

**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 PROPOSED PLAN OF
COMPROMISE OR ARRANGEMENT WITH RESPECT TO
HARD ROCK PAVING COMPANY LIMITED AND THE OTHER
APPLICANTS LISTED IN SCHEDULE "A"**

FACTUM OF GE CANADA

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Canada Leasing Services
Company, GE Capital Canada
Leasing Trust and General
Electric Capital Canada Inc.,
d.b.a. GE Capital Fleet Services**

TO: Service List

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FACTUM OF GE CANADA

PART I – NATURE OF THE MOTION

1. This Factum is submitted on behalf of GE Canada Equipment Financing GP, GE Canada Leasing Services Company, GE Capital Canada Leasing Trust and General Electric Capital Canada Inc., d.b.a. GE Capital Fleet Services (all of which are individually and collectively referred to as "**GE Canada**") for the motion by the Applicants seeking a vesting order in connection with the proposed sale transaction with Miller Paving Limited and Waterford Sand and Gravel Limited (the "**Purchasers**").

2. GE Canada respectfully submits that this Court cannot grant that part of the relief requested by the Applicants which seeks to vest in the Purchasers the Applicants' "title" in the GE Equipment (as defined below), as the Applicants do not have title to the GE Equipment.

3. There is no statutory or other authority which provides this Court with jurisdiction in a *Companies' Creditors Arrangement Act* ("CCAA") proceeding to transfer and vest in a purchaser a non-debtor third party's title and ownership of an asset without its consent.

PART II – FACTS**Indebtedness of Hard-Rock to GE Canada**

4. Hard-Rock Paving Company Limited (referred to in this affidavit as “**Hard-Rock**” or the “**Company**”) is a party to various contracts with GE Canada, including various Leasing Agreements, a Conditional Sale Agreement and a Master Lease Agreement (collectively, the “**GE Contracts**”), all in relation to construction equipment and light trucks and other motor vehicles used by Hard-Rock (the “**GE Equipment**”). GE Canada has caused registrations to be effected under the *Personal Property Security Act* (Ontario) (“**PPSA**”) with respect to all assets subject to these agreements.

*GE Canada’s Responding Motion Record, Tab 1, Affidavit of Neil Mitchell sworn July 18, 2008 (the “**Mitchell Affidavit**”), para. 3-4, Exhibit “A”*

5. The amounts owed under the GE Contracts (other than the Master Lease Agreement) as of July 15, 2008 total \$8,160,151.22, not including accrued interest, late payment charges, applicable taxes and legal fees. The amount owed under the Master Lease Agreement as of July 15, 2008 is \$468,552.06, not including taxes and legal fees.

Mitchell Affidavit, para.5, Exhibit “B”

6. All of the GE Equipment subject to the GE Contracts is owned by GE Canada.

Mitchell Affidavit, para. 6

7. Under each of the Leasing Agreements, “title to, ownership of, and property in Equipment shall at all times be and remain exclusively in” GE Canada. The Company’s only

rights therein “are to quiet enjoyment and use on the terms and conditions of this Lease while not in Default, and to purchase Equipment under any option granted herein” (Section 7.1).

Mitchell Affidavit, para. 7

8. Under the Conditional Sale Agreement, title to and ownership of the equipment remains with GE Canada until all amounts owed under the contract are paid in full (Section 4.2).

Mitchell Affidavit, para.8

9. Under the Master Lease Agreement, the Company agreed that it has no right, title or interest in and to any leased vehicle and has no option to purchase any such vehicle (Section 1).

Mitchell Affidavit, para.9

Vesting Order

10. On July 9, 2008, the Applicants obtained an Order approving the sale contemplated by the Agreements of Purchase and Sale between the Applicants and the Purchasers. GE Canada opposed the proposed sale of the Applicants’ assets.

11. The Agreements of Purchase and Sale between the Applicants and the Purchasers provide, *inter alia*, as follows: i) the Applicants shall apply to the Court for an Order (the “**Vesting Order**”), on terms reasonably satisfactory to the Purchasers, vesting *title* to the Purchased Assets in the Purchasers, and ii) the Applicants agree to assign their interest in all equipment leases which the Purchasers wish to assume, provided such equipment leases are assignable, and the purchase price will be reduced by the liability assumed by the Purchasers.

Applicants' Confidential Summary of Sale Process

12. In connection with the proposed sale of the Purchased Assets to the Purchasers, the Applicants are seeking an order vesting in the Purchasers all of the Applicants' "right, title and interest" in the purchased assets (emphasis added). Those assets include the GE Equipment. The Applicants are not seeking, and the Purchasers have not requested, an assignment of the GE Contracts.

Mitchell Affidavit, para.10

13. As explained above, the Applicants do not have title to the GE Equipment. Accordingly, the Applicants' "title" to the GE Equipment cannot be vested by the Court in the Purchasers.

