The Superintendent does not oppose the relief sought, but this position is based on the form of the Settlement Agreement that is before the Court.

Northern Trust

58 Northern Trust, the trustee of the pension plans and HWT, takes no position on the Settlement Agreement as it takes instructions from Nortel. Northern Trust indicates that an oversight left its name off the third party release and asks for an amendment to include it as a party released by the Settlement Agreement.

LAW AND ANALYSIS

A. Representation and Notice Were Proper

59 It is well settled that the Former Employees' Representatives and the LTD Representative (collectively, the "Settlement Employee Representatives") and Representative Counsel have the authority to represent the Former Employees and the LTD Beneficiaries for purposes of entering into the Settlement Agreement on their behalf: *see Grace 2008, supra* at para. 32.

60 The court appointed the Settlement Employee Representatives and the Representative Settlement Counsel. These appointment orders have not been varied or appealed. Unionized employees continue to be represented by the CAW. The Orders appointing the Settlement Employee Representatives expressly gave them authority to represent their constituencies "for the purpose of settling or compromising claims" in these Proceedings. Former Employees and LTD Employees were given the right to opt out of their representation by Representative Settlement Counsel. After provision of notice, only one former employee and one active employee exercised the opt-out right.

B. Effect of the Settlement Approval Order

61 In addition to the binding effect of the Settlement Agreement, many additional parties will be bound and affected by the Settlement Approval Order. Counsel to the Applicants submits that the binding nature of the Settlement Approval Order on all affected parties is a crucial element to the Settlement itself. In order to ensure all Affected Parties had notice, the Applicants obtained court approval of their proposed notice program.

62 Even absent such extensive noticing, virtually all employees of the Applicants are represented in these proceedings. In addition to the representative authority of the Settlement Employee Representatives and Representative Counsel as noted above, Orders were made authorizing a Nortel Canada Continuing Employees' Representative and Nortel Canada Continuing Employees' Representative Counsel to represent the interests of continuing employees on this motion.

63 I previously indicated that "the overriding objective of appointing representative counsel for employees is to ensure that the employees have representation in the CCAA process": *Re Nortel Networks Corp.,* [2009] O.J. No. 2529 at para. 16. I am satisfied that this objective has been achieved.

64 The Record establishes that the Monitor has undertaken a comprehensive notice process which has included such notice to not only the Former Employees, the LTD Employees, the unionized employees and the continuing employees but also the provincial pension regulators and has given the opportunity for any affected person to file Notices of Appearance and appear before this court on this motion.

65 I am satisfied that the notice process was properly implemented by the Monitor.

66 I am satisfied that Representative Counsel has represented their constituents' interests in accordance with their mandate, specifically, in connection with the negotiation of the Settlement Agreement and the draft Settlement Approval Order and appearance on this Motion. There have been intense discussions, correspondence and negotiations among Representative Counsel, the Monitor, the Applicants, the Superintendent, counsel to the Board of the Applicants, the Noteholder Group and the Committee with a view to developing a comprehensive settlement. NCCE's Representative Counsel have been apprised of the settlement discussions and served with notice of this Motion. Representatives have held Webinar sessions and published press releases to inform their constituents about the Settlement Agreement and this Motion.

C. Jurisdiction to Approve the Settlement Agreement

67 The CCAA is a flexible statute that is skeletal in nature. It has been described as a "sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest". *Re Nortel,* [2009] O.J. No. 3169 (S.C.J.) at paras. 28-29, citing *Metcalfe, supra,* at paras. 44 and 61.

68 Three sources for the court's authority to approve pre-plan agreements have been recognized:

(a) the power of the court to impose terms and conditions on the granting of a stay under s. 11(4) of the CCAA;
(b) the power of the court to make an order "on such terms as it may impose" pursuant to s. 11(4) of the CCAA; and
(c) the inherent jurisdiction of the court to "fill in the gaps" of the CCAA in order to give effect to its objects: see *Re Nortel,* [2009] O.J. No. 3169 (S.C.J.) at para. 30, citing *Re Canadian Red Cross Society*, [1998] O.J. No. 3306 (Gen. Div.) [*Canadian Red Cross*] at para. 43; *Metcalfe, supra* at para. 44.

69 In *Re Stelco Inc.*, (2005), 78 O.R. (3d) 254 (C.A.), the Ontario Court of Appeal considered the court's jurisdiction under the CCAA to approve agreements, determining at para. 14 that it is not limited to preserving the *status quo*. Further, agreements made prior to the finalization of a plan or compromise are valid orders for the court to approve: *Grace 2008, supra* at para. 34.

70 In these proceedings, this court has confirmed its jurisdiction to approve major transactions, including settlement agreements, during the stay period defined in the Initial Order and prior to the proposal of any plan of compromise or arrangement: see, for example, *Re Nortel*, [2009] O.J. No. 5582 (S.C.J.); *Re Nortel* [2009] O.J. 5582 (S.C.J.) and *Re Nortel*, 2010 ONSC 1096 (S.C.J.).

71 I am satisfied that this court has jurisdiction to approve transactions, including settlements, in the course of overseeing proceedings during a CCAA stay period and prior to any plan of arrangement being proposed to creditors: see *Re Calpine Canada Energy Ltd.,* [2007] A.J. No. 917 (C.A.) [*Calpine*] at para. 23, affirming [2007] A.J. No. 923 (Q.B.); *Canadian Red Cross, supra*; *Air Canada, supra*; *Grace 2008, supra,* and *Re Grace Canada* [2010] O.J. No. 62 (S.C.J.) [*Grace 2010*], leave to appeal to the C.A. refused February 19, 2010; *Re Nortel*, 2010 ONSC 1096 (S.C.J.).

D. Should the Settlement Agreement Be Approved?

72 Having been satisfied that this court has the jurisdiction to approve the Settlement Agreement, I must consider whether the Settlement Agreement *should* be approved.

73 A Settlement Agreement can be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all circumstances. What makes a settlement agreement fair and reasonable is its balancing of the interests of all parties; its equitable treatment of the parries, including creditors who are not signatories to a settlement agreement; and its benefit to the Applicant and its stakeholders generally.

i) Sprit and Purpose

74 The CCAA is a flexible instrument; part of its purpose is to allow debtors to balance the conflicting interests of stakeholders. The Former and LTD Employees are significant creditors and have a unique interest in the settlement of their claims. This Settlement Agreement brings these creditors closer to ultimate settlement while accommodating their special circumstances. It is consistent with the spirit and purpose of the CCAA.

ii) Balancing of Parties' Interests

75 There is no doubt that the Settlement Agreement is comprehensive and that it has support from a number of constituents when considered in its totality.

76 There is, however, opposition from certain constituents on two aspects of the proposed Settlement Agreement: (1) the Opposing LTD Employees take exception to the inclusion of the third party releases; (2) the UCC and Noteholder Groups take exception to the inclusion of Clause H.2.

Third Party Releases

77 Representative Counsel, after examining documentation pertaining to the Pension Plans and HWT, advised the Former Employees' Representatives and Disabled Employees' Representative that claims against directors of Nortel for failing to properly fund the Pension Plans were unlikely to succeed. Further, Representative Counsel advised that claims against directors or others named in the Third Party Releases to fund the Pension Plans were risky and could take years to resolve, perhaps unsuccessfully. This assisted the Former Employees' Representatives and the Disabled Employees' Representative in agreeing to the Third Party Releases.

78 The conclusions reached and the recommendations made by both the Monitor and Representative Counsel are consistent. They have been arrived at after considerable study of the issues and, in my view, it is appropriate to give significant weight to their positions.

79 In *Grace 2008, supra,* and *Grace 2010, supra,* I indicated that a Settlement Agreement entered into with Representative Counsel that contains third party releases is fair and reasonable where the releases are necessary and connected to a resolution of claims against the debtor, will benefit creditors generally and are not overly broad or **offensive to public policy.**

80 In this particular case, I am satisfied that the releases are necessary and connected to a resolution of claims against the Applicants.

81 The releases benefit creditors generally as they reduces the risk of litigation against the Applicants and their directors, protect the Applicants against potential contribution claims and indemnity claims by certain parties, including directors, officers and the HWT Trustee; and reduce the risk

of delay caused by potentially complex litigation and associated depletion of assets to fund potentially significant litigation costs.

82 Further, in my view, the releases are not overly broad or **offensive to public policy.** The claims being released specifically relate to the subject matter of the Settlement Agreement. The parties granting the release receive consideration in the form of both immediate compensation and the maintenance of their rights in respect to the distribution of claims.

Clause H.2

83 The second aspect of the Settlement Agreement that is opposed is the provision known as Clause H.2. Clause H.2 provides that, in the event of a bankruptcy of the Applicants, and notwithstanding any provision of the Settlement Agreement, if there are any amendments to the BIA that change the current, relative priorities of the claims against the Applicants, no party is precluded from arguing the applicability or non-applicability of any such amendment in relation to any such claim.

84 The Noteholders and UCC assert that Clause H.2 causes the Settlement Agreement to not be a "settlement" in the true and proper sense of that term due to a lack of certainty and finality. They emphasize that Clause H.2 has the effect of undercutting the essential compromises of the Settlement Agreement in imposing an unfair risk on the non-employee creditors of NNL, including NNI, after substantial consideration has been paid to the employees.

85 This position is, in my view, well founded. The inclusion of the Clause H.2 creates, rather than eliminates, uncertainty. It creates the potential for a fundamental alteration of the Settlement Agreement.

86 The effect of the Settlement Agreement is to give the Former and LTD Employees preferred treatment for certain claims, notwithstanding that priority is not provided for in the statute nor has it been recognized in case law. In exchange for this enhanced treatment, the Former Employees and LTD Beneficiaries have made certain concessions.

87 The Former and LTD Employees recognize that substantially all of these concessions could be clawed back through Clause H.2. Specifically, they acknowledge that future Pension and HWT Claims will rank *pari passu* with the claims of other ordinary unsecured creditors, but then go on to say that should the BIA be amended, they may assert once again a priority claim.

88 Clause H.2 results in an agreement that does not provide certainty and does not provide finality of a fundamental priority issue.

89 The Settlement Parties, as well as the Noteholders and the UCC, recognize that there are benefits associated with resolving a number of employee-related issues, but the practical effect of Clause H.2 is that the issue is not fully resolved. In my view, Clause H.2 is somewhat inequitable from the standpoint of the other unsecured creditors of the Applicants. If the creditors are to be bound by the Settlement Agreement, they are entitled to know, with certainty and finality, the effect of the Settlement Agreement.

90 It is not, in my view, reasonable to require creditors to, in effect, make concessions in favour of the Former and LTD Employees today, and be subject to the uncertainty of unknown legislation in the future.

91 One of the fundamental purposes of the CCAA is to facilitate a process for a compromise of debt. A compromise needs certainty and finality. Clause H.2 does not accomplish this objective. The inclusion of Clause H.2 does not recognize that at some point settlement negotiations cease and parties bound by the settlement have to accept the outcome. A comprehensive settlement of claims in the magnitude and complexity contemplated by the Settlement Agreement should not provide an opportunity to re-trade the deal after the fact.

92 The Settlement Agreement should be fair and reasonable in all the circumstances. It should balance the interests of the Settlement Parties and other affected constituencies equitably and should be beneficial to the Applicants and their stakeholders generally.

93 It seems to me that Clause H.2 fails to recognize the interests of the other creditors of the Applicants. These creditors have claims that rank equally with the claims of the Former Employees and LTD Employees. Each have unsecured claims against the Applicants. The Settlement Agreement provides for a transfer of funds to the benefit of the Former Employees and LTD Employees at the expense of the remaining creditors. The establishment of the Payments Charge crystallized this agreed upon preference, but Clause H.2 has the effect of not providing any certainty of outcome to the remaining creditors.

94 I do not consider Clause H.2 to be fair and reasonable in the circumstances.

95 In light of this conclusion, the Settlement Agreement cannot be approved in its current form.

96 Counsel to the Noteholder Group also made submissions that three other provisions of the Settlement Agreement were unreasonable and unfair, namely:

(i) ongoing exposure to potential liability for pension claims if a bankruptcy order is made before October 1, 2010;

(ii) provisions allowing payments made to employees to be credited against employees' claims made, rather than from future distributions or not to be credited at all; and

(iii) lack of clarity as to whether the proposed order is binding on the Superintendent in all of his capacities under the *Pension Benefits Act* and other applicable law, and not merely in his capacity as Administrator on behalf of the Pension Benefits Guarantee Fund.

97 The third concern was resolved at the hearing with the acknowledgement by counsel to the Superintendent that the proposed order would be binding on the Superintendent in all of his capacities.

