File No. CI 24-01-45056

<u>THE KING'S BENCH</u>
<u>WINNIPEG CENTRE</u>

IN THE MATTER OF: THE APPOINTMENT OF A RECEIVER PURSUANT TO SECTION 243 OF *THE BANKRUPTCY AND INSOLVENCY ACT,* R.S.C. 1985 c. B-3, AS AMENDED AND SECTION 55 of *THE COURT OF KING'S BENCH ACT*, C.C.S.M. c. C280

BETWEEN:

BANK OF MONTREAL,

Applicant,

- and -

GENESUS INC., CAN-AM GENETICS INC. and GENESUS GENETICS, INC.

Respondents.

MOTION BRIEF OF THE BANK OF MONTREAL (RESPONDING PARTY)
HEARING DATE: TUESDAY APRIL 22, 2025 at 2:00 p.m.
BEFORE THE HONOURABLE MR. JUSTICE CHARTIER

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(File No. 638/400)

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PART I

LIST OF DOCUMENTS TO BE RELIED UPON

1. Affidavit of Ed Barrington, affirmed February 9, 2024;

2. Affidavit of Ed Barrington, affirmed May 28, 2024;

3. Affidavit of Allan Herman, affirmed May 29, 2024;

4. Receivership Order, dated June 12, 2024;

5. Notice of Motion of Sea Air International Forwarders Limited, filed January 3, 2025;

6. Affidavit of Ed Barrington, affirmed January 15, 2025;

7. Transcript of the Cross Examination of James Long, dated February 27, 2025;

8. Transcript of the Cross Examination of Ed Barrington, dated February 27, 2025;

9. Motion Brief of Sea Air International Forwarders Limited, filed March 21, 2025;

10 Such further and other material as counsel may advise and this Honourable Court may allow.

PART II

AUTHORITIES TO BE RELIED UPON

TAB

1. *The Fraudulent Conveyances Act*, CCSM c F160

2. *DSTB Inc. v McGregor Landscaping & Design et al*, 2020 MBQB 142

3. *Aquino v Bondfield Construction Co.*, 2024 SCC 31

4. *Conte Estate v Alessandro*, 2002 CarswellOnt 4507 (ONSC)

5. *Beazer v Tollestrup Estate*, 2017 ABCA 429

6. *Alberta Drywall Supply Ltd. v Hauk*, 1984 CarswellAlta 261 (ABQB)

7. *Winnipeg Mortgage Exchange Ltd. v Winnipeg Mortgage Holdings Ltd.*, 1982 CarswellMan 10 (MBQB)

8. *Elias Markets Ltd. Re*, 2006 CarswellOnt 5597 (ONCA)

9. *Bank of Montreal v Wolchansky*, 1986 CarswellAlta 388 (ABQB)

10. *Little Souris Holdings Ltd., Re*, 1979 CarswellMan 17 (MBQB)

11. *Citifinancial Canada East Corp. v Hurley Estate (Trustee of)*, 2006 NBBR 133

12. *Re Weyman*, 1929 CarwellOnt 15 (Ont. Supreme Court in Bankruptcy)

13. *Bankruptcy and Insolvency Act*, RSC, 1985, c B-3, sections 2 and 95(1)(a)

14. *St. Anne-Nackawic Pulp Co (Trustee of) v Logistec Stevedoring (Atlantic) Inc.*, 2005 NBCA 55

15. *CWB Maxium Financial Inc. v 2026998 Alberta Ltd.*, 2021 ABQB 137

16. *Lloyd's Non-Marine Underwriters v J.J. Lacey Insurance Ltd.*, 2009 NLTD 148

17. *U.S. Steel Canada Inc., Re*, 2016 ONCA 662

18. *Indalex Ltd., Re*, 2013 SCC 6

19. *Puratone Corp., Re*, 2013 MBQB 171

PART III

STATEMENT OF FACTS

1. The Bank of Montreal ("**BMO**") repeats and relies upon the facts as set out in its Application Brief filed in these proceedings on February 13, 2024. The defined and capitalized terms herein have the same meaning as those contained in the Application Brief of BMO, filed on February 13, 2024.

2. BMO reiterates that its Special Accounts Management Unit first became involved in the Debtors' accounts in or about the beginning of 2023, due to the Debtors' financial difficulties and resulting default under the Loans and Security. Specifically, between February 10 and May 23, 2023, the Debtors' BMO accounts were often in an unauthorized overdraft position and BMO was required to return cheques written by the Debtors in order to cure the Debtors' overdraft position.

Affidavit of Ed Barrington, affirmed January 15, 2025, ("Third Barrington Affidavit"), paras 6-11

3. Throughout its involvement with the Debtors, BMO made reasonable efforts to work with and allow the Debtors to assess their financial position. Despite these efforts, BMO became increasingly concerned about the Debtors' cashflow projections and continued breaches of the Loans and Security. As a result, BMO ultimately made demand and served Notices of Intention to Enforce Security ("**NIES**") pursuant to the Bankruptcy and Insolvency Act and Notices of Intent by Secured Creditor pursuant to The Farm Debt Mediation Act upon the Debtors on or about June 16 and July 6, 2023.

Affidavit of Ed Barrington, affirmed February 9, 2024 ("First Barrington Affidavit"), para 37, Exh. "II"

4. It was a term of each of the Debtors' General Security Agreements with BMO, which were executed in or around 2011, that the Debtors granted a charge in favour of BMO with respect to,

inter alia, all of the Debtors' property, both real and personal, moveable or immovable, both present and future, of whatsoever nature and kind.

First Barrington Affidavit, para 12, Exh. "H", para 15, Exh. "U", para 18(a), Exh. "W"

5. After BMO made demand and served the NIES on the Debtors, the Debtors retained counsel. On or about July 7, 2023, counsel for the Debtors contacted counsel for BMO to advise, *inter alia*, that the Debtors sought to enter into a forbearance agreement with BMO, to allow the Debtors additional time to evaluate their financial situation. On or about July 21, 2023, counsel for the Debtors again reiterated to counsel for BMO that the Debtors were eager to address this matter and to review BMO's proposed forbearance terms.

Third Barrington Affidavit, para 17, Exh. "E", para 18, Exh. "F"

6. At the Debtors' request, counsel for the Debtors and counsel for BMO began negotiating the terms of a forbearance agreement beginning on or about July 26, 2023, which included that the Debtors would provide additional security to BMO against their real property by way of an all obligations second mortgage against all of the land and premises owned by Genesus and Can-Am in the amount of $8,000,000.00 (the "**Second Mortgage**"). On or about July 31, 2023, counsel for the Debtors advised counsel for the BMO that the Debtors agreed to provide the Second Mortgage to BMO as consideration for BMO's entering into the Forbearance Agreement.

Third Barrington Affidavit, para 19, Exh. "G", para 20, Exh. "H"

7. The terms of the Forbearance Agreement ultimately entered into by BMO and the Debtors included, *inter alia*:

(a) The Debtors acknowledged the Debt, the validity of BMO's Security, that default had been made thereunder, and that BMO was entitled to enforce its Security;

(b) BMO would not proceed to take further steps to recover payment of the Debt, or to enforce its Security, until 11:59 p.m. on January 15, 2024 (the "**Forbearance Term**"), provided that all terms and conditions of the Forbearance Agreement are complied with;

(c) The Debt shall be due and payable in full on January 15, 2024, at the end of the Forbearance Term;

(d) The Debtors shall pay to BMO a non-refundable forbearance fee of $45,000.00 on or before October 30, 2023, from the sale proceeds of the St. Andrews Property, as hereinafter defined (the "**Forbearance Fee**");

(e) The Debtors shall maintain all deposit accounts solely with BMO, and all accounts receivable and other revenue and cash resources of the Debtors shall be deposited to the Debtors' account;

(f) The Debtors shall consent in writing to BMO's appointment of BDO as monitor and consultant, on terms and conditions acceptable to BMO in its sole discretion. The Debtors shall cooperate with BDO and provide BDO with financial information upon request by BDO, including daily inflow and outflow of cash, AR, AP, income and balance sheets, for BDO's review and reconciliation;

(g) The Debtors shall provide to BMO monthly reporting, including, without limitation, income statements, balance sheets, and account receivable/account payable statements, to be provided to BMO by the 21st day following the prior month;

(h) In consideration of the Forbearance Agreement and as security for the repayment of the Debt owing, the Debtors agree to provide the Second Mortgage to BMO.

The Second Mortgage shall be a Demand Mortgage in the sum of $8,000,000.00, subordinate only to first mortgages to FCC, and subject to provision of a Forbearance Agreement between FCC and the Debtors, in a form satisfactory to BMO at its sole discretion;

(i) Can-Am intends to sell the St. Andrews Property and will provide copies of any contemplated offers to purchase the St. Andrews Property for the approval of BMO; and

(j) The sale proceeds of the St. Andrews Property shall be disbursed as follows:

i. To any outstanding real property taxes with respect to the St. Andrews Property;

ii. To reasonable costs and disbursements incidental to the sale of the St. Andrews Property;

iii. To FCC for payment of the balance due under its First Mortgage;

iv. To FCC the additional sum of $250,000.00 to be applied by FCC in reduction of the debt owing by Genesus to FCC, guaranteed by Can-Am;

v. To BDO in the sum of approximately $110,000.00 for payment of its account for consulting services;

vi. To BMO in the sum of $45,000.00 for payment of the Forbearance Fee;

vii. Balance of the net sale proceeds to BMO;

(k) The Debtors shall execute a Consent to Judgment and a Consent Receivership Order; and

(l) Upon expiry of the Forbearance Term in the absence of payment of the Debt in full, BMO may immediately proceed to take such steps as it deems necessary to recover payment of the Debt, including enforcement of its Security, without further notice.

First Barrington Affidavit, paras 39-40, Exh. "KK"

8. The Second Mortgage was accordingly registered against title to all of Genesus' and Can-Am's real Property in Manitoba on or about October 12, 2023.