Mitchell Affidavit, para.11

PART III – LAW

14. For the purpose of this motion only, GE Canada does not dispute that the GE Contracts in substance create "security interests" within the meaning of s. 2 of the PPSA. Accordingly, the PPSA applies to the GE Contracts.

15. Pursuant to s. 9 of the PPSA, except as otherwise provided by the PPSA or any other Act, the GE Contracts are effective according to their terms between the parties thereto and against third parties. The Ontario Court of Appeal has confirmed that s. 9 of the PPSA preserves the principle of freedom of contract as between the parties to the contract, and reinforced the need for the courts to give effect to the terms of the agreement concluded between the parties.

Credit Suisse Canada v. 1133 Yonge Street Holdings, [1998] O.J. No. 4468 (Ont. C.A.)

16. Unless the PPSA or any other statute otherwise provides, the title retention and ownership clauses in the GE Contracts are effective and the Applicants can only obtain title to the GE Equipment by paying all amounts owing the GE Contracts. There is nothing in the PPSA nor any other statute which renders meaningless the title retention and ownership clauses in the GE Contracts.

17. The issue of whether the express contractual right of a lessor to retain title to its property can be overridden by the Court appears to have been addressed in only two reported decisions: *PSINet (Re)*¹ and *Maksteel (Re)*².

18. In *PSINet*, the Honourable Hilda McKinlay presided over a court-ordered arbitration to determine the rights of a lessor, Royal Bank of Canada (“RBC”), with respect to monies held back from the proceeds of sale of the CCAA debtor’s assets. The lease agreement between RBC and the debtor, which was found to “secure payment or performance of an obligation” and thereby attract the application of the PPSA pursuant to s. 2(a) (ii) thereof, provided that title to, ownership of, and property in the leased assets remained with RBC at all times.

19. Following a thorough analysis of the relevant provisions of the PPSA and CCAA, as well as the relevant caselaw, the Honourable Hilda McKinlay found that the PPSA (and in particular

¹ Arbitration Award of The Honourable Hilda M. McKinlay is the *Matter of the Companies’ Creditors Arrangement Act and in the Matter of a Plan or Compromise or Arrangement of PSINet Limited, PSINet Realty Canada Limited, PSINetworks Canada Limited and Toronto Hosting Centre Limited* dated January 8, 2003 (“PSINet”)

² [2002] O.J. No. 3132 (Ont. S.C.J.) (“Maksteel”)

the characterization of RBC's lease as a financing arrangement under the PPSA) was not relevant to deciding whether the debtor was able to transfer title to RBC's collateral in breach of the provisions of the governing lease. The Honourable Hilda McKinlay stated, in part, as follows:

Can the provisions of s. 2 (a)(ii) of the PPSA apply in a situation involving federal insolvency legislation to render the retention of title by a lessor of no value to it under a lease which is in substance a financing vehicle? I don't see how it can, because s. 2 (a)(ii) simply sets out the nature of transactions to which *that act* applies. To apply the principles of that provision to the CCAA would have the effect of nullifying the terms of the agreement between the parties stating that title remains in the secured party. Without very specific provisions in the federal legislation, I have difficulty in seeing how this could be.

20. The Honourable Hilda McKinlay also found that RBC did not fall under the definition of "secured creditor" of the CCAA, and stated as follows:

[A] secured creditor is defined in s. 2 of the CCAA as a holder of security over "property of the debtor". In this case, the property, as acknowledged by the parties in the lease agreement, has never been the property of [the debtor], but has always been the property of the Bank. While it is true that title to property is irrelevant for purposes of requiring registration under the PPSA, I know of no reason why it should be irrelevant for the purposes of construing the provisions of the CCAA. I know of no cases, and have been referred to none, stating that the owner of personal property leased to a debtor is a secured creditor under the CCAA. Such an owner would, without specific statutory provisions to the contrary, remain the owner of the property, and be a creditor only for any arrears of rent owing.

21. In *Maksteel*, the Ontario Superior Court of Justice held that a lessor under a financing lease (RBC) was only entitled to the value of its assets following the sale of the CCAA debtor's assets. *Maksteel* is distinguishable from the case at bar on the basis that RBC did not oppose the vesting order in *Maksteel*. In addition, it is noteworthy that the *Maksteel* decision predated and the motions judge did not have the benefit of the decision of the Honourable Hilda McKinlay in *PSINet*.

22. While the locus of title is irrelevant for the purpose of determining whether the PPSA applies to a lease, Canadian courts have, in a variety of other contexts, refused to apply the PPSA characterization of a lease as financing arrangement to render meaningless title retention clauses contained in a lease or conditional sale agreement. For example, in *Honey Grove Estates Inc. v. AT&T Capital Canada Inc.*, the Ontario Superior Court of Justice considered the PPSA characterization of an equipment lease in a priority dispute between an equipment lessor and a landlord exercising the right to distrain. Under s. 31(2) of the *Commercial Tenancies Act* (Ontario), the landlord's right of distress generally applies only to the goods of the tenant on the leased premises. Pursuant to the equipment lease between the lessor and the debtor, title to the leased assets remained with the lessor until the debtor made all required payments under the lease. Although the equipment lease was characterized as a lease to which the PPSA applied, the Court held that the debtor never had title to the leased assets and, accordingly, the landlord was not entitled to distrain upon them. The Ontario Court of Appeal affirmed the lower court's decision.