98 With respect to the concern regarding the potential liability for pension claims if a bankruptcy order is made prior to October 1, 2010, counsel for the Applicants undertook that the Applicants would not take any steps to file a voluntary assignment into bankruptcy prior to October 1, 2010. Although such acknowledgment does not bind creditors from commencing involuntary bankruptcy proceedings during this time period, the granting of any bankruptcy order is preceded by a court hearing. The Noteholders would be in a position to make submissions on this point, if so advised. This concern of the Noteholders is not one that would cause me to conclude that the Settlement Agreement was unreasonable and unfair.

99 Finally, the Noteholder Group raised concerns with respect to the provision which would allow payments made to employees to be credited against employees' claims made, rather than from future distributions, or not to be credited at all. I do not view this provision as being unreasonable and unfair. Rather, it is a term of the Settlement Agreement that has been negotiated by the Settlement Parties. I do note that the proposed treatment with respect to any payments does provide certainty and finality and, in my view, represents a reasonable compromise in the circumstances.

DISPOSITION

100 I recognize that the proposed Settlement Agreement was arrived at after hard-fought and lengthy negotiations. There are many positive aspects of the Settlement Agreement. I have no doubt that the parties to the Settlement Agreement consider that it represents the best agreement achievable under the circumstances. However, it is my conclusion that the inclusion of Clause H.2 results in a flawed agreement that cannot be approved.

101 I am mindful of the submission of counsel to the Former and LTD Employees that if the Settlement Agreement were approved, with Clause H.2 excluded, this would substantively alter the Settlement Agreement and would, in effect, be a creation of a settlement and not the approval of one.

102 In addition, counsel to the Superintendent indicated that the approval of the Superintendent was limited to the proposed Settlement Agreement and would not constitute approval of any altered agreement.

103 In *Grace 2008*, *supra*, I commented that a line-by-line analysis was inappropriate and that approval of a settlement agreement was to be undertaken in its entirety or not at all, at para. 74. A similar position was taken by the New Brunswick Court of Queen's Bench in *Wandlyn Inns Limited (Re)* (1992), 15 C.B.R. (3d) 316. I see no reason or basis to deviate from this position.

104 Accordingly, the motion is dismissed.

105 In view of the timing of the timing of the release of this decision and the functional funding deadline of March 31, 2010, the court will make every effort to accommodate the parties if further directions are required.

106 Finally, I would like to express my appreciation to all counsel and in person parties for the quality of written and oral submissions.

G.B. MORAWETZ J.

cp/e/qlrxg/qlpxm/qlaxw/qlced/qljyw

1 On March 25, 2010, the Supreme Court of Canada released the following: *Donald Sproule et al. v. Nortel Networks Corporation et al.* (Ont.) (Civil) (By Leave) (33491) (The motions for directions and to expedite the application for leave to appeal are dismissed. The application for leave to appeal is dismissed with no order as to costs./La requête en vue d'obtenir des directives et la requête visant à accélérer la procédure de demande d'autorisation d'appel sont rejetées. La demande d'autorisation d'appel est rejetée; aucune ordonnance n'est rendue

concernant les dépens.): <http://scc.lexum.umontreal.ca/en/news_release/2010/10-03-25.3a/10-03-25.3a.html>

Tab 38

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2000 CarswellOnt 4837, [2001] G.S.T.C. 2, 10 B.L.R. (3d) 221, 25 C.B.R. (4th) 216

BlueStar Battery Systems International Corp., Re

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

In the Matter of a Plan of Compromise or Arrangement of BlueStar Battery Systems International Corp. and BlueStar Systems Canada Corp.

Ontario Superior Court of Justice [Commercial List]

Farley J.

Heard: October 31, 2000
Judgment: November 6, 2000
Docket: 00-CL-3860

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Counsel: *Kevin Dias*, for Her Majesty the Queen in Right of Canada (Canada Customs and Revenue Agency).

Derrick Tay and *Orestes Pasparakis*, for BlueStar Applicants.

Brent MacPherson, for PricewaterhouseCoopers Inc. (Monitor of Applicants).

Daniel R. Dowdall and *Alex A. Ilchenko*, for Finova Capital (Canada) Corp.

Steven Golick, for Enertek Mexico S. de R.L. de C.V.

Robert A. Klotz, for Bradley, Curtis Streelman and MDM Marketing Inc.

Subject: Corporate and Commercial; Goods and Services Tax (GST); Insolvency

Taxation --- Goods and services tax — Administration and enforcement — Directors' liability — General

Corporation owed in excess of $42,000,000 to unsecured creditors, including $1,096,684 in outstanding GST liability — Corporation filed plan of arrangement under Companies' Creditors Arrangement Act (CCAA) on September 5, 2000, with sanction hearing scheduled for October 31, 2000 — On October 26, creditors, including Minister, approved plan — On October 30, Minister brought motion for order declaring that claims against directors for outstanding GST liability were not compromised by plan, or for declaration that plan was not fair and reasonable, and for order granting leave to register certificate for amount of GST liability in Federal Court — Motion dismissed — Minister could not claim benefit of s. 5.1(3) of CCAA in circumstances — Plan of arrange-

ment provided that all unsecured creditors accepted plan "in full and final satisfaction of their proven claims", including claims against directors — Minister was unsecured creditor by virtue of s. 18.4 of CCAA — Section 323(2) of Excise Tax Act provides that director is not liable unless certificate for amount of corporation's GST liability has been registered in Federal Court and execution returned unsatisfied — Approval of plan meant that Minister's claim for GST was fully satisfied, so that no directors' liability could arise — Time for crystallizing directors' liability had passed and order granting leave to register certificate at this point would have no effect — If Minister had perfected claim against directors in timely manner, directors might still have included compromise of claims against them in plan of arrangement under s. 5.1(1) of CCAA — Section 5.1(3) of CCAA vests court with discretion to declare that claim against directors not be compromised where compromise would not be fair and reasonable — Fact that Minister was only creditor with potential claim against corporation's directors would not alone be sufficient grounds for exercise of discretion in Minister's favour — Exercise of discretion might have been appropriate had Minister served motion on more timely basis, to allow each director opportunity to refute allegation that he had knowledge of corporation's broken promises and late filing of GST returns — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 5.1, 5.1(1), 5.1(3), 18(4), 18.3(1), 18.3(2) — Excise Tax Act, R.S.C. 1985, c. E-15, ss. 222, 323(1), 323(2).

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

Corporation owed in excess of $42,000,000 to unsecured creditors, including $1,096,684 in outstanding GST liability — Corporation filed plan of arrangement under Companies' Creditors Arrangement Act (CCAA) on September 5, 2000, with sanction hearing scheduled for October 31, 2000 — On October 26, creditors, including Minister, approved plan — On October 30, Minister brought motion for order declaring that claims against directors for outstanding GST liability were not compromised by plan, or for declaration that plan was not fair and reasonable, and for order granting leave to register certification for amount of GST liability in Federal Court — Motion dismissed — Minister could not claim benefit of s. 5.1(3) of CCAA in circumstances — Plan of arrangement provided that all unsecured creditors accepted plan "in full and final satisfaction of their proven claims", including claims against directors — Minister was unsecured creditor by virtue of s. 18.4 of CCAA — Section 323(2) of Excise Tax Act provides that director is not liable unless certificate for amount of corporation's GST liability has been registered in Federal Court and execution returned unsatisfied — Approval of plan meant that Minister's claim for GST was fully satisfied, so that no directors' liability could arise — Time for crystallizing directors' liability had passed and order granting leave to register certification at this point would have no effect — If Minister had perfected claim against directors in timely manner, directors might still have included compromise of claims against them in plan of arrangement pursuant to s. 5.1(1) of CCAA — Section 5.1(3) of CCAA vests court with discretion to declare that claim against directors not be compromised where compromise would not be fair and reasonable — Fact that Minister was only creditor with potential claim against corporation's directors would not alone be sufficient grounds to invoke exercise of discretion in Minister's favour — Exercise of discretion might have been appropriate had Minister served motion on more timely basis, to allow each director opportunity to refute allegation that he had knowledge of corporation's broken promises and late filing of GST returns — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 5.1, 5.1(1), 5.1(3), 18(4) — Excise Tax Act, R.S.C. 1985, c. E-15 [am. 1990, c. 45, s. 12], s. 323(2).

Cases considered by *Farley J.*:

Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 93 D.L.R. (4th) 98, 55 O.A.C. 303 (Ont. C.A.) — considered

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Browne v. Southern Canada Power Co. (1941), 23 C.B.R. 131, 71 Que. K.B. 136 (Que. C.A.) — considered

Central Guaranty Trustco Ltd., Re (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) — considered

Keddy Motor Inns Ltd., Re (1992), 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4)*) 110 N.S.R. (2d) 246, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4)*) 299 A.P.R. 246 (N.S. C.A.) — considered

Sammi Atlas Inc., Re (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — considered

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16

Generally — considered

Canada Business Corporations Act, R.S.C. 1985, c. C-44

Generally — considered

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

Generally — considered

s. 5.1 [en. 1997, c. 12, s. 122] — considered

s. 5.1(1) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2)(a) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2)(b) [en. 1997, c. 12, s. 122] — considered

s. 5.1(3) [en. 1997, c. 12, s. 122] — considered

s. 18.3(1) [en. 1997, c. 12, s. 125] — considered

s. 18.3(2) [en. 1997, c. 12, s. 125] — considered

s. 18.4 [en. 1997, c. 12, s. 125] — considered

Excise Tax Act, R.S.C. 1985, c. E-15 [am. 1990, c. 45, s. 12]

Pt. IX — considered

s. 222 — considered

s. 227(4) [rep. & sub. 1994, c. 9, s. 13(2)] — considered

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s. 227(4.1) [en. 1994, c. 9, s. 13(2)] — considered

s. 323(1) [rep. & sub. 1997, c. 10, s. 239(1)] — considered

s. 323(2) [am. 1992, c. 27, s. 90(1)(p)] — considered

s. 323(2)(a) — considered

MOTION by Minister for order declaring that claims against directors were not compromised by corporation's plan of arrangement, or for declaration that plan was not fair and reasonable, and for order granting leave to register certification for amount of corporation's GST liability.

***Farley J.*:**

1 Canada Customs and Revenue Agency ("RevCan") by material dated October 30, 2000 moved for an order declaring that the claims against the directors of the Applicants not be compromised by this Court's sanction of the Plan of Arrangement made pursuant to the *Companies' Creditors Arrangement Act* ("CCAA"). This Plan was filed on September 5, 2000, the same day that the Applicants sought protection under the CCAA. The sanction hearing had been long scheduled for October 31, 2000. On that date I approved the Plan vis-à-vis the Applicants; however I reserved judgement on RevCan's late blooming motion. I now deal with it as if it were being dealt with coincident with the sanction hearing (that is the fact that I approved the Plan vis-à-vis the Applicants a few days ago is to be ignored). I was advised that it does not appear that s. 5.1 of the CCAA has been judicially commented on before. It may be that my analysis herein will be of some assistance — or at least a starting point for discussion — in understanding this section of the CCAA.

2 For the sake of easy reference I have reproduced s. 5.1 in its entirety below:

> 5.1(1) Claims against directors — compromise — A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> (2) Exception — A provision for the compromise of claims against directors may not include claims that
>
> > (a) relate to contractual rights of one or more creditors; or
> >
> > (b) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.
>
> (3) Powers of court — The court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.
>
> (4) Resignation or removal of directors — Where all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the debtor company shall be deemed to be a director for the purposes of this section.

3 RevCan asked for the alternative relief of a declaration that the Plan was not fair and reasonable in the cir-

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cumstances in that it precluded unsecured creditors of the Applicants from pursuing claims against the directors. RevCan sought the additional relief of an order granting it leave to register in the Federal Court a certification for the amount of the Goods and Services Tax ("GST") liability of BlueStar Systems Canada Corp. ("BSCC") and to obtain an execution for that amount from the Federal Court pursuant to s. 323 (2)(a) of the *Excise Tax Act* and leave to direct the Sheriff to attempt to satisfy that execution against assets of BSCC that were not protected by my CCAA stay order of September 5, 2000.

4 RevCan submitted that it was entitled to such relief for the following grounds. BSCC is indebted for GST liability for the period September 1999 to September 2000 in the amount of $1,096,684. While new management took control of the operations of BSCC beginning in February 2000, BSCC continued to fail to remit the GST it was required to remit pursuant to the *Excise Tax Act*. From March 2000 through the end of August 2000, BSCC representatives made numerous promises to RevCan representatives in respect of paying the outstanding GST liability but did not do so. GST returns for January — May 2000 were only filed at the end of August 2000. While not sworn to, RevCan asserts that the Applicants, their counsel and the Monitor were put on notice of RevCan's position several weeks before the hearing.