Third Barrington Affidavit, para 48

9. Throughout the Forbearance Term, BMO took no steps to enforce its Security or to otherwise collect on the Debt. Further, and while not under any obligation to do so, BMO elected to draw down any unused room on the Debtors' Operating Loan (Account 0545-1998-976) (the "**Operating Line**") and to deposit same into the Debtors' Deposit Account, thereby creating a float to assist the Debtors in, *inter alia*, clearing cheques and meeting their payroll obligations. BMO continued to allow the Debtors' Deposit Account to operate in this manner both before and after it made demand and served the NIES on the Debtors, and throughout the Forbearance Term.

Third Barrington Affidavit at paras 13-15 and 43

10. Genesus continued its operations, both throughout the Forbearance Term and after the expiry of the Forbearance Agreement and continued to use assets and the available funds in the Deposit Account, secured to BMO, to pay other creditors subordinate to BMO in the ordinary course of its business, without any payments being made to BMO to reduce the Genesus Debt to BMO. Interest continued to accrue on the Operating Line, both throughout the Forbearance Term and after the expiry of the Forbearance Agreement, without any interest payments being made by the Debtors, to BMO's detriment.

Third Barrington Affidavit, para 44

11. At the time of negotiating the Forbearance Agreement, through counsel, and registering the Second Mortgage on title to Genesus' and Can-Am's real Property in Manitoba, BMO was not aware that an Ontario action had been commenced by Sea Air International Forwarders Limited ("**Sea Air**") against Genesus, nor was BMO aware of the default judgment ultimately obtained by Sea Air on or about October 3, 2023. Sea Air's default judgment was not filed in the Manitoba Court of King's Bench until December 12, 2023, and its judgment was not registered against title to Genesus' real Property until December 15, 2023. BMO learned of Sea Air's default judgment against Genesus in the context of the within receivership proceedings.

First Barrington Affidavit, para 61(e)

12. On or about May 29, 2024, the Affidavit of Allan Herman, counsel of record for Sea Air, was filed in these proceedings (the "**Herman Affidavit**"). The Notice of Motion of Sea Air was subsequently filed on January 3, 2025.

Affidavit of Allan Herman, affirmed May 29, 2024 ("Herman Affidavit")

13. The Herman Affidavit alleges, among other things, that the granting and registration of BMO's Second Mortgage against title to Genesus' Property was a fraudulent conveyance and preference. The Herman Affidavit further alleges that there was insufficient consideration provided to BMO by Genesus for the granting of BMO's Second Mortgage and that BMO's intent in registering its Second Mortgage was to delay, disadvantage, or defeat Sea Air's interest in Genesus' Property, all of which BMO denies.

Herman Affidavit, paras 7 and 8

14. On June 12, 2024, the Honourable Justice Chartier granted an Order pursuant to section 243(1) of the *Bankruptcy and Insolvency Act* and section 55 of *The Court of King's Bench Act*, appointing BMO Canada Limited as Receiver and Manager, without security, of all assets,

undertakings and properties of the Debtors relating to, acquired for, or used in relation to a business carried on by the Debtors, including all proceeds thereof (the "**Receivership Order**"). It was subsequently agreed that any challenge Sea Air may wish to raise with respect to the validity and priority of BMO's Second Mortgage would be determined in the context of these Receivership Proceedings.

Receivership Order, dated June 12, 2024

15. Since the granting of the Receivership Order, Sea Air filed the Notice of Motion herein, seeking an Order, *inter alia*, that BMO's Second Mortgage be declared void and/or unenforceable. Sea Air's Notice of Motion and the Herman Affidavit allege that BMO's Second Mortgage should be found void and/or unenforceable on the basis that (1) BMO's Second Mortgage is a fraudulent conveyance within the meaning of *The Fraudulent Conveyances Act*; (2) that there was insufficient consideration provided by BMO to the Debtors with respect to the granting of BMO's Second Mortgage; and/or (3) BMO's Second Mortgage is a fraudulent preference within the meaning of s. 95 of the *BIA*. Sea Air's Motion challenges validity of the registration of BMO's Second Mortgage, in its entirety. However, while BMO's Second Mortgage is registered against title to all of Genesus' and Can-Am's real Property in Manitoba, Sea Air has obtained judgment against Genesus, only.

Notice of Motion of Sea Air, filed January 3, 2025

Herman Affidavit, para 7

16. In its Motion Brief, Sea Air raises, for the first time, two arguments regarding the applicability of section 4.2 of the *BIA* and the doctrine of equitable subordination to the circumstances of this case.

Motion Brief of Sea Air, filed March 21, 2025

17. BMO contests Sea Air's motion and submits that there is no basis upon which the relief sought by Sea Air can be granted. BMO accordingly seeks that Sea Air's motion be dismissed with costs payable to BMO.

PART IV

ISSUES

18. The issues to be determined with respect to Sea Air's motion are as follows:

(a) Was the registration of BMO's Second Mortgage against Genesus' and Can-Am's Property a "fraudulent conveyance" within the meaning of section 2 of *The Fraudulent Conveyances Act*, CCSM c F160 (the "*FCA*");

(b) Was sufficient consideration provided by BMO to the Debtors with respect to the registration of BMO's Second Mortgage;

(c) Was the registration of BMO's Second Mortgage against Genesus' and Can-Am's Property a "fraudulent preference" within the meaning of section 95 of the *Bankruptcy and Insolvency Act*, RSC, 1985, c B-3 (the "*BIA*"); and

(d) Should this Court exercise its discretion under section 4.2 of the *BIA* in issuing a declaration that the Second Mortgage is void and/or unenforceable; and

(e) Should this Court apply the doctrine of equitable subordination so as to subordinate BMO's Second Mortgage to Sea Air's Judgment?

PART V

ARGUMENT

The registration of BMO's Second Mortgage against Genesus' and Can-Am's Property was not a "fraudulent conveyance" within the meaning of section 2 of the *FCA*.

19. Section 2 of the *FCA* states:

> **When conveyances declared void as against creditors**
> **2** Every conveyance of real property or personal property and every bond, suit, judgment, and execution at any time had or made, or at any time hereafter to be had or made, with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties, or forfeitures is void as against such persons and their assigns.

***FCA*, section 2 [TAB 1]**

20. The main question to be asked when determining whether an encumbrance is captured by section 2 of the *FCA* is that of intent on the part of the transferor. Where a "conveyance is made for good consideration which defeats or delays creditors, the plaintiff must show the fraudulent intent of both the grantor and the grantee.

***DSTB Inc. v McGregor Landscaping & Design et al*, 2020 MBQB 142 ("*DSTB*") at paras 50-51 [TAB 2]**

21. Further, "[s]ection 2 of the *FCA* requires the establishment of an intent to defeat, hinder or delay creditors, which is more than knowledge that certain actions may have that effect.".

***DSTB*, *supra*, at para 63 [TAB 2]**

22. Canadian Courts have developed indicia or "badges of fraud" to assist in determining the existence of the necessary intent to defeat or delay creditors. Recently, in *Aquino v Bondfield Construction Co.*, the Supreme Court of Canada summarized these "badges of fraud" as follows:

> **44** Because it is often difficult to adduce evidence of a debtor's subjective intent, the intent requirement is often proved through the evidentiary shortcut of badges of fraud. Badges of fraud are suspicious circumstances from which a court may infer the debtor's intent to defraud, defeat, or delay a creditor [...] The badges of fraud approach to inferring a debtor's intent to defraud creditors is of ancient vintage, dating back to Twyne's Case in 1601 [...].

> **45** Case law has recognized the following non-exhaustive examples of badges of fraud: (a) the debtor had few remaining assets after the transfer; (b) the transfer was made to a non-arm's length party; (c) the debtor was facing actual or potential liabilities, was insolvent, or was about to enter a risky undertaking; (d) the consideration for the transaction was grossly inadequate; (e) the debtor remained in possession of the property for their own use after the transfer; (f) the deed of transfer had a self-serving and unusual provision; (g) the transfer was secret; (h) the transfer was made with unusual haste; and (i) the transaction was made despite an outstanding judgment against the debtor [...]
>
> **46** A <u>badge of fraud must be considered in the context of the surrounding circumstances and in relation to the question of the debtor's intention at the time of the transfer</u> [...] A court must avoid analyzing the debtor's actions with the benefit of hindsight; it "must resist the temptation to inject back into the circumstances surrounding the impugned transaction knowledge about how events unfolded after that time" [...] <u>The presence of one or more badges of fraud does not require the court to infer an intent to defraud, defeat, or delay a creditor</u>, nor does the absence of a particular badge of fraud prevent the court from inferring this intent.

Aquino v Bondfield Construction Co., 2024 SCC 31 at paras 44-46 [TAB 3]

23. The burden of proof in an action under provincial preferences legislation stays with the plaintiff who seeks to establish "fraudulent intent" on the part of the defendant.

