

**ONTARIO
SUPERIOR COURT OF JUSTICE – COMMERCIAL LIST**

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF TIMMINCO LIMITED AND
BÉCANCOUR SILICON INC.

Applicants

BOOK OF AUTHORITIES

May 28, 2012

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I N D E X

Tab

1. *Allarco Entertainment 2008 Inc. v. Rogers Communications Inc.*, [2011] O.J. No. 4686 (S.C.J.) (QL)
2. *Budget Waste Inc. (Re)*, [2009] A.J. No. 1456 (Q.B.) (QL)
3. *Cumberland Trading Inc. (Re)*, [1994] O.J. No. 132 (Gen. Div. (Comm. List.)) (QL)
4. *Scanwood Canada Ltd. (Re)*, [2011] N.S.J. No. 447 (S.C.) (QL)
5. *Dumbrell v. The Regional Group of Companies Inc.*, [2007] O.J. No. 298 (C.A.) (QL)
6. *Eli Lilly & Co. v. Novapharm Ltd.*, [1998] S.C.J. No. 59 (QL)
7. *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.*, [1998] O.J. No. 4368 (C.A.) (QL)
8. *Toronto Railway v. Toronto (City)* (1906), 37 S.C.R. 430
9. *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, [2007] O.J. No. 1083 (C.A.) (QL)

Secondary Sources

10. Corporate and Insolvency Law Policy, "Bill C-55: Clause by Clause Analysis", online: Industry Canada <http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00825.html>

Materials Previously Filed in the CCAA Proceedings

11. Initial Order dated January 3, 2012
12. DIP Agreement entered into between Timminco and QSI dated January 18, 2012 as of January 20, 2012

TAB 1

Case Name:

Allarco Entertainment 2008 Inc. v. Rogers Communications Inc.

Between

**Allarco Entertainment 2008 Inc., Allarco Entertainment Inc.,
and Allarco Entertainment Limited Partnership, Plaintiffs, and
Rogers Communications Inc., Rogers Cable Communications Inc.
and Rogers Media Inc., Defendants**

[2011] O.J. No. 4686

2011 ONSC 5623

Court File No. 09-8476-00CL

Ontario Superior Court of Justice

P.M. Perell J.

Heard: September 14 and 15, 2011.

Judgment: September 27, 2011.

(255 paras.)

Media and communications law -- Broadcasting -- Broadcasting policy -- Programming -- Pay TV -- Undue preference or advantage -- Distribution undertakings -- Undue preference or disadvantage -- Discretionary television service -- Specialty services -- Motion by Rogers for summary dismissal of Allarco's action allowed -- Allarco alleged Rogers liable for lack of success in selling Super Channel to its subscribers -- No genuine issue for trial with respect to any breach of contract or other duty owing by Rogers to Allarco -- CRTC determination Rogers subjected Allarco's pay TV service to undue disadvantage not binding in civil action -- Contract between Rogers and Allarco did not encompass Rogers' statutory duties -- No fiduciary relationship existed -- Exculpatory clause in contract precluded Rogers' liability -- Broadcasting Act, ss. 3, 13, 32.

Media and communications law -- Administration -- Canadian Radio-television and Telecommunications Commission (CRTC) -- Powers -- Regulations -- Broadcasting -- Motion by Rogers for summary dismissal of Allarco's action allowed -- Allarco alleged Rogers liable for lack of success in selling Super Channel to its subscribers -- No genuine issue for trial with respect to any breach of contract or other duty owing by Rogers to Allarco -- CRTC determination Rogers

subjected Allarco's pay TV service to undue disadvantage not binding in civil action -- Contract between Rogers and Allarco did not give rise to right to damages for matters within CRTC's mandate to regulate.

Motion by Allarco for partial summary judgment against Rogers in its breach of contract claim. Rogers brought a counter-motion for complete summary judgment, dismissing Allarco's action, which also included claims for negligence, breach of fiduciary duty, and unlawful interference with economic relations. Allarco was an independent Canadian broadcaster of a pay television service, Super Channel. It contracted with cable TV companies like Rogers and satellite TV companies like Bell, which distributors would take subscriptions from their customers for Super Channel and pay Allarco a portion of the subscription rate charged to their customers. Rogers had regulatory obligations to distribute certain must-carry pay TV services, and not to give an undue preference to any particular service. Allarco was granted must-carry status by the CRTC in May 2006, despite Rogers' opposition. Rogers was obliged to negotiate with Allarco to carry Super Channel. Negotiations took place over six months, involving some impolite exchanges between the companies' representatives. Their agreement provided that Rogers would distribute four standard definition channels for Allarco, with two high definition channels to be added in the future. Rogers had sole discretion regarding packaging Super Channel with other services. Allarco challenged Rogers' assertion it lacked sufficient bandwidth to distribute the two high definition channels right away. It also questioned Rogers' inability to bring Super Channel to Newfoundland right away. It submitted the launch of Super Channel was intentionally delayed by Rogers to further Rogers' commercial interests, citing Rogers' decision to allocate bandwidth to two popular American channels. Rogers ultimately started distributing Super Channel's video on demand channel in February 2008 and its high definition channels in July 2008. Super Channel's subscriber base was much smaller than expected. Allarco submitted this was because Rogers failed to adequately train and motivate its staff to market the service. Allarco complained to the CRTC. It pointed out other distributors had been much more successful in marketing Super Channel. The CRTC found Rogers subjected Allarco to an undue disadvantage by not including Super Channel in its VIP Ultimate with Movies package and through the lesser marketing efforts its staff used to promote Super Channel as opposed to TMN and other similar services. Rogers was unsuccessful in seeking to have the present action stayed pending the CRTC decision. After the decision, Rogers made attempts to respond to the CRTC's concerns, but none had a discernible impact on its sales of Super Channel.

HELD: Motion by Allarco dismissed; counter-motion by Rogers allowed. Allarco's action against Rogers was dismissed. Rogers had a statutory, not a contractual, obligation to distribute Super Channel. No monetary compensation was available to Allarco for a breach of this obligation by Rogers. The CRTC, not the court, had sole jurisdiction to enforce Rogers' obligation to distribute Super Channel. There was no basis for implying terms in the parties' agreement identical to those statutory obligations, or providing for a duty on Rogers' part to perform such obligations in good faith. Rogers breached no express contractual obligation. There was no genuine issue for trial, so Allarco's entire claim failed. Alternatively, Rogers was able to avow itself of an exculpatory clause

in the agreement rendering neither party liable for damages of any kind. This clause was not unconscionable, given that Allarco was a sophisticated corporate party with the CRTC's protection in regulating the bargain the parties reached. In the further alternative, the CRTC's decision was not a binding determination that Allarco's rights pursuant to the agreement had been violated. No fiduciary obligation existed between Rogers and Allarco. Rogers owed Allarco no common law duty of care.

Statutes, Regulations and Rules Cited:

Broadcasting Act, S.C. 1991, c. 11, s. 3(t)(iii), s. 13(1), s. 32(2)

Broadcasting Distribution Regulations, SOR/97-555, s. 9, s. 9(1), s. 18(5), s. 18(11.1), s. 38(2)

Ontario Rules of Civil Procedure, Rule 21

Counsel:

D. Urbas, K. Crain, and R. Ghignone for the Plaintiffs.

K. E. Thomson, M. Milne-Smith, and A. Carlson for the Defendants.

REASONS FOR DECISION

P.M. PERELL J.:--

A. INTRODUCTION

1 The Plaintiffs, Allarco Entertainment 2008 Inc., Allarco Entertainment Inc., and Allarco Entertainment Limited Partnership ("Allarco") operate the pay TV channels known as Super Channel. Allarco bring a motion for a partial summary judgment against Rogers Communications Inc., Rogers Cable Communications Inc., and Rogers Media Inc. ("Rogers"), which operate a cable TV service.

2 Allarco's motion for summary judgment is with respect to two alleged breaches of its contract with Rogers. Allarco seeks a judgment that Rogers breached their contract by: (1) subjecting Allarco to an "undue disadvantage"; and, (2) breaching the agreement to distribute Super Channel on the Rogers' service by failing to distribute two high definition (HD) channels in the initial launch of Super Channel and by unnecessarily delaying the distribution of Super Channel in Newfoundland.

3 For its part, Rogers brings a motion for a complete summary judgment dismissing Allarco's action, which, in addition to the above and other claims for breach of contract, asserts claims of negligence, breach of fiduciary duty, and unlawful interference with economic relations.

4 The theory of Allarco's action is that promises to launch Allarco's group of TV channels known as Super Channel and to not subject Allarco to an undue disadvantage were either implied terms or terms incorporated by reference into an agreement known as the Affiliation Agreement and that the parties could not contract out of, vary, or exculpate Rogers' implied or incorporated obligations. Allarco alleges various breaches of the Affiliation Agreement in addition to the two breaches that are the subject of its motion for summary judgment. The various breaches are the alleged wrongful conduct that constitutes the alleged tortious conduct of Rogers and are also characterized as breaches of fiduciary duty.

5 The theory of Allarco's motion for a partial summary judgment has a trunk and two branches. The trunk of the argument is the assertion that there were implied or incorporated terms of the contract between Allarco and Rogers that correspond to Rogers' statutory obligations under the *Broadcasting Act*, S.C. 1991, c. 11.

6 The first branch from this trunk is the argument that a decision of the Canadian Radio-television and Telecommunications Commission ("CRTC") proves that Allarco was subjected to an "undue disadvantage". By this argument, which, in effect, is an issue estoppel argument, Allarco relies on the CRTC as having already found that Rogers' wrongful acts caused Allarco losses.

7 The second branch of Allarco's motion for summary judgment is the submission that the evidence on this motion proves Rogers' failure to launch the full Allarco complex of channels, which is a breach of the "must carry" obligation that was incorporated into the Affiliation Agreement.

8 The quantification of the damages for either breach of contract is to be left for determination at a trial.

9 On its summary judgment motion to have Allarco's various causes of action dismissed, Rogers' main argument is that because neither a tort claim for breach of statutory duty nor a statutory cause of action for damages is available, Allarco has manufactured claims for breach of contract, tort, and breach of fiduciary duty, but Rogers submits that these claims, all based on purported implied or incorporated obligations, are untenable and do not present a genuine issue requiring a trial. Further, Rogers argues that Allarco's claim for damages is precluded by an exculpatory provision in the Affiliation Agreement.

10 Rogers has various other arguments to resist Allarco's motion for a partial summary judgment and to support its own motion to have the action dismissed in its entirety. Rogers denies any breaches of contract, and it says that it more than performed its obligations to help Allarco in its

efforts to be a commercial success, which would also be in Rogers' self-interest because as a retailer it would benefit by selling Allarco's offerings. In any event, Rogers submits that it has no contractual or fiduciary obligation to prefer Allarco's interests over its own interests or over those of any other participant in the broadcasting industry.

11 Rogers submits that rather than assume responsibility for its own commercial failures, Allarco has chosen to blame Rogers. Rogers submits that Allarco has only itself to blame for its poor and disappointing take-up by Rogers' customers, which poor take-up can be attributed to Super Channel's inferior product, Allarco's misdirected marketing decisions, inadequate self-promotion, and to Allarco being outmanoeuvred in the marketplace by its pay TV competitors, who allegedly offered vastly more popular programming and a product that was better priced and more attractive to consumers, who have been cutting back on subscriptions during the economic stagnations of recent years.

12 Rogers submits that Allarco's more successful launch by Bell ExpressVu was still disappointing and the greater take-up by Bell ExpressVu's customers reflected different commercial circumstances and arrangements in a materially different sector of the pay TV marketplace and this lukewarm success does not prove that Rogers did anything wrong.

13 Further, Rogers submits that no finding of breach of contract can be based on the administrative non-judicial decisions of the CRTC, which considered Allarco's long list of complaints and requests for relief in an expeditious, informal procedure involving only written submissions of evidence and arguments and not a formal hearing.

14 Allarco vigorously disputes all of various arguments advanced by Rogers and staunchly defends the quality and commercial attractiveness of Super Channel's programs and its ability to compete with its programming rivals. It points to its greater subscription presence on Bell ExpressVu's satellite TV service, and it denies any self-inflicted injuries and submits that Rogers is unsuccessfully attempting to avoid taking responsibility for the harm it, and not others, caused Allarco to suffer. Allarco submits that the principals of Rogers intentionally sought to harm Allarco because it was in Rogers' commercial interest to have Super Channel fail.

15 For the purposes of deciding the motion and counter-motion, it is not necessary to determine the merits of all of Rogers' and Allarco's arguments and counterarguments, most of which would require a trial to resolve fairly.

16 Nevertheless, I am satisfied that based on the evidentiary record before the court, this action may be determined by way of a summary judgment because there is no genuine issue requiring a trial.

17 Allarco's action should be dismissed because: (a) there were no implied terms or terms incorporated by reference as alleged; (b) the parties did not elevate Rogers' existing statutory obligations into contractual obligations or tort duties of care; (c) Allarco's claims for damages are

precluded by the exculpatory clause in the Affiliation Agreement; and, (d) Allarco's claims in contract, tort, or for breach of fiduciary duty will inevitably fail whatever the outcome would have been on the many contested factual issues.

18 Accordingly, I dismiss Allarco's motion for a partial summary judgment and I grant Rogers' motion and dismiss Allarco's action.

B. EVIDENTIARY BACKGROUND

19 In support of its motion for summary judgment, Allarco provided the affidavit evidence of Malcolm Knox, who is the president of Allarco Entertainment Inc. and of Allarco Entertainment 2008 Inc., which is the general partner of Allarco Entertainment Limited. Mr. Knox was cross-examined on his affidavits.

20 In support of its motion for summary judgment, Rogers provided the affidavit evidence of David Purdy, who is the Vice-President, TV/Video Product Management of Rogers Cable. He was one of the executives responsible for Rogers' relationship with Allarco. Mr. Purdy was cross-examined on his affidavits.

21 Before using the evidence to set out the factual background, I note that the affidavits and the testimony of Mr. Knox and Mr. Purdy (and also the factums of both parties) were filled with rhetorical excesses, innuendoes, aggrandizements, exaggerations, insults, and trivializations of the positions of the other party.

22 For examples, Allarco submitted that Rogers hid Super Channel in a closet and hoped that Allarco would go away and free up Rogers' bandwidth for other channels. Rogers described Allarco's cause of action as trying to make a cat bark, and Rogers submitted that Super Channel "had to make do with content from only one major studio, older or unwanted movies from the other five ... As a result Allarco has offered programming that is ... unquestionably less popular and well-known." Allarco took the bait, and it presented evidence to laud its own programming. For another example of immoderation, this time from Allarco; it complained that Rogers located the Super Channel's channels beside pornographic channels, which, if true, implies criminal broadcasts by Rogers. Rogers' response was to say that the channels were located beside "certain pay-per-view channels ... because that was the most favourable block of four contiguous channels available."

23 Below, I will attempt to set out the facts and the positions of the parties without the embellishments.

C. FACTUAL BACKGROUND AND THE POSITIONS OF THE PARTIES

1. The TV Broadcasting Industry and The Parties

24 Allarco and Rogers are participants in the intensely regulated and highly competitive market for TV services in Canada. Canadian TV programming services include: over-the-air network channels, specialty services, pay television services, pay-per-view services, and video-on-demand services. Pay TV channels, like Allarco's Super Channel, do not sell advertising and derive their revenue from subscriptions sold to consumers by distributors, like Rogers, who have the direct contractual relationship with the consumers.

25 Under the *Broadcasting Act*, the CRTC is "the single independent public authority" with the power to regulate and supervise all aspects of the Canadian broadcasting system and the broadcasting policy set out in the Act.

26 Because of various public policy arguments made by the parties, it will become important to note that the *Broadcasting Act* declares that the objectives of the broadcasting policy can best be achieved with a single regulatory authority; i.e. the CRTC. See *Broadcasting Act*, ss. 3 (1), 5.

27 The CRTC has extensive regulatory powers, but it does not have the jurisdiction to award damages or so-called administrative monetary penalties. Proceedings before the CRTC can range from informal proceedings based upon paper record to public hearings with evidence and the testimony of witnesses.

28 Allarco is an independent Canadian broadcaster with a broadcasting licence to carry on a national general interest pay television undertaking. It owns and operates a national English-language pay TV service known as "Super Channel," comprised of 4 "standard definition" ("SD") channels, 2 "high definition ("HD") channels and 1 "on demand" service ("SVOD").

29 It will be important to note how Allarco earns revenue. To do so, it enters into commercial agreements with distributors; that is, with cable TV companies, like Rogers, and with satellite TV companies, like Bell ExpressVu, which distributors take subscriptions from their own customers for Allarco's programming offerings. After having negotiated with Allarco, the distributors determine the price for the subscriptions for Allarco's offerings, which price is comprised of Allarco's charge plus the distributor's mark-up. Allarco can advertise its offerings in conventional ways, but it does not directly recruit the subscribers to the terrestrial or satellite providers of TV service.

30 While in some respects the arrangement between Allarco and its distributors resembles a wholesaler and retailer relationship, the commercial arrangement is perhaps closer to a consignment sale because the distributor only pays Allarco if one of its customers subscribes to Allarco's service. Allarco does not have a direct relationship with the consumer and it is dependent on the sales forces of the distributors.

31 Allarco's founder and majority shareholder is Charles Allard, who has a long personal and family history going back to 1965 in the Canadian radio, television, and entertainment industries. Its management team included Mr. Allard and others with considerable experience and expertise in the industry, including Mr. Knox and Thom Eggertson. Allarco had legal representation from Mark

Lewis, a leading entertainment lawyer, and it had business advice from the late Darrell Atherley, an experienced consultant in the industry, who acted as Allarco's representative in the negotiations for a distribution agreement and a marketing agreement.

32 Rogers is a diversified and vertically-integrated Canadian communications and media company. It has five lines of business: Rogers Cable, the cable TV service provider, Rogers Wireless, Rogers Home Phone, Rogers High Speed Internet, and Rogers Media, which includes magazines, radio, television channels, and sports teams.

33 Rogers' founder was the late Ted Rogers, who was one of the pioneers and leaders of the Canadian broadcast industry. He, and especially his son Edward Rogers, a senior Rogers' executive and President of the cable operating company, were involved in the business affairs and relationship between Rogers and Allarco. Also involved were Mr. Purdy, Jeremy McCarthy, the Product Manager responsible for Super Channel's launch, and Don Goudy, Senior Director Revenue Management,

34 Rogers is a Class 1 licenced "broadcasting distribution undertaking" ("BDU") under the *Broadcasting Act*. BDUs assemble the signals of various programming undertakings into a channel line-up, which they then distribute to television viewers via cable, direct-to-home satellite transmission, or, most recently, fiber optic cable. Rogers has spent billions of dollars building the technical infrastructure that it uses to broadcast television channels into the homes, apartments, and offices of its subscribers in the markets that Rogers is licensed to provide service.

35 Rogers' territory includes Ontario, New Brunswick, and Newfoundland, and it has approximately 1.4 million TV subscribers. Rogers serves approximately one-quarter of the Canadian television market. Bell ExpressVu and Shaw, which operates both Shaw Cable and a satellite television company, known as Star Choice, together comprise approximately another half. Vidéotron, Cogeco, and other smaller regional companies make up the balance.

36 Up until the launch of fiber TV in October, 2010, Rogers was the only terrestrial (cable) service in its market area, and its competition came from licenced satellite-TV providers, from satellite TV providers in the grey or black market, and from legal or illegal Internet streaming services.

37 It also will be important to note that the technical infrastructure influences how many channels Rogers is able to distribute and sell. As matter of technology, each channel takes up "bandwidth" or "spectrum," and the number of channels Rogers can distribute at any time depends upon its available bandwidth. The number of available channels can be increased by upgrading the equipment through which signals are transmitted to add more bandwidth or by using new technologies to compress the data being transmitted through the cable.

38 Under the *Broadcasting Distribution Regulations*, SOR/97-555 of the *Broadcasting Act*, as a condition of its licence, Rogers has obligations to other TV service providers. Section 9 of the

Regulations provides that "No licensee shall give an undue preference to any person, including itself, or subject any person to an undue disadvantage." Under ss. 18(5), 18(11.1) and 38(2) of the *Regulations*, Rogers is required to distribute all pay-television services that have been designated by the CRTC as "must carry" services. For example, TMN and Movie Central were and are what is known as "must carry" services.

39 Under the regime of the *Broadcasting Act*, as already noted above, pay-TV licensees, like Allarco, do not distribute their own services. Rather, it is the BDUs, like Rogers, that distribute and market the pay-TV service. The subscriptions for channels are in the main sold by customer service representatives ("CSRs"), who respond to calls from customers phoning in to call centres.

40 Rogers markets its cable, home phone, and Internet services through its subsidiary, Rogers Cable, which uses a call centre to recruit subscribers for the various services. Rogers Customer Service Representatives ("CSRs") sell numerous products and services in three lines of business; i.e., home phone, internet, and cable TV. There are hundreds of TV channels available on Rogers' cable service. Consumers purchase a portion of the channel offerings by subscriptions covering standard sets of channels that can be augmented by packages of additional channels or by prescribing for one or more discrete channels.

41 At any one time, Rogers employs thousands of CSRs in six call centres across Canada. Rogers also uses the services of four third-party call centres for a small number of callers. There is a large turnover rate of these low level employees, and Rogers says that it is challenged to keep the CSRs well trained with thorough product knowledge of all the services being offered by Rogers Cable. The first source of information available to CSRs is the Company's call centre library, which is an online database that includes information about the programming Rogers distributes. There are other sources of information including internal and external training and promotional visits from channel representatives.

2. The CRTC Decision to Licence Allarco

42 On January 14, 2005, by Broadcasting Public Notice CRTC 2005-6, the CRTC called for applications for a broadcasting licence to operate a new national English-language general interest pay television programming undertaking. Allarco and three others applied, and there were public hearings in Ottawa in October 2005.

43 As a BDU, distributor of programming, Rogers opposed Allarco's application for a "must-carry" designation at the licencing hearing. Rogers stated position was that adding more "must-carry" services would constrain the ability of BDUs to offer other diverse and innovative services. It also opposed a must-carry designation because it adversely affected what Rogers could negotiate as its charge for marketing and distributing the TV service.

44 On May 18, 2006, notwithstanding the opposition, the CRTC awarded Allarco a national licence as a "must carry" service. In its decision, the CRTC recognized that without "must-carry" status, it would be unreasonable to expect Allarco to be able to compete with TMN and Movie Central, its entrenched pay TV competitors, given that both enjoyed "... the benefits of incumbency, including significant subscriber bases and existing arrangements with BDUs and content providers."

45 In regard to designating Super Channel as a "must carry" service, the CRTC stated that: "it would be unreasonable to expect the new Allarco service to meet its business plan, including its commitments with respect to expenditures, promotion and exhibition of Canadian programming, and to provide an attractive service, without comparable distribution requirements."

46 The CRTC, however, refused Allarco's request that exclusive licences for popular programming be prohibited as a way of preventing its competitors, TMN and Movie Central, from monopolizing the most popular program content.

47 In a submission that was vigorously disputed by Allarco, Rogers alleges that Allarco's failure to obtain popular programming to rival the programming secured exclusively by the pay TV competitors meant that Allarco had a less attractive product to offer and that Allarco ineptly positioned Super Channel to be a complimentary service rather than a service that would compete with its pay TV rivals.

3. The Negotiations for an Affiliation Agreement

48 Pursuant to s. 3 (t) (iii) of the *Broadcasting Act*, Rogers and the other BDUs were obliged to provide reasonable terms to Allarco for the carriage, packaging and retailing of Super Channel, and pursuant to s. 9 (1) of the Regulations, the BDUs were obliged not to give an "undue preference" to any of Allarco's competitors or subject it to an "undue disadvantage."

49 With Rogers and Allarco's statutory rights and obligations being at least part of the contractual nexus, in 2006, Allarco and Rogers began negotiations for the distribution of Super Channel as a multiplex service that consisted of six channels plus a video on demand channel.

50 Allarco submits that success in Rogers' territory was critical for Super Channel's viability: Rogers represented 23% of Super Channel's potential subscribers. Allarco submits that Rogers knew that it was extremely important to Allarco to launch the Super Channel service in HD because HD customers are more likely to be pay TV subscribers and the incumbent TMN already had two HD channels.

51 It was Mr. Knox's evidence and his conjecture that Rogers' executives were not enthusiastic about entering into negotiations because: (a) selling pay TV services was not a priority among Rogers' various undertakings; (b) Rogers did not wish to have to distribute Super Channel, as

revealed by its opposition to a must carry designation at the licencing hearing; and, (c) it had a long standing close relationship with and preference for TMN, the incumbent pay TV service.

52 In making its plea that Rogers was not acting in good faith, Allarco also relies on evidence that suggests that on a personal level, Edward Rogers resented Allarco's taking up commercially valuable bandwidth at less than full market value and that he and others in the upper tiers of management had animosity towards Allarco and to the principals of Allarco.

53 Mr. Knox's conjectures were corroborated by some rude, profane, intemperate, and irritated e-mail messages and memoranda exchanged by Rogers' senior management that were disclosed by Rogers for Mr. Purdy's cross-examination. This material proves that there was no love lost between the parties, but in its factum and in oral argument, Rogers argued that placed in context, these exchanges were understandable or justifiable and certainly not evidence of any breaches of contract, tortuous misconduct, bad faith, or breaches of fiduciary duty by Rogers.

54 I have read and considered this offensive material; however, since, as already foreshadowed above, it will be my opinion that s. 9 of the *Regulations* is not a term of the Affiliation Agreement, and since it will be my opinion that there is no fiduciary relationship and that the tort and contract causes of action cannot be made out because of fatal flaws, it is not necessary for me to determine whether this offensive material proves a breach of contract, a tort, bad faith, or a breach of fiduciary duty. In any event, as I have also already noted above, if these causes of action were tenable, the contested factual issues would require a trial and it would not be appropriate to decide these issues on a summary judgment motion.

55 There is no evidence that Rogers was publically rude, and the negotiations lasted for approximately six months. Mr. Knox swore that the negotiations themselves focused on the terms not already imposed by law because, he said, everyone understood that the key terms had already been prescribed.

56 Mr. Purdy's evidence was to the contrary, and he deposed that there were no discussions in which Rogers was asked to incorporate its regulatory obligations into the agreement with Allarco.

57 It is Rogers' position that it did not agree to make the regulatory requirements part of the contract. During oral argument, Rogers' counsel suggested that it would be commercially idiotic for Rogers to take on contractual obligations commensurate with its statutory obligations. It submits that the language of the Affiliation Agreement shows that it did not intend to make the regulatory obligations contractual obligations.

58 During the negotiations in September 2007, to Allarco's surprise and consternation, Rogers advised Allarco that it only had capacity to launch one SD and one HD channel. This announcement, which Allarco relies on as revealing Rogers' bad faith, alarmed Allarco because it would have put it in a substantial competitive disadvantage to the incumbent rival TMN.

59 Rogers advice, however, was not the last word on the manner of Super Channel's launch, and negotiations continued. In the end, Allarco and Rogers negotiated an "Affiliation Agreement" and the "Marketing Support Agreement" to govern the commercial terms for Rogers' distribution of Super Channel.

4. **The Express Terms of the Affiliation Agreement**

60 On December 13, 2007, Allarco and Rogers signed the Affiliation Agreement for the distribution of Super Channel. The agreement expressly addresses, among other things, the transmission and distribution of Super Channel, intellectual property issues, audit rights, maintenance obligations, and the rate per subscriber to be charged by Allarco.

61 Under this agreement, Rogers was granted "the right (but not the obligation) to receive and distribute" Super Channel. The meaning and significance of this grant to Rogers is an important matter, which I will return to below as a part of the discussion of the extent, if any, of Rogers' implied promises or promises incorporated by reference into the Affiliation Agreement.

62 The following provisions of the Affiliation Agreement are particularly important to the parties' arguments on the competing motions for summary judgment:

1. GRANT OF RIGHTS:

- (a) Allarco grants to Rogers the right (but not the obligation) to receive and distribute in Canada via distribution undertakings directly or indirectly owned, operated or controlled by Rogers (such distribution undertakings will be more than 51% owned, operated or controlled by Rogers), Allarco's 24 hours a day television entertainment and information programming service known as "Super Channel" licensed by the Canadian Radio-television and Telecommunications Commission ("CRTC") in Decision CRTC 2006-193 (the "Service"). The content of the Service shall be similar in all respects to Rogers to the service described in Allarco's license to the CRTC.

2. WHOLESALE RATE:

- (b) Upon the expiration of the Preview and subject to the other terms and conditions of this Agreement, Rogers shall pay to Allarco (in arrears), no later than thirty (30) days following the end of the month, a monthly service fee (the "Monthly Fee") calculated in accordance with Schedule A attached hereto.

5. TRANSMISSION AND DISTRIBUTION:

- (b) ... Rogers shall distribute the entire signal of any channel it distributes from the Service. Upon launch, Rogers shall distribute four (4) standard definition channel ("SD Channels") from the Service. In addition to the SD channels, Allarco has high definition channels available for launch and the parties agree to launch such channels on a date to be agreed upon in writing.

8. CONTENT OF SERVICE:

Allarco and Rogers agree that the branding and quality of the Service is an integral part of this Agreement and, accordingly, Allarco represents warrants and covenants that, throughout the Term:

- (a) The name of the Service shall be "Super Channel"; and
- (b) the Service shall consist of a variety of content which may include, but not limited to, movies, sports, documentaries, series and specials.

10. MARKETING SUPPORT:

- (a) Allarco acknowledges and agrees that Rogers may, at its sole option, create retail product packages and/or bundles that may include the Service.
- (b) The parties will consult with one another on an ongoing basis to coordinate their respective efforts to advertise and promote the Service.

14. WARRANTIES AND INDEMNITIES:

- (a) Rogers represents and warrants and covenants to Allarco that it has the necessary authority to enter into this Agreement and to grant to Allarco all of the rights purported to be granted hereunder.

RIGHTS OF TERMINATION:

Rogers' Rights of Termination

Rogers may, at its option and without prejudice to any other remedies available to it, terminate this Agreement:

- (a) upon giving thirty (30) days prior written notice to Allarco, if Allarco defaults in the performance or observance of any of the material terms, covenants or agreements on its part contained in this Agreement and such default continues for a period of thirty (30) days after notice thereof from Rogers to Allarco.
- (d) upon giving thirty (30) days prior written notice to Allarco, if a change in Applicable Law, including, but not limited to, the issuance or promulgation of any decisions, regulations or license conditions applicable to or affecting Rogers or any of its affiliates by the CRTC or other competent regulatory authority, materially adversely affects the economic benefit to Rogers of distributing the Service pursuant to this Agreement;

Allarco's Rights of Termination

Allarco may, at its option and without prejudice to any other remedies available to it, terminate this Agreement by giving thirty (30) days prior written notice thereof to Rogers:

- (a) if Rogers defaults in the performance or observance of any of the material terms, covenants or agreements on its part contained in this Agreement and such default continues for a period of thirty (30) days after notice thereof from Allarco to Rogers; and/or
- (b) if a change in Applicable Law, including, but not limited to, the issuance or promulgation of any decisions, regulations or license conditions applicable to or affecting Allarco by the CRTC or other competent regulatory authority, materially adversely affects the economic benefit to Allarco of providing the Service to Rogers for distribution pursuant to this Agreement.

18. GOVERNING LAW:

This Agreement shall be governed by and interpreted in accordance with the substantive laws of the Province of Ontario and the federal laws of Canada applicable therein, without reference to conflicts of laws provisions. ...

19. LIMITATION OF LIABILITY:

Except with respect to any claim or liability arising out of an infringement of any third party intellectual property right as contemplated in Section 14, in no event shall any party be liable, by indemnification or otherwise, for any special, indirect, consequential or incidental damages of any kind, any loss of profit, loss of use, or business interruption. This Section shall survive the expiry or other termination of this Agreement.

23. APPLICABLE LAW:

This Agreement is subject to all laws, regulations, license conditions and decisions of the CRTC and/or municipal, provincial and federal governments or other authorities which are applicable to Rogers and/or Allarco, and which are now in force or hereafter adopted ("Applicable Law"). In the event that any such law, regulation or decision comes into force during the Term concerning the subject matter of this Agreement, such that it prevents or diminishes either party's ability to perform under this Agreement, the parties agree to enter into good faith negotiations to amend this agreement, where required, in order to remedy such diminution of or inability to perform.

24. LEGAL EFFECT:

- (a) Nothing herein contained shall be deemed to create, and the parties do not intend to create, any relationships of partner, agent or joint venture as between Rogers and Allarco.
- (b) This Agreement, including the schedules hereto and any agreements or documents to be delivered pursuant to the terms of this Agreement, constitutes the entire agreement of the parties relating to the subject matter hereof and supersedes all prior agreements, understandings, negotiations, representations and proposals, whether written or oral, relating to the subject matter hereof. There are no conditions, covenants, representations or warranties, express or implied, statutory or otherwise relating to the subject matter hereof, except as herein expressly provided.
- (c) Except as otherwise specifically set forth in this Agreement, no amendment, waiver or modification of any provision of this Agreement, including the

schedules hereto, shall be binding on a party unless consented to in writing by such party. No waiver of any provision of this Agreement shall constitute a waiver of any other provision, nor shall any waiver constitute a continuing waiver unless otherwise expressly provided in writing.

- (d) If any provision of this Agreement is determined to be invalid or unenforceable in whole or in part, such invalidity or unenforceability will attach only to such provision or part thereof, and the remaining part of such provision and all other provisions hereof will continue in full force and effect.

5. Terms Incorporated by Reference or Implied Terms

63 Relying particularly on s. 23 of the Affiliation Agreement, Allarco submits that the Affiliation Agreement incorporates by reference Allarco's statutory licence conditions, decisions of the CRTC, and all applicable laws and regulations with the result that certain terms are incorporated by reference, or in the alternative, they are implied terms of the contract.

64 As pleaded in Allarco's Amended Fresh as Amended Statement of Claim, the incorporated or implied terms are:

- (a) A term requiring Rogers not to give undue preference to any of Allarco's competitors, or to subject Allarco to an undue disadvantage;
- (b) A term requiring Rogers to provide reasonable terms of the carriage, packaging and retailing of Super Channel;
- (c) A term requiring Rogers to distribute Super Channel;
- (d) A term requiring Rogers to offer Allarco comparable distribution terms to those enjoyed by its competitors; and
- (e) A term requiring Rogers to perform its contractual duties in good faith, specifically those duties particularized above.

65 Allarco also pleads that Rogers owes it fiduciary duties in light of:

- (a) The unequal relationship between the parties;
- (b) Rogers' significant scope for the exercise of discretion including: Allarco's complete dependence on Rogers' customer support representatives ("CSR") to sell Super Channel subscriptions; Allarco's complete dependence on Rogers to set the retail price of the product, and Allarco's complete dependence on Rogers to place the channel in an appropriate place;
- (c) The fact that Rogers' power and discretion can be exercised unilaterally so as to affect Allarco's interests; and
- (d) Allarco's vulnerability to Rogers' exercise of discretion and power.

66 I will discuss later in these Reasons for Decision the critical issue about what is or is not a part of the contract between Allarco and Rogers, but in order to understand both the factual background and also the competing arguments on the summary judgment motions, it is necessary to highlight that Allarco argues that from the outset of the delivery of Super Channels' signals to Rogers, Rogers was contractually bound to launch all of the four SD channels, two HD channels, and one "on demand" service (SVOD) channel that comprised the Service.

67 Allarco makes this allegation notwithstanding that the signed Affiliation Agreement provides that "Upon launch, Rogers shall distribute four (4) standard definition channel ("SD Channels") from the Service." Under the Affiliation Agreement, the two available high definition channels are to be launched "on a date to be agreed upon in writing."

68 With respect to the issue of whether a complete launch was a contractual obligation, Allarco submits that Mr. Atherley, its representative for the negotiations, was misled by Rogers to believe incorrectly that Rogers did not have the bandwidth for the two HD channels, when the truth was that the bandwidth was available but just not for Allarco's two HD channels. Thus, Allarco submits that nothing can be taken from Mr. Atherley's alleged contentment with the terms of the Affiliation Agreement.

69 In pressing its position that a full launch was required, in response to one of my questions during the oral argument, Allarco's counsel stated that provisions in the Allarco agreement were illegal insofar as they were contrary to the terms incorporated by reference, which terms were derived from Rogers' statutory obligations and the CRTC's designation of Super Channel as a "must carry" channel.

70 Allarco also submitted that Rogers was obliged to terminate carrying other channels if that was necessary in order to distribute all the Super Channel's channels. In its reply during the oral argument, Rogers protested that there was no pleading of illegality that would permit Allarco to make this argument. I will return to the matter of illegality during the discussion below, but I simply note here that I regarded Allarco's submission to be part of the exercise of interpreting the Affiliation Agreement, and I thus considered Allarco's submission as not foreclosed by the absence of a plea of illegality.

71 It will also be helpful in understanding the competing arguments and my Reasons for Decision that at a high level, the dispute between the parties is about the extent to which Rogers' freedom of contract was constrained by the circumstances that the CRTC had ordered that Super Channel be a must carry channel and about whether or not it was necessary to add contractual or tort remedies to Rogers' express contractual obligations.

6. The Launches of Super Channel

72 Although internal memorandum indicates that Rogers had initially envisioned a full launch of Super Channel, on November 22, 2007, Rogers launched only Super Channel's 4 SD channels. The evidence of Mr. Purdy was that pending the implementation of a new technology called "switched digital video," anticipated to be available in the spring of 2008, Rogers was temporarily unable to launch Super Channel's 2 HD channels because of a short-term shortage of bandwidth. Mr. Purdy says that demand from new channels had outpaced available supply.

73 As may be gathered from the discussion above about the negotiation of the Affiliation Agreement, there is a bitter dispute between the parties about whether Rogers in truth had the bandwidth to launch Super Channel's two HD channels from the outset.

74 It should be noted that at the time of the launch, the Affiliation Agreement had not yet been officially signed. Rogers submits that this fact confirms that there were no implied terms or terms incorporated by reference and nothing upon which to base Allarco's breach of contract claims about the alleged failure to immediately distribute the two HD channels.

75 For similar reasons, Rogers also submits that there is no basis for a breach of contract claim about the fact that the original launch did not include Newfoundland. This was another contentious and bitter matter between the parties.

76 Rogers was in the process of building a marine cable that would enable it to bring Super Channel's channels to the island province. However, beginning May 22, 2009, Rogers was able to use a competitor's satellite service to bring Super Channel to Newfoundland. Allarco contends that Rogers knew or ought to have known about this means to service the island a year earlier. These allegations, once again, are disputed by Rogers.

77 In general, Allarco alleges that Mr. Edward Rogers was intentionally delaying the launch of Super Channels' offerings to further Rogers' own commercial interests rather than performing its obligations to Allarco. Allarco submits that Rogers had the capacity to launch Super Channel's HD channels but deliberately allocated an HD channel to CNN, the well-known American and international news channel. In paragraph 58 of its factum, Allarco states:

58. Simply put, Rogers' executives made this decision for commercial or business reasons, rather than a lack of capacity (bandwidth). Dave Purdy admitted in his cross-examination that when Rogers was considering whether or not to launch Super Channel in HD, Rogers did the following:

A. I think we looked at the HD road map, the channels that were going HD. And Ed [Rogers] always managed our road map, and weighing regulatory, and commercial, and consumer interests, and we made a decision of what we thought would be the best thing for our customers and for our shareholders.

78 Rogers' response was it truly did not have enough bandwidth and that it allocated its scarce bandwidth to TLC (The Learning Channel) and CNN, two popular specialty channels that were received by the vast majority of Rogers' customers.

79 As noted above, the Affiliation Agreement was signed on December 13, 2007, and a Marketing Support Agreement was signed on December 19, 2007, approximately one month after Super Channel launched on Rogers.

80 Under the Marketing Support Agreement, Rogers undertook to provide certain promotional activities. In this action, Allarco does not allege a breach of any particular term of the Marketing Support Agreement, although it does allege that Rogers breached its obligations to promote and encourage subscriptions to Super Channel by its improper treatment of Super Channel.

81 In February 2008, Rogers added Super Channel's SVOD channel.

82 In March of 2008, after Allarco's follow-up inquires regarding a launch date for the HD Channels, D'Arcy Hunt, Rogers' Director of Video Product Management, stated that the launch would be delayed another 6-9 months on account of delays in deploying the switched digital video. However, in July 2008, after a stern directive from the late Ted Rogers in his capacity as President and CEO of Rogers Cable, Rogers added Super Channel's two HD channels. The elder Mr. Rogers was personally embarrassed by his son turning down Allarco's requests, which he regarded as an unwise policy.

7. **Allarco's Market Performance, its Complaint to the CRTC and its Superior Court Action**

83 Following Super Channel's launch, Allarco expected almost 300,000 subscribers by the end of its first year and over 750,000 in its second. However Super Channel market performance was disappointing and fell far short of expectations.

84 Allarco believes and submits that one of the reasons for the poor sales of subscriptions to Super Channel to Rogers' customers is the poor performance of Rogers CSRs, whom Allarco alleges were not properly trained, informed, and motivated to sell Super Channel.

85 Allarco's belief was based, in part, on secretly recorded calls by persons retained by Allarco's counsel to pretend to be customers and, in part, by comparison to the relatively more successful sales efforts of other BUVs.

86 Rogers once again strongly denies Allarco's allegations. It says that it made numerous efforts to educate the CSRs and that it offered special commissions to encourage Super Channel sales. Rogers submits that Super Channel was given the same or better treatment than TMN at Rogers' call centres.

87 On April 13, 2009, Allarco complained to the CRTC. The main impetus for Allarco's complaint was the negative effect Rogers' conduct allegedly was having on Super Channel subscriptions. Subscription levels by other major BDUs were higher. For example, by May of 2008, Bell had over 60,000 Super Channel subscribers while, in contrast, Rogers only had 3,000 subscribers.

88 A complaint to the CRTC may only be submitted to the CRTC dispute resolution process if, among other things, the "dispute is relevant to the regulation and supervision of either the Canadian broadcasting or telecommunications system, primarily to matters of interpretation or application of an existing Commission decision, policy or regulation."

89 Allarco made at least 20 specific complaints, among other things, about the launch timing and channel positioning of Super Channel; the training, education and compensation of CSRs concerning Super Channel; the packaging and promotion of Super Channel; and the pricing and marketing of Super Channel.

90 A motivation for the complaint was the low number of Super Channel subscriptions at Rogers. In the early summer of 2009, Rogers' penetration rate - the percentage of Rogers' customers who subscribed to Super Channel - was 0.39%. In contrast, Bell's penetration rate was 7.58%, while Shaw Cable's and Shaw Direct's penetration rates were 5.9% and 4.78%.

91 Allarco complained that Rogers had contravened s. 9 of the *Regulations*, which provides that "[n]o licensee shall give an undue preference to any person, including itself, or subject any person to an undue disadvantage". Allarco alleged that Rogers had not offered Super Channel in a comparable manner to the incumbent pay television services of Astral Broadcasting Group, the Movie Network, HBO Canada, and Movie Pix.

92 Rogers moved to have the complaint dismissed on the basis that the CRTC did not have jurisdiction to hear the complaint because it was a commercial dispute, a submission with which the Commission disagreed.

93 On June 2, 2009, while a decision from the CRTC was pending, Allarco commenced its action in the Superior Court of Justice against Rogers. It claimed damages of in excess of \$25 million and specific performance of the Affiliation Agreement and the Marketing Support Agreement.

94 The CRTC issued its Decision on September 18, 2009. The CRTC found a breach of s. 9 of the *Regulations*. As noted above, Allarco relies on the CRTC decision in support of the first branch of its motion for a partial summary judgment.

95 For reasons that will become clearer later during the discussion of whether there are genuine issues requiring a trial, in its decision, the CRTC described its analytical approach. This approach included considerations beyond the commercial interests of Allarco and Rogers and involved the interests of other persons and the achievement of the objectives of the broadcasting policy. In this

regard, the CRTC stated in its decision:

In order to determine if a preference or disadvantage is undue, the test applied by the Commission is to examine whether the preference or disadvantage has had, or is likely to have, a material adverse impact on Super Channel or any other person. It also examines the impact that the preference or disadvantage has had, or is likely to have, on the achievement of the objectives of the broadcasting policy for Canada set out in the *Broadcasting Act*.

96 In its decision, the CRTC held that: (a) Rogers had subjected Allarco to an undue disadvantage; (b) Rogers' conduct had and would likely continue to have a material adverse impact on Super Channel; and (c) Rogers conduct has had or is likely to have a negative impact on the objectives of broadcasting policy. The CRTC stated:

The Commission finds that Rogers Cable Communications Inc. (Rogers) has subjected Allarco Entertainment 2008 Inc. to an undue disadvantage in regard to the marketing of Super Channel, a general-interest pay television programming service, contrary to s.9 of the Broadcasting Distribution Regulations. The Commission further finds that there is insufficient evidence to establish that Rogers has given an undue preference to Astral Broadcasting Group Inc. licensee of The Movie Network, HBO Canada and MoviePix in regard to the marketing of Super Channel. The Commission directs Rogers to file by 19 October 2009, written documentation setting out the steps it will take to ensure that, in future, its marketing of Super Channel does not result in the service being subjected to an undue disadvantage.

... Rogers has subjected Allarco to a disadvantage, first, by not including Super Channel in its VIP Ultimate with Movies package or in any other similar package, and second, through the significantly lesser marketing efforts used by its CSRs to promote Super Channel as compared to those used to promote TMN/HBO Canada/MoviePix. In the Commission's view, Rogers' conduct falls short of affording Super Channel comparable distribution. ...

... Rogers' conduct with respect to the marketing of Super Channel has had and is likely to continue to have a material adverse impact on Super Channel. It further considers that Rogers' conduct has had, or is likely to have, a negative impact on the achievement of the objectives of the broadcasting policy for Canada set out in the Act. Accordingly, the Commission finds that Rogers has subjected Allarco to an undue disadvantage with respect to its marketing of this service, contrary to section 9 of the Regulations.

97 While the CRTC decision had been pending, Rogers had moved for a stay of the court proceedings on the grounds that the CRTC had exclusive subject matter jurisdiction over the dispute. On December 8, 2009, Justice Pepall dismissed Rogers' Rule 21 motion. She found that the Superior Court had jurisdiction to award damages, but she stayed the action pending completion of the CRTC process. In paragraph 45 of her judgment, she stated:

[T]he complainants have sought certain monetary relief from the CRTC as part of their requested relief. Unlike its telecommunications jurisdiction, the CRTC does not have broadcasting jurisdiction to award damages. Consistent with the case law, the plaintiffs should not be deprived of their right to claim and pursue damages but such right should be stayed until the CRTC has disposed of the substance of the plaintiffs' complaints and their request before it for monetary relief.

98 Although Rogers does not now dispute the court's subject matter jurisdiction over Allarco's claim, Rogers submitted in its factum that Allarco's action was "forbidden" as being an attempt to get around the authority of *Canada v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205, where the Supreme Court of Canada rejected a nominate tort of statutory breach and established the principle that mere breach of a statutory duty does not constitute negligence. See also: *Holland v. Saskatchewan*, 2008 SCC 42; *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 and *Orpen v. Roberts*, [1925] S.C.R. 364.

99 I pause here to note that Rogers did not press this argument during the hearing of the motions for summary judgment, and, practically speaking, Rogers abandoned the argument. Rogers rather submitted that Allarco had manufactured a breach of contract claim and various tort claims because the CRTC cannot award damages and the *Saskatchewan Wheat Pool* stood in the way of a breach of statute, as such, being a nominate tort.

100 Because Rogers abandoned the argument, I need not discuss Allarco's counterargument that Rogers was improperly attempting to circumvent Justice Pepall's decision that refused to stay Allarco's action. I will, however, need to discuss several of the cases referred to by the parties as part of the discussion later of whether or not Allarco has a tort claim against Rogers.

101 Completing the narrative of the factual background, Rogers undertook a variety of measures to respond to the CRTC decision. None of those measures, however, had a discernable impact on Rogers' sales of Super Channel to its subscribers, and Allarco resumed its action for damages, and the parties brought their competing motions for summary judgment.

D. DISCUSSION

1. Introduction

102 The parties raise many arguments, and I will discuss their arguments and the merits of the competing motions for summary judgment through a sequence of topics.

103 The first topic is that of determining the terms of the agreement between Allarco and Rogers. My first conclusion will be that the terms relied on by Allarco in its motion for a partial summary judgment and as the underpinning for all its causes of action are not implied terms or terms incorporated by reference into the agreement between the parties. This conclusion undermines Allarco's motion for a partial summary judgment, and, means that its motion should be dismissed. The first conclusion also supports Rogers' motion to dismiss Allarco's action in its entirety.

104 The second topic is whether there is a genuine issue for trial about whether Rogers breached a contractual duty of good faith owed to Allarco. My second conclusion is that there is no genuine issue for trial and that this claim would inevitably fail. This conclusion supports Rogers' motion to dismiss Allarco's action.

105 Assuming my first and second conclusions are incorrect and assuming that the breaches of contract have been proven, the third topic is whether Rogers is entitled to rely on the exculpatory provisions in the Affiliation Agreement. My third conclusion is that the exculpatory provisions apply, and this conclusion provides an alternate basis for dismissing Allarco's motion for a partial summary judgment. The third conclusion also supports Rogers' motion to dismiss Allarco's action.

106 Assuming my first, second, and third conclusions are incorrect, the fourth topic is whether there is a genuine issue for trial with respect to the two alleged breaches of contract advanced by Allarco for its motion for a partial summary judgment. A subtopic is whether Allarco can rely on the decision of the CRTC as making a binding determination that Rogers breached its obligation not to subject Allarco to an undue disadvantage. My fourth conclusion is that there are genuine issues for trial about both alleged breaches of contract and at least for the purposes of the motion for summary judgment there are no issue estoppels. The fourth conclusion would provide a third basis for dismissing Allarco's motion for a partial summary judgment, but this conclusion is neutral to Rogers' motion to dismiss Allarco's action in its entirety.

107 Turning to Roger's motion to dismiss Allarco's action, the fifth topic is whether Rogers has a fiduciary relationship with Allarco. My fifth conclusion is that there is no fiduciary relationship. This conclusion supports Rogers' motion to dismiss Allarco's action.

108 The sixth topic is whether Allarco has a tenable negligence claim against Rogers. For this sixth topic, I will assume that the exculpatory provision does not protect Rogers from negligence claims. My sixth conclusion is that Allarco has no claim in negligence because Allarco's novel negligence claim does not pass the duty of care element of a negligence claim, particularly a claim for pure economic loss. This sixth conclusion supports Rogers' motion to dismiss Allarco's action.

109 The seventh topic is whether Allarco has a tenable claim for the tort of interference with contractual relations. For this seventh topic, I will assume that the exculpatory provision does not

protect Rogers. My seventh conclusion is that Allarco has no claim for interference with economic relations because there is no genuine issue for trial that the third constituent element of this tort is not satisfied. This seventh conclusion supports Rogers' motion to dismiss Allarco's action.

110 I do not propose to discuss in these Reasons for Decision, the law with respect to a motion for a summary judgment. There was no disagreement between the parties that it would be appropriate for me to apply the law as I set it out in *Healey v. Lakeridge Health Corp.* 2010 ONSC 725 (S.C.J.), aff'd 2011 ONCA 55, without comment about Rule 20, and that approach underlies my conclusions below about whether there are any genuine issues requiring a trial and about the use that may be made of the evidence tendered for the competing motions for summary judgment. I add that, in my opinion, the outcome would not have been different if the former version of Rule 20 had applied.

2. The Terms of the Agreement between Allarco and Rogers

111 Allarco submits that given the relationship between Allarco and Rogers was prescribed by the *Broadcasting Act* and its *Regulations*, the parties did not restate the statutory obligations in the Agreement, but rather incorporated them by reference by s.23 of the Agreement. Those obligations allegedly include: the "undue disadvantage" and "must-carry" provisions and an obligation on Rogers to perform the Affiliation Agreement in good faith, which is a matter that I will discuss in the next part below.

112 Alternatively, Allarco submits that these and other statutory obligations are implied terms of the agreement between the parties.

113 During the course of the oral argument, it was common ground that some or all the obligations found in the *Broadcasting Act* could have been expressly included in a contract between participants in the broadcasting industry. In acknowledging this point, as already noted above, Rogers backed away from an argument in its factum that any claim based on breach of statute was a claim "forbidden" by the authority of *Canada v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205.

114 In the immediate case of the Affiliation Agreement, the parties, however, did not expressly refer to s. 9 or the other obligations of the *Broadcasting Act* and its *Regulations*, and, hence, Allarco necessarily relies on the implication or the incorporation by reference of terms as a critical element of its claims against Rogers.

115 Allarco's argument for the incorporation by reference of the provisions of the *Broadcasting Act* and the *Broadcasting Distribution Regulations* into the Affiliation Agreement is a matter of contract interpretation, and in this regard, as already noted, Allarco relies on s.23 of the Affiliation Agreement, which states:

23. APPLICABLE LAW:

This Agreement is subject to all laws, regulations, license conditions and decisions of the CRTC and/or municipal, provincial and federal governments or other authorities which are applicable to Rogers and/or Allarco, and which are now in force or hereafter adopted ("Applicable Law"). In the event that any such law, regulation or decision comes into force during the Term concerning the subject matter of this Agreement, such that it prevents or diminishes either party's ability to perform under this Agreement, the parties agree to enter into good faith negotiations to amend this agreement, where required, in order to remedy such diminution of or inability to perform.

116 The primary goal of contractual interpretation is to give effect to the intentions of the parties at the time the contract was made: *Skye Properties Ltd. v. Wu* 2010 ONCA 499 at para. 79; *Van Ginkel v. QGZ Ltd.*, [2009] O.J. No. 6204 (S.C.J.) at para. 30. The rules of contract interpretation direct a court to search for an interpretation from the whole of the contract that advances the intent of the parties at the time they signed the agreement: *Consolidated-Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.*, [1980] 1 S.C.R. 888.

117 In searching for the intent of the parties, the court should give particular consideration to the terms used by the parties, the context in which they are used and the purpose sought by the parties in using those terms: *Frenette v. Metropolitan Life Insurance Co.*, [1992] 1 S.C.R. 647. Provisions should not be read in isolation but in harmony with the agreement as a whole: *McClelland and Stewart Ltd. v. Mutual Life Assurance Co. of Canada*, [1981] 2 S.C.R. 6; *Hillis Oil and Sales Limited v. Wynn's Canada*, [1986] 1 S.C.R. 57; *Scanlon v. Castlepoint Dev. Corp.* (1993), 11 O.R. (3d) 744 (C.A.)

118 Generally, words should be given their ordinary and literal meaning: *Indian Molybdenum Ltd. v. The King*, [1951] 3 D.L.R. 497 (S.C.C.). However, if there are alternatives, the court should reject an interpretation or a literal meaning that would make the provision or the agreement ineffective, superfluous, absurd, unjust, commercially unreasonable, or destructive of the commercial objective of the agreement: *Consolidated-Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co. supra*, *Scanlon v. Castlepoint Dev. Corp., supra*; *Aita v. Siverstone Towers Ltd.* (1978), 19 O.R. (2d) 681 (C.A.); *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, 2007 ONCA 205 at para. 24.

119 A court should construe a contract as a whole giving meaning to all its provisions: *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, 2007 ONCA 205 at para. 24; *Van Ginkel v. QGZ Ltd.*, [2009] O.J. No. 6204 (S.C.J.) at para. 30.

120 It follows from the normal rules of contract interpretation that s.23 must be read in the context of the whole agreement and giving meaning to all the provisions of the Affiliation

Agreement. Of the provisions that affect the interpretation of s. 23, perhaps the most important is s. 1 (Grant of Rights) of the Affiliation agreement, which provides that:

Allarco grants to Rogers the right (but not the obligation) to receive and distribute ... Allarco's 24 hours a day television entertainment and information programming service known as "Super Channel."

121 As may be observed, s. 1 emphasizes that Rogers' obligation to receive and distribute is not being granted under the Affiliation Agreement. This obligation is contractually negated by the parenthetical phrase "(but not the obligation)." The obligation to distribute Super Channel was intentionally and expressly left out of the Affiliation Agreement.

122 The obligation does exist, but it was not intended to be a contractual obligation. Because the CRTC had designated Super Channel as a "must carry" channel, Rogers had a statutory (but not a contractual) obligation to distribute Super Channel.

123 Applying the rules of contractual interpretation, s. 23 need not and could not have been intended to incorporate by reference what s. 1 of the contract had already excluded. Section 23 had other work to do, and s. 23 can be harmoniously read to direct the parties to negotiate to amend the agreement in the event that the "Applicable Law" (i.e., the non-private law to which the parties were subject as they performed their private law contractual obligations) diminished a party's ability to perform under the Affiliation Agreement.

124 Recalling Allarco's argument about illegal contract terms, in my opinion, there is no illegality in not including the statutory obligations, and, in my opinion, there is no inconsistency between Roger's statutory obligations and its contractual obligations. If, however, the express terms of the Affiliation Agreement were inconsistent with Rogers' statutory obligations, then this would and could have been a matter for the CRTC both during contract negotiations and after a contract had been settled.

125 Further, to interpret s. 23 in the manner contented by Allarco creates disharmony with s. 24 (b) of the Affiliation Agreement which provides that "there are no conditions, covenants, representations or warranties, express or implied, statutory or otherwise relating to the subject matter hereof, except as herein expressly provided."

126 Further still, in a point that will also be relevant to the following discussion of the implication of contract terms, none of undoubtedness, necessity, or business efficacy, justifies giving contractual weight to all of the obligations found in the *Broadcasting Act* and its regulations.

127 If Rogers breached its statutory obligations to Allarco, although monetary compensation would not be available, the CRTC did not want for other measures, including ordering specific performance, to enforce the provisions of its legislation. The *Broadcasting Act* gives the CRTC the power to issue mandatory orders that may be enforced by order of the Federal Court or provincial

Superior Courts. The Act in s. 13 (1) and s. 32 (2) also provides that contravention of a regulation or order made under the Act is an offence punishable by a fine. And, in what Rogers' counsel during argument described in apocalyptic terms, the CRTC has the enforcement power of cancelling or not renewing a licence.

128 Yet further still, to interpret s. 23 in the manner contented by Allarco would make the terms of the contract uncertain given that this interpretation would entail that all present and all future laws, regulations, licence conditions and decisions of the CRTC and/or municipal, provincial and federal governments or other authorities applicable to Rogers would have contractual weight. With respect, Allarco's interpretation of incorporating this corpus of present and future law is absurd at least in the sense contended by Rogers that it would be commercially idiotic for it to take on contractual obligations commensurate with this indeterminate statutory liability.

129 Relying on *Cami Automotive, Inc. v. Westwood Shipping Lines Inc.*, 2009 FC 664, which provides an example of an incorporation by reference clause, which actually uses the words "incorporates by reference," Rogers also argued that s. 23, which in contrast uses the words "is subject to all laws ...," could not be an incorporation by reference provision. In reaching my own conclusion, I do not rely on this argument by Rogers nor on Allarco's counterarguments; rather, I conclude, based on the normal principles of contract interpretation, that s. 23 cannot be interpreted to mean that the present (and future) provisions of the *Broadcasting Act* and the *Broadcasting Distribution Regulations* are incorporated by reference into the Affiliation Agreement.

130 I turn now to Allarco's alternative argument that the provisions of the *Broadcasting Act* and the *Broadcasting Distribution Regulations* are implied terms of the Affiliation Agreement.

131 After a careful review of the background to the contract, a court will imply terms to a contract based on the presumed intention of the parties and to give the contract business efficacy: *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711; *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619; *Dynamic Tpt. Ltd. v. O.K. Detailing Ltd.*, [1978] 2 S.C.R. 1072; *G. Ford Homes Ltd. v. Draft Masonry (York) Co.* (1983), 43 O.R. (2d) 401 (C.A.); *Pigott Const. Co. v. W.J. Crowe Ltd.*, [1961] O.R. 305 (C.A.); affd. [1963] S.C.R. 238; *Luxor, Ltd. v. Cooper*, [1941] 1 All E.R. 33 (H.L.).

132 In *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711, the Supreme Court identified three situations where terms will be implied. See also; *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619; *Lefebvre v. HOJ Industries Ltd.* (1992), 91 D.L.R. (4th) 491 (S.C.C.) and *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701 at para. 137.

133 (I pause here to add parenthetically that for reasons that will become apparent later as part of the discussion of Allarco's claim in negligence, it will be important to note that the three situations are not comprehensive; implied terms may also arise by statute or by operation of law. For example, in a contract to purchase a house to be built, there is a common law implied warranty that the house

will be completed fit for habitation. See *Fraser-Reid v. Droumtsekas* (1979), 103 D.L.R. (3d) 385 (S.C.C.)

134 In the first situation, a term is implied as a matter of an established custom or usage. The term is implied as a matter of presumed intention; i.e., the courts add what the parties know and would, if asked, unhesitatingly agree to be part of the bargain. The test of the implication is one of necessity. As to a test of necessity, Lord Wilberforce said in *Liverpool City Council v. Irwin*: [1977] A.C. 239 at p. 254. "such obligation should be read into the contract as the nature of the contract itself requires, no more, no less: a test, in other words, of necessity."

135 In the second situation, a term is implied as a matter of presumed intention because it is necessary to give business efficacy to a contract. The test again is one of necessity.

136 In the third situation, the term is implied as an incident of particular class of relationship. The implication in this third situation does not depend upon any presumed intention, but the implication still must meet the test of necessity.

137 As a general principle, which is important to the case at bar, a term will not be implied, if the term would be inconsistent with the existing wording of the contract; the implied term must fit with the existing contract: *G. Ford Homes Ltd. v. Draft Masonry (York) Co.* (1983), 43 O.R. (2d) 401 (C.A.); *Fort Frances (Town) v. Boise Cascade Can. Ltd.*; *Boise Cascade Can. Ltd. v. Ontario*, [1983] 1 S.C.R. 171; *Catre Industries Ltd. v. Alberta* (1989), 63 D.L.R. (4th) 74 (Alta. C.A.), leave to appeal to the S.C.C. refused [1989] S.C.C.A. No. 447, 65 D.L.R. (4th) vii.

138 In this regard, in *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, *supra* at para. 29, in a case where the court construed the implied term to be complimentary to the express terms of a bidding contract, Justice Iacobucci stated:

A court, when dealing with terms implied in fact, must be careful not to slide into determining the intentions of reasonable parties. This is why the implication of the term must have a certain degree of obviousness to it, and why, if there is evidence of a contrary intention, on the part of either party, an implied term may not be found on this basis. As G. H. L. Fridman states in *The Law of Contract in Canada* (3rd ed. 1994), at p. 476:

In determining the intention of the parties, attention must be paid to the express terms of the contract in order to see whether the suggested implication is necessary and fits in with what has clearly been agreed upon, and the precise nature of what, if anything, should be implied.