5 Sections 5.4 and 5.9 of the Plan that was approved by the unsecured creditors of the Applicants would compromise RevCan's claims against the directors of the Applicants. At the meeting of the unsecured creditors on October 26, 2000, the RevCan representative raised the concerns of RevCan and asked that the meeting consider amendments to the Plan. After consulting with representatives from BSCC, the chairman of the meeting, an officer of the Monitor, ruled that as BSCC did not wish to make any amendments to the Plan, the meeting would not consider such amendments. RevCan indicates that the Applicants never provided it with any explanation as to why the restructuring of both corporations could not proceed under the Plan without having the claims against the directors compromised by the Plan.

6 The meeting was attended by 222 unsecured creditors, either in person or by proxy. Three unsecured creditors abstained from voting. The 219 who voted represented claims totalling $42,286,376.82. A total of 211 unsecured creditors with claims totalling $41,877,271.70 voted to approve the Plan, representing 96.3% in number and 99.0% in value of those voting. RevCan did not vote against the Plan or abstain from voting; rather RevCan voted in favour of the unamended Plan. I would also point out that RevCan did not advance a competing CCAA Plan including one which would not wipe out the liability of the directors.

7 The Initial Order of September 5, 2000 contained a "come back" clause. Any creditor, including RevCan, would have been at liberty to move in court before the Plan was voted upon to attempt to amend the Plan. However once a vote has been taken, there are fairly definite restrictions upon amending a CCAA plan. See *Re Central Guaranty Trustco Ltd.* (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) at p. 143; *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]), at pp. 174-5; *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.) at p. 15. I shall deal later with the question of whether the present case falls within the "exceptional circumstances only" condition of the Court of Appeal in Algoma as to an amendment.

8 One might view RevCan's motion as one challenging the classification of creditors; in other words RevCan appears in essence to wish to be put into a separate class from the rest of the unsecured creditors. I think it fair to observe that it appears that RevCan is the only unsecured creditor to be affected by the inclusion of the compromise of directors liability in the Plan. However, where an initial order of the Court places creditors into certain classes (or in the present case puts them all into a single class), the proper procedure for attacking the

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classification is by way of appeal of the classification order, and "not the sanctioning order": see *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.) at pp. 251-2. In the present case, since the classification order was contained in the Initial Order effectively obtained on an *ex parte* basis since RevCan was not then present, RevCan could have utilized the "come back" clause on a timely basis instead of going to appeal. It is unfortunate for RevCan that it did not do so.

9 Under the CCAA, all Crown claims, including secured claims, rank as unsecured claims: see s. 18.4. Therefore RevCan's claim for unpaid GST is unsecured. In addition, the CCAA specifically eliminates the "deemed trust" in favour of GST found in s. 222 of the *Excise Tax Act*; but in contrast it does not interfere with the deemed trust provisions found in s. 227(4) and (4.1) of the *Excise Tax Act*[FN*]: see s. 18.3(1)(2)[FN**].

10 Director liability for GST arises pursuant to s. 323(1) of the *Excise Tax Act* which provides:

> s. 323 (1) Where a corporation fails to remit an amount of net tax as required under subsection 228 (2) or (2.3), the directors of the corporation at the time the corporation was required to remit the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest thereon or penalties relating thereto.

However that legislation goes on to provide that:

> s. 323(2) A director of a corporation is not liable under subsection (1) unless
>
> > (a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 316 and execution for that amount has been returned unsatisfied in whole or in part;
> >
> > (b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
> >
> > (c) the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the date of the assignment or receiving order.

Only s. 323 (2)(a) would be of any relevance in the present analysis.

11 The Applicants point out that pursuant to the Plan, in respect of which RevCan voted in favour, unsecured creditors, including RevCan, accepted "in full and final satisfaction of their Proven Claims" the consideration provided for under the Plan. The Applicants further reason that since RevCan's claim for GST has been fully satisfied, then pursuant to s. 323 (2)(a) of the *Excise Tax Act*, no director liability could arise in respect of same. On that basis, in respect of GST, RevCan's claim is satisfied by operation of law, and in particular the terms of the *Excise Tax Act*, upon confirmation of the Plan. On that basis, the directors of the applicants do not need to rely on s. 5.1 (1) of the CCAA to include "provision for the compromise of claims against directors of the company". Given that one may puzzle over why the directors in the present case included an excusatory provision in the Plan vis-à-vis themselves when such a claim for GST is a derivative claim relating to the original or foundation liability of BSCC. Perhaps their concern was that RevCan in the seven weeks between the Initial Or-

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der of September 5, 2000 and the vote on October 26, 2000 might have obtained leave to register the certificate for BSCC's GST liability in the Federal Court and obtained an execution for that amount pursuant to s. 323 (2)(a) of the *Excise Tax Act* and leave to direct the Sheriff to attempt to satisfy the execution against assets of BSCC unprotected from the stay. If that had taken place, then it seems to me that the Court would have to take a look at the Plan as a whole and on a single point of time basis. In other words, one would not necessarily conclude that the Plan *first* compromised the claims against BSCC in full satisfaction of the proven claims, including the proven claim of RevCan, *before* moving on to consider RevCan's then perfected claim (as opposed to the inchoate one we actually have in this case) against the directors.

12 Thus it appears to me that RevCan, not having put itself into position where it could (and did) perfect its derivative claims against the directors as set out in s. 323 (2)(a) of the *Excise Tax Act* never had a claim against the directors which could survive the sanction of the Plan vis-à-vis the Applicants. Nothing that this Court could do at the present time (that is, at time when considering the CCAA sanction motion) could crystalize a RevCan claim against the directors. RevCan would have to take additional multiple steps over some period of time to establish a claim against the directors. RevCan was alert to this concern, yet it did nothing to initiate even the first step in the procedure. In these circumstances, even if this Court's leave were effective in any way to protect RevCan's claim, it would not seem to me that RevCan has established any basis for the exercise of this Court's discretion in that regard. It would also be remiss of me not to observe here that this would prevail even if RevCan had not for whatever unexplained reason voted in favour of the (complete) Plan (complete in the sense of compromising claims against the Applicants *and the directors*).

13 I would note that RevCan raised certain passages of K.D. McGuiness, *The Law of Guarantee* (2nd ed., 1996; Toronto, Carswell) in support of its position: specifically s. 10.114 at pp. 601-2 (including the somewhat dated and inaccurate view of the CCAA as set forth in *Browne v. Southern Canada Power Co.* (1941), 23 C.B.R. 131 (Que. C.A.)). Suffice it to say that the present case is not a surety claim release one.

14 What then *if* RevCan here had in fact perfected its claim against the directors? Would the directors have been able to utilize s. 5.1 of the CCAA as a safe haven? It would appear to me that the directors would have been entitled (s. 5.1 (1)) to have included in the Plan a compromise of their liability included in the Plan and would not be disqualified (s. 5.1 (2)) from doing so. This disqualification from utilizing s. 5.1 (1) as is found in s. 5.1 (2) relates to (a) contractual rights of a creditor, such as a guarantee by a director for example, or (b) claims based on allegations of misrepresentations made by directors to creditors or of wrongful' or oppressive conduct by directors. Firstly there was nothing in this case to suggest that there was any sort of a contract (including a guarantee) from any of the directors. Secondly there was no allegation of any misrepresentation by any director nor was there any allegation of wrongful or oppressive conduct by any director. It would seem to me that while the reference in s. 5.1 (2) is to "directors", it would seem that the disqualification should relate to those of the directors who may fall within (a) or (b) thereof. As to the (b) category, there was no allegation against any director in the RevCan material; it appears that all of the RevCan dealing and difficulties with respect to either promises or getting information were restricted to non-directors at BSCC. However it seems to me that the directors of any corporation in difficulty and contemplating a CCAA plan would be unwise to engage in a game of hide and go seek since the language of s. 5.1 (2)(b) appears wide enough to encompass those situations where the directors stand idly by and do nothing to correct any misstatements or other wrongful or oppressive conduct of others in the corporation (either other directors acting qua directors, or officers or underlings). There was no evidence presented that the directors here had knowledge or ought to have had knowledge of such here. One may have the greatest of suspicion that they did or ought to have had such knowledge. This could have been crystallized if RevCan had put the directors on notice of the promises to pay GST. It would

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seem to me at first glance that the oppression claims cases which arise pursuant to corporate legislation such as the *Canada Business Corporations Act* and the *Business Corporations Act* (Ontario) would be of assistance in defining "oppressive conduct". Similarly it would appear that "wrongful conduct" would be conduct which would be tortious (or akin thereto) as well as any conduct which was illegal.

15 What then of s. 5.1 (3)? This is not a disqualification provision which automatically applies. Rather this provision establishes that the Court may use its discretion to "declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances". It is key to note that this declaration does not affect the Plan then in question vis-à-vis the applicant corporation. In *Sammi Atlas Inc., supra*, I noted at p. 174:

> ... In *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.) the Court of Appeal observed at p. 15 that the court's jurisdiction to amend a plan should "be exercised sparingly and in exceptional circumstances only" even if the amendment were merely technical and did not prejudice the interests of the corporation or its creditors and then only where there is jurisdiction under the CCAA to make the amendment requested, ...

However this s. 5.1 (3) declaration when viewed as an amendment (or equivalent to an amendment) of a plan is something which this amendment to the CCAA (enacted subsequent to the Algoma case) specifically authorizes, but in any even since the declaration only applies to the compromise as it relates to the directors, it does "not prejudice the interests of the corporation or its creditors".

16 Given that s. 5.1 (1) provides that the compromise of claims against directors be as to those claims "that relate to the obligations of the company unless the directors are by law liable in their capacity as directors for the payment of such other factors" and given the exception disqualifications of s. 5.1 (2), one would reasonably conclude that the most usual type of claim would be that imposed by statute whereby the director qua director is obliged as well as the corporation to pay a government. Then the fact that RevCan is "singled" out in this Plan in question with respect to its GST claim, would not appear on this ground alone to be sufficient to invoke the Court's discretion in RevCan's favour. However if RevCan had served its motion on a more timely basis so as to allow the directors sufficient opportunity to dispute RevCan's allegations concerning broken promises, then if RevCan's allegations were unrefuted or unchallenged, given the magnitude of the GST claim over an extended period of a year which unlikely would have escaped the notice of a reasonable director, and given the repeated and broken promises to pay the GST and the lack of advance notice to RevCan before obtaining the Initial Order which precluded RevCan from taking any preliminary enforcement proceedings (it being recognized that RevCan has to walk the tightrope between collecting taxes when due and allowing delinquent companies some leeway so that they might attempt to get over temporary difficulties without that opportunity being precluded by draconian collection techniques otherwise available to RevCan), I might well have been inclined to give such a declaration that the GST claim against the directors not be compromised on the basis that such a compromise would not have been full and reasonable in the circumstances. I think it also worth noting that s. 5.1 (3) provides that "a claim" not be compromised, as opposed to all claims as may otherwise have been included pursuant to s. 5.1 (1). It would also seem to me that the language of this provision is sufficiently wide enough to be able to pick and choose amongst the directors and further that any individual claim may be segmented so that it may be partially excepted.

17 In the end result however RevCan's motion is dismissed. Even if this were not a matter of first instance I

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would not award any costs against RevCan in these circumstances.

Motion dismissed.

FN* *Sic.* Should be *Income Tax Act* — ed.

FN** *Sic.* Should be s. 18.3(1), (2) — ed.

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Tab 39

Supreme Court of Newfoundland and Labrador, Trial Division
Ayles v. Neil
Date: 2002-08-08

Geoffrey E. Budden, for the plaintiff/applicant;

William J. Parsons, for the defendant/respondent.

(1999 St. J. No. 2355)

2002 CanLII 54082 (NL SCTD)

Introduction

[1] **Dunn, J.:** This is an application by the plaintiff under Rule 20A, Offers to Settle, for an order for party and party costs plus taxed disbursements to the date of the offer and solicitor and client costs plus taxed disbursements thereafter to the date of payment. The respondent asks dismissal of the applicant's request and for an order for costs on a party and party basis.

[2] At the end of the hearing on costs I gave counsel, and the plaintiff/applicant who was present, an outline as to what I thought would be appropriate in the circumstances. I indicated to all that I would file written reasons. These are the written reasons for the decision given at that time. If there is any conflict as between these reasons and my oral statements the written reasons given hereunder shall apply.

Background

[3] On September 22, 1999 the plaintiff issued a statement of claim out of this court and the defendant filed a defence thereto. The essence of the claim was the property the plaintiff had acquired from the defendant contained Urea Formaldehyde Foam Insulation. The defendant had warranted the property did not contain this type of insulation. Upon discovery by the plaintiff that this was not in fact the case, action was commenced for damages.