Conte Estate v Alessandro, 2002 CarswellOnt 4507 (ONSC)
at para 22 [TAB 4]

24. In this case, the circumstances surrounding the negotiation of the Forbearance Agreement and the registration of BMO's Second Mortgage do not justify an inference that BMO intended to defraud, defeat or delay Genesus' other creditors. These circumstances include, *inter alia*:

(a) BMO and Genesus are arm's length parties;

(b) BMO is Genesus' and Can-Am's primary secured creditor and holds real property mortgages with respect to Genesus' real Property and Can-Am's real Property, which are registered in priority to every other caveat and non-financial encumbrance;

First Barrington Affidavit, paras 18-34

(c) Since the time it became involved in the Debtors' accounts in or around early February 2023, BMO attempted to assist the Debtors through their financial difficulties by allowing them to, *inter alia*, continue drawing down on their Operating Line and to carry on business operations and maintain the animal inventory;

Third Barrington Affidavit, para 50

(d) Genesus continued its operations, throughout the Forbearance Term and after the expiry of the Forbearance Agreement and continued using assets and available funds in its Deposit Account, all of which were secured to BMO, to pay other creditors subordinate to BMO in the ordinary course of its business, without any payments being made to BMO to reduce its Debt;

First Barrington Affidavit, paras 52-55 and 62
Third Barrington Affidavit, para 44

(e) The Forbearance Agreement and Second Mortgage cannot be said to have been executed "with unusual haste", as the terms of the Forbearance Agreement, including the granting of BMO's Second Mortgage, were negotiated between counsel for the Debtors and counsel for BMO, over the course of several months and at the Debtors' request;

Third Barrington Affidavit, paras 16-40

(f) In or about June 2023, the Debtors consulted their own insolvency counsel and a licensed insolvency trustee;

Transcript from the Cross Examination of James Long ("Long Transcript"), page 6, lines 2-25 and page 7, lines 1-14

(g) Sea Air had not yet obtained default judgment against Genesus in its Ontario action at the time the Forbearance Agreement was executed by BMO and the Debtors on September 30, 2023;

Herman Affidavit, para 4

(h) Similarly, BMO was not aware of Sea Air's Ontario action against Genesus, nor of the default judgment obtained by Sea Air against Genesus, at the time the Second Mortgage was registered against title to all of Genesus' and Can-Am's real Property in Manitoba on October 12, 2023;

First Barrington Affidavit, para 61(e)
Third Barrington Affidavit, para 41

(i) When BMO's Second Mortgage was registered on October 12, 2023, Sea Air had not yet filed its default judgment against Genesus in the Manitoba Court of King's Bench. Rather, Sea Air's default judgment against Genesus was not filed in the Manitoba Court of King's Bench until December 12, 2023, and was not registered against title to Genesus' Property until December 15, 2023; and

First Barrington Affidavit, para 61(e)
Herman Affidavit, para 5

(j) Good consideration was provided by BMO to Genesus and Can-Am in exchange for the registration of BMO's Second Mortgage, in the form of, *inter alia*, the Forbearance Agreement and BMO's actual forbearance from suit against the Debtors, as more particularly described below.

25. BMO's registration of the Second Mortgage against Genesus' and Can-Am's Property was *bona fide*, negotiated with the Debtors through counsel, and was intended to allow time for the Debtors to pursue refinancing or sale of the business as a going concern.

Third Barrington Affidavit, para 50

26. There are accordingly no badges of fraud present in this case upon which the Court can infer any fraudulent intent on the part of BMO with respect to the granting or registration of the Second Mortgage.

27. As it relates to Genesus' "intent" in granting the Second Mortgage to BMO, Genesus confirmed that it requested the Forbearance Agreement from BMO and was appreciative of the time BMO provided, pursuant to the Forbearance Agreement, for Genesus to attempt to find a solution to its financial difficulties:

> 47 Q: Was Genesus not concerned about the Bank doing something precipitous if it didn't obtain creditor protection?
>
> A: Well, good question. I think what we were trying to do -- the Bank was -- I would say BDO and the Bank was supportive of us to try to find a solution, and they gave us -- we asked for the forbearance agreement to give us more time. And they agreed, and I guess we appreciate that they did.

Long Transcript, page 11, lines 11-20

28. Sea Air's argument regarding what BMO allegedly "would have done" if the Second Mortgage had not been registered is speculative. The reality is that BMO was in a position to begin enforcing its Security after making demand and serving the NIES upon the Debtors in or around June and July 2023 but agreed, instead, to enter into the Forbearance Agreement at Genesus' insistence. Had the Second Mortgage not been granted, BMO would nevertheless have considered bringing an Application for the Appointment of a Receiver. Further, BMO could have applied for a bankruptcy order with respect to the Debtors, in which case all unsecured debt would have been subordinate to BMO's existing security, including its GSA and unregistered equitable mortgage. Further, Genesus and Can-Am could have sought a stay of proceedings under the *Farm Debt Mediation Act* at that time, rather than negotiate forbearance terms with BMO.

Transcript from the Cross Examination of Ed Barrington, ("Barrington Transcript") page 16, lines 4-10

29. With respect to the three month "look-back" period set out under section 95(1)(a), for the reasons more particularly described below, BMO submits that section 95(1)(a) has no application to the circumstances of this case. As stated below, section 95(1)(a) of the *BIA*, which allows the Court to consider transfers of property between a creditor and an insolvent person dealing at

arm's length during the three months preceding the "date of the initial bankruptcy event", does not apply in this case because there has been no "initial bankruptcy event" as it relates to Genesus or any of the other Debtors. Further, during the cross examination of former officer and director of Genesus, James Long, Mr. Long confirmed that in the summer of 2023, when counsel for BMO and Genesus were negotiating the terms of the Forbearance Agreement, Genesus was not considering making any proposal under the *BIA*:

> 45 Q: Okay. So you didn't, for example, consider making Genesus – when I say "you," I mean you corporately. Genesus wasn't considering making a proposal under the *Bankruptcy and Insolvency Act*?
>
> A: No. We were actively thinking of selling the company.

Long Transcript, page 10, lines 21-24 and page 11, line 1

30. Additionally, during the Cross Examination of Ed Barrington, Senior Account Manager, Special Accounts Management Unit, Western Canada for BMO, Mr. Barrington confirmed BMO's rationale for agreeing to a Forbearance Term beginning on September 30, 2023, and ending on January 15, 2024:

> 34 Q: All right. So that explains that. Why the period of three and a half months? The forbearance period or term specified in the agreement and as outlined in paragraph 40(b) is almost exactly three and a half months. Why that length of time?
>
> A: That's typical of a timeline for a forbearance agreement to give shareholders in the company some time to find alternate financing or a solution to get the Bank of Montreal paid in full.

Barrington Transcript, page 13, lines 14-22

31. Further, Genesus was "positive" that the forbearance term was reasonable time to try to negotiate and culminate a sale of its assets.

Long Transcript, page 14, lines 19-25 and page 15, lines 1-2

32. BMO therefore submits that Sea Air has failed to establish that BMO or Genesus had the requisite intent to defraud, delay or defeat any other creditors of Genesus or Can-Am within the meaning of section 2 of the *FCA*, and further submits that registration of the Second Mortgage falls outside the application of section 2 of the *FCA*. This Court ought not infer any fraudulent intent on the part of BMO in registering the Second Mortgage.

Sufficient consideration was provided by BMO to the Debtors for the registration of BMO's Second Mortgage.

33. Sea Air alleges that the Forbearance Agreement was insufficient consideration for the registration of BMO's Second Mortgage.

34. However, it is trite that forbearance from suit constitutes valid consideration. In *Beazer v Tollestrup Estate*, the Alberta Court of Appeal stated as follows regarding consideration:

> **41** A contract requires consideration. <u>Consideration is "some right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other</u>": *Spruce Grove (Town) v. Yellowhead Regional Library Board (1982)*, 1981 ABCA 369

Beazer v Tollestrup Estate, 2017 ABCA 429 at para 41 [TAB 5]

35. In *Alberta Drywall Supply Ltd. v Hauk*, the Alberta Court of Queen's Bench was asked to determine whether forbearance by the plaintiff corporation from commencing action against the defendant was sufficient consideration for the registration of a mortgage against title to the defendants' property, in favour of the plaintiff.

Alberta Drywall Supply Ltd. v Hauk, 1984 CarswellAlta 261 (ABQB) ("_Hauk_") [TAB 6]

36. In that case, one of the defendants had personally guaranteed the indebtedness of a corporation controlled by both defendants to the plaintiff. To prevent legal action on the guarantee, the defendants granted a mortgage to the plaintiff but subsequently declared personal bankruptcy. The plaintiff commenced foreclosure proceedings and the defendants alleged, *inter alia*, that

insufficient consideration had been provided to them by the plaintiff with respect to the granting of the mortgage.

***Hauk*, *supra* at para 19 [TAB 6]**

37. In concluding that the plaintiff had provided sufficient consideration for the granting of the mortgage, the Alberta Court stated:

> **19** [...] According to the evidence, [the defendant] was personally indebted to the plaintiff under a guarantee at the time the mortgage was granted, and the consideration given by the plaintiff for the mortgage was the forbearance of the plaintiff to take action against [the defendant] on his guarantee [...]
>
> **20** It is trite law that forbearance to sue is good consideration, and there can be no doubt that there was good consideration so far as [the defendant] was concerned.

***Hauk*, *supra* at paras 19-20 [TAB 6]**

38. As previously stated herein, ample consideration was provided by BMO to the Debtors with respect to the registration of BMO's Second Mortgage.

39. Specifically, BMO agreed to enter into the Forbearance Agreement, at the Debtors' request and did not take action against the Debtors throughout the Forbearance Term. Instead, BMO allowed Genesus to continue operating throughout the Forbearance Term and after the expiry of the Forbearance Agreement, during which time Genesus continued to use assets and the available funds in the Deposit Account, secured to BMO, to pay other creditors subordinate to BMO in the ordinary course of its business, without making any payments to BMO to reduce the Debt. Interest also continued to accrue on the Operating Line, both throughout the Forbearance Term and after the expiry of the Forbearance Agreement, without any interest payments being made by the Debtors, to BMO's detriment.

Third Barrington Affidavit at paras 13-15 and 43

40. The Second Mortgage was provided by the Debtors as consideration to protect BMO's interests in light of the Debt owed by the Debtors to BMO and due to the Debtors' dissipation of BMO's existing Security during the Forbearance Term. The Second Mortgage was also provided as consideration for BMO to continue allowing the Debtors to draw from the Operating Line and to carry on business operations and maintain their animal inventory.

Third Barrington Affidavit, para 50

41. In light of the above, there is no evidence to suggest that Genesus received "no value" or "grossly inadequate" consideration for the granting of the Second Mortgage.

42. Additionally, and as referred to above, it was a term of each of the Debtors' General Security Agreements with BMO, which were executed in or around 2011, that the Debtors granted a charge in favour of BMO with respect to, *inter alia*, all of the Debtors' property, both real and personal, moveable or immovable, both present and future, of whatsoever nature and kind:

> 2. The Debtor hereby
>
> (f) charges in favour of the Bank as and by way of a floating charge its undertaking and all its property and assets, real and personal, moveable or immovable, of whatsoever nature and kind, both present and future, other than property and assets hereby validly assigned or subjected to a specific mortgage and charge and the exceptions hereinafter contained ...