Honey Grove Estates Inc. v. AT&T Capital Canada Inc. [1999] O.J. No. 3727 (Ont. S.C.J.), aff'd in [2000] O.J. No. 4147 (Ont. C.A.)

23. Similarly, in *DaimlerChrysler Financial Services (Debis) Canada Inc. v. Mega Pets Ltd.*, the British Columbia Court of Appeal dealt with a priority dispute between Canada Customs Revenue Agency ("CRA") and a conditional sale vendor. CRA claimed priority pursuant to a deemed trust under ss. 227(4) and (4.1) of the *Income Tax Act* (Canada) (the "ITA") to a vehicle purchased by the taxpayer under a conditional sale agreement with DaimlerChrysler. Those

sections of the ITA grant CRA beneficial ownership of the taxpayer's property and "property held by any secured creditor ... that but for a security interest" would be the taxpayer's property.

24. CRA relied, in part, on the definition of a "security interest" in the *Personal Property Security Act* (British Columbia). The Court held that the PPSA characterization of the conditional sale agreement as a financing arrangement was not relevant to the effect of the terms of the agreement retaining title in the vendor. The Court stated, in part, as follows:

First, as a matter of statutory interpretation, there is no basis for construing the term "security interest" as defined in s. 224(a.3) of the Income Tax Act, with reference to the PPSA of British Columbia. ... Thus, whereas the trial judge in the case at bar stated that 'whatever the common law principles may be, they cannot be taken to alter the effect of the PPSA on the characterization of security interests', the correct proposition was that whatever the PPSA may provide, it cannot be taken to alter the effect of the Income Tax Act on common law principles. ...

Of course, the distinction between conditional sale agreements and other forms of chattel security was effectively eliminated for purposes of the PPSA – as Cuming and Wood noted in their handbook ... one of the goals of the legislation was to ensure that the 'juridical nature of the security interest' was secondary to the registration regime. ... But as Cuming and Wood also note, the same approach cannot be used outside the PPSA regime. The particular terms of the agreement in question, such as that reserving title in the conditional seller, remain valid and must be considered in applying the wording of the Income Tax Act.

DaimlerChrysler Financial Services (Debis) Canada Inc. v. Mega Pets Ltd. [2002] B.C.J. No. 808 (B.C. C.A.)

25. The Saskatchewan Court of Appeal reached the same conclusion in a priority dispute between CRA and a lessor of equipment leased to a taxpayer pursuant to financing lease agreements which retained title to the equipment in the lessor.

Canada (Deputy Attorney General) v. Schwab Construction Ltd., [2002] S.J. No. 16 (Sask. C.A.)

26. In the case at bar, all of the GE Contracts provide that title to and ownership of the GE Equipment remains in GE Canada. The title retention clauses are effective as between GE Canada and Hard-Rock and against third parties. There is nothing in the PPSA, CCAA or any other statute that overrides the title retention clauses in the GE Contracts.

27. Accordingly, pursuant to the GE Contracts, the Applicants do not have title to the GE Equipment and, therefore, such title cannot be vested in the Purchasers unless all amounts payable under the applicable contracts are paid in full on closing.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Date: July 20, 2008



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Schedule “A” – AUTHORITIES

1. *Personal Property Security Act*, R.S.O. 1990, c. P.10, ss. 2 and 9
2. Arbitration Award of The Honourable Hilda M. McKinlay in the *Matter of the Companies’ Creditors Arrangement Act and in the Matter of a Plan or Compromise or Arrangement of PSINet Limited, PSINet Realty Canada Limited, PSINetworks Canada Limited and Toronto Hosting Centre Limited* dated January 8, 2003
3. *Canada (Deputy Attorney General) v. Schwab Construction Ltd.*, [2002] S.J. No. 16 (Sask. C.A.)
4. *Credit Suisse Canada v. 1133 Yonge Street Holdings*, [1998] O.J. No. 4468 (Ont. C.A.)
5. *DaimlerChrysler Financial Services (Debis) Canada Inc. v. Mega Pets Ltd.* [2002] B.C.J. No. 808 (B.C. C.A.)
6. *Honey Grove Estates Inc. v. AT&T Capital Canada Inc.* [1999] O.J. No. 3727 (Ont. S.C.J.)
7. *Honey Grove Estates Inc. v. AT&T Capital Canada Inc.* [2000] O.J. No. 4147 (Ont. C.A.)
8. *Maksteel (Re)* [2002] O.J. No. 3132 (Ont. S.C.J.)

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Applicants

Court File No. 08-CL-7503

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