[4] By Order of former Chief Justice T. Alex Hickman on June 14, 2000 the plaintiff/applicant obtained summary judgment on the issue of liability. The Order included direction to attend at a settlement conference. The settlement conference was ultimately unsuccessful and the matter set for assessment of damages.

[5] On March 28, 2002 the applicant/respondent filed a formal offer to settle pursuant to Rule 20A of the **Rules of the Supreme Court,** 1986 in the amount of $23,000.00. The offer to settle is set forth hereafter in its entirety:

"OFFER TO SETTLE

"TO: The Defendant

"The Plaintiff offers to settle his claim inclusive of all damages, prejudgment interest and costs for the sum of Twenty-Three Thousand Dollars ($23,000.00).

"DATED at the City of Mount Pearl, in the Province of Newfoundland, this 16th day of March, 2000."

The offer remained open up to and including during the conduct of the trial. The trial commenced on February 25, 2002, and continued in February and March for approximately four days. On March 29, 2002, counsel for the plaintiff advised the Court the substantive part of the trial had been settled and the only issue remaining was costs. At that time, counsel filed the offer to settle and requested a date for argument. Counsel for the defence consented.

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[6] In the course of the four days of trial the plaintiff/applicant called three witnesses, the plaintiff and two contractors with accreditation to remove Urea Formaldehyde Foam Insulation. Both of these latter individuals proposed the insulation be removed from the exterior of the building which would involve taking down and replacing the exterior siding. The lowest quote of the two was $23,000.00, the amount contained in the offer to settle. The defence called Ralph Neil, as well as a carpenter/friend of his. The defendant/respondent took the position it was more cost efficient to remove the Urea Formaldehyde Foam Insulation from the interior of the property. In the course of the examination it became apparent he believed the cost of such removal and repair could be effected for approximately ten to twelve thousand dollars.

[7] The only other point of note is the plaintiff/applicant in his examination indicated he was open to removal by either method, that is from the interior or exterior but simply stated he wanted the property put into the condition it should have been in, in accordance with the warranty.

Issue

[8] Is the plaintiff/applicant entitled to costs under Rule 20A, Offers to Settle, on a greater than party and party basis?

Rule 20A

[9] The relevant provisions of Rule 20A are:

"Where Available

"20A.01. A party may serve upon an adverse party an offer to settle (Form 20A(A)) any claim between them in the proceeding and, where there is more than one claim between them, to settle one or more of them, on the terms therein specified.

"Time for Making Offer

"20A.02. An offer to settle may be made at any time before the commencement of the trial or hearing; but, where an offer to settle is made less than seven days before the day on which the trial or hearing is commenced, the cost consequences prescribed by this rule shall not apply unless the offer to settle is accepted before the commencement of the trial or hearing.

. . . . .

"Effect of Offer

"20A.04(1) An offer to settle shall be deemed to be an offer of compromise made without prejudice, and shall not be taken as an admission of liability, unless the offer to settle provides otherwise.

. . . . .

"Time for Acceptance

"20A.06. Notice of acceptance may be delivered at any time before the commencement of the trial or hearing unless, in the meantime, the offer has been revoked.

"Effect of Acceptance

"20A.07. ...

"(4) Where the accepted offer is silent as to costs, and the offer was made by the plaintiff and accepted by the defendant, the plaintiff may tax his party and party costs of the proceeding to the date he was served with the notice of acceptance and, unless the defendant pays those costs within seven days after assessment, issue execution therefore.

"Effect of Failure to Accept

"20A.08(1) Unless ordered otherwise, when an offer to settle was made by a plaintiff at least seven days before commencement of the trial or hearing of the proceeding and was not revoked or accepted prior to commencement of the trial or hearing, and where that plaintiff obtains a judgment as favourable or more favourable than the terms of the offer to settle, that plaintiff shall be entitled to party and party costs plus taxed disbursements to the date of service of the offer to settle and thereafter to taxed disbursements plus costs on a party and party or some other greater basis as the judge deems appropriate.

. . . . .

"Discretion of Court

"20A.10. Notwithstanding the provisions of this rule, the court, in exercising its discretion as to costs, may taken into account any offer to settle made in writing, the date the offer to settle was served, the terms thereof and any other relevant matters."

Analysis

[10] Before embarking on an analysis of case law which has evolved since the coming into force of Rule 20A, and similar rules in the various provinces in Canada, it is

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important to note this fact circumstance is unique in that the offer to settle was accepted during the course of the trial. The manner in which Rule 20A is drafted presupposes the offer will be made in advance of the trial and accepted before the commencement of same (20A.06). A second distinguishing feature is no judgment, either judicial or by consent, has been entered in the matter. Rather, the Court was informed of settlement by counsel with the offer to settle being filed coincidental therewith.

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[11] Counsel approached the issue as if all the formal requirements of Rule 20A had been met. Other than the broad discretionary power of the Court set out in Rule 20A.10, this is not the case. Costs consequences arising under the Rule come into effect in respect of Rule 20A.08(1) where there has been a formal offer made under, and in accordance with, the Rule which offer has not been accepted and where judgment entered is ultimately more favourable, or as favourable, than the terms of the offer to settle. Once the foregoing is established, the plaintiff will usually be entitled to party and party costs, plus taxed disbursements to the date of service of the offer to settle and, thereafter, to taxed disbursements plus costs on a party and party, or some other greater basis, as the Judge deems appropriate. The reference to "judgment" in this sub-provision of the Rule inferentially suggests a judicial decision. The style of resolution of the within matter does not, on the face of it, come within Rule 20A.08(1).

[12] Had the offer been made and accepted prior to commencement of trial, and had it been silent on the issue of costs, then, as set out in Rule 20A.07(4), the plaintiff/applicant's cost may have been taxed on a party and party basis to the date of notice of acceptance of the offer.

[13] The style of the offer to settle, in its original form, was inclusive of costs. However, counsel, in advising the Court of the settlement, indicated the issue of costs remained alive, thereby opening the door for the argument before me. Before embarking on further analysis it is important to note offers to settle may be made outside the Rule as summarized in the **Bar Admission Course Materials (2001) Practice and Procedure** on p. 20A-7:

> "The making of an offer to settle under rule 20A is not the only way in which litigation may be concluded by settlement. Acceptance of money paid into court pursuant to rule 20 is another.
>
> "A settlement agreement may also be achieved and enforced by the operation of the ordinary principles of the law of contract outside of the mechanisms provided by the rules **(McCabe v. Verge)**. Such a settlement agreement does not require any formalities to be valid **(Picco v. Picco** (1987), 12 R.F.L.(3d) 345 (UFC); **McCabe v.**

Verge at para. [11]). Thus, a contract of settlement is capable of being formed outside of the operation of rule 20A by means of a telephone conversation if the requisite elements of offer, coincident acceptance, consideration, intention to create legal relations and certainty of terms are present.

"The key distinction with respect to an accepted offer under ordinary contract principles and one under rule 20A is that the former will not trigger the application of the special enforcement remedy provided under rule 20A.07. To invoke the special remedies under the rule, including the costs consequences of non-acceptance of an offer to settle, the formalities, including the requirements of writing and general compliance with forms provided by the rule, as well as the limitations on what can be included in an offer, will have to be observed."

[14] In presenting his argument, on facts elicited at trial, the plaintiff/applicant interprets these to establish on the part of the defendant/respondent mala fides by executing a warranty that the property did not contain Urea Formaldehyde Foam Insulation when he knew, or ought to have known, that it in fact did. As the matter was settled no judicial determination was made on this point. Indeed, it is likely not relevant in that the defendant/respondent conceded by admitting liability his failure in this respect. The issue before the Court related solely to assessment of damages. Therefore, it would be inappropriate to award solicitor and client costs on the basis of the mala fides of the defendant/respondent.

[15] Assuming the type of settlement herein gives rise to an argument for greater costs consequences than on a party and party basis under the rule, the defendant/respondent submits the offer in effect required capitulation on the part of the defendant/respondent, the result of which any costs greater than party and party costs are not warranted. The amount proposed and accepted does represent the lowest cost quote received by the applicant/plaintiff from a certified Urea Formaldehyde Foam Insulation removal contractor and encompasses all the work necessary both to remove the insulation and restore the property to its original, and perhaps a better condition, in that the exterior siding would have to be completely replaced with new siding.

[16] The plaintiff/applicant sees as significant the fact higher quotes were also received for such removal. I do not consider this fact particularly relevant in that the quote of $23,000.00 was from a bona fide and competent contractor. As well, the plaintiff/applicant suggests it would have successfully obtained a general damage award in the sum of $1,000 to $3,000. This is an unknown in that the trial had not progressed to argument or judgment on the issue. As well, the applicant submits substantial additional damages would result from the adverse effect on market value of the former presence of Urea Formaldehyde Foam Insulation in the subject property even after it had been

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removed. Again, the Court made no finding on this point. This is arguable in that once replaced, such adverse effect may have reasonably been viewed as eliminated. The factual basis in the plaintiff/applicant's brief on costs, for concluding the offer to settle is a significant compromise of the apparent value of this claim, are simply not substantiated. In light of this, the offer then must be viewed as non-compromising in nature. As is evident from case law, this alone does not rebut entitlement to greater costs.

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[17] At p. 20A-15 of the **Bar Admission Course Materials** referenced earlier the issue is succinctly stated:

> "One exception to the presumptive rule that solicitor and client costs will be awarded is where the offer contained no element of compromise, was nominal or required the other side to capitulate completely. In such a case, the post-offer costs entitlement of the offer or should be determined 'on the basis of the interests of justice and fairness after consideration of all of the relevant circumstances, including the nature of the claim, the merits of the claim and any defence, and any opportunity for resolution that could be attributed solely to the offer' **(Burton et al. v. Global Benefit Plan Consultants Inc. et al.).** Where it is not obvious that the claim is a frivolous one, and the outcome of the litigation is to a reasonable degree uncertain, an offer lacking compromise will probably be regarded as one made 'solely for the purpose of gaining a costs advantage' rather than for genuinely attempting to settle the claim before trial, and in such circumstances, would likely attract only an award of party and party costs rather than some greater amount **(Burton).**
>
> "In some circumstances, outside the general rule, the costs awarded could exceed full indemnity and be punitive in nature, or could be less than full indemnity, but such cases should be the exception rather than the rule. Once a favourable offer is made and not revoked or accepted, the other party should from that point on 'carry the full risk that he or she may gain nothing' by forcing the offer or to go to trial **(Mega Roofing).**"

[18] The presumptive nature of the Rule is reviewed by Orsborn, J., in **Burton et al. v. Global Benefit Plan Consultants Inc. et al.** (1999), 183 Nfld. & P.E.I.R. 86; 556 A.P.R. 86 (Nfld. T.D.) commencing at pp. 90 and 91:

> "In **Mega Roofing and Waterproofing Ltd. v. Dobbin (N.D.) Ltd. et al.** (1996), 143 Nfld. & P.E.I.R. 14; 448 A.P.R. 14 (Nfld. T.D.), I considered in some detail the purposes of rule 20A - then newly enacted - and the costs consequences that should flow from failure to accept an offer less favourable than the judgment eventually obtained. While Mega Roofing was in the context of an offer made by a plaintiff, the principles are equally applicable to an offer made, as here, by a defendant.
>
> . . . . .
>
> > 'Faced with an offer to settle, a party must objectively assess the economics of proceeding further. As Pattison phrased it, this "... is where the substantive and economic analyses of the value and risk of seeing a lawsuit through to judgment converge". A party may decide to accept the offer or to itself make an offer. If, having assessed the offer, it chooses to do nothing, that choice carries with it the implicit determination that the party is satisfied that it will achieve a better result at

trial. This is the party's own determination to make - it knows the strengths and weaknesses of its case. But such a determination also indicates that the party is willing to accept the risk of proceeding further. There is a willingness to accept the consequences of being wrong. A party who has offered to settle should not bear the expense of proceeding to trial because of the other party's over-optimistic assessment of its case.

'Again to quote **Pattison,** at p. 130:

"A well-designed formal offer is a powerful tool in the hands of a litigant who has thoroughly and realistically assessed the strengths and weaknesses of its case, and the damages that it stands to recover. Any party who fails to make best efforts to settle a lawsuit does so at its own peril, especially where the other party has made reasonable offers to settle."

'Predictable and severe cost consequences serve to focus the mind on a realistic assessment of the offer. Generally speaking, one can assume that a more favourable outcome at trial reflects positively on the reasonableness of the offer. Thus, in essence, the rule contemplates that a party who wrongly rejects a reasonable offer will absorb the post-offer costs of the other party.'