139 Applying these principles to the case at bar, there is no basis for the implication of the terms set out earlier in this judgment as a matter of an established custom or usage or as needed for

business efficacy or as an incident of a particular class of relationship. Further, as already noted above, given the ample enforcement powers available to the CRTC, there is no necessity to imply contractual obligations commensurate with Rogers' statutory obligations.

140 Further still, in a point that I will return to later during the discussion of Allarco's tort claims, from a public policy perspective, the implication of contract terms with the attendant role of the courts to enforce those terms is not only unnecessary it is inconsistent with the expressed public policy of the *Broadcasting Act* that the CRTC should be the single independent public authority with the power to regulate and supervise all aspects of the Canadian broadcasting system and the broadcasting policy set out in the Act.

141 Yet further still, the implication of contract terms sought by Allarco is not permissible because it would offend the principle that a term cannot be implied into an agreement when the proposed term would conflict with the express language of the contract. As already noted above, the proposed terms do not fit with s. 1 of the Affiliation Agreement which expressly made the obligation to distribute non-contractual. The proposed terms would expand Rogers' obligations beyond s. 10 of the Affiliation Agreement, which is the only provision relating to marketing. It provides that Rogers has no specific marketing obligations to Allarco. Further still, there is the controversy about the operation of s. 5 of the Affiliation Agreement and the alleged obligation to launch immediately all of Super Channel's channels.

142 Moreover, in the case at bar, s. 24 (b) of the Affiliation Agreement is an entire agreement clause that precludes implied terms.

143 Relying on the Ontario Court of Appeal's decision in *CivicLife.com Inc. v. Canada (Attorney General)*, [2006] O.J. No. 2474 (C.A.), Allarco submits that the entire agreement clause in s. 24 of the Affiliation Agreement does not operate to exclude terms implied into the contract because such a term is already part of the existing agreement." However, the *CivicLife.com* case does not stand for this proposition, at least not as a general proposition.

144 In understanding the precedential authority of *CivicLife.com*, the first point to note is that in this contract interpretation and breach of contract case, in contrast to the approach used in the Affiliation Agreement in the case at bar, the entire agreement clause in the agreement between CivicLife and Industry Canada did not say that the agreement contains no implied terms. It was in that context that Justice Weiler stated at para. 52 that "an entire agreement clause will not preclude the implication of a term of the contract, such as a duty of good faith performance or the duty not to abuse a discretion, because such a term is already part of the existing agreement."

145 The second point to note is that in the *CivicLife.com* case, the contract between CivicLife and Industry Canada had several provisions that conferred a discretion, and, thus, with the discretionary provision already being part of the existing agreement, Justice Weiler could say, as she did, that the connected implied contractual good faith duty not to abuse the discretion was already part of the existing agreement.

146 The third point to note is that in the *CivicLife.com* case, Justice Weiler noted that implication of implied terms was used by the trial judge as part of an exercise to determine the overall intentions and objectives of the parties in entering into the contract. Thus, the implied terms were consistent with and indeed built upon the existing terms of the contract, and thus Justice Weiler, once again, could say that the implied terms were already terms of the agreement notwithstanding the entire agreement clause.

147 Thus, having regard to these three points, the *CivicLife.com* case stands only for the proposition that an implied term of good faith built upon existing terms of the contract is also an existing term of the contract that is not precluded by an entire agreement clause, especially one that does not expressly exclude implied terms.

148 In any event, applied to the circumstances of the case at bar, the *CivicLife.com* case does not assist Allarco in refuting that a term cannot be implied into an agreement when the proposed term would conflict with the express language of the contract independent of the operation of an entire agreement clause.

149 I conclude, therefore, that the terms relied on by Allarco in its motion for a partial summary judgment and as the underpinning for all its causes of action are not implied terms or terms incorporated by reference into the agreement between the parties. It follows that Allarco's motion for a partial summary judgment should be dismissed.

3. Does Allarco Have a Claim for Breach of a Duty of Good Faith?

150 Allarco is not alleging that Rogers breached a duty of good faith independent from its performance of the terms of the Affiliation Agreement and, therefore, Allarco does not purport to have a stand-alone claim for breach of a duty of good faith.

151 Allarco relies on the incorporation or implication of an implied contract term that Rogers perform its statutory obligations in good faith. For the above reasons, I have already included that there is no basis for the incorporation or implication of the statutory obligations into the Affiliation Agreement. It follows that there is no basis to imply a term to perform non-existent contractual obligations in good faith. This is the first of two reasons to conclude that Allarco does not have a claim for breach of a duty of good faith.

152 The second reason for this conclusion is that Allarco is attempting to use a good faith obligation to alter and extend the agreement reached by the parties and this is not permissible.

153 The Ontario Court of Appeal in *Transamerica Life Canada Inc. v. ING Canada Inc.*, (2003), 234 D.L.R. (4th) 367 at p. 51 noted that Canadian courts have been cautious and conservative in recognizing a good faith obligation in the performance and enforcement of contracts. The court

stated (with my emphasis added):

... Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties.

154 In *Agribands Purina Canada Inc. v. Kasamekas*, 2011 ONCA 460 at para. 51, the Court of Appeal stated that an implied duty of good faith cannot be used to alter the express terms of the contract. The court stated:

Moreover, by finding an implied duty of good faith on Purina not to act in a way that defeats the very purpose of the contract and then finding that Purina could not rely on Article V(B) because it breached that implied duty, the trial judge erred by using the implied duty of good faith to alter the express terms of the contract, including the right to terminate on notice. In *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 68 O.R. (3d) 457 (C.A.), at para. 53 this court made clear that Canadian courts have not accorded this power to an implied duty of good faith.

155 In *Rogers & Rogers Inc. v. Pinehurst Woodworking Co.* (2005), 14 B.L.R. (4th) 142 at paras. 111-117 (Ont. S.C.J.), I held that even when a party is subject to a duty of good faith it may still act in its own self-interest so long as in doing so it has regard to the legitimate interests and expectations of the other party. The duty of good faith is not a fiduciary duty, and it does not extend to create new, unbargained-for rights.

156 In the case at bar, there is no express contractual obligation that Rogers is alleged to have breached. Allarco is trying through the purported implication of contract terms to alter the contract. Then it asserts that the altered contract has been breached. This is not the proper approach to the doctrine of good faith in contract performance, and, in my opinion, there is no genuine issue requiring a trial and Allarco's claim here will inevitably fail.

4. The Exculpatory Provisions in the Agreement between Allarco and Rogers

157 The exculpatory provisions in the agreement between Allarco and Rogers provide additional reasons to dismiss Allarco's motion for a partial summary judgment and to grant Rogers' motion to have Allarco's action dismissed.

158 Section 19 of the Affiliation Agreement provides that "in no event shall any party be liable, by indemnification or otherwise, for any special, indirect, consequential or incidental damages of

any kind, any loss of profit, loss of use, or business interruption."

159 Allarco submits that this exculpatory provision does not apply to the losses complained of in this litigation, or, if the clause applies, the court ought to exercise its discretion not to enforce it on the basis of public policy because Rogers acted in bad faith and never intended to honour its obligations.

160 The leading case about the enforcement of exculpatory provisions is now *Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways)*, 2010 SCC 4. In this case, Tercon Contractors bid on a contract being tendered by the Province of British Columbia. The Province awarded the contract to another bidder, and Tercon sued the Province for breach of the terms of the bidding contract. The Province relied on an exculpatory provision in the bidding contract.

161 A 5-4 majority of the Supreme Court of Canada (Justice Cromwell with Justices LeBel, Deschamps, Fish, and Charron concurring) concluded that the Province had breached the bidding contract but was not entitled to rely on an exemption clause or exculpatory provision contained in the bidding contract.

162 The minority of the court (Justice Binnie with Chief Justice McLachlin and Justices Abella and Rothstein concurring), however, concluded that the exemption clause applied, and the minority would have dismissed the action against the Province. Although the majority disagreed with the minority's interpretation of the exemption clause as applying to exculpate the Province's liability for breach of contract, the court was unanimous in adopting Justice Binnie's approach to the regulation of exculpatory provisions.

163 Justice Binnie summarized his analytical approach and applied it in the opening two paragraphs of his judgment, where he stated [with my emphasis added]:

81. The important legal issue raised by this appeal is whether, and in what circumstances, a court will deny a defendant contract breaker the benefit of an exclusion of liability clause to which the innocent party, not being under any sort of disability, has agreed. Traditionally, this has involved consideration of what is known as the doctrine of fundamental breach, a doctrine which Dickson C.J. in *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426, suggested should be laid to rest 21 years ago (p. 462).
82. On this occasion we should again attempt to shut the coffin on the jargon associated with "fundamental breach". Categorizing a contract breach as "fundamental" or "immense" or "colossal" is not particularly helpful. Rather, the principle is that a court has no discretion to refuse to enforce a valid and applicable contractual exclusion clause unless the plaintiff (here the appellant Tercon) can point to some paramount consideration of public policy sufficient to override the public interest in freedom of contract and defeat what would

otherwise be the contractual rights of the parties. Tercon points to the public interest in the transparency and integrity of the government tendering process (in this case, for a highway construction contract) but in my view such a concern, while important, did not render unenforceable the terms of the contract Tercon agreed to. There is nothing inherently unreasonable about exclusion clauses. Tercon is a large and sophisticated corporation. Unlike my colleague Justice Cromwell, I would hold that the respondent Ministry's conduct, while in breach of its contractual obligations, fell within the terms of the exclusion clause. In turn, there is no reason why the clause should not be enforced. I would dismiss the appeal.

164 Justice Binnie reviewed how the case law had developed after *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426, and he stated at paras. 113-117 that the courts had a narrow jurisdiction to refuse to enforce an exculpatory provision on grounds of public policy but not a general after-the-fact discretion to refuse to do so on broad grounds of unfairness or unreasonableness.

165 He stated at para. 117 that: "the residual power of a court to decline enforcement [on grounds of public policy] exists but, in the interest of certainty and stability of contractual relations, it will rarely be exercised."

166 Justice Binnie stated that the party seeking to avoid an exculpatory provision must show a public policy reason to overcome the countervailing public policy that favours freedom of contract. It was Justice Binnie's view that Tercon, however, could not show a public policy reason not to be bound by the terms of the contract that it had signed. Justice Binnie stated at para. 120:

120. Conduct approaching serious criminality or egregious fraud are but examples of well-accepted and "substantially incontestable" considerations of public policy that may override the countervailing public policy that favours freedom of contract. Where this type of misconduct is reflected in the breach of contract, all of the circumstances should be examined very carefully by the court. Such misconduct may disable the defendant from hiding behind the exclusion clause. But a plaintiff who seeks to avoid the effect of an exclusion clause must identify the overriding public policy that it says outweighs the public interest in the enforcement of the contract. In the present case, for the reasons discussed below, I do not believe Tercon has identified a relevant public policy that fulfills this requirement.

167 Justice Binnie described the contemporary analytical approach to exculpatory provisions at paras. 121-123 of his judgment where he stated:

121. The present state of the law, in summary, requires a series of enquiries to be addressed when a plaintiff seeks to escape the effect of an exclusion clause or

other contractual terms to which it had previously agreed.

122. The first issue, of course, is whether as a matter of interpretation the exclusion clause even applies to the circumstances established in evidence. This will depend on the Court's assessment of the intention of the parties as expressed in the contract. If the exclusion clause does not apply, there is obviously no need to proceed further with this analysis. If the exclusion clause applies, the second issue is whether the exclusion clause was unconscionable at the time the contract was made, "as might arise from situations of unequal bargaining power between the parties" (*Hunter*, at p. 462). This second issue has to do with contract formation, not breach.
123. If the exclusion clause is held to be valid and applicable, the Court may undertake a third enquiry, namely whether the Court should nevertheless refuse to enforce the valid exclusion clause because of the existence of an overriding public policy, proof of which lies on the party seeking to avoid enforcement of the clause, that outweighs the very strong public interest in the enforcement of contracts.

168 Thus, the contemporary approach to the enforcement of exculpatory provisions involves a three-stage analysis.

169 In the first stage, the court asks whether as a matter of interpretation, the exclusion clause applies to the circumstances. Exculpatory provisions are interpreted strictly and clear words are necessary for the exclusion to apply: *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533 (C.A.) at para. 32.

170 In the second stage, if the exclusion clause does apply, then the court asks whether the exclusion clause was unconscionable at the time the contract was made.

171 If the exclusion clause is held to be valid and applicable, in the third stage, the court asks whether the court should refuse to enforce the valid exclusion clause because of the existence of an overriding public policy, proof of which lies on the party seeking to avoid enforcement of the clause, that outweighs the very strong public interest in the enforcement of contracts. The residential power of the court to decline enforcement exists but will rarely be exercised.

172 Applying the three-step analysis to the circumstances of the case at bar, in my opinion: first, as a matter of contract interpretation, s. 19 of the Affiliation Agreement applies; second, s. 19 was not unconscionable at the time the contract was made; and third, there is no overriding public policy reason to decline to enforce s. 19.

173 As a matter of contract interpretation, the claims for damages raised by Allarco in this action are within the language of s. 19 as "damages of any kind" or "any special, indirect, consequential or incidental damages" or "any loss of profit" or "loss of use" or "business interruption."

174 The heart of s. 19 is that "no party shall be liable for any damages of any kind." "Damages of any kind" covers damages for breach of contract, breach of fiduciary duty, negligence, or intentional interference with economic relations. Given that the parties had the remedy of resort to the CRTC to enforce their statutory obligations one to another, it is understandable that they might agree to exculpate each other from liability for damages of any kind.

175 It is notable that the parties made an exception for "any claim or liability arising out of an infringement of any third party intellectual property right as contemplated in Section 14." Not surprisingly, in an industry that depends upon broadcasting the creative content of third parties, the contracting parties carved out an exception to protect themselves should they be sued by a third party for damages.

176 It was not unconscionable for Allarco to have agreed to the exculpatory clause. As a legal doctrine, unconscionability has three elements. The elements of unconscionability are: (1) pronounced inequality of bargaining power; (2) substantially improvident or unfair bargain; and (3) the defendant knowingly taking advantage of the vulnerable plaintiff: *Birch v. Union of Taxation Employees, Local 70030* (2008), 93 O.R. (3d) 1 (C.A.); *Titus v. William F. Cooke Enterprises Ltd.* (2007), 284 D.L.R. (4th) 734 (Ont. C.A.); *Black v. Wilcox* (1976), 12 O.R. (2d) 759 (C.A.); *Mundinger v. Mundinger*, [1969] 1 O.R. 606 (C.A.); affd. [1970] S.C.R. vi; *Vanzant v. Coates* (1917), 40 O.L.R. 556 (C.A.); *Waters v. Donnelly* (1884), 9 O.R. 391 (Ch. Div.).

177 There is no genuine issue for trial that the elements of unconscionability are not present in the case at bar. Allarco is a sophisticated, experienced, and well advised and well represented contracting party, and it had the protection of the CRTC to regulate the bargaining and the bargain ultimately reached by the arms-length negotiators.

178 In the case at bar, there is no public policy factor that negates the public policy of supporting freedom of contract. Allarco's argument that Rogers' breaches and misconduct and its alleged avoidance of its obligations under the *Broadcasting Act* are so egregious that s. 19 should be negated as a matter of public policy is fallacious. This argument simply repeats the error of the so called fundamental breach approach to exculpatory provisions, which has been soundly rejected in Canada and in England and which rejection led to the current three-step approach. See: *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426; *Atlantique Société d'Armement Maritime SA v. NV Rotterdamsche Kolen Central*, [1966] 2 All E.R. 61 (H.L.); *Photo Production Ltd. v. Securicor Transport Ltd.*, [1980] A.C. 827 (H.L.).

179 Allarco submits that permitting Rogers to use s. 19 to shield itself from liability would legitimize behaviour which undermines the public policy behind the regulation of the Canadian broadcasting industry and the promotion of Canadian-owned programming. I disagree with this submission. Section 19 does not legitimize or permit behaviour contrary to the regulation of the Canadian broadcasting industry. Section 19 would not stop and did not stop the CRTC in the immediate case from determining that Rogers had contravened the regulations under the

Broadcasting Act. Contrary to the submission of Allarco, enforcing this exclusion clause does not allow Rogers to contract out of regulatory obligations without any sanctions from the CRTC except for the remedy of revoking Rogers' licence.

180 For the above reasons, I conclude that all of Allarco's claims are excluded by s. 19 of the Affiliation Agreement. It follows that Rogers' motion for a summary judgment should be granted.

5. Are there Genuine Issues requiring a Trial about the Two Alleged Breaches of Contract?

181 Assuming my conclusions that Allarco's various causes of action in contract should be dismissed are incorrect, the next matter to discuss is whether there are genuine issues for trial about the two alleged breaches of contract.

182 In this regard, it should be recalled that the theory of Allarco's motion for a partial summary judgment is that there are terms of the contract between Allarco and Rogers that correspond to Rogers' statutory obligations under the *Broadcasting Act*. Then Allarco submits that: (1) the decision of the CRTC proves that Allarco was subjected to an "undue disadvantage" in breach of the Agreement; and, (2) the evidence on this motion proves Rogers' failure to launch the full Allarco complex of channels was a breach of the "must carry" obligation that was incorporated into the Affiliation Agreement.

183 Assuming that Allarco is correct about the terms of the Affiliation Agreement, then, in my opinion, whether those terms have been breached requires a trial and, therefore, I would not grant Allarco a partial summary judgment.

184 In my opinion, it would not be appropriate to treat the decision of the CRTC as a binding determination that as a matter of a contractual obligation, that Allarco was subjected to an "undue disadvantage" in breach of the Agreement. I say this for two main reasons.

185 First, as may be gathered from its analytical approach as described in its decision, the CRTC was not just concerned about a dispute between two parties to a contract. In determining what counts as an "undue disadvantage," the CRTC was concerned about the interests of other persons and about the achievement of the objectives of the broadcasting policy. Thus, the issue that was before the CRTC is not the same as the issue before the court. In turn, this means that Allarco is unable to establish the technical elements of an issue estoppel.

186 Issue estoppel prevents a litigant from re-litigating an issue that has been decided by a court in a previous proceeding between the same parties or their privies. The four requirements for an issue estoppel are: (1) the same issue must be involved in the initial and subsequent litigation; (2) the issue must have been actually litigated and determined in the first suit and its determination must have been necessary or fundamental to the result in the litigation; (3) the decision on the issue

in question must have been final; and (4) the litigants must be a party or a privy of a party in the first suit: *Danyluk v. Ainsworth Technologies Inc.*, [2001] 2 S.C.R. 460.

187 In my opinion, the technical requirements for an issue estoppel are not made out in the case at bar, which brings me to the second reason for not treating the decision of the CRTC as a binding determination.

188 *Danyluk v. Ainsworth Technologies Inc.*, *supra*, adds an element of discretion to the determination of whether there is an issue estoppel. In this case, the Supreme Court of Canada held that where a party establishes the pre-conditions for an issue estoppel, a court must still determine whether, as a matter of discretion, issue estoppel ought to be applied. The court should stand back and, taking into account the entirety of the circumstances, consider whether application of issue estoppel in the particular case would work an injustice.

189 In my opinion, it would not be procedurally fair to decide a multi-million dollar claim based on the CRTC's fair but relatively informal procedure for deciding how to resolve Allarco's complain under the *Broadcasting Act*, and, therefore, I exercise the court's discretion to decline to use an issue estoppel to decide the motion for summary judgment.

6. Is There a Fiduciary Relationship between Rogers and Allarco?

190 In my opinion, Allarco's claim for breach of fiduciary duty would inevitable fail because there is no fiduciary relationship between Allarco and Rogers. Rogers and Allarco, both of which are sophisticated entrepreneurs, are in a commercial and regulatory relationship but not a fiduciary one where the fiduciary must suppress self-interest and act loyally in the best interests of the beneficiary.

191 There is no categorical fiduciary relationship between Allarco and Rogers, and such a relationship is expressly precluded by s. 24(a) of the Affiliation Agreement (Legal Effect), which provides that: "Nothing herein contained shall be deemed to create, and the parties do not intent to create, any relationships of partner, agent or joint venture as between Rogers and Allarco."

192 A fiduciary relationship can arise from the particular circumstances of the parties' association one with the other, but Allarco's and Rogers' association one with the other does not have the indicia or elements of an *ad hoc* fiduciary relationship.

193 In *Alberta v. Elder Advocates of Alberta Society*, 2011 SCC 24 at para. 36, Chief Justice McLachlin described when an *ad hoc* fiduciary duty can arise. She stated:

In summary, for an *ad hoc* fiduciary duty to arise, the claimant must show, in addition to the vulnerability arising from the relationship as described by Wilson J. in *Frame*; (1) an undertaking by the alleged fiduciary to act in the best interests

of the alleged beneficiary or beneficiaries; (2) a defined person or class of persons vulnerable to a fiduciary's control (the beneficiary or beneficiaries); and (3) a legal or substantial practical interest of the beneficiary or beneficiaries that stands to be adversely affected ...

194 In *Frame v. Smith*, [1987] 2 S.C.R. 99 at 137 at p. 137, Justice Wilson dissented in the result, but she was in the majority in noting that fiduciary duties will generally not extend to sophisticated business entities. She stated.

Because of the requirement of vulnerability of the beneficiary at the hands of the fiduciary, fiduciary obligations are seldom present in the dealings of experienced businessmen of similar bargaining strength acting at arm's length ... The law takes the position that such individuals are perfectly capable of agreeing as to the scope of the discretion or power to be exercised, i.e., any 'vulnerability' could have been prevented through the more prudent exercise of their bargaining power ...

195 In *Galambos v. Perez*, 2009 SCC 48 at para. 66, Justice Cromwell, writing for the court, held that: "it is fundamental to *ad hoc* fiduciary duties that there be an undertaking by the fiduciary, which may be either express or implied, that the fiduciary will act in the best interests of the other party". At para. 77, he stated:

The fiduciary's undertaking may be the result of the exercise of statutory powers, the express or implied terms of an agreement or, perhaps, simply an undertaking to act in this way. In cases of *per se* fiduciary relationships, this undertaking will be found in the nature of the category of relationship in issue. The critical point is that in both *per se* and *ad hoc* fiduciary relationships, there will be some undertaking on the part of the fiduciary to act with loyalty

196 In the case at bar, there is no expressed or implied undertaking by Rogers to act with loyalty to Allarco, and the only remaining possible source of a undertaking that Rogers would act in the best interests of Allarco are Rogers' statutory obligations under the *Broadcasting Act*. However, these statutory obligations fall short of a fiduciary obligation and go no farther than Rogers not giving an undue preference to any of Allarco's competitors or not subjecting Allarco to an undue disadvantage.

197 Allarco is a sophisticated commercial entity with full access to highly experienced and competent legal counsel and industry consultants. Its contract with Rogers contains no express undertaking to act in the best interests of Allarco and expressly excludes a fiduciary relationship. Allarco was not vulnerable in the requisite sense because it had and, indeed, it exercised the protections available to it from the CRTC, which included enforcement of Rogers' statutory obligation not to subject Allarco to an undue disadvantage, and with competent and experienced representatives, it exercised its contractual autonomy. As Justice Wilson noted in *Frame v. Smith*,

supra, "the law takes the position that such individuals are perfectly capable of agreeing as to the scope of the discretion or power to be exercised, i.e., any 'vulnerability' could have been prevented through the more prudent exercise of their bargaining power."

198 For the above reasons, I conclude that there is no genuine issue for trial about the claim for breach of fiduciary duty, which claim would inevitable fail; this claim should be dismissed.

7. Does Allarco Have a Negligence Claim against Rogers?

199 Allarco asserts a negligence claim against Rogers. The elements of the tort of negligence are: (1) the defendant owes a duty of care to the plaintiff; (2) the defendant breaches the standard of care; (3) the plaintiffs suffers an injury; and (4) the defendant's conduct caused the injury: *Mustapha v. Culligan of Canada Ltd.*, 2008 SCC 27.

200 In the case at bar, there are, in my opinion, genuine issues for trial with respect to: (a) whether Rogers breached the standard of care, which would be defined by Rogers' statutory obligations under the *Broadcasting Act Regulations*; (b) whether Allarco suffered an injury, which in this case would be a pure economic loss; and, (c) whether Allarco's pure economic losses were caused by Rogers.

201 In my opinion, however, there is no genuine issue for trial that Rogers does not owe Allarco a common law duty of care to perform its statutory obligations.

202 I begin the explanation for my opinion by noting that I do not agree with Rogers' abandoned argument that Allarco's negligence action is barred by *Canada v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205. Allarco is not bringing a claim based on a nominate tort of breach of statutory duty. Rather, it is bringing a negligence claim in which the alleged breach of the statutory duty would be evidence of negligence. While a statutory breach does not automatically give rise to civil liability, it may be evidence of negligence. The nominate tort principle from *Saskatchewan Wheat Pool* is not applicable to the case at bar. See: *Odhavji Estate v. Woodhouse* [2003] 3 S.C.R. 263 at para. 31; *3021386 Nova Scotia Ltd. v. Barrington (District)*, 2010 NSSC 173 at paras. 26, 28; *Ryan v. Victoria (City)*, [1999] 1 S.C.R. 201 at p. 222; *BCE Inc. v. 1976 Debentureholder*, 2008 SCC 69 at para. 44.

203 The contemporary Canadian approach to determining whether there is a duty of care has been developed in a series of Supreme Court of Canada's decisions adapting and explaining the House of Lord's decision in *Anns v. Merton London Borough Council*, [1978] A.C. 728 (H.L.). See: *Kamloops (City of) v. Nielsen*, [1984] 2 S.C.R. 2; *Cooper v. Hobart*, [2001] 3 S.C.R. 537; *Odhavji Estate v. Woodhouse*, [2003] 3 S.C.R. 263; *Childs v. Desormeux*, [2006] 1 S.C.R. 643; *Syl Apps Secure Treatment Centre v. B.D.*, [2007] 3 S.C.R. 83; and *Mustapha v. Culligan of Canada Ltd.*, [2008] 2 S.C.R 114.

204 The first element of a tort claim for negligence is a duty of care. As Lord Esher stated in *Le Lievre v. Gould*, [1893] 1 Q.B. 491 (C.A.), at p. 497, "[a] man is entitled to be as negligent as he pleases towards the whole world if he owes no duty to them." The contemporary analysis of whether a duty of care exists begins by asking whether the plaintiff and the defendant are in a relationship that the law categorically recognizes as involving a duty of care or whether the relationship constitutes a new category of claim. If the claim falls within an established category, then precedent will have established that there is a duty of care associated with the relationship between the parties: *Childs v. Desormeaux*, [2006] 1 S.C.R. 643 at para. 14.

205 If the case does not come within an established category, it is necessary to undertake a duty of care analysis. In *Anns v. Merton London Borough Council*, [1978] A.C. 728 (H.L.), the House of Lords adopted a two-step analysis to determining whether there was a duty of care between a plaintiff and a defendant: (1) Is there a sufficiently close relationship between the plaintiff and the defendant such that in the reasonable contemplation of the defendant, carelessness on its part might cause damage to the plaintiff? and, (2) Are there any considerations that ought to negative or limit: (a) the scope of the duty; (b) the class of persons to whom it is owed; or (c) the damages to which a breach of it may give rise.

206 As developed by the case law in Canada, if the relationship between the plaintiff and the defendant does not fall within a recognized class whose members have a duty of care to others, then whether a duty of care to another exists involves satisfying three requirements: (1) foreseeability, in the sense that the defendant ought to have contemplated that the plaintiff would be affected by the defendant's conduct; (2) sufficient proximity, in the sense that the relationship between the plaintiff and the defendant is sufficient *prima facie* to give rise to a duty of care; and (3) the absence of overriding policy considerations that would negate any *prima facie* duty established by foreseeability and proximity. Thus, whether a relationship giving rise to a duty of care exists depends on foreseeability moderated by policy concerns: *Anns v. Merton London Borough Council*, [1978] A.C. 728 (H.L.); *Mustapha v. Culligan of Canada Ltd.*, [2008] 2 S.C.R. 114 at para. 4.

207 Proximity focuses on the type of relationship between the plaintiff and defendant and asks whether this relationship is so close that the defendant may reasonably be said to owe the plaintiff a duty to take care not to injure him or her: *Donoghue v. Stevenson*, [1932] A.C. 562 (H.L.). Proximate relationships giving rise to a duty of care are of such a nature as the defendant in conducting his or her affairs may be said to be under an obligation to be mindful of the plaintiff's legitimate interests: *Odhavji Estate v. Woodhouse*, [2003] 3 S.C.R. 263 at para. 49; *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, at para. 24.

208 The proximity inquiry probes whether it would be unjust or unfair to hold the defendant subject to a duty of care having regard to the nature of the relationship between the defendant and the plaintiff: *Syl Apps Secure Treatment Centre v. B.D.* 2007 SCC 38 at para. 26.

209 The proximity analysis involves considering factors such as expectations, representations,

reliance, and property or other interests involved: *Cooper v. Hobart*, [2001] 3 S.C.R. 537 at para. 34; *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41 at para. 23; *Odhavji Estate v. Woodhouse* [2003] 3 S.C.R. 263 at para. 50.

210 Proximity is not concerned with how intimate the plaintiff and defendant were or with their physical proximity, so much as with whether the actions of the alleged wrongdoer have a close or direct effect on the victim, such that the wrongdoer ought to have had the victim in mind as a person potentially harmed: *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41 at para. 29.

211 It needs to be emphasized that the proximity analysis of the first stage of the *Anns* test involves policy issues because it asks the normative question of whether the relationship is sufficiently close to give rise to a legal duty: *Cooper v. Hobart*, [2001] 3 S.C.R. 537 at paras. 25-30. The focus of the probe is on the nature of the relationship between victim and alleged wrongdoer and the question is whether the relationship is one where the imposition of legal liability for the wrongdoer's actions would be appropriate. See *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41 at para. 23.

212 Moving on to the second stage of the duty of care analysis, if the plaintiff establishes a *prima facie* duty of care, the evidentiary burden of showing countervailing policy considerations shifts to the defendant, following the general rule that the party asserting a point should be required to establish it: *Childs v. Desormeaux*, [2006] 1 S.C.R. 643 at para. 13. Policy concerns raised against imposing a duty of care must be more than speculative, and a real potential for negative consequences must be apparent: *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41 at para. 48.

213 This second stage of the analysis is not concerned with the type of relationship between the plaintiff and the defendant. At this stage of the analysis, the question to be asked is whether there exists broad policy considerations that would make the imposition of a duty of care unwise, despite the fact that harm was a reasonably foreseeable consequence of the conduct in question and there was a sufficient degree of proximity between the plaintiff and the defendant such that the imposition of a duty would be fair: *Cooper v. Hobart*, [2001] 3 S.C.R. 537 at para. 37; *Odhavji Estate v. Woodhouse*, [2003] 3 S.C.R. 263 at para. 51.

214 The second stage of the analysis is about the effect of recognizing a duty of care on other legal obligations, the legal system, and society more generally: *Cooper v. Hobart*, [2001] 3 S.C.R. 537 at para. 37; *Odhavji Estate v. Woodhouse*, [2003] 3 S.C.R. 263 at para. 51. An adverse effect may justify negating the defendant's duty of care.

215 Applying the above legal principles to the case at bar, the first question to determine is whether the relationship between Allarco and Rogers is within a recognized class whose members have a duty of care to others.

216 Allarco's negligence claim is a claim for pure economic losses arising from Rogers' failure to comply with its statutory obligations under the *Broadcasting Act Regulations*. Although, the recognized classes are not closed, the recognized classes for negligence claims for pure economic loss are: (a) the liability of public authorities for operational negligence; (b) negligent misrepresentation claims; (c) negligent performance of a service claims; (d) negligent supply of shoddy goods or structures; and (e) relational economic loss claims: *Martel Building Ltd v. Canada*, 2000 SCC 60 at para. 38. In my opinion, Allarco's claim does not fall within a recognized category. Therefore, it is necessary to undertake a duty of care analysis.

217 Undertaking a duty of care analysis, for the following reasons, it is my opinion that: (1) it was foreseeable that Rogers ought to have contemplated that Allarco would be affected by Rogers' conduct; (2) however, on grounds of policy, the relationship between Allarco and Rogers is not sufficient *prima facie* to give rise to a duty of care; the nature of the relationship is one where the imposition of a duty of care would not be appropriate; and, (3) there are overriding policy considerations that would negate any *prima facie* duty established by foreseeability and proximity.

218 In the case at bar, in my opinion, the relationship between Allarco and Rogers in the broadcast industry is such that it is foreseeable that Rogers ought to have contemplated that Allarco would be affected by Rogers' conduct.

219 It is, however, important to note, for reasons that will soon become apparent, why the foreseeability factor is satisfied. In the case at bar, foreseeability is based upon Allarco's and Rogers' being part of the interconnected and intensively regulated broadcasting community or industry. It is that context that explains and justifies why arms-length commercial entities might have a duty of care, one to another. By itself, the fact that they are contracting parties would not establish the foreseeability of a duty of care.

220 However, while Allarco's and Rogers' relationship one with the other in the broadcasting industry makes the possibility of a duty of care foreseeable, the nature of the relation in the broadcast industry also provides policy reasons for not imposing a common law duty of care; namely: (a) the imposition of common law duties is not necessary, given the regulatory regime already in place that intensively regulates the relationship between the members of the broadcasting industry; and, (b) the imposition of common law duties is inconsistent with the *Broadcasting Act's* expressed policy that the CRTC be the single regulatory authority.

221 Put somewhat differently, the behaviour modification function of tort law is unnecessary given the administrative law powers under the *Broadcasting Act*, and the imposition of tort law would attenuate the singularity of the authority of the CRTC.

222 To be clear, the above reasoning is different than the rejected argument based on *Canada v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205. The point here is that in determining whether there is a proximate relationship between the parties that would justify the regulation of the common law, there is little element of necessity in the sense that wrongs should have remedies.

223 Members of the broadcasting industry who suffer from breaches of statutory duties have the recourse of taking their complaints to the CRTC. And recalling that there is nothing prohibiting the parties from adding contractual remedies, the members of the broadcasting industry have the recourse of contract law remedies should they exercise their freedom of contract. In these circumstances, in my opinion, the proximity factor in the test of a duty of care is not satisfied.

224 Assuming, however, that the above analysis is incorrect and there is a *prima facie* duty of care, then the question becomes whether there are policy considerations that would negate the duty of care.

225 As noted by Justices Iacobucci and Major for the court in *Martel Building Ltd. v. Canada*, [2000] 2 S.C.R. 860, the situations for which actions for the recovery of economic losses have been allowed have been few because of policy considerations. In paragraph 37 of their judgment, they stated:

37. Over time, the traditional rule was reconsidered. In *Rivtow* and subsequent cases it has been recognized that in limited circumstances damages for economic loss absent physical or proprietary harm may be recovered. The circumstances in which such damages have been awarded to date are few. To a large extent, this caution derives from the same policy rationale that supported the traditional approach not to recognize the claim at all. First, economic interests are viewed as less compelling of protection than bodily security or proprietary interests. Second, an unbridled recognition of economic loss raises the spectre of indeterminate liability. Third, economic losses often arise in a commercial context, where they are often an inherent business risk best guarded against by the party on whom they fall through such means as insurance. Finally, allowing the recovery of economic loss through tort has been seen to encourage a multiplicity of inappropriate lawsuits.

226 In the case at bar, in my opinion, there are four overriding policy considerations that would negate any *prima facie* duty established by foreseeability and proximity; namely: (1) the undesirable presence of indeterminate liability; (2) the encouragement of inappropriate lawsuits; (3) the weakening of the primacy of the CRTC as the regulator of the broadcasting industry; and (4) the interference with freedom of contract.

227 The first overriding policy consideration is the undesirable presence of indeterminate liability. If Rogers has a duty of care to Allarco based on their relationship in the broadcasting, then Rogers should have similar duties of care to the other members of the broadcasting industry. Using the case at bar as an example, Rogers could be exposed to tort claims from Allarco's competitors who might assert that they and not Allarco were the victims of an undue disadvantage or an undue preference. Rogers liability is indeterminate if it has to combine a duty of care with duties not to unduly disadvantage and not to unduly prefer the other members of the broadcasting industry.

228 The second overriding policy consideration is perhaps a corollary to the first because recognizing a tort duty of care for economic losses consequent to breaching the regulations of the *Broadcasting Act* will encourage a multiplicity of inappropriate proceedings.

229 The third overriding policy consideration is weakening the primacy of the CRTC as the regulator of the broadcasting industry. Albeit in the different context of determining whether the law of negligence should scrutinize the bargaining practices of parties negotiating a contract, the court in *Martel Building Ltd. v. Canada*, *supra*, at para. 70 recognized that it may be undesirable to introduce court regulation by tort. Justices Iacobucci and Major stated:

[T]o extend the tort of negligence into the conduct of commercial negotiations would introduce the courts to a significant regulatory function, scrutinizing the minutiae of pre-contractual conduct. It is undesirable to place further scrutiny upon commercial parties when other causes of action already provide remedies for many forms of conduct.

230 I appreciate that it cannot be the case that the CRTC would or should have exclusive jurisdiction over the participants in the broadcasting industry. As I have noted several times, members of the industry can contract to make the statutory obligations, which are enforceable by the CRTC, also contractual promises enforceable by the courts. Rather, the policy point here is that the common law should not be quick to find a duty of care that will take the injured party to seek redress from the courts where Parliament has established a regulator to have primary responsibility.

231 The fourth overriding policy consideration is freedom of contract. The principle of primacy of private ordering, the right of individuals to arrange their affairs and assume risks in a different way than would be done by the law of tort, is the third policy factor that negates a duty of care in the circumstances of the case at bar. The third policy factor involves the principles of concurrent liability and the doctrinal relationship between tort and contract law.

232 This principles of concurrent liability were discussed by the Supreme Court in *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12. In this case, B.C. Hydro was found liable for breach of contract and one issue for the court was whether B.C. Hydro was also liable in tort. A minority of the court concluded that because of the existence of contract terms that addressed the matter of the dispute, concurrent liability in tort was not possible. Justice Iacobucci (Sopinka, J. concurring), dissenting in part, posited a categorical rule that the right to sue in tort is precluded if an express term in the contract deals with the subject matter of the negligence claim.

233 The majority of the court, however, disagreed. Relying on *Central Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147, Justices La Forest and McLachlin in *BG Checo International* at paras. 15 and 16 (L'Heureux-Dubé and Gonthier, JJ., concurring) (Stevenson J. took no part in the judgment.) concluded that the proper principle was that tort liability may, but does not always, yield to the parties' superior right to arrange their rights and duties in a different way. Justices La Forest and

McLachlin stated:

15. In our view, the general rule emerging from this Court's decision in *Central Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147, is that where a given wrong *prima facie* supports an action in contract and in tort, the party may sue in either or both, except where the contract indicates that the parties intended to limit or negative the right to sue in tort. This limitation on the general rule of concurrency arises because it is always open to parties to limit [page 27] or waive the duties which the common law would impose on them for negligence. This principle is of great importance in preserving a sphere of individual liberty and commercial flexibility. ... So a plaintiff may sue either in contract or in tort, subject to any limit the parties themselves have placed on that right by their contract. The mere fact that the parties have dealt with a matter expressly in their contract does not mean that they intended to exclude the right to sue in tort. It all depends on how they have dealt with it.
16. Viewed thus, the only limit on the right to choose one's action is the principle of primacy of private ordering -- the right of individuals to arrange their affairs and assume risks in a different way than would be done by the law of tort. It is only to the extent that this private ordering contradicts the tort duty that the tort duty is diminished. The rule is not that one cannot sue concurrently in contract and tort where the contract limits or contradicts the tort duty. It is rather that the tort duty, a general duty imputed by the law in all the relevant circumstances, must yield to the parties' superior right to arrange their rights and duties in a different way. In so far as the tort duty is not contradicted by the contract, it remains intact and may be sued upon. ...

234 In my opinion, the case at bar, is one of the cases where tort liability does yield to the principle of private ordering. Allarco and Rogers could have infused the Affiliation Agreement with contractual obligations replicating the statutory obligations, but they expressly did not do so. Rather, they exercised their rights to arrange their affairs and duties contractually. To add tort duties is to contradict their private ordering, in which it may be recalled that Allarco agreed in s. 1 of the Affiliation agreement that Rogers would have the right (but not the obligation) to distribute Super Channel and in s. 19 that Rogers shall not be liable for damages of any kind.

235 In an argument with which I agree, on the issue of concurrent liability, Rogers relies on *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711 as authority for the proposition that where an implied duty in contract fails, the same duty must also fail in tort. From this proposition it argues that if Allarco's implied terms argument fails (as it has), it cannot assert a duty of care.

236 In the *Canadian Pacific Hotels Ltd.* case, CP Hotels sued BMO for negligence in failing to examine bank statements and report discrepancies that would have revealed forgery. The banking

contract did not impose this obligation on BMO, and the Supreme Court held that the principle of concurrent liability in contract and in tort "cannot extend to the recognition of a duty of care in tort when that same duty of care has been rejected by the courts as an implied term of a particular class of contract."

237 Relying on *Ring Contracting Ltd. v. Aecon Construction Group Inc.*, [2006] B.C.J. No. 1369 (B.C.C.A.) Allarco, however, submitted that the holding in *Canadian Pacific Hotels Ltd.* is confined to the specific contractual relationship between a bank and its customer.

238 It is true that at para. 15 of his judgment in *Ring Contracting*, Justice Kirkpatrick stated: "In my opinion, the holding in *Canadian Pacific Hotels* must be regarded as confined to the specific contractual relationship in that case, namely that of bank and customer." However, "the holding" of the Supreme Court in *Canadian Pacific Hotels Ltd.* that Justice Kirkpatrick was explaining as confined to a specific contractual relationship was not the Supreme Court's proposition about concurrent liability in tort and contract but rather was about whether the implication of contract terms was always a matter of necessity.

239 The issue in *Ring Contracting Ltd.* was whether the court should imply as a term of a settlement agreement that certain acts should be done within a reasonable period of time when the contract did not specify a time for performance. Ring contended that the contract could not imply a term for a reasonable time for performance unless the test of necessity described in *Canadian Pacific Hotels Ltd.* was satisfied. Justice Fitzpatrick disagreed on the matter of the test of necessity applying to whether there should be an implied term that required performance within a reasonable time. He was not discussing the matter of whether contract provisions can preclude or prescribe the limits of tort liability.

240 Put shortly, Justice Fitzpatrick's comment has been taken out of context and does not negate the principle that concurrent liability in contract and in tort cannot extend to the recognition of a duty of care in tort when that same duty of care has been rejected by the courts as an implied term of a particular class of contract. Thus, *Ring Contracting Ltd.* is of no assistance to Allarco in refuting Rogers' argument against there being concurrent liability in the case at bar.

241 For the above reasons, I conclude that there is no genuine issue for trial that Allarco does not have a negligence claim against Rogers because of the absence of a duty of care.

8. Does Allarco Have a Claim for Interference with Economic Relations Against Rogers?

242 The last matter to consider is whether Allarco has a tort claim for interference with economic relations.

243 The elements of a claim of intentional interference with economic relations are: (1) intent to

injure and cause loss to the plaintiff; (2) interference with the plaintiff's business or livelihood by illegal or unlawful means; (3) the unlawful means are directed at a third party who has an actionable claim or an actionable claim but for the absence of having suffered a loss; and, (4) the plaintiff suffering economic loss as a result of the unlawful means: *Alleslev-Krofchak v. Valcom Ltd.* 2010 ONCA 557, leave to appeal to the SCC ref'd [2010] S.C.C.A. No. 403; *Correia v. Canac Kitchens* (2008), 91 O.R. (3d) 353 (C.A.); *Reach M.D. Inc. v. Pharmaceutical Manufacturers Association of Canada* (2003), 65 O.R. (3d) 30 (C.A.); *Lineal Group Inc. v. Atlantis Canadian Distributors Inc.* (1998), 42 O.R. (3d) 157 (C.A.), leave to appeal ref'd [1998] S.C.C.A. no. 608; *Destiny Software Productions Inc. v. Musicrypt Inc.*, 2011 ONSC 470.

244 Under the third constituent element of the tort, to make out a claim, a plaintiff must establish that the defendant's misconduct was directed at a third party who would have an actionable claim against the defendant for that misconduct or an actionable claim but for not having suffered a loss. See: *Alleslev-Krofchak v. Valcom Ltd.*, *supra* at paras. 54-61; *OBG v. Allan*, [2008] 1 A.C. 1 at para. 49; *Destiny Software Productions Inc. v. Musicrypt Inc.*, 2011 ONSC 470.

245 To rebutte Allarco's tort claim for interference with economic relations, Rogers focuses on the third element of the tort and argues that in the circumstances of this case, the only possible third parties are its customers, but the customers do not have a cause of action against Rogers in respect of the losses suffered by Allarco. Therefore, Rogers argues that there is a fatal flaw in Allarco's claim of interference with economic relations.

246 In its factum, to counter this argument, Allarco relies on *Agribands Purina Canada Inc. v. Kasamekas* 2011 ONCA 460 at para. 32, and its argues that the full scope of the actionability element of the tort, the third constituent element, remains to be fully defined, and during oral argument, it submitted the following novel counterargument.

247 The counterargument was that Rogers committed the wrongful acts of: (1) failing to launch Super Channel's two HD channels; (2) failing to package Super Channel with other channels; and (3) failing to have CSRs tell customers about Super Channel. For these wrongful acts, the customers could complain to the CRTC that Rogers had failed to comply with its statutory obligations. Therefore, Allarco submitted that the customers had an actionable claim that satisfied the third element of the tort of interference with economic relations.

248 With respect, I find this imaginative argument fallacious. The notion of "actionable" in the third constituent element of the tort refers to causes of action not activities like making a complaint to the CRTC.

249 Moreover, in *Alleslev-Krofchak v. Valcom Ltd.*, *supra*, at para. 60 and in *Correia v. Canac Kitchens*, *supra*, at para. 107, the Court of Appeal held that the defendant's actions cannot be actionable directly by the plaintiff and must be directed at a third party, which then becomes the vehicle through which harm is caused to the plaintiff. See also *Destiny Software Productions Inc. v. Musicrypt Inc.*, *supra*.

250 In the case at bar, the three wrongful acts relied on by Allarco to constitute the third element of the tort of wrongful interference with economic relations are directly actionable by Allarco in proceedings before the CRTC and would have been actionable in the courts had Allarco and Rogers agreed to make the statutory obligations contractual ones.

251 Further still, the impugned activities are not unlawful acts against the customers who, for instance, have no right to have Super Channel broadcast in high definition, or to have Super Channel packaged with other TV channels, or to receive a sales pitch about subscribing to Super Channel. In the absence of suffering personal harm - of which there is none for them to suffer - it is not the business of the customers to complain about these matters on behalf of Allarco. The customers would have no private or personal interest in their complaint, which amounts to a grievance that Rogers subjected Super Channel to an undue disadvantage. The customers themselves have no actionable complaint.

252 At most, Rogers' customers might have a public interest that the broadcasting industry be properly regulated; however, the Rogers' customers still would have no individual actionable claim. The Rogers' customer's situation is analogous to the situation of victims of a public nuisance as opposed to a private one. A public nuisance is an activity that unreasonably interferes with the public's interest in questions of health, safety, morality, comfort, or convenience and an individual may bring a private action in public nuisance only by proving special damage: *Ryan v. Victoria (City)*, [1999] 1 S.C.R. 201. The Rogers customers have no actionable claim that would satisfy the third element of the tort of unlawful interference with economic relations.

253 For the above reasons, I conclude that there is no genuine issue for trial that Allarco does not have a claim against Rogers for interference with economic relations.

E. CONCLUSION

254 For the above Reasons for Decision, I dismiss Allarco's motion and I grant Rogers' motion for a summary judgment dismissing Allarco's action.

255 If the parties cannot agree about the matter of costs, they may make written submissions beginning with Rogers within 20 days of the release of these Reasons for Decision followed by Allarco's submissions within a further 20 days.

P.M. PERELL J.

cp/e/qlacx/qljxr/qlced

TAB 2

Case Name:
Budget Waste 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 Budget Waste Inc.**

[2009] A.J. No. 1456

2009 ABQB 752

62 C.B.R. (5th) 145

2009 CarswellAlta 2153

Docket: 0901 03296

Registry: Calgary

Alberta Court of Queen's Bench
Judicial District of Calgary

S.J. LoVecchio J.

Heard: November 26, 2009.

Judgment: December 18, 2009.

(49 paras.)

*Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters --
Compromises and arrangements -- With class of creditors -- Directions -- Claims -- Priority --
Application for order that unpaid lease payments were unsecured claims dismissed -- Applicant
obtained protection under Companies' Creditors Arrangement Act and, by terms of Initial Order,
undertook to pay in full all post-petition trade creditors or have unpaid amounts protected by
security -- Applicant failed to pay leases but argued arrears should be unsecured because it was not
using vehicles -- Applicant could have terminated leases, but kept vehicles to keep options open, so
lessors could not be expected to bear burden -- Accrued payments protected in accordance with
Initial Order.*

Application for an order that unpaid lease payments were unsecured claims. The applicant had obtained protection under the Companies' Creditors Arrangement Act. By the terms of the Initial Order, the applicant undertook to pay in full all post-petition trade creditors or have the unpaid amounts protected by a security interest. The applicant, however, had not made any payments on leases since March 2009, and some of the arrears accrued after the Initial Order was made, until the applicant finally applied to have the leases terminated. The applicant argued that it was not using the leased vehicles and the claims should be unsecured. The lessors argued that the accrued arrears since the date of the Initial Order should be protected or paid in full.

HELD: Application dismissed. Even though the applicant was not using the vehicles post-order, the vehicles were still the applicant's care and control, so the lessors continued to provide a service. The applicant could have moved to terminate the leases earlier, but chose to keep the vehicles in order to keep its options open. The lessors could not be expected to bear the burden for this decision. The accrued payments were protected in accordance with the Initial Order.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.4

Counsel:

James G. Hanley, for the Applicant Budget Waste Inc.

Dufferin Harper, for the Monitor Hardie & Kelly Inc.

Michael Dery, for the Respondent Transportation Lease Systems Inc.

Sean T. FitzGerald, for the Respondent JPL Vehicle Management Services.

Reasons for Judgment

S.J. LoVECCHIO J.:--

Introduction

1 Budget Waste Inc. has asked the Court to determine the priority of a number of unpaid post Initial Order lease payments for vehicles leased but no longer used by BWI. The Court also heard at the same time an application by BWI to terminate those leases.

Facts

2 BWI operates a waste disposal business and employs a fleet of vehicles, the majority of which are leased from various lessors.

3 BWI filed for and obtained protection under the *Companies' Creditors Arrangement Act*¹ on March 4, 2009. Hardie & Kelly Inc. was appointed as the Monitor. By the terms of the Initial Order, BWI undertook to effectively pay in full all post-petition trade creditors for post Initial Order services or have any unpaid amounts for post Initial Order services protected by a security interest, all in accordance with the terms of paragraphs 40 and 42 of the Initial Order.

4 Between March 4, 2009 and the present, BWI and the Monitor have reviewed the company's operations. During that review, it became apparent to BWI that a number of its vehicle leases were uneconomic and related to redundant or unusable vehicles.

5 As a consequence of this determination, BWI ceased using a number of the leased vehicles in its operations and, in the latter part of May 2009, segregated and isolated these vehicles in a storage facility.

6 BWI has not made any payments on the majority of the leases since March 4, 2009 and a number of the leases were in arrears at the time of the Initial Order.

7 By Notice of Motion filed November 11, 2009 and heard on November 26, 2009, BWI sought permission from the Court to terminate certain of the leases and a declaration as to the priority, if any, the unpaid lease payments, which have accrued since the Initial Order, should enjoy.

Issue

8 Should unpaid lease payments which accrued after the Initial Order have a different priority than unpaid lease payments which accrued prior to the Initial Order?

Position of the Parties

Position of BWI

9 BWI submits that all unpaid lease payments, regardless of when they accrued, should simply be unsecured claims.

10 The rationale for this submission being the lessors knew that BWI was not making payments on the leases BWI now seeks to terminate, and the lessors failed to take action by asking the Court to lift the stay against them so they could reclaim their vehicles. So, BWI asserts, the lessors should assume the financial consequences and be deemed unsecured creditors in respect of their unpaid lease payments.

11 In the alternative, BWI submits the only lease payments that should be protected are those which accrued after the date of the Initial Order but prior to the lessors receiving notice from BWI

that the unused vehicles were not being used and were being stored, and that BWI intended to disclaim the leases. BWI asserts the unpaid amounts arising post such notice should simply be unsecured claims.

12 The rationale for this submission being in the event the Court does not want to make the lessors fully responsible for all post-petition lease payments, the lessors should at least be unsecured creditors for those payments arising after the date they had actual knowledge that BWI was not using the vehicles. BWI submits the Court should find that knowledge to have been acquired through the Monitor's Report dated May 14, 2009. That Report, and more specifically the accompanying May 13 affidavit of Jim Can, CEO of BWI, publicly disclosed to the lessors that the unused vehicles were parked, that they could get their vehicles back, and that BWI was considering terminating the leases. This was new information the lessors did not previously have.

Position of the Lessors

13 Transportaction Lease Systems Inc. and JPL Vehicle Management Services were the only lessors that appeared and made oral arguments at the hearing of the application.

14 They submit that all accrued and unpaid lease payments since the date of the Initial Order should be treated as post-petition creditor claims and as such be entitled to full payment or otherwise protected. The rationale being that they should not bear financial responsibility for any unpaid lease payments because the unused vehicles were still in BWI's care and control until their leases were finally terminated by the Court.

15 They also argue that a failure by them to apply to the Court to lift the stay following a CCAA order so as to permit them to reclaim their vehicles should not change their entitlements. Instead, it is the company under CCAA protection that is in control of the process and knows which of its assets and equipment it is using and which it is not. They submit it is the company that should be required to take legal action. As BWI took no steps to terminate their leases until November 2009, the lessors claim they should not be disadvantaged by BWI's inaction.

16 Finally, they claim there is some variance and uncertainty as to when they individually acquired knowledge that their vehicles were not being used by BWI. Therefore, they assert BWI's alternative claim should fail because there is no clear date on which they all learned this information.

Analysis

17 BWI has made an application to terminate a number of leases. As noted above only two of the lessors appeared at the hearing, even though all were given notice. For the purposes of this decision, there is no reason for a lessor (and by extension their lease) who appeared and made submissions to be treated any differently than a lessor (and by extension their lease) who did not. Accordingly, when I use the terms "Lessors" and "Leases" in the balance of this decision, that should be seen a

reference to all of the lessors and all of the leases BWI has sought to affect in this application.

18 Transportaction and JPL accept that, given the circumstances, the Court should permit BWI to terminate the Leases, and they are terminated effective November 26, 2009 being the date I heard this application.

19 The only contested issue is the status of the unpaid lease payments between March 4, 2009, being the date BWI obtained the Initial Order, and November 26, 2009, the date the Leases were terminated.

20 If I hold that the Lessors are not post-petition creditors in respect of these unpaid amounts, I would essentially be saying they are unsecured claims having the same status and priority as the lease payments which had accrued and were unpaid as of the date of the Initial Order. On the other hand, if I hold that the Lessors are post-petition creditors, BWI would be responsible for the payments, and the Lessors should be paid as post-petition creditors and as such be entitled to either receive 100 cents on the dollar from the date of the Initial Order to the date the Leases were terminated, or otherwise be protected as provided in the Initial Order.

21 There is no statutory provision to guide me, nor is there any common law precisely on point. The resolution of this issue is ultimately about finding the proper balance between two competing interests, and that will require me to examine the equities of this situation.

22 On one side - should the Lessors bear the financial responsibility for these lease payments because they had notice that their vehicles were not being used and took no action to reclaim the unused vehicles? On the other side - should the Lessors be protected as BWI was in control of the entire reorganization process?

23 This decision also engages the integrity of the Initial Order and the protection provided in the Initial Order for post-petition creditors. If I rule against the Lessors and find that they are not entitled to be fully paid or protected for the post-CCAA unpaid amounts, such a ruling could chip away at the CCAA principle noted below of protecting suppliers who provide services after the date of the Initial Order.

24 A general principle of the CCAA regime is that suppliers are not required to provide products or services to companies under CCAA protection unless they are deemed critical suppliers under section 11.4 of the CCAA and protected accordingly. The notion of post-petition creditors in the Initial Order encapsulates this principle and protection.

25 In the present case, the CCAA order said that post-petition creditors of BWI would be effectively entitled to receive full payment for any products or services they provided to BWI after the Initial Order, or would otherwise be protected in accordance with the Initial Order.

26 Transportaction and JPL assert that because BWI still had possession of the unused vehicles

following the date of the Initial Order, they are post-petition creditors up to the date the Leases were terminated. On the other side, BWI asserts that the Court should distinguish between post-petition creditors that actually provide goods or services following the date of the Initial Order and those, like the Lessors, who simply leave their vehicles with the company even though the company is not making actual use of them.

27 The problem with BWI's argument is that even though BWI may not have been using the vehicles post Initial Order, the vehicles were still in the care and control of BWI. Therefore, the Lessors technically continued to provide a good or service to BWI because BWI still had the vehicles in its possession, albeit they were not actually using them to earn revenue.

28 As will become evident, my decision ultimately rests on who was in control of the process, and I find that was BWI. Moving to terminate the contracts for the unused vehicles was within the company's discretion. It could have done so at any time. Counsel for BWI acknowledges that the company knew in May 2009 which vehicles it was no longer using and that it parked a number of the vehicles at that time.

29 Had BWI come to the Court to terminate the Leases back in May, we likely would not be here today. However, BWI did not bring such an application for several months. The company provides a couple of reasons for the delay, including that it was working through some tax issues with the Canada Revenue Agency and that it had not fully determined which vehicles were truly unnecessary to its business.

30 BWI took time to do its due diligence and decide which vehicle leases were still viable, as it was permitted to do. To now require the Lessors to pay for the time the company took to reorganize itself would go against the foundation of the post-petition creditor notion. This notion, so key to the CCAA process, permits a company to carry on business and assures those creditors that continue to supply goods and services to the company that they will be paid or otherwise protected.

31 BWI wanted to keep its options open as long as possible regarding which vehicle leases it would maintain and which it would terminate. That was what it did. However, BWI should not expect the Lessors to bear the costs associated with the time it took to consider which option it would choose.

32 In addition to upholding the status of post-petition creditors, this decision also turns on who should have the burden of making a court application in these situations - the company under CCAA protection or the unpaid creditors.

33 Here again, the burden should fall on BWI. By the terms of the Initial Order, the creditors have been stayed from proceeding. The "price" for the stay should be an obligation on the company to act.

34 There is another reason for placing the burden on BWI. These cases often involve numerous

lessors, and their individual exposure is small. They are a disparate group, often not situated within the same city or even province. They could not collectively bring a court action without a tremendous amount of effort, and would be more likely to bring individual claims.

35 The cost of coming to Court to lift the stay and reclaim their equipment would not make financial sense for these companies in that the legal costs associated with hiring and informing legal counsel and making the court application would often outweigh the lessors' actual financial stake in the unpaid leases. In such a situation, it is more equitable to put the burden of commencing court action on the company under CCAA protection.

36 Instead of making the Lessors responsible for all post-CCAA lease payments, BWI has, in the alternative, suggested a compromise. It would have the Court recognize as post-petition claims only those lease payments due prior to the May Monitor's Report.

37 BWI bases this argument on the knowledge of the Lessors. It asserts that as of the end of May, all of the Lessors knew, through the public release of the Monitor's Report, that their vehicles were parked and were not being used by BWI. The Lessors also knew at that point, according to BWI, that they were not being paid by BWI. Once the Lessors acquired that knowledge, BWI asserts the Lessors should become responsible for the lease payments because they failed to act knowing their equipment was not being used, knowing that BWI had ceased making lease payments, and knowing that the Leases would eventually be terminated.

38 I have two difficulties with this alternative argument. First, as I already mentioned, there was some dispute and uncertainty as to when each of the Lessors actually acquired knowledge that their vehicles were no longer being used. While BWI asserts that all Lessors would have acquired such knowledge in May with the Monitor's Report, Transportation submitted that it did not know the status of its leases until August 2009.

39 A second difficulty with using the knowledge of the Lessors as the cut-off point is that it would make for a much more cumbersome process. I would have to look at each of the 21 leases individually and determine on a lease-by-lease basis when exactly each of the Lessors acquired knowledge that BWI was no longer using its vehicles. Such a process would complicate the CCAA process and add more cost to the creditors. I prefer to take a less complicated and likely more cost-effective approach.

40 In so deciding, I am mindful of BWI's argument that this seems to permit lessors to simply sit on their hands when they know their equipment is not being used by a company under CCAA protection and knowing they are post-petition creditors entitled to a preference. This has the potential to create a certain level of inequality among lessors, and courts are generally reluctant to create an economic advantage for some creditors over others.

41 That being said, in *Re Air Canada*², Farley J. ultimately followed similar reasoning as I am applying here based on somewhat similar facts. In that case, Air Canada was under CCAA

protection. At issue were lease payments for an airplane Air Canada had leased from the lessor TA. Air Canada did not apply to terminate the lease for several months following the initial CCAA order and then sought to reduce the lease payment arrears it owed to TA. After examining the fairness issue, Farley J. held that Air Canada was responsible for making full lease payments on the airplane despite the fact that Air Canada was no longer using the plane, and the plane had been parked for several months.

42 Another case that looked at the fairness to creditors issue and found a compromise is *Re Winnipeg Motor Express Inc.*³ BWI advances the case to support its alternative argument that I should cut off the lease payment arrears at May 14, 2009, the date of the Monitor's Report.

43 In *Re Winnipeg* the company was undergoing a CCAA restructuring. At the plan approval stage, the Court had to deal with several unpaid lessors who had leased equipment to the company. The lessors asserted they were unduly prejudiced by the stay put on them with the CCAA order because not only were they not being paid by the lessee, but they could not re-obtain their equipment, which was being used and deteriorated in the meantime.

44 The Court in *Re Winnipeg* recognized at paras. 58-59 the prejudice faced by equipment lessors in these situations. Suche J. wanted to find a solution that addressed that prejudice but also honoured the ultimate purpose of the CCAA, which she said is to relieve a company of ongoing financial burden to allow it the opportunity to restructure. As a solution, Suche J. said the equipment lessors were entitled to some of their unpaid lease payments, but she cut off the damages at two and a half months of arrears.

45 BWI urges me to similarly choose a reasonable period of time at which to cut off the protected amounts owing to the Lessors. The fundamental difference, however, between the present case and the situation in *Re Winnipeg* is the timing in the CCAA process. In *Re Winnipeg*, Suche J. was approving the company's plan of arrangement, and it was a term of the plan how these lessors were to be treated. In this case, BWI is merely at the stage of developing its plan.