First Barrington Affidavit, para 12, Exh. "H", para 15, Exh. "U", para 18(a), Exh. "W"

43. The effect of this provision in each of the Debtors' General Security Agreements with BMO was that BMO received an equitable mortgage with respect to the Debtors' real Property. As stated by the Manitoba Court in *Winnipeg Mortgage Exchange Ltd. v Winnipeg Mortgage Holdings Ltd.*:

> **67** ... Equitable mortgages of the property of legal owners, on the other hand, are created by some instrument or act which is insufficient to pass the legal title, but which, being founded on valuable consideration, shows the intention of the parties to create a security; or in other words, evidences a contract to do so. The following are common examples of such mortgages:

> ... Any written instrument showing the intention of the parties that a security should be thereby created, although it contains no general words of charge ...

Winnipeg Mortgage Exchange Ltd. v Winnipeg Mortgage Holdings Ltd., 1982 CarswellMan 10 (MBQB) (rev'd on other grounds 1982 CarswellMan 14) [TAB 7]

44. As the Ontario Court of Appeal in *Elias Markets Ltd., Re*, stated:

> **65** In essence, the concept of an equitable mortgage seeks to enforce a common intention of the mortgagor and the mortgagee to secure property for either a past debt or future advances, where that common intention is unenforceable under the strict demands of the common law.

Elias Markets Ltd. Re, 2006 CarswellOnt 5597 (ONCA) at para 65 [TAB 8]

45. In *Bank of Montreal v Wolchansky*, the Alberta Court found that a hypothecation agreement entered into by the debtor and the plaintiff bank containing the words "... I hereby charge the said property for any indebtedness I may have at the Bank of Montreal from time to time" constituted an equitable mortgage.

Bank of Montreal v Wolchansky, 1986 CarswellAlta 388 (ABQB) at para 50 [TAB 9]

46. Additionally, in the bankruptcy context, this Court has recognized that the "holder of an equitable mortgage is a secured creditor in bankruptcy".

Little Souris Holdings Ltd., Re, 1979 CarswellMan 17 (MBQB) at para. 14 [TAB 10]

47. With respect to the real property of a bankrupt, the trustee in bankruptcy "only acquires whatever interest the bankrupt may have had and takes the property subject to unregistered deeds or equitable mortgages".

**_Citifinancial Canada East Corp. v Hurley Estate (Trustee of)_,
2006 NBBR 133 at para 23 [TAB 11]**

Re Weyman, 1929 CarswellOnt 15 (Ont. Supreme Court in Bankruptcy) [TAB 12]

48. Clause 2(f) in each of the Debtors' General Security Agreements evidences the parties' intention to create security, in favour of BMO, with respect to the Debtors' real Property. As a

result, BMO has held an equitable mortgage over Genesus' Property since in or around 2011, which was subsequently registered in the Manitoba Personal Property Registry as the Second Mortgage.

49. BMO submits that as no additional charge in the real Property was created, no further consideration was necessary. And if such consideration was necessary, it was given by the entering into of the Forbearance Agreement. As such, the Second Mortgage is not a "fraudulent conveyance".

The registration of BMO's Second Mortgage against Genesus' and Can-Am's Property was not a "fraudulent preference" within the meaning of section 95 of the *BIA*.

50. Contrary to the allegations set out at paragraphs 7(f) and (g) of the Herman Affidavit, section 95(1)(a) of the BIA does not apply to BMO's Second Mortgage.

51. Section 95(1)(a) of the *BIA* provides as follows:

> **Preferences**
> **95 (1)** A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person
>
> (a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, <u>during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy</u>; and

***BIA*, section 95(1)(a) [TAB 13]**

52. Section 2 of the *BIA* defines the "date of the bankruptcy", and the "date of the initial bankruptcy event", as follows:

> ***date of the bankruptcy***, in respect of a person, means the date of
>
> (a) the granting of a bankruptcy order against the person,

> (b) the filing of an assignment in respect of the person, or
>
> (c) the event that causes an assignment by the person to be deemed;
>
> ***date of the initial bankruptcy event***, in respect of a person, means the earliest of the day on which any one of the following is made, filed or commenced, as the case may be:
>
> (a) an assignment by or in respect of the person,
>
> (b) a proposal by or in respect of the person,
>
> (c) a notice of intention by the person,
>
> (d) the first application for a bankruptcy order against the person, in any case
>
> (i) referred to in paragraph 50.4(8)(a) or 57(a) or subsection 61(2), or
>
> (ii) in which a notice of intention to make a proposal has been filed under section 50.4 or a proposal has been filed under section 62 in respect of the person and the person files an assignment before the court has approved the proposal,
>
> (e) the application in respect of which a bankruptcy order is made, in the case of an application other than one referred to in paragraph (d), or
>
> (f) proceedings under the *Companies' Creditors Arrangement Act*;
>
> ***person*** includes [...] a corporation [...]

53. Canadian Courts have long held that three conditions must be met in order for a payment to a creditor to qualify as a "fraudulent preference" within the meaning of section 95 of the *BIA*. As stated by the New Brunswick Court of Appeal in *St. Anne-Nackawic Pulp Co (Trustee of) v Logistec Stevedoring (Atlantic) Inc.*:

> 4 The law is settled with respect to the interpretation and application of s. 95 of the BIA. In order for a payment to a creditor to qualify as a fraudulent preference three conditions precedent must be met: (1) the payment must have been made within three months of bankruptcy; (2) the debtor must have been insolvent at the date of the payment; and (3) as a result of the payment the creditor must have in fact received a preference over other creditors ...

***St. Anne-Nackawic Pulp Co (Trustee of) v Logistec Stevedoring (Atlantic) Inc.*, 2005 NBCA 55 ("*Logistec*") at para 4 [TAB 14]**

54. The Herman Affidavit alleges that the defined term, “date of the initial bankruptcy event” includes “the commencement of a receivership application in which a bankruptcy order is eventually made”.

Herman Affidavit, para 7(g)

55. There is no authority for this proposition. Further, none of the criteria set out at section 2 of the *BIA* are present in this case. Specifically none of the Debtors made an assignment into bankruptcy; an assignment into bankruptcy was not made in respect of any of the Debtors; none of the Debtors made a proposal in bankruptcy; a proposal in bankruptcy was not made in respect of any of the Debtors; none of the Debtors filed a notice of intention to make a proposal in bankruptcy; an application for a bankruptcy order was not filed against any of the Debtors; and no proceedings were commenced under the Companies’ Creditors Arrangements Act with respect to any of the Debtors, either three months before BMO filed its Notice of Application for the Appointment of a Receiver with respect to the Debtors on February 12, 2024, or at any other time.

Third Barrington Affidavit, para 4

56. As there has been no “bankruptcy” of Genesus, or any of the Debtors, and no “initial bankruptcy event”, the first condition set out in *Logistec* has not been met in this case and the application of section 95(1)(a) of the *BIA* is not triggered.

57. Further, the same “badges of fraud” that have been developed by the Courts in the context of provincial preferences legislation, which are previously identified herein at 22 to 24, are also relevant to the Court’s determination of whether a transfer constitutes a “fraudulent preference” within the meaning of section 95(1)(a). As previously stated, there are no indicia or badges of fraud present in this case.

BMO has not acted contrary to section 4.2 of the *BIA*.

58. Section 4.2(1) of the *BIA* provides:

> **Good faith**
> **4.2 (1)** Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.

***BIA*, *supra*, section 4.2(1) [TAB 13]**

59. The statutory requirement of good faith "requires that an interested party not <u>bring or conduct proceedings for an oblique motive or purpos</u>e" and in relation to a secured creditor "the good-faith requirement relates to a secured creditor's invoking and conduct of insolvency proceedings under the *BIA*.".

***CWB Maxium Financial Inc. v 2026998 Alberta Ltd.*, 2021 ABQB 137 ("*CWB*") at para 59 and 203 [TAB 15]**

60. BMO submits that section 4.2 of the *BIA* does not apply in the circumstances of this case, as Sea Air's challenge is to the validity of the Second Mortgage, not to BMO's commencement of the within Application for the Appointment of a Receiver or its conduct during these proceedings. There is no suggestion, nor any evidence, that BMO commenced the within proceedings for an "oblique' purpose.

61. Alternatively, BMO submits that it has at all times acted in good faith within the meaning of s. 4.2 of the *BIA*.

62. The Alberta Court in *CWB*, relying on the principles established by the Supreme Court of Canada in *Bhasin v Hrynew*, recognized that duty of faith for purposes of section 4.2 of the *BIA* "requires the actor to avoid dishonesty or lying. It does not bind the actor to a duty of loyalty or disclosure. <u>It does not require a party to subordinate its interests</u>".

***CWB*, *supra* at para 202 [TAB 15]**

63. The Court in *CWB* further stated:

> **52** In this context (at para 65), the Supreme Court of Canada [in *Bhasin v Hrynew*] comments that <u>the duty of good faith does not require one party to serve the interests of the other but rather not to undermine the other's interests in bad faith</u>.

CWB, _supra_ at para 52 [TAB 15]

64. Sea Air has failed to point to any evidence of dishonesty on the part of BMO or any evidence suggesting that BMO "lied" to Genesus in the course of negotiating the Forbearance Agreement, through counsel, or in registering the Second Mortgage. There can be no suggestion that BMO was dishonest or "lied to" Sea Air, as BMO has had no dealings with Sea Air and, as previously stated herein, the Forbearance Agreement was executed and the Second Mortgage was registered long before Sea Air's Default Judgment was filed in the Manitoba Court of King's Bench and registered against title to Genesus' Property.

First Barrington Affidavit, para 61(e)

65. There is no evidence that BMO knew that the registration of its Second Mortgage would allegedly delay or defeat other creditors of Genesus. As previously stated herein, BMO only learned of Sea Air's default judgment against Genesus in the context of these proceedings.

