SUPERIOR COURT OF JUSTICE
COUR SUPÉRIEURE DE JUSTICE

361 University Avenue
Toronto, ON M5G 1T3

Telephone: (416) 327-5284 Fax: (416) 327-5417

FAX COVER SHEET

Date: January 5, 2012

TO:	**FAX NO.:**
Harvey Chaiton/George Benchetrit Chaitons LLP	416-218-1849/416-218-1841
Melvyn Solmon Solmon Rothbart Goodman LLP	416-947-0079
Fred Tayar/Colby Linthwaite Fred Tayar & Associates Professional Corporation	416-363-3356
Robb English Aird & Berlis LLP	416-863-1515
Aubrey Kauffman Fasken Martineau Dumoulin LLP	416-364-7813
Jennifer Imrie Stikeman Elliott LLP	416-947-0866

FROM: Pat Lyon-McIndoo, secretary to The Honourable Madam Justice Mesbur

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MESSAGE: Endorsement
Callidus Capital v. Carcap Inc.
Court File No. CV-11-00009498-00CL

CITATION: Callidus v. Carcap, 2012 ONSC 163
COURT FILE NO.: CV-11-00009498-OOCL
DATE: 20120105

SUPERIOR COURT OF JUSTICE - ONTARIO
(COMMERCIAL LIST)

RE: CALLIDUS CAPITAL CORPORATION, Applicant/Respondent by cross-application

A N D:

CARCAP INC. and CAR EQUITY LOANS CORP., Respondents/Applicants by cross-application

APPLICATION UNDER Section 243(1) of the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3 and Section 101 of the *Courts of Justice Act,* R.S.O. 1990 c. C.43

AND RE: KAPTOR FINANCIAL INC. and CARCAP AUTO FINANCING, Applicants by cross-application

AND:

CALLIDUS CAPITAL CORPORATION, Respondent by cross-application

BEFORE: MESBUR J.

COUNSEL: Harvey G. Chaiton and George Benchetrit for the applicant/respondent by cross-application

Mel Solmon, Fred Tayar and Colby Linthwaite for the respondents and applicants by cross-application

Robb English for the Toronto Dominion Bank

A. Kaufman for proposed Receiver, BDO Canada Ltd.

Jennifer Imrie for Third Eye Capital

HEARD: December 14, 2011

ENDORSEMENT

Introduction:

[1] I heard this application for the appointment of a receiver and the debtors' cross application for an initial order under the *Companies' Creditors Arrangement Act* [1] (*CCAA*) on December 14, 2011. At the end of the hearing I made the following endorsement:

> For reasons to follow, an order will go in the following terms:
>
> a) The debtors' cross application for an initial order under the CCAA is dismissed.
>
> b) The application to appoint a Receiver is granted, but will not take effect until 5:00 p.m. on December 20, 2011.
>
> c) If the debtor has obtained alternate financing & has paid the applicant in full by 5:00 p.m. December 20, 2011 then the Receivership Order will not take effect.
>
> d) If the terms of paragraph (3) [i.e. paragraph (c)] above have not occurred then the Receivership order will be with effect as of 5:01 pm December 20/11.
>
> e) If the parties cannot agree on the terms of the Receivership order (following the terms of the Model Order) they may make an appointment to settle the terms of the order.
>
> f) Even if the Receivership Order takes effect on December 20/11 at 5:00 pm nothing prohibits the Debtor from continuing its efforts to refinance.

[2] Counsel tell me the debtor was unable to obtain financing to pay the applicant in full by December 20, 2011. Accordingly, the Receivership Order is now in effect, and it is necessary for me to deliver the reasons for my decision to appoint a receiver and decline to make an initial order under the *CCAA*.

[3] These are those reasons.