46 If BWI wants some of the arrears BWI owes to the Lessors for post-petition lease payments to be compromised, based on *Re Winnipeg* BWI could propose that as a term of its plan of arrangement. In so doing, BWI will no doubt have regard for and take into account the protection for unpaid amounts provided for in the Initial Order. What happens then will be left to another day.

47 As a final matter, there was some dispute between the parties about whether the Leases were true leases or financing leases. This distinction would not affect my decision, so that matter will not be addressed.

Conclusion

48 As the unused vehicles were still under the care and control of BWI at the time of the application, the lease payments accrued and unpaid between the date of the Initial Order and

November 26, 2009, when the Leases were terminated, are protected in accordance with the Initial Order.

Costs

49 The issue of costs was not addressed. If Counsel so desire, the issue of costs may be spoken to at a later date.

S.J. LoVECCHIO J.

cp/e/qlcct/qlpwb/qlaxw/qlcas

1 R.S.C. 1985, c. C-36.

2 (2004), 47 C.B.R. (4th) 182, 129 A.C.W.S. (3d) 21 (Ont. S.C.J.).

3 2009 MBQB 204.

TAB 3

Indexed as:
Cumberland Trading Inc. (Re)

**IN THE MATTER OF the proposal of Cumberland Trading Inc. of
the City of Toronto, in the Municipality of Metropolitan
Toronto**

[1994] O.J. No. 132

23 C.B.R. (3d) 225

1994 CarswellOnt 255

45 A.C.W.S. (3d) 199

Action No. 31-282225

Ontario Court of Justice - General Division
In Bankruptcy - Commercial List - Toronto, Ontario

Farley J.

January 24, 1994.

(13 pp.)

Bankruptcy -- Proposals -- Annulment of -- Delay -- Failure to make proposal within limitation period.

The applicant S demanded payment in full of its operating financing loan to Cumberland, and gave notice under section 244 of the Bankruptcy and Insolvency Act (BIA) of its intention to enforce its security in ten days. The day before S's section 244 notice would have allowed it to take control of the security, Cumberland filed with the Official Receiver a Notice of Intention to Make a Proposal. Ten days had now passed since Cumberland filed its Notice of Intention, and five days since S served Cumberland with this motion. No proposal had yet been tabled. S sought a declaration that the 30 day period to file a proposal was terminated. S represented 95% of the value of the claims of secured creditors of Cumberland and 67 per cent of all creditors' claims. S would therefore have a veto power on any vote on a proposal, and had asserted that there was no proposal which

Cumberland could make that it would approve.

HELD: S succeeded in having the 30 day period in which to file a proposal terminated. The Act did not allow debtors absolute immunity and impunity from their creditors. S had shown that the insolvent corporation would not likely be able to make a proposal that would be accepted by the creditors.

STATUTES, REGULATIONS AND RULES CITED:

Bankruptcy and Insolvency Act, S.C. 1992, c. 27, ss. 50.4(1), 50.4(8), 50.4(11)(c), 69, 69.1, 68.4, 244.

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

Kevin J. Zych, for the secured creditor, Skyview International Finance Corporation.

Jeff Carhart, for the debtor, Cumberland Trading Inc.

1 FARLEY J.:-- Skyview International Finance Corporation ("Skyview") brought this motion for a declaration that the stay provisions (ss. 69 and 69.1) of the Bankruptcy and Insolvency Act, RSC 1985 c.B-3 as amended ("BIA") no longer operate in respect of Skyview taking steps to enforce its security (including accounts receivable and inventory) given by Cumberland Trading Inc. ("Cumberland") which it has been financing for the last 9 years. In addition Skyview moved for a declaration that the 30 day period to file a proposal mentioned in s. 50.4(8) BIA was terminated. Thirdly, Skyview was asking for an order removing Doane Raymond Limited ("Doane") which was Cumberland's choice as trustee and substituting A. Farber Associates ("Farber") as trustee under the Notice of Intention to File a Proposal of Cumberland. In the alternative to the relief awarded in the last two aspects, Skyview wished to have an order appointing Farber as interim receiver.

2 On January 5, 1994 Skyview demanded payment in full of its operating financing loan to Cumberland and gave a s. 244 BIA notice of its intention to enforce its security in ten days. The affidavit filed on behalf of Skyview indicated that Cumberland was not cooperating with it in providing appropriate financial information for the last half year. This was disputed in the affidavit filed by Cumberland. Suffice it to say that there has been a falling out between the two. Skyview asserted that it was owed \$966,478 and that there was an exposure to it under a guarantee given on Cumberland's behalf to a potential of approximately \$200,000 U.S. Skyview's deadline for repayment was January 16th. On January 14th Cumberland filed with the Official Receiver a Notice of Intention to make a Proposal (s. 50.4(1) BIA) and pursuant to s. 69 BIA there would be a stay of proceedings upon this filing.

3 Skyview's president swore that:

21. In light of the unpleasant and frustrating experience Skyview has had to endure over the preceding 3 to 4 months with Cumberland, including specifically the persistent refusal by Cumberland to account for its sales from the Retail Business, the misrepresentation of Cumberland's pre-sold orders referred to above and particularly its secretive purported 'termination' of its direction to accord to pay sums to Skyview in reduction of Cumberland's indebtedness, Skyview's faith and confidence in the management of Cumberland has been irreparably damaged such that Skyview would not be prepared to vote in terms of any proposal which Cumberland may make.

and further that

24. The continued operation of a stay of proceedings preventing Skyview from enforcing its security will be materially prejudicial to the rights of Skyview. The assets of Skyview consist primarily of inventory and receivables (both from the Distribution Business and the Retail Business). With each day that passes Cumberland is converting its inventory (financed by Skyview) into cash (primarily in the Retail Business) and receivables (primarily in the Distribution Business) and it is Skyview's fear that those sums will be used by Cumberland to pay its other creditors and to fund the professional costs which it inevitably must incur in formulating and implementing a proposal. This fear is especially heightened insofar as the receivables generated from the Retail Business are concerned as they are under the direct and immediate control of Cumberland and are not collected by Accord.

4 Cumberland's Notice of Intention to File a Proposal acknowledges that Skyview is owed \$750,000. On that basis Skyview has 95% in value of Cumberland's admitted secured creditors' claims and 67% of all creditors' claims of whatever nature. No matter what, Skyview's claim is so large that Skyview cannot be swamped in any class in which it could be put. Clearly Skyview would have a veto on any vote as to a proposal, at least so far as the secured class, assuming the secureds are treated as a separate class. This leaves the interesting aspect that under the BIA regime one could have a proposal turned down by the secured creditor class but approved by the unsecured creditor class and effective vis-à-vis this latter class, but with the secured class being able to enforce their security. One may question the practicality a proposal affecting only unsecured creditors becoming effective in similar circumstances to this situation.

5 Cumberland's essential position is that it must have some time under BIA to see about reorganizing itself. While I am mindful that both BIA and the Companies' Creditors Arrangement

Act, R.S.C. 1985 c.C-36 ("CCAA") should be classified as debtor friendly legislation since they both provide for the possibility of reorganization (as contrasted with the absence of creditor friendly legislation which would allow, say, creditors to move for an increase in interest rates if inflation became rampant), these acts do not allow debtors absolute immunity and impunity from their creditors. I would also observe that all too frequently debtors wait until virtually the last moment, the last moment or, in some cases, beyond the last moment before even beginning to think about reorganization (and the attendant support that any successful reorganization requires from the creditors). I noted the lamentable tendency of debtors to deal with these situations as "last gasp" desperation moves in *Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 308 (Ont. Gen. Div.). To deal with matters on this basis minimizes the chances of success, even if "success" may have been available with earlier spadework. It is true that under BIA an insolvent person can get an automatic stay by merely filing a Notice of Intention to File a Proposal - as opposed to the necessity under CCAA of convincing the court of the appropriateness of granting a stay (and the nature of the stay). However BIA does not guarantee the insolvent person a stay without review for any set period of time. To keep the playing field level and dry so that it remains in play, a creditor or creditors can apply to the court to cut short the otherwise automatic (or extended) stay; in this case Skyview is utilizing s. 50.4(11) to do so.

6 Cumberland relies upon *Re N.T.W. Management Group Ltd.* (1993), 19 C.B.R. (3d) 162 (Ont. Gen. Div.), a decision of Chadwick J. Skyview asserts that N.T.W. is distinguishable or incorrectly decided and secondly that the philosophy of my decision in *Re Triangle Drugs Inc.* (1993), 16 C.B.R. (3d) 1 (Ont. Gen. Div.) should prevail. In *Triangle Drugs* I allowed the veto holding group of unsecured creditors to in effect vote at an advance poll in a situation where there appeared to be a gap in the legislation. The key section of BIA is s. 50.4(11) which provides:

The court may, on application by the trustee, the interim receiver, if any, appointed under section 47.1, or a creditor, declare terminated, before its actual expiration, the thirty day period mentioned in subsection (8) or any extension thereof granted under subsection (9) if the court is satisfied that

- (a) the insolvent person has not acted, or is not acting, in good faith and with due diligence,
- (b) the insolvent person will not likely be able to make a viable proposal before the expiration of the period in question,
- (c) the insolvent person will not likely be able to make a proposal, before the expiration of the period in question, that will be accepted by the creditors, or
- (d) the creditors as a whole would be materially prejudiced were the application under this subsection rejected,

and where the court declares the period in question terminated, paragraphs (8)(a) to (c) thereupon apply as if that period had expired."

It does not seem to me that there is any gap in this sector of the legislation.

7 As the headnote in N.T.W. stated, Chadwick J. viewed a situation similar to this one as requiring that the debtor must have an opportunity to put forth its proposal when he stated at p. 163:

The bank had stated that it would not accept any proposal. However, since the companies had not yet had the opportunity to put forth their proposal, it was impossible to make a final determination under s. 50.4(11)(c). The companies should have the opportunity to formulate and make their proposal.

However I note that in this instance Cumberland has filed its Notice of Intention to File a Proposal the day before Skyview's s. 244 notice would have allowed it to take control of the security. Cumberland's president swore that:

2. The efforts which Cumberland is currently undertaking represent a bona fide effort, made in good faith, to restructure its finances in order to preserve the business of the company for the benefit of all of the creditors of the company, including Skyview. It is my belief that the proposal process will represent a significantly better treatment of all such creditors than would be available through either an enforcement by Skyview of its security against the assets of Cumberland, a bankruptcy of Cumberland or other processes available in the circumstances.

and further that:

I intend to submit a proposal, pursuant to the provisions of the Bankruptcy and Insolvency Act, which represents the most advantageous treatment available, in my view, to all of the creditors of Cumberland and which allows for the continued viability of the business of Cumberland. This proposal is being prepared, and will be presented, in complete good faith. In the course of reviewing and preparing this proposal material with Mr. Godbold, I have determined that the legitimate claim of Skyview does not, in fact, represent in excess of 66-2/3 of all of the claims against Cumberland. At this time, Doane Raymond Limited is already in the position of Trustee under the proposal, in accordance with the provisions of the Bankruptcy and Insolvency Act. In addition, as noted above, I am prepared to consent to the appointment of Doane Raymond Limited as interim receiver of Cumberland. In the circumstances, I respectfully submit

that the stay in favour of Cumberland pursuant to the Bankruptcy and Insolvency Act should not be lifted.

No explanation was given as to the lower share indicated for Skyview but in any event there was no assertion that Skyview lost its veto.

8 However we do not have any indication of what this proposal proposes to be - notwithstanding that 10 days have now passed since Cumberland filed its Notice of Intention to File a Proposal and five days since Skyview served Cumberland with this motion. In a practical sense one would expect, given Skyview's veto power and its announced position, that Cumberland would have to present "something" to get Skyview to change its mind - e.g. an injection of fresh equity or a take out of Skyview's loan position. However there was not even a germ of a plan revealed - but merely a bald assertion that the proposal being worked on would be a better result for everyone including Skyview. This is akin to trying to box with a ghost. While I agree with the logic of Chadwick J. when he said at p. 168 of N.T.W. that:

C.I.B.C. the major secured creditor has indicated they will not accept any proposal put forth, other than complete discharge of the C.I.B.C. indebtedness. Other substantial creditors have taken the same position. There is no doubt that the insolvent companies have a substantial obstacle to overcome. As the insolvent companies have not had the opportunity to put forth this proposal, it is impossible to make the final determination. In Triangle Drugs Inc. Farley J. had the proposal. Well over one-half of the secured [sic; in reality unsecured] creditors indicated they would not vote for the proposal. As such, he then terminated the proposal. We have not reached that stage in this case. The insolvent companies should have the opportunity of putting forth the proposal. [emphasis added].

9 However this analysis does not seem to address the test involved. With respect I do not see this logical aspect as coming into play in s. 50.4(11)(c) which reads:

The court may, on application ... a creditor, declare terminated, before its actual expiration, the thirty day period mentioned in subsection (8) ... if the court is satisfied that ...

(c) the insolvent person will not likely be able to make a proposal, before the expiration of the period in question, that will be accepted by the creditors, ...

and where the court declares the period in question terminated, paragraphs (8)(a) to (c) thereupon apply as if that period had expired.

It seems to me that clause (c) above deals specifically with the situation where there has been no proposal tabled. It provides that there is no absolute requirement that the creditors have to wait to see what the proposal is before they can indicate they will vote it down. I do not see anything in BIA which would affect a creditor (or group of creditors) with a veto position from reaching the conclusion that nothing the insolvent debtor does will persuade the creditor to vote in favour of whatever proposal may be forthcoming. I think that this view is strengthened when one considers that the court need only be satisfied that "the insolvent person will not likely be able to make a proposal, before the expiration of the period in question, that will be accepted by the creditors...." (emphasis added). This implies that there need not be a certainty of turndown. The act of making the proposal is one that is still yet to come. I am of the view that Skyview's position as indicated above is satisfactory proof that Cumberland will not likely be able to make a proposal that will be accepted by the creditors of Cumberland.

10 Skyview of course also has the option of proceeding under s. 69.4 BIA which provides:

A creditor who is affected by the operation of sections 69 to 69.3 may apply to the court for a declaration that those sections no longer operate in respect of that creditor, and the court may make such a declaration, subject to any qualifications that the court considers proper, if it is satisfied

- (a) that the creditor is likely to be materially prejudiced by the continued operation of those sections; or
- (b) that it is equitable on other grounds to make such a declaration.

11 Is Skyview entitled to the benefit of s. 69.4(a) BIA? I am of the view that the material prejudice referred to therein is an objective prejudice as opposed to a subjective one - i.e., it refers to the degree of the prejudice suffered vis-à-vis the indebtedness and the attendant security and not to the extent that such prejudice may affect the creditor qua person, organization or entity. If it were otherwise then a "big creditor" may be so financially strong that it could never have the benefit of this clause. In this situation Skyview's prejudice appears to be that the only continuing financing available to Cumberland is that generated by turning Cumberland's accounts receivable and inventory (pledged to Skyview) into cash to pay operating expenses during the period leading up to a vote on a potential proposal, which process will erode the security of Skyview, without any replenishment. However Skyview does not go the additional step and make any quantitative (or possibly qualitative) analysis as to the extent of such prejudice so that the court has an idea of the magnitude of materiality. In other words, Skyview presently estimates that it would be fortunate to realize \$450,000 on Cumberland's accounts receivables and inventory, but it does not go on to give any foundation for a conclusion that in the course of the next month \$x of this security would be eaten up or alternatively that the erosion would likely be in the neighbourhood of \$y per day of future operations. The comparison would be between the "foundation" of a maximum of \$450,000 and what would happen as to deterioration therefrom if the stay is not lifted. I note there was no

suggestion by Cumberland that there would be no erosion of Skyview's position by, say, getting a cash injection or by improving margins by increasing revenues or decreasing expenses. Skyview's request for its first relief request is dismissed since in my view Skyview did not engage in the correct comparison of material prejudice.

12 I note that Cumberland does not oppose Skyview's request for an interim receiver. But for my conclusion that Skyview succeeds in its second relief request (to have the 30 day period in which to file a proposal terminated) and the ancillary third relief request of substitution of Farber for Doane as trustee, I would have granted the fourth relief request of appointing Farber as interim receiver. I would also award Skyview costs of \$600 payable out of the estate of Cumberland from the proceeds first realized.

FARLEY J.

TAB 4

Case Name:
Scanwood Canada Ltd. (Re)

**IN THE MATTER OF the Companies' Creditors Arrangement Act
1985, c. C-36, as amended
AND IN THE MATTER OF a Plan of Compromise or Arrangement of
Scanwood Canada Limited, a body corporate under the laws of
the Province of Nova Scotia**

[2011] N.S.J. No. 447

2011 NSSC 189

305 N.S.R. (2d) 34

84 C.B.R. (5th) 57

2011 CarswellNS 564

Docket: Hfx. No. 342377

Registry: Halifax

Nova Scotia Supreme Court
Halifax, Nova Scotia

S.M. Hood J.

Heard: June 1, 2011.

Oral judgment: June 2, 2011.

Released: July 27, 2011.

(31 paras.)

Bankruptcy and insolvency law -- Creditors and claims -- Creditors -- Secured creditors -- Notice of intention to enforce security -- Motion by secured creditor to have stay lifted against certain assets dismissed -- \$61,000 debt owing to creditor was secured by Purchased Money Security interest and creditor wanted to exercise enforcement rights -- Receiver, Province, Debtor in Possession lender and other creditors opposed motion -- Receiver reported that best realization of Company's assets

would come from en bloc sale -- Creditor's claim it could obtain better realization than en bloc sale was merely speculative -- Creditor gave no evidence of material prejudice -- Lifting stay would make en bloc sale impossible and be unfair to other creditors.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Stays -- Motion by secured creditor to have stay lifted against certain assets dismissed -- \$61,000 debt owing to creditor was secured by Purchased Money Security interest and creditor wanted to exercise enforcement rights -- Receiver, Province, Debtor in Possession lender and other creditors opposed motion -- Receiver reported that best realization of Company's assets would come from en bloc sale -- Creditor's claim it could obtain better realization than en bloc sale was merely speculative -- Creditor gave no evidence of material prejudice -- Lifting stay would make en bloc sale impossible and be unfair to other creditors.

Statutes, Regulations and Rules Cited:

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

Personal Property Security Act, S.N.S. 1995-96,

Court Summary:

Companies Creditors Arrangement Act: lifting of stay.

Homag Canada Inc. seeks to have the stay ordered in the Receivership Order lifted against certain assets.

Issue: Lifting of CCAA stay.

Result: No evidence of material prejudice; stay not lifted.

[Note: This summary does not form part of the Court's judgment. Quotations must be from the judgment, not this summary.]

Counsel:

Carl Holm, Q.C., for Homag Canada Inc.

James MacNeil and Tracy Smith (AC), for Royal Bank of Canada.

Stephen Kingston, Q.C. and John Stringer, Q.C., for Green Hunt Wedlake.

Joseph Pettigrew, for the Province of Nova Scotia.

Tim Hill, for TCE Capital Corp.

DECISION

- 1 **S.M. HOOD J.** (orally):-- The motion is dismissed. My reasons are as follows.
- 2 Homag Canada Inc. ("Homag") seeks to have the stay ordered in the Receivership Order lifted against certain assets. Its debt is approximately \$611,000.00 secured by a Purchase Money Security Interest. In the Notice of Motion filed, Homag asks, among other things, for a Declaration that the applicant "has a first ranking Purchase Money Security Interest pursuant to the provisions of the *Personal Property Security Act*, S.N.S., 1995-96, c. 13" and lists specific goods. It also requests an order "Notwithstanding the provisions of a Receivership Order issued herein on the 18th day of April, 2011, giving leave to the applicant, Homag Canada Inc., to exercise its enforcement rights as a holder of a Purchase Money Security Interest in the Goods pursuant to the provisions of the PPSA without any interference by the Receiver or any other secured creditor of or person claiming an interest in the assets of Scanwood Canada Ltd."
- 3 Homag's request is opposed by the Receiver, the Province (the Minister of Economic and Rural Development and Tourism), the DIP lender, TCE Capital Corp., and the Royal Bank of Canada.
- 4 For the purposes of its submissions, Homag agreed that the burden is on it to show that it will suffer prejudice if the stay is not lifted. The other parties say that there must be evidence of material prejudice to Homag for Homag to meet its burden.
- 5 The Receivership Order of April 18, 2011 says in part in paragraph 9:
 9. All rights and remedies against Scanwood, the Receiver or affecting the Property, are hereby stayed and suspended except with the written consent of the Receiver or leave of this court. ...
- 6 The February 23, 2011 order providing for the DIP financing provides for priorities as follows in para. 28:
 28. The DIP charge, the Administration Charge and the Director's Charge have relative priority as follows:
 - a) Firstly, the Administration Charge
 - b) Secondly, the DIP Charge; and
 - c) Thirdly, the Director's Charge.
- 7 When the Receiver was the monitor pursuant to the CCAA, he filed a Schedule of Relative

Order of Priority based upon independent legal advice.

8 The affidavit of Christian Vollmers was filed in support of Homag's motion. Mr. Vollmers is the President of Homag Canada Inc. The critical parts of his affidavit, in my view, are paras. 22-24 where he says:

22. If Homag is not permitted to act on its security, its ability to maximize its recovery and minimize its costs will be prejudiced.
23. Homag as manufacturer and worldwide distributor of woodworking equipment of the nature and kind on which it has a first ranking PMSI security charge believes it is best able, through its networks, to maximize, whether in the short or longer term realization on the Goods against which it holds security.
24. Homag does not believe it will maximize its realization on the Goods if they are included in an en bloc package and Homag is required to accept a portion of the purchase price bid by an en bloc bidder, if in fact such a bidder, materializes.

9 The Receiver has filed his first Receiver's Report dated May 30. He also provided some additional information to the court when he took the witness stand as an officer of the court. One of the things he said was that the reason why he refused Homag's offer to leave the equipment but have Homag not subject to a costs allocation was because it would be unfair to the other creditors to have one creditor exempted from those costs.

10 In his report, the Receiver gives his opinion that the best realization of the assets of Scanwood would come from a sale of the assets en bloc. He says in para. 5.9:

5.9

The Receiver's experience is that an en bloc tender will typically result in greater realizations to the creditors than a breakup of the assets. The Receiver and the secured creditors (other than Homag) believe this would likely be the case with Scanwood's Fixed Assets, although only a market test will determine whether this is the case.

11 He continued:

6.9

The Receiver has received a verbal indication from one interested party that it intends to submit a tender to acquire the Fixed Assets en bloc with a view to operating the facility as a going concern.

6.10

The Receiver has received an email from another interested party indicating that it is interested in the complete factory.

6.11 These parties now are awaiting the information package and Conditions of Sale. Additionally, we have received requests for the information package from other parties including liquidation/auction firms. While some parties have expressed an interest in certain assets, others have been silent on the extent of their interest.

12 He put his proposal to try to sell the assets en bloc to a meeting to which all secured creditors were invited. All those who participated except Homag agreed. Those creditors also requested that there be an opportunity to bid on individual parcels. A tender package has been prepared and Conditions of Sale (Exhibits 2 and 3 to the Receiver's Report) and plans have been made to advertise as set out in Exhibit 4 to the report.

13 The report in paras. 6.6, 6.7 and 6.8 refer to these advertising plans. In addition, the Receiver proposes to ask for individual bids on various parcels including the subject assets. The tenders will close on July 22 and the sale of any assets is subject to court approval. At that court hearing, all creditors will have an opportunity to make submissions about the recommendation of the Receiver and about the costs allocation.

14 The Receiver has specifically addressed Mr. Vollmer's comments on the fifth Monitor's Report with respect to Scanwood's unsuccessful efforts to sell on a going-concern basis. He says in paras. 7.3 and 7.4:

7.3

The Receiver notes that the Monitor was not directly involved in any efforts by Mr. Thorn or others to market Scanwood's assets during the CCAA process, and that the Monitor's comments were based solely on information provided to it by representatives of Scanwood.

7.4

The Monitor's comments in the Fifth Report were made in the context of a possible sale by Scanwood during the course of the CCAA proceedings. This is distinct from the orderly administration of a sale process by a Court-Appointed Receiver for the benefit of the general body of creditors.

He then concludes in para. 7.5:

7.5

It is the opinion of the Receiver that any buyer interested in operating the Facility will require all of the Fixed Assets that Scanwood had been using until it discontinued operations on April 15, 2011.

15 He then goes on in para. 7.14 to refer to feedback he received from Scanwood's former Director of Operations, Mr. Robert Moore, in which Mr. Moore said in part:

7.14

... In my opinion, the removal of the 330 line or pieces of the line would seriously impede

the chance of receiving a viable en bloc offer. These items make the 330 line unique in its function and therefore more desirable. It would cost approximately 1.2m to replace, perhaps even more after installation costs.

16 The Receiver concludes in paras. 7.15 and 7.16:

7.15

It is the Receiver's opinion that selling the Fixed Assets without the New Machinery will seriously impair and impede the Receiver's ability to attract an en bloc buyer.

7.16

The Receiver accordingly opposes the Homag Motion and has declined to consent to Homag's request to remove the New Machinery, as it believes this would impair the Receiver's ability to maximize recovery for the general benefit of creditors

17 Homag says there is only a faint hope that the assets will be sold en bloc. Homag also says that the price attributed in such a bid to the subject assets may be less than Homag could achieve if it were to market them pursuant to its security. Homag also says that, if there are individual bids on parcels, the bid on the subject assets may be less than it could achieve if Homag sold them. The bid could also be lower than the amount attributed to those assets in an en bloc bid. In these cases, Homag says it would suffer prejudice, although the other secured creditors might benefit from an en bloc sale. Homag says it is unfair to it to require it to leave the equipment in place with the result that Homag will be required to contribute to the costs of the receivership and the other priority costs.

18 The powers of the Receiver are set out in para. 3 of the Receivership Order and include the following: "to receive, preserve, protect and maintain control of the Property or any part or parts thereof ...; to market any or all of the Property... ." The Receiver submits that the intent of the receivership was to prevent a "free for all" by the secured creditors and, instead, provide for an orderly realization of the assets of Scanwood so as to benefit the general body of creditors.

19 In *Ford Credit Canada Ltd. v. Welcome Ford Sales Limited*, 2010 ABQB 199, the Court said in para. 14:

14. In deciding whether the stays contained in the Receivership Order ought to be lifted, I note that the Courts in Canada have considered the totality of the circumstances and the relative prejudice to both sides. ...

20 In *Village Green Lifestyle Community Corp., Re*, 2007 CarswellOnt 654 (Ont. S.C.J.), the Court referred in para. 13 to s. 69.4 of the Bankruptcy and Insolvency Act, R.S., 1985, c. B-3 saying:

13. ... I also note that, although not strictly applicable, guidance may be drawn from the provisions of section 69.4 of the Bankruptcy and Insolvency Act wherein a person affected by the operation of a statutory stay may apply to

the court to request that the stay be inoperative. The court may make such a declaration if it is satisfied that the person is likely to be materially prejudiced by the stay or if the court is satisfied that it is equitable on other grounds. ...

21 Furthermore, in *Cumberland Trading Inc., Re*, 1994 CarswellOnt 255 (Ont. C.J.), Justice Farley referred to the type of evidence which would satisfy the test of material prejudice. He said in para. 11:

11. Is Skyview entitled to the benefit of s. 69.4 (a) of the BIA? I am of the view that the material prejudice referred to therein is an objective prejudice as opposed to a subjective one, i.e., it refers to the degree of prejudice suffered *vis-a-vis* the indebtedness and the attendant security and not to the extent that such prejudice may affect the creditor, qua person, organization or entity.

He continued in that para.:

... However, Skyview does not go the additional step of making any quantitative (or possibly qualitative) analysis as to the extent of such prejudice so that the court has an idea of the magnitude of materiality. ...

22 The Province and the Royal Bank support the position of the Receiver. TCE does as well. It says that, if the Order were granted, it would put Homag ahead of TCE, contrary to the DIP financing Order as well as exempting it from the priority given to the Administration and Director's charges. The allocation of those charges will be the subject of a subsequent hearing and it is unknown now what the proposal for allocation will be. The Receiver said there are so many possibilities that it is impossible to speculate at this time. In addition, there will be the Receiver's costs to be allocated in the future.

23 During his oral submissions, Mr. Holm made two alternate proposals. He proposed that the equipment be left so an en bloc sale could occur but with no cost allocation against Homag or that cash collateral be posted towards a future costs allocation. In my view, these issues are not encompassed in the Notice of Motion and are not properly before the Court.

24 The Affidavit of Mr. Vollmers does not contain evidence of material prejudice to Homag if the stay is not lifted. Mr. Vollmers says that, in his opinion, a greater realization can be achieved if Homag sells the subject assets. The Receiver has a different opinion.

25 There is nothing in Mr. Vollmers Affidavit to establish that it has offers or what efforts have been made to market the assets. As Mr. MacNeil put it, it is a bald assertion of prejudice.

26 The case law, in my view, makes it clear that mere supposition or speculation is not sufficient

to warrant lifting of the stay. The Receiver's duty is to act in the interests of the general body of creditors. This does not, in my view, necessarily mean that the majority rules. The Receiver must consider the interests of all creditors and then act for the benefit of the general body of creditors. The Court must weigh the benefits and disadvantages to each against the general good and consider the totality of the circumstances.

27 The scheme of the receivership is to allow for the orderly disposition of the assets of the company in receivership. To allow one secured creditor to have the stay lifted would be unfair to the remaining creditors. If the assets were removed, it would make it virtually impossible to have a sale en bloc. In my view, the situation is not dissimilar to that in the *Ford Credit, supra*, case where Justice Thomas, said in para. 28:

That evidence of prejudice must be weighed against the interest of all of the other parties and creditors who assert that an en bloc sale should be conducted to maximize recovery. Clearly, that opportunity would be gone if the inventory claimed by Ford Credit is removed from the en bloc sale.

28 The opinion of Mr. Vollmers with respect to maximizing the realization on the equipment is an opinion only and is not proof. When I consider the benefit of an en bloc sale against the removal of an integral part of the production capability, I cannot conclude that any possible prejudice to Homag outweighs the benefit to the general body of creditors of an en bloc sale.

29 Considering all the circumstances as set out in the Receiver's Report and the Affidavit of Mr. Vollmers, I cannot conclude that I should exercise my discretion to lift the stay.

30 On the issue of costs, TCE says it is important that Homag pay its costs of the unsuccessful motion. This is so because all TCE's expenses have priority according to the DIP financing Order. If TCE's costs are not paid, there will be an adverse effect upon the remaining creditors who must bear that cost. The Province and RBC also seek their costs as does the Receiver.

31 I conclude these parties are entitled to their costs. I can hear from counsel now or leave it to counsel to try to agree, failing which written submissions can be made to me within 30 days.

S.M. HOOD J.

cp/e/qlcct/qlvxw/qlhcs/qlced/qlhcs

TAB 5

Case Name:

Dumbrell v. Regional Group of Companies Inc.

Between

**J. Michael B. Dumbrell, Plaintiff/Respondent, and
The Regional Group of Companies Inc. and Steven
H. Gordon, Defendants/Appellants**

[2007] O.J. No. 298

2007 ONCA 59

85 O.R. (3d) 616

279 D.L.R. (4th) 201

220 O.A.C. 64

25 B.L.R. (4th) 171

55 C.C.E.L. (3d) 155

154 A.C.W.S. (3d) 1097

2007 CarswellOnt 407

Docket: C43885

Ontario Court of Appeal
Toronto, Ontario

D.H. Doherty, M.J. Moldaver and R.J. Sharpe JJ.A.

Heard: October 23, 2006.

Judgment: January 31, 2007.

(90 paras.)

Contracts -- Breach of contract -- Remedies -- Damages -- Appeal by the Regional Group of Companies and Gordon from a decision awarding the respondent 50 per cent of the profit earned

on a commercial real estate transaction -- Gordon appeal allowed -- Regional appeal allowed in part -- Trial judge found breach of contract only -- Contract was made between the respondent and Regional only -- No legal basis upon which Gordon could be found personally liable for a breach of the contract made between Dumbrell and Regional -- Regional was liable under the contract but only for commission on profits earned by Gordon's company and his wife and children -- Regional was not liable for commission on profits earned by the other investors brought into the project by Gordon.

Appeal by the Regional Group of Companies and Gordon from a decision awarding the respondent 50 per cent of the profit earned on a commercial real estate transaction. The respondent was employed by Regional for about one year beginning in 1998. The appellant, Gordon, was the president, CEO, and directing mind of Regional. The respondent left Regional's employment in November 1999. He sued Regional and Gordon claiming that he was owed 50 per cent of the profit earned on a commercial transaction referred to as the "Queen Street project". The trial judge found that the respondent was entitled, under the terms of his employment contract, to 50 per cent of the \$1 million profit earned on the Queen Street project. The appellants submitted that the trial judge erred in holding that the respondent was entitled to 50 per cent of the profit even though that profit was earned long after the termination of his employment contract. Second, the appellants submitted that even if the respondent was entitled to profits under the terms of the employment contract, the trial judge erred in awarding him 50 per cent of the profits earned by entities other than Regional or Gordon. Finally, Gordon submitted that the trial judge erred in holding him personally liable.

HELD: Gordon appeal allowed. Regional's appeal allowed in part. The Court held Regional liable under the contract but only for commission on profits earned by Gordon's company and his wife and children. Regional was not liable for commission on profits earned by the other investors brought into the project by Gordon. Dumbrell had alleged various causes of action against Regional and Gordon; the trial judge found a breach of contract, but rejected the other claims. Dumbrell's contract was with Regional and only Regional. There was no legal basis upon which Gordon could be found personally liable for a breach of the contract made between Dumbrell and Regional.

Appeal From:

On appeal from the order of Justice Monique Métivier of the Superior Court of Justice dated June 23, 2005 and amended on October 28, 2005.

Counsel:

Benjamin Zarnett and Alexa Abiscott for the appellants.

R.G. Slaght, Q.C., for the respondent.

The judgment of the Court was delivered by

D.H. DOHERTY J.A.:--

I

Overview

1 The respondent, J. Michael B. Dumbrell ("Dumbrell"), was employed by the appellant, the Regional Group of Companies Inc. ("Regional"), for about one year beginning in November 1998. The appellant, Steven H. Gordon ("Gordon"), was the president, CEO, and directing mind of Regional.

2 Dumbrell left Regional's employment in November 1999. He subsequently sued Regional and Gordon claiming he was owed fifty percent of the profit earned on a commercial real estate transaction referred to as the "Queen Street project". The trial judge found that Dumbrell was entitled, under the terms of his employment contract, to fifty percent of the \$1,000,000 profit earned on the Queen Street project.

3 Regional and Gordon appeal. Counsel raises three issues:

- * Did the trial judge err in holding that Dumbrell was entitled to fifty percent of the profit earned on the Queen Street project even though that profit was earned long after the termination of his employment contract?
- * Even if Dumbrell was entitled to the profits under the terms of the employment contract, did the trial judge err in awarding him fifty percent of the profit earned by entities other than Regional or Gordon?¹
- * Did the trial judge err in holding Gordon personally liable?

4 I would allow Regional's appeal in part. I would hold Regional liable under the contract but only for commission on profits earned by Gordon's company and his wife and children. I would not hold Regional liable for commission on profits earned by other investors brought into the project by Gordon.

5 I would allow Gordon's appeal. Dumbrell alleged various causes of action against Regional and Gordon at trial. The trial judge found a breach of contract, but rejected the other claims made by Dumbrell. Dumbrell's contract was with Regional and only Regional. He could have no reasonable expectation of recovery upon breach of the contract from any entity other than Regional. I see no legal basis upon which Gordon could be found personally liable for a breach of the contract made between Dumbrell and Regional. Nor can Gordon be liable for inducing Regional's breach of contract. Dumbrell did not plead that cause of action and did not adduce evidence capable of

establishing that Gordon induced a breach of contract.

II

The Facts

6 The trial lasted two weeks. The trial judge heard different versions of many events, some of which are not relevant to this appeal. I will summarize only those facts germane to the issues raised on appeal. My summary also reflects the trial judge's findings of fact and her credibility assessments. Neither are challenged on appeal. The trial judge preferred Dumbrell's version of events over Gordon's whose evidence she found to be unworthy of belief in many respects.

(a) Dumbrell's Employment with Regional

7 In the summer of 1998, Dumbrell was living in British Columbia. He had spent most of his working life in the real estate development business and was looking for an opportunity to get back into that business in Ottawa where he had previously worked for many years.

8 Regional operated a large, well established real estate business in the Ottawa area. Gordon had been Regional's CEO since 1984. He held all the voting shares. Regional provided a variety of services, including property management, property appraisals, land acquisitions, land development, and consulting.

9 Regional would sometimes put together groups of investors or syndicates to purchase and develop properties. The properties would be located by Regional and purchased in trust by a shell company for the investors. Regional would earn various fees for arranging the purchase, syndication, management, and development of the property. Investors in the syndicate often were officers or employees of Regional or relatives of Gordon. Gordon sometimes took an equity position in these developments through Regional or various other corporate entities he controlled.

10 Gordon had the final say in respect of all facets of Regional's operation. He decided which projects in which Regional would become involved, the fees Regional would charge, which corporate entities would be used, the roles those entities would play in a transaction, and which investors would be invited to join which syndicates.

11 Dumbrell met with an employee of Regional in the summer of 1998 to discuss the possibility of Dumbrell working with Regional. Dumbrell met with Gordon either at the same meeting or in a subsequent meeting shortly afterward. Dumbrell had considerable expertise in the commercial real estate field, an area in which Gordon wanted Regional to become more involved.

12 Gordon and Dumbrell agreed that Dumbrell would work for Regional and would have the title Vice-President, Commercial Development. Dumbrell understood that he would find commercial real estate projects, bring them to Regional and that Regional would then become involved in the

purchase and development of those properties. Dumbrell would be paid a commission on the profits earned from the projects that he brought to Regional.

13 On Gordon's instructions, Regional's lawyer drafted an employment contract between Dumbrell and Regional. Three drafts were prepared and reviewed by Dumbrell, Gordon, and their respective lawyers. There were several changes made in the various drafts of the contract. Almost all of these changes reflected Gordon's and not Dumbrell's preferences. Eventually, in November 1998, they agreed on the terms and both signed the agreement. Gordon signed as president of Regional.

14 Some of the contract terms are set out in full below. Generally speaking, the contract provided that Dumbrell would be compensated exclusively on a commission basis. His commission would be calculated as a percentage of the profit generated from projects that he brought to Regional.

(b) The Queen Street Property

15 Like most people familiar with the Ottawa real estate market, Dumbrell knew of the Queen Street property in November 1998. The property was owned by Canadian Real Estate Investment Trust ("CREIT"). It occupied a full downtown city block in Ottawa and in late 1998 was being used as a parking lot. It was zoned for use as office space. Dumbrell believed that the price of the property would increase dramatically in the immediate future as the need for office space increased in Ottawa. He also believed that the property was ripe for development in late 1998. The property was not on the market, but Dumbrell mentioned it to Gordon as a potential project for development by Regional. Gordon encouraged him to look into the possibility of acquiring the Queen Street property.

16 In early 1999, Dumbrell began to assemble a file on the Queen Street property. He received information from an employee of CREIT pertaining to possible development plans for the property and certain rent schedules. CREIT gave the information to Dumbrell on the undertaking that it would be kept confidential.

17 Shortly after Dumbrell acquired information from CREIT, he contacted an architect who had worked on development plans for that property some years earlier. Dumbrell and the architect spoke at length and the architect gave Dumbrell a great deal of background information pertaining to the property. Based on the information he had accumulated, Dumbrell concluded that the Queen Street property was under priced and presented an excellent opportunity for a profitable development as an office tower. Regional decided to proceed with efforts to acquire the Queen Street property.

18 In February 1999, on Gordon's instructions, Dumbrell prepared and submitted an offer to purchase the Queen Street property for \$7,745,000. That offer was in the name of Canadian Gateway, a consortium of five companies, including Regional, that had been assembled by Gordon. CREIT was not interested in selling the property on the terms of the offer.

19 Gordon instructed Dumbrell to submit a second offer in February 1999. This offer, also in the name of Canadian Gateway in the amount of \$9,000,000, was rejected by CREIT. In March 1999, a third offer, also at \$9,000,000, but providing for a shorter due diligence period, was submitted by Dumbrell on Gordon's instructions. This offer was also rejected.

20 The trial judge described, at para. 35, Dumbrell's role in these three offers as follows:

Mr. Dumbrell was the point man in these negotiations, drafting these offers at Mr. Gordon's direction and reporting back the reactions of Mr. Dansereau [the vendors' representative] who communicated only with Mr. Dumbrell.

21 Some time after the third offer was rejected, some of the partners in Canadian Gateway decided they were no longer interested in purchasing the Queen Street property. In July 1999, Dumbrell, on Gordon's direction, prepared a fourth offer. This offer showed Regional as the purchaser at a purchase price of \$9.3 million. It also provided for a \$300,000 commission payable to Regional on closing by CREIT. The corporate identity of the purchaser was irrelevant to Dumbrell. As far as he was concerned, he was working on a "Regional" project and it was up to Gordon to decide what corporate entities would be used to effect the transactions and subsequent development of the property.

22 CREIT knew that Regional would not be the ultimate purchaser and developer of its property. It, therefore, wanted to know the identity of Regional's investors. Negotiations broke down when Regional could not or would not identify its investors. The July offer was rejected in August 1999.

23 In August, Gordon told Dumbrell that he was no longer interested in the Queen Street property. Dumbrell had spent most of his time since he commenced employment with Regional in November 1998 working on the Queen Street property. His interest in the property continued even after Gordon told him that he was no longer interested in the property.

24 In October 1999, Gordon spoke with a government official who told him that there would be a significant increase in the demand for downtown office space in Ottawa in the immediate future. This information made the Queen Street property more attractive.

25 In late October 1999, Mr. Samuel Grosz, a friend of Gordon's and a real estate developer whose Ottawa properties were managed by Regional, visited Ottawa primarily to look at his properties. Gordon showed Mr. Grosz the Queen Street property and gave him all of the information that Dumbrell had assembled, including the confidential information that had been provided to him by CREIT in January 1999. Mr. Grosz soon became interested in the Queen Street property.

26 Shortly after Gordon alerted Mr. Grosz to the possibility of purchasing the Queen Street property, Mr. Grosz learned that Philip Reichman and his company, O. & Y. Properties Inc. ("O. & Y."), were about to make an offer to purchase the Queen Street property. Mr. Grosz and Mr. Reichman knew each other well and decided to proceed by way of a joint venture with each holding

a fifty percent interest in the Queen Street property if they were able to purchase it from CREIT.

27 By early November 1999, it was clear that the working relationship between Gordon and Dumbrell was not going to last. None of the projects that Dumbrell had worked on had produced any profit for Regional. Dumbrell had not received any remuneration in the year he had been at Regional. Gordon had refused Dumbrell's request for an advance on his commissions. Gordon was also systematically excluding Dumbrell from meetings and the decision-making process at Regional. On November 4, 1999, Dumbrell resigned effective November 22, 1999. He had decided to go into business for himself.

28 On November 19, 1999, after Dumbrell had tendered his resignation from Regional, but while he was still employed there, Mr. Grosz told Gordon that Mr. Grosz and O. & Y. were considering making an offer on the Queen Street property. Mr. Grosz asked Gordon to determine the status of the property. He also told Gordon that because Gordon had brought the property to his attention, he was prepared to allow Gordon to participate with he and O. & Y. in the joint venture. Mr. Grosz indicated that Gordon could purchase one-half of Mr. Grosz's fifty percent interest in the joint venture. This would mean that Gordon would have a twenty-five percent interest in the Queen Street property if the joint venture could acquire it.

29 Mr. Grosz and O. & Y. were respected and high profile participants in the Ottawa commercial real estate market. They did not need Regional's participation to complete the purchase. Gordon wanted to be involved in a joint venture with them. At Mr. Grosz's suggestion, Gordon prepared an offer to purchase the Queen Street property in the name of Regional. When he did so, he anticipated that Regional would purchase the property in trust for Mr. Grosz (twenty-five percent), Gordon or his corporate nominee (twenty-five percent), and O. & Y. (fifty percent).

30 The offer to purchase the Queen Street property prepared by Gordon in November 1999 was very similar to the offer prepared by Dumbrell in July 1999. Both offers provided for a purchase price of \$9.3 million with a commission of \$300,000 payable to Regional. The only significant difference between the two offers was that the July offer identified Dumbrell as the contact person at Regional and the November offer identified Gordon as the contact person.

31 The asking price for the Queen Street property had dropped by about \$1 million since July when Regional had submitted its offer at \$9.3 million. Unlike Dumbrell, Gordon was not familiar with the commercial real estate market in Ottawa and was unaware that the asking price for the property had gone down. Gordon did not speak to Dumbrell before preparing this offer. The offer prepared by Gordon was reviewed by his putative partners. Mr. Reichman of O. & Y. learned that the offer prepared by Gordon was about one million dollars more than the current asking price for the Queen Street property. He decided that he would take over any negotiations to purchase the Queen Street property. He submitted an offer in the name of O. & Y. at \$8,000,000. That offer did not provide for any commissions payable to Regional.

32 The offer submitted by O. & Y. was accepted by CREIT on or about November 25, 1999. The

transaction was completed on December 2, 1999 and closed on January 24, 2000. The Queen Street property was purchased in trust by a numbered company. The numbered company was owned fifty percent by O. & Y., and fifty percent by a numbered company owned equally by Mr. Grosz and a company controlled by Gordon. Gordon's company held its twenty-five percent interest in the property in trust for a syndicate assembled by Gordon. The syndicate consisted of Gordon, his wife and children, several cousins, and his lawyer. Gordon, his wife and his children owned 73.33 percent of the syndicate. In total, the syndicate advanced about \$1,200,000 toward the project. Some of the payments went through Regional.

33 Gordon acknowledged in cross-examination that this was not a typical syndication for which Regional would charge a fee for bringing the investors together. Regional did all of the work that had to be done for the syndicate on the project, but did not charge any fees until it submitted an invoice in late May 2002 after the interest in the property was sold. The trial judge was dubious as to the *bona fides* of that invoice.

34 Early in 2000, Dumbrell learned through a contact at O. & Y., that O. & Y. had agreed to purchase the Queen Street property. Dumbrell spoke with Gordon and asked him about his or Regional's involvement in that purchase. Gordon lied to Dumbrell. He told him that he was unaware of the proposed purchase of the Queen Street property by O. & Y. and that neither Regional nor Gordon had anything to do with the purchase. Dumbrell subsequently learned of Gordon's involvement and commenced this lawsuit in October 2000. At that time, the syndicate put together by Gordon still held a twenty-five percent interest in the Queen Street property.

35 Under the terms of the agreement between O. & Y., Mr. Grosz and Gordon's syndicate, O. & Y. had an option to purchase the interests held by the other partners. In May 2002, O. & Y. exercised its option and bought out Gordon's syndicate. The syndicate's twenty-five percent interest was sold at a profit of slightly more than \$1,000,000. Dumbrell amended his statement of claim and alleged that he was entitled to fifty percent of that profit.

III

Issue #1 - Did the trial judge err in holding that Dumbrell was entitled to fifty percent of the profit under the terms of the employment contract?

(a) The trial judge's analysis

36 The trial judge found that the potential value of the Queen Street property as a development was made known to Gordon and Regional through Dumbrell's efforts. She further held that it was through those efforts that Regional established contacts with CREIT, assembled a file containing a great deal of information on the property, and was in a position to provide that information to Mr. Grosz when he expressed an interest in the property in October 1999. Mr. Grosz in turn offered Regional/Gordon a twenty-five percent interest in the property because of the information he had received from Gordon.

37 On the trial judge's findings, Dumbrell was directly responsible for the syndicate, under Gordon's direction and control, obtaining a twenty-five percent interest in the Queen Street property. The syndicate ultimately made a one million dollar profit from its involvement in the transaction.

38 The trial judge rejected Gordon's evidence that he and Dumbrell had agreed that the Queen Street project would not be covered by the terms of Dumbrell's employment contract. She noted that it made no sense that Dumbrell would spend the vast majority of his time over several months trying to secure a property that was excluded from the terms of his employment contract. She then turned to the terms of that agreement.

39 The contract was between Regional and Dumbrell. It described Dumbrell as "an employee". The services to be provided to Regional by Dumbrell were described in Schedule "A" to the agreement:

The Corporation and the Employee agree that the Employee will be charged with the responsibility to provide the Corporation with Development, Acquisitions, Financing and Syndications and Consulting Services. Employee to research, investigate, report and recommend real property capital asset purchases suitable for development or syndication. Employee shall not bind the Corporation to any contract or legal commitment without the prior written authority of the Corporation. [Emphasis added.]

40 The contract was for a term of six months with an expiry date of May 1, 1999 and provided for renewal for an additional term of six months on mutual agreement of the parties. Although the contract was not formally renewed, the parties agreed that it was renewed and was in effect when Dumbrell resigned in November 1999.

41 The agreement provided for termination "at the end of the Term hereof", and further provided that neither party could commence an action under the contract more than one year after the expiration of the term of the contract. Dumbrell commenced this action in October 2000, less than one year after he quit. This initial claim eventually developed into one for commission on a profit realized more than two years after the contract was terminated.

42 The provision of the contract governing Dumbrell's compensation is found under the heading "Employee Earnings":

1. EMPLOYEE EARNINGS

The Corporation shall pay to the Employee the sum of [as per the commissions payable as set out in Schedule "B" attached]. The Corporation is responsible for making source deductions, including payments on account of Canada Pension

Plan and Employment Insurance. Employee shall be entitled to participate in Corporation's Health Benefit Package as exists as of the date hereof and as amended from time to time. [Emphasis in original.]

43 Schedule "B" referred to in the above clause reads as follows:

SCHEDULE "B"

DESCRIPTION OF REMUNERATION PACKAGE TO EMPLOYEE

1(1) The remuneration package for the Employee will be based on performance of the Employee payable as follows:²

- (a) For each project, profits to be split 50% to the Employee and 50% to the Corporation.

1(2) For purposes of this Agreement, "profit" shall include monies earned and actually received by the Corporation as completed Acquisition Fees, Development Fees and Syndication Fees earned as a result of the Employee's direct involvement for completed and closed projects in accordance with standard operating policy of the Corporation on the following business activities:

- (a) Development projects;
- (a) Syndication projects;
- (a) Special consulting and brokerage fees payable to the Division.

1(3) "Profit" shall be defined as the Gross Revenues received for a particular Project less expenses directly related to the negotiation, acquisition, development and sale of the project. All such expenses shall be deducted from Gross Revenues as would a prudent accountant applying generally accepted accounting principles. Expenses shall include, but not limited to:

- (a) Acquisition cost of the property;
- (a) Governmental and development fees;
- (a) Professional advice (accountants, engineers, lawyers, third party consultants);
- (a) Financing fees, brokers fees, interest and carrying charges;
- (a) Fees paid to investors for the project;

- (a) Costs and disbursements paid pursuant to any syndication agreement;
- (a) Realtor's fees; and
- (a) Construction costs and related site improvements. [Emphasis added.]

44 The trial judge did not find that the contract of employment provided for payment of commission to Dumbrell on profits earned after the termination of the employment agreement. Rather, she equated the relationship between Regional and Dumbrell with a principal-agent relationship. Relying on *Charles P. Rowen & Associates Inc. v. Ciba-Geigy Canada Inc.* (1994), 19 O.R. (3d) 205 (C.A.), the trial judge held that since Regional accepted the benefit of the work done by Dumbrell regarding the Queen Street property, Regional was obligated to pay for that work in the absence of an agreement to the contrary. Next, she examined the language of the employment contract and concluded at para. 131:

The fact that crystallization of the deal [the sale of the syndicate's interest in the Queen Street property], and the culminating events occurred after the employee left his employment, is not, in my view, relevant. ... The contract did not deal with this situation and therefore the entitlement is as set out in *Charles P. Rowen & Associates Inc. et al. v. Ciba-Geigy Canada Inc., supra.* [Emphasis added.]

45 I agree with the trial judge's conclusion that Dumbrell was entitled to compensation for profits earned after the termination of the agreement, but my analysis is somewhat different than hers. I do not regard *Charles P. Rowen, supra*, as controlling. In *Charles P. Rowen*, the court was faced with a true principal-agent relationship, the terms of which had not been reduced to writing by the parties. The reasoning of the majority blends notions of *quantum meruit* and implied terms of a contract to resolve a problem that the parties had not addressed when establishing their relationship.

46 In the present case, the parties did consider the nature of their working relationship. After considerable negotiation and legal assistance, they entered into an employment contract which described Dumbrell as an "employee" and addressed the nature of his compensation. In my view, the question of whether Dumbrell was entitled to commission on the profits earned on the Queen Street project depends on an interpretation of the language used in the contract. If he is entitled to commission on the profits from the Queen Street property, that entitlement must be found in the language of the agreement he entered into with Regional.

(b) Contractual interpretation

47 Judges spend most of their working time deciphering the meaning of various kinds of legal documents, including written contracts: see e.g. Lord Justice Johan Steyn, "The Intractable Problem of the Interpretation of Legal Texts" (2003) 25 Sydney L. Rev. 5; Sir Christopher Staughton, "How Do the Courts Interpret Commercial Contracts?" (1998) 58 Cambridge L.J. 303. Most Canadian judges faced with interpreting a written commercial contract, cite either or both of *Consolidated-Bathurst Export Limited v. Mutual Boiler and Machinery Insurance Company*, [1980] 1 S.C.R. 888 at 901, and *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 at paras. 52-56.

Professor Ruth Sullivan has observed that these two authorities can be read as advancing different notions of contractual intent. She observes that *Consolidated-Bathurst, supra*, arguably looks to the subjective intention of the contracting parties at the time the contract was made, while *Eli Lilly, supra*, looks to the intent as discerned from the words used in the written contract. Professor Sullivan refers to the former approach as the intentionalist approach, and the latter as the textualist approach: see Ruth Sullivan, "Contract Interpretation in Practice and Theory" (2000) 13 Sup. Ct. L. Rev. (2d) 369 at 375-86, 392.

48 In *Eli Lilly, supra*, at paras. 52-54, Iacobucci J. refers to *Consolidated-Bathurst, supra*, with approval. He clarifies, at para. 54, what is meant in *Consolidated-Bathurst* by "the true intent of the parties" for contractual purposes:

The trial judge appeared to take *Consolidated-Bathurst* to stand for the proposition that the ultimate goal of contractual interpretation should be to ascertain the true intent of the parties at the time of entry into the contract, and that, in undertaking this inquiry, it is open to the trier of fact to admit extrinsic evidence as to the subjective intentions of the parties at that time. In my view, this approach is not quite accurate. The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time.

49 On the approach taken in *Eli Lilly, supra*, the focus is on the meaning of the words used in the contract. Evidence of the subjective intention of the parties has "no independent place" in the interpretative process: *Eli Lilly*, at para. 54; see also Staughton, "How Do the Courts Interpret Commercial Contracts?", *supra*, at 304-306; *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, [1998] 1 All. E.R. 98 at 114-15 (H.L.).

50 In my view, when interpreting written contracts, at least in the context of commercial relationships, it is not helpful to frame the analysis in terms of the subjective intention of the parties at the time the contract was drawn. This is so for at least two reasons. First, emphasis on subjective intention denudes the contractual arrangement of the certainty that reducing an arrangement to writing was intended to achieve. This is particularly important where, as is often the case, strangers to the contract must rely on its terms. They have no way of discerning the actual intention of the parties, but must rely on the intent expressed in the written words. Second, many contractual disputes involve issues on which there is no common subjective intention between the parties. Quite simply, the answer to what the parties intended at the time they entered into the contract will often be that they never gave it a moment's thought until it became a problem: see Kim Lewison, *The Interpretation of Contracts*, 3d ed. (London: Sweet & Maxwell, 2004) at 18-31.

51 *Eli Lilly, supra*, instructs that the words of the contract drawn between the parties must be the focal point of the interpretative exercise. The inquiry must be into the meaning of the words and not

the subjective intentions of the parties. In this sense, my approach is textualist. However, the meaning of the written agreement must be distinguished from the dictionary and syntactical meaning of the words used in the agreement. Lord Hoffmann observed in *Investors Compensation Scheme Ltd., supra*, at 115:

The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean.

52 No doubt, the dictionary and grammatical meaning of the words (sometimes called the "plain meaning") used by the parties will be important and often decisive in determining the meaning of the document. However, the former cannot be equated with the latter. The meaning of a document is derived not just from the words used, but from the context or the circumstances in which the words were used. Professor John Swan puts it well in *Canadian Contract Law* (Markham, Ont.: Butterworths, 2006) at 493:

There are a number of inherent features of language that need to be noted. Few, if any words, can be understood apart from their context and no contractual language can be understood without some knowledge of its context and the purpose of the contract. Words, taken individually, have an inherent vagueness that will often require courts to determine their meaning by looking at their context and the expectations that the parties may have had.

53 The text of the written agreement must be read as a whole and in the context of the circumstances as they existed when the agreement was created. The circumstances include facts that were known or reasonably capable of being known by the parties when they entered into the written agreement: see *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12 at 23-24; *H.W. Liebig & Co. v. Leading Investments Ltd.*, [1986] 1 S.C.R. 70 at 80-81, La Forest J.; *Prenn v. Simmonds*, [1971] 1 W.L.R. 1381 at 1383-84 (H.L.); Staughton, "How Do the Courts Interpret Commercial Contracts?", *supra*, at 307-308.

54 A consideration of the context in which the written agreement was made is an integral part of the interpretative process and is not something that is resorted to only where the words viewed in isolation suggest some ambiguity. To find ambiguity, one must come to certain conclusions as to the meaning of the words used. A conclusion as to the meaning of words used in a written contract can only be properly reached if the contract is considered in the context in which it was made: see McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at 710-11.

55 There is some controversy as to how expansively context should be examined for the purposes of contractual interpretation: see Geoff R. Hall, "A Curious Incident in the Law of Contract: The Impact of 22 Words from the House of Lords" (2004) 40 Can. Bus. L.J. 20. Insofar as written

agreements are concerned, the context, or as it is sometimes called the "factual matrix", clearly extends to the genesis of the agreement, its purpose, and the commercial context in which the agreement was made: *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.* (1998), 114 O.A.C. 357 at 363 (C.A.).

56 I would adopt the description of the interpretative process provided by Lord Justice Steyn, "The Intractable Problem of the Interpretation of Legal Texts", *supra*, at 8:

In sharp contrast with civil legal systems the common law adopts a largely objective theory to the interpretation of contracts. The purpose of the interpretation of a contract is not to discover how the parties understood the language of the text, which they adopted. The aim is to determine the meaning of the contract against its objective contextual scene. By and large the objective approach to the question of construction serves the needs of commerce.³
[Emphasis added.]

(c) The interpretation of this contract

57 The context in which the written words used in this agreement must be understood begins with the parties who negotiated the agreement. Both were sophisticated, experienced, successful businessmen who could reasonably be expected to negotiate a commercially sensible and workable agreement. When they agreed to work together, it was anticipated that Dumbrell, whose expertise lay in finding commercial real estate projects, would investigate and, where appropriate, bring potentially profitable large-scale commercial developments to Regional. Regional had the ability to finance and develop these projects. It did so in various ways using whatever corporate vehicle Gordon deemed appropriate.

58 The agreement reached by the parties contemplated a relatively short working relationship of between six months and one year. It also contemplated that Dumbrell would receive nothing unless he brought projects to Regional which earned profits for Regional. If he did that, his compensation would be significant (fifty percent of the profits). In tying Dumbrell's compensation to profits as opposed to, for example, fees earned by Regional, the parties anticipated that Dumbrell's entitlement to commissions would not be known until a project was complete and Regional's net profit on the project could be determined.

59 Given Regional's business history, it could reasonably be anticipated when the employment agreement was made that when projects were brought to it by Dumbrell, Regional would be involved in various ways and that its involvement could yield profits through a variety of methods at different stages of Regional's involvement in any given project. On the findings made by the trial judge, Dumbrell was not taking employment with a company whose sole source of profits came through various forms of fees, but was taking employment with a company whose profits could come through various kinds of involvement in different projects.

60 I turn from the context in which the employment agreement was made to the words used in the agreement and in particular the words used in Schedule "B". Schedule "B" begins by stating that Dumbrell's remuneration will be based on his performance. He must produce to be paid. Schedule "B" then describes his remuneration as fifty percent of "profits" for each project. "Profits" are described in paras. 1(2) and 1(3).

61 Paragraph 1(2) makes it clear that profits must be earned as a result of Dumbrell's direct involvement in the project. In addition, the project must be "completed and closed ... in accordance with standard operating policy of the Corporation". The reference to "standard operating policy" is of no assistance as it is common ground that there was no such thing.

62 Paragraph 1(2) sets out certain kinds of fees that are included in the meaning of profits, such as acquisition fees, development fees, and syndication fees. The fees described in para. 1(2) are not an exhaustive list of the kinds of payments to Regional that can constitute profits. Lastly, para. 1(2) refers to business activities which constitute projects for the purpose of the calculation of profits, including "Syndication projects".

63 Paragraph 1(3) sets out a formula by which profits are to be determined by deducting certain expenses from "Gross Revenues". The reference in para. 1(3) to "Gross Revenues" and the types of expenses identified in that paragraph indicates two things. First, the question of whether Regional earned any profit and, if so, the amount of that profit may well not be determined until the end of Regional's involvement in a particular project. Second, Regional's involvement in projects could take forms other than a fee for service basis. The reference to "Gross Revenues" and many of the expenses described in para. 1(3) are consistent with Regional taking equity positions in a project and realizing a profit upon a sale of that equity position.

64 On my reading of Schedule "B", Dumbrell was entitled to a fifty percent commission on profits if:

- * he was directly responsible for the project in that it was secured for Regional through his efforts;
- * Regional had earned and actually received monies on the project;
- * the project was "completed and closed", that is Regional's involvement was completed; and
- * using the method described in para. 1(3), Regional had earned a profit.

65 Nothing in the language of Schedule "B" limits Dumbrell's potential remuneration to projects that are completed and closed as of the date of termination of his employment contract. The context in which the contract was made contraindicates imposing any such limitation on profits. Reasonable people in the position of Dumbrell and Gordon would have appreciated that Regional's involvement in the kind of complex large scale commercial projects that it was anticipated Dumbrell would bring to it may well not be completed within the relatively short time span contemplated by the employment contract. Similarly, the method used for calculating Dumbrell's compensation by

reference to profit as calculated in para. 1(3) contemplates that the projects could well extend over a considerable period of time with the ultimate determination of whether any profit was made and, therefore, any remuneration owed to Dumbrell being based on events that occurred well after the relatively brief period of employment contemplated by the agreement. On my reading of Schedule "B", Dumbrell was entitled to fifty percent of Regional's profits even if the profits were made after the employment contract was terminated.