First Barrington Affidavit, para 61(e)

66. Regardless, and as previously stated herein, mere knowledge that the registration of security may have the effect of delaying or defeating a debtor's other creditors is insufficient to ground a finding of fraudulent intent under the *FCA*. BMO submits that such knowledge is therefore also an insufficient basis upon which to find a lack of "good faith" within the meaning of s. 4.2 of the *BIA*.

DSTB, _supra_, at para 63 [TAB 2]

67. BMO owes no duty of loyalty to Sea Air and is not required to serve the interests of Sea Air, or any of Genesus' other creditors, nor is it required to subordinate its interests to those of any other creditor of Genesus.

68. Importantly, while Sea Air's default judgment is only as against Genesus, the Second Mortgage was negotiated by counsel for all of the Debtors and was registered against title to the real Property of both Genesus and Can-Am. The registration of the Second Mortgage cannot be said to have been an intentional, "bad faith" or fraudulent attempt to defeat Sea Air's interest with respect to the real Property owned by Genesus, as the Second Mortgage was granted to BMO as consideration for the Forbearance Agreement, the intent of which was, *inter alia*, to allow all of the Debtors time to pursue refinancing or sale of the business as a going concern.

Third Barrington Affidavit, para 50

69. BMO therefore submits that Sea Air has failed to establish any lack of good faith on the part of BMO, or any basis upon which the Court ought to exercise its remedial discretion under s. 4.2(2) of the *BIA*.

The doctrine of equitable subordination does not apply.

70. The doctrine of equitable subordination has not been endorsed by the Supreme Court of Canada. At best, the application of this doctrine has been described by lower Courts in Canada as "sketchy" and has led to "inconclusive results".

***Lloyd's Non-Marine Underwriters v J.J. Lacey Insurance Ltd.*, ("*Lloyd's*") 2009 NLTD 148 at para 50 [TAB 16]**

***U.S. Steel Canada Inc., Re*, 2016 ONCA 662 at para 23 [TAB 17]**

71. In *Indalex Ltd., Re*, the Supreme Court of Canada recognized that while it had previously discussed the doctrine of equitable subordination in *Canada Deposit Insurance Corp. v Canadian Commercial Bank*, [1992] 3 SCR 558, the doctrine had not been endorsed in that decision, and the Supreme Court again declined to do so in *Indalex*.

***Indalex Ltd., Re*, 2013 SCC 6 at para 77 [TAB 18]**

72. Similarly, in *Puratone Corp. Re*, this Court recognized that there would be potential legal impediments to the bringing of a claim for equitable subordination.

***Puratone Corp., Re*, 2013 MBQB 171 at para 33 [TAB 19]**

73. BMO submits that given the uncertainty of the status of the doctrine of equitable subordination in Canada, this is not an appropriate case in which to ask this Court firstly to determine whether the doctrine of equitable subordination applies in Canadian law, or secondly to determine whether the doctrine ought to be applied to the facts of this case.

74. Alternatively, if this Court accepts that the doctrine of equitable subordination forms part of Canadian law, the doctrine ought not be applied in the circumstances of this case, as Sea Air has failed to show that BMO has engaged in any alleged "inequitable conduct" or has obtained any "unfair advantage" in registering the Second Mortgage.

75. In the rare instances where Canadian Courts have elected to apply the doctrine, the allegedly inequitable conduct complained of is far removed and factually distinct from the circumstances of the present case. For example, in *Lloyd's*, the allegedly inequitable conduct included a fraudulent scheme perpetrated by the debtors, whereby one of the debtors illegally

appropriated revenue from insurance policy premiums and funneled that revenue to an affiliated company, which were otherwise due and owing to the plaintiff.

***Lloyd's, supra* at para 51 [TAB 16]**

76. In this case, the terms of the Forbearance Agreement, and the registration of the Second Mortgage, were negotiated between counsel for the Debtors and counsel for BMO, over the course of several months and at the Debtors' request. For the reasons previously stated herein, there is no evidence that BMO acted inequitably

77. BMO therefore submits that the circumstances of this case do not justify the application of the doctrine of equitable subordination.

CONCLUSION

78. In light of the above, BMO submits that there is no basis upon which this Court can find that its Second Mortgage is void or unenforceable, or that it is subordinate to the Sea Air Judgment. BMO therefore respectfully requests that Sea Air's motion ought to be dismissed, with costs payable to BMO.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 31st day of March, 2025.

PITBLADO LLP

Per: ____________________

Catherine E. Howden / Madison Laval
Counsel for the Bank of Montreal

TAB 1

MANITOBA

THE FRAUDULENT CONVEYANCES ACT

C.C.S.M. c. F160

LOI SUR LES TRANSFERTS FRAUDULEUX DE BIENS

c. F160 de la *C.P.L.M.*

As of 30 Mar. 2025, this is the most current version available. It is current for the period set out in the footer below.

It is the first version and has not been amended.

Le texte figurant ci-dessous constitue la codification la plus récente en date du 30 mars 2025. Son contenu était à jour pendant la période indiquée en bas de page.

Il s'agit de la première version; elle n'a fait l'objet d'aucune modification.

LEGISLATIVE HISTORY

The Fraudulent Conveyances Act, C.C.S.M. c. F160

Enacted by	**Proclamation status (for provisions in force by proclamation)**
RSM 1987, c. F160	whole Act: in force on 1 Feb 1988 (Man. Gaz. 6 Feb 1988)

HISTORIQUE

Loi sur les transferts frauduleux de biens, c. F160 de la C.P.L.M.

Édictée par	**État des dispositions qui entrent en vigueur par proclamation**
L.R.M. 1987, c. F160	l'ensemble de la Loi : en vigueur le 1er févr. 1988 (Gaz. du Man. : 6 févr. 1988)

CHAPTER F160

THE FRAUDULENT CONVEYANCES ACT

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Manitoba, enacts as follows:

Definitions

1 In this Act,

"conveyance" includes transfer, assignment, delivery over, payment, gift, grant, alienation, bargain, charge, encumbrance, limitation of use or uses of, in, to or out of real property or personal property, by writing or otherwise; (« transfert »)

"personal property" includes goods, chattels, effects, bills, bonds, notes and securities, and shares, dividends, premiums and bonuses in any bank, company or corporation, and any interest therein; (« biens personnels »)

"real property" includes lands, tenements, hereditaments, and any estate or interest therein. (« biens réels »)

When conveyances declared void as against creditors

2 Every conveyance of real property or personal property and every bond, suit, judgment, and execution at any time had or made, or at any time hereafter to be had or made, with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties, or forfeitures is void as against such persons and their assigns.

CHAPITRE F160

LOI SUR LES TRANSFERTS FRAUDULEUX DE BIENS

SA MAJESTÉ, sur l'avis et du consentement de l'Assemblée législative du Manitoba, édicte :

Définitions

1 Les définitions qui suivent s'appliquent à la présente loi.

« biens personnels » Y sont assimilés les objets, effets, effets de commerce, obligations, billets, valeurs mobilières, actions, dividendes, primes, bonis d'une banque, compagnie ou corporation et tout domaine ou intérêt à l'égard de ces biens. ("personal property")

« biens réels » Y sont assimilés les biens-fonds, tènements, héritages et tout domaine ou intérêt à l'égard de ces biens. ("real property")

« transfert » Y sont assimilés la cession, la délivrance, le paiement, la donation, l'octroi, l'aliénation, l'affaire, la charge, la restriction de l'usage relatifs à des biens réels ou personnels, que ce soit par écrit ou autrement. ("conveyance")

Transferts déclarés nuls

2 Les transferts de biens réels ou de biens personnels et les cautionnements fournis, les poursuites engagées, les jugements obtenus et les exécutions effectuées dans l'intention de frustrer d'une façon quelconque des créanciers ou d'autres personnes de leurs actions, poursuites, créances, comptes, dommages-intérêts, pénalités ou déchéances, justes et légitimes, sont nuls à l'égard de ces personnes et de leurs ayants droit.

Saving as to conveyances by tenants in tail

3 Where a conveyance made by a tenant in tail is impeached under section 2, it is nevertheless as valid as against the heirs in tail and all persons entitled in reversion or remainder as if this Act had not been passed.

Transferts effectués par des propriétaires en fief taillé

3 Lorsqu'un transfert effectué par un propriétaire en fief taillé est nul en application de l'article 2, il est néanmoins aussi valide à l'égard des héritiers en fief taillé et de tous les titulaires d'un domaine de réversion ou d'un domaine résiduel que si la présente loi n'avait pas été adoptée.

Saving as to conveyances made bona fide and for good consideration

4 Section 2 does not extend to any estate or interest in real property or personal property conveyed upon good consideration and bona fide to any person not having, at the time of the conveyance to him, notice or knowledge of that intent.

Transferts effectués de bonne foi

4 L'article 2 ne s'applique pas à un transfert de biens réels ou personnels effectué pour une contrepartie valable et de bonne foi à une personne qui, au moment du transfert, n'a pas été avisée ou n'a pas connaissance de l'intention prévue à cet article.

How far valuable consideration and intent to pass interest to avail

5 Section 2 applies to every conveyance executed with the intent in that section set forth, notwithstanding that it may be executed upon a valuable consideration and with the intention, as between the parties thereto, of actually transferring to, and for the benefit of, the transferee the interest expressed to be thereby transferred, unless it is protected, under section 4, by reason of bona fides and want of notice or knowledge on the part of the purchaser.

Application de l'article 2

5 L'article 2 s'applique à tout transfert effectué dans l'intention prévue à cet article, même si le transfert peut être effectué pour une contrepartie valable et dans l'intention, entre les parties au transfert, de transmettre réellement au cessionnaire, et à son profit, l'intérêt déclaré être transmis de cette façon, à moins que ce transfert ne soit protégé, en application de l'article 4, en raison de la bonne foi de l'acheteur et du fait que celui-ci n'a pas été avisé ou n'a pas connaissance de l'intention prévue à l'article 2.