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[1] R.S.C. 1985 c. C-36

The application and cross-application:

[4] The applicant, Callidus, is the respondents' first secured lender. On this application, it sought the appointment of a Receiver under both the *Bankruptcy and Insolvency Act*[2] and section 101 of the *Courts of Justice Act*.[3] The TD Bank, who is the respondents' second secured lender, supported the receivership application. It pointed out none of the respondents' refinancing proposals included sufficient financing to retire the respondents' debt to the TD Bank. Accordingly, the TD Bank took the position that even if the respondents were able to find alternate financing sufficient to pay out Callidus, the TD Bank would bring its own application to appoint a receiver under the terms of its own security.

[5] The respondents brought a cross-application for relief under the *CCAA*. Both Callidus and TD Bank opposed the cross-application.

Facts:

[6] The respondent CarCap is in the business of sub-prime car lease financing. The respondent Cashland provides sub-prime equity car loans. Both companies are subsidiaries of CarCap Auto Finance Inc., which itself is a subsidiary of Kaptor Financial Inc. Kaptor Financial owns several other companies, either in whole or in part. The parties refer to these companies as the Kaptor Group. An individual named Eric Inspektor controls the entire Kaptor Group, either directly or indirectly.

[7] The Kaptor Group, including the respondents, had deposit accounts with the TD Bank. Initially, they did not have any credit facilities with the TD. Both the respondents and the Kaptor Group had financing elsewhere. Before Callidus lent operating funds to the respondents, the Laurentian Bank provided an operating facility to them. In addition, the Kaptor Group used private investors to finance their businesses through separately incorporated special purpose investment vehicles. They refer to them as "silos". The silos provided funding either through secured term debentures or preference shares.

Callidus provides financing

[8] On September 1, 2011 Callidus replaced the Laurentian Bank as the respondents' first secured lender. It did so pursuant to a credit facility agreement, under which it agreed to advance a demand loan of up to $15 million subject to certain margin conditions. The agreement provided that advances were to be used:

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[2] R.S.C. 1985 c. B-3 as amended

[3] R.S.O. 1990, c. C-43, as amended

a) To pay off the existing indebtedness to the Laurentian Bank;

b) To repay certain silo investors;

c) To provide working capital; and

d) To finance existing and future vehicle lease and vehicle loan transactions.

[9] Another term of the agreement required the respondents to establish "blocked" accounts at a bank. The respondents had to deposit all funds they received from all sources into these blocked accounts. The respondents established the blocked accounts at the TD Bank.

[10] The Callidus credit facility had other provisions that are relevant to this application. The respondents' representations required them to disclose "all commitments of any lender (other than the Lender) for all debt for borrowed money, and all debt for borrowed money outstanding of the Borrowers or Corporate Guarantors."[4] The respondents did not disclose they owed any money to TD Bank, although at the time they did. In fact, in the schedule where the respondents were required to list their "current debt defaults", they entered "none". This was not true. I will discuss this more fully in the section "Changes to the respondents' arrangements with TD Bank", below.

[11] The respondents also represented that all the information they had given Callidus was "true and correct and does not omit any fact necessary in order to make such information not misleading."[5]

[12] Callidus made its advances to a disbursement account that the respondents maintained. The disbursement account was also at the TD Bank.

[13] The credit facility's terms provided that it was due on demand, and was repayable in full on the earlier of September 1, 2012 or an event of default. Remedies on default include Callidus' right to appoint a receiver and to apply to the court to appoint a receiver.

[14] The credit facility is fully secured by general security agreements as well as a first ranking secured interest over the properties, assets and undertakings of the respondents.

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[4] Credit facility agreement paragraph 17(k)
[5] *Ibid.* paragraph 17(q)

Changes to the respondents' arrangements with TD Bank.

[15] The respondents and other Kaptor Group companies initially had only deposit accounts with the TD Bank. Their banking arrangements did not include any overdraft or credit facilities. In July and August of 2011 the TD noticed what it characterized as a high rate of unusual activity in the respondents' accounts as well as in those of other Kaptor Group companies.

[16] What was unusual is that more than $60 million in cheques passed through various Kaptor Group accounts. On August 18, 2011 about $18 million flowed through in a single day. TD Bank viewed this as unusual since the businesses generally had annual revenue of about $24 million. That day, the TD Bank froze the Kaptor Group accounts. When they froze the accounts, they were in an overdraft position of about $7 million, contrary to their banking arrangements with the TD.