66 The appellants rely on the termination provision:

1.1 This contract shall terminate:

1.1.1

at the end of the Term hereof.

1.1 Upon termination or other expiration of this contract the Employee shall forthwith return to the Corporation all papers, materials, equipment and other properties of the Corporation held for the purpose of execution of the contract. In addition, each party will assist the other party in the orderly termination of the contract and the transfer of all aspects hereof, tangible and intangible, as may be necessary for the orderly, non-disrupted business continuation of the Corporation.

1.1 Neither party may commence an action under this contract more than one (1) year after the expiration of its term, or, in the event of default, more than one (1) year after the occurrence of said default. [Emphasis added.]

67 The termination provision does not assist in defining profits for the purpose of calculating Dumbrell's compensation. The first part of the termination clause speaks to the point at which the contractual relationship ends. It does not purport to terminate obligations that existed under the contract when the contract came to an end. If, as I would hold, profits as defined in Schedule "B" include profits earned and calculated after the termination of the contract, the obligation to pay those profits, when and if they arise, is an obligation that exists under the contract as of the date of termination albeit in an inchoate form.

68 The last paragraph in the termination clause is also a relevant consideration. That paragraph answers one of the arguments relied on by the appellants. They submitted that a definition of profits that included profits made after the termination date of the contract would create indefinite and potentially open-ended liability by Regional to Dumbrell for profits earned on projects many years down the road. The limitation provision in the termination clause excludes any claim by Dumbrell that is not advanced within one year of the termination of the contract. This provision effectively

places limits on Regional's potential liability to Dumbrell. As it happens, the limitation clause does not assist Regional here because Dumbrell had commenced his action within the one year period.

69 In summary, like the trial judge, I conclude that Dumbrell was entitled to fifty percent of the profits earned by Regional on the Queen Street project. I reach that conclusion through a reading of Schedule "B" of the agreement in the context of the circumstances in which the agreement was made. I do not read the termination clause as modifying the meaning of profits in the agreement.

IV

Issue #2 - Was Dumbrell entitled to fifty percent of the profits earned by entities other than Regional/Gordon?

70 As outlined above, through Dumbrell's efforts, and at Mr. Grosz's invitation, Regional/Gordon acquired a twenty-five percent interest in the Queen Street property early in 2000.

71 At Gordon's direction, the twenty-five percent interest in the Queen Street property was held by one of his companies in trust for a syndicate of investors. Another Gordon company (LPH), his wife and his children held 73.33 percent of the syndicate. Several of Gordon's cousins and his lawyer, who practised with one of the cousins, held the other 26.67 percent of the syndicate.

72 The accounting breakdown on the syndicate's investment in the Queen Street property, prepared at Gordon's request, but accepted by Dumbrell at trial, showed that the syndicate advanced about \$1,200,000 on the Queen Street project and received about \$2,200,000 on that project resulting in a profit of just over \$1,000,000. The accounting records indicate that the funds were distributed in accordance with the percentage of ownership in the syndicate. Gordon and his immediate family received about \$732,000 of the \$1,000,000 profit earned by the syndicate.

73 In oral argument, Mr. Zarnett acknowledged that if Dumbrell was entitled to compensation on the Queen Street project under the terms of the employment contract, no distinction could be drawn between profits earned directly by Regional and profits earned by other corporate entities used by Gordon to generate the profit. I would extend the same reasoning to cover profits earned by Gordon's wife and children. On this approach, Dumbrell was entitled to fifty percent of the profits earned by LPH, Gordon's wife and Gordon's children.

74 Counsel submits, however, that profits earned by other investors in the syndicate cannot be treated as the same as Regional's profits. The accounting records demonstrate that profits were paid out to the other investors when the syndicate sold its twenty-five percent interest in the Queen Street property to O. & Y.

75 In her reasons, the trial judge accepted, at para. 158, that there were "third parties investing and risking money". I take this to mean that the trial judge accepted that Gordon's cousins and his lawyer were *bona fides* investors who helped finance the twenty-five percent interest in the Queen

Street property. She went on to hold, however, that Gordon's resort to other investors could not affect the compensation owed to Dumbrell. She said, at paras. 159-60:

In calculating damages, there is no evidentiary foundation of any kind on which to assess legitimate costs which might have been set off against this profit.

Without a scintilla of such evidence, the court is unable to do other than order damages of \$500,000, pursuant to the first part of the paragraph in the employment contract dealing with employee remuneration.

76 I cannot agree with this analysis. To the extent that the syndicate was owned by third parties who genuinely invested funds in the project, I do not see how profits payable to those investors can become the profits of Regional for the purposes of calculating Dumbrell's compensation. The accounting records do provide evidence that 26.67 percent of the profit realized on the sale of the twenty-five percent interest in the Queen Street project was paid to third party investors and not to Regional, Gordon, his companies, or his immediate family. The calculation of Dumbrell's compensation on the Queen Street project should not have extended to a percentage of the profits earned by third party investors. If my arithmetic is correct, Dumbrell should have received fifty percent of the profits realized by a 73.33 percent interest in the syndicate.

V

Issue #3 - Did the trial judge err in holding Gordon personally liable for breach of contract?

77 In his statement of claim, Dumbrell alleged several causes of action against Regional and Gordon. At trial, he succeeded only on the breach of contract claim. In the statement of claim, Dumbrell alleged a breach of contract against only Regional. In her initial reasons for judgment, the trial judge found both Regional and Gordon liable for breaching the contract. She did not separately address Gordon's personal liability for breaching a contract to which he did not appear to be a party. Gordon's liability for breach of contract as distinct from Regional's liability was not addressed by counsel in closing argument.

78 After the trial judge released her initial reasons, and at the request of counsel for Regional and Gordon, she heard further argument on Gordon's personal liability for breach of contract. The trial judge gave additional reasons in which she confirmed her initial finding that Regional and Gordon were both liable for the breach of contract.

79 I have difficulty understanding the basis upon which the trial judge found Gordon liable for breach of contract. She spoke of "piercing the corporate veil" and described Regional as Gordon's agent for the purposes of the contract. However, she found both Regional and Gordon liable for breaching the contract. I agree with Mr. Zarnett's submission that if Regional acted as Gordon's agent for the purposes of the contract, only Gordon could be liable for breaching that contract. The

trial judge's finding that Regional was liable along with Gordon for breaching the contract was also inconsistent with the trial judge's conclusion, at para. 187, that she should "pierce the corporate veil" and hold Gordon liable. Either Regional had a separate legal persona for the purposes of the contract or it did not.

80 The concepts of piercing the corporate veil and holding that a corporation acts as an agent for the individual who controls that corporation achieve the same result in that they both impose personal liability for what appear to be corporate actions. They achieve that result, however, in different ways. The agency relationship assumes that the corporation and the controlling mind are distinct, but that on the relevant facts the former acted as agent for the latter. Piercing the corporate veil ignores the legal persona of the corporation: Bruce L. Welling, *Corporate Law in Canada: The Governing Principles*, 2d ed. (Markham, Ont.: Butterworths, 1991) at 122-36.

81 There is no basis in this record for describing Regional as Gordon's agent for the purpose of entering into the employment contract with Dumbrell. Dumbrell did not plead that Regional acted as Gordon's agent. The terms of the contract offer no suggestion that Regional was acting in an agency capacity. Finally, Dumbrell's evidence does not suggest that he regarded Regional as Gordon's agent for the purposes of the contract.

82 Nor is any case made out for ignoring Regional's separate legal persona. There can be no doubt that Dumbrell contracted with Regional and only Regional in November 1998. The employment contract clearly describes Dumbrell as Regional's employee. Dumbrell's pleadings and his evidence do not suggest otherwise. Gordon's total ownership and control of Regional and the fact that he made all decisions on behalf of Regional in respect of its dealings with Dumbrell does not detract from Regional's standing as a separate and distinct legal entity. Corporations must necessarily act at the instance and under the direction of those fixed with the responsibility and authority to direct the affairs of the corporation: see *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.* (1995), 26 O.R. (3d) 481 at 492 (C.A.).

83 The separate identity of a corporation can be ignored where the corporation is inserted into a transaction for a fraudulent or dishonest purpose. Corporations used in that way often have no assets, no corporate history, and no reason for existence other than facilitating a particular transaction. None of those indicia apply to Regional. Regional cannot be described as a shell or corporation of convenience put in place by Gordon for the purpose of entering into the contract with Dumbrell. As of November 1998, Regional had been a thriving well established corporate entity for many years. It participated in many different real estate transactions and employed many people. Dumbrell chose to become one of those employees. There is no suggestion in the evidence that the creation of the employer/employee relationship between Regional and Dumbrell was tainted by fraud or dishonesty on the part of Gordon. There is simply nothing to suggest that Gordon set out to deceive or trick Dumbrell when he and Dumbrell negotiated the employment contract which created the contractual relationship between Dumbrell and Regional, and not between Dumbrell and Gordon. Dumbrell knew full well he was contracting with Regional. He could only reasonably

expect to look to Regional for compensation in the event of a breach of the terms of the contract.

84 The trial judge's reasons also suggest a second basis for holding Gordon liable. She referred to authorities that hold a directing mind of a company liable for inducing a breach of contract by that company: see e.g. *Said v. Butt*, [1920] 3 K.B. 497 at 504-506 (H.L.); *Truckers Garage Inc. v. Krell* (1993), 68 O.A.C. 106 at 114-15 (C.A.); *Kepic v. Tecumseh Road Builders* (1987), 23 O.A.C. 72 at 74 (C.A.).

85 Cases where an individual has been held liable for inducing a corporation's breach of contract have nothing to do with piercing the corporate veil or the concept of agency. These cases acknowledge the separate legal identity of the corporation and its directing mind. They hold the directing mind liable for the discrete tort of inducing the breach of contract and not for breach of contract itself. The measure of damages for inducing the breach of contract may or may not be the same as would apply to the breach of contract.

86 Gordon cannot be liable for inducing a breach of the contract between Regional and Dumbrell. That cause of action was not pleaded. Nor do I understand counsel at trial or on appeal to have argued that Gordon's liability could be based on the separate tort of inducing a breach of contract. An allegation of inducing a breach of contract is very different from a claim that a person is liable for breaching the contract. In the absence of any pleading which expressly or impliedly alleges the tort of inducing a breach of contract, I do not think the principles underlying that tort can be relied on to render Gordon liable for the breached contract.

87 The difficulties inherent in transforming an allegation of a breach of contract into a finding of inducing a breach of that contract are apparent in the trial judge's reasons. To establish the tort of inducing a breach of contract by the directing mind of the contracting party, it must be shown, among other things, that the conduct of the directing mind was not *bona fides* in the best interest of the corporation. In the addendum to her reasons, the trial judge indicates that Gordon's conduct caused Regional to lose certain fees on the Queen Street property. She states, at para. 173:

His [Gordon's] secretive and misleading conduct eventually caused a serious loss to his company when the company became unable to make the offer which would have resulted in another \$300,000.-\$400,000. fee.

88 I cannot agree that anything Gordon did caused Regional to act to its detriment in respect of the Queen Street property. The trial judge found that as a result of Dumbrell's efforts, Regional/Gordon acquired a twenty-five percent interest in the Queen Street property. That is the only interest that was available to Gordon in the joint venture that ultimately purchased the property. As the trial judge found, the calculation of Regional's profits and, therefore, Dumbrell's commission, did not depend on what part of the profits Regional described as fees. Had Gordon chosen to describe some of the profits generated for the syndicate from the sale of its interests as fees payable to Regional, it would not have increased the overall profit earned by the syndicate and would have had no effect on the quantification of Dumbrell's compensation. There is no evidentiary

basis to hold that Gordon's conduct in respect of the Queen Street property cost Regional anything. On my reading of Gordon's cross-examination, it was not suggested to him that his conduct had somehow deprived Regional of profits that it would otherwise have earned. A finding that Gordon acted against Regional's best interests in connection with the profit earned on the Queen Street property has no foundation in either the pleadings or the evidence.

VI

Conclusion

89 I would allow Gordon's appeal, set aside the trial judge's finding regarding Gordon's personal liability, and dismiss the action against Gordon. I would allow Regional's appeal in part and vary the trial order to provide that Dumbrell is entitled to fifty percent of the profit from the Queen Street project earned by LPH, Gordon's wife and Gordon's two daughters.

90 Counsel should make written submissions (no more than ten pages each) as to costs both at the trial and on appeal.

D.H. DOHERTY J.A.

M.J. MOLDAVER J.A.:-- I agree.

R.J. SHARPE J.A.:-- I agree.

cp/e/qlgxc/qlslc/qlrme

1 In their factum, the appellants argued that under the terms of the employment contract, Dumbrell was entitled only to fifty percent of Regional's profits and that none of the profit from the Queen Street project was earned by Regional. In oral argument, counsel accepted that the terms of the employment contract would reach profits earned by Regional or other entities controlled by Gordon.

2 In the contract, all of the paragraphs in Schedule "B" are numbered "1". For ease of reference, I have added the numbers in parentheses.

3 Lord Steyn has taken the same approach in his judgments: see *Pagnan SpA v. Tradax Ocean Transportation SA*, [1987] 1 All E.R. 81 (Q.B.), Steyn J., aff'd [1987] 3 All E.R. 565 (C.A.). See also *Toronto-Dominion Bank v. Leigh Instruments Ltd.* (1999), 178 D.L.R. (4th) 634 at 639 (Ont. C.A.); Lewison, *The Interpretation of Contracts*, *supra*, at 5, 22-24; *Mount Joy Farms Limited v. Kiwi South Island Co-operative Dairies Ltd.*, [2001] NZCA 372 at para. 38.

TAB 6

Case Name:

**Eli Lilly & Co. v. Novopharm Ltd.; Eli Lilly & Co.
v. Apotex Inc.**

Novopharm Limited, appellant;

v.

**Eli Lilly and Company and Eli Lilly Canada Inc., respondents,
and**

The Minister of National Health and Welfare, respondent.

And between

Apotex Inc., appellant;

v.

**Eli Lilly and Company and Eli Lilly Canada Inc., respondents,
and**

The Minister of National Health and Welfare, respondent.

[1998] S.C.J. No. 59

[1998] A.C.S. no 59

[1998] 2 S.C.R. 129

[1998] 2 R.C.S. 129

161 D.L.R. (4th) 1

227 N.R. 201

J.E. 98-1562

80 C.P.R. (3d) 321

1998 CanLII 791

80 A.C.W.S. (3d) 871

1998 CarswellNat 1061

1998 CarswellNat 1062

File Nos.: 25402, 25348.

Supreme Court of Canada

1998: January 21 / 1998: July 9.

**Present: L'Heureux-Dubé, Gonthier, Cory, McLachlin,
Iacobucci, Major and Bastarache JJ.**

ON APPEAL FROM THE FEDERAL COURT OF APPEAL

Patents -- Infringement -- Sublicensing -- Licensee agreeing to supply patented medicine to unlicensed third party -- Licence expressly prohibiting sublicensing -- Breach of licence terms grounds for termination of licence -- Whether supply agreement between licence holder and third party a sublicense or having legal effect of creating a sublicense.

Agency -- Supply agreement -- Licensed party to obtain patented bulk medicine for unlicensed party -- Whether licensed party acting as agent of unlicensed party in carrying out contractual obligations.

Patents -- Notice of allegation (NOA) -- Proper date for assessing NOA.

Jurisdiction -- Declaratory relief -- Whether declaration should issue as to patent holder's failure to show notice of allegation unjustified or that it was entitled to terminate compulsory licence -- Whether appropriate to declare that supply agreement not constituting sublicense or transfer of compulsory licence.

Patents -- Medicine -- Reformulation of patented product -- Bulk medicine reformulated into final-dosage form -- Whether reformulation of patented product amounting to infringement of patent.

Eli Lilly and Co. ("Eli Lilly") owned the Canadian patents for nizatidine and for its manufacturing process. It alone held a notice of compliance (NOC) to produce and market certain final-dosage forms of the medicine. Novopharm held a compulsory licence, obtained under the Patent Act (the "Act") as it existed prior to February, 1993, which permitted it to use the patented process to make nizatidine for the preparation or production of medicine and to import and/or sell medicine made by the process. The licence stipulated that it was non-transferable, prohibited Novopharm from granting any sublicense, and provided Eli Lilly with the option to terminate the licence upon any breach of its terms.

In anticipation of the 1993 amendments to the Act, which radically altered the procedures for the

issuance of NOCs and eliminated the compulsory licensing regime entirely, Novopharm and Apotex entered a "supply agreement" in November, 1992. The agreement provided that, where one party held a licence for a patented medicine for which the other did not, the licensed party would obtain, at the request and direction of the unlicensed party, specified quantities of that medicine, and supply it to the unlicensed party at cost plus a four per cent royalty. In April, 1993, Apotex commenced efforts to obtain a NOC for certain final-dosage forms of nizatidine, and issued a notice of allegation ("NOA") alleging that no claim for nizatidine or for its use would be infringed. In support of this allegation, Apotex relied upon the licence issued to Novopharm and the "mutual understanding" with Novopharm. On the same date, Apotex notified Novopharm of its intention to request Novopharm to supply it with nizatidine. However, Apotex also indicated that, because it did not yet have a NOC to permit it to market nizatidine in Canada, it could not provide Novopharm with any specifics as to its requirements, but that it would advise in due course as to the required quantity and the manufacturer from whom the nizatidine should be purchased.

Eli Lilly and Eli Lilly Canada Inc. ("Eli Lilly Canada") brought an application (Eli Lilly and Co. v. Apotex Inc., S.C.C., No. 25348 (Apotex #1)), under s. 6(1) of the Patented Medicines (Notice of Compliance) Regulations (the "Regulations"), for an order prohibiting the Minister from issuing a NOC to Apotex at all or, alternatively, until after December 31, 1997, ten years after the issuance of the NOC to Eli Lilly Canada, which, under the amended Patent Act, would be the first date on which Apotex, without a NOC, would be entitled to import nizatidine for consumption in Canada. On July 15, 1993, Eli Lilly purported to exercise its option to terminate Novopharm's compulsory licence, alleging that Novopharm had breached the terms of the licence by granting a sublicense to Apotex. Novopharm denied this allegation, stating that the commercial agreement into which it had entered with Apotex did not constitute a sublicense or any transfer of rights under the licence. The Federal Court -- Trial Division found that the supply agreement between Novopharm and Apotex did not constitute a sublicense but nonetheless granted the prohibition order on the grounds that, because the reformulation of nizatidine for consumption in Canada would infringe Eli Lilly's patent, the NOA was not justified. The Federal Court of Appeal dismissed Apotex's appeal, but on the grounds that the agreement did constitute a sublicense.

In July 1993, Novopharm issued a NOA in support of its own application for a NOC in relation to nizatidine and relied on its own compulsory licence as the basis for the non-infringement of the patents. Eli Lilly and Eli Lilly Canada brought an application before the Federal Court--Trial Division (Eli Lilly and Co. v. Novopharm Ltd., S.C.C., No. 25402 (the Novopharm proceeding)), requesting a prohibition order to enjoin the Minister from issuing the requested NOC to Novopharm on the grounds that Novopharm's licence had been terminated and that Novopharm could not, therefore, obtain the bulk medicine in a non-infringing way. The application was dismissed at trial but this decision was reversed by the Federal Court of Appeal.

The issue common to both appeals is whether the agreement between Apotex and Novopharm constituted a sublicense, such as to justify Eli Lilly's purported termination of Novopharm's compulsory licence. If it did, then the NOAs issued by both Novopharm and Apotex were not

justified and the requested prohibition order should issue. Each appeal also raises other discrete issues. Specifically, in the Novopharm proceeding, this Court is asked to determine: (1) whether the Federal Court of Appeal erred in applying its decision in Apotex #1 to the Novopharm appeal, whether as *res judicata* or otherwise; (2) whether Novopharm's NOA was not justified, regardless of whether its compulsory licence was terminated by breach, because the licence did not permit the activities which the NOA proposed; and (3) whether the Federal Court had the jurisdiction to grant declaratory relief on a limited judicial review proceeding of this type. In Apotex #1, it is further alleged that, apart from the primary issue of infringement, Apotex's proposed reformulation into final-dosage form would itself constitute an infringement of the patents held by Eli Lilly, and that the prohibition order should therefore have issued regardless of whether or not the supply agreement constituted a sublicense.

Held: The appeals should be allowed.

A sublicense amounts to a grant by a licensee of certain licensed rights to a third party, the sublicensee. By the grant of a licence, the patentee grants to the licensee the right to act in a certain way *vis à vis* the patented article, a right which, but for the licence, the licensee would not enjoy. Thus, for Novopharm to have granted a sublicense to Apotex, it must have granted, either expressly or impliedly, the right to do something which Apotex would otherwise be prohibited from doing, and which Novopharm was permitted to do only by virtue of its compulsory licence. This may have been accomplished either by virtue of some express provision or provisions of the agreement, or by virtue of its actual legal effect (even if this runs contrary to the subjective intentions of the parties).

The ultimate goal of contractual interpretation should be to ascertain the true intent of the parties at the time of entry into the contract. The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. Evidence of one party's subjective intention has no independent place in this determination. It is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face. Here, there was no ambiguity to the contract entered into between Apotex and Novopharm and further interpretive aids were therefore unnecessary. The evidence as to the subjective intentions of the principals at the time of drafting was thus inadmissible by virtue of the parol evidence rule especially since it did not go to the circumstances surrounding the making of the contract.

Nothing in the wording of the document suggested that the parties intended to grant sublicences to each other. Rather, every indication was that they intended to establish a commercial arrangement whereby the unlicensed party would enjoy the right to require the licensed party to use its various licences for the benefit of the unlicensed party by acquiring, potentially at the direction of the unlicensed party, and subsequently reselling to the unlicensed party, various patented medicines. While no express words of grant are required to create a sublicense, clearly the supply agreement, to have this character, must have transferred to Apotex more than simply the right to compel Novopharm to use its licence in a given way. But there was no indication that Apotex acquired any

other independent rights under the compulsory licence. In fact, such an interpretation would be inconsistent with the combined effect of certain express provisions of the agreement.

To prove the existence of a sublicense, it must be established that the agreement was, in substance if not form, more than merely an elaborate arrangement under which future contracts for purchase and sale might be completed. The sale of a licensed article, while it does transfer to the purchaser the rights of use and alienation, does not have the automatic effect of constituting the purchaser a sublicensee; thus, the fact that a third party enjoys these rights cannot alone be indicative of the existence of a sublicense. Any number of ways exist in which a licensee can sell a licensed article to a third party with the complete range of ordinary incidents of ownership, without constituting that party a sublicensee. The rights of use and alienation can only be determinative of the existence of a sublicense where there has been no sale of the licensed article to the third party. In such a case, a right of use could only be derived from a sublicense of some type. Where the rights of the unlicensed party are derived from a sale of licensed material, it would be misleading to rely on the rights of use and alienation as a basis for the conclusion that a sublicense has been or is to be granted. This situation was plainly contemplated by the supply agreement here, under which the only way Apotex could acquire bulk nizatidine was by purchasing it from Novopharm, not directly from Novopharm's supplier.

Further, because legitimate transfers were to take place between separate entities, dealing at arm's length, the contemplated transactions could not be characterized, *ex ante*, as shams. While it was theoretically possible that the agreement could be implemented in an infringing way, it had not yet been implemented at all and thus any suggestion of infringement was speculative. The agreement did not, on its face or in its actual legal effect, amount to a sublicense.

The degree of control likely to be exercised by Apotex over the acquisition of nizatidine would not result in a situation where Novopharm in reality would be acting as Apotex's agent. Nor would Novopharm, because of its allegedly standing in the shoes of Apotex, become an unlicensed entity. Under the supply agreement, any contractual relations that might be established for the purchase of nizatidine would be between Novopharm and the third-party supplier. Apotex would not be a party to the contract; Novopharm would not be entering into the contract "on behalf of" Apotex in any sense. The notion of an agent's entering into contractual relations with the third party is inimical to the entire concept of agency, which contemplates the agent's binding the principal, not itself, to contractual relations and obligations.

Given that the agreement was properly characterized as a supply agreement and given that the agreement had not been implemented at the material time, it was not necessary to decide if the Federal Court of Appeal erred in applying its decision in *Apotex #1* to its decision in *Novopharm*.

Since the appropriate date for assessment of a NOA, where a prohibition order is sought by a patentee, is the date of hearing and not the date on which the NOA was issued (see *Merck Frosst Canada Inc. v. Canada (Minister of National Health and Welfare, S.C.C., No. 25419 (Apotex #2))*),

Novopharm's NOA was not premature and therefore unjustified. Pursuant to s. 39.14 of the Patent Act, it was entitled to manufacture the medicine itself or through Canadian agents seven years after the date of the issue of the first NOC to Eli Lilly Canada. As this seven-year period had expired before the date the application was heard, Novopharm was entitled, as of the date of hearing, to manufacture or have made the drug for its own use, for sale for consumption in Canada. The NOA did not specify that the nizatidine was to be imported and not produced in Canada, and so, at the date of hearing, there existed at least one non-infringing way for Apotex to obtain the necessary medicine.

In light of its other findings, it was not necessary for the Court to grant declaratory relief to the effect that Eli Lilly failed to show either that the NOA was not justified, or that it was entitled to terminate the compulsory licence. Moreover, in light of the limited nature of these judicial review proceedings, it would be inappropriate for this Court to declare conclusively, and for purposes other than those of these appeals, that the supply agreement did not constitute a sublicense or a transfer of the compulsory licence from Novopharm to Apotex. Accordingly, the requested declaratory relief was denied.

Absent express conditions to the contrary, a purchaser of a licensed article is entitled to deal with the article as he or she sees fit, so long as such dealings do not infringe the rights conferred by the patent. The reformulation of nizatidine into final-dosage form would not have the effect of creating a new article, such as to infringe Eli Lilly's patent. Rather, reformulation is more akin to repackaging the substance into a commercially usable form, which is not a violation of any rights under the patents. The right of use and sale which Apotex would acquire inherently, through its acquisition of nizatidine from Novopharm, encompasses the right to use and sell things produced with this nizatidine, including capsules in final-dosage form. This is, in reality, the only practical use of bulk medicine in the hands of a purchaser, which may explain why reformulation was implicitly contemplated by the compulsory licence held by Novopharm. Apotex therefore would not infringe the patents held by Eli Lilly simply by selling the medicine in the form contemplated by the NOA. This is particularly so when the exclusive rights enjoyed by the patentee under the patent are limited, in essence, to the formulation of bulk medicine according to the patented process. Nothing in the reformulation process can be seen as infringing upon this right. Thus, in the absence of some express prohibition in the compulsory licence, the right to reformulate should be seen as inherent to the purchaser's right to deal with licensed material as he or she sees fit. Eli Lilly accordingly failed in its various efforts to establish that Apotex's NOA was not justified and that a prohibition order should thus be issued.

Cases Cited

Distinguished: *E.I. du Pont de Nemours & Co. v. Shell Oil Co.*, 227 USPQ 233 (1985); referred to: *Apotex Inc. v. Merck Frosst Canada Inc.*, [1998] 2 S.C.R. 193; *Glaxo Wellcome Inc. v. Canada (Minister of National Health and Welfare)* (1997), 75 C.P.R. (3d) 129; *David Bull Laboratories (Canada) Inc. v. Pharmacia Inc.*, [1995] 1 F.C. 588; *Consolidated-Bathurst Export Ltd. v. Mutual*

Boiler and Machinery Insurance Co., [1980] 1 S.C.R. 888; Merck & Co. v. Apotex Inc. (1994), 59 C.P.R. (3d) 133, rev'd in part [1995] 2 F.C. 723; Carey v. United States, 326 F.2d 975 (1964); Howard and Bullough, Ltd. v. Tweedales and Smalley (1895), 12 R.P.C. 519; Lampson v. City of Quebec (1920), 54 D.L.R. 344; Joy Oil Co. v. The King, [1951] S.C.R. 624; Indian Molybdenum Ltd. v. The King, [1951] 3 D.L.R. 497; Badische Anilin und Soda Fabrik v. Isler, [1906] 1 Ch. 605; Gillette v. Rea (1909), 1 O.W.N. 448; Betts v. Willmott (1871), L.R. 6 Ch. App. 245; Intel Corp. v. ULSI System Technology Inc., 995 F.2d 1566 (1993); Cyrix Corp. v. Intel Corp., 77 F.3d 1381 (1996); Merck Frosst Canada Inc. v. Canada (Minister of National Health and Welfare) (1994), 55 C.P.R. (3d) 302; National Phonograph Co. of Australia, Ltd. v. Menck, [1911] A.C. 336; Libbey-Owens-Ford Glass Co. v. Ford Motor Co. of Canada, Ltd., [1970] S.C.R. 833, aff'g [1969] 1 Ex. C.R. 529; Rucker Co. v. Gavel's Vulcanizing Co. (1985), 7 C.P.R. (3d) 294.

Statutes and Regulations Cited

Food and Drug Regulations, C.R.C., c. 870, s. C.08.004.
 Patent Act, R.S.C., 1985, c. P-4, s. 39(4), 39.11 [ad. c. 33 (3rd Supp.), s. 15], 39.14 [idem].
 Patent Act Amendment Act, 1992, S.C. 1993, c. 2, s. 11(1).
 Patented Medicines (Notice of Compliance) Regulations, SOR/93-133, ss. 4(1), 5, 6, 7.

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APPEAL (Eli Lilly and Co. v. Novopharm Ltd., S.C.C., No. 25402) from a judgment of the Federal Court of Appeal (1996), 67 C.P.R. (3d) 377, 197 N.R. 291, [1996] F.C.J. No. 576 (QL), allowing an appeal from a judgment of McGillis J. (1995), 60 C.P.R. (3d) 181, 91 F.T.R. 161, [1995] F.C.J. No. 238 (QL), granting an application for judicial review and prohibiting the Minister from issuing a notice of compliance. Appeal allowed.

APPEAL (Eli Lilly and Co. v. Apotex Inc., S.C.C., No. 25348) from a judgment of the Federal Court of Appeal (1996), 66 C.P.R. (3d) 329, 195 N.R. 378, [1996] F.C.J. No. 425 (QL), dismissing an appeal from a judgment of McGillis J. (1995), 60 C.P.R. (3d) 206, 91 F.T.R. 181, [1995] F.C.J. No. 237 (QL), dismissing an application for judicial review. Appeal allowed.

Harry B. Radomski, Richard Naiberg and David Scrimger, for the appellant Apotex Inc.
 Donald N. Plumley, Q.C., Mark Mitchell and Stephanie Chong, for the appellant Novopharm Limited.

Anthony G. Creber and David Watson, Q.C., for the respondents Eli Lilly and Company and Eli Lilly Canada Inc.

Solicitors for the appellant Apotex Inc.: Goodman, Phillips & Vineberg, Toronto.

Solicitors for the appellant Novopharm Limited: Ridout & Maybee, Toronto.

Solicitors for the respondents Eli Lilly and Company and Eli Lilly Canada Inc.: Gowling, Strathy & Henderson, Ottawa.

The judgment of the Court was delivered by

1 IACOBUCCI J.-- A single agreement entered into by Novopharm Limited ("Novopharm") and Apotex Inc. ("Apotex"), competitors in the pharmaceutical industry, has given rise to litigation resulting in no fewer than three appeals to this Court. In addition to the two instant cases, which I shall refer to as "Novopharm" and "Apotex #1", reasons in *Apotex Inc. v. Merck Frosst Canada Inc.*, [1998] 2 S.C.R. 193 ("Apotex #2"), are also being released today. The issue common to all three is whether the agreement in question constitutes a simple supply agreement, as alleged by the two parties to the agreement, or, as alleged by the various respondents, a sublicense to exercise the rights acquired by Novopharm pursuant to compulsory licences obtained prior to recent changes to the legislative regime which governs patented medicines. This determination is key to the resolution of the issues in these appeals because, as shall be discussed, the grant of a sublicense by Novopharm could justify the termination by the patentee of the compulsory licence in question and render the supply agreement useless.

2 Owing to the intertwining nature of the lower court decisions in *Novopharm* and *Apotex #1*, I shall deal with these two appeals in one set of reasons. In addition to the common issue of interpretation, each case raises a number of other issues, which I shall endeavour to deal with appropriately as they arise.

I. Background

A. The Patents and the Compulsory Licence

3 Prior to February, 1993, there existed in Canada a compulsory licensing regime with respect to patents for pharmaceuticals. Under s. 39(4) of the Patent Act, R.S.C., 1985, c. P-4, as it then existed, in respect of any patent intended or capable of being used for medicine or for the preparation or production of medicine, any person could make an application for a licence:

39.... (4)... (a) where the invention is a process, to use the invention for the preparation or production of medicine, import any medicine in the preparation or

production of which the invention has been used or sell any medicine in the preparation or production of which the invention has been used, or

- (b) where the invention is other than a process, to import, make, use or sell the invention for medicine or for the preparation or production of medicine. . . .

According to the terms of s. 39(4), the Commissioner of Patents was obliged to grant to the applicant a licence to do the things specified in the application unless there existed a good reason not to grant such licence.

4 These appeals relate to two Canadian patents owned by Eli Lilly and Company ("Eli Lilly") in respect of the medication nizatidine: one in respect of the medicine itself and one in respect of the process by which the medicine is made. On December 31, 1987, the Department of National Health and Welfare granted a notice of compliance ("NOC") to Eli Lilly Canada Inc. ("Eli Lilly Canada"), pursuant to s. C.08.004 of the Food and Drug Regulations, C.R.C., c. 870, thereby permitting Eli Lilly Canada to market 150 mg and 300 mg final-dosage form capsules of nizatidine for consumption in Canada. To date, no other company has been issued a NOC in respect of nizatidine.

5 On January 17, 1990, Novopharm applied under s. 39(4) of the Patent Act for a compulsory licence under the patents owned by Eli Lilly. The application was vigorously contested by Eli Lilly, but, it was found that none of the objections constituted a valid reason to refuse the application and the Commissioner of Patents accordingly granted the licence, as he was obliged to do under the Act as it then existed. The licence, which, unless validly terminated by Eli Lilly (a very contentious issue in the instant appeals), is still in force, permits Novopharm to use the patented process to make nizatidine for the preparation or production of medicine, and to import and/or sell medicine made by the process. It also permits Novopharm to make, use, sell and import either or both of the invention for medicine and the invention for the preparation or the production of medicine. The royalty rate to be paid by Novopharm to Eli Lilly Canada on sales of the medicine in final-dosage form is fixed at six percent of the selling price. The Commissioner of Patents, in a decision dated October 21, 1991, found that the licence is not restricted to the forms of medicine listed by Novopharm in its application, as such "would place unnecessary limits on [Novopharm's] operations under the licence".

6 Certain other specific terms and conditions of the licence are also relevant. Paragraph 1 contains terms and conditions pertaining to the calculation of royalties for the sale of nizatidine to arm's length purchasers and contemplates the sale of the medication by Novopharm in both final-dosage and bulk forms, stipulating royalty rates for each. Novopharm is also required, under paragraphs 3 and 4, to obtain quarterly statements showing the descriptions, quantities, net selling prices and royalty computations resulting from the operations of arm's length purchasers of the medicine, non-arm's length purchasers of the medicine in final-dosage form, and any subsequent non-arm's length purchasers from the latter.

7 Paragraph 9 of the licence, which is of paramount importance to this appeal, provides Eli Lilly with the option to terminate the licence upon any breach of its terms by Novopharm by giving notice in writing. In the event that Novopharm fails to rectify the breach within 30 days, the licence is terminated automatically. However, under paragraph 10, if Novopharm disputes the breach by written notice to Eli Lilly, the licence is not terminated pending adjudication by the courts or arbitration as agreed upon by the parties. Finally, paragraph 12 stipulates that the licence is non-transferable, and that Novopharm is prohibited from granting "any sublicense".

B. The Supply Agreement Between Novopharm and Apotex

8 On November 27, 1992, Novopharm and Apotex entered into what they described as a "supply agreement", in anticipation of proposed changes to the Patent Act, then embodied in Bill C-91. It was expected that this bill, if passed, would both eliminate the then-existing compulsory licensing regime and threaten the existing licences and licence applications of both companies. The agreement was drafted, apparently without the advice of counsel, by Dr. Bernard Sherman, the president of Apotex, and Mr. Leslie Dan, the president of Novopharm, and reads as follows:

WHEREAS THE Federal Government has introduced Bill C-91 which, if passed, would eliminate compulsory licensing under the Patent Act,

AND WHEREAS Apotex and Novopharm have various licences and licence applications pending which are threatened by Bill C-91,

AND WHEREAS, depending on the cut-off dates that will pertain when Bill C-91 is finalized, it is expected that the parties hereto each may hold valid licences for products for which the other may not hold valid licences, details of which cannot be predicted at this time,

AND WHEREAS for their mutual benefit in relation to other competitors, the parties wish to ensure that they have available for use licences on the maximum number of products,

AND WHEREAS the parties have thus agreed that they will share their rights under licences for any product for which only one of the parties may hold a useable licence,

NOW THEREFORE in consideration of the premises and the mutual covenants and other good and valuable consultations, receipt of which is hereby

acknowledged, the parties hereto agree as follows:

1. At any time subsequent to the date upon which Bill C-91 or any Bill derived therefrom is enacted and proclaimed, for any product for which one party (hereinafter the "licensed" party) shall hold a useable licence and the other party (hereinafter called the "unlicensed party") shall not, the licensed party shall, at the request of the unlicensed party, use its licence for the benefit of the unlicensed party in the manner hereinafter set out.
2. In the event that the licence is a licence to import, the licensed party shall import from such source, in such quantity, and on such terms as the unlicensed party shall direct, and shall resell the imported goods to the unlicensed party at the cost thereof together with such royalties as shall be payable under the terms of the licence.
3. In the event that the licence is a licence to manufacture in Canada, the licensed party shall enter into such contracts with Canadian chemical manufacturers as the unlicensed party shall direct for the manufacture of the relevant material and shall sell the manufactured materials to the unlicensed party at the cost thereafter together with such royalties as shall be payable under the terms of the licence.
4. In the event that the licensed party has a source of material from which it imports or in the event that the licensed party is producing the material under a licence to manufacture, and in the event that it is not possible for the unlicensed party to find another source from which to import, or at which to arrange for the manufacture of material, then the licensed party shall supply material to the unlicensed party from the licensed party's source at a price equal to the fair market price of the material together with such royalties as shall be payable under the terms of the licence. Any disagreement as to fair market price shall be settled by binding arbitration.
5. In addition to the payments provided for in paragraphs 2, 3 and 4 hereof, the unlicensed party shall pay to the licensed party a fee equal to 4% of the unlicensed party's net sales of product covered by any unexpired patent included in the licensed party's licence and purchased from the licensed party.

Within 60 days of the end of each quarter year the unlicensed party shall deliver to the licensed party payment of the fee on sales made during the previous quarter along with a statement certified by an independent auditor setting out the quantities sold, the net dollar sales, and the fee payable thereon.

6. The licensed party shall comply with the terms of the licence.
7. The licensed party shall not be excused from performing any act as directed by

the unlicensed party pursuant to paragraphs 2 or 3 or 4 hereof, on the grounds that there is doubt as to whether or not the licence has remained in force or permits the requested acts, nor on the basis of litigation or threatened litigation by the patentee, provided that the unlicensed party shall undertake to defend any lawsuit against the licensed party resulting from such act and hold the licensed party harmless for the costs of such lawsuit any damage award arising therefrom.

8. For greater clarity, the foregoing paragraphs shall not be limiting, and the licensed party shall cooperate fully with the unlicensed party and follow the directions of the unlicensed party to enable the unlicensed party to enjoy the use of the licence to the same extent that would be possible if the unlicensed party itself held such licence, so long as the licensed party is held harmless from any such use.
9. The unlicensed party shall resell any product purchased from the licensed party only under its own label and shall not sell the product for resale under a label other than that of the unlicensed party.
10. Neither party will engage in preventing or blocking the accessibility [sic] of HPB clearance of any raw material affecting present and future pharmaceutical products.
11. This agreement shall expire on December 31, 1994 unless extended by mutual agreement.
12. Notwithstanding paragraph 11 hereof, if Bill C-91 is passed into law with an amendment that permits companies to continue to apply for and obtain compulsory licenses for any product for which a licence was issued to any one or more licence [sic] prior to December 20, 1991, then this agreement shall be terminated.
13. Notwithstanding paragraph 11 hereof, in relation to any specific licence in respect of which the unlicensed party shall have on or before December 31, 1994, advised the licensed party of an intention to utilize such licence, this agreement shall continue in force until expiry of the last patent covered by such licence.

9 On February 15, 1993, most of the provisions of the Patent Act Amendment Act, 1992, S.C. 1993, c. 2, were proclaimed into force. On March 12, 1993, the Patented Medicines (Notice of Compliance) Regulations, SOR/93-133 (the "Regulations"), came into force and radically altered the procedures governing the issuance of NOCs, strengthening the monopoly position of the patentee by eliminating the compulsory licensing scheme and curtailing the ability of generic drug companies to obtain approval to market a patented medicine until the expiry of all relevant product and use patents. The new NOC regime is lucidly summarized in the following excerpt from the judgment of Teitelbaum J. in *Glaxo Wellcome Inc. v. Canada (Minister of National Health and Welfare)* (1997), 75 C.P.R. (3d) 129 (F.C.T.D.), at pp. 131-32:

A NOC, which formally authorizes a drug to be sold, is issued by the Minister after a drug manufacturer has complied on two fronts. The first element of compliance concerns the overall safety and efficacy of the drug: (see regulation C.08.004 of the Food and Drug Regulations, C.R.C. 1978, c. 870). The second element of compliance figures on the drug manufacturer's non-infringement of certain patents embodied in the drug. This second, rather more unexpected, patent-related requirement came into existence after changes to the compulsory licensing regime. Formerly, under a compulsory license, a generic drug manufacturer could obtain a licensed supply of a patented drug from the patent owner. The NOC process did not then concern itself with questions of patent infringement. However, with the abolition of compulsory licenses under the Patent Act Amendment Act, 1992, ... (the "Patent Act") the regime for obtaining NOCs also changed. Generic drug manufacturers now seeking NOCs must file what is called a Notice of Allegation under Section 5 of the Regulations.

...

In effect, under Subsection 5(3) of the Regulations, in a "Notice of Allegation", the generic drug manufacturer, "the second person", signals its compliance with the patents embodied in a medicine. Under Section 4 of the Regulations, the patent owner or licensee, usually a brand name drug manufacturer like the applicants, submits a list of the patents that contain claims for the medicine itself or the use of the medicine. Under Section 3 of the Regulations, the Minister compiles the patent lists into a public document called the "Patent Register".

10 As required under s. 4(1) of the new Regulations, Eli Lilly Canada submitted a patent list, dated April 6, 1993, to the Minister of National Health and Welfare, which included the patents for nizatidine for which it held the NOC.

11 Apotex commenced efforts to obtain a NOC for 150 mg and 300 mg capsules of nizatidine under the new scheme, and accordingly sent a letter to Eli Lilly Canada, dated April 28, 1993, which constituted a Notice of Allegation ("NOA") as required by s. 5(3)(b) of the Regulations. In the NOA, Apotex alleged that no claim for the patented medicine itself or for the use of the medicine would be infringed by its making, constructing, using or selling the specified nizatidine capsules. In support of this allegation, Apotex relied upon the licence issued to Novopharm for nizatidine and upon the "mutual understanding" whereby Novopharm, the licensed party, would supply Apotex with raw materials obtained pursuant to its licence. Apotex stated that it had given Novopharm notice of its intention to obtain nizatidine, and undertook not to obtain, use, or sell any nizatidine other than from Novopharm until such time as the patents had expired.

12 The letter of intention referred to, also dated April 28, 1993, indicated that, because Apotex

did not yet have a NOC to permit it to market nizatidine in Canada, it could not provide Novopharm with any specifics as to its requirements, but that it would advise in due course as to the required quantity and the manufacturer from whom the nizatidine should be purchased. Although Apotex did apparently locate a source for the nizatidine, it had not, by the date of the hearing of this appeal, disclosed the identity of the source to Novopharm, and the evidence remained sealed as confidential information.

13 Eli Lilly and Eli Lilly Canada brought an application, under s. 6(1) of the Regulations, for an order prohibiting the Minister from issuing a NOC to Apotex at all or, alternatively, until after December 31, 1997, ten years after the issuance of the NOC to Eli Lilly Canada, which, under s. 39.11 of the Patent Act, would be the first date on which Apotex, without a NOC, would be entitled to import the patented medicine for consumption in Canada. This application forms the basis of the litigation in Apotex #1, upon which I shall elaborate shortly.

14 On July 15, 1993, Eli Lilly purported to exercise its option to terminate Novopharm's compulsory licence by providing 30 days' notice in writing to Novopharm. In support of the notice of termination, Eli Lilly alleged that Novopharm had breached the terms of the licence by granting a sublicense to Apotex. Novopharm denied this allegation, stating that the commercial agreement into which it had entered with Apotex did not constitute a sublicense or any transfer of rights under the licence. Novopharm apprised the Commissioner of Patents of the purported termination and its having disputed the allegations of breach.

C. The Novopharm Proceeding

15 On July 30, 1993, Novopharm issued a NOA in support of its own application for a NOC in relation to 150 mg and 300 mg capsules of nizatidine. It relied on its own compulsory licence as the basis for the non-infringement of the patents owned by Eli Lilly. On September 15, 1993, Eli Lilly and Eli Lilly Canada brought an application before the Federal Court--Trial Division, requesting a prohibition order to enjoin the Minister from issuing the requested NOC to Novopharm, on the grounds that Novopharm's licence had been terminated and that Novopharm could not, therefore, obtain the bulk medicine in a non-infringing way.

16 Meanwhile, Eli Lilly also brought a separate application in the Ontario Court of Justice (General Division), seeking a declaration that Novopharm's licence was terminated by virtue of its granting a sublicense to Apotex, contrary to the terms of the licence. Forget J. found that that court had concurrent jurisdiction with the Federal Court--Trial Division to grant the relief sought, but, applying the convenient forum test, held that the matter ought to be decided by the Federal Court in the context of the prohibition proceedings. Eli Lilly and Eli Lilly Canada then brought an interlocutory motion in the Federal Court to amend the originating notice of motion by adding a claim for declaratory relief. Pinard J. dismissed the motion, stating that, in dealing with the originating notice of motion (i.e., the prohibition application), the Court had jurisdiction to make an incidental finding that the compulsory licence in question had been terminated, which would be

sufficient to justify an order prohibiting the Minister from issuing a NOC.

17 On July 20, 1993, Mr. Dan of Novopharm wrote to Dr. Sherman of Apotex, stating that the two companies did not have an agreement to transfer licences or to sublicense, and asking Apotex to refrain from claiming in its applications for NOCs that licences would be transferred. He confirmed that the supply agreement contemplated that Novopharm would supply Apotex, as a third party customer, with specific licensed products, but stipulated that Novopharm never intended to create a sublicense, given that such would be "contrary to the standard conditions of all compulsory licenses". Dr. Sherman responded by letter the next day, stating that Apotex had never suggested that any transfer of rights or sublicensing would occur, only that Novopharm would be supplying materials to Apotex, as a third-party purchaser.

18 Mr. Dan also filed an affidavit concerning his intentions as to the nature of the agreement with Apotex. On cross-examination, he testified that Novopharm and Apotex had intended to create a supply agreement, and that the statement in the preamble as to sharing of rights was improperly worded. He further testified that Apotex had not yet requested Novopharm to supply it with nizatidine, but that, if and when a request was made to obtain nizatidine from a foreign source, it would be Novopharm which would approach various sources, obtain quotations, import the bulk material, and finally sell it to Apotex on the terms agreed upon with the supplier. He stated that, if there was only one supplier for a given medicine, the accepted commercial practice would be that "if we have access, they should have access". Also, responding to a question concerning provisions of the Patent Act which would prohibit the importation and manufacture of nizatidine until December 31, 1997 and December 31, 1994, respectively, Mr. Dan asserted that "[w]e have to abide by the regulations".

19 McGillis J. of the Federal Court--Trial Division dismissed Eli Lilly's application for judicial review, finding that the agreement between Novopharm and Apotex did not constitute a sublicense, that the licence, therefore, could not be terminated on that ground by Eli Lilly, and, accordingly, that Eli Lilly had failed to prove that Novopharm's notice of allegation was not justified. This decision was reversed by a unanimous panel of the Federal Court of Appeal, which, relying on its earlier decision in Apotex #1, *infra*, held that a sublicense had in fact been conferred by virtue of the supply agreement.

D. The Apotex #1 Proceeding

20 In cross-examination on the hearing of the application for a prohibition order in Apotex #1, the background of which is detailed above, Dr. Sherman of Apotex testified that the supply agreement with Novopharm did not enable Apotex to import or manufacture nizatidine, but only to require Novopharm to import or manufacture the medicine under the terms of its licence and to sell the material to Apotex. He testified that Apotex would in fact be acquiring the nizatidine from Novopharm and, if the NOC were granted, formulating it into 150 mg and 300 mg capsules for sale in Canada. He was of the view that this would not constitute an infringement of Eli Lilly's patents,

given that no further licence would be necessary once the licensed material was purchased from Novopharm. However, he did appear to make reference at one point to Apotex's "having rights" under the licence.

21 Relying on her analysis in *Novopharm*, McGillis J. of the Federal Court--Trial Division found that the supply agreement between Novopharm and Apotex did not constitute a sublicense. Nonetheless, she granted the prohibition order on the basis that Apotex's allegations of non-infringement were not justified, as its formulation of nizatidine capsules for consumption in Canada would infringe Eli Lilly's patents.

22 The Federal Court of Appeal, Pratte J.A. dissenting, dismissed Apotex's appeal, but on different grounds. It found that, despite the parties' apparent intention to avoid conferring sublicences on one another, this was in fact the legal effect of the written contract which they had completed. Therefore, Novopharm's licence was properly terminated and thus Apotex had no non-infringing means by which to obtain the nizatidine. While it was not necessary to decide the question, it was nevertheless unanimously held, contrary to the view of McGillis J., that Apotex's reformulation of nizatidine into final-dosage form would not have infringed the patents.

II. Relevant Statutory Provisions

23 Patent Act, R.S.C., 1985, c. P-4

39.11 (1) Subject to this section but notwithstanding anything in section 39 or in any licence granted under that section, no person shall under a licence granted under that section in respect of a patent for an invention pertaining to a medicine, regardless of when the licence was granted, have or exercise any right,

- (a) where the invention is a process, to import the medicine in the preparation or production of which the invention has been used, if the medicine is for sale for consumption in Canada; or
- (b) where the invention is other than a process, to import the invention for medicine or for the preparation or production of medicine, if the medicine is for sale for consumption in Canada.

(2) The prohibition under subsection (1) expires in respect of a medicine

...

- (c) ten years after the date of the notice of compliance that is first issued in respect of the medicine where that notice of compliance is issued after June 27, 1986.

39.14 (1) Notwithstanding anything in section 39 or in any licence granted under that section, where the notice of compliance that is first issued in respect of a medicine is issued after June 27, 1986, no person shall, under a licence granted under that section in respect of a patent for an invention pertaining to the medicine, have or exercise any right,

- (a) where the invention is a process, to use the invention for the preparation or production of medicine, or
- (b) where the invention is other than a process, to make or use the invention for medicine or for the preparation or production of medicine

for sale for consumption in Canada, until the expiration of seven years after the date of that notice of compliance.

Patented Medicines (Notice of Compliance) Regulations, SOR/93-133

5. (1) Where a person files or, before the coming into force of these Regulations, has filed a submission for a notice of compliance in respect of a drug and wishes to compare that drug with, or make a reference to, a drug that has been marketed in Canada pursuant to a notice of compliance issued to a first person in respect of which a patent list has been submitted, the person shall, in the submission, with respect to each patent on the patent list,

- (a) state that the person accepts that the notice of compliance will not issue until the patent expires; or
- (b) allege that
 - (i) the statement made by the first person pursuant to paragraph 4(2)(b) is false,
 - (ii) the patent has expired,
 - (iii) the patent is not valid, or
 - (iv) no claim for the medicine itself and no claim for the use of the medicine would be infringed by the making, constructing, using or selling by that person of the drug for which the submission for the notice of compliance is filed.

(2) Where, after a second person files a submission for a notice of compliance, but before the notice of compliance is issued, a patent list is submitted or amended in respect of a patent pursuant to subsection 4(5), the second person shall amend the submission to include, in respect of that patent, the statement or allegation that is required by subsection (1).

(3) Where a person makes an allegation pursuant to paragraph (1)(b) or subsection (2) the person shall

- (a) provide a detailed statement of the legal and factual basis for the allegation; and
- (b) serve a notice of the allegation on the first person and proof of such service on the Minister.

6. (1) A first person may, within 45 days after being served with a notice of an allegation pursuant to paragraph 5(3)(b), apply to a court for an order prohibiting the Minister from issuing a notice of compliance until after the expiration of one or more of the patents that are the subject of an allegation.

(2) The court shall make an order pursuant to subsection (1) in respect of a patent that is the subject of one or more allegations if it finds that none of those allegations is justified.

(3) The first person shall, within the 45 days referred to in subsection (1), serve the Minister with proof that an application referred to in that subsection has been made.

(4) Where the first person is not the owner of each patent that is the subject of an application referred to in subsection (1), the owner of each such patent shall be made a party to the application.

7. (1) The Minister shall not issue a notice of compliance to a second person before the latest of

- (a) the expiration of 30 days after the coming into force of these

Regulations,

- (b) the day on which the second person complies with section 5,
- (c) subject to subsection (3), the expiration of any patent on the patent list that is not the subject of an allegation,
- (d) subject to subsection (3), the expiration of 45 days after the receipt of proof of service of a notice of any allegation pursuant to paragraph 5(3)(b) in respect of any patent on the patent list,
- (e) subject to subsections (2), (3) and (4), the expiration of 30 months after the receipt of proof of the making of any application referred to in subsection 6(1), and
- (f) the expiration of any patent that is the subject of an order pursuant to subsection 6(1).

(2) Paragraph (1)(e) does not apply if at any time, in respect of each patent that is the subject of an application pursuant to subsection 6(1),

- (a) the patent has expired; or
- (b) the court has declared that the patent is not valid or that no claim for the medicine itself and no claim for the use of the medicine would be infringed.

(3) Paragraphs (1)(c), (d) and (e) do not apply in respect of a patent if the owner of the patent has consented to the making, constructing, using or selling of the drug in Canada by the second person.

(4) Paragraph (1)(e) ceases to apply in respect of an application referred to in subsection 6(1) if the application is withdrawn or is finally dismissed by the court.

(5) A court may shorten or extend the time limit referred to in paragraph (1)(e) in respect of an application where the court has not yet made an order pursuant to subsection 6(1) in respect of that application and where the court finds that a party to the application failed to reasonably cooperate in expediting the application.

III. Judicial History

A. Novopharm Ltd. v. Eli Lilly and Co.

(1) Federal Court--Trial Division (1995), 60 C.P.R. (3d) 181

24 As a preliminary matter, McGillis J. considered the nature of the proceedings before the court. She observed that an application for prohibition under s. 6(1) of the Regulations is a judicial review proceeding which is intended to determine expeditiously whether a NOC should be issued. In this connection, she referred to *David Bull Laboratories (Canada) Inc. v. Pharmacia Inc.*, [1995] 1 F.C. 588 (C.A.), where Strayer J.A. held that the issues to be decided in such proceedings are of a limited or preliminary nature, only for the limited purpose above stated, and that, if a full trial of validity or infringement issues is required, it is to be obtained in the usual way, by commencing an action.

25 Turning to the question of whether the allegations of non-infringement made by Novopharm in requesting the NOC were justified, McGillis J. noted that, since Novopharm's position was premised on its licence, the key issue was the proper interpretation to be given the November, 1992 agreement between Apotex and Novopharm. If the agreement was in substance a sublicense, then the licence would have been properly terminated by Eli Lilly, and Novopharm would have been left with no non-infringing way in which to obtain the medication for which the NOC was requested.

26 Relying on the decision of this Court in *Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, McGillis J. identified the task at hand (at p. 197) as ascertaining the "true intent of the parties at the time of the entry into the contract". She rejected the submissions by Eli Lilly that the evidence of Mr. Dan, both in his affidavit and his cross-examination, as to his intention at the time the supply agreement was drafted, was inadmissible on the basis of the parole evidence rule. In her view, Mr. Dan was entitled to tender direct evidence concerning his intention at the time of drafting. As to the exchange of letters between Mr. Dan and Dr. Sherman, McGillis J.A. declined to rule on their admissibility, inasmuch as even if they were admissible, she would have accorded them no weight on the basis that they were written to clarify the intent of the parties long after the supply agreement had been signed, and apparently only in response to the threatened termination of the licence held by Novopharm.

27 With regard to the intentions of Mr. Dan at the time of drafting, McGillis J. concluded on the basis of his direct evidence that he intended to enter into a supply agreement with Apotex. However, she recognized (at p. 199) the need to examine the agreement as a whole in order to determine whether the words used by the parties reasonably expressed their intent, bearing in mind that "a sublicense could only have been created if Novopharm granted some or all of its rights under the licence to Apotex". In her view, at p. 199, the true nature of the agreement was that of "a supply agreement dressed up to look like a sublicense". In other words, despite the presence in the supply agreement of wording which might tend to suggest the conferral of a sublicense, the actual operative provisions of the agreement did not amount to the granting of any of Novopharm's licensed rights to Apotex.

28 In the view of McGillis J., the plain fact that the supply agreement contemplated Novopharm's

entering into contracts with third parties at the direction of Apotex did not itself amount to a sublicense. Indeed, if the licensed rights had in fact been sublicensed to Apotex, Novopharm's continued involvement in the transactions would have been unnecessary. On balance, McGillis J. was of the view that none of the provisions of the agreement conferred any of Novopharm's licensed rights upon Apotex, and that paragraph 6, by stipulating that the licensed party must comply with the terms of its licence, including the prohibition against sublicensing, strongly suggested that the parties did not intend to create a sublicense.

29 Therefore, McGillis J. found that no sublicense was granted by Novopharm to Apotex. In her view, this interpretation served to promote the true intent of the parties at the time of entry into the supply agreement and to produce a sensible commercial result from their perspective, which she viewed as an important interpretive goal, based on *Consolidated-Bathurst*, supra. Indeed, she stated that to find that a sublicense had been created would have defeated the parties' entire objective in entering into the supply agreement, as the compulsory licences could then have been terminated by the patentees. She also stipulated that, even had she not considered the extrinsic evidence given by Mr. Dan as to his intention, she would have reached the same conclusion based on the plain wording of the agreement as a whole. On this basis, McGillis J. concluded that Eli Lilly and Eli Lilly Canada had failed to establish, on a balance of probabilities, that the allegation of Novopharm in its NOA was not justified within the meaning of s. 6(2) of the Regulations. Accordingly, she dismissed the application for a prohibition order.

30 As to the question of whether the licence had been terminated, McGillis J. declined jurisdiction to decide this matter, despite the earlier orders of Forget J. and Pinard J. She felt bound by the subsequent ruling in *David Bull Laboratories*, supra, that the court lacks jurisdiction, in the context of a judicial review proceeding to determine an application for a prohibition order of this kind, to determine ancillary or incidental questions which pertain solely to the rights of two private parties. However, in the event that she was wrong in this conclusion, she expressed the opinion that her finding that Novopharm had not granted a sublicense to Apotex necessarily led to the conclusion that the licence had not been breached.

(2) Federal Court of Appeal (1996), 67 C.P.R. (3d) 377

31 In oral reasons delivered from the bench, Stone J.A. (MacGuigan and McDonald JJ. A. concurring) dismissed the appeal. The appeal was heard three weeks after the hearing of the appeal in *Apotex #1*, infra, and at the hearing, the court invited submissions as to the possible application of that decision to the outcome of the instant appeal. Eli Lilly argued that the decision was dispositive, in that the court there held that the supply agreement contravened the sublicensing prohibition in the compulsory licence, and that, by notice, Eli Lilly had succeeded in terminating the licence. For its part, Novopharm argued that the decision should not be applied because the facts of the instant appeal differed materially from the facts in the previous case, and also because, while a decision on a prohibition order application binds the parties to the specific litigation, it has little precedential value for other cases.

32 The court held that, while the previous decision was not *res judicata*, it was nonetheless binding on the court unless it could be distinguished on its facts or was manifestly wrong owing to the failure of the court to consider a relevant legal rule. The latter was not alleged. As to the former, while the court recognized that there were some factual differences and that some of the evidence which was before the court in *Apotex #1* was not part of the record in the instant case, the same compulsory licence and the same supply agreement were at issue and in evidence in both cases. To the extent that it was unaffected by evidence unique to its own record, the analysis of the supply agreement in *Apotex #1* could therefore be applied to Novopharm. While it was true that paragraph 6 of the supply agreement required Novopharm to act in compliance with the terms of its licence, the court concluded that this clause was to be read together with the other clauses of the agreement, leading to the conclusion that a sublicense had indeed been granted. Accordingly, the appeal was allowed.

B. *Apotex Inc. v. Eli Lilly and Co.*

(1) Federal Court--Trial Division (1995), 60 C.P.R. (3d) 206

33 In this proceeding, the basis for Eli Lilly's claim of non-justification was that Novopharm's licence for nizatidine had been terminated by virtue of its grant of a sublicense to Apotex, and that Apotex therefore had no non-infringing way of obtaining the bulk nizatidine in order to formulate the capsules that were the subject of the NOC request. Alternatively, it was argued that the formulation of the capsules would itself constitute an infringement of Eli Lilly's patent rights.

34 In concluding in *Novopharm, supra*, that the arrangement between Apotex and Novopharm was not a sublicense but merely a supply agreement, McGillis J. had considered the evidence of Mr. Dan of Novopharm concerning his intent at the time he drafted the agreement with Dr. Sherman. While this evidence was not part of the record in the instant matter, McGillis J. had indicated in *Novopharm* that she would have reached the same conclusion even without considering that evidence. Accordingly, she was of the view that her conclusion as to the nature of the agreement in *Novopharm* applied equally to the case at bar.

35 Turning, then, to the question of whether the formulation of capsules from the bulk material would infringe Eli Lilly's patent rights, McGillis J. considered the decision of MacKay J. in *Merck & Co. v. Apotex Inc.* (1994), 59 C.P.R. (3d) 133 (F.C.T.D.), and agreed with his conclusion that this processing activity would in fact constitute an infringement, as "an unlicensed third party purchaser acquires none of the exclusive rights granted to a patentee merely by virtue of the fact that he has purchased bulk material from a licensed supplier" (p. 218).

36 Therefore, McGillis J. found that Eli Lilly had established, on a balance of probabilities, that the allegation of non-infringement made by Apotex in its notice of allegation was not justified within the meaning of s. 6(2) of the Regulations. Accordingly, she allowed the application for judicial review and prohibited the Minister from issuing a NOC to Apotex until after the expiry of Eli Lilly's patents.