TAB 2

2020 MBQB 142
Manitoba Court of Queen's Bench

DSTB Inc. v. McGregor Landscaping & Design et al.

2020 CarswellMan 373, 2020 MBQB 142, 14 P.P.S.A.C. (4th) 1, 168 W.C.B. (2d) 234, 326 A.C.W.S. (3d) 256

DSTB Inc. (Plaintiff) and McGREGOR LANDSCAPING & DESIGN INC. and TAVIS McGREGOR (Defendants)

Grammond J.

Judgment: October 8, 2020
Docket: Winnipeg Centre CI 18-01-17130

Counsel: Paul D. Edwards, Tashia L. Dreger, for Plaintiff
No one for Defendants
Sarah R. McEachern, James (Jesse) Rock, for Moving Party, 7081040 Manitoba Ltd.

Subject: Civil Practice and Procedure; Contracts; Corporate and Commercial; Criminal; Estates and Trusts; Evidence; Insolvency

Related Abridgment Classifications

Debtors and creditors
III Garnishment
III.3 Practice and procedure
III.3.m Miscellaneous

Headnote

Debtors and creditors --- Garnishment — Practice and procedure — Miscellaneous

Plaintiff company D provided business consulting, accounting and administrative services to corporate defendant in 2015 and 2016 — D made loans to defendant after it became clear that defendant required outside source of funding — Another financial services company, J, began providing accounting services to defendant in 2018, and determined that defendant was in debt and experiencing cash flow issues — Defendant and J executed eight documents assigning some receivables — In October 2018, plaintiff obtained order for garnishment before judgment, and sum of $113,350.90 was attached representing eight accounts receivable issued by defendant to paving company and construction company — J brought motion for declaration that it purchased receivables, such that order should be rescinded against paving and construction companies with funds being paid out to J — Motion granted in part — Issue was whether all or part of funds were debt due and payable by paving and construction companies to defendant at time notices of garnishment were served — Language in agreement was unconditional and conveyed absolute assignment of receivables from defendant to J — Since sequence of events concerning agreement 8 were unclear, J failed to meet evidentiary burden regarding that agreement — Order was rescinded as against paving and construction companies with respect to invoices covered by four agreements, and funds paid with respect to those receivables were to be paid to J.

Table of Authorities

Cases considered by *Grammond J.*:

Aebig v. Miller Contracting Ltd. (1993), 81 B.C.L.R. (2d) 221, 11 C.L.R. (2d) 155, 1993 CarswellBC 181 (B.C. S.C.) — considered

Bank of Nova Scotia v. Bass (1983), 47 C.B.R. (N.S.) 203, 22 Man. R. (2d) 153, 1983 CarswellMan 28 (Man. Q.B.) — considered

Best Brand Meats Ltd. v. Jack Forgan Meat Ltd. (1998), 128 Man. R. (2d) 150, 1998 CarswellMan 312, 23 C.P.C. (4th) 173 (Man. Q.B.) — considered

Bomek v. Bomek (1983), [1983] 3 W.W.R. 634, 20 Man. R. (2d) 150, 21 B.L.R. 205, 146 D.L.R. (3d) 139, 1983 CarswellMan 97 (Man. C.A.) — referred to

Canada Trustco Mortgage Corp. v. Port O'Call Hotel Inc. (1996), 39 C.B.R. (3d) 157, 27 B.L.R. (2d) 147, (sub nom. *Pigott Project Management Ltd. v. Land-Rock Resources Ltd.*) [1996] 5 W.W.R. 153, (sub nom. *Pigott Project Management Ltd. v. Land-Rock Resources Ltd.*) 38 Alta. L.R. (3d) 1, (sub nom. *Pigott Project Management Ltd. v. Land-Rock Resources Ltd.*) 11 P.P.S.A.C. (2d) 1, (sub nom. *Pigott Project Management Ltd. v. Land-Rock Resources Ltd.*) [1996] 1 C.T.C. 395, (sub nom. *Minister of National Revenue v. Alberta (Treasury Branches)*) 196 N.R. 105, (sub nom. *Minister of National Revenue v. Alberta (Treasury Branches)*) 184 A.R. 1, (sub nom. *Minister of National Revenue v. Alberta (Treasury Branches)*) 122 W.A.C. 1, (sub nom. *Alberta (Treasury Branches) v. Minister of National Revenue*) 133 D.L.R. (4th) 609, (sub nom. *Alberta (Treasury Branches) v. Minister of National Revenue*) [1996] 1 S.C.R. 963, (sub nom. *R. v. Alberta Treasury Branches*) 96 D.T.C. 6245, [1996] G.S.T.C. 17, (sub nom. *R. v. Province of Alberta Treasury Branches*) 4 G.T.C. 6103, 1996 CarswellAlta 366, 1996 CarswellAlta 366F (S.C.C.) — considered

Couiyk v. Couiyk (1999), 1999 CarswellBC 2676, 25 B.C.T.C. 208 (B.C. S.C.) — considered

Creston Moly Corp. v. Sattva Capital Corp. (2014), 2014 SCC 53, 2014 CSC 53, 2014 CarswellBC 2267, 2014 CarswellBC 2268, 373 D.L.R. (4th) 393, 59 B.C.L.R. (5th) 1, [2014] 9 W.W.R. 427, 461 N.R. 335, 25 B.L.R. (5th) 1, 358 B.C.A.C. 1, 614 W.A.C. 1, (sub nom. *Sattva Capital Corp. v. Creston Moly Corp.*) [2014] 2 S.C.R. 633 (S.C.C.) — considered

Evans Coleman & Evans Ltd. v. R.A. Nelson Construction Ltd. (1958), 27 W.W.R. 38, 16 D.L.R. (2d) 123, 1958 CarswellBC 139 (B.C. C.A.) — considered

Garland v. Consumers' Gas Co. (1998), 1998 CarswellOnt 4053, 1998 CarswellOnt 4054, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 40 O.R. (3d) 479 (note) (S.C.C.) — considered

Glenko Enterprises Ltd. v. Keller (2000), 2000 MBCA 7, 2000 CarswellMan 467, [2001] 1 W.W.R. 229, 5 C.L.R. (3d) 1, 150 Man. R. (2d) 1, 230 W.A.C. 1 (Man. C.A.) — considered

India Films Overseas Ltd. v. Keefer Investments Inc. (1984), 55 C.B.R. (N.S.) 154, 1984 CarswellBC 603 (B.C. S.C.) — referred to

Lane v. Merchants Consolidated Ltd. (1990), [1990] 3 W.W.R. 364, 78 C.B.R. (N.S.) 131, 67 D.L.R. (4th) 576, 63 Man. R. (2d) 267, 1990 CarswellMan 25 (Man. Q.B.) — considered

Quick Auto Lease Inc. v. Nordin (2014), 2014 MBCA 32, 2014 CarswellMan 122, 303 Man. R. (2d) 262, 600 W.A.C. 262 (Man. C.A.) — considered

Royal Bank v. Kenward (1925), [1925] 3 W.W.R. 549, 35 Man. R. 301, [1925] 4 D.L.R. 905, 1925 CarswellMan 51 (Man. C.A.) — considered

Royal Bank v. O'Brien (1997), [1997] 9 W.W.R. 439, 1997 CarswellMan 420, 49 C.B.R. (3d) 5, 122 Man. R. (2d) 1, 34 B.L.R. (2d) 1 (Man. Q.B.) — considered

Royal Bank v. Thiessen (1981), 38 C.B.R. (N.S.) 284, 1981 CarswellMan 21, 12 Man. R. (2d) 260 (Man. Q.B.) — followed

TCE Capital Corp. v. Lainas (1999), 1999 CarswellOnt 1626, 96 O.T.C. 380 (Ont. Gen. Div.) — distinguished

Winnipeg Enterprises Corp. v. 4133854 Manitoba Ltd. (2008), 2008 MBCA 23, 2008 CarswellMan 63, 37 B.L.R. (4th) 216, [2008] 3 W.W.R. 579, (sub nom. *Winnipeg Enterprises Corp. v. Canada Customs & Revenue Agency*) 2008 G.T.C. 1232 (Eng.), 225 Man. R. (2d) 189, 419 W.A.C. 189, [2008] G.S.T.C. 59 (Man. C.A.) — considered

5009678 Ontario Inc. v. Rock Developments Inc. (2020), 2020 ONSC 630, 2020 CarswellOnt 1256 (Ont. S.C.J.) — considered

Statutes considered:

Builders' Liens Act, R.S.M. 1987, c. B91

Generally — referred to

s. 4 — considered

s. 4(2) — considered

s. 4(4) — considered

s. 6(2) — considered
Court of Queen's Bench Act, S.M. 1988-89, c. 4
s. 61 — considered
Criminal Code, R.S.C. 1985, c. C-46
Generally — referred to

s. 347 — considered

s. 347(1) — considered

s. 347(2) "credit advanced" — considered

s. 347(2) "criminal rate" — considered

s. 347(2) "interest" — considered
Fraudulent Conveyances Act, R.S.M. 1987, c. F160
Generally — referred to

s. 2 — considered
Garnishment Act, R.S.M. 1987, c. G20
s. 4(1)(a) — considered
Personal Property Security Act, S.M. 1993, c. 14
Generally — referred to
Unconscionable Transactions Relief Act, R.S.M. 1987, c. U20
Generally — referred to

s. 1 "money lent" — considered

s. 2 — considered

s. 3(c) — considered

Rules considered:
Queen's Bench Rules, Man. Reg. 553/88
R. 37.11(1) — considered

MOTION by financial services company for declaration that it purchased receivables from defendant, such that garnishment order in favour of plaintiff should be rescinded.

***Grammond J.*:**

INTRODUCTION

1 The plaintiff claims from the defendants repayment of a series of loans in the aggregate amount of $146,857.96 (the "Loans").