[17] TD Bank then entered into an accommodation agreement with the Kaptor Group, including the respondents. The accommodation agreement, which was dated August 23, 2011, provided a secured loan of $5 million to cover the overdraft, and to provide some working capital. The loan was to be repaid in full by August 29, 2011. It was not.

Callidus advances

[18] Callidus knew nothing about the Kaptor Group/respondents' overdraft with the TD Bank, the accommodation agreement or their failure to repay the TD loan. On September 1, 2011 Callidus made its first advance into the respondents' disbursement accounts. The advance totalled just over $8.4 million and was used to pay out the Laurentian Bank debt, make payments to silo investors and provide working capital of just under $1 million. Clearly, given the respondents' situation with TD Bank at the time of the advance, the respondents were in breach of their representations to Callidus in the credit facility agreement.

The TD Bank's accommodation agreement is amended, then terminated

[19] Since the TD Bank had not been repaid, it entered into an agreement to amend the original accommodation agreement. The amending agreement was dated September 7, 2011, a week after Callidus had advanced. The amending accommodation agreement provided for the Kaptor Group to acknowledge it was in overdraft at that date to the extent of $2.6 million. TD Bank agreed to advance up to $2 million (instead of the original $5 million) to cover the overdraft. TD Bank was to be repaid in full by September 12, 2011. Again, it was not.

[20] On September 16, TD Bank entered into an agreement to terminate the accommodation agreement. In the termination agreement TD Bank agreed to extend

the financing subject to certain paydowns, and with the requirement that the financing be paid in full by September 30. Once again, Kaptor Group failed to pay off the debt. It remains outstanding. Currently, the respondents owe the TD Bank about $1 million.

[21] By this point the respondents had set up the required blocked account and disbursement accounts at TD Bank, and Callidus had advanced. By this point as well, TD Bank was no longer prepared to do business with the respondents. As part of its termination agreement with the respondents, TD Bank required them to transfer the blocked accounts and disbursement accounts within 90 days of September 16, 2011.

[22] Before TD Bank made its various accommodation agreements with the respondents and Kaptor Group, there was a three week period in September where the TD Bank returned as NSF many cheques the respondents had written for payroll, investor payments and dealer and supplier payments. The NSF cheques to silo investors also put the respondents in breach of their obligations to Callidus.

Callidus learns of the debt with TD Bank

[23] Callidus did not learn of any of the respondents' agreements with TD Bank, or the security they had given the Bank until three weeks after Callidus had made its first advance. It was only around that time that Eric Inspektor, who essentially controls the Kaptor Group, including the respondents, told Callidus that the respondents and other Kaptor Group companies maintained accounts with the TD Bank. He said that their arrangements with the TD Bank permitted the TD Bank to offset overdrafts in one corporate account against deposits in another, including the disbursement accounts into which Callidus deposited its advances to the respondents.

[24] Mr. Inspektor explained that because of the overdraft position the Kaptor Group found itself in, the TD Bank had returned as NSF some of the cheques the respondents had written to some silo investors under Callidus' initial advance. It was one of the conditions of the advance that these investors were to be paid from the advance. Until this time, Callidus knew nothing of any debt the respondents owed to TD Bank. Callidus also did not know that one of the conditions of its initial advance had not been fulfilled – that is, paying off some specific silo investors.

[25] Matters deteriorated. TD Bank dishonoured various Cashland cheques for things like payroll, dealership payments and business expenses. Dealers were complaining to the Ontario Motor Vehicle Industry Council.