(2) Federal Court of Appeal (1996), 66 C.P.R. (3d) 329

(a) MacGuigan J.A. (Robertson J.A. concurring)

37 In reviewing the facts and the evidence, MacGuigan J.A. observed that, on several occasions, Dr. Sherman had emphasized that all decisions under the supply agreement would be made by Apotex and communicated to Novopharm. Apotex's stated intention was to deal with a Canadian manufacturer, independent of Novopharm, and it in fact refused to communicate to Novopharm the identity of this manufacturer until such was convenient for Apotex. But Dr. Sherman insisted that Novopharm, not Apotex, would purchase the material and sell it to Apotex, within the terms of its licence.

38 MacGuigan J.A. noted that the conclusion of McGillis J. in *Novopharm* as to the proper characterization of the Apotex-Novopharm agreement was premised, to some extent, on the evidence of Mr. Dan as to his intention at the time the agreement was drafted. He observed not only that this evidence did not form part of the record in the case before him, but also that any direct evidence as to the intention of the parties was to be excluded from consideration under the parole evidence rule. In his view, the question as to the meaning of the agreement was a legal one which was to be determined from its text. Although McGillis J. had made clear that she would have reached the same conclusion even absent the extrinsic evidence, MacGuigan J.A. observed that she also appeared to have been influenced in her decision by two particular legal propositions: that a sublicense could only have been created if Novopharm had granted some or all of its rights under the licence to Apotex, and that, when interpreting a contract, courts should favour an interpretation which promotes a sensible commercial result: see *Consolidated-Bathurst*, *supra*.

39 MacGuigan J.A. relied on the decision of the Delaware Supreme Court in *E.I. du Pont de Nemours & Co. v. Shell Oil Co.*, 227 USPQ 233 (1985) ("du Pont"), which, although it dealt with somewhat different facts, considered what was in his view essentially the same type of transaction, that is, one in which the patented product was produced not for the licensed party but for an unlicensed party. In that case, the court, relying on *Carey v. United States*, 326 F.2d 975 (Ct. Cl. 1964), held that the test for a sublicense is whether the production of the licensed item is by or for the use of the original licensee or the alleged sublicensee, and concluded that the application of this test revealed a sublicense in a situation where an unlicensed party purported to manufacture a patented item as the agent of the licensee, only to purchase the item from the licensee immediately upon its manufacture, each transfer of property being nothing more than a paper transaction.

40 In the view of MacGuigan J.A., a similar form of "legerdemain" occurred in the present case. He found that, under the supply agreement, the separate contracts between Novopharm and its suppliers and Novopharm and Apotex were to be maintained only to avoid a direct contractual link between Apotex and the suppliers. He viewed this as a matter of form only. Because Apotex was in reality the directing mind, with Novopharm using its licence for Apotex's benefit, he found that the arrangement between the two was, contrary to the view of McGillis J., "a sublicense dressed up to

look like a supply agreement" (p. 338). While he recognized that the subjective intention of the parties was to avoid creating a sublicense, he found that this was at odds with the objective intention of the document they executed. The legal effect of the contract, in other words, was to create a sublicense.

41 MacGuigan J.A. also found that, in accordance with his reading of Consolidated-Bathurst, *supra*, any consideration of whether this interpretation would promote a "sensible commercial result" must be accorded only a "tertiary status", behind the "primary" rule of interpretation -- the objective analysis of the actual words used by the parties -- and the application of the *contra proferentum* doctrine to interpret any ambiguity against the drafting party. In his view, at p. 338, the primary rule governed in the present case, as there was no ambiguity in "the words they used, as I interpret the reality behind them".

42 Therefore, MacGuigan J.A. dismissed Apotex's appeal, finding that Novopharm's licence had been properly terminated by Eli Lilly. Although he found it unnecessary to decide the issue of infringement by formulation, he stated that he would have agreed with the reasons of Pratte J.A. on the matter.

(b) Pratte J.A., dissenting

43 Pratte J.A. differed from the majority on the issue of contractual interpretation. In his view, there was nothing obscure in the text of the supply agreement such as to require further interpretation. Although both the intention and the effect of the contract was to afford the parties, as far as possible, the same benefits they would have obtained under mutual sublicences, the supply agreement did not provide for the granting of any sublicense. As to Eli Lilly's contention that the agreement did not disclose the true nature of the arrangement -- that each party would give sublicences to each other and then, for the sake of appearances, act as the sublicensee's agent in procuring the drug -- there was, in the view of Pratte J.A. at p. 342, "absolutely no evidence that the parties ever intended to enter into such a surrealistic arrangement". In his view, Eli Lilly had not succeeded in proving that the arrangement was a sham merely by showing that the parties could have obtained the same advantages by entering into a different agreement. Therefore, he concluded that Novopharm had not breached the terms of its licence.

44 Turning to the question of non-infringement by Apotex's actual activities, Pratte J.A. was of the view, at pp. 342-43, that "Apotex, by purchasing from Novopharm bulk nizatidine manufactured or imported by that company under its compulsory licence, would acquire the right to use that drug and, as an incident of that right, the right to make capsules from it". He found that, by selling a patented article, a patentee transfers the ownership of that article to the purchaser. The patentee no longer has any right with respect to the article, and the purchaser, as the new owner, "has the exclusive right to possess, use, enjoy, destroy or alienate it" (p. 343) without fear of infringing the vendor's patent. The patentee, in other words, has impliedly renounced his exclusive right of use and sale. In the view of Pratte J.A., with whom the majority concurred on this point, the same

principles apply to the sale of a patented article by a licensee who is entitled by the licence to sell without restrictions, and therefore, Apotex was entitled to make capsules from the nizatidine obtained from Novopharm without infringing Eli Lilly's patent. For these reasons, Pratte J.A. would have allowed the appeal.

IV. Issues

45 As I have already stated, the issue common to both appeals is whether the supply agreement between Apotex and Novopharm constituted a sublicense, such as to justify the termination by Eli Lilly of Novopharm's compulsory licence for nizatidine. If it did, then the NOAs issued by both Novopharm and Apotex were not justified and the requested prohibition order should issue. However, each appeal also raises other discrete issues, which I shall consider in turn.

46 Specifically, in the Novopharm proceeding, this Court is asked to determine: (1) whether the Federal Court of Appeal erred in applying its decision in Apotex #1 to the Novopharm appeal, whether as *res judicata* or otherwise; (2) whether Novopharm's NOA was not justified, regardless of whether its compulsory licence was terminated by breach, because the licence did not permit the activities which it proposed; and (3) whether the Federal Court had the jurisdiction to grant declaratory relief on a limited judicial review proceeding of this type. In Apotex #1, it is further alleged that, apart from the primary issue of infringement, Apotex's proposed reformulation of the nizatidine into final-dosage form would itself constitute an infringement of the patents held by Eli Lilly, and that the prohibition order should therefore have issued regardless of whether or not the supply agreement constituted a sublicense.

V. Analysis

A. The Agreement Between Apotex and Novopharm

47 The primary argument advanced by Eli Lilly is that the supply agreement constituted the grant of a sublicense by Novopharm to Apotex in direct violation of paragraph 12 of Novopharm's compulsory licence for nizatidine. It is undisputed that such a breach would, pursuant to paragraph 8 of the licence, entitle Eli Lilly to terminate the licence, which would in turn preclude Novopharm from manufacturing, using, importing or selling nizatidine without infringing Eli Lilly's patent. In this event, neither Novopharm's nor Apotex's NOA would be justified.

(1) The Nature of a Sublicence

48 Relatively little argument was directed at defining what a sublicense is. As a general matter, a sublicense amounts to a grant by a licensee of certain licensed rights to a third party, the sublicensee. That is, the licensee in effect transfers or licenses some or all of his or her rights to the sublicensee, which means that the sublicense has similar incidents to the primary licence, including the right to exercise independently certain rights enjoyed by the licensee pursuant to its licence. It has been said, in fact, that "a sublicense is simply another name for the indirect granting of a

licence": see Leslie W. Melville, *Forms and Agreements on Intellectual Property and International Licensing*, vol. 1 (3rd ed. rev. 1997 (loose-leaf)), at sec. 3.18.

49 To understand the nature of a sublicense, then, it is first necessary to appreciate the nature of a licence. In Harold G. Fox, *The Canadian Law and Practice Relating to Letters Patent for Inventions* (4th ed. 1969), the concept is expressed as follows (at p. 285):

A licence, even though exclusive, does not give the licensee all the rights of the patentee. A licence does not set up rights as between the licensee and the public, but only permits him to do acts that he would otherwise be prohibited from doing. He obtains merely a right of user. But a licence is a grant of a right and does not merely confer upon the licensee a mere interest in equity. A licence is the transfer of a beneficial interest to a limited extent, whereby the transferee acquires an equitable right in the patent. A licence prevents that from being unlawful which, but for the licence, would be unlawful; it is a consent by an owner of a right that another person should commit an act which, but for that licence, would be an infringement of the right of the person who gives the licence. A licence gives no more than the right to do the thing actually licensed to be done. [Emphasis added.]

In other words, by the grant of a licence, the patentee grants to the licensee the right to act in a certain way vis à vis the patented article, a right which, but for the licence, the licensee would not enjoy. The licensee's rights, however, are not necessarily equivalent to those of the patentee; rather, they are limited to, and qualified by, the express terms of the licence.

50 Moreover, I should note, as an aside, that, unless the intention is expressed or implied in the licence, a licensee is not at liberty to grant a sublicense without the permission of the licensor: see, for example, *Howard and Bullough, Ltd. v. Tweedales and Smalley* (1895), 12 R.P.C. 519, at p. 528. This may be viewed as an effort by the law to protect the property rights of the owner of the property, notwithstanding that the exclusive nature of these rights has been compromised by the granting of a licence. Thus, even without the express prohibition against sublicensing in the compulsory licence, Novopharm would not have been permitted to grant a sublicense to Apotex. The effect of the express prohibition, however, in the context of this licence as a whole, is that the grant of a sublicense by Novopharm would occasion a breach which could lead to the termination of the compulsory licence at the instance of Eli Lilly.

51 For Novopharm to have granted a sublicense to Apotex by means of the supply agreement, it must have transferred some or all of its rights under its compulsory licence to Apotex. Simply put, the question comes down to this: did Novopharm grant to Apotex, either expressly or impliedly, the right to do something which Apotex would otherwise be prohibited from doing, and which Novopharm was permitted to do only by virtue of its compulsory licence for nizatidine? This may have occurred in one of two ways: either some express provision or provisions, apparent on the face

of the agreement, may reveal that the intentions of the parties was to create a sublicensing arrangement, or the legal effect of the document may be such that a sublicense was created in spite of the parties' contrary intentions. I will examine each of these possibilities in turn.

(2) Contractual Interpretation and the Intentions of the Parties

52 In order to ascertain whether the supply agreement conferred or had the effect of conferring a sublicense upon Apotex, it is first necessary to consider the proper approach to the interpretation of such a contract, and, in particular, the evidence which may be considered in this respect. In *Consolidated-Bathurst*, supra, at p. 901, Estey J., writing for himself and Pigeon, Dickson, and Beetz JJ., offered the following analysis:

Even apart from the doctrine of *contra proferentem* as it may be applied in the construction of contracts, the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted. Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation ... which promotes a sensible commercial result.

53 From this passage emerge a number of important principles of contractual interpretation. Not all of these, however, apply to the instant appeal. One which surely does not is the doctrine of *contra proferentem*. *Contra proferentem* operates to protect one party to a contract from deviously ambiguous or confusing drafting on the part of the other party, by interpreting any ambiguity against the drafting party. When both parties are in agreement as to the proper interpretation of the contract, however, it is not open to a third party to assert that *contra proferentem* should be applied to interpret the contract against both contracting parties. Indeed, a third party has no basis at all upon which to rely upon *contra proferentem*: see G. H. L. Fridman, *The Law of Contract in Canada* (3rd ed. 1994), at p. 471. Therefore, I would, as a preliminary matter, reject the suggestion that the doctrine should apply to read any ambiguity in the contract against the drafting parties, in this case both Novopharm and Apotex.

54 The trial judge appeared to take *Consolidated-Bathurst* to stand for the proposition that the ultimate goal of contractual interpretation should be to ascertain the true intent of the parties at the time of entry into the contract, and that, in undertaking this inquiry, it is open to the trier of fact to admit extrinsic evidence as to the subjective intentions of the parties at that time. In my view, this

approach is not quite accurate. The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. Evidence of one party's subjective intention has no independent place in this determination.

55 Indeed, it is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face. In the words of Lord Atkinson in *Lampson v. City of Quebec* (1920), 54 D.L.R. 344 (P.C.), at p. 350:

. . . the intention by which the deed is to be construed is that of the parties as revealed by the language they have chosen to use in the deed itself [I]f the meaning of the deed, reading its words in their ordinary sense, be plain and unambiguous it is not permissible for the parties to it, while it stands unreformed, to come into a Court of justice and say: "Our intention was wholly different from that which the language of our deed expresses. . . ."

56 When there is no ambiguity in the wording of the document, the notion in *Consolidated-Bathurst* that the interpretation which produces a "fair result" or a "sensible commercial result" should be adopted is not determinative. Admittedly, it would be absurd to adopt an interpretation which is clearly inconsistent with the commercial interests of the parties, if the goal is to ascertain their true contractual intent. However, to interpret a plainly worded document in accordance with the true contractual intent of the parties is not difficult, if it is presumed that the parties intended the legal consequences of their words. This is consistent with the following dictum of this Court, in *Joy Oil Co. v. The King*, [1951] S.C.R. 624, at p. 641:

. . . in construing a written document, the question is not as to the meaning of the words alone, nor the meaning of the writer alone, but the meaning of the words as used by the writer.

57 In my view, there was no ambiguity to the contract entered into between Apotex and Novopharm. No attempt was made to disguise the true purpose of the arrangement, or the circumstances surrounding its drafting. Clearly, the agreement was meant to minimize the deleterious effects of the amendments to the Patent Act, which were expected to and did eventually place severe restrictions on the former scheme of compulsory licensing, by maximizing the access of each party to as wide a variety of patented medicines as possible. This was to be accomplished by obliging each party to obtain such material for the other in the event that one party possessed a licence which the other lacked and could no longer readily obtain. All of this is evident on a plain reading of the recitals to the supply agreement. Leaving aside the question of circumventing the legislation, which has no bearing on the interpretation of the contract, the parties' intentions are clear on the face of the agreement. Accordingly, it cannot properly be said, in my view, that the supply agreement contains any ambiguity that cannot be resolved by reference to its text. No further interpretive aids are necessary.

58 More specifically, there is no need to resort to any of the evidence tendered by either Apotex or Novopharm as to the subjective intentions of their principals at the time of drafting. Consequently, I find this evidence to be inadmissible by virtue of the parol evidence rule: see *Indian Molybdenum Ltd. v. The King*, [1951] 3 D.L.R. 497 (S.C.C.), at pp. 502-3.

59 Moreover, even if such evidence were required, that is not the character of the evidence tendered in this case, which sheds no light at all on the surrounding circumstances. It consisted only of the subjective intentions of the parties: Mr. Dan's subjective intention at the time of drafting and Dr. Sherman's subjective intention to implement the agreement in a certain way.

60 Therefore, I am of the opinion that the trial judge erred, in the Novopharm proceeding, in considering the evidence of Mr. Dan as to his intention at the time the contract was made. However, I am also cognizant of her clear statement that she would have reached the same conclusion even without considering the evidence and thus I would not reject her interpretation of the supply agreement for this reason alone. Appropriately, McGillis J. did not appear to consider the evidence of Dr. Sherman in Apotex #1, although the same cannot be said for MacGuigan J.A. in his disposition of that case. Indeed, he seemed to have been influenced heavily by this evidence, which necessarily casts doubt on the validity of his conclusions.

61 Having established that no extrinsic evidence is admissible, what does the text of the agreement say about the intentions of the parties? Despite the somewhat strident submissions to the contrary by Eli Lilly, one thing which it most assuredly does not say is that, pursuant to its terms, Apotex is entitled to the independent use of any compulsory licence owned by Novopharm for its own benefit. Nor does it say that Apotex is entitled to exercise any right enjoyed by Novopharm pursuant to any such licence. Rather, it simply provides, in paragraph 1, that Novopharm will, at the direction of Apotex, "use its licence for the benefit of" Apotex. To my mind, this does not satisfy the definition of a sublicense, as previously set out. The only right acquired by Apotex pursuant to this provision is the right to require Novopharm to exercise its licensed rights in a particular way, that is, to enable it to set in motion and benefit from Novopharm's exercise of its own rights to obtain and sell certain patented medicines. Apotex acquires no right to obtain these medicines independently of Novopharm. Indeed, it remains abundantly clear that Novopharm is still the only party actually entitled to act pursuant to the licence.

62 Thus, it is really of no consequence that the agreement gives Apotex the right to direct Novopharm as to who should make the medicine, from whom it should be purchased, and at what price, or that Novopharm is contractually obliged to follow these directions. Nor does it matter that Novopharm is to receive a royalty for supplying to Apotex the licensed materials so obtained. In some ways, these provisions create nothing more than an elaborate agreement to agree. That is, the agreement sets out a procedure by which the unlicensed party may require the licensed party to enter into another agreement, one of purchase and sale, the specific terms of which may be set substantially by the unlicensed party except that the licensed party is always entitled to the same rate of return: four percent of the cost of the material sold. In this way, the royalty does no more

than assure the licensed party a certain margin of profit in consideration of its role in these anticipated future transactions. The arguments of the respondent notwithstanding, I do not see how this can be indicative of either an intention to confer, or the actual conferral of, a sublicense.

63 It is true that, in the recitals, the parties refer to a mutual intention to "share their rights", which itself might well be taken to suggest an intention to create a sublicense. However, this provision must be read in light of the rest of the agreement, which clearly discloses the intention not to create a sublicense. In particular, the requirement in paragraph 6 that the licensed party comply with the terms of its licence militates against the conclusion that the parties intended by the agreement to grant sublicences to one another. It simply would not be possible for Novopharm to grant a sublicense while still complying with the terms of its compulsory licence for nizatidine, given the express prohibition in that licence against the conferral of sublicences. On the evidence, there is no reason to conclude that Novopharm intended to breach both the supply agreement and its compulsory licence by granting a sublicense to Apotex.

64 Moreover, I do not read paragraph 7 of the agreement, which provides that "[t]he licensed party shall not be excused from performing any act as directed by the unlicensed party ... on the grounds that there is doubt as to whether or not the licence ... permits the requested acts" (emphasis added), provided also that the unlicensed party is obliged to defend the licensed party from any ensuing litigation, as either permitting or requiring the conferral of a sublicense in this case. If paragraph 6 is to have any meaning at all, it must at least be seen as prohibiting acts which would be in clear violation of the licence held by the licensed party. I can conceive of no clearer violation than the conferral of a sublicense. There is no "doubt" as to whether the licence permits such an act; rather, it is expressly prohibited by paragraph 12 of the licence. Consequently, I do not believe that paragraph 7 has any application in the circumstances; certainly, it does not oust the effect of paragraph 6.

65 Paragraph 8, which requires the licensed party to "cooperate fully with the unlicensed party and follow the directions of the unlicensed party to enable the unlicensed party to enjoy the use of the licence to the same extent that would be possible if the unlicensed party itself held such licence" (emphasis added), is admittedly an unusual and arguably unfortunately worded clause. Indeed, if anyone were to question whether the supply agreement was actually drafted without the benefit of counsel, as asserted by both Novopharm and Apotex, this paragraph would stand as cogent evidence in support of that claim. However, it too must be read in light of the rest of the agreement, which simply does not permit the unlicensed party to "enjoy the use of the licence" in the active sense, that is, to actually use it. Rather, it permits only indirect enjoyment: the enjoyment of the licensed party's use of the licence. It is certainly true that the licensed party is obliged to follow the directions of the unlicensed party and to take all legal steps possible to enable the unlicensed party to benefit from the existence of the licence, when requested. However, this stops short of actually permitting the unlicensed party to exercise licensed rights independently of the licensed party, which is the essence of a sublicense.

66 In short, I can find nothing in the wording of the document to suggest that the parties intended to grant sublicences to each other. Rather, every indication is that they intended to establish a commercial arrangement whereby the unlicensed party would enjoy the right to require the licensed party to use its various licences for the benefit of the unlicensed party by acquiring, potentially at the direction of the unlicensed party, and subsequently reselling to the unlicensed party, various patented medicines. Indeed, it is worth noting that the creation of sublicences really would not have been in the parties' commercial interests, as this would have justified the termination of the various compulsory licences held by each company and thereby not only rendered the supply agreement itself useless but also jeopardized the business operations of both. While it is true, as submitted by Eli Lilly, that no express words of grant are required to create a sublicense, clearly the supply agreement, to have this character, must have transferred to Apotex more than simply the right to compel Novopharm to use its licence in a given way. But it is apparent that, in the context of the agreement as a whole, this is all that was meant by sharing rights.

(3) The Legal Effect of the Supply Agreement

67 Eli Lilly contends that the legal effect of the agreement was that a sublicense was granted by each party to the other, despite what they may have intended. In light of the foregoing analysis, however, I do not see how this argument can be sustained. Apotex and Novopharm intended to create a specific type of supply agreement, not a sublicense, and I believe they succeeded in doing so. However, to the extent that Eli Lilly's argument may be premised upon some confusion as to the distinction between a sublicense and an ordinary agreement of purchase and sale, that distinction does merit some brief examination at this stage.

(i) Sublicence Versus Purchase and Sale

68 By virtue of its compulsory licence, Novopharm is entitled to manufacture and/or import bulk nizatidine, subject to the temporal restrictions imposed by the Patent Act, and to sell the nizatidine so obtained to Apotex or any other third party. Apotex, having acquired the nizatidine from Novopharm, would then be free to use it in any way that did not infringe the patents held by Eli Lilly. Thus, no sublicense could have been created by an agreement that was confirmatory of these rights and simply conferred upon Apotex the additional right to require Novopharm to acquire and sell to it bulk nizatidine at a certain rate. In other words, to prove the existence of a sublicense, it must be established that the agreement was, in substance if not form, more than merely an elaborate arrangement under which future contracts for purchase and sale might be completed.

69 As I have said, a sublicense requires the conferral of licensed rights by a licensee upon a third party, the sublicensee. This may create some confusion between a sublicense and an ordinary contract of purchase and sale, though, as a third party may acquire similar rights under each of these arrangements. That is, just as a sublicensee can obtain the rights to use and sell a patented article if this right is enjoyed by the licensee and transferred accordingly, so too is the sale by a licensee of a patented article presumed to give the purchaser the right "to use or sell or deal with the goods as the

purchaser pleases": see *Badische Anilin und Soda Fabrik v. Isler*, [1906] 1 Ch. 605, at p. 610; see also *Gillette v. Rea* (1909), 1 O.W.N. 448 (H.C.); *Betts v. Willmott* (1871), L.R. 6 Ch. App. 245. In other words, unless otherwise stipulated in the licence, a licensee is generally entitled to pass to a purchaser the right to use or resell the patented article without fear of infringing the patent.

70 But the sale of a licensed article obviously does not have the automatic effect of constituting the purchaser a sublicensee, and thus the fact that a third party enjoys rights of use and alienation cannot alone be indicative of the existence of a sublicense. Indeed, as Apotex points out, both the case law and common sense disclose any number of ways in which a licensee can sell a licensed article to a third party with the complete range of ordinary incidents of ownership, without constituting that party a sublicensee. These range from the ordinary casual purchase to the licensee's manufacturing, at the purchaser's instigation and direction, and according to the purchaser's own design specifications, products which incorporate the subject matter of the licence: see *Intel Corp. v. ULSI System Technology Inc.*, 995 F.2d 1566 (Fed. Cir. 1993).

71 Thus, practically speaking, the rights of use and alienation can only be determinative of the existence of a sublicense in cases in which it is clear that no transfer of property rights has occurred, i.e., that there has been no sale of the licensed article to the third party. In such a case, a right of use could only be derived from a sublicense of some type, and an untrammelled right of alienation could not be enjoyed at all, as it would be impossible for a third party to transfer good title without first having any proprietary right in the article. Where the rights of the unlicensed party are derived from a sale of licensed material, however, it would be misleading to rely on the rights of use and alienation as a basis for the conclusion that a sublicense has been or is to be granted.

72 In the present case, it is plainly the latter situation which is contemplated by the supply agreement between Novopharm and Apotex. Under the agreement, any right Apotex might enjoy to sell nizatidine would obviously emanate from its first having purchased such material from Novopharm. As I have stated, the possibility that the material might be acquired by Novopharm at and subject to Apotex's direction is of no consequence. What is important, rather, is that the supply agreement in no way permits Apotex to exercise rights licensed to Novopharm in order to manufacture, or otherwise acquire independently, patented material for which it is not itself licensed. If the agreement were in substance a sublicense, Novopharm's involvement would be entirely unnecessary; Apotex could deal directly with the manufacturer or exporter of the material, or manufacture the drugs itself. But no such rights in fact exist under the supply agreement.

73 A number of recent U.S. cases support the view that establishing the existence of a sublicense in situations analogous to the one before us will typically depend on demonstrating that the unlicensed party is exercising the licensee's right to manufacture or import the licensed material. For example, in *Intel*, supra, it was held that the sale of microchips by the licensee, Hewlett-Packard ("HP"), to a third party, ULSI, did not constitute a sublicense, notwithstanding that the chips were built by HP according to the design and specifications of ULSI and were then resold by ULSI. The court in that case did acknowledge, however, that HP's empowering ULSI to make the chips itself

would have constituted a sublicense.

74 In the instant appeals, the Federal Court of Appeal relied on *du Pont*, *supra*, for the proposition that, in effect, a sublicense is created whenever a patented product is made for the benefit of the unlicensed party rather than the licensee. However, with respect, I view *du Pont* as readily distinguishable from the cases before us, and do not, in any event, believe that it stands for the legal principle propounded. In *du Pont*, it was more significant that the unlicensed party actually manufactured the licensed article, allegedly as the agent of the licensee, only then to "purchase" the article from the licensee immediately upon its manufacture. This arrangement was characterized by the Delaware Supreme Court as a sham, and rightfully so. The only factor which distinguished it from an overt situation of an unlicensed party's manufacturing a patented article strictly for its own benefit was a series of paper transactions carried out between a subsidiary corporation and its parent for the purpose of obscuring the true character of the arrangement.

75 But the situation is manifestly different in a case where the manufacturer and the end user are embodied in two different legal personae, and legitimate transfers of property do, in fact, take place. In *Cyrix Corp. v. Intel Corp.*, 77 F.3d 1381 (Fed. Cir. 1996), the licensed party agreed to supply a third party with microprocessors which it was entitled to manufacture pursuant to a licence conferred upon it by the patentee. The licensed party, in turn, had the processors made by another corporation (affiliated but not a subsidiary), which then sold them to the licensed party for resale to the third party. It was argued that this arrangement constituted in essence a sublicense granted by the licensed party to the third-party manufacturer, and that the licensed party's "have made" rights under the licence extended only to the manufacture of goods for its own benefit. The court rejected this argument, finding that the licensed party was entitled to have the licensed products made by an agent and to resell them as it saw fit. It distinguished *du Pont*, *supra*, on the basis that the manufacturer and the end user were two completely separate entities, and so the arrangement could not be characterized as a sham.

76 In my view, *Cyrix* is much more closely analogous than *du Pont* to the instant appeal, a case in which two arm's-length companies, one licensed and the other unlicensed, have contracted for the prospective purchase and sale of patented goods. They have agreed that the licensed party, in this case *Novopharm*, will, at and according to the direction of the unlicensed party, *Apotex*, either manufacture or import the goods, acquire property rights in them, and sell them to *Apotex*. The only real difference is that, where in *Cyrix* the licensee presumably had the chips made on such terms as would ensure that a profit would be earned on the agreement of purchase and sale previously completed with the third party, in the present circumstances, the profit of which *Novopharm* is assured is based not on its arrangement with its supplier, but from the guaranteed four percent royalty payable by *Apotex*. This distinction alone cannot transform the supply agreement into a sublicense.

77 Because the supply agreement has not yet been implemented, the evidence certainly does not establish that this is a case where the unlicensed party is manufacturing the goods itself, as in *du*

Pont. Consequently, I need not decide whether a sublicense would be granted in this hypothetical situation. Indeed, it has not been argued, and I cannot simply presume that the supply agreement has been or is intended to be carried out in this manner. Moreover, I note again that the supply agreement expressly provides, in paragraph 6, that the licensed party must comply with the terms of the licence, which, *inter alia*, precludes it from granting sublicences. Therefore, while it is theoretically possible that this arrangement could someday be implemented in a way that would result in the grant of a sublicense, it must be presumed for the present purposes that, if the agreement is ever actually acted upon, the parties will act in accordance with the law.

78 Pursuant to the terms of the contract as it stands, Apotex is simply permitted to direct Novopharm to the third party manufacturer which it favours and with whom it has negotiated terms, which would then oblige Novopharm to deal with that manufacturer and acquire the patented medicine on the terms negotiated. Despite this considerable degree of control by Apotex, it remains the case that separate entities are involved, that Apotex is in no way ultimately responsible for the supply of the goods that Novopharm will eventually sell to it, and that a legitimate and *de facto* transfer of property must occur between Novopharm and the third party before any proprietary rights can be acquired by Apotex. Therefore, only if Apotex's designation of a preferred source or manufacturer would necessarily render it a sublicensee of Novopharm would the agreement between the two companies amount to a breach of the terms of the compulsory licence. Since it is possible for Apotex to exercise this contractual right without the benefit of licensed rights transferred to it by Novopharm, it would be incorrect to say that the supply agreement necessarily infringes the licence.

79 As I have already made clear, Apotex enjoys no rights of its own under the licence as a consequence of the supply agreement with Novopharm, regardless of the parties' apparent intention to "share their rights". At bottom, the agreement amounts to nothing more than an agreement to agree, a mutual obligation for the parties to enter into future contractual arrangements with one another. Neither the text of the agreement nor the manner in which the parties purported to implement it supports the conclusion that it is in substance a sublicense.

(4) The Agency Argument

80 In the alternative, Eli Lilly submitted that the supply agreement ought to be interpreted as a sublicense because the degree of control likely to be exercised by Apotex over the acquisition of nizatidine would result in a situation where Novopharm in reality would be acting as Apotex's agent. Novopharm would not be acting on its own behalf in the acquisition but rather on behalf of Apotex, which would imply that Apotex has acquired licensed rights from Novopharm. As a variation on this theme, it is suggested that Novopharm would in effect be unlicensed to make these acquisitions because it would be standing in the shoes of Apotex, an unlicensed entity. The latter submission, then, stands as an alternative to the sublicense argument, and remains even if the supply agreement is not considered a sublicense.

81 To my mind, both forms of this argument must fail, for one very simple reason. It is abundantly clear that, under the supply agreement, any contractual relations that might be established for the purchase of nizatidine would be between Novopharm and the third-party supplier. Apotex would not be a party to the contract; Novopharm would not be entering into the contract "on behalf of" Apotex in any sense. The notion of an agent's entering into contractual relations with the third party is inimical to the entire concept of agency, which contemplates the agent's binding the principal, not itself, to contractual relations and obligations. The completion of a contract between Novopharm and a third-party supplier would prevent the formation of an agency relationship because, even if contemplated, such a relationship could not be embodied by a transaction which resulted in the completion of a contract between the third party and the agent rather than the principal.

(5) Conclusion as to the Nature of the Supply Agreement

82 The arrangement entered into by Apotex and Novopharm is not a sublicence. Regardless of the level of control that might be exercised by Apotex over arranging and facilitating the acquisition of licensed materials for its own benefit, no actual acquisition is itself possible without the involvement of Novopharm. The agreement does not grant Apotex the right to do independently of Novopharm anything which only Novopharm is licensed to do, nor does it purport or disclose any contractual intent to do so. In other words, no licensed rights are transferred by Novopharm to Apotex. Thus, the substance of the arrangement, while perhaps resulting in an unconventional commercial situation, is ultimately inconsistent with the grant of a sublicence. To the extent that the Federal Court of Appeal held otherwise, it was, with respect, in error.

83 That is not to say, however, that it would be impossible to implement the agreement in such a manner as to create a sublicence. For example, while I need not decide this hypothetical issue, I would again observe that, if the domestic supplier from which Apotex directed Novopharm to obtain the nizatidine were found to be Apotex itself, the agreement would likely be seen as a sham, just as in *du Pont*, supra. Similarly, if Novopharm were to be less than vigilant in enforcing the terms of the agreement and permit Apotex to contract directly with a third party supplier for the purchase of nizatidine, this relaxation of terms might well be shown to result in the effective conferral of a sublicence. But these are hypotheticals, not our facts. Indeed, there can be no possible evidence in this case of the manner in which the agreement was implemented by the parties because, at the time of the hearing, it had not been implemented at all. On the other hand, if the agreement has subsequently been implemented so as to create a sublicence, or if it is so implemented in the future, it would certainly then be open to the patentee to move to terminate the compulsory licence or to seek whatever other relief might be appropriate under the Patent Act or otherwise. However, this has no bearing on the justification of the NOAs here at issue.

84 Accordingly, I would emphasize that the conclusions reached in this case should not be taken to characterize every supply agreement similar to the one here at issue as insulating the parties to it from any allegation of sublicensing. Rather, this decision is to be substantially confined to its facts:

a case in which an agreement has been entered into between companies dealing at arm's length, which is not on its face a sublicense, and which had not been implemented at any time material to the litigation. Depending on the implementation of the agreement, the identities of the parties, or any number of other distinguishing factors, it is entirely possible that a different result might be reached on the specific facts of another case.

B. Other Issues in the Novopharm Appeal

- (1) Did the Federal Court of Appeal Err in Applying its Decision in Apotex #1 to its Decision in Novopharm?

85 Novopharm submits that, even if the supply agreement were properly interpreted by the Federal Court of Appeal as conferring a sublicense upon Apotex, it nonetheless should not be considered a sublicense for the purposes of the Novopharm appeal. The reason advanced for this distinction is that nothing on the face of the agreement can be seen as constituting a sublicense, and, whereas the conclusion of the court in Apotex #1 may have been premised in part on Dr. Sherman's evidence as to the manner in which Apotex expected the agreement to be implemented, no steps had actually been taken to implement the agreement. Thus, it is argued that, while it might have been open to the court to grant the requested prohibition order in Apotex #1 if Dr. Sherman's proposed implementation would have resulted in the conferral of a sublicense, this evidence was not before the court in Novopharm and, in fact, was inconsistent with Mr. Dan's evidence as to his understanding of the agreement. To the extent that the Federal Court of Appeal failed to take into consideration this material evidentiary difference, it is suggested, this constituted an error of law.

86 It is certainly true that each case must be considered on its own facts, and I have already expressed the view that the implementation of the agreement in a certain way might well result, hypothetically, in the creation of a sublicense. As such, I agree that it would have been inappropriate for the Federal Court of Appeal to apply its decision in the first appeal to the second, whether as res judicata or otherwise, without considering any material factual differences which might have existed between the two cases. However, in light of my earlier conclusion as to the character of the supply agreement, together with the fact that the agreement had not been implemented at the material time, it is not necessary to decide this issue. None of the parol evidence considered by the Federal Court of Appeal has had any bearing on the conclusions I have reached.

- (2) Was Novopharm's Notice of Allegation Premature and Therefore not Justified?

87 Even the unequivocal conclusion as to the character of the supply agreement does not put the Novopharm matter to rest. Still to be determined is whether, as alleged by Eli Lilly, Novopharm's NOA was not justified regardless of whether its compulsory licence for nizatidine was successfully terminated.

88 Pursuant to s. 39.11(2)(c) of the Patent Act, Novopharm was prohibited from importing, under

its compulsory licence, medicine in respect of which a previous NOC had been granted after June 27, 1986, until 10 years after the date of the issuance of that NOC. While this section was repealed by the Patent Act Amendment Act, 1992, s. 11(1) of that Act provides that licences granted under the former s. 39 prior to December 20, 1991, continue in effect according to their terms, and ss. 39 to 39.14 of the former Act continue to apply to such licences as if those sections had not been repealed.

89 A NOC in respect of nizatidine was granted to Eli Lilly Canada on December 31, 1987. Accordingly, it is submitted by Eli Lilly that Novopharm's NOA, which was issued on July 30, 1993, could not have been justified before December 31, 1997, the first date on which it would have been entitled, under its compulsory licence, to import nizatidine. Thus, Eli Lilly argues that, even if no sublicense was granted and the termination of Novopharm's licence was not therefore justified, Novopharm would nonetheless have infringed Eli Lilly's patents if it had received a NOC for nizatidine, as it had no non-infringing way in which to obtain the bulk medicine.

90 However, this submission appears to ignore the fact that Novopharm's NOA does not seem to disclose any specific intention to import the nizatidine. Rather, the request was for a NOC to make, construct, use, and/or sell nizatidine in 150 mg and 300 mg capsules. No mention was made of how Novopharm proposed to obtain the bulk medicine, and no evidence was led to suggest that it was to be imported. Indeed, while Mr. Dan acknowledged in his written answers to undertakings on cross-examination that, at the time of the hearing, Novopharm's suppliers were located outside of Canada, he also indicated that Novopharm was aware of the prohibition against its importing nizatidine before December 31, 1997, and intended to abide by the relevant provisions of the Patent Act. Further, he indicated that Novopharm might locate a Canadian supplier between December 31, 1994, and December 31, 1997, and expressly disavowed any intention to import nizatidine prior to the latter date.

91 Pursuant to s. 39.14 of the Patent Act, Novopharm was entitled to use the patented invention for the preparation or production of medicine -- that is, to manufacture the medicine itself or through Canadian agents -- after the expiration of seven years after the date of the issue of the first NOC to Eli Lilly Canada. This seven-year period expired on December 31, 1994, and while Novopharm served its NOA on Eli Lilly Canada on July 30, 1993, the application was not heard until January 30, 1995. Thus, as of the date of hearing, Novopharm was entitled to manufacture or have made the drug for its own use, for sale for consumption in Canada.

92 In *Apotex #2*, supra, the companion to the instant appeals, I have held that the appropriate date for assessment of a NOA, where a prohibition order is sought by a patentee, is the date of hearing and not the date on which the NOA was issued. Accordingly, I cannot conclude that Novopharm's NOA was premature and therefore not justified. As of the date of hearing, it did indeed have a non-infringing way to obtain bulk nizatidine, and, in the absence of evidence to the contrary, I presume that its intention was, as Mr. Dan asserted, to operate within the restrictions of the Patent Act by obtaining the medicine either from a Canadian supplier or not at all.

(3) Jurisdiction to Grant Declaratory Relief

93 The final issue to be determined with respect to the Novopharm appeal is whether this Court has the jurisdiction, on a summary judicial review proceeding concerning an application for a prohibition order against the issuance of a NOC, to grant declaratory relief. Specifically, Novopharm asks that this Court declare: (1) that Eli Lilly has failed to show that the notice of allegation was not justified; (2) that Eli Lilly has failed to show that it was entitled to terminate the compulsory licence; and (3) that the supply agreement does not constitute a sublicense or a transfer of the compulsory licence from Novopharm to Apotex.

94 In my view, the first two requests are unnecessary. The finding that the supply agreement was not a sublicense necessarily leads to the conclusion, at least for the purposes of this appeal, that Eli Lilly was not entitled to terminate Novopharm's compulsory licence. Indeed, no other breach was alleged, such as to trigger paragraph 9 of the licence. Similarly, this finding, in combination with the finding that Novopharm's NOA was not premature, leads to the conclusion that Eli Lilly has failed to show that the NOA was not justified. I can see no reason to grant what would be superfluous declaratory relief on these issues, when all that is necessary is to determine whether or not the Federal Court of Appeal erred by granting the prohibition orders as requested.

95 As for the third request, I am of the view that it would be inappropriate for this Court to grant the requested relief in light of the nature of these proceedings. As McGillis J. correctly observed, the summary judicial review that is to be conducted on an application for a prohibition order under the Regulations is highly fact-specific and is generally considered to be binding only on the parties in the specific litigation. This is only appropriate, given the limited nature of the proceedings, the question that is to be answered, and the record generated for this limited purpose. In *Merck Frosst Canada Inc. v. Canada (Minister of National Health and Welfare)* (1994), 55 C.P.R. (3d) 302 (F.C.A.), at pp. 319-20, Hugessen J.A. made this point in the following terms, with which I agree:

In determining whether or not the allegations are "justified" (s. 6(2)), the court must then decide whether, on the basis of such facts as have been assumed or proven, the allegations would give rise in law to the conclusion that the patent would not be infringed by the respondent.

In this connection, it may be noted that, while s. 7(2)(b) seems to envisage the court making a declaration of invalidity or non-infringement, it is clear to me that such declaration could not be given in the course of the s. 6 proceedings themselves. Those proceedings, after all, are instituted by the patentee and seek a prohibition against the Minister; since they take the form of a summary application for judicial review, it is impossible to conceive of them giving rise to a counterclaim by the respondent seeking such a declaration. Patent invalidity, like patent infringement, cannot be litigated in this kind of proceeding.

[Emphasis added.]

96 This point was reinforced more recently by Strayer J.A. in *David Bull Laboratories*, supra, at p. 600:

If the Governor in Council had intended by these Regulations to provide for a final determination of the issues of validity or infringement, a determination which would be binding on all private parties and preclude future litigation of the same issues, it surely would have said so. This Court is not prepared to accept that patentees and generic companies alike have been forced to make their sole assertion of their private rights through the summary procedure of a judicial review application. As the Regulations direct that such issues as may be adjudicated at this time must be addressed through such a process, this is a fairly clear indication that these issues must be of a limited or preliminary nature. If a full trial of validity or infringement issues is required this can be obtained in the usual way by commencing an action. [Emphasis added.]

97 While the relief requested of the Federal Court of Appeal in these cases touched on issues pertaining to the infringement and/or invalidity of the actual patents, not the effect of an external agreement, I believe that the reasoning involved is also applicable to the Novopharm appeal. The nature of the inquiry on this judicial review proceeding requires only a determination as to whether or not the NOA was justified in the circumstances of this case. While this necessarily entails a decision as to whether, in these particular circumstances, the supply agreement constituted a sublicense and thus justified the termination of the licence, this is not to be taken as a final decision on the nature of the agreement for all purposes. For this Court to make a binding declaration concerning the private rights and obligations of the parties to the agreement would go well beyond the limited scope of the proceeding. Accordingly, I would deny the declaratory relief requested by Novopharm.

C. Other Issues in the Apotex #1 Appeal

(1) Would the Reformulation of Nizatidine by Apotex into Final-dosage Form Infringe the Patent Held by Eli Lilly?

98 Even assuming that the supply agreement did not constitute a sublicense, that Novopharm's licence remains in force, and that Apotex is therefore able to purchase bulk nizatidine under the supply agreement as a third-party purchaser, the possibility remains that the use to which Apotex proposes, in its NOA, to put the drug would infringe Eli Lilly's patent. In this vein, Eli Lilly submits that the Federal Court of Appeal erred in holding that the formulation of final-dosage capsules by Apotex would not infringe the patent. Specifically, it is submitted that the rights of use and sale that are inherent in the unrestricted purchase of a licensed article do not permit the making of a new article.

99 In the Federal Court of Appeal, Pratte J.A., with whom the majority agreed on this point, disposed of this argument in the following concise and useful passage, at p. 343 with which I agree:

If a patentee makes a patented article, he has, in addition to his monopoly, the ownership of that article. And the ownership of a thing involves, as everybody knows, "the right to possess and use the thing, the right to its produce and accession, and the right to destroy, encumber or alienate it".... If the patentee sells the patented article that he made, he transfers the ownership of that article to the purchaser. This means that, henceforth, the patentee no longer has any right with respect to the article which now belongs to the purchaser who, as the new owner, has the exclusive right to possess, use, enjoy, destroy or alienate it. It follows that, by selling the patented article that he made, the patentee impliedly renounces, with respect to that article, to [sic] his exclusive right under the patent of using and selling the invention. After the sale, therefore, the purchaser may do what he likes with the patented article without fear of infringing his vendor's patent.

The same principles obviously apply when a patented article is sold by a licensee who, under his licence, is authorized to sell without restrictions. It follows that, if Apotex were to purchase bulk Nizatidine manufactured or imported by Novopharm under its licence, Apotex could, without infringing Lilly's patents, make capsules from that substance or use it in any other possible way. [Emphasis added.]

100 Perhaps the principles underlying this well-founded statement of the law merit some brief elaboration at this stage. As I have already noted in connection with the distinction between a sublicense and an ordinary agreement of purchase and sale of a patented or licensed article, the sale of a patented article is presumed to give the purchaser the right "to use or sell or deal with the goods as the purchaser pleases": see *Badische Anilin und Soda Fabrik v. Isler*, supra, at p. 610. Unless otherwise stipulated in the licence to sell a patented article, the licensee is thus able to pass to purchasers the right to use or resell the article without fear of infringing the patent. Further, any limitation imposed upon a licensee which is intended to affect the rights of subsequent purchasers must be clearly and unambiguously expressed; restrictive conditions imposed by a patentee on a purchaser or licensee do not run with the goods unless they are brought to the attention of the purchaser at the time of their acquisition: see *National Phonograph Co. of Australia, Ltd. v. Menck*, [1911] A.C. 336 (P.C.).

101 Therefore, it is clear that, in the absence of express conditions to the contrary, a purchaser of a licensed article is entitled to deal with the article as he sees fit, so long as such dealings do not infringe the rights conferred by the patent. On this score, Eli Lilly alleges that the reformulation of nizatidine would in this case exceed the scope of the rights obtained by the purchaser because it

would constitute not simply the resale of the material purchased, but rather, the creation of a new article in violation of Eli Lilly's patent. However, I can find no basis, either in the evidence or in the case law cited by Eli Lilly, for this submission. In my view, the reformulation of nizatidine into final-dosage form does not have the effect of creating a new article. Rather, it is more akin to repackaging the substance into a commercially usable form, which I do not view as violating any rights under the patents.

102 No specific evidence was led in the instant appeal concerning the nature of the process by which bulk medicine is reformulated into final-dosage form. However, in *Merck & Co. v. Apotex Inc.*, supra, at p. 155, MacKay J. offered a useful summary of the process. While it is possible that the process employed in the reformulation of nizatidine may differ slightly from the reformulation of the medicine at issue in that case, namely enalapril maleate, the gist of MacKay J.'s description is nonetheless apposite: the basic patented compound at issue, that is, the bulk medicine produced by the patentee or licensee, remains unchanged throughout the reformulation process. It exists in the same chemical form in the final-dosage product as in the bulk product. However, the two products are substantially different, in that the bulk form is essentially a powder without other form or shape, while the final-dosage form is a coloured tablet, consisting of the bulk medicine and other ingredients and shaped in a form associated with a particular dosage. Indeed, in the view of MacKay J., the process so described was such a significant transformation that the final-dosage form of enalapril maleate sold by Apotex was not protected by s. 56 of the Patent Act, which authorizes the use and sale of a "specific" patented article by a party who purchased, constructed, or acquired the article before the patent application became open to the inspection of the public. In other words, MacKay J. was unwilling to accept that the final-dosage form was the same "specific article" as the bulk enalapril maleate purchased by Apotex prior to the date on which Merck's patent application became open for inspection.

103 However, this conclusion was rejected by the Federal Court of Appeal, in a judgment reported at [1995] 2 F.C. 723. At p. 738, MacGuigan J.A., writing for a unanimous court, expressed the view that "the right to use or sell the 'specific article, etc.' is independent of the form in which the invention is purchased: any form of the invention may be used or sold within the immunity conferred by s. 56" (emphasis in original). In so holding, MacGuigan J.A. relied on the following statement of Hall J. in *Libbey-Owens-Ford Glass Co. v. Ford Motor Co. of Canada, Ltd.*, [1970] S.C.R. 833, at p. 839, affirming the judgment of Thurlow J. (as he then was) in the court below (reported at [1969] 1 Ex. C.R. 529):

The question in this case is with respect to the extent of the meaning of "using" and it arises because with respect to "vending" the right of the owner of the specific machine or other thing is expressed as that of vending it, not as that of vending its output. However, it is obvious that in the case of a machine designed for the production of goods, there would really be no worthwhile protection allowed by s. 58 [now s. 56] if the owner could not put it to the only use for which it is usable without being liable for infringement. [Emphasis

added.]

104 Accordingly, MacGuigan J.A. concluded, at p. 741, that:

The use and sale of the product of a machine, particularly if production is the only possible use of the machine, is accorded protection under section 56 as a use of the machine itself. . . . In my view, use must be given the same sense in the case of a chemical invention. [Emphasis added.]

105 The *Merck & Co. v. Apotex Inc.* decision highlights the fact that there is really no commercial use for bulk medicine other than its reformulation into final-dosage form, for consumption by the ultimate consumer. In order to realize any utility from the acquisition, then, the purchaser must take steps to convert it into this commercially usable form. In my view, MacGuigan J.A.'s conclusion that the right to use and sell an article includes the right to use and sell things produced with the article, though reached in the specific context of a s. 56 defence, applies with equal force to the case at bar. That is, the right of use and sale which Apotex would acquire inherently, through its acquisition of nizatidine from Novopharm, must be seen as encompassing the right to use and sell things produced with this nizatidine, including capsules in final-dosage form. It follows, therefore, that Apotex would not infringe the patents held by Eli Lilly simply by selling the medicine in the form contemplated by the NOA. This is particularly so when, as in the case at bar, the exclusive rights enjoyed by the patentee under the patent are limited, in essence, to the formulation of bulk medicine according to the patented process. Nothing in the reformulation process can be seen as infringing upon this right.

106 Any doubt as to this conclusion of non-infringement must, in my view, be eliminated by an examination of Novopharm's compulsory licence, which specifically contemplates the sale of the licensed material in bulk form by providing a formula for calculating royalties on product thus sold. As I see it, because there is no other practical use for bulk medicine, this must also be taken to contemplate and implicitly permit the reformulation of the product by the purchaser into final-dosage form. This conclusion is only reinforced, in my view, by the fact that the contemplated royalty rates are based on the amounts received by subsequent purchasers in consideration of the sale of final-dosage forms to the retail trade. Had the Commissioner of Patents intended to restrain such use of the medication, he would have provided for this expressly, or, at least, would not have specifically delineated the procedure that is to compensate the patentee for such use.

107 Therefore, Eli Lilly is incorrect to assert that the reformulation proposed by Apotex would either have to be carried out pursuant to a sublicense granted by Novopharm, which would justify the termination of Novopharm's compulsory licence and, therefore, the sublicense, or would be entirely unauthorized and infringe Eli Lilly's patents. The better view, as I have stated, is that the right to reformulate is premised on the inherent right of an owner of property to deal with that property as he or she sees fit. In the absence of some express term in the compulsory licence, prohibiting purchasers of bulk nizatidine from Novopharm from reformulating it into final-dosage

form, the weight of the case law supports the view that Apotex, having validly acquired the bulk medicine, would be free to reformulate it for resale without fear of infringing any right under Eli Lilly's patents.

108 I would emphasize, however, that this conclusion is in no way premised upon, and should not be taken to have any bearing on, the well-established rules concerning the acceptable limits on the repair of a patented article: see, for example, *Rucker Co. v. Gavel's Vulcanizing Ltd.* (1985), 7 C.P.R. (3d) 294 (F.C.T.D.). Here, we are not considering the repair of a patented article, but its resale in a somewhat different form. I would also add that I am unconvinced by the authorities cited by Eli Lilly in support of the proposition that the rights of the purchaser do not include the right to reformulate.

109 In light of the foregoing, I am in agreement with Pratte J.A. and the majority of the Federal Court of Appeal, and conclude that the reformulation of the bulk nizatidine into final-dosage form would not infringe Eli Lilly's patent. Accordingly, I conclude that Eli Lilly has failed in its various efforts to establish that Apotex's NOA was not justified and that a prohibition order should thus be issued.

VI. Disposition

A. Novopharm Ltd. v. Eli Lilly and Co.

110 For the foregoing reasons, I would allow the appeal, set aside the judgment of the Federal Court of Appeal, and restore the judgment of the Federal Court--Trial Division, with costs to the appellant throughout. However, I would deny the appellant's request for declaratory relief.

B. Apotex Inc. v. Eli Lilly and Co.

111 Also for the foregoing reasons, and after a full consideration of the factual differences existing between the two appeals considered herein, I would allow the appeal, set aside the judgment of the Federal Court of Appeal, and dismiss the application for an order of prohibition. The appellant shall have its costs throughout.

cp/d/hbb/qlhcs

TAB 7

Indexed as:

**Kentucky Fried Chicken Canada, a Division of Pepsi-Cola
Canada Ltd. v. Scott's Food Services Inc.**

Between

**Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada
Ltd., plaintiff (respondent), and
Scott's Food Services Inc. and Scott's Hospitality Inc.,
defendants (appellants)**

[1998] O.J. No. 4368

114 O.A.C. 357

41 B.L.R. (2d) 42

83 A.C.W.S. (3d) 382

Docket No. C28208

Ontario Court of Appeal
Toronto, Ontario

Moldaver, Goudge JJ.A. and Ferrier J. (ad hoc)

Heard: May 4 and 5, 1998.

Judgment: November 2, 1998.

(29 pp.)

*Franchises -- Franchise agreement -- Interpretation -- Breach of agreement -- What constitutes --
Transfer of franchises -- Consent of franchisor.*

Appeal by Scott's Food Services from a trial judgment allowing Kentucky Fried Chicken's (KFC) action for termination of a licensing agreement. Scott's was the largest KFC franchisee in the world. Scott's Food was owned by Scott's Hospitality. Scott's Hospitality owned a school bus business as well as the KFC franchise. In 1996, as part of a transaction with Laidlaw Inc., the shareholders of Scott's Hospitality transferred its ownership of the franchise to Scott's Restaurants. The

Shareholders then owned Scott's Restaurants which owned Scott's Food. Laidlaw purchased the shares of Scott's Hospitality and acquired the school bus business. The change in ownership of the franchise was made without KFC's consent. In issue was whether the license agreement required Scott's to obtain KFC's consent to the change in ownership of the franchisee failing which KFC could terminate the contract. Also in issue was whether Scott's had failed to meet its obligations to enhance its KFC outlets. The trial judge found that consent to a change in ownership was required and that KFC had the right to terminate the agreement. The trial judge also found that Scott's failed to meet its obligation to enhance which was a material and substantive failure also entitling KFC to terminate the license agreement unless the outlets were enhanced within three months. Scott's appealed.

HELD: Appeal allowed. The contract, being a negotiated commercial document, was interpreted objectively and in accordance with sound commercial principles and good business sense. The contract did not give KFC a right to approve a change in the controlling shareholder of the franchisee, Scott's. Such a right would have meant a significant change in the agreement which had governed the franchise relationship since 1969. Prior to executing the agreement, KFC was told that Scott's would not agree to any restriction on changes of ownership in the franchisee. Furthermore, the standard "deemed transfer" language present in every other KFC franchise agreement, which provided for KFC's right to approve a change in shareholders of the franchisee, was conspicuously absent from the Scott's license agreement. The interpretation suggested by KFC resulted in a commercial absurdity. Scott's had bargaining power at least equal to that of KFC and sufficient power to achieve a contract with no restriction on the transferability of shares. Therefore, the license agreement could not be interpreted to give KFC a right to approve a change in the shareholders of Scott's. Consequently, KFC did not have the right to terminate the franchise. The appeal was also allowed on the enhancement issue. The franchise agreement did not give KFC a substantive right to terminate for failure by Scott's to discharge its enhancement obligations.

Counsel:

Dennis R. O'Connor, Q.C., David Stockwood, Q.C., Nancy J. Spies and Timothy H. Mitchell, for the appellants.

David R. Byers, Katherine L. Kay and Christopher J. Cosgriffe, for the respondent.

The following judgment was delivered by

1 GOUDGE J.A.:-- This appeal was heard on May 4 and 5, 1998. This court's reasons for judgment were ready for release on July 9, 1998 when the parties contacted the court to request that this not be done. On the basis of the reasons given by the parties for this request, the court agreed to refrain from releasing its judgment until November 1, 1998 but made clear that the judgment would

then be released unless prior to October 31, 1998 both parties notified the court in writing that the matter had been fully and finally settled and that the appellant wished to withdraw the appeal. This has not happened and these reasons are therefore being released.

2 The appellant Scott's Food is the largest Kentucky Fried Chicken ("KFC") franchisee in the world. Its franchise agreement (the "license agreement") with the respondent covers some four hundred outlets, approximately half of all KFC outlets in Canada.

3 Up until 1996, Scott's Food was owned by the appellant Scott's Hospitality whose other major business was a school bus operation. At that point, as part of a transaction with Laidlaw Inc. ("Laidlaw") in which Laidlaw acquired the school bus business, the shareholders of Scott's Hospitality replaced it as the sole shareholder of the franchisee with a new company, Scott's Restaurants. As a result, these shareholders then owned Scott's Restaurants which in turn owned Scott's Food. This change was made without the respondent's consent.

4 There were two main issues at trial. The second, which the parties call the enhancement issue, was whether, apart altogether from the corporate changes entailed by the Laidlaw transaction, Scott's Food had upgraded its outlets as required by its contract. At trial, Steele J. found that it had not. I will come in due course to the limited appeal taken from the judgment below on this issue.

5 The first and indeed the fundamental issue at trial, called the transfer issue, was whether the license agreement required the appellants (to whom I will refer jointly as "Scott's") to obtain the respondent's consent to the change in ownership of the franchisee failing which the respondent could terminate the agreement. Steele J. interpreted the contract as requiring consent, thereby giving the respondent the right to terminate since no consent was obtained. For the reasons that follow, I have come to the opposite conclusion and I would therefore allow the appeal on the transfer issue.

THE TRANSFER ISSUE

The Relevant Facts

6 The license agreement that is the subject of this litigation was signed on June 9, 1989, effective January 1, 1989. The respondent was the franchisor and the appellant Scott's Food the franchisee. The latter was a wholly-owned subsidiary of Scott's Hospitality which was not a party to the agreement.

7 At the time the license agreement was made, Scott's operated about one-half of all the KFC outlets in Canada and more than ten times as many as the next largest franchisee in the country. Unlike most franchisees, Scott's had very significant bargaining power in the negotiations which led up to the agreement.

8 For the purposes of the transfer issue, the critical paragraphs of the license agreement are the following:

16. Transfer

16.1 The grant of the License hereunder is personal to Licensee. The grant of the License hereunder is based upon full disclosure in writing by the Licensee to KFC, and approval by KFC, of all directors and holders of majority control of the voting shares of Licensee and of any corporation or corporations which directly or indirectly (whether by means of any intermediate corporations or otherwise) own or control or have an interest in the shares of the Licensee. Licensee acknowledges that the restrictions provided in this Paragraph 16 are reasonable and necessary to protect the KFC System and the KFC Marks and are for the benefit and protection of all KFC licensees as well as KFC.

16.2 Licensee agrees that it shall not sell, transfer, assign, encumber, sub-license or otherwise deal with this Agreement or its rights or interest hereunder (hereinafter referred to as "transfer"), without KFC's prior written consent and Licensee's compliance in all respects with the terms and conditions of this Paragraph 16. Any transfer or any attempt to do so, contrary to Paragraph 16 shall be a breach of this Agreement and shall be void but shall give KFC the right of termination as provided in Paragraph 17.2(d).

9 Paragraph 17.2(d) reads as follows:

17.2 KFC may, without prejudice to any other rights or remedies contained in this Agreement or at law or in equity, terminate the License upon immediate notice (or in the event advance notice is required by law, upon the giving of such notice) in the event that:

...

(d) Licensee makes or permits a transfer contrary to the provision of Paragraph 16;

10 The history of Scott's as a KFC franchisee predates the license agreement by twenty years. It goes back to 1969 when Scott's Hospitality entered into an agreement to become a franchisee operating KFC outlets in Canada. The franchisor then was Col. Sanders Kentucky Fried Chicken Limited ("Colonel Sanders"), the owner of the KFC trademarks in Canada. This agreement was to run until January 1, 1994. It is noteworthy that it contained no clause like the current paragraph 16.1. It did not specify that the rights of Scott's Hospitality were personal to it, nor were there any provisions restricting the transfer of its shares. There was, however, a provision restricting the transfer of the license without the prior written consent of the franchisor.

11 By 1985, the franchisor had developed a standard franchise agreement ("the 1985

Agreement") containing certain restrictions on the transfer of shares in the franchisee which, at that point, were standard in all KFC franchise agreements in Canada except that with Scott's Hospitality.

12 While paragraph 16.1 of the 1985 Agreement reads identically to paragraph 16.1 in the license agreement, paragraph 16.2 of the 1985 Agreement when coupled with paragraph 16.4 contains significant differences. These two paragraphs are reproduced below, highlighting the words that do not appear in the license agreement:

16.2 The Franchisee agrees that it shall not sell, transfer, assign, encumber, sub-license or otherwise deal with this Agreement or its rights or interest hereunder (hereinafter referred to as "transfer"), and shall not suffer or permit any deemed sale, transfer or assignment of this Agreement or its rights or interest hereunder (hereinafter referred to as "deemed transfer" and more particularly defined in paragraph 16.4), without KFC's prior written consent and Franchisee's compliance in all respects with the terms and conditions of this Paragraph 16. Any transfer or deemed transfer, or any attempt to do so, contrary to this Paragraph 16 shall be a breach of this Agreement and shall be void but shall give KFC the right of termination as provided in paragraph 17.2(d).

16.4 For the purposes of this Paragraph 16, a deemed transfer of this Agreement or the rights and interest hereunder shall include:

- (a) ...
- (b) in the event that Franchisee is a corporation, any change (including but without limitation any issuance, sale, assignment, transfer, redemption or cancellation of, or conversion of any securities into, voting shares of the corporate Franchisee or any other corporation referred to in paragraph 16.1, or any amalgamation, merger or other reorganization of the corporate Franchisee or any such other corporation) in any of the holdings of voting shares referred to in paragraph 16.1; provided that, in the case of any such corporation the voting shares of which are listed and publicly traded on a stock exchange, no such change in any of the holdings of its voting shares shall constitute a deemed transfer unless, in the sole opinion of KFC, direct or indirect control of the corporate Franchisee would thereby be changed.

13 In 1987, Col. Sanders sold its entire interest in the KFC trademarks in Canada to Kentucky Fried Chicken's corporation ("KFC Corp." or "KFC") which held those rights for the rest of the world.

14 Just prior to this sale, by letter agreement dated July 16, 1987, KFC Corp. agreed that when the sale from Col. Sanders was concluded, it would grant Scott's Hospitality a ten-year renewal of

the 1969 agreement. This letter agreement suggested no constraint on the transfer of shares of the franchisee.