"In conclusion - at paras. 28-29:

'Accordingly, in all but the most unusual circumstances, it will be appropriate to award costs, from the date of the offer, on a "greater basis" than party and party. Further, for the reasons I have outlined, the general rule should be that the "greater basis" is "solicitor and own client", thus providing for full indemnity for reasonable legal fees and taxed disbursements from the date of the offer. It may be that, in some circumstances, an award of costs should be in some degree punitive and provide for more than full indemnity, or, in other circumstances, that the award be on a party and party basis or something less than solicitor and own client.

'In my view, any such departures from solicitor and own client costs should be the exception rather than the rule.'"

[19] At par. 17, Orsborn, J., discusses the appropriateness of greater awards of costs in situations where an offer is either nominal, or lacks any dimension of compromise, the result of which to accept it is to capitulate as follows:

"The starting point for the discussion is the decision of the Ontario Court of Appeal in **Data General (Canada) Ltd. et al. v. Molnar Systems Group Inc. et al.** (1991), 52 O.A.C. 212; 6 O.R.(3d) 409 (C.A.).

"At trial, Data General obtained a judgment for $103,412, the full amount of the claim. Soon after it had commenced its action, it served an offer to settle for the full amount that was claimed. There was no element of compromise in the offer.

"The trial judge rejected Data General's claim for solicitor-client costs ...

. . . . .

"On appeal, Morden, A.C.J.O., rejected the opinion of the trial judge. At p. 414:

'... I do not think that an element of compromise is an essential element of an offer to settle but that its absence can be a relevant factor to be taken into account in "ordering otherwise" under rule 49.10(1).'

. . . . .

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'As far as the dictionary meaning of "settle" is concerned, while it may commonly be the case that when a party "settles" a proceeding the settlement will involve some element of compromise, on one side or both, I do not think that "settle" necessarily requires a compromise. The word means to bring a dispute to an end by arrangement of the parties as opposed to by judgment of a court on the merits.'"

[20] After the foregoing review Orsborn, J., concludes at p. 94:

"Thus, Morden, A.C.J.O., was content to conclude that an offer without compromise was an offer to settle, and that the absence of compromise, and the nature and strength of the claim in question would be relevant factors in the determination of the discretionary decision whether or not to award other than solicitor and client costs."

[21] And further at p. 95:

"The primary conclusion that I take from **Data General** is that to be considered as an offer to settle, an offer does not have to contain an element of compromise. However, the lack of any element of compromise may be taken into account in deciding whether or not, in any particular case, the interests of justice and fairness require a departure from the presumptive solicitor-client costs consequences of the rule."

[22] In **Walker Estate et al. v. York Finch General Hospital et al.** (1999), 118 O.A.C. 217 (C.A.), also referenced by Orsborn, J., and contained in the defendant/respondent's brief, the Court considered and applied the principles set out in **Data General (Canada) Limited** concluding an offer to settle of $100 less than a liquidated claim fell so short of a compromise that a discretionary exception to the presumptive rule should be invoked.

[23] The Newfoundland rule includes not only reference to offer to "settle" but also makes direct reference to the concept of "compromise". In Rule 20A.04(1), "an offer to settle shall be deemed to be an offer of compromise made without prejudice. ..." As noted by Morden, A.C.J.O., in **Data General,** the definition of "settle" means to bring a dispute to an end by arrangement of the parties. But what of the definition of "compromise"? The **Webster's Ninth New Collegiate Dictionary** defines compromise as follows:

"1(a): a settlement of differences by arbitration or by consent reached by mutual concessions, (b): something blending qualities of two different things. 2: a concession to something derogatory or prejudicial. ..."

[24] In this context the idea of moving from one's stated position is a recognized element of the settlement. Insofar as the wording of 20A.04(1) is concerned it may be inferentially concluded that some aspect of concession is deemed to come into play. I have already expressed the view the offer, as contained in the plaintiff/applicant's offer to settle, is non-compromising in nature. Acceptance of the offer represents a capitulation by the defendant, and despite the fact it was initially inclusive of costs, I see no significant concession made by the plaintiff/applicant which would attract the defendant/respondent to

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settlement. As well, during the course of the trial, the plaintiff/applicant accepted the notion that the property might be repairable from the interior, wanting assurance only that the property be put back into its original condition. In light of the foregoing, I am of the view it would be inappropriate, in these circumstances, to award costs on a greater than party and party basis. In having settled the matter during trial both parties eliminated the potential risk of a decision either partially or wholly unfavourable to them.

Disposition:

[25] Ultimately, be it under Rule 20A.10, or other costs related rules, the Court retains general discretion in awarding costs. I am satisfied the appropriate costs, in these circumstances, to the plaintiff/applicant, should be on a party and party basis only, and I so order.

Order accordingly.

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Tab 40

Case Name:
Allen-Vanguard Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF a Plan of Arrangement and Reorganization of Allen-Vanguard Corporation under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended and Section 186 of the Ontario Business Corporations Act., R.S.O. 1990, c. B.16, as amended, Applicants

[2011] O.J. No. 3946

2011 ONSC 5017

81 C.B.R. (5th) 270

2011 CarswellOnt 8984

Court File No. CV-09-00008502-00CL

Ontario Superior Court of Justice
Commercial List

C.L. Campbell J.

Heard: November 16, 2010.
Judgment: August 25, 2011.

(113 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Sanction by court -- Motions by directors, officers and underwriters to enjoin actions allowed -- Cross-motion by plaintiffs to vary Sanction Order dismissed -- Initial Order stayed Laneville action against corporation, which plaintiffs sought to continue against directors -- Love action against directors, officers and underwriters claimed negligence and failure to disclose transactions -- Sanction Order permitted only claims contemplated by s. 5.1(2) of CCAA, which these were not -- Plaintiffs could not claim against directors for acts undertaken in Corporation's name prior to initial order -- Release deprived underwriters of indemnity and plaintiffs never sought leave for derivative action -- Sanction Order was relied on by parties.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Stays -- Of concurrent proceedings -- Motions by directors, officers and underwriters to enjoin actions allowed -- Cross-motion by plaintiffs to vary Sanction Order dismissed -- Initial Order stayed Laneville action against corporation, which plaintiffs sought to continue against directors -- Love action against directors, officers and underwriters claimed negligence and failure to disclose transactions -- Sanction Order permitted only claims contemplated by s. 5.1(2) of CCAA, which these were not -- Plaintiffs could not claim against directors for acts undertaken in Corporation's name prior to initial order -- Release deprived underwriters of indemnity and plaintiffs never sought leave for derivative action -- Sanction Order was relied on by parties.

Corporations, partnerships and associations law -- Corporations -- Directors and officers -- Personal liability of directors to persons other than the corporation -- Joint and several liability -- Derivative actions -- Powers of court -- Conduct of the action -- Oppression remedy -- Stay, discontinuance, settlement or dismissal -- Motions by directors, officers and underwriters to enjoin actions allowed -- Cross-motion by plaintiffs to vary Sanction Order dismissed -- Initial Order stayed Laneville action against corporation, which plaintiffs sought to continue against directors -- Love action against directors, officers and underwriters claimed negligence and failure to disclose transactions -- Sanction Order permitted only claims contemplated by s. 5.1(2) of CCAA, which these were not -- Plaintiffs could not claim against directors for acts undertaken in Corporation's name prior to initial order -- Release deprived underwriters of indemnity and plaintiffs never sought leave for derivative action -- Sanction Order was relied on by parties.

Securities regulation -- Civil liability -- Misrepresentation in a prospectus -- Persons liable -- Underwriters -- Motions by directors, officers and underwriters to enjoin actions allowed -- Cross-motion by plaintiffs to vary Sanction Order dismissed -- Initial Order stayed Laneville action against corporation, which plaintiffs sought to continue against directors -- Love action against directors, officers and underwriters claimed negligence and failure to disclose transactions -- Sanction Order permitted only claims contemplated by s. 5.1(2) of CCAA, which these were not -- Plaintiffs could not claim against directors for acts undertaken in Corporation's name prior to initial order -- Release deprived underwriters of indemnity and plaintiffs never sought leave for derivative action -- Sanction Order was relied on by parties.

Motion by the former directors and officers of the Corporation to enforce the terms of the Sanction Order and enjoin the class actions against them. Motion by the underwriters to stay or dismiss the shareholder class action against them. Cross-motion by the plaintiffs to vary the Sanction Order to permit the proposed actions. The Initial Order was made in December 2009 and stayed the existing Laneville action against the corporation. 100 per cent of affected creditors voted in favour of the plan, which the Corporation would have been unable to carry on without, and the Sanction Order was made. In the Laneville action, the shareholders alleged the corporation, directors and officers were liable for negligence, misrepresentation and oppression. The plaintiffs sought to continue the Laneville action against the directors. After the Sanction Order was made, the Love action was commenced by shareholders against the directors, officers and Corporation's underwriters and claimed negligence and failure to disclose transactions.

HELD: Motions allowed. Cross-motion dismissed. The released contained in the Sanction Order clearly permitted only those claims against directors that were contemplated by s. 5.1(2). These claims were not the type of claims contemplated by s. 5.1(2). It would be inconsistent with the CCAA to allow the plaintiffs to proceed with their oppression claim against the directors for acts or omissions undertaken in the Corporation's name prior to the Initial Order being made. The plaintiffs did not oppose the Sanction Order, so took their chances that the order would permit their claim to proceed. Allowing the claim to proceed would permit an inappropriate sort of priority for unsecured creditors. The claims against the directors in both actions were enjoined. Protection for the underwriters was not discussed when the Sanction Order was approved, but s. 5.1(2) was to be read narrowly to ensure to objectives of the CCAA. Furthermore, s. 5.1(2) could not be used to create a cause of action that would otherwise require court approval and leave. The plaintiffs had plenty of opportunity to seek leave to commence a derivative action but never did. The terms of the release in the Sanction Order deprived the underwriters of any indemnity they would otherwise be entitled to from the Corporation. The claim against the underwriters was struck in negligence and misrepresentation. Had the plaintiffs claimed and provided full particulars of fraud, such a claim may have survived as the terms of the release did not extend to fraud. The plaintiffs' motion to vary the terms of the Sanction Order was dismissed. It would be inappropriate to vary an order that was relied on by all parties and approved by all affected creditors.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.1(1), s. 5.1(2), s. 5.1(3)

Excise Tax Act, R.S.C. 1985, c. E-15,

Ontario Business Corporations Act, R.S.O. 1990, c. B.16, s. 131(1), s. 246(1)

Ontario Securities Act, s. 130, s. 138.3

Counsel:

Ronald G. Slaght, Q.C. and Eli S. Lederman for the Directors and Officers of Allen-Vanguard Corporation.

C. Scott Ritchie, Michael G. Robb and Daniel E.H. Bach for class action plaintiffs.

Alan L.W. D'Silva and Daniel S. Murdoch for Underwriters.

REASONS FOR DECISION

1 **C.L. CAMPBELL J.**:-- Two motions were heard together: the first by former directors and officers of Allen-Vanguard to enforce the terms of a Sanction Order, which the directors and officers say release them as well as Allen-Vanguard from all claims except those specifically provided for in section 5.1(2) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA.") In addition, the former directors assert that the claims of the Plaintiffs in two proposed Class Actions are not sustainable against them in law under s. 5.1(2) of the CCAA.

2 The second motion by the Underwriters of Allen-Vanguard seeks to dismiss or stay the action brought against the Underwriters by shareholders in a proposed Class Action.

3 A cross-motion brought by Plaintiffs in the two proposed Class Actions seeks, if required, variation of the terms contained in the Sanction Order granted December 16, 2009, to permit the Class Actions to proceed.

4 By way of an endorsement dated February 9, 2011, the Court sought further information from the parties with respect to the factual circumstances that surrounded the agreement that was embodied in the terms of the Sanction Order. That information has been provided and will be referred to later in these Reasons.

5 The claims that the directors who are the moving parties seek to effectively enjoin are those brought in two Class Actions (hereinafter the "Laneville action" and the "Love action"), wherein former shareholders seek damages against directors, officers and Underwriters based on alleged misrepresentation to shareholders by the Defendants about the effect on Allen-Vanguard of its purchase of another company in 2007.

Background

6 As of December 2009, Allen-Vanguard was insolvent. An Application was made on December 9 for an Initial Order under the CCAA, appointment of a Monitor and a Plan Filing and Meeting Order. The effect of the Initial Order among other matters stayed the existing Class proceeding.

7 The circumstances that surrounded the Plan Filing/Meeting Order, the Court was advised, were necessary to avoid a bankruptcy. The subsequent vote on December 9, 2010 was approved in favour of the Plan by 100% of affected creditors.

8 The circumstances that surrounded the December 9, 2010 Application and Order were a variation on a CCAA process that has come to be known as a "pre-packaged" Application. The secured creditors agreed to a restructuring of their secured debt in circumstances involving a going concern sale of assets where, had a bankruptcy ensued, there would have been no recovery for creditors or shareholders beyond very incomplete recovery for those secured creditors.