The field audit

[26] Under the terms of its security, Callidus was permitted to conduct a field audit of the respondents. When it did, it discovered that some government remittances were made late. It also learned that Mr. Inspector had directed funds in various Kaptor Group accounts to cover overdrafts in other accounts. This might have included diversion of funds from the respondents to cover overdrafts of other Kaptor Group companies. Over $300,000 in September lease and loan payments had been deposited into the disbursement accounts instead of into the blocked accounts. Mr. Inspektor and his wife deposited nearly $700,000 into the disbursement accounts instead of the blocked accounts. Again, this constituted a breach of the terms of the credit facility agreement.

The Callidus demand

[27] Needless to say, all of this created significant concern for Callidus. Callidus took the position that the respondents had made misrepresentations and material non-disclosure to it. It viewed the respondents' actions as constituting material breaches of the credit facility agreement. It was not prepared to continue to lend. On October 18, 2011 it demanded payment in full, pursuant to the terms of the credit facility agreement. It also served notice under section 244 of the *BIA* of its intention to enforce its security.

The Callidus forbearance agreement and events following

[28] On October 25, 2011 Callidus entered into a forbearance agreement with the respondents. Callidus agreed to forbear from enforcing its rights, but only on a day-to-day basis. The agreement permitted Callidus to terminate it at any time, in its sole and absolute discretion.

[29] In the Callidus forbearance agreement the respondents have acknowledged Callidus' *BIA* Notices are valid. They agree not to contest the validity of the demands for payment. They waive the 10-day notice period, and consent to the immediate enforcement of Callidus' security.

[30] The forbearance agreement also required the respondents to hire a new interim executive officer to replace Mr. Inspektor, who ceased to have any managerial role, or any cheque signing authority. The respondents also agreed to hire MNP corporate Finance Inc. to find them alternate financing so they could pay out Callidus by April 30, 2012. They were not able to secure alternate financing in this way.

[31] The agreement also required the respondents to submit a complete restructuring plan to Callidus by November 30, 2011. First, the plan had to be acceptable to Callidus, and second had to be completed by December 31, 2011. The respondents have been unable to comply with either of these conditions.

[32] Although the parties concede the term is not enforceable, the Callidus forbearance agreement also contains a promise from the respondents not to commence any restructuring or reorganization proceedings under either the *BIA* or *CCAA*.

[33] Since the forbearance agreement, Callidus says the respondents' financial position has deteriorated more. The loan balance has increased by more than $770,000 while the lease rental stream has dropped by about $225,000. By the end of November, the respondents were in an over advance position of more than $1.2 million.

[34] Callidus was not prepared to continue without changes to the arrangement. On November 16, Callidus told the respondents it would continue to fund under the credit facility if and only if there was a minimum cash injection at least $500,000 into the businesses by subordinated debt or equity within two days, and the respondents would also have to fund their 30% of the cost of buying new vehicles for lease. The respondents failed to fulfil either of these conditions.

[35] On November 24, Callidus terminated the forbearance agreement, and told the respondents it would apply to court to have a receiver appointed.

[36] Even though it has terminated the forbearance agreement, Callidus continues to provide some funding to the respondents. It does so at its discretion, in order to protect its security.

[37] The respondents have been looking for alternate financing. They have not been able to secure any.

Discussion:

[38] Callidus takes the position that the respondent made material misrepresentations even before the first advance. It says had it known of the respondents' situation with TD Bank it would never have agreed to advance in the first place. Now it sees the respondents' financial position deteriorating. Its demand for payment has not been satisfied. The respondents' revenue stream is declining, meaning it cannot acquire new vehicles to lease. Callidus says this results in a reduction of its security, while the debt increases. As a result, Callidus says it is just and convenient to appoint a receiver in order to protect its security and the interests of other stakeholders.

[39] For their part, the respondents accuse Callidus of taking an aggressive and unreasonable position (even though every position Callidus has taken has been

supported by the specific terms of either the credit facility or the forbearance agreement.) The respondents point out that they are not actually behind in their payments. They view the interim financial officer who is now in place as being akin to a "soft receivership", and suggested that if they were able to have a *CCAA* stay in place for thirteen weeks, they would be able to restructure. They did not, however, present any restructuring plan, even in very draft form.

Receiver?