2 On October 25, 2018, the plaintiff obtained an order for garnishment before judgment, without notice, naming a number of garnishees (the "Order"). Notices of garnishment before judgment issued on November 1, 2018, and thereafter the sum of $113,350.90 was attached (the "Funds"), representing eight accounts receivable (the "Receivables") issued by the corporate defendant to Bituminex Paving Ltd. ("Bituminex") and Maple Leaf Construction Ltd. ("Maple Leaf") between September 17 and October 31, 2018.

3 7081040 Manitoba Ltd. carrying on business as Jackie Challoner Financial Services ("JCFS") seeks a declaration that it purchased the Receivables pursuant to a series of valid and enforceable assignment agreements, such that the Order should be rescinded against Bituminex and Maple Leaf, and the Funds paid out to JCFS.

BACKGROUND

4 In late 2015 and early 2016 the plaintiff provided business consulting, accounting and administrative services to the corporate defendant. The plaintiff was familiar with the defendants' financial position and made the Loans after it "became clear that the defendants required an outside source of funding".

5 JCFS began providing accounting services to the corporate defendant in January 2018. It became apparent to JCFS that the corporate defendant was "in debt and experiencing cash flow issues" and was "experiencing difficulty in managing its accounts".

6 Between June and November 2018 the defendants and JCFS executed eight documents entitled "Agreement of Assignment of Part of Receivables and their Administration" (collectively the "Agreements"). Five of the Agreements relate to the Receivables at issue on this motion.

7 On March 26, 2019, the individual defendant filed for bankruptcy. His trustee did not take a position on this motion.

POSITION OF THE PARTIES

JCFS

8 JCFS submitted that pursuant to the Agreements it took absolute assignments of the Receivables, such that the corporate defendant no longer had either an interest in them or a creditor/debtor relationship with Bituminex or Maple Leaf. Accordingly, when the Order was obtained, the Funds were not owing to the corporate defendant and could not be garnished.

The plaintiff

9 The plaintiff argued that the Agreements documented a series of loans made by JCFS to the defendants, and that:

a) the June 7, 2018 Agreement ("Agreement #1") caused the subsequent Agreements to be void;

b) the Agreements are unenforceable pursuant to s. 347 of the *Criminal Code*, R.S.C. 1985, c. C-46 (the "*Code*");

c) the Agreements are void pursuant to s. 2 of *The Fraudulent Conveyances Act*, C.C.S.M. c. F160 (the "*FCA*");

d) the Agreements should be set aside under *The Unconscionable Transactions Relief Act*, C.C.S.M. c. U20 (the "*UTRA*");

e) the October 29, 2018 and November 2, 2018 Agreements ("Agreements #7 and #8 respectively) post-date the Order and cannot supersede it; and

f) JCFS did not register the Agreements in the Personal Property Registry (the "PPR") until 2019 and did not otherwise give notice of the Agreements, to the plaintiff's prejudice.

RELEVANT LEGAL PRINCIPLES

10 JCFS pointed to s. 4(1)(a) of *The Garnishment Act*, C.C.S.M. c. G20, which provides:

Debts bound

4(1) Subject to this Act, service of a garnishment order on a garnishee binds

(a) any debt due or accruing due at the time of service from the garnishee to the defendant or judgment debtor, other than wages;

. . . . .

11 Section 61 of *The Court of Queen's Bench Act*, C.C.S.M. c. C280, however, provides as follows:

Garnishment before judgment

61 In an action in which the plaintiff claims the payment of a debt or liquidated demand, the court may, on motion and in accordance with *The Garnishment Act*, order garnishment before judgment of a debt due and payable by a third party to a defendant.

12 In *Best Brand Meats Ltd. v. Jack Forgan Meat Ltd.* [1998 CarswellMan 312 (Man. Q.B.)], 1998 CanLII 28078, Master Lee, as he then was, considered a motion to revoke an order for garnishment before judgment. He stated:

[5] The **Garnishment Act** does not specifically address the matter of garnishment before judgment. A garnishment before judgment is an extraordinary remedy which is provided for pursuant to the **Court of Queen's Bench Act** and the court rules. ...

. . . . .

[8] ... Section 4(1) of the **Garnishment Act** provides that service of a notice of garnishment binds

(a) Any debt due or accruing due at the time of service ...

[9] However, I am persuaded that this is a general provision relating to garnishment after judgment and that s. 61 of the **Court of Queen's Bench Act** restricts a plaintiff to garnishing only "a debt due and payable". I am satisfied that the specific wording "due and payable" is more restrictive than the wording "due or accruing due". ...

[10] For a debt to be garnisheed before judgment it must be both due and payable at the time of service of the notice of garnishment. ...

13 I agree with Master Lee's analysis. Section 61 of *The Court of Queen's Bench Act* applies to this motion, and the broad issue to be determined is whether all or part of the Funds were a "debt due and payable" by Bituminex and/or Maple Leaf to the corporate defendant at the time the notices of garnishment were served. In other words, did the Agreements extinguish the corporate defendant's interest in the Receivables, such that the Funds were unavailable for garnishment by the plaintiff, or did the corporate defendant grant to JCFS a security interest in the Receivables in exchange for a series of loans?

14 In *Evans Coleman & Evans Ltd. v. R.A. Nelson Construction Ltd.* [1958 CarswellBC 139 (B.C. C.A.)], 1958 CanLII 226, the court considered the competing interests of a garnishing order and a general assignment of book debts. The court stated (at pages 125-26):

As between the assignor and the appellant (assignee) the assignment, which is an equitable assignment, is absolute and complete without notice having been given to the debtors. The respondent stands in the same position as the assignor. Its right depends upon the debt belonging to the assignor when the garnishing order was issued and the assignor (defendant) having already parted with the debt under an assignment, good as between it and the appellant (assignee), the garnishing order could not attach it.

15 In *Canada Trustco Mortgage Corp. v. Port O'Call Hotel Inc.*, [1996] 1 S.C.R. 963 (S.C.C.) [hereinafter Alberta (Treasury Branches)], the court commented upon the nature of an absolute assignment, as compared with a security interest. It stated:

22 ... the same instrument cannot be both a "security interest" and an "absolute assignment". If an instrument is an absolute assignment, then since it is complete and perfect in itself, there cannot be a residual right remaining with the debtor to recover the assets. By definition, a complete and perfect assignment cannot recognize the concept of an equity of

redemption. An absolute assignment cannot function as a means of "securing" the payment of a debt since there would be no basis for the debtor to recover that which has been absolutely assigned. An absolute assignment is irrevocable. ...

[Emphasis in original.]

. . . . .

30 ... In an absolute assignment, all interests are transferred and no property remains in the hands of the assignor. It is, simply, a sale of the book debts of the company. This is the basis of the business of factoring. Factoring is described in R. Burgess, *Corporate Finance Law* (2nd ed. 1992), at p. 100, in this manner:

> Factoring is a legal relationship between a financial institution (the factor) and a business concern (the client) selling goods or providing services to trade customers (the customers) whereby the factor purchases the client's book debts either with or without recourse to the client and administers the client's sales ledger.

. . . . .

31 A factoring of accounts receivable is based upon an absolute assignment of them. It is in effect a sale by a company of its accounts receivable at a discounted value to the factoring company for immediate consideration. ...

16 *Alberta (Treasury Branches)* was cited in *Winnipeg Enterprises Corp. v. 4133854 Manitoba Ltd.*, 2008 MBCA 23 (Man. C.A.) (CanLII), where the court considered whether a contract created an absolute assignment or a security interest. MacInnes J.A. stated:

17 To discern the contractual intention of the parties at the time of the creation of the document, one must consider the language of the document itself and, as well, the evidence of the parties as to the surrounding circumstances existing at the time of the document's creation; in other words, the overall factual matrix or context at the relevant time.

. . . . .

[30] Every absolute assignment is irrevocable because it must be in order to be absolute. The essence of an absolute assignment is that once the assignment has been granted, the subject matter is gone. Thus, an absolute assignment cannot be revoked.

[31] On the other hand, the subject matter of an assignment that is not absolute is given on terms, the terms of the assignment document itself, and may revert to the assignor.

17 In *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 (S.C.C.) (CanLII), the court stated:

[57] While the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement (*Hayes Forest Services*, at para. 14; and Hall, at p. 30). The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract (Hall, at pp. 15 and 30-32). While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement (*Glaswegian Enterprises Inc. v. B.C. Tel Mobility Cellular Inc.* (1997), 1997 CanLII 4085 (BC CA), 101 B.C.A.C. 62).

[58] The nature of the evidence that can be relied upon under the rubric of "surrounding circumstances" will necessarily vary from case to case. It does, however, have its limits. It should consist only of objective evidence of the background facts at the time of the execution of the contract (*King*, at paras. 66 and 70), that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting. Subject to these requirements and the parol evidence rule discussed below, this includes, in the words of Lord Hoffmann, "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man" (*Investors Compensation Scheme*, at p. 114). Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

18 I note also the recent decision in *5009678 Ontario Inc. v. Rock Developments Inc.*, 2020 ONSC 630 (Ont. S.C.J.) (CanLII), where the court commented:

> [59] Commercial contracts must be interpreted in a manner that accords with sound commercial principles and good business sense; and avoids a commercial absurdity: see *Bell Canada v. The Plan Group*, 2009 ONCA 548, 96 O.R. (3d) 81 at paras. 37-38.
>
> [60] ... Knowledge of the relevant background information or "*what the parties knew*" may assist the court in understanding vague or obscure references in the contract's terms. An understanding of the context in which a contract was conducted enables the court to give the written text "*the most appropriate meaning which the words can properly bear*": see *Orbus Pharma Inc. v. Kung Man Lee Properties Inc.*, 2008 ABQB 754, 463 A.R. 351at para. 28. ...
>
> .....
>
> [62] Finally, in order to resolve an ambiguity, the court may consider the doctrine of *contra proferentem*, pursuant to which an ambiguity in a contract's terms is interpreted against its drafter ... However, the principle of *contra preferentem* ought to be invoked as a last resort, when all other principles of construction have failed to ascertain the correct meaning of the contract in question ...