9 The First Report of the then proposed Monitor, Deloitte and Touche, in support of the Initial Order, outlined the transaction that had been proposed to all creditors as early as September 2009, posted on SEDAR and to which (apart from the question of releases) no party was opposed on December 9.

10 The Plan provided for the Secured Lenders foregoing a portion of their existing debt and fees, converting the remainder of the existing debt into a multi-year restructured term loan with terms more favourable to the Company and a new revolving credit facility.

11 The Court accepted the opinion of Deloitte & Touche that without the proposed transaction, the Company would likely not be able to meet its financial obligations as they became due and would likely be unable to carry on the business beyond the very short-term, which would then necessitate liquidation.

12 The conclusion by Deloitte & Touche, accepted by the Court, was that the restructuring process in the Plan maximized the value of the Company for the benefit of all stakeholders and represented the best offer from that process.

13 The alternative faced by the Company was that of a forced liquidation, which as estimated by the Monitor would result in a shortfall to secured lenders in excess of $100 million.

The Laneville Action

14 The proposed Class Action Plaintiff in the Laneville action issued on October 9, 2009 a Statement of Claim dated November 26, 2009, which sought appointment on behalf of a Representative Plaintiff and for a class of Allen-Vanguard shareholders who allege that Allen-Vanguard Corporation and its directors and officers are liable for various misrepresentations, negligence and oppression.

15 The Statement of Claim detailed a transaction that occurred in 2007 for which the Class Plaintiffs claim the directors and officers failed to properly value and account for in the financial statements of Allen-Vanguard, when Allen-Vanguard purchased all of the shares of a private corporation called Mid-Eng Systems Inc.

16 In addition, the Class Plaintiff claims damages for negligent misrepresentation not only under the common law but as well under s. 138.3 of the *Ontario Securities Act* in connection with the same transaction.

17 The only creditor objection to the Plan taken at the time of the Initial Order was from counsel for the Proposed Class Plaintiff in the Laneville action, who sought an adjournment of the vote based on the wording of the proposed release terms.

18 The adjournment of the vote was not granted given the financial fragility of Allen-Vanguard, and the sanction hearing, which was to deal with the wording of the proposed release terms, was set for December 16, 2009.

19 The Second Report of the Monitor, dated December 10, 2010, advised the Court of the terms of the release and injunctions that had been negotiated, the terms of which were put forward for approval on an unopposed basis. No objection was taken at the sanction hearing by counsel for the Class Plaintiff and no amendment to the Release portion of the Sanction Order sought. Whatever had been negotiated between the parties came before the Court on an unopposed basis. Counsel for the Class Action Plaintiffs and for the Defendant directors had input into and agreed to the wording.

20 The Court has been advised that by agreement of counsel, the wording of the Release was negotiated by the parties with the recognition that there would likely remain an issue on which the Court would have to rule. That issue is now the subject of the first motion and the cross motion. I have been advised as a result of the inquiry of February 9, 2011 and what is now obvious as a result of the recent correspondence (including an affidavit sworn June 30, 2011 and objected to) is that Plaintiffs' counsel in the Laneville action and counsel for the directors had quite different views in respect of the kinds of claims that could be included in s. 5.1(2).

21 As I now understand it, counsel for the Allen-Vanguard Corporation made no representation or agreement that the claims in the Laneville action were within those permitted by s. 5.1(2) of the CCAA.

22 Counsel for the Plaintiff in the Laneville action believe that the language in the Sanction Order preserves the claims in both the Laneville action and the Love action, including the claims against the Underwriters. It is submitted by the Plaintiff that the jurisprudence in respect of s. 5.1(2) permits not only claims against directors but as well officers to the extent there is insurance coverage, and that the Plaintiffs' position is consistent with the jurisprudence under s. 5.1(2).

23 Counsel for the Directors and for Underwriters submit that counsel for the Plaintiff knew or ought to have known at the time they agreed to the language of the Plan of Arrangement and the draft Sanction Order that the claims asserted against the Directors and Officers of Allen-Vanguard might nevertheless fail to meet one of the exceptions set out in s. 5.1(2) of the CCAA.

24 In the result, the issue of what was or was not agreed to as part of the Sanction Order comes down to the question of whether or not the wording of s. 5.1(2) of the CCAA, read in context of statutory interpretation, is sufficient to permit continuance of claims in the Laneville and Love actions.

25 As reported by the Monitor in the First Report, the Plan contemplated two releases: a General Release and an Equity Claims Release, both of which had been contemplated in the proposed Plan. Neither the Equity Claims Release nor the General Release was intended to release or deal with or affect in any respect claims under ss. 5.1(1), (2) and (3) of the CCAA, which read:

> 5.1(1) a compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> 5.1(2) A provision for the compromise of claims against directors may not include claims that
>
> (a) relate to contractual rights of one or more creditors; or
> (b) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressed conduct of directors.
>
> 5.1(3) the court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.

26 The Monitor in its Second Report remarked as follows:

> 28. The injunctions provided in the Plan are limited by section 5.1(2) of the CCAA. The injunctions barring any person from commencing, continuing or pursuing any proceeding on or after the Effective Time for a claim that such person may have against the Company or any current or former officer of the Company of the type referred to in subsection 5.1(2) of the CCAA ... but permit any such subsection 5.1(2) claim to proceed against a current or former director of the company except that any such claim against a current or former director of the company is permitted recourse, and sole recourse, to the Company's insurance policies in respect of its current and former directors. The estimated value of any coverage under such insurance is $30 million as per the Luxton Affidavit.
>
> 29. The Monitor is aware of at least one group of stakeholders affected and by the Supplemental Injunction, being a group of current and former shareholders of the Company that have served a Notice of Action and Statement of Claim on the Company seeking approximately $80 million in damages from the Company and

its directors and officers, as further described in the monitors First Report. As stated above the terms of the Supplemental Injunction would permit this claim to survive against the current and former directors of the Company with recourse limited to the Companies insurance as referenced above."

27 The Releases and Sanctions are contained in the language of the Sanction Order. A summary of the provisions with paragraph references to the Sanction Order is as follows:

22. Releases are essential to the Plan
23. All Persons give full release to each of the Released Parties including contribution and indemnity but directors not released in respect of any claim of the kind referred to in section 5.1(2) of the CCAA.
24. Release of Applicant and current and former directors provided that nothing therein releases a director or current or former officer in respect of any claim of the kind referred to in section 5.1(2) of the CCAA.
25. All Persons enjoined and estopped from commencing or continuing actions with the exception of any claim against the directors of the kind referred to in section 5.1(2) of the CCAA..
26. Injunction and bar with respect to section 5.1(2) against the applicant ... and that the sole recourse for any claims against a current or former director or officer of the Applicant Limited to any recoveries from the Applicants insurance policies in respect of current or former directors and officers
27. Laneville Action dismissed as against the Applicant without prejudice to discovery rights against representative of the Applicant.

The Love Action

28 On February 8, 2010, after the Sanction Order had been made, another Proposed Representative Plaintiff, Gordon Love, commenced a second action and is represented by the same counsel as in the Laneville action. The Statement of Claim, dated March 10, 2010 against the directors and officers of Allen-Vanguard Corporation, includes claims against Cannacord Financial Ltd (and others collectively referred to as "Underwriters.")

29 An Amended Statement of Claim dated August 10, 2010 asserts in the Love action claims for negligence against directors, officers and Underwriters, all arising out of the transaction and alleged failure to properly disclose the transaction in the financial statements and transaction referred to in paragraph 15 above in respect of a 2007 acquisition.

Issues

1. Do the Laneville action and the Love action and their proposed class claims fall within those claims non-exempt under s. 5.1(2) of the CCAA?
2. Does the language of the Release contained in the Sanction Order apart from s. 5.1(2) permit either the Laneville or Love actions, including that against Underwriters, to continue?
3. Is there any basis on which the Court could or should vary the terms of the Release section of the Sanction Order?

30 Having reviewed the language of the Releases contained in the Sanction Order, I am satisfied that the only basis that the release language permits claims as against the directors is if they are those contemplated in s. 5.1(2) of the CCAA not to be released.

31 The object of the CCAA is to facilitate the restructuring of an insolvent corporation. In order to effect restructuring, a compromise of creditors' claims is almost inevitably an essential ingredient of a Plan under the CCAA.

32 The Plan, to be effective and to obtain Court approval, requires consensus and agreement by various classes of creditors. Many of the issues that arise before a Plan is approved by the Court involve a contestation between creditor groups as to how they should be classified and what extent of what group approval should be appropriately required. No motion was brought to seek to lift the stay in respect of actions provided for in the Initial Order.

33 In this case, no creditor came forward to oppose approval of the Plan, including the terms of the release language as set out in the Sanction Order. The effect of a Sanction Order is to create a contract between creditors. (See *Canadian Red Cross Society* (2002), 35 C.B.R. (4th) 43 (Ont. S.C.J.).

34 The most significant feature of the CCAA Applications that have come before the Court in the last two or three years is that the negotiation has taken place to achieve consensus among creditors often before the Initial Order under the statute.

35 One can rightly understand the reluctance on the part of a provider of interim financing to continue to do so on an indefinite basis, when the approval process may be dragged out for days, weeks or months.

36 All secured creditors whose security continues to deteriorate during the period of negotiation will seek an early determination of the consensus necessary for approval of a Plan; otherwise, liquidation may be preferable.

37 Such consensus requires agreement among many stakeholders, including not just creditors but as well current and former directors and officers, many of whose continued cooperation is necessary and integral to a Plan's success.

38 To avoid the inequity that would result from creditor claims that were outstanding as against directors at the time of a CCAA application, s. 5.1(2) was amended in 1997 to its present form. As Hart J. noted in *Re-Liberty Oil & Gas Ltd.* 2002 ABQB 949 at paragraph 4, before the enactment of this section, the legislation provided for compromises of claims only against the petitioning company. The new section extends relief against directors of the petitioning company subject to exceptions.

39 It is appropriate to approach statutory interpretation with the assumption that meaning is to be accorded to each of the words used in the provision within the overall purpose of the CCAA. The absence of other words can also be purposeful.

40 The CCAA has been said to be a skeletal statute designed to give flexibility and expediency in the ability of the company, with the concurrence of its creditors, to accomplish a restructuring of its debt in the avoidance of liquidation or bankruptcy, and does not contain a comprehensive code that lays out all that is permitted or barred. (See *ATB Financial v. Metcalfe & Mansfield Alternative Investments 11 Corp.*, 2008 ONCA 587 per Blair J.A. para. 44.)

41 Since the hearing in this matter, the Supreme Court of Canada has rendered a decision in *Century Services Inc. v. Canada (Attorney General)* 2010 SCC 60, which endorses the broad principles of the CCAA and the discretion granted to the Court to effect a restructuring if possible or an orderly liquidation.

42 The case involved a contest between the deemed trust provisions of the *Excise Tax Act* and the CCAA. Madam Justice Deschamps, speaking for the majority, noted the need for clarity of the underlying purpose with respect to the CCAA.

43 Paragraphs 12 to 14, 17, 58-59 and 63 of that decision read as follows:

> 12. Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R.J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.
>
> 13. Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute -- it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.
>
> 14. Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below, the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

...

17. Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected -- notably creditors and employees -- and that a workout which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

...

58. *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).
59. Judicial discretion must of course be exercised in furtherance of the *CCAA*'s purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.
>
> *Elan Corp. v. Comiskey* reflex, (1990), 41 O.A.C. 282, at para. 57, *per* Doherty J.A., dissenting.)

...

63. Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) what are the sources of a court's authority during *CCAA* proceedings? (2) what are the limits of this authority?

44 I have quoted from the above decision at length to stress the nature of the discretion that is inherent in the CCAA statute to allow the Court to fashion a structure or process to best benefit stakeholders. Consistent with that purpose and as a matter of statutory interpretation, it is appropriate to look at the interpretation of s. 5.1(1) and (2) of the CCAA. Section 5.1(1) deals with "obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations."

45 A Plan can therefore provide for the compromise of claims against directors where a director may in law be liable for the payment of a company's obligation with the exceptions set out in s. 5.1(2).

46 In my view, the best that can be said of s. 5 is that it is not as clearly drafted as it might have been.

47 It is noteworthy that in the first line of s. 5.1(2), the only claims that may not be excluded in a compromise are those against "directors." Claims that can be excluded in a compromise include those against "officers" and the "company" itself. Why is this the case? One reason undoubtedly is the personal liability that directors face under both Federal and Provincial legislation, or the personal undertaking of a director to a creditor such as a personal guarantee. (See *C.I.T. Financial v Lambert* 2005 BCSC 1779.)