[40] Callidus brought its receivership application under both section 101 of the *Courts of Justice Act,* and s.47 of the *BIA*. The test to appoint a receiver under the *CJA* requires the court to conclude it would be just and convenient to do so. The court may appoint an interim receiver under s. 47 of the *BIA* if and only if the court is persuaded a receiver is necessary to protect the debtor's estate or the interests of the creditor who sent a notice under s. 244(1) of the *BIA*.

[41] The question is whether it is more in the interests of all concerned to have the receiver appointed or not.[6] In order to answer the question the court must consider all the circumstances of the case, particularly:

a) The effect on the parties of appointing the receiver. This includes potential costs and the likelihood of maximizing return on and preserving the subject property;

b) The parties' conduct; and

c) The nature of the property and the rights and interests of all parties in relation to it.[7]

[42] Receivers are considered an "extraordinary" remedy, much in the same way as granting an injunction is considered an extraordinary remedy. The law is clear, however, that an applicant who wishes the court to appoint a receiver need not show irreparable harm if a receiver is not appointed.[8]

[43] Many security instruments will specifically contemplate appointing a receiver. The fact that the creditor has a right to appoint a receiver under its security is therefore an important consideration. Generally, a court will appoint a receiver when it is necessary to enforce rights between the parties or to preserve of assets pending judgment. Receivers will also be appointed where there is a serious apprehension about the safety of the assets.

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[6] *Bank of Nova Scotia v. Freure Village on Clair Creek,* 1996 CarswellOnt 2328, 40 C.B.R. (3d) 274 (S.C.J.)
[7] *Bank of Montreal v. Carnival Leasing Limited,* 2011 ONSC 1007 (CanLII)
[8] *Swiss Bank Corp. (Canada) v. Odyssey Industries Inc.* [1995] O.J. No. 144 (O.C.J. – Gen. Div.)

[44] Here, of course, the credit facility agreement itself specifically contemplated appointing a receiver. Following the reasoning in *Fruere Village,* the "extraordinary" nature of the remedy is therefore less important here than it might otherwise be.

[45] This leads me to consider the interests of all concerned, in order to determine whether the test under either the *Courts of Justice Act* or *Bankruptcy and Insolvency Act*, or both, has been met.

[46] What is the likely effect on the parties of appointing a receiver? From Callidus' point of view, it will allow it to protect its security, and dispose of it in an organized and court-supervised fashion. It proposes to sell the businesses as a going concern, in order to maximize value for all stakeholders. The respondents concede that a possible restructuring plan might be to liquidate, in which case the hope would also be a going concern sale. In this regard, I see no difference in outcome if a receiver is appointed.

[47] Callidus has legitimate concerns about the businesses continuing as a going concern while the respondents attempt to restructure. The respondents have stopped purchasing vehicles for lease. They have no money to do so. As a result, the value of Callidus' security is declining.

[48] The activities in the TD accounts that led to the Bank's freezing them suggest companies that were out of financial control, operating outside of the normal course of business.

[49] The respondents' difficulties with the TD Bank overdraft arose in August of last year. They have been given every opportunity since then to cure their defaults, and have failed to do so.

[50] Similarly, the respondents have been in default with Callidus since it demanded payment in mid October of last year, and delivered its notice of intention to enforce its security. Even though Callidus had agreed to forbear, the respondents have failed to honour the terms of the forbearance agreement.

[51] Neither Callidus nor TD Bank has faith in the respondents' management. This is a factor that supports appointing a receiver. [9] While the interim executive officer Mr. Willis has brought some stability to the businesses, they cannot operate without further borrowing, and none is available. Without further borrowing, the respondents cannot purchase new inventory for lease, and thus its inventory is declining. What this means is that its lease and loan revenues are also declining, while its debt load to Callidus is increasing. All this suggests to me that appointing a receiver is necessary in order to protect Callidus' security from further erosion.

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[9] *GE Commercial Distribution Finance Canada v. Sandy Cove Marine Co.* [2011] O.J. No. 2954 (S.C.J.)