15 Pursuant to the 1987 letter agreement, negotiations ensued between KFC and Scott's Hospitality. In these negotiations, Scott's Hospitality refused to agree to terms in the language of the 1985 agreement, just as it had previously refused to do with Col. Sanders. The Scott's representative made clear to KFC that Scott's would not agree to any restrictions on changes of ownership in the licensee.

16 The relative bargaining power of Scott's and KFC in these negotiations was the subject of some considerable attention at trial. The chief KFC negotiator testified that Scott's was at least the equal of KFC in bargaining power. The leading expert for KFC testified that it was unusual for a franchisee to be in such a position.

17 Because of these unique circumstances, the trial judge concluded that the evidence of the experts as to the usual practice in the franchising industry must be applied with caution. Ultimately, he found that Scott's had sufficient bargaining power to negotiate a contract in which there would be no restriction on the transferability of shares. The question he had to decide was whether the resulting license agreement contained such a restriction.

18 The first of the two Laidlaw transactions, which triggered the need to answer this question, began in January 1996 with an unsolicited offer from Laidlaw to purchase all of the shares of Scott's Hospitality. Laidlaw's intention was that following a successful takeover, it would sell off Scott's Food and retain the school bus business operated by Scott's Hospitality. Laidlaw's offer contained a condition that it be satisfied that there was no impediment to its disposing of the shares of Scott's Food to a third party without affecting the franchisee's rights under the license agreement. KFC was not prepared to give its consent to this transaction and indeed commenced this litigation in response. As a result, this Laidlaw proposal could not be completed within its time frame and hence it did not proceed.

19 Rather, a second Laidlaw transaction was structured in which Scott's Restaurants was incorporated as a subsidiary of Scott's Hospitality. Scott's Hospitality then transferred its shares in Scott's Food to Scott's Restaurants in exchange for shares of Scott's Restaurants which were divided out to the shareholders of Scott's Hospitality. The shareholders of Scott's Hospitality thereby became the owners of Scott's Restaurants which, in turn, became the owner of the franchisee, Scott's Food. Laidlaw then purchased the shares of Scott's Hospitality thereby acquiring the school bus business.

20 KFC was kept fully informed of this transaction but continuously opposed it. Indeed, its consent was never expressly sought. The simple question at trial was whether that consent was required.

The Judgment Below

21 The trial judge found that while Scott's Food as franchisee was bound by the license agreement, Scott's Hospitality was not bound by its terms. He concluded that Scott's Food was neither the alter ego nor the agent of Scott's Hospitality. The respondent does not contest this conclusion.

22 He then went on to his core finding on the transfer issue, namely, the construction of paragraph 16.1 of the license agreement. He construed that paragraph to contain a continuing obligation on the part of the franchisee to obtain approval of KFC to any transfer of the shares of either Scott's Food or its controlling shareholder. He put his findings in these terms:

In my opinion the disclosure and approval of the directors and holders of majority control would be meaningless unless it was a continuing obligation and not merely at the time of execution. Based on good business sense section 16.1 must be construed as being a continuing obligation.

...

In my opinion there is nothing in section 16 that prohibits or gives the right of approval to KFC of trading of shares of Scott's Food or Hospitality provided that there is no issue of a change of control.

There are no clearly expressed words requiring the approval of KFC to any transfer of the shares of Scott's Food or its controlling shareholders. However section 16.1 referring to the grant being personal and the reference to the directors and holders of majority control of the shares of Scott's Food and the broad reference to any other corporations with control make it clear that any transfer of the controlling shares of Scott's Food or Hospitality are subject thereto. To interpret the section otherwise would defeat the personal aspect and not make good business sense and would be contrary to the generally accepted practice in the franchise industry.

23 He then moved directly and without elaboration to a finding that paragraph 16.2 prohibits a transfer or an attempted transfer of the license agreement without consent and since the first Laidlaw proposal was an attempted transfer and the second was an actual transfer, each breached paragraph 16.2 and gave KFC the right to terminate the license agreement pursuant to paragraph 17.2(d).

Analysis

24 The question to be determined on the transfer issue is one of contractual interpretation:

properly construed, does either paragraph 16.1 or paragraph 16.2 of the license agreement require KFC's consent to either Laidlaw transaction? The trial judge determined that this was not a case of ambiguity and on this basis, he declined to consider evidence of the subjective intentions of the parties which were not communicated to each other. Equally he excluded the various draft documents leading up to the license agreement. He did, however, consider the relationship between the parties and the custom of the industry, including the license agreements between the respondent and other franchisees in Canada, as part of the factual matrix that must be looked at in interpreting the agreement.

25 I agree with this approach. While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its "factual matrix" will also provide the court with useful assistance. In the famous passage in *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-96 (H.L.) Lord Wilberforce said this:

No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.

26 The scope of the surrounding circumstances to be considered will vary from case to case but generally will encompass those factors which assist the court "... to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract." *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 at 901.

27 Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity¹. Rather, the document should be construed in accordance with sound commercial principles and good business sense². Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

28 With these broad principles of interpretation in mind, I turn first to the construction to be given to paragraph 16.1 of the license agreement. Properly construed, does it give KFC the right to approve a change in the controlling shareholder of the franchisee? It is the second Laidlaw transaction that requires this question to be answered. Given that the first Laidlaw transaction was not proceeded with, KFC did not argue at trial or on appeal that it breached paragraph 16.1.

29 It is helpful at this point to set out the provision again:

16.1 The grant of the License hereunder is personal to Licensee. The grant of the License hereunder is based upon full disclosure in writing by the Licensee to KFC, and approval by KFC, of all directors and holders of majority control of the voting shares of Licensee and of any corporation or corporations which directly or indirectly (whether by means of any intermediate corporations or otherwise) own or control or have an interest in the shares of the Licensee. Licensee acknowledges that the restrictions provided in this Paragraph 16 are reasonable and necessary to protect the KFC System and the KFC Marks and are for the benefit and protection of all KFC licensees as well as KFC.

30 I have concluded that this clause does not give KFC a right to approve a change in the controlling shareholder of its franchisee Scott's Food. In other words, paragraph 16.1 does not extend to the second Laidlaw transaction. I say this for a number of reasons.

31 First, the license agreement was signed in 1989. The Laidlaw transactions occurred in 1996. The ordinary meaning of the language used in paragraph 16.1 suggests that the franchisor KFC had the right on entering the contract to know and approve the shareholders of the franchisee. There is nothing to suggest a right to approve a change in those shareholders some seven years later.

32 Second, such a right would mean a significant change from the agreement which had governed this franchise relationship since 1969 which clearly contained no such right. Moreover, Scott's had refused to enter into an agreement like the 1985 standard franchise agreement which did provide the franchisor with this right. The trial judge found that prior to executing the license agreement, KFC knew this and had been told that Scott's would not agree to any restriction on changes of ownership in the franchisee.

33 Third, the language of the 1985 standard franchise agreement is revealing. In 1989, when the license agreement was concluded, every other KFC franchise agreement in Canada expressly provided for the franchisor's right to approve a change in the shareholders of the franchisee. This was done not by means of paragraph 16.1 but rather through the "deemed transfer" language of paragraphs 16.2 and 16.4. Paragraph 16.1 in the license agreement ought not to be construed to provide the franchisor with this right where the identical language in the 1985 standard franchise agreement was clearly not intended to have that effect. The corollary to this is that the deemed transfer language which does provide this right to the franchisor in the 1985 standard franchise agreement is conspicuously absent from the license agreement.

34 Fourth, paragraph 16.1 extends the right of approval to the holders of majority control of the franchisee and any corporation which has an interest in the shares of the franchisee. If this language is read to give KFC a right to approve any subsequent change in the majority shareholder of the franchisee, it must also give KFC the right to approve a subsequent change in shareholder control of any corporation which owns any interest in the franchisee, even if it is only a single share. In argument, the respondent conceded that this would be a commercial absurdity. To find, as the trial

judge did, that the franchisor's right of approval is limited to a change of control in the franchisee is, in my opinion, to read out of paragraph 16.1 the phrase "have an interest in". By contrast, to extend this right of approval to the majority shareholder and also to shareholders who have an interest in the shares of the franchisee does not create a commercial absurdity if that right applies simply at the point of entering the license agreement.

35 Fifth, paragraph 16.4 provides support for this interpretation. It requires the franchisee to seek KFC's consent to a transfer to a third party of the franchisee's interest under the license agreement. To allow an informed consent, this paragraph expressly obliges the franchisee to give KFC the same information about the shareholders of the third party that paragraph 16.1 provided concerning the franchisee. However, if paragraph 16.1 contained an ongoing right of KFC to be informed of and approve the shareholders of the party holding the franchise, paragraph 16.4 would be superfluous.

36 Finally, and with respect, it is my view that the three reasons offered by the trial judge for the opposite interpretation of paragraph 16.1 do not withstand scrutiny.

37 The first reason given by the trial judge was that the meaning I would accord to paragraph 16.1 would defeat the personal aspect of the license agreement. That paragraph certainly makes clear that the grant of the license is personal to the licensee. However, that licensee is clearly and expressly Scott's Food, not its controlling shareholder. A change in the latter leaves the licensee unchanged. Following the second Laidlaw transaction, the license is still granted personally to Scott's Food.

38 The second reason was that it would not make good business sense to read paragraph 16.1 so that it did not extend to a change in the shareholders of the franchisee. While this might not make good business sense from the perspective of the franchisor, it might well make good business sense for the franchisee. In my view, neither of these is helpful in the required task of contractual interpretation. Rather, in applying objectively the interpretive principle of what accords with sound commercial principles and good business sense, the key fact is that for twenty years, from 1969 to 1989, this franchise relationship operated with apparent viability without the right of approval contended for by the respondent. In light of this history, it cannot be concluded that the meaning I give to paragraph 16.1 would not make good business sense.

39 Finally, it was said that reading paragraph 16.1 as I do would be contrary to the generally accepted practice in the franchise industry. The fallacy in this reasoning is that, as the trial judge recognized, this was a very unusual franchising relationship. This franchisee appeared to have bargaining power at least equal to that of KFC and certainly sufficient power to achieve a contract with no restriction on the transferability of shares. By contrast, the trial judge found the industry standard to be that the franchisor has control over the franchisee. In these circumstances, the generally accepted industry practice is of little use in interpreting this particular license agreement.

40 Hence, I conclude that paragraph 16.1 of the license agreement cannot be construed to give KFC the right to approve a change in the shareholders of Scott's Food. This paragraph, therefore,

was not breached when Scott's did not obtain KFC's approval of the second Laidlaw transaction.

41 It is next necessary to consider the proper interpretation to be given to paragraph 16.2 of the license agreement. It is helpful to reproduce this provision a second time:

16.2 Licensee agrees that it shall not sell, transfer, assign, encumber, sub-license or otherwise deal with this Agreement or its rights or interest hereunder (hereinafter referred to as "transfer"), without KFC's prior written consent and Licensee's compliance in all respects with the terms and conditions of this Paragraph 16. Any transfer or any attempt to do so, contrary to Paragraph 16 shall be a breach of this Agreement and shall be void but shall give KFC the right of termination as provided in Paragraph 17.2(d).

42 The respondent's primary argument was that the second Laidlaw transaction engaged the last sentence of this paragraph. It was said to be a transfer contrary to paragraph 16.1 which, because of paragraph 16.2, triggered the right of termination in paragraph 17.2(d). Given the conclusion I have reached concerning paragraph 16.1, this argument must fail.

43 Apart altogether from paragraph 16.1, however, the respondent also argues that for the purposes of paragraph 16.2, the first Laidlaw transaction was an attempted transfer and the second was an actual transfer and that KFC's prior written consent was therefore required.

44 In my view, this argument also must fail. On the ordinary meaning of the words used in paragraph 16.2, it is the licensee Scott's Food that is constrained from dealing with its interest under the license agreement. Once the alter ego argument is dismissed, this paragraph simply cannot reach Scott's Hospitality, the shareholder of the franchisee. Nor does it reach the shareholders of Scott's Hospitality. Neither an attempted change nor an actual change in the shareholders of the franchisee constitutes the franchisee dealing with its interest under the license agreement.

45 This conclusion is assisted by examining the language of the counterpart paragraph 16.2 in the 1985 standard franchise agreement. The two Laidlaw transactions would be encompassed by that provision only because of the inclusion of the "deemed transfer" concept. As I have said, this concept is conspicuously absent from paragraph 16.2 of this license agreement.

46 The respondent argues that its proposed reading of paragraph 16.2 is consistent with good business sense and industry practice. However, as I have indicated in connection with the argument on paragraph 16.1, in the circumstances of this case, neither of these aids to interpretation requires that paragraph 16.2 be read to give KFC the right to consent to a change in the shareholders of its franchisee.

47 Finally, the respondent relies on *GATX v. Hawker-Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 (Ont. Gen. Div.) to assert a broad meaning for the phrase "or otherwise deal with" as found in paragraph 16.2. That case is different from this one in that, there, the contracting party was

clearly dealing indirectly with its interest under the agreement. Here, neither Laidlaw transaction involved the franchisee dealing in any way with its interest under the license agreement.

48 I therefore find that, properly construed, paragraph 16.2 does not give KFC the right to prior written consent to either Laidlaw transaction.

49 Given my conclusions about paragraphs 16.1 and 16.2 of the license agreement, it is unnecessary to deal with the appellant's alternative arguments: that paragraph 16.1 is limited to a change in ultimate control of the franchisee; that KFC could not have reasonably refused its approval of the second Laidlaw transaction; that a breach of paragraph 16.1 entitles KFC to terminate only if it was a fundamental breach of the license agreement; but in any event, for KFC to terminate would be a breach of its good faith duty under the license agreement; and finally, that the appellants are entitled to relief from forfeiture. Nor is it necessary to deal with the respondent's alternative argument that a breach of paragraph 16.1 allows it to terminate through direct resort to paragraph 17.3 of the license agreement.

50 Before leaving the transfer issue, the remaining matter required to be dealt with arises from the finding below that pursuant to paragraph 16.3 of the license agreement, KFC had a right of first refusal in the circumstances of both Laidlaw transactions. That paragraph reads in part as follows:

16.3 In the event that Licensee receives a bona fide offer, which licensee is willing to accept, from a third party to purchase or otherwise acquire any of the Licensee's rights and interest in this Agreement, ..., Licensee shall first offer to sell the same to KFC at the same price and on the same terms and conditions as in the third party's offer ... In the event that KFC so accepts such offer to sell, a binding agreement of purchase and sale shall thereby be constituted between Licensee and KFC at the said price and upon the said terms and conditions ...
[Emphasis added.]

51 The reasons below reveal no analysis of the language in this paragraph by the trial judge in reaching his conclusion.

52 In my opinion, the ordinary meaning of the words used in the paragraph dictates the opposite conclusion -- that neither Laidlaw transaction triggered a right of first refusal. Neither an offer to purchase the shares of Scott's Hospitality nor an offer to change the controlling shareholder of Scott's Food is an offer which the franchisee receives or one which the franchisee can accept. The licensee cannot receive a takeover bid for the licensee's parent or for the licensee itself.

53 In summary, therefore, the appellant did not breach either paragraph 16.1 or paragraph 16.2 of the license agreement because of the Laidlaw transactions and KFC does not have the right to terminate the license agreement as a result. Nor did either Laidlaw transaction give KFC a right of first refusal.

54 I would accordingly allow the appeal on the transfer issue and set aside the declarations in paras. 1, 2, 3 and 4 of the judgment below. Instead, an order will go dismissing the claims for these declarations. Finally, I would set aside para. 13 of the judgment below and would grant the declaration sought therein.

THE ENHANCEMENT ISSUE

55 The other major issue at trial was whether Scott's Food had failed to meet its obligations to enhance its KFC outlets. These obligations are contained in the license agreement and the addendum to it, the Master Development Agreement, signed at the same time. The trial judge's two principal findings on this issue were that Scott's Food had failed to enhance its outlets as required by paragraph 7.2 of the Master Development Agreement and, secondly, because more than five to ten per cent of the outlets had not been enhanced as required, the failure was material and substantive, thereby entitling KFC to terminate the license agreement pursuant to paragraph 17.2(e) unless Scott's Food corrects the failure within three months. The appellants appeal neither of these findings. Indeed, they raise only two grounds of appeal in connection with the enhancement issue.

56 Firstly, they appeal the declaration that KFC is also entitled to terminate the license agreement pursuant to paragraphs 17.2(e) and 17.3 because Scott's Food's enhancement failures were breaches of paragraphs 3.2, 5 and 6 of the license agreement. While the judgment contains this declaration, the reasons for judgment do not reveal the basis upon which the declaration was made.

57 Second, they appeal the finding that to avoid KFC's right to terminate under paragraph 17.2(e), Scott's Food must, within three months, enhance all of its outlets, not just a sufficient number that the failure becomes less than material and substantive.

58 Turning to the first of these two grounds of appeal, it is helpful to set out paragraphs 17.2(e) and 17.3 of the license agreement:

17.2 KFC may, without prejudice to any other rights or remedies contained in this Agreement or at law or in equity, terminate the License upon immediate notice (or in the event advance notice is required by law, upon the giving of such notice) in the event that:

...

- (e) Licensee fails to satisfy, in a material and substantive manner, the requirements for enhancement and development contained in Articles 3.3, 3.4, 7.2 and 7.3 of the Addendum, provided that notice of any such failure is delivered to Licensee and Licensee shall not have corrected such failure within (3) months from the delivery of such notice.

17.3 The License will terminate on the termination date specified in any notice by KFC to Licensee (without any further notice of termination unless required by law), provided that (a) the notice is hand delivered or mailed at least thirty (30) days (or such longer period as may be required by law) in advance of the termination date, (b) the notice reasonably identifies one or more breaches or defaults in Licensee's obligations or performance hereunder, (c) the notice specifies the manner in which the breach(es) or default(s) are not fully remedied before, and as of, the termination date.

59 In my view, paragraph 17.2(e) deals explicitly and exhaustively with the enhancement obligations on the franchisee that, if not met, give KFC the right to terminate the license agreement. None of paragraphs 3.2, 5 or 6 of the license agreement is included in that list.

60 Moreover, as indicated by the trial judge, paragraph 17.3 merely sets out the procedure of formal notice. It does not accord to KFC a substantive right to terminate for any failure by Scott's Food to discharge its enhancement obligations. To so interpret paragraph 17.3 would fly in the face of paragraph 17.2 where the parties have carefully selected the enhancement obligations that, if breached, justify termination. Hence I would reverse the declaration that because the franchisee's enhancement failures breached paragraphs 3.2, 5 and 6 of the license agreement, KFC is entitled to terminate pursuant to paragraphs 17.2(e) and 17.3.

61 As to the second ground of appeal on the enhancement issue, paragraph 17.2(e) of the license agreement provides that failure in a material and substantive manner (my emphasis) to meet the franchisee's enhancement obligations as specified therein gives KFC the right to terminate if the failure is not corrected within three months. As I have said, the trial judge found that where more than five to ten per cent of the outlets fall below this required standard, Scott's Food was in substantial breach for the purposes of this paragraph. He went on to say this:

... KFC must give three months' notice from the date of this judgment to Scott's to allow it to remedy the default found in this decision on the enhancement issue. In other words, Scott's must be given three months in which to upgrade all of its remaining outlets to certification standards. If it chooses not to do so, it may close those stores under other termination procedures.

62 There is nothing in the actual judgment appealed from that requires the franchisee to enhance or close all of its remaining outlets to avoid termination. Hence, I propose to make no order on this ground of appeal.

63 However, in my opinion, if failure in a material and substantive manner to meet the enhancement requirements occurs when five to ten per cent of the outlets are below standard, correcting that failure means enhancing at least enough outlets so that there is no possibility of this line being crossed. This means that to correct that failure within three months, Scott's Food must ensure that no more than five per cent of its outlets are substandard. I would therefore not think it

necessary that to correct the failure, the franchisee must sufficiently upgrade all its remaining outlets. To do so would make the correction incongruent with the failure contrary to what I think is meant by the final phrase of paragraph 17.2(e).

64 The view I have expressed is also consistent with paragraph 6.3 of the Master Development Agreement. It contemplates that the franchisee could operate outlets for a limited period of time even if they had not been enhanced to the required standard. This paragraph is inconsistent with a correction requirement that would compel the franchisee to properly enhance all of its remaining outlets.

65 In summary, I would allow the appeal on the enhancement issue. I would set aside the declaration in para. 9 of the judgment below and order that the claim for this declaration be dismissed.

COSTS

66 The trial judge ordered that there be no costs of the trial on the basis of paragraph 18.3 of the license agreement which required this result unless one party prevailed entirely, something that did not occur at this trial.

67 Before us, neither party sought to disturb this order and I do not do so. Both parties submitted that costs of the appeal should follow the result. I can see no reason why this should not happen.

68 In conclusion, I would allow the appeals with costs on the transfer issue and the enhancement issue in accordance with these reasons. The trial judgment is otherwise undisturbed.

GOUDGE J.A.

MOLDAVER J.A. -- I agree.

FERRIER J. (ad hoc) -- I agree.

cp/d/ln/aaa/DRS/qlgxc

¹ City of Toronto v. W.H. Hotel Ltd. (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.).

² Scanlon v. Castlepoint Development Corporation et al. (1992), 11 O.R. (3d) 744 at 770 (Ont. C.A.).

TAB 8

Indexed as:

Toronto Railway Co. v. Toronto (City)

**The Toronto Railway Company (Defendants), Appellants; and
The City of Toronto (Plaintiff), Respondent.**

(1906), 37 S.C.R. 430

Supreme Court of Canada

1906: March 24-29 / 1906: May 1.

Present: Sedgewick, Girouard, Davies and Idington JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

*Contract -- Breach of conditions -- Liquidated damages -- Penalty -- Cumulative remedy --
Operation of tramway -- Construction and location of lines -- Use of highways -- Car service --
Time-tables -- Municipal control -- Territory annexed after contract -- Abandonment of monopoly --
55 V. c. 99 (Ont.)*

Except where otherwise specially provided in the agreement between the Toronto Railway Company and the City of Toronto set forth in the schedules to chapter 99 of the statutes of Ontario, 55 Vict., in 1892, the right of the city to determine, decide upon and direct the establishment of new lines of tracks and tramway service, in the manner therein prescribed, applies only within the territorial limits of the city as constituted at the date of the contract. Judgment appealed from (10 Ont. L.R. 657) reversed, Girouard J. dissenting.

The city, and not the company, is the proper authority to determine, decide upon and direct the establishment of new lines, and the service, time-tables and routes thereon. Judgment appealed from affirmed, Sedgewick J. dissenting.

As between the contracting parties, the company, and not the city, is the proper authority to determine, decide upon and direct the time at which the use of open cars shall be discontinued in the Autumn and resumed in the Spring, and when the cars should be provided with heating apparatus and heated. Judgment appealed from reversed, Girouard J. dissenting.

Upon the failure of the company to comply with requisitions for extensions as provided in the agreement, it has no right of action against the city for grants of the privilege to others; the right of making such grants accrues, ipso facto, to the city, but is not the only remedy which the city is entitled to invoke. Judgment appealed from affirmed, Sedgewick J. dissenting.

Cars starting out before midnight as day-cars may be required by the city to complete their routes, although it may be necessary for them to run after midnight or transfer their passengers to a car which would carry them to their destinations without payment of extra fares, but at midnight their character would be changed to night-cars and all passengers entering them after that hour could be obliged to pay night-fares. Sedgewick J. dissenting.

APPEAL from the judgment of the Court of Appeal for Ontario, 10 Ont. L.R. 657, which in part affirmed and in part varied the judgment of Mr. Justice Anglin, 9 Ont. L.R. 333, upon a special case stating questions of law for the opinion of the court in pursuance of the consolidated rules (Ontario) numbers 372, 373 and 374, and the proceedings thereon.

The City of Toronto, in 1891, acquired the Toronto Street Railway with its appurtenances and property from its former owners and called for tenders for the purchase of the same together with the right and privilege of operating surface tramways in the city for a specified term of years, subject to certain conditions and limitations as to the establishment of new lines and branches and respecting the operation of the entire system. An agreement was subsequently entered into between the city and the successful tenderers, in September, 1891, for the purpose of carrying out the sale and the contract in respect to the franchises and privileges granted, which had been assigned to the appellants, and this agreement was validated by legislation under the 99th chapter of the statutes of Ontario, 55 Vict., in 1892. The agreement, bye-law and conditions in question are set forth in the schedules to the statute and the issues to be decided on the present appeal are stated in the judgments now reported.

By the special case the following questions were submitted for the opinion of the court.

"Is the city or the railway company, and which of them, on the proper construction of the agreement, entitled to determine, decide upon and direct :-

"1. What new lines shall be established and laid down and tracks and service extended thereon by the company, whether on streets in the city as existing at the date of the agreement or as afterwards extended?

"2. What time-tables and routes shall be adopted and observed by the company?

"3. Whether if so determined by the city engineer with the approval of the city council cars which start before midnight must finish the route on which they have so started, though it may require them to run after midnight?

"4. At what time the use of open cars shall be discontinued in the autumn and resumed in the spring, and when the cars should be provided with heating apparatus and heated?"

"5. In the event of the decision of the court being in favour of the city on any of the above questions, is the city entitled to a decree for specific performance as to the matter so decided or in any and which of them.

"6. Is the privilege to the city to grant to another person or company for failure of the company to establish and lay down new lines and to open same for traffic or to extend the tracks and services upon any street or streets as provided by the agreement, the only remedy the city can claim?"

On hearing the special case Anglin J. decided in effect, that the right to determine what new lines should be established was vested in the city, not only in respect to lines within its limits as constituted at the time of the contract but also in respect to lines areas annexed to this city subsequently; that the remedy of the city was not restricted merely to the right of granting the privileges to others upon the failure of the company to construct new lines when required to do so; that the city could settle timetables, fix the routes of cars, determine the seasons during which open cars might be used and how and when the cars should be heated, but that the city could not compel the company to continue to run, after midnight, cars which, having started before midnight, could not in due course finish their routes by that time. By the judgment appealed from the Court of Appeal affirmed the decision of Mr. Justice Anglin, except as to the running of day-cars after midnight, and decided that cars starting out upon their routes before midnight should finish such routes, even if it was necessary to run after midnight in order to do so.

Nesbitt K.C., and Laidlaw K.C., for the appellants. Aylesworth K.C., and Fullerton K.C., for the respondent.

McCarthy, Osler, Hoskin and Harcourt, for the appellants. W.C. Chisholm, for the respondent.

SEDGEWICK J.:-- This is an appeal by the defendants from the judgment of the Court of Appeal for Ontario affirming the judgment of Anglin J. in the special case agreed upon between the parties in the course of the action. The action was brought upon the agreements set forth as a schedule to chapter 99 of 55 Victoria (Ontario), 1892; between the plaintiffs and the defendants, relating to the purchase of the street railways and properties and street railway privileges, and involved, on one branch of the case, the questions: (1) Whether under the agreement the defendants were compelled to lay down new lines or extensions of lines in territory annexed to the city after the date of the agreement; (2) Whether the company had a right to choose the streets in the city upon which it would lay down its lines subject to the approval as to location, etc., mentioned in clause 12

of the conditions; (3) Whether the city also had the right under clause 14 of the conditions to require the company to lay down its rails and operate upon a street selected by the city, and if so required, could the company abandon such street or streets and so abandon its exclusive franchise to operate upon such street or streets, and thus allow the city to grant the franchise to another company, the Toronto Railway Company having no right to claim compensation by reason of such grant, or, could the city compel the company when so required to lay down its lines and operate its railway, or obtain any other remedy in addition?

In construing an instrument in writing, the court is to consider what the facts were in respect to which the instrument was framed, and the object as appearing from the instrument, and taking all these together it is to see what is the intention appearing from the language when used with reference to such facts and with such an object, and the function of the court is limited to construing the words employed; it is not justified in forcing into them a meaning which they cannot reasonably admit of. Its duty is to interpret, not to enact. It may be that those who are acting in the matter, or who either framed or assented to the wording of the instrument, were under the impression that its scope was wider and that it afforded protection greater than the court holds to be the case. But such considerations cannot properly influence the judgment of those who have judicially to interpret an instrument. The question is not what may be supposed to have been intended, but what has been said. More complete effect might in some cases be given to the intentions of the parties if violence were done to the language in which the instrument has taken shape; but such a course would on the whole be quite as likely to defeat as to further the object which was in view.

Bearing in mind these observations, it is apparent that the City of Toronto owning the railway, then operated by horse cars, advertised the same to be sold to the highest bidder, together with and in addition to such railway, the exclusive privilege of operating surface street railways within the limits of the City of Toronto as is shewn by the bye-law, No. 2920, passed on 27th July, 1891, which recites the ownership by the City of Toronto of the Toronto Street Railway and all the real and personal property in connection with the working thereof, and that the city had asked by public advertisement for tenders from persons seeking to acquire the said railway and the privileges of operating surface street railways in the City of Toronto.

Certain conditions were made, numbered from 1 to 47, and the tender of Messrs. Kieley, Mackenzie and Everett was accepted, and the contract, containing some thirty clauses, was entered into on the 1st day of September, 1891, and subsequently, in 1892, an Act was passed validating the agreement and the conditions and tenders therein referred to, and declaring, by its first section, that under the said agreement the purchasers acquired

and are entitled to the exclusive right and privilege of using and working the street railways in and upon the streets of the said City of Toronto (except certain portions) for the full period of thirty years from the first day of September, 1891, ... subject, nevertheless, to all the conditions, provisoes and restrictions in the said agreement expressed or contained, and as hereinafter mentioned.

And by the fourth clause therein it was enacted that:

(1) After the said agreement has been duly assigned to the company it shall, subject to the provisions and conditions contained therein, have full and exclusive power to acquire, construct, complete, maintain and operate ... along all or any of the said streets or highways of the City of Toronto, subject to the exceptions and under the qualifications contained in the first section hereof.

And further providing by section 19, subsection 4, for a special case of annexation to the City of Toronto of an outside municipality or any part thereof.

In my opinion the city clearly only purported to deal with streets within its jurisdiction. Outside municipalities into whose area the company might desire to extend its operations had independent powers in these respects, and the Act provides that with them the company could make separate arrangements, and without going in detail through the various provisions in the conditions, agreement and statute, it appears to me plain that by the special reference contained in section 19, subsection 4 of the Act, the parties did not intend to provide for territory subsequently annexed and as to which the city, at the time, had no right to give any franchise or make any contract.

On the second part of this branch of the case, it appears to me plain that the city granted the exclusive right to construct, maintain and operate their railway along all or any of the said streets or highways of the City of Toronto subject to the exceptions, etc., contained in the conditions and agreement, and, so far as the right of construction is concerned, I think the only over-riding exception to this power is that contained in clause 12 of the conditions, namely, that the gauge of the system was fixed and the location of the railway on any street should not be made by the company or confirmed by the council until plans thereof, shewing the proposed position of the rails, style of rail to be used, and the other works in each such street had been submitted to and approved in writing by the city engineer, and I think the language of the Privy Council in the case of *The City of Toronto v. The Bell Telephone Company of Canada* [1905] A.C. 52, is applicable. To this extent, this clause and clause 14 are derogations from the grant to construct and use and work a railway along any of the streets, and make plain the meaning of "subject to the conditions, provisoes," etc. I cannot understand how the right to use and operate street railways which has been conferred upon the company along all or any of the streets can be made effective unless they have a right to lay down the rails upon the street and to operate the cars upon them.

On the third part of this branch of the case, I am of opinion that clauses 14 and 17 must be read together, and that the city may require the company to extend its tracks and street-car service on such streets as may be from time to time recommended by the city engineer and approved by the city council, etc but that the language does not import that the purchaser "shall build," but, upon such requisition being made, the company has the right to abandon the privilege which it had

purchased, and that, on so abandoning, it had no right of action against the city for granting the privilege of laying down lines on much streets, and the city had the right to make such grant to another, and that these two clauses contain both the rights and remedies of the parties. In my opinion failure to comply with the requisition ipso facto creates the right of granting a privilege to another person or company, and that is the only remedy, and the remedy which the parties have themselves seen fit to provide. It has been stated in the Court of Appeal that this is an illusory remedy, but reference to *Winnipeg Street Railway Co. v. Winnipeg Electric Street Railway Co.*, [1894] A.C. 615, and *The City of Toronto v. The Toronto Street Railway Co.*, 15 Ont. Love. R. 30, at page 35, shews that it has apparently been a most effective remedy in the past.

The next question involves substantially the point whether the city engineer, under the 26th clause of the conditions, really has free management of the company, or whether, as one would have supposed, the company had the right of management of its own business subject to the express provisions in the public interest for the city engineer to regulate the number of cars and the intervals at which the same should run on the various routes, both as to day cars and night cars.

In my opinion it is the legitimate rule of construction to construe words in an instrument in writing with reference to the words found in immediate connection with them. See *Robertson v. Day*, 5 Love. Cas. 63, at page 69; also as explained in *Inglis v. Robertson*, [1898] A.C. 616, at page 630. The headings must be read in connection with the groups to which they belong and interpreted by the light of them.

And, so construing the instrument, I think that having in mind the fact that at the date of the sale it had not been determined whether horse cars should be continued, or whether on main lines the use of electricity, either by overhead trolley (single or double) or storage battery, or by what is known as the slot system, or cable cars, should be adopted, the use of the word "service" in section 26 must be limited to its context and cannot be taken as an over-riding word destroying all meaning in the subsequent conditions, and rendering 27, 28, 36, 37, 38 and 39 substantially useless. The wide meaning given to the word "service" in the courts below would render wholly unnecessary the subsequent particular provisions. I think such a construction entirely destructive of the ordinary canons of construction adopted by the courts. I think the cardinal feature to be borne in mind is that the company were empowered to "use and work" the railway, which involves necessarily the idea of operation through its board of management. I view the fact that an existing system of nearly sixty-two miles in length, enabling the routing of cars through various streets, coupled with the fact that routes are assumed to exist by the wording of the conditions, is evidence that the ordinary management and routing of cars must be left to the company, and I find no word anywhere in the agreement which would justify the assumption that "routes" could be created by the city engineer, whose sole duty is to regulate, under 27 and 28, the time of starting of the cars on such routes as the company lays down, and to fix the intervals at which cars should run. Even if the word "service" is given an extended meaning under clause 26, that service is confined to what is necessary on each main line, part of same or branch, which in no sense confers a right of creating or fixing the routes, which it was admitted involved a service on various main lines or parts of same or branches and,

therefore, a much greater scope than a mere service on a main line or branch taken by itself. The right of regulation in the city engineer which I have indicated, seems to me to conserve all the rights that any person could be reasonably supposed to have contemplated at the time. The company are bound under section 33 to give transfers and to so arrange the system that the transfers could be made effective. The company, not the engineer is to "make the arrangements," that is, route the cars; the engineer is to approve. They are also bound to start the cars on their routes under 27 and 28 under the direction of the city engineer, and necessarily the engineer having the control of the interval between cars must control the number of cars and so conserve the rights of the public to the accommodation which was sought for, namely, to have as many cars in service as the engineer might determine, and to have those cars so routed that the transfer system would be effective. This seems to me to make a clear and harmonious document and to give effect to the various conditions under their various headings, and so read also gives effect to the language both of the statute and the conditions and leaves the company in the management of its business, subject to the qualifications that were intended.

Another branch of the case is as to the right of the city engineer to determine the time for running open and closed cars, heating, etc. The headings and the language of clause 36 seem to me to completely negative the suggestion that the city engineer can regulate these matters. It seems to me that the parties must have had in mind a rule of law that any passenger would have a right to complain of improper accommodation, and that it would be for a jury to determine in any case whether the company was complying with the provisions of clause 36, and it is not for the city engineer.

Another branch of the case dealt with the running of the cars up to midnight. It seems to me perfectly plain that the proper construction of the document is that the first day-car shall not be compelled to start before 5.30 a.m., and that no day-car can be compelled to run after midnight. The city engineer has a right to start night-cars at such hour as he deems necessary and he can in this way see to it that cars for the accommodation of passengers are kept running on the streets. It was admitted by both counsel that there was no dispute between the parties as to question of fares; that a person who entered a day-car up to midnight had a right to a ride in that car to the end of its route, and under clause 33 a right to transfer to a night-car, without extra fare, and that any person entering a car for the first time after midnight had to pay double fare. Be that as it may, it seems me quite plain that no day-car can be compelled to run after midnight, and if the city engineer attempted to start day-cars upon a route fixed by the company which would compel any such day-car to run after midnight, the company has a right to so arrange its routes that the all day-cars may finish their run at midnight.

This covers the various questions which were submitted other than the fifth, and as to that it seems to me that granted that there may be some other remedy open, the remedy is certainly not open to the court of compelling the company to lay down the line so required, since that would entirely destroy the provision of the contract which permits the company to abandon the street upon which it is so required to lay down a line.

The appeal should be allowed with costs.

GIROUARD J.:-- I have come to the conclusion that the Court of Appeal has correctly answered the questions submitted for our determination. The answer to the first question might be open to some doubts, but they are not strong enough in my mind to cause me to dissent from the views they took. I am, therefore, of opinion that the present appeal should be dismissed with costs for the reasons given by Mr. Justice Osler.

DAVIES J.:-- The respondent corporation, having in the year 1891 acquired from its former owners the then Toronto Street Railway with its property and appurtenances, called for tenders for the purchase of the same together with the right and privilege of operating surface street railways in the City of Toronto for a specified time, all tenders being subject to certain conditions of sale which had been previously agreed to by the city council and published with the call for tenders.

Certain parties successfully tendered and an agreement was made between them and the city in September, 1891, for the purpose of carrying out the sale and contract. The award under which the city had become the owner of the street railway, containing (inter alia) schedules describing the property, the conditions, the tender and the city by-law authorizing the execution of the agreement were each and all expressly incorporated with the agreement and made part and parcel of it.

The successful tenderers subsequently applied to the Legislature of Ontario for an Act of incorporation enabling the company to be incorporated to take over from them the contract and agreement they had made with the City of Toronto so that the company might carry out the agreement for the purchase of the street railway and own and operate the same.

The necessary legislation was passed by the Province of Ontario, 55 Vict. ch. 99.

The agreement was declared, in section 1, with all its schedules to be valid and legal and binding upon the parties and it was further declared that under it the purchasers acquired and were

entitled to the exclusive right and privilege of using and working the street railways in and upon the streets of the said City of Toronto

excepting certain specified portions of such streets.

The 4th section of the Act, upon which much reliance was placed by the appellant in support of its argument for the right to lay down a street railway on any street it might select within the city, enacted that:

(1) After the said agreement has been duly assigned to the Davies J. company it shall, subject to the provisions and conditions contained therein, have full and exclusive power to acquire construct, complete, maintain and operate, etc., a double or single track street railway, etc., upon or along all or any of the

said streets or highways of the City of Toronto subject to the exceptions and under the qualifications contained in the first section," etc.

The first question to be determined before proceeding to answer those submitted for our decision in this appeal is whether this Act of incorporation and the declarations it contains were in any way intended to alter, extend or enlarge and did in fact alter, extend or enlarge the rights, liabilities, obligations or privileges of the parties to the agreement or whether it was merely intended to validate the agreement and fonder upon the company the rights and privileges of the individual parties who had successfully tendered and entered into the agreement with the city subject to the obligations and liabilities of these parties under that agreement.

I am of the opinion that the incorporating Act was not intended to do more than the latter and that to determine the relative rights, liabilities and obligations of the respective parties to this appeal we are relegated to the agreement and all its schedules and parts which were validated by the incorporating Act and must determine from them the extent and nature of these rights, liabilities and obligations.

Sections one and two of the agreement confer full and exclusive powers of constructing, completing, maintaining and operating street railways upon all or any of the streets of the city but they do not confer any right to do so beyond the right prescribed by the agreement, conditions, etc.

I have had the advantage of reading the judgments prepared by my brothers Sedgewick and Idington and for the reasons given by them I concur in the answer to the first question that there is no obligation on the part of the railway company, appellant, to lay down tracks and establish services on streets in territorial area added to the city since the date of the agreement.

I agree with the courts below and with my brother Idington that the railway company has not the right to build extensions of the main line or branches within the city as it existed at the time of the agreement excepting as it may be required to do so under the 14th clause of the agreement. That clause seems to be the only one expressly providing for the establishment and extension of new or additional lines on the streets.

It was contended that a further right was given by the statute to the company to build on any street they chose in their own uncontrolled discretion. A construction of the contract and legislation validating the same conferring such a right would, in my opinion, be a very startling one and would require very clear language to support it. The exclusive power to build and operate no doubt is given but the right to exercise the power is controlled by the agreement and can be exercised only when called into existence under and in manner provided for by the 14th clause. Even under the 11th clause of the agreement the city while conceding to the company the right to change the method of operating the street railway to electric power so far as then existing tracks were concerned reserved complete control as to when the change to electric cars should be made so far as branch lines or extensions of the main line and branches were concerned. To give the company the exclusive power to construct and operate street railways on any streets of the city and so prevent

competition was one thing. To confer the uncontrolled right of building and operating on any street the company might from time to time select was quite another and different thing. On this branch of the question I concur with the Court of Appeal and my brother Idington.

I am also of opinion, answering the 6th question, that if the company should fail to establish any new line which it was required to establish under the 14th clause the remedy of the city for breach of the requirement is not confined to what in many if not in most cases would be the illusory one of granting the privilege to establish such line to some other person or company but that it may resort to its other remedies under the contract. The specific power to make such a grant might, in certain conceivable cases, be a desirable one for the city to possess while quite illusory as a remedy in others and was properly introduced into the agreement for the purpose of avoiding difficulties which the exclusive powers granted to the company would probably give rise to. But it was not intended as the only remedy the city might resort to arising out of the neglect of the company to carry, out its obligations.

Then with respect to the timetables and routes to be adopted and observed by the company I adopt the reasoning of Anglin J. He says:

Reading clauses 26, 27 and 25 of the conditions together and having regard to the tenor of the whole agreement, I think the conclusion is inevitable that both timetables and routes are within their purview. The city engineer cannot satisfactorily or efficiently exercise his right to determine speed, service and intervals between cars unless he also possesses power to decide upon and fix routes. His right to determine, with the approval of the city council, the "service" necessary upon all lines is unrestricted and is quite wide enough to include the power to specify the routes to be established and maintained. Given the routes and condition No. 27, fixing the hours of starting and finishing the daily runs, the making of timetables is nothing more than a convenient method of exercising the right to determine speed and intervals.

For these reasons and those given by the Court of Appeal I concur with the answer given by it to the second question.

Much was said at the argument before us as to the unreasonableness of such a construction with which I do not agree. It seems to me that to allots to the company the determination of the routes while giving the power and imposing the duty on the city engineer of determining alike the "speed" and the service necessary on each main "line" as also the "intervals" between which day-cars are to run would be more likely to create chaos than the construction I have concurred in as the proper one.

The contention put forward by the company as the proper answer to question 3, namely, that day-cars are not to be started at a later hour than would clearly enable them to finish their route before midnight is not I think the proper one. By this construction it was admitted that day-cars

could not be started on any of the routes after 11 or 11.15 o'clock p.m. I think a fair answer to the question is that cars started before midnight as day-cars must finish the route on which they have so started though it may require them to run after midnight or transfer their passengers to a car which would carry them to their destination, but that at midnight they, eo instanti, change their character to night-cars and all passengers entering them after that hour must pay the night fares.

I concur in the answer proposed to question 4 by my brother Sedgewick and Idington and in the Davies J. disposition made by them of the 5th question.

IDINGTON J.:-- This is an appeal from the judgment of the Court of Appeal for Ontario.

The case is reported in 10 Ontario Law Reports, page 657, maintaining in part and varying in part the judgment of Mr. Justice Anglin in 9 Ontario Law Reports, 333.

I am of opinion that the answer given to the first question by the Court of Appeal should be varied, so as to exclude the obligation of the railway company to establish and lay down tracks and services on streets in territorial area added to the city since the date of the agreement.

I am unable to see anything in the contract binding the railway company in respect of future extensions of the city, save so far as is expressed in clause 16 of the conditions of sale incorporated with the agreement and section 19 of the Act whereby the appellants became incorporated and bound to execute the agreement entered into by the purchasers.

I cannot see how these provisions may be so enlarged as to imply that all the rest of the contract must necessarily be held as intended to become operative in any new territory annexed to the city, whenever and wherever such additions might happen to be made.

To provide in express terms for such a contract, as operative and binding from the execution thereof, would have been beyond the powers of the municipal corporation.

It is said, however, that it was unnecessary to have made any provision anticipating such extensions because the contracting parties well knew that the City of Toronto was likely to expand within thirty years from the date of the contract, during which the franchise created thereby was to exist, and must be taken to have contracted in light of that anticipation and in light of the provisions of the Municipal Act to continue the corporate existence, in such cases of addition to a municipality, so as to give the municipality the same powers over the new territory as it had over the old.

I am, after fully considering all these things, still unable to apprehend how any such implication must necessarily exist, in a contract such as we have to pass upon, as would make all the covenants between the parties that bound them in relation to the old territory operative upon the new.

The provisions for continuous existence of the city and all its corporate powers when its

territorial limits have been extended are merely relative to jurisdiction. It would seem as if the necessity for expressly providing, as the Municipal Act does, that in the case of annexation of new territory the by-laws of the city shall be held to apply to the new territory, suggests that contracts of this nature, if to operate upon the new territory, must do so by express provision made therefor. There is none shewn in the Municipal Act or any other act. There is none in this contract.

Status and jurisdiction are not in any way the same thing as a contract, which either may enable to be made. The contract may, and generally must, remain valid even if the status be lost or the jurisdiction be increased or diminished. But can its operative field be of necessity affected by any such change and especially in a contract of this nature?

There seems to me to be a confusion of ideas in contending that this jurisdiction over a defined area and the inhabitants thereof must, of necessity, give such legal effect to a contract with a municipal corporation to do something to or in relation to its property as existent before extension as to bind the contracting parties to do or submit to have the things contracted for done to the new extension of property or domain.

But for what has been brought under our notice and stoutly maintained I would have said that such a case needed only to be stated to carry with it refutation. If it need, as it seems to need, refutation may illustrate the distinction by something like unto what may come to be within the range of modern possibilities.

If a fire insurance company should undertake with a municipal corporation for a fixed compensation the fire risk for a number of years of all the houses within its bounds, or a life insurance company undertake in like manner for such a term to pay at the death of each of the inhabitants a certain sum of money, and the risks were in either case within the term without further consideration doubled or trebled simply by joining one municipality to another and the name and jurisdiction of the one, thus supposedly contracted with, extended to include the increased sized surely there could not be found any one to claim that such added risks in such a contract were within the terms of the contract or the reasonable intendment thereof.

On the other hand, if, by an enactment, power were given to a municipality to insure the houses and inhabitants therein against fire and death respectively, and the defined area of the municipality were added to by legislation, it would not surprise or shock any one, if the defined area were then doubled, to find it contended that the power of insurance could be exercised within the increased district and for the added inhabitants.

Why are we likely to be surprised or shocked by the first proposition and undisturbed by the second? Plainly because the reasonable or probable intendment was obviously against the first proposition; and yet might be within the second. And why? The first relates to a contract, the other to extended power or authority implied in extended jurisdiction.

Apply this to the case in hand.

When we look at the thing they are contracting about, the nature of the enterprise involved, the many uncertain factors in the operation of such a contract, even within a well-known and defined area, and we reflect how much more complicated the contract must be if projected into the future possibilities that might arise in relation to any added territory, we seem to be forbidden to entertain the thought that any such contracting parties could have intended to apply the terms agreed upon for thirty years to territory over which neither party had any domain or any security for the future condition thereof in any regard, and especially in regard to the value thereof for the purpose of constructing therein or extending therein a system of street railway.

We must bear in mind that the key note of this contract, is an exclusive, right for thirty years. We must also bear in mind that whilst the city could assure the company in regard to the exclusive right within the then existing boundaries that there was no power that could exclude any other railway system from existing or coming into existence in what was likely to become part of the territory to be added in course of time to the city.

Ambitious suburban towns might spring up, with municipal powers enabling them to construct such railways and form such alliances in regard to the transportation of their own people not only through and about their own town but to do business with and in the centre of the greater town. We might find existent railways, at the time this contract was executed, which in all probability would grapple with the situation and make accessory to their business the entire travel of such suburban towns. The chances were entirely, one would say, in favour of such development, rather than that the territory to be occupied by these suburban towns would remain and be in regard to railway service, for years before and at annexation, like a blank sheet of paper to have written over it the policy of the City of Toronto in relation to street railways.

To assume that such adjacent territory might possibly within thirty years be annexed might be reasonable; but to assume that it would be annexed in the same plight and condition in every way in relation to the development of street railway business as when this contract was entered into is something that the common knowledge of any one living upon this continent with observant eyes is unlikely to believe was assumed.

I can hardly comprehend how the varying and variable conditions likely to arise, beyond the power of control of the contracting parties here, could have been adequately dealt with within their limited powers in any other way than that in which it was dealt with in section 19 of the incorporating Act or in something of a similar way.

The parties anticipated, as was likely, that the company might pave the way for future annexations and pave the way also for future accommodations and future extensions of the relation of the contracting parties hereto and encouraged the company to extend its tracks into the suburban district. Hence in relation thereto they provided for the junction of tracks by stipulating that the grade should be appropriate to such junction. And in the event of annexation such extensions of the company's lines were to become subject to the terms of this contract.

If we find that the contracting parties had no power to go beyond the then area of the city or right to assume the continuation of things beyond that in the same condition, how can we attribute to them any such purpose or intention as that of extending the contract thereto as within their contemplation? How can we under such a contract unless by express language seek to bind them? How can we where they have by express language partially dealt with this problem hold that there was any reasonable intendment to go beyond what they have so expressed? It seems to me, with every respect, that if ever there was a case in which the maxim "expressio unius est exclusio alterius" was applicable this must be one.

I do not read the judgment of the Privy Council, *Toronto Ry. Co. v. City of Toronto*, [1906] A.C. 117, as deciding this question at all. The court was dealing with one of those very extensions of a line which the contract expressly provided for as far as it could then provide for it.

The company having sought to take it out of the operation of this contract by maintaining they had built not by virtue thereof, but under another charter, refused to pay the mileage contracted for. That was decided against it and the decision upheld by the Privy Council. Needless to say that had the Privy Council judgment been otherwise than of this character and an express decision upon the point now in question we would not have been now troubled with it.

I am of opinion, further, that the power to direct the establishment and laying down of new lines within the city as it existed at the date of the agreement came entirely within, the scope of clause 14 of the conditions of sale.

I agree with Mr. Justice Osler when he says that,

one cannot read the contract between these parties without seeing how anxiously - I do not know how effectively - the city has attempted to provide in many respects for the control of their streets and, for the protection and convenience of the public.

I will not labour with the question. It is to be gathered from the entire scope and purpose of the contract as a whole that clause 14 I have referred to was intended to be the governing authority in regard to the establishment of new lines.

There could be in the minds of those concerned in the business no doubt but that the city would prefer to have as many tracks and as much street car service as could possibly be got. The thing to be feared was not that the city would object to the railway company laying down a new track, but that it might be tardy in doing so.

The company, on the other hand, had to fear lest the desire for new lines would go beyond the bounds of reason and justice and hence the provision that two-thirds of all the members of the council must as sent before such an obligation could be imposed upon the company.

The social and commercial forces at work would solve the rest.

There need not and should not be two parties armed with authority to outline where new lines should be run. One authority, or source of authority, should suffice.

This interpretation of the contract will become more apparently correct by the application of the propositions that I am about to submit in relation to question 2.

If the city engineer had the right to direct which route should be taken, as I think he had, it would almost necessarily follow that effective operation could only be given to that power by the same remaining in the same hands that directed the placing of new lines.

It seems to me it would have been a manifest absurdity that the exercise of these powers so related if not absolutely dependent on each other should be in different hands.

Much has been said of the meaning of the word "service" as used in the 26th condition of sale. It is urged that it applies to and was intended to apply to the subjects, or some of the subjects, under the head of "Tracks, etc., and Roadways," of which clause 26 is the last.

It has been especially urged that inasmuch as the electric or other new system of motor or a combined system were contemplated that a selection from the varieties of motive power or mechanical means of applying motive power might be what was referred to. I cannot accept any one of these suggestions; indeed I think that the application of clause 26 to such subject matters or any one of them would be strained. Paragraph 26 hardly seems germane to most of the paragraphs that precede it under this heading.

In almost everything provided for under the heading of "Tracks, etc., and Roadways", the city engineer and council, or both, are in each particular case, including selection of motive power, referred to as the determining authority. It was not necessary for the purpose of applying their authority to any of these subject matters to reiterate it in clause 26 or to connect it with the use of the words "the speed" as is done in the clause 26, which reads as follows:

26. The speed and service necessary on each main line, part of same or branch, is to be determined by the city engineer and approved by the city council.

What is the most obvious meaning that the word "service" can have in such a sentence in such a contract? What was the purpose of every appliance, track, car, motive power and the service of the men all combined but to furnish a service? What was that service? The transportation of passengers on these tracks, in these cars, by means of this motive power.

The transportation of the largest number of passengers that could possibly be induced to accept the use of these cars was the object of the entire contract and all that relates to the contract. But for the reiteration in detail of some particular parts of what were covered by the words used in

26 there could not have rested a shadow of doubt in regard to what the word "service" here means.

The draftsman, like many others, has in the two following sections of these conditions seen fit to specify particulars as to day-cars and night-cars and thereby weaken the force of the general and comprehensive expression of the ideas present to his mind in framing clause 26. The power of generalization, the apt use of words to express a generalization when the idea has been once seized and the courage to leave such expression as first and best bodied forth are very often more or less wanting in the drafting of documents much as we are now dealing with.

Clause 13 of the agreement seems intended to rectify these defects in the agreement and conditions by adding,

it being understood that the reference to particular matters to be performed by the purchasers shall not diminish or limit the obligations of this agreement.

Making allowances for these considerations and having regard to the latter part of clause 13 just quoted, I have no hesitation in accepting the word "service" here as conclusively meaning all that is implied in fixing a route. Not only is the wise selection of routes necessary to maintain the service (that is, the transportation of passengers), in the highest degree of efficiency in working the railway but it is of the very essence of such service that it shall be so determined as to so meet the requirements of those using the streets that there will be accommodated the largest possible number that can be accommodated by means of a given mileage of track. The citizens would probably feel more promptly and acutely than the shareholders of the company the lack of the best possible service. The engineer would therefore be more responsive to new demands than the manager of the company.

When we couple routes with speed and what in both respects is to be done on the main line or part of same or branch we have almost everything that in relation to service can be advantageously determined by the city engineer and approved by the city council, including, of course, what sections 27 and 28 specially covered.

The manifest purpose was to control the lessees or contractors who might fail, as they do in such cases, to go to the expense of modifying a service as it becomes less efficient than it may have formerly been.

From time to time a spur is needed in every public service.

What we are asked here to do is to suppose that any and every efficient means of supplying this was omitted.

Speaking of the possible incompetency of a city engineer to discharge such a duty is beside the question. It would be equally to the purpose to speak of the manager of the company as possibly incompetents. We must assume both contracting parties intended to have efficient officers. We

cannot overlook the facts that both parties to the contract were deeply interested in the best financial results being got, and that though this was the case the interest of the company was and is only temporary whilst that of the city is perpetual.

The engineer and manager in order to produce the best results should work harmoniously, each giving the best of his skill and knowledge and results of his experience to the other. One would suppose in such kind of a partnership that the final decision ought to rest with those nominated by the parties who undoubtedly have the greatest and a continuous interest.

These considerations, of course cannot decide the meaning of the contract if clearly expressed in a different sense; but such considerations are an obvious answer to so much of what was strenuously advanced in argument as needed to be borne in mind for the purpose of interpreting correctly this contract.

When we try to find how this word "service" has been applied in other parts of the same contract we see in every instance where it has been used, except in clause 41, it is applicable to, and can, I think, only be fairly read as being applied to the transportation of passengers.

In clause 14 it is contradistinguished from the tracks and properly described as a street car service. In condition 17 it is again used in contradistinction to the tracks, and in 33 it is used in harmony with the idea of transportation of passengers, when it provides for the transfer service as a means of carrying out the transportation. And when used in the condition 36 it is the car that is designed for what? For service in the transportation of passengers. The same may be said to be true of its use in condition number 40.

I do not think it derogates from the force of this to find that the word "service" is used in 41 in relation to the word "men" in its original sense.

Timetables and routes are but incidental to the same idea of transportation of passengers. Stoppages may be also, but though referred to in argument they do not seem covered by any of these questions.

As to the third question, I am unable to appreciate what this dispute is about. We have been assured by counsel for the appellants that there is not and has never been any claim to turn out a passenger who may have entered upon a car near midnight before that passenger was carried to his destination. We also are assured that no such passenger has ever had exacted or claimed from him the double fare payable after midnight.

I can conceive that the use of a day-car after midnight when passengers are few may entail extra expense upon the company and that the gradual introduction of the night-car instead of the day-car would be less burdensome for the company and quite as serviceable for the greater part of the time as carrying out the requirements of the city engineer. At other times this might not be so.

I am unable, however, to see how the requirements of the citizens and other passengers can be ensured, by any other means, within the specifications in this contract, than those the city engineer has adopted. I can conceive of a manager in the car-barn being able, from day to day, and night to night, to accurately determine whether or not the requirements of the travelling public would or would not be served by putting on night coaches earlier than midnight. I am unable, however, to see how the city engineer can foretell all this. If these parties cannot accommodate each other in any other way than by a rigid interpretation of the provisions of the contract in this regard it must be applied. I think undoubtedly the correct answer has been given by the Court of Appeal to this third question.

As to question 4 and the answer thereto, I am unable to concur in the view expressed by the Court of Appeal.

I think it would be impossible to carry out by any hard and fast rule, consistently with the greatest degree of the comfort and convenience of the passengers, just what the city engineer has chosen to lay down. The requirements in spring months and fall months might vary from week to week, from day to day in changeable weather such as occasionally occurs in spring and autumn. Such an interference with the carrying on of the appellants' business is undesirable and, ought therefore not to be inferred as intended. It does not form an essential part of the service and so necessarily come within clause 26 as I interpret it.

Clause 36 I think provides all that is to be looked at in this connection. The section on this point reads thus:

Cars are to be of the most approved design for service and comfort, including heating, lighting, signal appliance, numbers and route boards.

Plainly the cars here spoken of are not those that are in the barn but those that are actually running, and they must be heated, lighted, as well as otherwise according to the most approved design.

That does not entitle a company to put out a summer car in winter weather or a winter car in summer weather. It leaves, as there is no power given to any one expressly or as I think impliedly to determine the matter, the parties complaining, either passengers or covenantees, to their respective remedies on this which by force of clause 13 of the agreement is part of a covenant.

A persistent defiance of the requirements of this covenant can be dealt with also upon the facts either in a case seeking to rescind the charter or otherwise quite as efficiently as the requirements of the engineer had he the power to specially direct in this regard as I do not think he has. That in the same section there are two objects committed to the determination of the city engineer and that the cars or heating thereof as described are not so intrusted to his direction is to my mind conclusive that it never was intended that anything further should be open to the respondents or others than the usual remedies for a breach, or for persistent breaches of contract on

the part of such a corporation as the appellants'.

I would therefore answer question 4 in the negative.

I have no doubt of question 5 being properly passed over for the reasons given in the court below.

I have no difficulty in assenting to and upholding the answer of the Court of Appeal to the 6th question. But for the able and strenuous argument addressed to us I should have supposed the question was not arguable. There is to my mind as clear as can be a covenant to observe each one of the provisions in this contract and one of them is the obligation resting upon the company to obey the requirement of the city council and the city engineer when that is made known in the manner described in clause 14.

In effect we are asked to give the same meaning to the word "require" as if it were "request" or something that did not imply an obligation upon those subjected to it. I cannot assent to such a proposition.

The option rests with the city to accept this alternative of clause 17 or pursue their remedies on the covenant or possibly (upon which point I express no opinion) do both.

I am of opinion that the judgment of the court below should be varied accordingly and the appeal to that extent allowed.

Appeal allowed in part with costs.

TAB 9

Case Name:

**Ventas, Inc. v. Sunrise Senior Living Real Estate
Investment Trust**

Between

**Ventas, Inc., 2124678 Ontario Inc., and 2124680 Ontario
Inc., Applicants (Respondents in Appeal), and
Sunrise Senior Living Real Estate Investment Trust,
Sunrise REIT Trust, Sunrise REIT GP, Inc., Sunrise
Senior Living Inc., and Health Care Property Investors,
Inc., Respondents (Appellants in Appeal)**

And between

**Sunrise Senior Living Real Estate Investment Trust,
Sunrise REIT Trust, and Sunrise REIT GP, Inc.,
Applicants (Appellants in Appeal), and
Ventas SSL Ontario II, Inc. (Formerly 2124678 Ontario
Inc.), Ventas SSL Ontario I, Inc. (Formerly 2124680
Ontario Inc.), Ventas Inc., Sunrise Senior Living,
Inc., and Health Care Property Investors, Inc.,
Respondents (Respondents in Appeal) (Ventas Inc.
and numbered companies) (Appellant by Cross-Appeal)
(Health Care Property Investors, Inc.)**

[2007] O.J. No. 1083

2007 ONCA 205

85 O.R. (3d) 254

222 O.A.C. 102

29 B.L.R. (4th) 312

56 R.P.R. (4th) 163

156 A.C.W.S. (3d) 95

2007 CarswellOnt 1705

Dockets: C46790 and C46791

Ontario Court of Appeal
Toronto, Ontario

R.A. Blair, J.L. MacFarland and H.S. LaForme JJ.A.

Heard: March 20, 2007.
Judgment: March 23, 2007.

(69 paras.)

Corporations and associations law -- Sale of a business -- Asset purchase agreement -- Conditions and warranties -- Restrictive covenants -- Appeal by trust and potential purchaser of trust's assets from decision concluding trust was precluded from considering or accepting bid from potential purchaser dismissed -- Trust and plaintiff purchaser entered into purchase agreement -- Agreement precluded trust from negotiating other bids and obliged trust to enforce existing standstill agreements -- Potential purchaser made post-auction bid, exceeding plaintiff purchaser's bid -- Trust held to be unable to consider or accept bid -- Fact plaintiff purchaser negotiated better terms in its standstill agreement did not render potential purchaser's agreement unenforceable -- Trust's shareholders still entitled to vote on plaintiff purchaser's bid, such that court's decision did not prevent trust from maximizing shareholder value.