48 By way of example, s. 131(1) of the OBCA provides that directors are made personally liable for unpaid wages of the corporation's employees to a maximum of six months. Reading through s. 5.1(1) and (2), there is nothing in the wording that would prevent the compromise of such claims against officers or the company itself, but not as against directors. The CCAA does not contain a definition of the word "creditor" but does of the terms "secured creditor," "unsecured creditor" and "shareholder." It would seem that for the purposes of the CCAA and in particular s. 5.1(2), a creditor would include both a secured creditor and an unsecured creditor, but would not include a shareholder.

49 Section 5.1(2) refers only to creditors and not shareholders as prospective claimants, whether in contract, tort or statutory oppression.

50 In this case, the claims by the Class Action Plaintiffs are on behalf of shareholders against directors, since the effect of the CCAA stayed the action against the company Allen-Vanguard. The claims arise with respect to a 2007 transaction and the pre-filing financial statements, but the claims do not involve officers or the company, only directors.

51 While framed in negligence, the claims in these actions seek to involve the remedy of oppression under the OBCA to enlist the broad scope of remedy possible under that statute. However, it is only in respect of unpaid obligations of the company and other contract-type claims where the law imposes liability on the Defendant directors that invokes the exception in s. 5.1(2). It is noteworthy that the word "negligence" does not appear in the section at all.

52 In their essence, the claims in the two actions allege a failure on the part of the directors in 2007 and the company to enter into a provident transaction and the transaction represented a misrepresentation to shareholders of the value of the transaction causing a reduction in shareholder value. Such claims are not of the same kind as those contemplated in section 5.1(1). They do not relate to "obligations of the company where the directors are by law liable."

53 The claims relate to transactions that were well in advance of the Initial CCAA Order. In *Re Canadian Airlines Corp.* 2000 ABQB 442 (leave refused to ABCA, [2000] A.J. No. 1028, and to SCC, [2001] S.C.C.A. No. 60), it was held that claims against the directors should only be released if they arose prior to the date of the CCAA proceeding.

54 I agree that the oppression remedy is expansive in scope and empowers the Court to make determinations and orders that can have a direct and even a radical impact on the internal management and status of a corporation, including even an order winding up the corporation. (See *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.) and *Incorporated Broadcasters Ltd. v. CanWest Global*, [2001] O.J. No. 4882, 2001 CanLII 28395 (Ont. S.C.) at paragraphs 101-105.) Oppression as it occurs within s. 5.1(2) of the CCAA must be read within the context of the section itself.

55 The claims in the Love and Laneville actions are in negligence and no other remedy is sought apart from a claim for damages and access to whatever insurance may be available to respond to claims against directors and officers. There is nothing before the Court to suggest that the insurers, assuming there is a valid policy, are aware of the restriction on remedy.

56 I see no basis from the pleadings in this action for which it would be appropriate to consider the scope of relief that might otherwise apply under the oppression remedy section of the OBCA. Counsel for the Plaintiffs in the Proposed Class Actions cannot bolster their position by limiting recovery to the applicable Directors and Officers Insurance, when there is no basis for the claim at all, either under the language of the Release or the meaning to be accorded to s. 5.1(2).

57 In *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560, the Supreme Court of Canada commented on the expectations of stakeholders including but not limited to shareholders, in considering a Plan of Arrangement in the context of an oppression claim. Part of the test for "oppression" referred to in that decision is an expectation on the part of the claimant to be "treated in a certain way and that failure to meet the expectation involved unfair conduct."

58 I fail to understand how the expectation of one or more shareholder groups can be any different with respect to the impugned transaction than those of creditors or indeed the company itself vis-à-vis the directors, particularly since neither the officers nor the company itself is pursued.

59 The Sanction Order in this case by its terms provided release of the claims now sought to be pursued. By the terms of the Sanction Order, the only reasonable expectation of stakeholders would be that unless specifically authorized by the Order, any claim against directors would be barred. Potential claims against directors were not assigned to class plaintiffs nor was direction sought by any party about the effect of s. 5.1 prior to the issuance of the Order. Given the issue now before the Court and the disagreement of the parties, perhaps the better practice would have been to advise the Court of the issue and "carve" it out of the Plan.

60 The Court is put in a difficult position when asked in a very constrained timeframe to approve the restructuring with releases. It should certainly not be the expectation that in every instance, releases of the type here should be granted as a matter of course. Those with unpaid obligations of the company may assert that directors are liable if they fail to fulfill the company's obligation when they are legally bound to do so.

61 I am of the view that third-party releases in particular should be the exception rather than the rule. There may very well be instances in which the releases are not integral or necessary to the restructuring and should not be approved. That was not suggested in the approval process here. There was no evidence presented at the time of the granting of the Sanction Order to suggest that directors were not important to the restructuring. Indeed, the only evidence before the Court was to the contrary: that the directors were integral to the Plan's success.

62 In this case, the putative Plaintiffs did not oppose the granting of the Sanction Order and in effect took their chances that the Order might after the fact permit the limited claim referred to in the Monitor's Report.

63 All of the other stakeholders, including the secured creditors, directors, officers and the Applicant Company, approved the form of Order.

64 It is certainly speculative at this time to consider, had the form of Order proposed been objected to, to what extent the Court would have any jurisdiction to grant the language now sought by the Plaintiffs, without rejecting the Plan entirely.

65 The duty of directors is first and foremost to the company itself. The oppression remedy does not in my view permit one group (shareholders) to claim oppression when other stakeholders, for example employees or creditors or indeed the company itself, have allegedly suffered a loss that results in insolvency and are unable to seek redress and still preserve restructuring.

66 To vary or amend the Sanction Order now to permit the claims to continue might at the very least require the presence and concurrence of all of those who supported the form of Order in the first place.

67 Counsel for the proposed Plaintiffs refer to several decisions, which they urged support the proposition that shareholder actions for oppression against directors are permitted under s. 5.1(2) of the CCCA.

68 Each of those decisions, while fact-specific, in my view is consistent with a narrow range of actions warranted for a shareholder against the director under the exception to s. 5.1(2).

69 In *Re-Liberty Oil & Gas Ltd.*, 2002 ABQB 949, where the action did proceed, the allegation involved a personal representation, indeed a fraudulent one, by the defendant director to two individuals who happened to be shareholders. The complained acts were not those of the company (as here), but rather personal and direct as between the director and shareholder. In other words, there was the proximity that one would expect in a tort situation.

70 In *Worldwide Pork Corp.*, 2009 SKQB 414, the action was not permitted to proceed. At paragraphs 14 and 15 Justice Dawson said:

> It must be remembered that the oppression remedy is not designed to settle every dispute of a corporation but only those that involve and abuse of the corporate system and for which a common-law remedy does not exist.
>
> As well, the plaintiffs have pled that their claim is for damages, for loss of profits and loss of pay out dividends. There must be a causal connection between the alleged oppressive conduct and the loss claimed to be suffered by the plaintiffs. That is, there must be a causal nexus between the alleged conduct and the loss suffered by the plaintiffs. There is no pleading which sets out how the alleged loss of profit or dividends resulted from the conduct alleged to be oppressive. But in any event the losses claimed are losses as a result of Worldwide Pork not being profitable, that is, being unable to provide a return to shareholders for their investment. Such a loss cannot support an action for oppression since it comes with in the exception contained in section 5.1(2)(b) of the CCAA.

71 In *Re-Blue Star Battery Systems International Corp.* (2000), 10 B.L.R. (3d) 221, Farley J. of this Court dealt with a claim very much like that considered by the Supreme Court of Canada in *Century Services, supra,* as it involved G.S.T. At paragraph 12, he said

> Thus it appears to me that RevCan, not having put itself into position where it could (and did) perfect its derivative claims as set out in section 323(2)(a) of the

> *Excise Tax Act* never had a claim against the directors which could survive the sanction of the Plan vis-à-vis the Applicants. Nothing that this Court could do at the present time (that is, at the time when considering the CCAA sanctioned motion) could crystallize a RevCan claim against the directors. RevCan would have to take additional multiple steps over some period of time to establish a claim against the directors."

72 Farley J. went on to discuss the hypothetical of a claim in oppression against the directors as provided for in s. 5.1(2) in the context where the creditor had put the directors on notice of the promise of the company to pay the tax.

73 The argument of the Proposed Plaintiffs here is that "oppressive conduct" is not to be carved out, but that wrongful conduct that involves directors, even though the action as against the company cannot continue, it can continue against the directors.

74 What in my view is consistent with the decisions in the three cases mentioned and in the Québec case *Papiers Gaspésia* 2006 QCCS 1460 (CanLII) and with the interpretation of s. 5.1(2) is that the actions of the directors toward persons who may be regarded as creditors, and may in this context include a shareholder, are based on a direct relationship when a director takes on an obligation to make a payment that would otherwise be the obligation of the company and promises to do so or is obliged to do so by legislation. In most cases this will be a post-filing obligation. In other words, a promise by a director directly to a creditor stakeholder that is made following a CCAA Initial Order may attract liability to the director and should not be released.

75 It would be inconsistent with the scheme of the CCAA to allow all claims in which shareholders claim oppression to proceed against directors for acts or omissions that they did in the name of the company prior to the Initial Order. There would be little if any incentive to directors to pursue restructuring if they were going to be so exposed. On the other hand, personal undertakings or obligations of directors made during the CCAA process should not easily be released.

76 To permit the kind of claims as the Proposed Plaintiffs would see them would create a priority to that class of unsecured creditors that properly should belong to the creditors as a group. No leave to continue the Class action was sought before the Sanction Order was granted and even on this motion no submission was put forward for the exercise of discretion under section 5.1(3).

77 None of the cases referred to in argument dealing with s. 5.1(2) squarely deals with the issue raised here -- that the section was intended to related to post-filing claims or personal undertakings of directors to creditors in connection with the proposed plan prior to filing.

78 The final argument on behalf of Class Plaintiffs is that to deny the claim of shareholders as against directors would only benefit their insurers, since the Class Plaintiffs have agreed to limit any recovery to the amount of the insurance. I fail to see how this advances the position of the Proposed Plaintiffs. No information was put before the Court about the particulars of the insurance. The Court has no information to know whether or not the insurers even know of this issue.

79 If the claim does not lie as against the directors in the first place under s. 5.1(2), the limitation of the claim as against the potentially available insurance does not advance the case of the class of Plaintiffs.

80 There would be little meaning left to s. 5.1 if all claims of negligence and wrongful conduct against directors for pre-filing activity could not be released and no need for the discretion provided

for in s. 5.1(3) for Court to override this compromise as not being fair or reasonable. As noted above in the passages from the *Century Services* case, the purpose of the CCAA and the discretion granted to the Court are to permit restructuring to work, not create new causes of action.

81 The concern of the Court, which necessitated the further inquiry, was that the language of the Sanction Order might imply on the part of the Applicant and directors who had knowledge of the particulars of the claim that the facts could give rise to a s. 5.1(2) claim. I am satisfied based on the further information provided that no such admission is to be implied.

82 The relief sought by the directors is therefore granted.

Underwriters

83 Underwriters acted on share and warrant offerings of Allen-Vanguard in September 2007 and certified a related prospectus. The Love Class Action was commenced in February 2010 and the proposed Representative Plaintiff claims damages against Underwriters under s. 130 of the *Securities Act (Ontario)* and also makes claims on the basis of negligence, unjust enrichment and waiver of tort.

84 Underwriters rely on the provisions of the releases granted by the Sanction Order and in particular the claims against the Applicant Company Allen-Vanguard. As well, Underwriters rely on the definition of "Equity Claims" in the Sanction Order and submit that because the provisions of the Order in paragraph 26(ii) bar certain claims against third parties who might claim contribution and indemnity against the restructured company, they should be entitled to the benefit of that provision.

85 The response of the proposed Class Plaintiffs in the Love litigation is that the claim against Underwriters is based on the negligence, fraud or wilful misconduct of Underwriters. It is submitted that Underwriters are not entitled to indemnity as against Allen-Vanguard for the several negligence of Underwriters, either at law or under s. 130 of the *Securities Act*.

86 The proposed Class Plaintiff submits that given the nature of the claim as against Underwriters, Underwriters would never have had a right to an indemnity for the claims asserted in the Love Action and therefore there were no such claims to be released.

87 It is submitted that Underwriters bargained any possible indemnity away by the terms of their contract with Allen-Vanguard in September 2007, and that even if they had the benefit of an indemnity, all that was required for the Plan's success was that Alan-Vanguard be protected from Underwriters, not that Mr. Love's claims against Underwriters be eliminated.