[52] The respondents' past conduct also gives cause for concern if there is no receiver who can manage the businesses and arrange for an orderly sale under the court's supervision.

[53] As to the nature of the property, I note that Callidus' security is declining in value. Both secured creditors' rights in it are being eroded. The court must put an end to the continued haemorrhaging of money. Given the respondents' failure to come up with even a rudimentary restructuring plan, it is time for a receiver to take control, and manage the businesses to the extent necessary to result in an orderly liquidation to protect the interests of all stakeholders.

[54] At the hearing of the application and cross-application, the respondents urged me to consider only the current situation with the businesses, and look to the future, rather than to problems in the past. Even doing only this, there is no comfort to Callidus. The respondents have repeatedly sought new financing and failed – even after I made the receivership order, but held it in abeyance so they could refinance. Most importantly, nothing prevents the respondents from continuing their efforts to restructure, even though I have appointed a receiver.

CCAA?

[55] The respondents took the position that granting an initial order under the *CCAA* is the proper way to proceed. They point to the fact that Mr. Willis (the interim executive officer) says the businesses are not out of control, are not a disaster, and are good businesses that will not deteriorate if a stay is granted and the companies are allowed to restructure. I disagree.

[56] The respondents have no operating capital. They are borrowers in default, with two unwilling lenders who are unprepared to lend more. Under the *CCAA* these lenders have no obligation to advance more funds.[10] Without further advances, the respondents cannot continue to operate without further deterioration in inventory of vehicles and the resulting deterioration in revenue.

[57] The respondents ask, what is the harm in letting them reorganize? While that is an interesting question, it is not the test. It seems to me this is nothing more than a last ditch effort on the respondents' part to stave off the inevitable. In *Re Marine Drive Properties Ltd.* [11] the court put a similar situation this way: "to put in bluntly, the Petitioners have sought *CCAA* protection to buy time to continue their attempts to raise new funding ... they need time to 'try to pull something out of the hat.'" Or, as Farley J. put it in *Re Inducon Development Corp.,* [12] "... *CCAA* is designed to be remedial; it is not however designed to be preventative. *CCAA* should not be the

[10] Section 11.01(b) of the *CCAA*
[11] 2009 BCSC 145
[12] [1992] O.J. No. 8 (Gen. Div.)

last gasp of a dying company; it should be implemented if it is to be implemented, at a stage prior to the death throe."

[58] Here, the respondents only brought their application after Callidus had brought its application for a receiver. The respondents knew in November that Callidus intended to seek a receiver. They waited until they had been served with the receivership application before launching their own effort to restructure. As a result, the cross-application for *CCAA* relief seems more a defensive tactic than a *bona fide* attempt to restructure. The respondents have no restructuring plan. They have no outline of a plan. They do not have even a "germ of a plan". Again, as the court said in *Inducon*:

> [W]hile it is desirable to have a formalized plan when applying, it must be recognized as a practical matter that there may be many instances where only an outline is possible. I think it inappropriate, absent most unusual and rare circumstances, not to have a plan outline at a minimum, in which case then I would think that there would be requisite for the germ of a plan.

[59] The respondents have been attempting to refinance for some time. They have failed to meet every deadline for payment they agreed to with Callidus as well as with the TD Bank. Even when I delayed the date for the receivership order to take effect in order to give the respondents time to complete a refinancing, they were unable to do so.

[60] The absence of even a "germ of a plan" militates against granting relief under the *CCAA*.

[61] Finally, in considering the question of whether to grant relief under the *CCAA*, I must also look at the position of the two major secured creditors. Neither will support a plan of arrangement. They represent a considerable part of the respondents' creditors. I have no evidence any other creditors would support a plan, either. I see no merit in making an initial order and imposing a stay in circumstances where a plan of arrangement is most likely going to be defeated.

[62] Having considered all these factors, I decline to grant relief under the *CCAA*.

Conclusion:

[63] It is for these reasons I made the order I did on December 14, 2011.

MESBUR J.

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