Appeal by Sunrise and HCPI from a decision concluding Sunrise was precluded from considering or accepting a post-auction bid for its assets by HCPI. Sunrise owned and invested in seniors communities. It decided to sell its assets. All bidding parties were required to enter into confidentiality agreements, as well as standstill agreements preventing bidders from attempting unsolicited takeover bids. Ventas' standstill agreement differed from HCPI's, in that Ventas' agreement would terminate at the end of the auction process. HCPI's standstill agreement did not contain this term. Ventas and HCPI were the two bidders asked to participate in the final round of an auction. Sunrise waived the standstill agreements for Ventas and HCPI for the purpose of further negotiations, and informed both companies they should not assume the winning bid was assured of acquiring the assets. HCPI withdrew from the auction process. Ventas' bid of \$15 per unit succeeded, and was to be put to Sunrise's shareholders on March 30, 2007. Ventas and Sunrise entered a purchase agreement for all of Sunrise's assets, subject to subsequent third-party unsolicited bids. Sunrise was allowed to accept such bids if they were financially superior to Ventas' bid. Sunrise was precluded from participating in discussions or negotiations for acquisition proposals, and was bound to enforce existing standstill agreements. HCPI subsequently put forward a post-auction bid for \$18 per unit. Ventas took the position Sunrise breached its confidentiality agreement, by permitting HCPI to communicate with another potential bidder, SSL. Ventas did not assert HCPI was in breach of its standstill agreement because Ventas assumed it contained the same

termination clause as Ventas' standstill agreement. Sunrise applied to court for an interpretation of the purchase agreement it had with Ventas. Ventas then learned of the terms of the HCPI standstill agreement, and brought an application for a declaration Sunrise was required to enforce it. The judge found Sunrise had agreed with Ventas that it would continue to enforce standstill agreements, that HCPI's bid was in breach of its standstill agreements, and therefore unacceptable. Sunrise's application was dismissed as moot in light of the judge's decision on Ventas' application.

HELD: Appeal dismissed. The purchase agreement between Sunrise and Ventas precluded Sunrise from considering HCPI's post-auction bid. The enforcement of standstill agreements by Sunrise was an important purpose of the purchase agreement, negotiated by Ventas to protect its position with respect to competition from unsuccessful bidders in the auction. The fact Ventas was more skillful than HCPI in negotiating its standstill agreement did not render HCPI's agreement unenforceable. The court's interpretation of the purchase agreement was not inconsistent with Sunrise's obligation to maximize shareholder value. Sunrise's shareholders were still entitled to reject the Ventas bid when they voted on March 30.

Appeal From:

On appeal from the Order of Justice Sarah E. Pepall of the Superior Court of Justice dated March 6, 2007.

Counsel:

Peter F.C. Howard and Eliot Kolers for the Appellants (Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust, and Sunrise REIT GP Inc.).

Jeffrey S. Leon and Derek J. Bell, for the Appellants (Health Care Property Investors, Inc.).

Mark A. Gelowitz and Laura K. Fric, for the Respondents (Ventas, Inc. and numbered companies).

Luis G. Sarabia and Cynthia Spry, for the Respondent Sunrise Senior Living Inc.

The judgment of the Court was delivered by

R.A. BLAIR J.A.:--

OVERVIEW

1 Sunrise REIT is a Canadian public real estate investment trust whose units are traded on the Toronto Stock Exchange. It owns and invests in senior living communities in Canada and the

United States. In September 2006, Sunrise's board of trustees determined that a strategic sale process of its assets would be beneficial to its unitholders, thus effectively putting Sunrise "in play" on the public markets.

2 To carry out this plan, the Trustees developed a two-stage auction process with a view to maximizing the value of Sunrise's units. Ventas, Inc. ("Ventas") and Health Care Property Investors, Inc. ("HCPI") were two of seven initially interested prospective purchasers in the auction process. They emerged from the preliminary round as the only two potential bidders asked to participate in the final round.

3 Ventas submitted a successful bid to acquire all of Sunrise's assets for a total purchase price of \$1,137,712,410 (representing a price of \$15 per unit), subject to unitholder approval. HCPI withdrew from the auction process and did not bid at that time. Instead, it put forward a post-auction bid - after it knew what Ventas had offered - "topping up" the Ventas offer by twenty per cent to \$18 per unit. This increased offer represents an additional \$227.5 million for the unitholders, who are to meet on March 30, 2007, to consider the Ventas proposal.

4 Hence the urgency of this appeal.

5 The appeal turns on the interpretation of the terms of the purchase agreement executed by Sunrise and Ventas following acceptance of the Ventas bid. The issue is whether Sunrise is obliged to enforce the terms of a prior standstill agreement entered into between it and HCPI in the course of the auction process and which prohibits HCPI from making an offer for the Sunrise assets without Sunrise's consent. If the answer to that question is "Yes", Sunrise will be precluded from considering or accepting the richer HCPI offer pending the unitholders' meeting.

6 Following an urgent application, determined on March 6, 2007, Justice Pepall answered the foregoing question in the affirmative. Sunrise and HCPI appeal from that decision. Ventas supports it.

7 For the reasons that follow, I would dismiss the appeal and uphold the decision of the application judge.

FACTS

8 As mentioned above, Sunrise owns and invests in senior living communities in Canada and the United States. The properties are managed by Sunrise Senior Living, Inc. ("SSL"), a U.S. public company whose shares are traded on the New York Stock Exchange.

9 HCPI is a self-administered real estate investment trust that also invests in healthcare facilities. Ventas is a U.S.-based health care real estate investment trust whose shares are listed on the New York Stock Exchange.

10 In September 2006, after Sunrise's board of trustees determined that a strategic sale process of the Trust's assets would be beneficial to its unitholders, it began an auction process with a view to maximizing unitholder value.

11 Parties who were interested in acquiring Sunrise (including HCPI and Ventas) were required to enter into a confidentiality agreement with it in order to prevent non-public information exchanged by the parties from being publicly disclosed (the "Confidentiality Agreements"). The Confidentiality Agreements contained restrictions preventing each prospective acquiring party from attempting a hostile (unsolicited) takeover bid (the "Standstill Agreements").

12 Although the parties' Confidentiality Agreements were largely similar, Ventas's Standstill Agreement was worded differently from HCPI's in that the Ventas standstill ceased to apply if, among other things, Sunrise entered into an agreement to sell more than twenty per cent of its assets to a third party. Notably, HCPI's Standstill Agreement did not contain a similar termination clause.

13 On November 21, 2006, Sunrise invited potential bidders to submit bids in the non-binding preliminary round of an auction. After the first round of bids, Sunrise invited HCPI and Ventas to engage in further negotiations and on December 29, 2006, it invited them to submit final binding bids in the second round of the auction by January 8, 2007. Sunrise waived the Standstill Agreements with those bidders for that purpose, and HCPI and Ventas were expressly told not to assume that the "winning" bid was assured of actually acquiring Sunrise at the price agreed upon or that they would be given an opportunity to rebid, renegotiate, or improve the terms of their proposal.

14 Ventas submitted a second bid on January 8, but HCPI withdrew from the auction and did not.

15 On January 14, 2007, Ventas and Sunrise signed an agreement contemplating the purchase by Ventas of all of Sunrise's assets for a total purchase price of \$1,137,712,410 (representing a price of \$15.00 per Unit), subject to Unitholder approval (the "Purchase Agreement"). This price represented a 35.8% premium over the closing price of the units on January 12, 2007. The Purchase Agreement contemplated subsequent third-party unsolicited bids and allowed Sunrise to accept such a bid if it was financially superior to Ventas's bid.

16 On January 17, 2007, Sunrise notified HCPI of the agreement with Ventas and asked for the return of Sunrise's confidential materials. In the letter, Sunrise's solicitor reminded HCPI of the terms of the Confidentiality Agreement it signed in November 2006.

17 On February 14, 2007, HCPI submitted a proposal to acquire all of Sunrise's assets for \$18.00 per unit (the "HCPI Proposal"), conditional on HCPI's ability to reach a management agreement with SSL. Sunrise treated the HCPI Proposal as an unsolicited third-party bid, but it concluded that it was not in a position to determine whether the bid was a superior bid because of the SSL condition.

18 The Confidentiality Agreements entered into in the course of the auction process contained a provision prohibiting prospective purchasers from communicating with SSL. This was because SSL was viewed as a possible bidder. Following the preliminary round of the auction, in late November 2006, and after realizing that SSL was not an interested purchaser, Sunrise had authorized its financial advisors to arrange to allow HCPI and Ventas to contact SSL for purposes of the second round of bidding. On February 15, 2007, however - after learning of the HCPI Proposal - Ventas advised Sunrise that, if it permitted communications between SSL and HCPI, Sunrise would be in breach of the Purchase Agreement. It did not assert that HCPI would be in breach of its Standstill Agreement because it apparently assumed that HCPI's Standstill Agreement was worded similarly to the Ventas Standstill Agreement, which meant that the restraint on an unsolicited bid was no longer enforceable since Sunrise had entered into an agreement with a third party.

19 On February 18, 2007, Sunrise served application materials upon Ventas, HCPI and SSL indicating its intention to seek the court's interpretation of the Purchase Agreement, specifically on the issue of communications between HCPI and SSL. It is at this point that Ventas learned of the specific terms of HCPI's Confidentiality Agreement and realized that HCPI's Standstill Agreement did not contain the same termination clause as Ventas's Standstill Agreement. On February 21, 2007, Ventas brought the within Application seeking a declaration that Sunrise was required to enforce its Standstill Agreement with HCPI, thereby preventing it from considering the HCPI Proposal.

20 The application judge found that Sunrise had agreed with Ventas that it would enforce existing Standstill Agreements and that any bid made in breach of an existing Standstill Agreement would not be *bona fide*. She then concluded that Sunrise was required to enforce the Standstill Agreement with HCPI and that HCPI did not have prior written consent to submit its bid. She dismissed Sunrise's application on the grounds that the issue was moot in light of her earlier conclusion.

THE PROVISIONS OF THE AGREEMENT

21 Section 4 of the Purchase Agreement deals generally with the covenants of the parties. Section 4.4 deals with Sunrise's "Covenants Regarding Non-Solicitation". Because of their importance, I reproduce the provisions of section 4.4 in their entirety (the underlining is mine):

4.4(1) Following the date hereof, Sunrise REIT shall not, directly or indirectly, through any trustee, officer, director, agent or Representative of Sunrise REIT or any of its Subsidiaries, and shall not permit any such Person to,

- (i) solicit, initiate, encourage or otherwise facilitate (including by way of furnishing information or entering into any form of agreement, arrangement or understanding or providing any other form of assistance) the initiation of any inquiries or proposals regarding, or other action that constitutes, or may reasonably be expected to lead to, an actual or potential

- Acquisition Proposal,
- (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligations to Sunrise REIT or any of its Subsidiaries,
 - (iii) approve, recommend or remain neutral with respect to, or propose publicly to approve, recommend or remain neutral with respect to, any Acquisition Proposal,
 - (iv) accept or enter into any agreement, arrangement or understanding, related to any Acquisition Proposal (other than a confidentiality agreement contemplated in Section 4.4(2)), or
 - (v) withdraw, modify or qualify, or publicly propose to withdraw, modify or qualify, in any manner adverse to the Purchasers, the approval or recommendation of the Board (including any committee thereof) of this Agreement or the transactions contemplated hereby.
- (2) Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from complying with Sunrise REIT's disclosure obligations under applicable Laws with regard to a bona fide written, unsolicited Acquisition Proposal or, following the receipt of any such Acquisition Proposal from a third party (that did not result from a breach of this Section 4.4), from furnishing or disclosing non-public information to such Person if and only to the extent that:
- (i) the Board believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal if consummated could reasonably be expected to result in a Superior Proposal; and
 - (ii) such third party has entered into a confidentiality agreement containing terms in the aggregate no more favourable to such third party than those in the Confidentiality Agreement as are then in effect in accordance with its terms.
- (3) Notwithstanding anything, contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from withdrawing or modifying, or proposing publicly to withdraw or modify its approval and recommendation of the transactions contemplated by this Agreement, or accepting, approving or recommending or entering into any agreement, understanding or arrangement providing for a bona fide written, unsolicited Acquisition Proposal (that did not

result from a breach of this Section 4.4) ("Proposed Agreement") if and only to the extent that:

- (i) it has provided the Purchasers with a copy of all of the documents relating to the Acquisition Proposal,
 - (ii) the Board, believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal constitutes a Superior Proposal and has promptly notified the Purchasers of such determination,
 - (iii) a period of at least five Business Days (the "Matching Period") has elapsed following the later of (x) the date the Purchasers received written notice advising the Purchasers that the Board has resolved, subject to compliance with this Section 4.4(3), to withdraw, modify its approval and recommendation of the transactions contemplated by this Agreement or accept, approve or recommend or enter into a Proposed Agreement in respect of such Superior Proposal and (y) the date the Purchasers received a copy of the documentation related to such Superior Proposal pursuant to Section 4.4(3)(i),
 - (iv) if the Purchasers have proposed to amend the transactions contemplated under this Agreement in accordance with Section 4.4(6), the Board has again made the determination in Section 4.4(3)(ii) taking into account such proposed amendments; and
 - (v) if Sunrise REIT proposes to enter into a Proposed Agreement (other than a confidentiality agreement referred to in Section 4.4(2)) after complying with this Section 4.4(3), Sunrise REIT shall have complied with Section 5.2 and 5.3. For the purposes of this Section 4.4(3) the preparation and delivery of a directors' circular pursuant to Section 99 of the *Securities Act* relating to an Acquisition Proposal shall be deemed to be a qualification, withdrawal or modification, of the Board's recommendation of the transactions contemplated hereby unless the Board expressly, and without qualification, reaffirms its recommendation of the transactions contemplated hereby in such disclosure.
- (4) If the expiry of the Matching Period referred to in Section 4.4(3)(iii) falls on a date which is less than five Business Days prior to the Unitholder Meeting, Sunrise REIT shall, at the request of the Purchasers, adjourn the Unitholder Meeting to a date that is not more than 10 Business Days following such expiry date.
- (5) Sunrise REIT acknowledges and agrees that each successive amendment to any Acquisition Proposal shall constitute a new Acquisition Proposal for purposes of

section 4.4.

- (6) During the Matching Period, the Purchasers shall have the right, but not the obligation, to propose to amend the terms of this Agreement. The Trustees will review any proposal by the Purchasers to amend the terms of this Agreement in good faith in order to determine (after consultation with their financial advisor and legal counsel) whether the transactions contemplated by this Agreement, taking into account the Purchasers' proposed amendments would, if consummated in accordance with its terms, result in the Superior Proposal ceasing to be a Superior Proposal. If the Trustees so determine, Sunrise REIT will enter into an amending agreement with the Purchasers reflecting such proposed amendment.
- (7) Sunrise REIT shall, as promptly as practicable, notify the Purchasers of any relevant details relating to any Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or any amendments to any Acquisition Proposal (including the identity of the parties and all material terms thereof), or any request for non-public information relating to Sunrise REIT or any of its Subsidiaries in connection with an Acquisition Proposal or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or for access to the properties, books or records of Sunrise REIT or any of its Subsidiaries by any Person that informs Sunrise REIT or such Subsidiary that it is considering making, or has made, an Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, in each case which any of Sunrise REIT, any of its Subsidiaries or any officer, trustee, director, employee or Representative may receive after the date hereof relating to an Acquisition Proposal. Sunrise REIT shall promptly and fully keep the Purchasers informed of the status on a current basis, including any change to any of the terms, of any such Acquisition Proposal.
- (8) Sunrise REIT shall
 - (i) ensure that its officers and Trustees and its Subsidiaries and their respective officers and directors and any Representatives retained by it or its Subsidiaries in connection herewith are aware of the provisions of this Section 4.4, and Sunrise REIT shall be responsible for any breach of this Section 4.4 by its and its Subsidiaries' officers, directors, trustees or representatives;
 - (ii) immediately cease and cause to be terminated any existing activities, discussions or negotiations with any parties conducted heretofore with respect to any Acquisition Proposal;
 - (iii) require all Persons other than the Purchasers who have been furnished with confidential information regarding Sunrise REIT or its Subsidiaries in connection with the solicitation of or discussion regarding any Acquisition

- Proposal within 12 months prior to the date hereof promptly to return or destroy such information, in accordance with and subject to the terms of the confidentiality agreement entered into with such Persons;
- (iv) terminate access for all Persons (other than the Purchasers and its Representatives) of the electronic dataroom accessible through Merrill Datasite's website; and
 - (v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties.

22 The Purchase Agreement defines "Acquisition Proposal" and "Superior Proposal" as follows:

"Acquisition Proposal" means any proposal or offer made by any Person other than the Purchasers (or any affiliate of the Purchasers or any Person acting jointly and/or in concert with the Purchasers or any affiliate of the Purchasers) with respect to the acquisition, directly or indirectly, of assets, securities or ownership interests of or in Sunrise REIT or any of its Subsidiaries representing 20% or more of the consolidated assets of Sunrise REIT and its Subsidiaries taken as a whole, in a single transaction or a series of transactions, or, of equity interests representing a 20% or greater economic interest in Sunrise REIT or such Subsidiaries taken as a whole, in a single transaction or a series of transactions pursuant to any merger, amalgamation, tender offer, share exchange, business combination, liquidation, dissolution, recapitalization, take-over or non-exempt issuer bid, amendment to the Declaration of Trust, redemption of units, extraordinary distribution, sale, lease, exchange, mortgage, pledge, transfer, purchase, or issuance as consideration or similar transaction or series of transactions involving Sunrise REIT or any of such Subsidiaries or any other transaction the consummation of which would reasonably expected to impede, interfere with, prevent or materially delay the transactions contemplated hereby.

"Superior Proposal" means any unsolicited bona fide written Acquisition Proposal made by a third party that in the good faith determination of the Trustees, after consultation with its financial advisors and with outside counsel:

- (a) is reasonably capable of being completed without undue delay having regard to financial, legal, regulatory and other matters;
- (b) in respect of which adequate arrangements have been made to ensure that the required funds will be available to effect payment in full of the consideration; and
- (c) would, if consummated in accordance with its terms, result in a transaction

more favourable to Unitholders from a financial point of view (including financing terms, any termination fee or expenses reimbursement payable under this Agreement, any conditions to the consummation thereof) than the transactions contemplated by this Agreement; provided, however, that for purposes of this definition the references in the definition of Acquisition Proposal to "20%" shall be deemed to be references to "100%".

ANALYSIS

23 The central issue on this appeal, as it was before the application judge, is whether the provisions of section 4.4 of the Purchase Agreement impose an obligation on Sunrise to enforce the Standstill Agreement between it and HCPI, thus precluding it from considering the Acquisition Proposal submitted by HCPI following the close of the auction and after the Ventas bid had been accepted. In my view, they do.

24 Counsel accept that the application judge correctly outlined the principles of contractual interpretation applicable in the circumstances of this case. I agree. Broadly stated - without reproducing in full the relevant passages from her reasons (paras. 29-34) in full - she held that a commercial contract is to be interpreted,

- (a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;¹
- (b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the "cardinal presumption" that they have intended what they have said;²
- (c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties;³ and (to the extent there is any ambiguity in the contract),
- (d) in a fashion that accords with sound commercial principles and good business sense, and that avoid a commercial absurdity.⁴

25 The appellants assert, however, that the application judge misapplied the principles of contractual interpretation that she had properly enunciated. They say she did so essentially,

- a) by misapprehending the interplay between sections 4.4(1), 4.4(2), 4.4(3) and 4.4(8)(v) of the Purchase Agreement and, in particular by failing to appreciate, and to reconcile, the differences between the wording of sections 4.4(1) and 4.4(8), and more generally,
- b) by failing to understand the "architecture" of section 4.4 of the Purchase Agreement and to consider it against the background of the factual matrix in which the Agreement was negotiated.

26 I do not agree.

The Application Judge's Reasoning

27 The thrust of the application judge's reasoning in this regard is found at paragraphs 35, 36, 38 and 39 of her reasons:

35 Sunrise REIT expressly and unambiguously agreed that it would not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties. The standstill enforcement obligations are found in sections 4.4(1) and 4.4(8) of the Purchase Agreement.

36 Sections 4.4(2) and 4.4(3) address Sunrise REIT's obligations with regard to "a bona fide written, unsolicited Acquisition Proposal (that did not result from a breach of this section 4.4)." Sections 4.4(2) and 4.4(3) are prefaced with the words "notwithstanding anything contained in section 4.4(1)." Sections 4.4(2) and (3) do not say "notwithstanding anything contained in section 4.4(1) or 4.4(8)." If it had been the parties' contractual intention to exempt the circumstances described in sections 4.4(2) and (3) from the operation of section 4.4(8), they could have so provided but they did not. Similarly, unlike sections 4.7 and 4.8 which commence with the words "notwithstanding any other term of the Agreement", sections 4.4(2) and 4.4(3) do not use this language.

38 It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. This was part of the package negotiated between it and Sunrise REIT.

39 Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with the context of the transaction including the auction process which was the genesis of the Purchase Agreement. The Purchase Agreement does not preclude bona fide written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement operated to permit such a proposal. It simply precludes a proposal from anyone who is in breach of its standstill agreement. While creative, I view Sunrise REIT's and HCP's interpretation arguments to be strained. They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole.

[Footnote omitted.]

The Scheme and Interpretation of Section 4.4

28 I agree with the application judge that an important purpose of this part of the Purchase Agreement is to ensure the enforcement of standstill agreements entered into by previous players in the auction process. The negotiating context demonstrates that Ventas has been skilful in protecting its own position with respect to competition and standstills - unlike the HCPI Standstill, the Ventas/Sunrise Standstill Agreement expired at the conclusion of the auction - and it is objectively reasonable, given this background, that it would seek protection against competition from those who were unsuccessful in the auction, particularly its principle competitor.

29 From Sunrise's perspective, the safety valve lies in the unitholders' meeting. If the unitholders believe that there is a more favourable offer available - one worth the risk of rejecting the Ventas proposal - they may well vote to reject the Ventas proposal at their meeting on March 30.

30 The language used by the parties in the Purchase Agreement supports this interpretation.

31 Viewed contextually, sections 4.4(1), 4.4(2), 4.4(3) and 4.4(8) form part of a section of the Purchase Agreement that deals with the general covenant of Sunrise not to shop for other offers pending unitholder consideration of the Ventas bid. Viewed in light of the factual matrix in which the Agreement was negotiated, the provisions provide deal protection for Ventas, as the successful bidder in the auction, subject to Sunrise REIT's fiduciary out obligations.

32 As I read section 4.4 of the Agreement, it has four major components. First, it contains the overriding obligation of Sunrise not to solicit other bids, buttressed by the commitment of Sunrise to enforce existing standstill agreements that may be in place with bidders who have already engaged in the auction process (section 4.4(1)). Secondly, it contains the "fiduciary out" protection for the Sunrise Trustees (and unitholders), permitting the Trustees to consider *bona fide* unsolicited Acquisition Proposals from third parties (that are not in breach of the provisions of section 4.4) (sections 4.4(2) and 4.4(3)). Thirdly, it contains a series of provisions dealing with how the parties are to address a situation where a permitted Acquisition Proposal is received (sections 4.4(3) - 4.4(7)).⁵ Lastly, section 4.4(8)(v) returns to the general non-solicitation obligation, reinforcing it by ensuring that Sunrise will (i) ensure all of its officers, Trustees and agents are aware of the non-solicitation provisions, (ii) immediately stop negotiating with anyone previously involved in the bidding process, (iii) require those bidders to return any confidential documentation and information they may have received during the process, (iv) terminate access to the data room by anyone other than Ventas and its representatives, and finally (a reiteration of the requirement set out in section 4.4(1)):

- (v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise

REIT and any third parties ...

33 Contrary to the appellants' submissions, however, it is not *any* Acquisition Proposal that the Trustees are free to consider as part of the fiduciary out scenario; it is only an Acquisition Proposal from a third party that is not in breach of section 4.4 of the Agreement.

34 Properly understood in this fashion, then, a reading of section 4.4 demonstrates that there is no *conflict* between the provisions of sections 4.4(1)(ii), 4.4(2), 4.4(3) and 4.4(8)(v). The repeated standstill enforcement terms *complement* one another. As the application judge pointed out, the opening phrases of sections 4.4(2) and 4.4(3) - "notwithstanding anything contained in Section 4.4(1)" - do not have the words "or Section 4.4(8)(v)" added to them. This reinforces the interpretation that section 4.4(8)(v) is there to clarify that Sunrise's obligation to enforce its Standstill Agreements with third parties is not negated by the fiduciary out clause. An unsolicited proposal by a prior bidder bound by a Standstill Agreement is a proposal that is otherwise in breach of section 4.4, because it violates section 4.4(8)(v), and therefore is not immunized by the fiduciary out provisions.

35 In that sense, contrary to the appellants' submissions, the application judge's reading of the Purchase Agreement does not reduce section 4.4(8)(v) to simply the functional equivalent of section 4.4(1)(ii). Nor is it a case of section 4.4(8)(v) continuing to require the enforcement of a Standstill Agreement even when the fiduciary out clause is otherwise applicable. The fiduciary out clause does not apply where the unsolicited proposal is tendered in breach of the non-solicitation provisions of the Purchase Agreement, i.e., in breach of a Standstill Agreement that Sunrise is obliged to enforce. The fiduciary out formula is an important feature of the non-solicitation format, but it does not allow Sunrise to resile from the terms of its Standstill Agreements with earlier bidders, in my opinion.

The Difference in Wording between Sections 4.4(1)(ii) and 4.4(8)(v)

36 Mr. Howard emphasized what he argued was a difference in wording between those two provisions. He points out that section 4.4(1)(ii) expressly refers to situations involving "an actual or potential Acquisition Proposal" whereas section 4.4(8)(v) contains no such reference, and further, that other subsections of section 4.4(8) - namely, sections 4.4(8)(ii) and (iii) - refer to Acquisition Proposals as well, although not in the context of standstill agreements (4.4(8)(ii) and 4.4(8)(iii)). Because section 4.4(8)(v) does not refer to "Acquisition Proposals", Mr. Howard submits it does not apply in the context of such a proposal and therefore does not apply in the context of the HCPI Acquisition Proposal.

37 There are several problems with this argument. First, it misapprehends the fact that *any* proposal to acquire more than twenty percent of the assets of Sunrise - whether made before or after the close of the auction - constitutes an "Acquisition Proposal" as defined in the Agreement. Consequently, section 4.4(8)(v) can only apply in the context of an Acquisition Proposal of some sort, regardless of its wording.

38 Secondly, the argument appears to be founded on the unarticulated premise that an Acquisition Proposal, as referenced in sections 4.4(1)(ii), 4.4(2) and 4.4(3), is the equivalent of a Superior Proposal. The appellants' theory of the Agreement is that the Trustees are entitled to consider any Acquisition Proposal received after the close of the auction, and that the commitment in section 4.4(8)(v) to enforce standstill agreements only applies in the event that a subsequent Acquisition Proposal received by the Trustees does not make the grade as a Superior Proposal. The function of section 4.4(8)(v), they say, is to permit the Trustees in such circumstances to prevent a bidder in such a case - whether a prior bidder or not - from continuing to participate in the bidding process.

39 It is not the case, however, that an Acquisition Proposal and a Superior Proposal are the same thing. The latter is a narrower concept than the former. While an Acquisition Proposal is essentially an offer by anyone to acquire more than twenty percent of the assets of Sunrise, a Superior Proposal is an Acquisition Proposal⁶ that is more favourable to the unitholders from a financial point of view than the Ventas bid. Sunrise submits, at paragraph 43 of its factum, that section 4.4(8)(v) "is part of the filtering protection for both Ventas and Sunrise REIT that allows and obliges Sunrise REIT to deal summarily with offers that do not meet the Acquisition Proposal threshold." Sunrise does not mean the "Acquisition Proposal threshold" in this statement, however; it means the "Superior Proposal threshold." To support the appellants' argument, the reference to "Acquisition Proposal" in section 4.4(1)(ii) would have to be read as "Superior Proposal". That is not what it says.

40 Moreover, and in any event, a careful reading of section 4.4(1)(ii) does not bear out the nexus between the reference to "Acquisition Proposal" and the commitment to enforce the standstill agreements. For ease of reference I repeat the wording of section 4.4(1)(ii) here:

4.4(1) Following the date hereof, Sunrise REIT shall not ...

- (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual or potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligation to Sunrise REIT or any of its Subsidiaries.

41 Section 4.4(1)(ii) in reality contains two prohibitions, not one. The language does not work otherwise. Sunrise agrees not to participate in discussions or negotiations regarding actual or potential Acquisition Proposals. It also agrees not to release anyone from, or fail to enforce, existing Standstill Agreements. The drafters could well have divided section 4.4(1) into six general prohibitions rather than five. The commitment to enforce the Standstill Agreements is not, therefore, tied to "Acquisition Proposals" in a way that section 4.4(8)(v) is not.

42 Accordingly, I agree with the application judge's observation that while the appellants' interpretation arguments are creative, they are strained. As she said, "They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole."

An Interpretation that Reflects the "Factual Matrix", is "Commercially Sensible",
and Accords with the Fiduciary Obligations of the Sunrise Trustees

43 Nor do I accept the submission that the application judge failed to consider the factual matrix underlying the negotiation of the Purchase Agreement, or that she failed to give effect to the "commercial sense" component of contract interpretation.

44 In a blended argument, the appellants submit that the application judge's interpretation of the Purchase Agreement ignores the factual matrix in which the Agreement was negotiated, defies commercial sense and reasonableness, and eviscerates the fiduciary out mechanism that was central to the parties' agreement. Respectfully, I do not read the application judge's reasons in this fashion.

The Factual Matrix

45 Contracts are not made in a vacuum, and there is no dispute that the surrounding circumstances in which a contract is negotiated are relevant considerations in interpreting contracts. As this court noted in *Kentucky Fried Chicken, supra*, at para. 25, "[w]hile the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its 'factual matrix' will also provide the court with useful assistance."

46 Sunrise points to a number of surrounding circumstances which it says the application judge ignored in arriving at her decision. These include that:

- a) the Purchase Agreement was entered into at the conclusion of the second stage of a private sale auction process where it was clear that the overall objective of Sunrise was to maximize value for its unitholders;
- b) the expectations of the bidders, objectively determined, could not have been that the "winner" of the auction was assured of acquiring the Sunrise assets, because everyone was aware that there would be a fiduciary out clause and that superior proposals could displace the winning bid;
- c) Ventas's own standstill terms ceased to apply in the event that Sunrise entered into a sales transaction with a third party, and Ventas could not know whether the other Standstill Agreements rested on the same footing (and did not know that HCPI's did not);
- d) Ventas never told Sunrise it believed the participants in the auction would be excluded from the operation of the fiduciary out provision; and
- e) Ventas had bargained for, and achieved, considerable deal protection, in the form of the "no shop" provision, the right to match any Superior Proposal, and the right to receive a \$39.8 million break fee if it chose not to match such an offer.

47 Matters involving the factual matrix underlying a contract are matters of fact, or at least matters of mixed fact and law. A judge is owed considerable deference in her assessment of such

matters. Here, the experienced Commercial List judge was exercising a function common to that role - the interpretation of a commercial contract - and, while she may not have dealt with the foregoing themes expressly as the appellants would like, her reasons, read as a whole, indicate that she was alive to most, if not all, of them. She was certainly aware of the facts contained in points (a), (b), (c) and (e) above, as she dealt with them at one time or another in the reasons. The factor mentioned in (d) is not dispositive of anything.

48 At the conclusion of her consideration of the interpretation issue, as noted earlier, the application judge said (at paras. 38 and 39):

38 It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. This was part of the package negotiated between it and Sunrise REIT.

39 Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with the context of the transaction including the auction process which was the genesis of the Purchase Agreement. The Purchase Agreement does not preclude bona fide written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement operated to permit such a proposal. It simply precludes a proposal from anyone else who is in breach of its standstill agreement. [Emphasis added, footnote omitted.]

49 I can find no basis for concluding the applications judge was not attuned to the need to keep the factual matrix in mind when conducting her interpretative exercise.

50 Nor do I accept that she either ignored the need to interpret the contract in a way that reflected sound commercial sense, or that she failed to give it such an interpretation. It is apparent from her recitation of the principles of contract interpretation that she was aware of the relevance of the "sound commercial sense" theme. She cited the following passage from this Court's decision in *Kentucky Fried Chicken, supra*, at para. 27:

Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity: [*City of Toronto v. W.H. Hotel Ltd.* (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.)]. Rather, the document should be construed in accordance with sound commercial principles and good business sense: [*Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.)]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make

good business sense to one party would not necessarily do so for the other.

51 The appellants' argument that the application judge failed to interpret the Purchase Agreement in a fashion that accords with sound commercial sense is grounded in the belief that she overlooked the importance of the "maximizing value" principle and the centrality of the Trustees' fiduciary obligations in that regard, in cases of this nature. She did neither, in my view.

52 As noted above, the application judge was sensitive to the fiduciary out provisions that permitted other *bona fide* written unsolicited Acquisition Proposals. In her view, however, this was balanced, objectively and reasonably, by the requirement that Sunrise ensure enforcement of Standstill Agreements that had been signed as part of the auction process in order to protect the successful bidder. This interpretation makes commercial sense, in my view.

53 On behalf of HCPI, Mr. Leon placed great emphasis on the sanctity of the fiduciary out mechanism in acquisition agreements of this nature. There is no doubt that the directors of a corporation that is the target of a takeover bid - or, in this case, the Trustees - have a fiduciary obligation to take steps to maximize shareholder (or unitholder) value in the process: see *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755, at 768 and 774 (Gen. Div.). That is the genesis of the "fiduciary out" clauses in situations such as the case at hand. They enable directors or trustees to comply with their fiduciary obligations by ensuring that they are not precluded from considering other *bona fide* offers that are more favourable financially to the shareholders or unitholders than the bid in hand.

54 It is not necessary - nor would it be wise, in my view - to go as far as HCPI suggests this court might go, and adopt the principle gleaned from some American authorities, that the target vendor can place no limits on the directors' right to consider superior offers and that any provision to the contrary is invalid and unenforceable: see *Paramount Communications, Inc. v. QVC Network Inc.* 637 A. 2d 34 (Del. 1994), and *ACE Ltd. v. Capital Re Corp.*, 747 A. 2d 95 at 105 (Del. Ch. 1999). That is not what happened in this case.

55 The Trustees did not contract away their fiduciary obligations. Rather, they complied with them by setting up an auction process, in consultation with their professional advisers, that was designed to maximize the unit price obtained for Sunrise's assets, in a fashion resembling a "shotgun" clause, by requiring bidders to come up with their best price in the second round, subject to a fiduciary out clause that allowed them to consider superior offers from anyone save only those who had bound themselves by a Standstill Agreement in the auction process not to make such a bid. In this case, that turned out to be only HCPI.

56 An auction process is well-accepted as being one - although only one - "appropriate mechanism to ensure that the board of a target company acts in a neutral manner to achieve the best value reasonably available to shareholders in the circumstances": *Maple Leaf Foods Inc. v. Schneider Corp.* (1999), 42 O.R. (3d) 177 at 200 (C.A.). Here, the trustees, acting reasonably and on professional advice, formed the view that an auction process was the best way to maximize

value, and conducted such an auction to the point where they attracted a successful bidder. This is not a case where the Trustees were unable to judge the adequacy of the bid (*Schneider*, at 200). They had dealt with seven prospective purchasers in the course of the two auction rounds, and had received preliminary proposals. Ventas's \$15.00-per-unit price represented a 35.8% increase over the market price of the Units on the date the auction closed. I do not think the Trustees can be said to have failed in the exercise of their fiduciary obligations to their unitholders in these circumstances simply by agreeing in the Purchase Agreement to preclude earlier bidders, who had bound themselves under Standstill Agreements not to do so, from coming in after the auction was concluded and the "successful" bidder had showed its cards and attempting to "top up" that bid.

57 It is well accepted that "where an agreement admits of two possible constructions, one of which renders the agreement lawful and the other of which renders it unlawful, courts will give preference to the former interpretation": John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at 729. Advancing this principle, the appellants argue that we should be loathe to adopt an interpretation of the Purchase Agreement that is inconsistent with overarching fiduciary obligations. While I accept the principle put forward, however, I do not think it applies in the context of this case for the reasons outlined above. The interpretation given to the Purchase Agreement by the application judge is not inconsistent with the Trustee's fiduciary obligation to maximize unitholder value. Indeed, it is consistent with that obligation.

58 Finally, Mr. Leon emphasizes the importance of the word "nothing" in the opening language of sections 4.4(2) and 4.4(3) of the Purchase Agreement. Both provisions open with the words "Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, *nothing* shall prevent the Board from ..." [emphasis added]. Mr. Leon submits that "nothing" means what it says, and must be given the full scope of that meaning, in order to ensure that "nothing" in the Purchase Agreement or otherwise is permitted to stand in the way of the Trustees performing their duty to maximize shareholder value. This point involves parsing the Purchase Agreement in a microscopic fashion that is a little too fine, in my view. The use of the word "nothing" in sections 4.4(2) and 4.4(3) is nothing more than a different way of saying "Notwithstanding anything contained in Section 4.4(1) ... the Board is not prevented from ...". I would not ascribe to it the expanded role that HCPI proposes.

The Meaning of "Bona Fide"

59 The appellants also attack the conclusion of the application judge that the HCPI Acquisition Proposal was not a "bona fide" offer. She accepted the Ventas submission that "a proposal made in breach of a contractual obligation not to make such a proposal cannot be considered to be *bona fide*," noting that sections 4.4(2) and 4.4(3) of the Purchase Agreement contemplate an Acquisition Proposal from a third party "that did not result from a breach of ... Section 4.4".

60 There was much debate about the meaning of "bona fide". The application judge viewed it as meaning acting "in good faith; sincere, genuine", relying upon *The Oxford English Dictionary*.⁷ She

found that the HCPI Acquisition Proposal was not *bona fide* because it was made in breach of the HCPI Standstill Agreement, which Sunrise was obliged by s. 4.4 to enforce. The appellants agree that *bona fide* means "genuine" or "made in good faith" but submit that a *bona fide* Acquisition Proposal, as contemplated by the Purchase Agreement, is one that is "genuine" or "authentic" in the sense that it is not a sham and is reasonably capable of becoming a Superior Proposal, and that this decision must be made in the context of the entire situation.

61 In the end, there is not much difference between the parties as to the meaning of the term "*bona fide*". As with the principles of contract interpretation, they differ on the application of the term in the circumstances of this case. Given the language of the Purchase Agreement, and the context in which it was negotiated - particularly the language "that did not result from a breach of this Section 4.4" in sections 4.4(2) and 4.4(3) - I do not think the application judge erred in her assessment and use of the term "*bona fide*" here.

Miscellaneous

62 Two additional points were made by the appellants, but need not be dealt with at length.

63 First, HCPI argued that Sunrise had given its prior consent to HCPI to make its subsequent Acquisition Proposal following completion of the auction process and the execution of the Purchase Agreement. This consent is said to derive from the waiver Sunrise gave to both HCPI and Ventas as part of the invitation to bid in the second round. The application judge made a specific finding against this position, however, concluding that the December 29, 2006 letter "cannot possibly be construed as constituting Sunrise REIT's prior written consent as that term is used in the Standstill Agreement." There is no basis for interfering with this finding.

64 Secondly, HCPI submitted that the position of Ventas on these applications was tantamount to saying that the benefit of the HCPI Standstill Agreement had been assigned to it. The application judge correctly found that there was no merit in this argument. I agree with her that neither the Standstill Agreement nor its benefits had been assigned to anyone, and no one was taking the position that they had.

The HCPI Cross-Appeal

65 HCPI applied for a declaration that communications between it and SSL regarding Sunrise were permitted. The application judge declined to deal with this request, given her ruling which effectively precluded the HCPI Acquisition Proposal from being pursued. She concluded the application was moot.

66 I agree and for the same reason find it unnecessary to deal with the cross-appeal for the same relief.

CONCLUSION

67 For the foregoing reasons, then, I would dismiss both the appeal and the cross-appeal.

68 If the parties are unable to agree as to costs, they may make brief written submissions in that regard, not to exceed five pages in length.

69 In closing, I would like to thank all counsel for their able presentations and assistance.

R.A. BLAIR J.A.

J.L. MacFARLAND J.A.:-- I agree.

H.S. LaFORME J.A.:-- I agree.

cp/e/qlmxd/qlkjb/qlkjg

1 *B.G. Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12 at 23-24; *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744 at 770 (C.A.).

2 *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* (1998), 40 B.L.R. (2d) 1 at para. 403 (Ont. Gen. Div.), aff'd (1999), 45 O.R. (3d) 417 (C.A.); *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325 at para. 26 (C.A.); *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 at 166-68 [*Eli Lilly*].

3 *Eli Lilly*, *ibid.* at 166; *Kentucky Fried Chicken v. Scott's Food Services Inc.* (1998), 114 O.A.C. 357 at paras. 25-27 (C.A.) [*Kentucky Fried Chicken*].

4 *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 at 901; *Kentucky Fried Chicken*, *ibid.*

5 The Proposal has to be a Superior Proposal; Sunrise has to notify Ventas of the Proposal and provide it with all relevant documentation; Ventas had the right to match the Proposal within five days (as defined) and, if it chooses not to, to terminate the Agreement and receive the break fee (see also, section 5.3 and Schedule "B" (definition of "Termination Payment")).

6 That meets the section 4.4(2) requirements of being *bona fide* and unsolicited.

7 2d ed., s.v. "bona fide".

TAB 10



Industry Canada

Corporate and Insolvency Law Policy

↔ First ◀ Previous ▶ Next ▶

CCAA: Disclaimer of contracts

Clause by Clause Briefing Book

An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts

- **Bill Clause No. 131 - CCAA Section 32**

Bill Clause No. 131

Section No. 32

Topic: Disclaimer of Agreements

Proposed Wording

32. (1) Subject to subsection (3), a debtor company may disclaim or resiliate any agreement to which it is a party on the day of the filing of the initial application in respect of the company by giving 30 days notice to the other parties to the agreement in the prescribed manner.

(2) Subsection (1) does not apply in respect of

- (a) an eligible financial contract within the meaning of subsection 11.05(3);
- (b) a collective agreement;
- (c) a financing agreement if the debtor is the borrower; and
- (d) a lease of real property or an immovable if the debtor is the lessor.

(3) Within 15 days after being given notice of the disclaimer or resiliation, a party to the agreement may apply to the court for a declaration that subsection (1) does not apply in respect of the agreement, and the court, on notice to any parties that it may direct, shall, subject to subsection (4), make that declaration.

(4) No declaration under subsection (3) shall be made if the court is satisfied that a viable compromise or arrangement could not be made in respect of the company without the disclaimer or resiliation of the agreement and all other agreements that the company has disclaimed or resiliated under subsection (1).

(5) If the company has, in any agreement, granted the use of any intellectual property to a party to the agreement, the disclaimer or resiliation of the agreement does not affect the party's right to use

the intellectual property so long as that party continues to perform its obligations in relation to the use of the intellectual property.

(6) If an agreement is disclaimed or resiliated by a company, every other party to the agreement is deemed to have a claim for damages as an unsecured creditor.

Rationale

When a debtor company enters the restructuring process under the CCAA, it is necessary for it to negotiate a reduction of its debts and obligations with its creditors. Among the obligations that the debtor company may seek to renegotiate are ongoing agreements.

The intention of the reform is to allow debtor companies to be freed from unwanted and burdensome agreements that make up part of the financial distress experienced by it. The agreements may be the result of poor negotiations, poor planning or unforeseen circumstances; however, the result is the weighing down of the debtor by unsound commitments. To successfully emerge from restructuring, the debtor company may need to rid itself of some agreements.

The debtor company will be entitled to unilaterally terminate agreements, subject to specific limitations. This ability to act unilaterally differs from normal process that requires negotiating, however, the provision is balanced by granted to the injured third parties a claim for damages resulting from the disclaimer.

Subsection (2) specifies certain agreements that may not be unilaterally disclaimed by the debtor company. Paragraphs (a) and (b) refer to agreements that are subject to special treatment under the CCAA. Paragraphs (c) and (d) refer to agreements that have been specifically excluded because the effect of disclaimer on co-parties to those agreements could be grievous. For example, without paragraph (d), an apartment building landlord making a proposal could be entitled to evict all of its residential tenants. While that may assist the restructuring of the landlord debtor, its societal effects would be heinous.

Subsection (3) provides the third party with the right to challenge a disclaimer by application to the court.

Subsection (4) provides the test to determine if a court should grant the declaration under subsection (3). The test requires the court to determine whether it is necessary for the contracts being disclaimed to actually be disclaimed for the purposes of a successful restructuring. It is expected that the courts will refuse blanket disclaimers and require the debtor to show, at least to a minimal standard of evidence, that the disclaimer is required for it to emerge from the proceedings with a viable business.

Subsection (5) is intended to address the issue of intellectual property licenses. If a debtor company is entitled to disclaim agreements in which the debtor is the licensor of intellectual property, the licensees may be grievously harmed. In the United States, a similar approach is taken – the licensor must allow the licensee to continue to use the intellectual property provided the licensee continues to meet its obligations relating to the use.

Subsection (6) provides parties to a disclaimed agreement with the right to a claim for damages arising from the disclaimer.

Present Law

None.

Senate Recommendation

The reform follows Senate recommendation #30.

TAB 11

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

THE HONOURABLE MR.)
JUSTICE MORAWETZ)
)
) TUESDAY, THE 3RD
) DAY OF JANUARY, 2012

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
TIMMINCO LIMITED AND BÉCANCOUR SILICON INC.

Applicants

INITIAL ORDER

THIS APPLICATION, made by Timminco Limited ("**Timminco**") and Bécancour Silicon Inc. ("**BSI**" and, together with Timminco, the "**Timminco Entities**"), pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**") was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the affidavit of Peter A.M. Kalins sworn January 2, 2012 and the Exhibits attached thereto (the "**Kalins Affidavit**"), and on being advised that Investissement Québec ("**IQ**") was given notice of this application, and on hearing the submissions of counsel for the Timminco Entities and FTI Consulting Canada Inc. and on reading the consent of FTI Consulting Canada Inc. to act as the Monitor (the "**Monitor**"),

SERVICE

1. **THIS COURT ORDERS** that the time for service of the Notice of Application and the Application Record is hereby abridged and validated so that this Application is properly returnable today and hereby dispenses with further service thereof.

APPLICATION

2. **THIS COURT ORDERS AND DECLARES** that the Timminco Entities are companies to which the CCAA applies.

PLAN OF ARRANGEMENT

3. **THIS COURT ORDERS** that one or both of the Timminco Entities shall have the authority to file and may, subject to further order of this Court, file with this Court a plan or plans of compromise or arrangement (hereinafter referred to as the "**Plan**").

POSSESSION OF PROPERTY AND OPERATIONS

4. **THIS COURT ORDERS** that the Timminco Entities shall remain in possession and control of their current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate including all proceeds thereof (the "**Property**"). Subject to further Order of this Court, the Timminco Entities shall continue to carry on business in a manner consistent with the preservation of their business (the "**Business**") and Property. The Timminco Entities shall be authorized and empowered to continue to retain and employ the employees, consultants, agents, experts, accountants, counsel and such other persons (collectively, the "**Assistants**") currently retained or employed by them, with liberty to retain such further Assistants as they deem reasonably necessary or desirable in the ordinary course of business or for the carrying out of the terms of this Order.

5. **THIS COURT ORDERS** that the Timminco Entities shall be entitled to continue to utilize the central cash management system currently in place as described in the

Kalins Affidavit or replace it with another substantially similar central cash management system (the “Cash Management System”) and that any present or future bank providing the Cash Management System shall not be under any obligation whatsoever to inquire into the propriety, validity or legality of any transfer, payment, collection or other action taken under the Cash Management System, or as to the use or application by the Timminco Entities of funds transferred, paid, collected or otherwise dealt with in the Cash Management System, shall be entitled to provide the Cash Management System without any liability in respect thereof to any Person (as hereinafter defined) other than the Timminco Entities, pursuant to the terms of the documentation applicable to the Cash Management System, and shall be, in its capacity as provider of the Cash Management System, an unaffected creditor under the Plan with regard to any claims or expenses it may suffer or incur in connection with the provision of the Cash Management System.

6. **THIS COURT ORDERS** that, notwithstanding anything to the contrary contained herein, the Timminco Entities are authorized and empowered to continue to negotiate discounts on their invoices with customers in exchange for early payment at discount rates consistent with rates previously provided by the Timminco Entities ~~of~~ ^{and} as approved by the Monitor or the Court and is authorized and empowered to continue to accept such discounted amounts in full satisfaction of the associated gross amount owing by such customer.

7. **THIS COURT ORDERS** that the Timminco Entities shall be entitled but not required to pay the following expenses whether incurred prior to or after this Order:

- a) all outstanding and future wages, salaries, employee and pension benefits, vacation pay and expenses, and similar amounts owed to any Assistants, payable on or after the date of this Order, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements; and

- b) the fees and disbursements of any Assistants retained or employed by the Timminco Entities in respect of these proceedings, at their standard rates and charges.

8. **THIS COURT ORDERS** that, except as otherwise provided to the contrary herein, the Timminco Entities shall be entitled but not required to pay all reasonable expenses incurred by the Timminco Entities in carrying on the Business in the ordinary course after this Order, and in carrying out the provisions of this Order, which expenses shall include, without limitation:

- a) all expenses and capital expenditures reasonably necessary for the preservation of the Property or the Business including, without limitation, payments on account of insurance (including directors and officers insurance), maintenance and security services; and
- b) payment for goods or services actually supplied to the Timminco Entities following the date of this Order.

9. **THIS COURT ORDERS** that the Timminco Entities shall remit, in accordance with legal requirements, or pay:

- a) any statutory deemed trust amounts in favour of the Crown in right of Canada or of any Province thereof or any other taxation authority which are required to be deducted from employees' wages, including, without limitation, amounts in respect of (i) employment insurance, (ii) Canada Pension Plan, (iii) Québec Pension Plan, and (iv) income taxes;
- b) all goods and services or other applicable sales taxes (collectively, "Sales Taxes") required to be remitted by the Timminco Entities in connection with the sale of goods and services by the Timminco Entities, but only where such Sales Taxes are accrued or collected after the date of this Order, or where such Sales Taxes were accrued or collected prior to the

date of this Order but not required to be remitted until on or after the date of this Order, and

- c) any amount payable to the Crown in right of Canada or of any Province thereof or any political subdivision thereof or any other taxation authority in respect of municipal realty, municipal business or other taxes, assessments or levies of any nature or kind which are entitled at law to be paid in priority to claims of secured creditors and which are attributable to or in respect of the carrying on of the Business by the Timminco Entities.

10. **THIS COURT ORDERS** that until a real property lease or a lease with respect to use of a portable structure is assigned, disclaimed or resiliated in accordance with the CCAA, the Timminco Entities shall pay all amounts constituting rent or payable as rent under real property leases or a lease with respect to use of portable structure (including, for greater certainty, common area maintenance charges, utilities and realty taxes and any other amounts payable to the landlord under the lease) or as otherwise may be negotiated between the Timminco Entities and the landlord from time to time ("**Rent**"), for the period commencing from and including the date of this Order, twice-monthly in equal payments on the first and fifteenth day of each month, in advance (but not in arrears). On the date of the first of such payments, any Rent relating to the period commencing from and including the date of this Order shall also be paid.

11. **THIS COURT ORDERS** that, except as specifically permitted herein, the Timminco Entities are hereby directed, until further Order of this Court: (a) to make no payments of principal, interest thereon or otherwise on account of amounts owing by the Timminco Entities to any of their creditors as of this date; (b) to grant no security interests, trust, liens, charges or encumbrances upon or in respect of any of their Property; and (c) to not grant credit or incur liabilities except in the ordinary course of the Business.

12. **THIS COURT ORDERS** that Québec Silicon Limited Partnership ("QSLP") and Québec Silicon General Partner Inc. ("QSGP") shall provide access to the Timminco Entities or permit the Timminco Entities to make, retain and take away copies of books, documents, securities, contracts, orders, corporate and accounting records, and any other papers, records and information of any kind related to the business or affairs of QSLP, and any computer programs, computer tapes, computer disks, or other data storage media containing any such information (the foregoing, collectively, the "QSLP Records") and grant to the Timminco Entities unfettered access to and use of accounting, computer, software and physical facilities relating thereto, provided however that nothing in this paragraph 12 or in paragraph 13 of this Order shall require the delivery of QSLP Records, or the granting of access to QSLP Records, which may not be disclosed or provided to the Timminco Entities due to privilege attaching to solicitor-client communication or due to statutory provisions prohibiting such disclosure.

13. **THIS COURT ORDERS** that QSLP and QSGP shall provide access to the Timminco Entities or permit the Timminco Entities to make, retain and take away copies of books, documents, securities, contracts, orders, corporate and accounting records, and any other papers, records and information of any kind related to the business or affairs of BSI, and any computer programs, computer tapes, computer disks, or other data storage media containing any such information (the foregoing, collectively, the "BSI Records") and grant to the Timminco Entities unfettered access to and use of accounting, computer, software and physical facilities relating thereto, provided however that nothing in this paragraph 13 or in paragraph 12 of this Order shall require the delivery of BSI Records, or the granting of access to BSI Records, which may not be disclosed or provided to the Timminco Entities due to privilege attaching to solicitor-client communication or due to statutory provisions prohibiting such disclosure.

14. **THIS COURT ORDERS** that if any QSLP Records or BSI Records are stored or otherwise contained on a computer or other electronic system of information storage,

whether by independent service provider or otherwise, all individuals, firms, corporations, or any other entities in possession or control of such QSLP Records or BSI Records shall forthwith give unfettered access to the Timminco Entities for the purpose of allowing the Timminco Entities to recover and fully copy all of the information contained therein whether by way of printing the information onto paper or making copies of computer disks or such other manner of retrieving and copying the information as the Timminco Entities deem expedient, and shall not alter, erase or destroy any QSLP Records or BSI Records without the prior written consent of the Timminco Entities. Further, for the purposes of this paragraph, all Persons shall provide the Timminco Entities with all such assistance in gaining immediate access to the information in the records as the Timminco Entities may require including providing the Timminco Entities with instructions on the use of any computer or other system and providing the Timminco Entities with any and all access codes, account names and account numbers that may be required to gain access to the information.

RESTRUCTURING

15. **THIS COURT ORDERS** that the Timminco Entities shall, subject to such requirements as are imposed by the CCAA, have the right to:

- a) permanently or temporarily cease, downsize or shut down any of its business or operations and to dispose of redundant or non-material assets not exceeding \$100,000 in any one transaction or \$1,000,000 in the aggregate,
- b) terminate the employment of such of its employees or Assistants or temporarily lay off such of its employees or Assistants as it deems appropriate, and
- c) pursue all avenues of refinancing of their Business or Property, in whole or part, subject to prior approval of this Court being obtained before any material refinancing,

- d) all of the foregoing to permit the Timminco Entities to proceed with an orderly restructuring of the Business (the "**Restructuring**").

16. **THIS COURT ORDERS** that the Timminco Entities shall provide each of the relevant landlords with notice of the Timminco Entities' intention to remove any fixtures from any leased premises at least seven (7) days prior to the date of the intended removal. The relevant landlord shall be entitled to have a representative present in the leased premises to observe such removal and, if the landlord disputes the Timminco Entities' entitlement to remove any such fixture under the provisions of the lease, such fixture shall remain on the premises and shall be dealt with as agreed between any applicable secured creditors, such landlord and the Timminco Entities, or by further Order of this Court upon application by the Timminco Entities on at least two (2) days' notice to such landlord and any such secured creditors. If the Timminco Entities disclaim or resiliate the lease governing such leased premises in accordance with Section 32 of the CCAA, it shall not be required to pay Rent under such lease pending resolution of any such dispute (other than Rent payable for the notice period provided for in Section 32(5) of the CCAA), and the disclaimer or resiliation of the lease shall be without prejudice to the Timminco Entities' claim to the fixtures in dispute.

17. **THIS COURT ORDERS** that if a notice of disclaimer or resiliation is delivered pursuant to Section 32 of the CCAA, then (a) during the notice period prior to the effective time of the disclaimer or resiliation, the landlord may show the affected leased premises to prospective tenants during normal business hours, on giving the Timminco Entities and the Monitor 24 hours' prior written notice, and (b) at the effective time of the disclaimer or resiliation, the relevant landlord shall be entitled to take possession of any such leased premises without waiver of or prejudice to any claims or rights such landlord may have against the Timminco Entities in respect of such lease or leased premises and such landlord shall be entitled to notify the Timminco Entities of the basis on which it is taking possession and to gain possession of and re-lease such leased premises to any third party or parties on such terms as such landlord considers

advisable, provided that nothing herein shall relieve such landlord of its obligation to mitigate any damages claimed in connection therewith.

NO PROCEEDINGS AGAINST THE TIMMINCO ENTITIES OR THE PROPERTY

18. **THIS COURT ORDERS** that until and including February 2, 2012, or such later date as this Court may order (the "**Stay Period**"), no proceeding or enforcement process in any court or tribunal (each, a "**Proceeding**") shall be commenced or continued against or in respect of the Timminco Entities or the Monitor, or affecting the Business or the Property, except with the written consent of the Timminco Entities and the Monitor, or with leave of this Court, and any and all Proceedings currently under way against or in respect of the Timminco Entities or affecting the Business or the Property are hereby stayed and suspended pending further Order of this Court.

NO EXERCISE OF RIGHTS OR REMEDIES

19. **THIS COURT ORDERS** that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "**Persons**" and each being a "**Person**") against or in respect of the Timminco Entities or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of the Timminco Entities and the Monitor, or leave of this Court, provided that nothing in this Order shall (a) empower the Timminco Entities to carry on any business which the Timminco Entities are not lawfully entitled to carry on, (b) affect such investigations, actions, suits or proceedings by a regulatory body as are permitted by Section 11.1 of the CCAA, (c) prevent the filing of any registration to preserve or perfect a security interest, or (d) prevent the registration of a claim for lien.

20. **THIS COURT ORDERS** that, without limiting anything contained in paragraphs 19 and 21 hereof, any and all rights, remedies, modifications of existing rights and events deemed to occur pursuant to the QSLP Agreements (as defined in the paragraph 23 of the Kalins Affidavit) upon or as a result of (a) an Act of Insolvency (as

that term is used in the Kalins Affidavit) occurring with respect to BSI, (b) any default or non-performance by the Timminco Entities, (c) the making or filing of these proceedings, or (d) any allegation, admission or evidence in these proceedings, are hereby stayed and suspended except with the written consent of the Timminco Entities and the Monitor, or leave of this Court. Without limiting the foregoing, the operation of any provision of any QSLP Agreement that purports to (y) effect or cause a cessation of any rights of the Timminco Entities, or (z) to accelerate, terminate, discontinue, alter, interfere with, repudiate, cancel, suspend or modify such agreement or arrangement as a result of any default or non-performance by or the insolvency of the Timminco Entities, the making or filing of these proceedings, or any allegation, admission or evidence in these proceedings, is hereby stayed and restrained and any steps or actions purported to be taken by any counterparty to any of the QSLP Agreements and any event that is deemed to have occurred in respect of the QSLP Agreements shall be null and void and of no effect.

NO INTERFERENCE WITH RIGHTS

21. **THIS COURT ORDERS** that during the Stay Period, no Person having oral or written agreements with the Timminco Entities shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform or provide any right, renewal right, contract, agreement, licence, permit or access right in favour of or held by the Timminco Entities, including without limitation, access rights held by BSI with respect to the Quebec Silicon Real Property and the Becancour Properties (as these terms are defined in the Kalins Affidavit), except with the written consent of the Timminco Entities and the Monitor, or leave of this Court.

CONTINUATION OF SUPPLY

22. **THIS COURT ORDERS** that during the Stay Period, all Persons, including QSLP and QSGP, having oral or written agreements with the Timminco Entities or statutory or regulatory mandates for the supply of goods and/or services, including without limitation all computer software, communication and other data services,

centralized banking services, payroll services, insurance, transportation services, utility, customs clearing or other services to the Business or the Timminco Entities, are hereby restrained until further Order of this Court from discontinuing, altering, interfering with or terminating the supply of such goods or services as may be required by the Timminco Entities, and that the Timminco Entities shall be entitled to the continued use of its current premises, telephone numbers, facsimile numbers, internet addresses and domain names, provided in each case that the normal prices or charges for all such goods or services received after the date of this Order are paid by the Timminco Entities in accordance with normal payment practices of the Timminco Entities or such other practices as may be agreed upon by the supplier or service provider and each of the Timminco Entities and the Monitor, or as may be ordered by this Court.

NON-DEROGATION OF RIGHTS

23. **THIS COURT ORDERS** that, notwithstanding anything else in this Order, no Person shall be prohibited from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided on or after the date of this Order, nor shall any Person be under any obligation on or after the date of this Order to advance or re-advance any monies or otherwise extend any credit to the Timminco Entities. Nothing in this Order shall derogate from the rights conferred and obligations imposed by the CCAA.

PROCEEDINGS AGAINST DIRECTORS AND OFFICERS

24. **THIS COURT ORDERS** that during the Stay Period, and except as permitted by subsection 11.03(2) of the CCAA, no Proceeding may be commenced or continued against any of the former, current or future directors or officers of the Timminco Entities with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of the Timminco Entities whereby the directors or officers are alleged under any law to be liable in their capacity as directors or officers for the payment or performance of such obligations, until a compromise or

arrangement in respect of the Timminco Entities, if one is filed, is sanctioned by this Court or is refused by the creditors of the Timminco Entities or this Court.

25. **THIS COURT ORDERS** that during the Stay Period, and except as permitted by subsection 11.03(2) of the CCAA, no Proceeding may be commenced or continued against any of the former, current or future directors of QSGP serving as BSI's nominated or appointed representatives on the Board of Directors of QSGP or any of the former, current or future officers of the Timminco Entities also serving as officers of QSGP (collectively, the "QSGP/BSI Directors") with respect to any claim against the QSGP/BSI Directors that arose before the date hereof and that relates to any obligations of QSGP or QSLP whereby the QSGP/BSI Directors are alleged under any law to be liable in their capacity as directors or officers of QSGP for the payment or performance of such obligations, until a compromise or arrangement in respect of the Timminco Entities, if one is filed, is sanctioned by this Court or is refused by the creditors of the Timminco Entities or this Court.

DIRECTORS' AND OFFICERS' INDEMNIFICATION AND CHARGE

26. **THIS COURT ORDERS** that the Timminco Entities shall indemnify their directors and officers against obligations and liabilities that they may incur as directors or officers of the Timminco Entities after the commencement of the within proceedings, except to the extent that, with respect to any officer or director, the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct.

27. **THIS COURT ORDERS** that the directors and officers of the Timminco Entities shall be entitled to the benefit of and are hereby granted a charge (the "D&O Charge") on the Property, which charge shall not exceed an aggregate amount of \$400,000, as security for the indemnity provided in paragraph 26 of this Order. The D&O Charge shall have the priority set out in paragraphs 38 and 40 herein.