88 Counsel for the Plaintiff in the Love Action also urges that Underwriters did not have the right of indemnity as at the time of the Initial Order, and the Sanction Order bars any indemnity that they might otherwise have had and there is nothing in the language of either Order to preclude the claim of the Class Plaintiff against Underwriters limited to Underwriters' negligence.

89 Finally, it is submitted that since Underwriters did not "bring anything to the table" in respect of the restructuring, there is no basis on which the Court should vary the Sanction Order to now provide the indemnity that the Order fails to provide.

90 In the alternative, the Class Plaintiffs suggest that the Sanction Order be clarified, if necessary, to clearly provide the right of the Class Plaintiff to proceed against Underwriters.

91 In my view, there is a distinction to be made between the claim as against the directors and that against Underwriters, since in the case as against the directors, the parties appear to have bargained that if the claim could be brought under s. 5.1(2), it could proceed. That consideration was known to the parties who negotiated and agreed on the form of the Sanction Order and that was the only claim not otherwise covered by the Release terms.

92 In the case of Underwriters, there was nothing to suggest that any discussion or negotiation took place with respect to specific protection for Underwriters or the allowance of a claim against Underwriters at the time that the Sanction Order was approved.

93 This is another reason why in my view s. 5.1(2) of the CCAA should be read narrowly with respect to pre-filing claims or claims that relate to pre-filing activity.

94 The *Ontario Business Corporations Act*, R.S.O. 1990 c. B. 16 ("OBCA") contains a statutory process for that kind of action and remedy sought by the Class Plaintiffs in both actions. Section 246(1) reads as follows:

> **246.**(1) Subject to subsection (2), a complainant may apply to the court for leave to bring an action in the name and on behalf of a corporation or any of its subsidiaries, or intervene in an action to which any such body corporate is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate.

95 The Supreme Court of Canada dealt with the issue of collective shareholder claims versus claims that are those of the corporation itself in *Hercules Management Ltd. et al. v. Ernst & Young*, 1997 CanLII 345, [1997] 2 S.C.R. 165. The case involved a claim by shareholders of the corporation against its auditors for an alleged negligence in preparation of financial statements of the corporation. Paragraph 48 of the reasons refers to and adopts a statement of Farley J. in *Roman Corp. v Peat Marwick Thorne* (1992), 11 O.R. (3d) 248 (Gen. Div.) at p. 260.

> As a matter of law the only purpose for which shareholders receive an auditor's report is to provide the shareholders with information for the purpose of overseeing the management and affairs of the corporation and not for the purpose of guiding personal investment decisions or personal speculation with a view to profit.

96 The plaintiffs in *Hercules* asserted reliance on financial statements in monitoring the value of their equity and then due to auditors' negligence, they failed to extract it before the financial demise of the company.

97 The Supreme Court, in assessing the claim, referred at paragraph 59 to the rule in *Foss v. Harbottle*, 67 E.R. 189:

> 59. The rule in *Foss v. Harbottle* provides that individual shareholders have no cause of action in law for any wrongs done to the corporation and that if an action is to be brought in respect of such losses, it must be brought either by the corporation itself (through management) or by way of a derivative action. The legal rationale behind the rule was eloquently set out by the English Court of Appeal in *Pruden-*

tial Assurance Co. v. Newman Industries Ltd. (No. 2), [1982] 1 All E.R. 354, at p. 367, as follows:

> The rule [in *Foss v. Harbottle*] is the consequence of the fact that a corporation is a separate legal entity. Other consequences are limited liability and limited rights. The company is liable for its contracts and torts; the shareholder has no such liability. The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in the shareholder. When the shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting. The law confers on him the right to ensure that the company observes the limitations of its memorandum of association and the right to ensure that other shareholders observe the rule, imposed on them by the articles of association. If it is right that the law has conferred or should in certain restricted circumstances confer further rights on a shareholder the scope and consequences of such further rights require careful consideration.

To these lucid comments, I would respectfully add that the rule is also sound from a policy perspective, inasmuch as it avoids the procedural hassle of a multiplicity of actions.

60. The manner in which the rule in *Foss v. Harbottle*, *supra*, operates with respect to the appellants' claims can thus be demonstrated. As I have already explained, the appellants allege that they were prevented from properly overseeing the management of the audited corporations because the respondents' audit reports painted a misleading picture of their financial state. They allege further that had they known the true situation, they would have intervened to avoid the eventuality of the corporations' going into receivership and the consequent loss of their equity. The difficulty with this submission, I have suggested, is that it fails to recognize that in supervising management, the shareholders must be seen to be acting as a body in respect of the corporation's interests rather than as individuals in respect of their own ends. In a manner of speaking, the shareholders assume what may be seen to be a "managerial role" when, as a collectivity, they oversee the activities of the directors and officers through resolutions adopted at shareholder meetings. In this capacity, they cannot properly be understood to be acting simply as individual holders of equity. Rather, their collective decisions are made in respect of the corporation itself. Any duty owed by auditors in respect of this aspect of the shareholders' functions, then, would be owed not to shareholders *qua* individuals, but rather to all shareholders as a group, acting in the interests of the corporation. And if the decisions taken by the collectivity of shareholders are in respect of the corporation's affairs, then the shareholders' reliance on negligently prepared audit reports in taking such decisions will result in a wrong to the corporation for which the shareholders cannot, as individuals, recover.

61. This line of reasoning finds support in Lord Bridge's comments in *Caparo*, [1980] 1 All E.R. 568, *supra*, at p. 580:

> The shareholders of a company have a collective interest in the company's proper management and in so far as a negligent failure of the auditor to report accurately on the state of the company's finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected, the shareholders ought to be entitled to a remedy. But in practice no problem arises in this regard since the interest of the shareholders in the proper management of the company's affairs is indistinguishable from the interest of the company itself and any loss suffered by the shareholders ... will be recouped by a claim against the auditor in the name of the company, not by individual shareholders. [Emphasis in Supreme Court decision.]

It is also reflected in the decision of Farley J. in *Roman I*, *supra*, the facts of which were similar to those of the case at bar. In that case, the plaintiff shareholders brought an action against the defendant auditors alleging, *inter alia*, that the defendant's audit reports were negligently prepared. That negligence, the shareholders contended, prevented them from properly overseeing management which, in turn, led to the winding up of the corporation and a loss to the shareholders of their equity therein. Farley J. discussed the rule in *Foss v. Harbottle* and concluded that it operated so as to preclude the shareholders from bringing personal actions based on an alleged inability to supervise the conduct of management.

62. One final point should be made here. Referring to the case of *Goldex Mines Ltd. v. Revill* (1974), 7 O.R. (2d) 216 (C.A.), the appellants submit that where a shareholder has been directly and individually harmed, that shareholder may have a personal cause of action even though the corporation may also have a separate and distinct cause of action. Nothing in the foregoing paragraphs should be understood to detract from this principle. In finding that claims in respect of losses stemming from an alleged inability to oversee or supervise management are really derivative and not personal in nature, I have found only that shareholders cannot raise individual claims in respect of a wrong done to the corporation. Indeed, this is the limit of the rule in *Foss v. Harbottle*. Where, however, a separate and distinct claim (say, in tort) can be raised with respect to a wrong done to a shareholder *qua* individual, a personal action may well lie, assuming that all the requisite elements of a cause of action can be made out.

98 The policy of limiting indeterminate liability as in *Hercules* is consistent with the basis for the limitation of claims under s. 5.1(2) as set out above. In my view the words of s. 5.1(2) do not create a cause of action that would otherwise not exist except by leave of the Court. It simply provides an exception to what otherwise could be included in a release.

99 The release terms contained in the Sanction Order would deprive Underwriters from any claims for contribution or indemnity to which they would otherwise be entitled at law from the Company and its directors and officers should the actions of the Class Plaintiffs proceed.

100 This is just one further reason to support not just what is required for a derivative action but also what is required to be taken into consideration before the Court issues a Sanction Order in this case in effect on consent.

101 As noted above, what has come to be known as a "liquidating" CCAA application can provide problems not just for the parties but the Court itself. The presumption behind the timing of the Application in this case was that if not granted quickly, bankruptcy would have ensued with the inevitable loss of jobs, assets and creditor claims.

102 The Class Plaintiffs are taken to have known of the CCAA proposal as early as September 2009 and could have sought leave to commence a derivative action prior to or during the CCAA process. No such step was taken.

103 I am satisfied that it is appropriate in the circumstances to stay the claims as against Underwriters in negligence and misrepresentation.

104 The Claim against Underwriters also alleges fraud. If the only claim were in fraud and full particulars of alleged fraud were contained in the pleading, the claim might survive since the wording of the Release does not extend to fraud.

105 Apart from fraud, claims in negligence against Underwriters are caught by the terms of the Release. Arguably, the claims are those of the Company that are specifically released.

Variation of the Sanction Order

106 As noted above in reference to the decision in *Canadian Red Cross*, a Sanction Order in addition to being an Order of the Court and subject to the normal rules for variation thereof, represents an agreed contract between the creditors of an insolvent corporation.

107 The Class Plaintiffs in the Laneville action did not seek to lift the stay at the time of the Initial Order. The Class Plaintiff accepted the Release provisions which extend to Underwriters when the Sanctioned Order was granted.

108 Underwriters were released by the terms of the Sanction Order, and the Order, which was not appealed, represents a final determination of the rights of shareholders as against Underwriters.

109 As was mentioned above, in respect of the suggestion of variation of the Sanction Order to permit the claim as against the directors, I conclude that it is not appropriate to vary a Sanction Order after the fact. The reliance that parties place on the finality of a Sanction Order is such that it would only be in extraordinary circumstances of a clear mistake, operative misrepresentation or fraud that would permit variation without re-opening the whole process.

110 In *Extreme Retail (Canada) Inc. v. Bank of Montréal*, [2007] O.J. No. 3304 (Ont. S.J.) [Commercial List], Stinson J. held at paragraph 21 that an Approval and Vesting Order was a final determination of the rights of parties represented in that proceeding. Morawetz J. adopted those comments in *Royal Bank Body Blue Inc.*, [2008] O.J. No. 1628, 2008 CanLII 19227 [Ont. S.C.], to the same effect at paragraphs 19 and 20. In my view the same principle applies to a Sanction Order.

111 I see nothing in the requests of either Underwriters or the Class Plaintiffs that would be appropriate to permit variation of the Sanction Order as each of them have proposed.

112 Should the Class Plaintiff in the Laneville action seek to pursue a claim against Underwriters limited alone in fraud, the action should be permitted to proceed subject to the Plaintiff persuading a judge that such a limited claim should be certified.

Conclusion

113 For the above reasons the motion by the directors will succeed to enjoin the claims as against them in both the Love and Laneville actions. The motion of Underwriters to strike is granted, and motions for variation of the Sanction Order of both Underwriters and the Class Plaintiffs are dismissed. Counsel may make written submissions on the issue of costs.

C.L. CAMPBELL J.

cp/e/qlrxg/qlvxw/qlbdp/qlced/qlhcs

Tab 41

The Concise Oxford Dictionary
of Current English

First edited by
H. W. Fowler and F. G. Fowler

NINTH EDITION

Edited by
Della Thompson

CLARENDON PRESS · OXFORD

compromise /'kɒmprəmaɪz/ *n.* & *v.* • *n.* **1** the settlement of a dispute by mutual concession (*reached a compromise by bargaining*). **2** (often foll. by *between*) an intermediate state between conflicting opinions, actions, etc., reached by mutual concession or modification (*a compromise between ideals and material necessity*). • *v.* **1 a** *intr.* settle a dispute by mutual concession (*compromised over the terms*). **b** *tr.* *archaic* settle (a dispute) by mutual concession. **2** *tr.* bring into disrepute or danger esp. by indiscretion or folly. □ **compromiser** *n.* **compromisingly** *adv.* [Middle English via Old French *compromis* from Late Latin *compromissum*, neut. past part. of *compromittere* (as COM-, *promittere* PROMISE)]

compte rendu /ˌkɔ̃t rɑ̃'dju:, French kɔ̃t rɑ̃dy/ *n.* (*pl.* ***comptes rendus*** *pronunc.* same) a report; a review; a statement. [French, = account rendered]

Comptometer /kɒm(p)'tɒmɪtə/ *n.* *Brit.* *propr.* an early type of calculating machine. [apparently from French *compte* COUNT[1] + -METER]

comptroller /kən'trəʊlə/ *n.* a controller (used in the title of some financial officers) (*Comptroller and Auditor General*). [variant of CONTROLLER, by erroneous association with COUNT[1], Late Latin *computus*]

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 OR COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No. CV-12-9667-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced in Toronto

BRIEF OF AUTHORITIES
OF SINO-FOREST CORPORATION
(Motion for Sanction Order Returnable December 7, 2012)

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