28. **THIS COURT ORDERS** that, notwithstanding any language in any applicable insurance policy to the contrary, (a) no insurer shall be entitled to be subrogated to or claim the benefit of the D&O Charge, and (b) the Timminco Entities' directors and officers shall only be entitled to the benefit of the D&O Charge to the extent that they do not have coverage under any directors' and officers' insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified in accordance with paragraph 26 of this Order.

APPOINTMENT OF MONITOR

29. **THIS COURT ORDERS** that FTI Consulting Canada Inc. is hereby appointed pursuant to the CCAA as the Monitor, an officer of this Court, to monitor the business and financial affairs of the Timminco Entities with the powers and obligations set out in the CCAA or set forth herein and that the Timminco Entities and their shareholders, officers, directors, and Assistants shall advise the Monitor of all material steps taken by the Timminco Entities pursuant to this Order, and shall co-operate fully with the Monitor in the exercise of its powers and discharge of its obligations and provide the Monitor with the assistance that is necessary to enable the Monitor to adequately carry out the Monitor's functions.

30. **THIS COURT ORDERS** that the Monitor, in addition to its prescribed rights and obligations under the CCAA, is hereby directed and empowered to:

- (a) monitor the Timminco Entities' receipts and disbursements;
- (b) report to this Court at such times and intervals as the Monitor may deem appropriate with respect to matters relating to the Property, the Business, and such other matters as may be relevant to the proceedings herein;
- (c) advise the Timminco Entities in the development of the Plan and any amendments to the Plan;

- (d) assist the Timminco Entities, to the extent required by the Timminco Entities, with the holding and administering of creditors' or shareholders' meetings for voting on the Plan;
- (e) have full and complete access to the Property, including the premises, books, records, data, including data in electronic form, and other financial documents of the Timminco Entities, to the extent that is necessary to adequately assess the Timminco Entities' business and financial affairs or to perform its duties arising under this Order;
- (f) be at liberty to engage independent legal counsel or such other persons as the Monitor deems necessary or advisable respecting the exercise of its powers and performance of its obligations under this Order;
- (g) hold and administer funds in connection with arrangements made among the Timminco Entities, any counter-parties, and the Monitor, or by Order of this Court; and
- (h) perform such other duties as are required by this Order or by this Court from time to time.

31. **THIS COURT ORDERS** that the Monitor shall not take possession of the Property and shall take no part whatsoever in the management or supervision of the management of the Business and shall not, by fulfilling its obligations hereunder, be deemed to have taken or maintained possession or control of the Business or Property, or any part thereof.

32. **THIS COURT ORDERS** that nothing herein contained shall require the Monitor to occupy or to take control, care, charge, possession or management (separately and/or collectively, "Possession") of any of the Property that might be environmentally contaminated, might be a pollutant or a contaminant, or might cause or contribute to a spill, discharge, release or deposit of a substance contrary to any federal, provincial or

other law respecting the protection, conservation, enhancement, remediation or rehabilitation of the environment or relating to the disposal of waste or other contamination including, without limitation, the *Canadian Environmental Protection Act*, the Civil Code of Québec, the Québec *Environment Quality Act*, the *Ontario Mining Act*, the *Ontario Environmental Protection Act*, the *Ontario Water Resources Act*, or the *Ontario Occupational Health and Safety Act* and regulations thereunder (the "**Environmental Legislation**"), provided however that nothing herein shall exempt the Monitor from any duty to report or make disclosure imposed by applicable Environmental Legislation. The Monitor shall not, as a result of this Order or anything done in pursuance of the Monitor's duties and powers under this Order, be deemed to be in Possession of any of the Property within the meaning of any Environmental Legislation, unless it is actually in possession.

33. **THIS COURT ORDERS** that that the Monitor shall provide any creditor of the Timminco Entities with information provided by the Timminco Entities in response to reasonable requests for information made in writing by such creditor addressed to the Monitor. The Monitor shall not have any responsibility or liability with respect to the information disseminated by it pursuant to this paragraph. In the case of information that the Monitor has been advised by the Timminco Entities is confidential, the Monitor shall not provide such information to creditors unless otherwise directed by this Court or on such terms as the Monitor and the Timminco Entities may agree.

34. **THIS COURT ORDERS** that, in addition to the rights and protections afforded the Monitor under the CCAA or as an officer of this Court, the Monitor shall incur no liability or obligation as a result of its appointment or the carrying out of the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Monitor by the CCAA or any applicable legislation.

35. **THIS COURT ORDERS** that the Monitor, counsel to the Monitor and counsel to the Timminco Entities shall be paid their reasonable fees and disbursements, in each

case at their standard rates and charges, by the Timminco Entities as part of the costs of these proceedings. The Timminco Entities are hereby authorized and directed to pay the accounts of the Monitor, counsel for the Monitor and counsel for the Timminco Entities on a weekly basis and, in addition, the Timminco Entities are hereby authorized and directed to pay to the Monitor, counsel to the Monitor, and counsel to the Timminco Entities, retainers in the amounts of \$75,000, \$30,000 and \$100,000, respectively, to be held by them as security for payment of their respective fees and disbursements outstanding from time to time.

36. **THIS COURT ORDERS** that ~~at the request of the Timminco Entities, any party of interest, or this Court,~~ the Monitor and its legal counsel shall pass their accounts from time to time, and for this purpose the accounts of the Monitor and its legal counsel are hereby referred to a judge of the Commercial List of the Ontario Superior Court of Justice.

37. **THIS COURT ORDERS** that the Monitor, counsel to the Monitor, if any, and the Timminco Entities' counsel shall be entitled to the benefit of and are hereby granted a charge (the "**Administration Charge**") on the Property, which charge shall not exceed an aggregate amount of \$1 million, as security for their professional fees and disbursements incurred at the standard rates and charges of the Monitor and such counsel, both before and after the making of this Order in respect of these proceedings. The Administration Charge shall have the priority set out in paragraphs 38 and 40 hereof.

VALIDITY AND PRIORITY OF CHARGES CREATED BY THIS ORDER

38. **THIS COURT ORDERS** that the priorities of the Administration Charge and the D&O Charge (collectively, the "**Charges**"), as among them, shall be as follows:

First - the Administration Charge (to the maximum amount of \$500,000);

Second - the D&O Charge (to the maximum amount of \$400,000); and

Third – the Administration Charge (to the maximum amount of \$500,000) ranking behind all Encumbrances (as defined below) pending return of the Comeback Motion (as defined below).

39. **THIS COURT ORDERS** that the filing, registration or perfection of the Charges shall not be required, and that the Charges shall be valid and enforceable for all purposes, including as against any right, title or interest filed, registered, recorded or perfected subsequent to the Charges coming into existence, notwithstanding any such failure to file, register, record or perfect.

40. **THIS COURT ORDERS** that, the Charges shall constitute a charge on the Property and the D&O Charge and the Administration Charge to a maximum amount of \$500,000 shall rank ahead in priority to the existing security interests of IQ, but behind all other security interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise, including any deemed trust created under the Ontario *Pension Benefits Act* or the Quebec *Supplemental Pension Plans Act* (collectively, the “**Encumbrances**”) in favour of any Persons that have not been served with notice of this application. The Applicants and the beneficiaries of the Charges shall be entitled to seek priority ahead of the Encumbrances on notice to those parties likely to be affected by such priority (it being the intention of the Timminco Entities to seek priority for the Charges ahead of all such Encumbrances at the Comeback Motion.

41. **THIS COURT ORDERS** that except as otherwise expressly provided for herein, or as may be approved by this Court, the Timminco Entities shall not grant any Encumbrances over any Property that rank in priority to, or *pari passu* with, any of the Charges unless the Timminco Entities also obtain the prior written consent of the Monitor and the beneficiaries of the D&O Charge and the Administration Charge, or further Order of this Court.

42. **THIS COURT ORDERS** that the Charges shall not be rendered invalid or unenforceable and the rights and remedies of the chargees entitled to the benefit of the

Charges (collectively, the "Chargees") shall not otherwise be limited or impaired in any way by (a) the pendency of these proceedings and the declarations of insolvency made herein; (b) any application(s) for bankruptcy order(s) issued pursuant to BIA, or any bankruptcy order made pursuant to such applications; (c) the filing of any assignments for the general benefit of creditors made pursuant to the BIA; (d) the provisions of any federal or provincial statutes; or (e) any negative covenants, prohibitions or other similar provisions with respect to borrowings, incurring debt or the creation of Encumbrances, contained in any existing loan documents, lease, sublease, offer to lease or other agreement (collectively, an "Agreement") which binds the Timminco Entities, and notwithstanding any provision to the contrary in any Agreement:

- (a) the creation of the Charges shall not create or be deemed to constitute a breach by the Timminco Entities of any Agreement to which it is a party;
- (b) none of the Chargees shall have any liability to any Person whatsoever as a result of any breach of any Agreement caused by or resulting from the creation of the Charges; and
- (c) the payments made by the Timminco Entities pursuant to this Order and the granting of the Charges, do not and will not constitute preferences, fraudulent conveyances, transfers at undervalue, oppressive conduct, or other challengeable or voidable transactions under any applicable law.

43. **THIS COURT ORDERS** that any Charge created by this Order over leases of real property in Canada shall only be a Charge in the Timminco Entities' interest in such real property leases.

SERVICE AND NOTICE

44. **THIS COURT ORDERS** that the Monitor shall (a) without delay, publish in *The Globe and Mail*, National Edition, and *La Presse*, in French, once a week for two weeks a notice containing the information prescribed under the CCAA, and (b) within five

business days after the date of this Order (i) make this Order publicly available in the manner prescribed under the CCAA, (ii) send, in the prescribed manner, a notice to every known creditor who has a claim against the Timminco Entities of more than \$1,000, and (iii) prepare a list showing the names and addresses of those creditors and the estimated amounts of those claims, and make it publicly available in the prescribed manner, all in accordance with Section 23(1)(a) of the CCAA and the regulations made thereunder, provided that the Monitor shall not make the names and addresses of individuals who are creditors publicly available.

45. **THIS COURT ORDERS** that the Timminco Entities and the Monitor be at liberty to serve this Order, any other materials and orders in these proceedings, any notices or other correspondence, by forwarding true copies thereof by prepaid ordinary mail, courier, personal delivery or electronic transmission to the Timminco Entities' creditors or other interested parties at their respective addresses as last shown on the records of the Timminco Entities and that any such service or notice by courier, personal delivery or electronic transmission shall be deemed to be received on the next business day following the date of forwarding thereof, or if sent by ordinary mail, on the third business day after mailing.

46. **THIS COURT ORDERS** that the Timminco Entities, the Monitor, and any party who has filed a Notice of Appearance may serve any court materials in these proceedings by e-mailing a PDF or other electronic copy of such materials to counsels' email addresses as recorded on the Service List from time to time, and the Monitor may post a copy of any or all such materials on its website at <http://cfcanada.fticonsulting.com/timminco>.

47. **THIS COURT ORDERS** that the Timminco Entities are authorized to ~~serve~~ their court materials with respect to the comeback motion expected to be heard ~~the week of~~ January 12, 2012 (the "Comeback Motion") by forwarding a copy of this Order and any additional materials to be filed with respect to the Comeback Motion by electronic transmission, where available, or by courier to the parties likely to be affected by the

relief to be sought on the Comeback Motion at such parties' respective addresses as last shown on the records of the Timminco Entities as soon as practicable. The Timminco Entities shall serve the beneficiaries of the BSI Non-Union Pension Plan, the BSI Union Pension Plan and the Haley Pension Plan by serving in the manner described above the pension plan committees for the BSI Non-Union Pension Plan and the BSI Union Pension Plan, Financial Services Commission of Ontario, and the Régie Des Rentes Du Québec.

GENERAL

48. **THIS COURT ORDERS** that the Timminco Entities or the Monitor may from time to time apply to this Court for advice and directions in the discharge of its powers and duties hereunder.

49. **THIS COURT ORDERS** that nothing in this Order shall prevent the Monitor from acting as an interim receiver, a receiver, a receiver and manager, or a trustee in bankruptcy of the Timminco Entities, the Business or the Property.

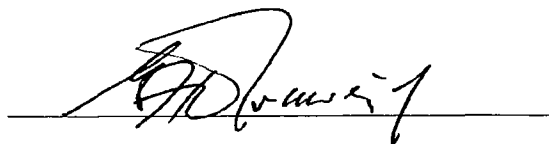
50. **THIS COURT HEREBY REQUESTS** the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States, to give effect to this Order and to assist the Timminco Entities, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Timminco Entities and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Timminco Entities and the Monitor and their respective agents in carrying out the terms of this Order.

51. **THIS COURT ORDERS** that each of the Timminco Entities and the Monitor be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order

and for assistance in carrying out the terms of this Order, and that the Monitor is authorized and empowered to act as a representative in respect of the within proceedings for the purpose of having these proceedings recognized in a jurisdiction outside Canada.

52. **THIS COURT ORDERS** that any interested party (including the Timminco Entities and the Monitor) may apply to this Court to vary or amend this Order on not less than seven (7) days' notice to any other party or parties likely to be affected by the order sought or upon such other notice, if any, as this Court may order.

53. **THIS COURT ORDERS** that this Order and all of its provisions are effective as of 12:01 a.m. Eastern Standard/Daylight Time on the date of this Order.



REGISTERED AT / ENREGISTRÉ À TORONTO
DE / BOOK NO:
LE / DANS LE REGISTRE NO.:

JAN 3 2012

FILED BY:



IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,
R.S.C. 1985, c. C-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF TIMMINCO LIMITED AND BÉCANCOUR SILICON INC.

Court File No. 12-111-9539-0001

(Applicants)

ONTARIO
SUPERIOR COURT OF JUSTICE COMMERCIAL
LIST

Proceeding commenced at Toronto

INITIAL ORDER

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TAB 12

DIP AGREEMENT

Dated as of January 18, 2012

WHEREAS the DIP Lender (as defined below) has agreed to provide funding in order to fund certain obligations of the Borrowers (as defined below) in the context of their proceedings (the “**CCAA Proceedings**”) under the *Companies’ Creditors Arrangement Act* (Canada) (the “**CCAA**”), commenced on January 3, 2012 before the Ontario Superior Court of Justice (Commercial List) (the “**Court**”) pursuant to the initial order granted on January 3, 2012, as amended by the comeback order dated January 16, 2012 (the “**Initial Order**”) in accordance with the terms set out herein;

NOW THEREFORE, the parties, in consideration of the foregoing and the mutual agreements contained herein (the receipt and sufficiency of which are hereby acknowledged), agree as follows:

- 1. DIP BORROWERS:** Timminco Limited (“**Timminco**”) and Becancour Silicon Inc. (“**BSI**” and together with Timminco, the “**Borrowers**”).
- 2. DIP LENDER:** QSI Partners Ltd. (the “**DIP Lender**”).
- 3. PURPOSE:** As set out in Section 13(c) below.
- 4. DIP FACILITY AND MAXIMUM AMOUNT**
A super-priority credit facility (the “**DIP Facility**”) in the amount of US\$4,250,000.00 (the “**Maximum Amount**”). Within 1 business day following the entry of an order, in a form and substance satisfactory to the DIP Lender, authorizing the DIP Facility on the terms and conditions hereof and creating the DIP Charge (as defined below) with the priority contemplated herein (the “**DIP Order**”), the DIP Lender shall deposit the Maximum Amount into a segregated interest bearing Canadian Dollar account (the “**Monitor Account**”) of the Monitor (as defined below) with DIP Advances (as defined below) from the Maximum Amount to be advanced by the Monitor to the Borrowers in accordance with the terms hereof. DIP Advances (as defined below) shall be deposited into the Borrowers’ current account (the “**Borrower’s Account**”), and withdrawn by the Borrowers in accordance with the terms hereof.

DIP Advances shall be made to the Borrowers from the DIP Facility by the Monitor on the terms and conditions set out in this DIP Agreement after the entry of the DIP Order and upon satisfaction of, or waiver by the DIP Lender of the conditions set out under the paragraph below entitled “Availability under DIP Facility”. Each of the Borrowers shall be jointly and severally liable for all DIP Advances and all other amounts

owing hereunder.

5. REPAYMENT:

The aggregate principal amount owing under the DIP Facility, all accrued and unpaid interest, prepayment penalties, if applicable, and all fees and expenses incurred by the DIP Lender in connection with the DIP Facility (the “**DIP Obligations**”) shall be repaid in full on the earlier of (i) the occurrence of any Event of Default hereunder which is continuing and has not been cured, and (ii) June 20, 2012 (the “**Maturity Date**”). The Maturity Date may be extended at the request of the Borrowers and with the prior written consent of the DIP Lender, in its sole discretion, for such period and on such terms and conditions as the Borrowers and the DIP Lender may agree.

The commitment in respect of the DIP Facility shall expire on the Maturity Date and all DIP Obligations shall be repaid in full no later than the Maturity Date, without the DIP Lender being required to make demand upon the Borrowers or to give notice that the DIP Facility has expired and/or that the DIP Obligations are due and payable.

All payments received by the DIP Lender shall be applied first to any fees due hereunder, then to accrued and unpaid interest and then after all such fees and interest are brought current, to principle.

6. CASH FLOW PROJECTIONS:

The Borrowers, with assistance of FTI Consulting Canada Inc., in its capacity as court appointed monitor (the “**Monitor**”) in the CCAA Proceedings, shall have provided to the DIP Lender prior to the execution of this DIP Agreement, the cash flow projections in Schedule “A” hereto, which shall be in form and substance satisfactory to the DIP Lender, reflecting the projected cash requirements of the Borrowers from January 14, 2012 through the period ending June 22, 2012, calculated on a weekly basis (the “**Weekly CCAA Cash Flow**”).

The Borrowers, with the assistance of the Monitor, shall keep the DIP Lender apprised on a weekly basis of its cash flow requirements by providing subsequent cash flow projections together with actual cash flow results from the immediately preceding week, in form consistent with the Weekly CCAA Cash Flow and in substance satisfactory to the DIP Lender and the Monitor, in their reasonable discretion, by no later than 5:00 p.m. (Toronto time) on the Tuesday of each week (individually, as amended from time to time, a “**Cash Flow Projection**” and together with the Weekly CCAA Cash Flow, collectively, the “**Cash Flow Projections**”).

**7. AVAILABILITY UNDER
DIP FACILITY:**

Advances under the DIP Facility (a “**DIP Advance**”) will be made from the Monitor Account on the second business day following delivery of the drawdown certificate in accordance with paragraph (c) below, unless within one business day of delivery of such drawdown certificate the DIP Lender delivers to the Borrowers and the Monitor a notice of non-consent to such DIP Advance as a result of one or more of the conditions precedent not being met or the occurrence of an Event of Default that is continuing and such notice shall include reasonable details outlining any such condition precedent or Event of Default. The DIP Lender may also consent to the making of a DIP Advance prior to the second business day following delivery of the drawdown certificate by providing its written consent to same, to the Monitor and the Borrowers.

The following conditions precedent shall be satisfied, or waived by the DIP Lender in its sole discretion, prior to each DIP Advance hereunder:

- (a) Each DIP Advance (together with all previous DIP Advances) must be no greater than the amount shown on the Cash Flow Projections, as reviewed by the Monitor, and in the aggregate shall not exceed the Maximum Amount and shall be subject to the terms and conditions hereof;
- (b) The Borrowers shall have provided not less than seven (7) days’ notice of the motion for the DIP Order to all parties identified for such service by the DIP Lender not less than nine (9) days prior to the return date for such motion;
- (c) Delivery to the DIP Lender with a copy to the Monitor of a drawdown certificate, in substantially the form set out in Schedule “**B**” hereto, executed by an officer on

behalf of BSI and Timminco, certifying, *inter alia*, that the drawdown is within the relevant Cash Flow Projections and that the Borrowers are in compliance with the Restructuring Court Orders (as defined below) and that no Event of Default has occurred or is continuing;

- (d) There is no Event of Default which has occurred and is continuing, nor will any such event occur as a result of the DIP Advance;
- (e) The DIP Order, in the form and substance substantially in the form attached hereto as Schedule “C” or otherwise as satisfactory to the DIP Lender acting reasonably, shall have been obtained;
- (f) Neither the Initial Order nor the DIP Order has been vacated, stayed or otherwise caused to become ineffective or is amended in a manner prejudicial to the DIP Lender and leave to appeal the DIP Order has not been granted;
- (g) No material adverse change in the financial condition or operation of the Borrowers on a consolidated basis shall have occurred after the date of the issue of the Initial Order;
- (h) There are no pending appeals, injunctions or other legal impediments relating to the closing of the DIP Facility, or pending litigation seeking to restrain or prohibit the closing of the DIP Facility;
- (i) The DIP Lender has received the Weekly CCAA Cash Flow in form and substance reasonably satisfactory to the DIP Lender;
- (j) The DIP Lender has received an officer’s certificate of each of the Borrowers attaching a true and correct copy of Schedule “D”, updated to the date of the DIP Order, which shall be deemed to be incorporated herein for the purposes of Section 12(j); and
- (k) Each of the representations and warranties made in this Agreement shall be true and correct as of the date made or deemed made (other than those representations and warranties that are not subject to a materiality threshold, which shall be true and correct in

all material respects as of the date made or deemed made).

The Borrowers may issue a drawdown certificate once each week with the amount of each drawdown to be a drawing of US\$50,000.00 or a multiple of US\$50,000.00, and for certainty, not be in an amount greater than the amount shown on the applicable Cash Flow Projections.

The Monitor shall deposit the proceeds of each DIP Advance into the Borrower's Account unless otherwise agreed by the DIP Lender, acting reasonably.

Notwithstanding the foregoing, to the extent that an emergency cash need arises in the Borrowers' business that is not contemplated in the Cash Flow Projections, the Borrowers may request a DIP Advance from the DIP Lender by providing written particulars relating to such emergency cash need to the DIP Lender and the Monitor, which DIP Advance shall only be permitted with the prior written consent of the DIP Lender delivered to the Borrowers and the Monitor, in its sole and absolute discretion. If such requested emergency DIP Advance is so consented to by the DIP Lender, such DIP Advance shall be made from the Monitor Account and deposited into the Borrower's Account.

**8. VOLUNTARY
PREPAYMENTS:**

The Borrowers may prepay the DIP Obligations at any time prior to the Maturity Date with prepayment penalties at the following rates: (i) 5% of the outstanding principal under the DIP Facility if the voluntary prepayment occurs more than 60 days prior to the Maturity Date, (ii) 2.5% of the outstanding principal under the DIP Facility if the voluntary prepayment occurs more than 30 days but less than 60 days prior to the Maturity Date and (iii) 1% of the principal outstanding under the DIP Facility if the voluntary prepayment occurs within 30 days of the Maturity Date. Notwithstanding the foregoing, any prepayment that is made in connection with a sale of all or substantially all of the assets of the Borrowers will not be subject to a prepayment penalty.

9. INTEREST RATE:

The outstanding principal amount of all DIP Advances shall bear interest at a rate per annum of Bank of Canada prime rate plus five percent (5%), and upon the occurrence and during the continuance of an Event of Default at a rate per annum of Bank of Canada prime rate plus seven percent (7%), determined daily and calculated and payable monthly in

arrears.

Interest on each DIP Advance shall accrue from day to day and shall be calculated from and after the date of advance of such DIP Advance to the applicable Borrower to, but excluding, the date of repayment, as well as after as before maturity, demand and default and before and after judgment and shall be calculated on a daily basis on the principal amount of such DIP Advance and any overdue interest remaining unpaid from time to time and on the basis of the actual number of days elapsed in a year of 365 days.

For the purposes of the *Interest Act* (Canada), the annual rates of interest referred to in this DIP Agreement calculated in accordance with the foregoing provisions of this DIP Agreement, are equivalent to the rates so calculated multiplied by the actual number of days in a calendar year and divided by 365.

From the date of receipt of the Maximum Amount in the Monitor Account, until the date on which there are no Maximum Amount funds remaining in the Monitor Account, the aggregate amount of the Maximum Amount in the Monitor Account available to be drawn hereunder shall bear interest at a rate of two (2%) per annum and be payable by the Borrowers monthly in arrears on the last day of each month. Interest on the outstanding Maximum Amount in the Monitor Account shall accrue from day to day and shall be calculated from and after the date that the Maximum Amount is deposited into the Monitor Account to, but excluding, the date that the Maximum Amount is fully advanced or returned to the DIP Lender, as well as after as before maturity, demand and default and before and after judgment and shall be calculated on a daily basis on the aggregate Maximum Amount in the Monitor Account remaining from time to time and on the basis of the actual number of days elapsed in a year of 365 days.

If any provision of this Agreement or any ancillary document in connection with this Agreement would obligate the Borrowers to make any payment of interest or other amount payable to the DIP Lender in an amount or calculated at a rate which would be prohibited by law or would result in a receipt by the DIP Lender of interest at a criminal rate (as such terms are construed under the Criminal Code (Canada)) then, notwithstanding such provision, such amount or rate shall be deemed to have been adjusted with retroactive effect to the maximum amount or rate of interest, as the case may be, as

would not be so prohibited by law or so result in a receipt by the DIP Lender of interest at a criminal rate and any such amounts actually paid by the Borrowers in excess of the adjusted amount shall be forthwith refunded to the Borrowers.

10. DIP SECURITY:

All obligations of the Borrowers under or in connection with the DIP Facility and this DIP Agreement shall be secured by a super priority Court-ordered charge (the “**DIP Charge**”), over all present and after-acquired property, assets and undertakings of the Borrowers (including for greater certainty and without limitation, insurance proceeds, any tax refunds and those assets set forth on the financial statements of the Borrowers), including all proceeds therefrom and all causes of action of the Borrowers (collectively, the “**Collateral**”), and ranking in priority to all other creditors, interest holders, lien holders and claimants of any kind whatsoever (including for greater certainty all holders of Permitted Encumbrances other than Permitted Encumbrances that are Priority Charges (as defined below)) except for (i) a court ordered administration charge to secure payment of professional fees in a principal amount not to exceed C\$1,000,000.00 (the “**Administration Charge**”), (ii) a charge securing payment of amounts owing by the Borrowers under a key employee retention plan in a principal amount not to exceed C\$269,000.00 (the “**KERP Charge**”) and (iii) any purchase money security interests (collectively purchase money security interests, the Administration Charge and the KERP Charge, the “**Priority Charges**”).

11. MANDATORY REPAYMENTS:

Subject to any Order of the Court, the first C\$1,269,000 (the “**Priority Charge Reserve**”) of any net cash proceeds (for greater certainty, net of reasonable costs and closing adjustments, as applicable) payable to the Borrowers arising from (i) any sale of Collateral out of the ordinary course of business (including for greater certainty, any sale of all or substantially all of the Collateral of either of the Borrowers) or (ii) insurance proceeds in respect of any of the Collateral of either of the Borrowers (collectively the “**Net Sale Proceeds**”) shall be paid to the Monitor. The Administration Charge and KERP Charge shall attach to the Priority Charge Reserve. The Priority Charge Reserve will be held by the Monitor in a segregated account. Subject to the further Order of the Court, upon payment of all outstanding amounts secured by the Administration Charge and the KERP Charge following the termination of the CCAA Proceedings, the remaining balance of the Priority Charge Reserve shall be paid (i) forthwith

firstly, to the DIP Lender to the extent of any outstanding DIP Obligations, and (ii) secondly, to the Borrowers or such other Persons entitled thereto in accordance with applicable law.

Once the Priority Charge Reserve has been fully funded, unless otherwise consented to in writing by the DIP Lender and subject to any further Order of the Court, the Borrowers shall be required to make mandatory repayment of the DIP Obligations to the extent of 100% of all Net Sale Proceeds. Such mandatory repayment amount shall be applied as a permanent reduction of the DIP Facility. For greater certainty, any mandatory repayments shall not be subject to any premium or penalty.

**12. REPRESENTATIONS
AND WARRANTIES:**

Each of the Borrowers represents and warrants to the DIP Lender, upon which the DIP Lender relies in entering into this DIP Agreement, that subject to the entry of the DIP Order:

- (a) Each of the Borrowers is a corporation duly incorporated, and validly existing under the laws of its jurisdiction of incorporation and is duly qualified, licensed or registered to carry on business under the laws applicable to it in all jurisdictions in which the nature of its assets or business makes such qualification necessary, except where the failure to have such qualification, license or registration would not have a material adverse effect (a "Material Adverse Effect") on (i) the financial condition, business or assets of the Borrowers on a consolidated basis or (ii) the ability of the Borrowers to comply with their obligations hereunder or under any Restructuring Court Order;
- (b) Each of the Borrowers has all requisite corporate power and authority to (i) own and operate its properties and assets and to develop, own and operate its business; and (ii) to enter into and perform its obligations under this Agreement;
- (c) The execution and delivery of this DIP Agreement by the Borrowers and the performance by the Borrowers of its respective obligations hereunder have been duly authorized by all necessary corporate action and no authorization under any applicable law, and no registration, qualification, designation, declaration or filing with any governmental body, is or was necessary therefor, other than filings which may be made to

register or otherwise record the DIP Charge;

- (d) This DIP Agreement has been duly executed and delivered by each of the Borrowers and constitutes a legal, valid and binding obligation of each of the Borrowers, enforceable against it in accordance with its terms, subject only to any limitation under applicable laws relating to (i) bankruptcy, insolvency, reorganization, moratorium or creditors' rights generally; and (ii) the discretion that a court may exercise in the granting of equitable remedies;
- (e) The execution and delivery of this DIP Agreement by the Borrowers and the performance by the Borrowers of its respective obligations hereunder and compliance with the terms, conditions and provisions hereof, will not conflict with or result in a breach of (i) its constating documents or by-laws or (ii) any applicable law;
- (f) The business operations of each of the Borrowers have been and will continue to be conducted in compliance with all laws of each jurisdiction in which business has been or is being carried on, except where the failure to comply would not have a Material Adverse Effect;
- (g) The Borrowers have obtained all licenses and permits required for the operation of its business, which licenses and permits remain in full force and effect, except where the failure to obtain any such licenses or permits would not have a Material Adverse Effect. No proceedings have been commenced or threatened to revoke or amend any of such licenses or permits which have not been stayed pursuant to the CCAA Proceedings;
- (h) Cash Flow Projections include all payments that, if not paid, could result in statutory liens ranking in priority to the DIP Charge except for the Special Payments (as defined below) and purchase money security interests;
- (i) All representations and warranties made by the Borrowers in this DIP Agreement are true and correct as of the date such representations and warranties are made or deemed to be made;

- (j) As at the dates indicated in the summaries set out in Exhibit "A" of Schedule "D" attached hereto, the Borrowers have good and marketable title to all of the Collateral free from any liens except for (i) Permitted Encumbrances (as defined on Schedule "D" attached hereto) and (ii) title defects or irregularities that do not, individually or in the aggregate, materially affect the operation of the business of the Borrowers. As at the date of the CCAA Proceeding, the Borrowers have good and marketable title to all of the Collateral free from any liens except for (i) Permitted Encumbrances (as defined on Schedule "D", as amended with the consent of the DIP Lender, acting reasonably) and (ii) title defects or irregularities that do not, individually or in the aggregate, materially affect the operation of the business of the Borrowers.
- (k) Each of the Borrowers has filed or cause to be filed all tax returns and reports which are required to have been filed and has paid or caused to be paid all taxes required to have been paid by it, except taxes that are being contested in good faith by appropriate proceedings;
- (l) There are no actions, suits or proceedings (including any tax-related matter) by or before any arbitrator or governmental authority or by any other person pending against or, to the knowledge of the Borrowers, threatened against or affecting the Borrowers that could reasonably be expected, individually or in the aggregate, to result in a Material Adverse Effect which have not been stayed pursuant to the CCAA Proceedings;
- (m) The Borrowers maintain insurance policies and coverage which (i) is sufficient for compliance with law and all material agreements to which any Borrower is a party and (ii) provide adequate insurance coverage in at least such amounts and against at least such risks as are usually insured against in the same general area by persons engaged in the same or similar business to the assets and operations of the Borrowers;
- (n) The only subsidiaries of the Borrowers are set out in the corporate structure chart attached as Exhibit "A" to the Affidavit of Peter A.M. Kalins sworn on January 2,

2012 in support of the CCAA Proceedings; and

- (o) All factual information provided by or on behalf of each of the Borrowers to the DIP Lender for the purposes of or in connection with this DIP Agreement or any transaction contemplated herein, is true and accurate in all material respects on the date as of which such information is dated or certified and remains true as of the date provided and is not incomplete by omitting to state any fact necessary to make such information (taken as a whole) not materially misleading at such time in light of the circumstances under which such information was provided.

**13. AFFIRMATIVE
COVENANTS:**

Each of the Borrowers covenants and agrees to do the following until such time as the DIP Obligations are repaid in full:

- (a) Keep the DIP Lender apprised on a timely basis of all material developments with respect to the business and affairs of the Borrowers except for any confidential information reasonably designated by the Borrowers as Sensitive Confidential Information pursuant to the addendum to the confidentiality and standstill agreement dated January 11, 2012 between Timminco and the DIP Lender (the “**Confidentiality Addendum**”), *provided that* any information with respect to any Event of Default or any event which, with the passing of time or the giving of notice could be an Event of Default, shall not be considered to be Sensitive Confidential Information;
- (b) Deliver to the DIP Lender (i) the Cash Flow Projections as set out herein, (ii) as soon as practicable after the filing thereof with the Court, each report of the Monitor to the Court, and (iii) such other reporting and other information from time to time reasonably requested by the DIP Lender except for any confidential information reasonably designated by the Borrowers as Sensitive Confidential Information pursuant to the Confidentiality Addendum;
- (c) Use the proceeds of the DIP Facility only for the purpose of funding (i) transaction costs and expenses incurred by the DIP Lender in connection with the DIP Facility, (ii) professional fees and expenses incurred by the Borrowers and the Monitor in respect of the DIP

Facility and the CCAA Proceedings, and (iii) the Borrowers' operating costs, expenses and liabilities (including, without limitation, wages, bonuses, vacation pay, active employee benefits and current service contributions to all registered pension plans, but specifically excluding any special payments or amortization payments in respect of pension plans and payments relating to post-retirement benefits) in accordance with the Cash Flow Projections;

- (d) Comply with the provisions of the court orders made in connection with the CCAA (collectively, the **"Restructuring Court Orders"** and each a **"Restructuring Court Order"**);
- (e) Preserve, renew and keep in full force its respective corporate existences and its respective material licenses, permits, approvals, etc. required in respect of its business, properties, assets or any activities or operations carried out therein;
- (f) Maintain the insurance, in existence of the date hereof, with respect to the Collateral subject to the DIP Charge;
- (g) Conduct all activities in accordance with the Cash Flow Projections reviewed by the Monitor and the credit limits established under the DIP Facility as set out hereunder;
- (h) Forthwith notify the DIP Lender and the Monitor of the occurrence of any Event of Default, or of any event or circumstance that may constitute an Event of Default or a material adverse change from the Cash Flow Projections;
- (i) Forthwith notify the DIP Lender and the Monitor of the commencement of any action, suit, investigation, litigation or proceeding before any court, governmental department, board, bureau, agency or similar body affecting any Borrower;
- (j) Promptly after the same is available, provide copies to the DIP Lender of all pleadings, motions, applications, judicial information, financial information and other documents filed by or on behalf of any of the

Borrowers within the CCAA Court;

- (k) Subject to the Restructuring Court Orders, comply in all material respects with all applicable laws, rules and regulations applicable to their businesses, including, without limitation, environmental laws; and
- (l) Except where a stay of proceedings applies and except for the Special Payments, the Borrowers shall pay when due all statutory liens, trust and other Crown claims including employee source deductions, GST, HST, PST EHT and work place safety and insurance premiums but only with respect to those priority payments which rank ahead of the DIP Charge or with respect to the Borrowers' post CCAA filing obligations in all cases in accordance with the Cash Flow Projections.

14. NEGATIVE COVENANTS:

Each of the Borrowers covenants and agrees not to do the following while any DIP Obligations remain outstanding, other than with the prior written consent of the DIP Lender or an Order of the Court:

- (a) Transfer, lease or otherwise dispose of all or any part of its property, assets or undertaking except for (i) dispositions in the ordinary course of business and (ii) the sale of any of the assets of the Borrowers which results in the repayment of the DIP Obligations in accordance with the provisions herein under the paragraph entitled "Mandatory Repayments";
- (b) Make any payment of principal or interest in respect of any indebtedness outstanding on January 2, 2012 ("**Existing Indebtedness**") other than as may be permitted by a Restructuring Court Order;
- (c) Create or permit to exist indebtedness for borrowed money other than (i) Existing Indebtedness, (ii) debt contemplated by this DIP Facility, (iii) post-filing trade payables in the ordinary course of business and (iv) intercompany loans by one of the Borrowers to the other Borrower to pay for operating costs, expenses and liabilities of such other Borrower in accordance

with Cash Flow Projections;

- (d) Permit any new Liens to exist on any of its properties or assets other than the Liens in favour of the DIP Lender as contemplated by this DIP Agreement;
- (e) Create or permit to exist any other Lien which is senior to or *pari passu* with the DIP Charge, other than the Priority Charges;
- (f) Change its name, amalgamate, consolidate with or merge into, or enter into any similar transaction with any other entity or make any changes to its organizational documents which would be adverse to the DIP Lender;
- (g) Make any acquisitions, investments or loans to any party or guarantee the obligations of any party except for intercompany loans by one of the Borrowers to the other Borrower to pay for operating costs, expenses and liabilities of such other Borrower in accordance with Cash Flow Projections;
- (h) Enter into any transaction with any affiliate other than any transaction on terms and conditions at least as favourable to the Borrowers as could reasonably be obtained in an arms-length transaction; and
- (i) Pay any dividends, distributions, advances and/or management bonus or similar payments, except for management bonuses relating to the year ended December 31, 2011 approved by the Board of Directors of Timminco and contemplated in Cash Flow Projections or pursuant to the KERP approved by the Court.

Notwithstanding anything to the contrary in this DIP Agreement, no DIP Advances shall be used to make any payment in respect of any special payment or amortization payment, including without limitation, in respect of pension plans, payment related to post-retirement benefits, solvency deficiencies or wind up shortfalls in relation to any pension plan administered by either Borrower as of the date hereof (collectively, "**Special Payments**").

15. INDEMNITY AND

The Borrowers agree, on a joint and several basis, to indemnify and hold harmless the DIP Lender and each of its

RELEASE:

directors, officers, employees, agents, attorneys, advisors and affiliates (all such persons and entities being referred to hereafter as “**Indemnified Persons**”) from and against any and all actions, suits, proceedings (including any investigations or inquiries), claims, losses, damages, liabilities or expenses of any kind or nature whatsoever (excluding indirect or consequential damages and claims for lost profits) which may be incurred by or asserted against or involve any Indemnified Person as a result of or arising out of or in any way related to or resulting from any bankruptcy or insolvency proceedings, this DIP Agreement and, upon demand, to pay and reimburse any Indemnified Person for any reasonable legal or other out-of-pocket expenses incurred in connection with investigating, defending or preparing to defend any such action, suit, proceeding (including, without limitation, any inquiry or investigation) or claim (whether or not any Indemnified Person is a party to any action or proceeding out of which any such expenses arise); provided, however, the Borrowers shall not be obligated to indemnify pursuant to this paragraph any Indemnified Person against any loss, claim, damage, expense or liability to the extent (i) it resulted from the gross negligence or wilful misconduct of such Indemnified Person as finally determined by a court of competent jurisdiction or (ii) it arose in connection with any stalking horse bid or transaction with the Borrowers other than the DIP Facility.

The indemnities granted under this DIP Agreement shall survive any termination of the DIP Facility.

16. EVENTS OF DEFAULT:

The occurrence of any one or more of the following events, without the prior written consent of the DIP Lender, shall constitute an event of default (“**Event of Default**”) under this DIP Agreement:

- (a) The issuance of an order terminating the CCAA Proceedings or lifting the stay in the CCAA Proceedings to permit the enforcement of any security against either of the Borrowers, or the appointment of a receiver and manager, receiver, interim receiver or similar official or the making of a bankruptcy order against either of the Borrowers;
- (b) The issuance of an order granting a Lien equal or superior status to that of the DIP Charge, other than the Priority Charges;

- (c) The issuance of an order staying, reversing, vacating or otherwise modifying the DIP Charge or, any Restructuring Court Order in a manner which adversely impacts the rights and interests of the DIP Lender or the issuance of any order by the Court directing the Borrowers to pay any special payment or amortization payment in respect to pension plans, payments relating to post-retirement benefits, solvency deficiencies or wind-up shortfalls in relation to any pension plan administered by the Borrowers as of the date hereof, provided, however, that any such order which provides for payment in full of all of the obligations of the Borrowers under the DIP Facility shall not constitute an Event of Default;
- (d) If (i) the DIP Order is varied without the consent of the DIP Lender in a manner adverse to the DIP Lender or (ii) the stay of proceedings contained in any Restructuring Court Orders is terminated or is lifted to allow an action adverse to the DIP Lender;
- (e) Failure of the Borrowers to pay any principal, interest, fees or any other amounts, in each case when due and owing hereunder;
- (f) Failure of the Borrowers to comply with the Cash Flow Projections in all material respects which shall include, without limitation, the occurrence of any negative variance in "Net Cash Flow" as shown on the Cash Flow Projections that is greater than 10% in any given week;
- (g) Any representation or warranty by the Borrowers herein or in any certificate delivered by the Borrowers to the DIP Lender shall be incorrect or misleading in any material respect as of the date made or deemed made;
- (h) A Court order is made, a liability arises or an event occurs, including any change in the business, assets, or conditions, financial or otherwise, of the Borrowers, that will have a Material Adverse Effect;
- (i) Any material violation or breach of any Restructuring Court Order upon receipt by the Borrowers of notice from the DIP Lender of such violation or breach; and

- (j) Failure of the Borrowers to perform or comply with any other term or covenant under this DIP Agreement and such default shall continue unremedied for a period of three (3) business days.

17. REMEDIES:

Upon the occurrence of an Event of Default, whether or not there is availability under the DIP Facility, without any notice or demand whatsoever, the right of the Borrowers to receive any DIP Advance or other accommodation of credit shall be terminated, subject to any applicable notice provision in any Order (as the case may be) in the case of remedies against Collateral (which notice provisions shall be acceptable to the DIP Lender). Without limiting the foregoing, upon the occurrence of an Event of Default and with the leave of the Court, the DIP Lender shall have the right to exercise all other customary remedies, including, without limitation, the right to realize on all Collateral and to apply to the court for the appointment of a court appointed receiver. No failure or delay by the DIP Lender in exercising any of its rights hereunder or at law shall be deemed a waiver of any kind, and the DIP Lender shall be entitled to exercise such rights in accordance with this DIP Agreement at any time.

18. COMMITMENT FEE:

The Borrowers shall pay the DIP Lender a US\$100,000.00 commitment fee, which is payable from the first drawdown following approval by the Court of this DIP Agreement.

19. LEGAL FEES:

The Borrowers shall pay all reasonable out-of-pocket expenses, including all reasonable legal expenses, incurred by the DIP Lender in connection with this DIP Agreement and the transactions contemplated herein (but, for greater certainty excluding any expenses incurred in connection with the stalking horse bid or any transaction with the Borrowers other than the DIP Facility) including those with any respect to any enforcement of the terms hereof or of the DIP Charge or otherwise incurred in connection with the DIP Facility. Subject to Court approval, the Borrowers shall remit from the first drawdown following approval by the Court of this DIP Agreement a payment to the DIP Lender of C\$150,000.00 in satisfaction of expenses incurred as of the date thereof and as a retainer to be credited towards the DIP Lender's expenses to be incurred in the future, with any remainder to be credited against the DIP Obligations.

20. DIP LENDER APPROVALS:

Any consent, approval, instruction or other expression of the DIP Lender to be delivered in writing may be delivered by any written instrument, including by way of electronic mail, by the

DIP Lender pursuant to the terms hereof.

21. TAXES:

All payments by the Borrowers under the DIP Agreement to the DIP Lender, including any payments required to be made from and after the exercise of any remedies available to the DIP Lender upon an Event of Default, shall be made free and clear of, and without reduction for or on account of, any present or future taxes, levies, imposts, duties, charges, fees, deductions or withholdings of any kind or nature whatsoever or any interest or penalties payable with respect thereto now or in the future imposed, levied, collected, withheld or assessed by any country or any political subdivision of any country, but excluding any reduction for any amount required to be paid by the Borrowers under subsection 224(1.2) of the *Income Tax Act* (Canada) or a similar provision of that or any other taxation statute (collectively “**Taxes**”).

22. FURTHER ASSURANCES:

The Borrowers shall, at their expense, from time to time do, execute and deliver, or will cause to be done, executed and delivered, all such further acts, documents and things as the DIP Lender may reasonably request for the purpose of giving effect to this DIP Agreement. Without limiting the foregoing, the Borrowers agree that if so requested by the DIP Lender, acting reasonably, they shall promptly execute and return to the DIP Lender any general security agreement or other security documents securing the obligations of the Borrowers to the DIP Lender hereunder in forms customary for debtor in possession financings, provided however that the execution of any such security document shall not be a condition precedent to funding the Maximum Amount or DIP Advances hereunder.

23. ENTIRE AGREEMENT; CONFLICT:

This DIP Agreement, including the schedules hereto constitutes the entire agreement between the parties relating to the subject matter hereof.

24. AMENDMENTS, WAIVERS, ETC.:

No waiver or delay on the part of the DIP Lender in exercising any right or privilege hereunder will operate as a waiver hereof or thereof unless made in writing and delivered in accordance with the terms of this DIP Agreement. Any amendment to the terms of the DIP Agreement shall be made in writing and signed by the parties hereto.

25. EXCLUSIVITY PERIOD FOR STALKING HORSE BID: The Borrowers shall not, directly or indirectly through any representative, solicit or entertain offers from, negotiate with or accept any proposal of any person other than the DIP Lender for the acquisition of substantially all of the assets of BSI and Timminco from the date hereof until January 31, 2012 (the “**Exclusivity Period**”) in order to provide the DIP Lender with the opportunity to prepare a “stalking horse bid” for consideration by the Borrowers who shall be under no obligation to accept any such bid, provided that if the DIP Order is not granted in form and substance satisfactory to the DIP Lender and the Borrowers on the return date of the motion for the granting of the DIP Order, or if the DIP Obligations are declared to be immediately due and payable in accordance with the provisions of this DIP Agreement, the Exclusivity Period shall immediately terminate. Notwithstanding the foregoing, if the DIP Lender submits a “stalking horse bid” to the Borrowers on or prior to January 31, 2012 in a form and substance that the Borrowers are prepared to consider, acting reasonably and subject to negotiation of the definitive transaction documents, the Exclusivity Period shall be extended one week to February 7, 2012.

Notwithstanding any other provision herein, neither the DIP Lender nor its advisors, agents or representatives shall be entitled to receive any information reasonably considered to be confidential by the Borrowers or the Monitor relating to the sale or marketing of their respective business and assets, including, without limitation, any confidential bid, offer or expressions of interests by any potential purchaser for such business or assets, in whole or in part.

26. ASSIGNMENT: The DIP Lender may assign this DIP Agreement and its rights and obligations hereunder, in whole or in part, to any party acceptable to the DIP Lender in its sole and absolute discretion (subject to providing the Monitor with reasonable evidence that such assignee has the financial capacity to fulfill the obligations of the DIP Lender hereunder). Neither this DIP Agreement nor any right and obligation hereunder may be assigned by the Borrowers.

27. SEVERABILITY: Any provision in this DIP Agreement which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof or affecting the validity or enforceability of such provision in any other jurisdiction.

28. COUNTERPARTS AND FACSIMILE SIGNATURES:

This DIP Agreement may be executed in any number of counterparts and by facsimile or other electronic transmission, each of which when executed and delivered shall be deemed to be an original, and all of which when taken together shall constitute one and the same instrument. Any party may execute this DIP Agreement by signing any counterpart of it.

29. NOTICES

Any notice, request or other communication hereunder to any of the parties shall be in writing and be well and sufficiently given if delivered personally or sent by fax or electronic mail to the attention of the person as set forth below:

In the case of each Timminco Limited and Becancour Silicon Inc.:

150 King Street West, 2401
Toronto, Ontario
M5H 1J9

Attention: Peter Kalins
President, General Counsel and Corporate Secretary

Fax: (416) 364-3451
Email: PKalins@timminco.com

With a copy to:

Stikeman Elliott LLP
5300 Commerce Court West, 199 Bay Street
Toronto, Ontario
M5L 1B9

Attention: Daphne MacKenzie
Fax: (416) 947-0866
Email: DMacKenzie@stikeman.com

With a copy to the Monitor:

FTI Consulting Canada Inc.

TD Waterhouse Tower, Suite 2010
79 Wellington Street
Toronto, Ontario
M5K 1G8

Attention: Nigel Meakin

Fax: (416) 649-8101
Email: nigel.meakin@fticonsulting.com

With a copy to:

Blake, Cassels & Graydon LLP
199 Bay Street
Suite 4000, Commerce Court West
Toronto ON
M5L 1A9

Attention: Linc Rogers
Fax: (416) 863-2653
Email: Linc.Rogers@blakes.com

In the case of the QSI Partners Ltd.:

QSI Partners Ltd
1st Floor – Windward 1
Regatta Office Park
PO BOX 10338
Grand Cayman KY1-1003
Cayman Islands

Attention: Desiree Mercer
Fax: (345) 949-7230
Telephone: (345) 949-7232

And a copy to:

Torys LLP
79 Wellington Street East
Suite 3000
Toronto, Ontario
M5K 1N2

Attention: David Bish
Fax: (416) 865-7380
Email: dbish@torys.com

Any such notice shall be deemed to be given and received, when received, unless received after 5:00 EST or on a day other than a business day, in which case the notice shall be

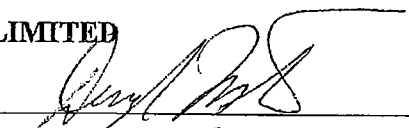
deemed to be received the next business day. Either party may request notices be sent to additional recipients so long as, in the case of notices to the DIP Lender, such recipient is subject to the confidentiality provisions contained in the Confidentiality Agreement.

30. GOVERNING LAW AND JURISDICTION:

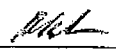
This DIP Agreement shall be governed by, and construed in accordance with, the laws of the Province of Ontario and the federal laws of Canada applicable therein.

IN WITNESS HEREOF, the parties hereby execute this DIP Agreement as at the date first above mentioned.

TIMMINCO LIMITED

Per: 
Name: *Douglas Fasten*
Title: *Chief Executive officer.*

BECANCOUR SILICON INC.

Per: 
Name: *Peter A. M. Kalins*
Title: *President, General Counsel and
Corporate Secretary*

QSI PARTNERS LTD.

Per: _____
Name:
Title:

IN WITNESS HEREOF, the parties hereby execute this DIP Agreement as at the date first above mentioned.

TIMMINCO LIMITED

Per: _____
Name:
Title:

BECANCOUR SILICON INC.

Per: _____
Name:
Title:

QSI PARTNERS LTD.

Per: _____
Name: *John A. King*
Title: *Authorized Representative*

SCHEDULE "A"
Weekly CCAA Cash Flow

See attached.

Timminco Limited & Beauport Silicon Inc.
CASH FLOW FORECAST
 CAN
 In 000s

| | Forecast Week 3 20-Jan | Forecast Week 4 27-Jan | Forecast Week 5 3-Feb | Forecast Week 6 10-Feb | Forecast Week 7 17-Feb | Forecast Week 8 24-Feb | Forecast Week 9 2-Mar | Forecast Week 10 9-Mar | Forecast Week 11 16-Mar | Forecast Week 12 23-Mar | Forecast Week 13 30-Mar | Forecast Week 14 6-Apr | Forecast Week 15 13-Apr | Forecast Week 16 20-Apr | Forecast Week 17 27-Apr | Forecast Week 18 4-May | |
|---|---------------------------|---------------------------|--------------------------|---------------------------|---------------------------|---------------------------|--------------------------|---------------------------|----------------------------|----------------------------|----------------------------|---------------------------|----------------------------|----------------------------|----------------------------|---------------------------|---------|
| Beginning Cash Position | 3,251 | 590 | 1,299 | 3,145 | 1,799 | 1,799 | 200 | 221 | 265 | 223 | 259 | 599 | 239 | 306 | 249 | 248 | 326 |
| Receipts | | | | | | | | | | | | | | | | | |
| Sales and receivables | 1,195 | 1,351 | 2,291 | 187 | 175 | 1,014 | 1,944 | 921 | 921 | 1,039 | 885 | 987 | 1,555 | 831 | 871 | 871 | 935 |
| Government and other receivables | - | - | - | - | - | - | - | - | - | - | 700 | - | - | - | - | - | 700 |
| Total Receipts | 1,195 | 1,351 | 2,291 | 187 | 175 | 1,014 | 1,944 | 921 | 921 | 1,039 | 1,585 | 987 | 1,555 | 831 | 871 | 1,571 | 935 |
| Disbursements | | | | | | | | | | | | | | | | | |
| Materials | (2,559) | (199) | (149) | (1,043) | (1,658) | (895) | (1,532) | (1,017) | (1,017) | (1,017) | (1,013) | (1,140) | (1,140) | (1,140) | (1,140) | (1,075) | (1,007) |
| OSLP/DCC obligation | (847) | (318) | (171) | (312) | (291) | (349) | (336) | (209) | (211) | (177) | (596) | (251) | (174) | (231) | (354) | (236) | (236) |
| Operating Expenses | (450) | (125) | (125) | (178) | (25) | (50) | (25) | (87) | (87) | (25) | (14) | (87) | (25) | (50) | (25) | (87) | (87) |
| Restructuring Expenses | - | - | - | - | (250) | - | (8) | - | - | - | - | - | - | - | - | - | (18) |
| DIP Interest and Fees | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Other | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Total Disbursements | (3,856) | (642) | (445) | (1,533) | (2,224) | (1,294) | (1,900) | (1,314) | (1,233) | (1,244) | (1,647) | (1,488) | (1,339) | (1,421) | (1,493) | (1,348) | |
| Net Cash Flow | (2,661) | 709 | 1,846 | (1,346) | (2,049) | (279) | 44 | (392) | (312) | (204) | 340 | (660) | 67 | (507) | (550) | 78 | (413) |
| Plus: DIP Facility Borrowings | - | - | - | - | 450 | 300 | - | - | 350 | 250 | - | 300 | - | 450 | 550 | - | 300 |
| Less: DIP Facility Repayment | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Ending Cash Position | 590 | 1,299 | 3,145 | 1,799 | 200 | 221 | 265 | 223 | 259 | 259 | 599 | 239 | 306 | 249 | 248 | 326 | 212 |
| DIP Facility Availability b/f | - | - | 4,250 | 4,250 | 4,250 | 3,800 | 3,500 | 3,500 | 3,500 | 3,150 | 2,900 | 2,900 | 2,600 | 2,600 | 2,150 | 1,600 | 1,600 |
| Less: Outstanding DIP Facility Borrowings | - | - | - | - | 450 | 300 | - | 350 | 250 | - | - | 300 | - | 450 | 550 | - | 300 |
| DIP Facility (Borrowings)/Repayments | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| DIP Facility Availability c/f | - | 4,250 | 4,250 | 4,250 | 3,800 | 3,500 | 3,500 | 3,150 | 2,900 | 2,900 | 2,600 | 2,600 | 2,150 | 1,600 | 1,600 | 1,300 | |

Notes:

- The purpose of this cash flow projection is to determine the liquidity requirements of Timminco during the forecast period.
- Receipts from operations have been forecast based on current payment terms, historical trends in collections, and the sales forecast. The sales forecast for the period has been determined based on scheduled orders from BSI customers, taking into consideration the OSLP production schedules and the anticipated allocation of such production to each of OSLP's customers.
- Materials purchases are based on OSLP production schedules and the anticipated allocation of such production to each of OSLP's customers.
- Operating Expenses in respect of BSI have been forecast based on costs to support shipment of materials, solar related expenses, shared service support costs, and overhead and insurance costs.
- Payroll and benefits costs included in Operating Expenses are based on actual payroll funding in the period leading up to the forecast period and include adjustments for increased sourced deductions beginning in 2012.
- Corporate costs included in Operating Expenses have been forecast based on known recurring historical costs and expected future costs.
- The cash flow does not include interest charges for amounts owing under Timminco's and BSI's current debt obligations.
- Restructuring Expenses include legal and professional fees based on estimates provided by the current legal and financial advisors.

Timminco Limited & Becancour Silicon Inc.
CASH FLOW FORECAST
 CAN
 in 000s

| | Week Ending on Friday | | | | | | | | | | | | Forecast Total |
|---|----------------------------|----------------------------|----------------------------|---------------------------|---------------------------|----------------------------|----------------------------|----------------------------|---------------------------|----------------------------|----------------------------|----------------------------|----------------|
| | Forecast Week 19 11-May | Forecast Week 20 18-May | Forecast Week 21 25-May | Forecast Week 22 1-Jun | Forecast Week 23 8-Jun | Forecast Week 24 15-Jun | Forecast Week 25 22-Jun | Forecast Week 26 29-Jun | Forecast Week 27 6-Jul | Forecast Week 28 13-Jul | Forecast Week 29 20-Jul | Forecast Week 30 27-Jul | |
| Beginning Cash Position | 212 | 257 | 252 | 570 | 202 | 52 | (445) | (752) | | | | | 3,251 |
| Receipts | | | | | | | | | | | | | |
| Sales and receivables | 875 | 875 | 815 | 757 | 799 | 1,271 | 1,329 | 1,268 | | | | | 25,040 |
| Government and other receivables | - | - | 700 | - | - | - | - | 700 | | | | | 2,800 |
| Total Receipts | 875 | 875 | 1,515 | 757 | 799 | 1,271 | 1,329 | 1,968 | | | | | 27,840 |
| Disbursements | | | | | | | | | | | | | |
| Materials | (1,007) | (838) | (873) | (833) | (1,369) | (1,434) | (1,366) | (163) | | | | | (25,581) |
| OSLP/DCC obligation | - | - | - | - | - | - | - | - | | | | | - |
| Operating Expenses | (188) | (191) | (298) | (160) | (259) | (181) | (169) | (380) | | | | | (6,929) |
| Restructuring Expenses | (25) | (50) | (25) | (108) | (25) | (50) | (100) | (400) | | | | | (2,225) |
| DIP Interest and Fees | - | - | - | (25) | - | - | - | (27) | | | | | (342) |
| Other | - | - | - | - | - | - | - | - | | | | | - |
| Total Disbursements | (1,230) | (1,180) | (1,196) | (1,125) | (1,653) | (1,665) | (1,635) | (949) | | | | | (35,073) |
| Net Cash Flows | (355) | (305) | 318 | (368) | (854) | (394) | (306) | 1,019 | | | | | (7,233) |
| Plus: DIP Facility Borrowings | 400 | 300 | - | - | 600 | - | - | - | | | | | 4,250 |
| Less: DIP Facility Repayment | - | - | - | - | - | - | - | - | | | | | - |
| Ending Cash Position | 257 | 252 | 570 | 202 | 52 | (445) | (752) | 267 | | | | | 267 |
| DIP Facility Availability b/f | 1,300 | 900 | 600 | 600 | 600 | - | - | - | | | | | - |
| Less: Outstanding DIP Facility Borrowings | 400 | 300 | - | - | 600 | - | - | - | | | | | 4,250 |
| DIP Facility Borrowings/Repayments | - | - | - | - | - | - | - | - | | | | | - |
| DIP Facility Availability c/f | 900 | 600 | 600 | 600 | 600 | - | - | - | | | | | - |

Notes:

- 1) The purpose of this cash flow projection is to determine the liquidity requirement for operations based on current payment schedules.
- 2) Receipts from operations have been forecast based on current payment schedules and the anticipated allocation of such production to each of OSLP's customers.
- 3) Materials purchases are based on OSLP production schedules and the anticipated operating expenses in respect of OSLP have been forecast based on costs to produce and overhead and insurance costs.
- 4) Payroll and benefits costs included in Operating Expenses are based on current operating costs for increased sourced deductions beginning in 2012.
- 5) Corporate costs included in Operating Expenses have been forecast based on current operating costs for increased sourced deductions beginning in 2012.
- 6) The cash flow does not include interest charges for amounts owing under the current financing arrangements.
- 7) Restructuring Expenses include legal and professional fees based on estimates.

SCHEDULE "B"

Form of Drawdown Certificate

DRAWDOWN CERTIFICATE

TO: **QSI PARTNERS LTD. (the "DIP Lender")**

FROM: Timminco Limited and Becancour Silicon Inc. (collectively, the
"Borrowers")

DATE: •

1. This certificate is delivered to you, as DIP Lender, in connection with a request for a DIP Advance pursuant to the DIP agreement made as of January 18, 2012 between the Borrowers and the DIP Lender, as amended, supplemented, restated or replaced from time to time (the "**DIP Agreement**"). All defined terms used, but not otherwise defined, in this certificate shall have the respective meanings set forth in the DIP Agreement, unless the context requires otherwise.
2. The Borrower hereby requests a DIP Advance as follows:
 - (a) Date of DIP Advance: _____
 - (b) Aggregate amount of DIP Advance (US\$): _____
3. All of the representations and warranties of the Borrowers as set forth in the DIP Agreement are true and accurate in all material respects as at the date hereof, as though made on and as of the date hereof (except for any representations and warranties made as of a specific date, which shall be true and correct as of the specific date made).
4. All of the covenants of the Borrowers contained in the DIP Agreement and all other terms and conditions contained in the DIP Agreement to be complied with by the Borrowers, and not properly waived in writing by or on behalf of the DIP Lender, have been fully complied with.
5. In addition to the foregoing, the Borrowers are in compliance with the Restructuring Court Orders.
6. The DIP Advance hereby requested is within the relevant Cash Flow Projections approved by the DIP Lender and reviewed by the Monitor.

7. No Default or Event of Default has occurred and is continuing nor will any such event occur as a result of the DIP Advance hereby requested.

TIMMINCO LIMITED

Per: _____
Name:
Title:
I have authority to bind the corporation.

BECANCOUR SILICON INC.

Per: _____
Name:
Title:
I have authority to bind the corporation.

Cc: FTI Consulting Canada Inc. in its capacity as the Court-appointed monitor of the Borrowers in the CCAA Proceeding.

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,
R.S.C. 1985, c. C-36
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF
TIMMINCO LIMITED AND BÉCANCOUR SILICON INC.

Court File No: 12-CL-9539-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE-
COMMERCIAL LIST**

Proceeding Commenced at Toronto

BOOK OF AUTHORITIES

DAVIES WARD PHILLIPS & VINEBERG LLP
1 First Canadian Place
Suite 4400
Toronto, ON M5X 1B1

Robin B. Schwill (LSUC#: 384521)
Natasha MacParland (LSUC#: 42383G)
Chantelle T. Spagnola (LSUC#: 60620Q)

Tel: 416.863.5502
Fax: 416.863.0871

Lawyers for J. Thomas Timmins