ANALYSIS

19 I note at the outset of this analysis that JCFS is not a party to this action, and filed its motion pursuant to Court of Queen's Bench Rule 37.11(1), which provides:

> **Motion to rescind or vary**
>
> 37.11(1) A person affected by an order made without notice ... may, by notice of motion filed, served and made returnable promptly after the order first came to the person's notice, move to rescind or vary the order.

20 The plaintiff did not contest the motion pursuant to any aspect of this rule, and I am satisfied on the evidence that JCFS had proper standing to bring the motion.

21 It is also important to note that there is no evidence before me from either of the defendants. In other words, the only evidence relative to the surrounding circumstances and context in which the Agreements were signed is that of JCFS. The plaintiff has admitted that it had no direct knowledge of the business relationship between the defendants and JCFS, and that its only source of knowledge of their intentions is the evidence filed by JCFS.

22 JCFS's evidence reflects that in early 2018, it discussed with the defendants financial strategies to increase their cash flow and "bridge" the corporate defendant from the winter months to the landscaping season. These strategies included both a loan arrangement and an invoice purchase arrangement. In mid-February 2018, JCFS loaned to the corporate defendant the sum of $16,800, secured by a promissory note.

23 In addition, JCFS assisted the corporate defendant with the formulation of repayment plans to be put forward to its creditors, including the plaintiff, that reconciled 2017 liabilities with the corporate defendant's projected cash flow in the 2018 landscaping season.

24 JCFS's evidence reflects that while the plaintiff rejected the payment plan proposed to it on February 28, 2018, nine of the corporate defendant's other creditors accepted proposals, and arrears were paid. By November 30, 2018, six creditors were paid in full and the remaining three creditors were paid in part.

25 In June 2018, the defendants approached JCFS for a second loan, and there was another discussion about the purchase of accounts receivable, to which the corporate defendant agreed. This approach would increase its cash flow and "allow a third party to manage credit control". On cross-examination, the JCFS representative defined the management of credit control as

keeping the corporate defendant "in line financially with obligations" and "not going ... to a bank to get a loan, to get credit ... without discussing it". JCFS and the corporate defendant also agreed that JCFS would "expressly select receivables to purchase".

26 I will now comment upon the Agreements, which, speaking generally, were not well drafted. On cross-examination, the JCFS representative, a non-lawyer, testified that she obtained a form of assignment from the internet and then modified it for each usage in this case. The defendants reviewed each of the Agreements before execution, and had the opportunity to obtain legal advice, but did not propose changes to the language of the Agreements.

27 I will comment briefly upon Agreement #1, which differed from the other Agreements. I do so only because the plaintiff argued that the language of Agreement #1 caused the balance of the Agreements to be void. Otherwise, the language of Agreement #1 is irrelevant to this motion, because JCFS does not rely upon it, having recouped the purchase price and fee set out in Agreement #1.[1]

28 Agreement #1 is unique because, as written, it applied to accounts receivable owing to the corporate defendant by Maple Leaf from June 6, 2018 to December 31, 2018, whereas most of the subsequent Agreements included reference to specific invoice numbers and amounts. Since Agreement #1 was signed on June 7, 2018, the time frame to which it pertained was mainly prospective, and as the plaintiff argued, if it was valid the Receivables were not available to be assigned pursuant to the subsequent Agreements. JCFS gave evidence that Agreement #1 related to two invoices issued on June 6, 2018 in the amounts of $23,887.07 and $2,312.69, but that evidence is inconsistent with its clear language.

29 Having considered the whole of Agreement #1, together with sound commercial principles, I have concluded that, objectively, the parties did not intend that the corporate defendant would assign to JCFS approximately seven months of future Maple Leaf accounts receivable, in exchange for payment of a fixed price of $15,000. Such an agreement would result in a commercial absurdity, and may be void for uncertainty. For these reasons, I reject the plaintiff's submission that the scope of Agreement #1 caused the balance of the Agreements to be void. To be clear, I make no finding as to the overall validity of Agreement #1, because I need not do so to decide this motion.[2]

30 The details of the Agreements at issue on this motion are:

Agreement #	Date	Invoice Number(s)	Invoice Amount(s)	Debtor
4	September 20, 2018	188	$19,477.50	Bituminex
5	October 12, 2018	193, 195	$25,101.30	Maple Leaf
6	October 19, 2018	196	$4,410.00	Maple Leaf
7	October 29, 2018	199, 200, 202	$30,967.90	Maple Leaf
8	November 1, 2018	203	$33,394.20	Maple Leaf

31 The salient provisions of the Agreements read as follows (note that "a)", "b)" and "c)" do not form part of the Agreements and have been inserted for subsequent reference only):

> a) Based on this Agreement, the Assignor [the defendants] assigns a part of receivables further specified in the Appendix No. 1 of this Agreement (hereinafter referred to as the "*Receivables*") to the Assignee [JCFS] in exchange for a Price, the specific amount of which is also specified in Appendix No. 1 of this agreement; and the Assignee accepts this part of group Receivables in exchange for remuneration which is specified in Article II. of this Agreement and under the conditions specified in the General Terms and Conditions.[3]
>
> b) Once payment ... has been received by the Assignee [JCFS] from [Bituminex or Maple Leaf], the balance of this assignment will be considered paid in full.
>
> c) This Agreement enters into force at the moment of its conclusion and becomes effective at the moment of payment of the Price for the assignment from the Assignee [JCFS] according to article II of this Agreement; i.e. when the Assignor's

[the defendants'] bank account is credited with the amount of the appropriate Price, whilst the details are governed by the General Business Terms and Conditions.

32 As provided in *Winnipeg Enterprises Corp.*, *Sattva Capital Corp.* and *3009678 Ontario Inc.*, I have considered both the language of the Agreements and the context underlying their creation, so as to accord with sound commercial principles and good business sense.

33 The context in which the Agreements were signed is as follows:

a) the corporate defendant had been experiencing ongoing financial difficulties for years;

b) the corporate defendant needed cash flow to meet, among other things, its obligations to nine creditors pursuant to a series of payment plans;

c) JCFS was inexperienced in this type of transaction but was willing to assist the corporate defendant with funding; and

d) the language of the Agreements evolved after the execution of Agreement #1.

34 The subject of Agreements #4 through #8 was clear as between the parties, with reference to a specific invoice number(s) and invoice amount(s) issued by the corporate defendant. In addition, each Agreement specified a fixed purchase price but did not contain language consistent with a loan arrangement, such as reference to an interest charge, an interest calculation mechanism or a repayment requirement. Instead, the Agreements listed a flat fee to be charged by JCFS.

35 While the language of the provision reflected at paragraph 31(a) above is clumsy, I have taken into account the parties' intentions and the factual matrix, and I am satisfied that this language is unconditional and is sufficient to convey an absolute assignment of the Receivables from the corporate defendant to JCFS.

36 The plaintiff argued that the provision set out at paragraph 31(b) above is consistent with a loan agreement and should be construed against JCFS as the drafter of the Agreements pursuant to the principle of *contra proferentem*. I agree that the reference to "the balance of this assignment" is troubling, because that concept is more consistent with an ongoing liability to JCFS than with an absolute assignment of the Receivables. In other words, if JCFS purchased the Receivables outright, it would have assumed a risk that it would not be paid if, for example, either Bituminex or Maple Leaf encountered financial difficulties or raised an issue with the work performed by the corporate defendant. In an absolute assignment there would be no "balance" of the Agreement to be addressed, because payment "in full" would occur when JCFS paid the purchase price to the corporate defendant, and payment to JCFS by the debtor would be irrelevant. Having considered this provision in light of the entire contract, however, together with the surrounding circumstances and objective intentions of the parties, I have concluded that it does not derogate from the assignment clause set out at paragraph 31(a) above. In other words, I have concluded that Agreements #4 to #8 constituted absolute assignments of the Receivables, and not loan arrangements secured by the Receivables.

37 Although the provision referenced at paragraph 31(c) above is also worded poorly, I am satisfied that the parties intended for the Agreements to take effect when JCFS paid the purchase price to the corporate defendant. The documentary evidence of payments made by JCFS is detailed and was not contested. I have concluded, therefore, that JCFS paid to the corporate defendant the purchase price specified in each of the Agreements, and that the effective date of each Agreement can be discerned from the evidence before me.

38 I will now consider each of the plaintiff's remaining arguments.

The Code

39 Section 347(1) of the *Code* provides that "every one who enters into an agreement or arrangement to receive interest at a criminal rate, or receives a payment or partial payment of interest at a criminal rate" is guilty of an offence.

40 Section 374(2) of the *Code* reflects the following definitions:

> ***interest*** means the aggregate of all charges and expenses, whether in the form of a fee ... or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by ... the person to whom the credit is ... advanced ...;
>
> ***criminal rate*** means an effective annual rate of interest calculated in accordance with generally accept actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;
>
> ***credit advanced*** means the aggregate of the money ... advanced ... under an agreement or arrangement minus the aggregate of any ... fee ... directly or indirectly incurred under the ... agreement or arrangement;

41 In *Garland v. Consumers' Gas Co.* [1998 CarswellOnt 4053 (S.C.C.)], 1998 CanLII 766, the court found that a 5% late payment penalty was a breach of the *Code*, because the annual rate charged was over 60% for a period of time. The court stated that s. 347 imposes a "generally applicable ceiling on all types of credit arrangements without regard to the sophistication of the parties or the amount in issue" (para. 23), and that it "applies to a very broad range of commercial and consumer transactions involving the advancement of credit, including secured and unsecured loans, mortgages and commercial financing agreements" (para. 25). In other words, I must consider whether the percentage-based fee charged by JCFS offends the *Code*.

42 The court in *Garland* also stated:

> [30] ... not every charge or expense will be subject to the criminal interest rate provision. In order to constitute "interest" under s. 347, a charge — whatever its form — must be "paid or payable for the advancing of credit under an agreement or arrangement" (emphasis added) ... The issue is whether [the] penalty constitutes, in substance, a cost incurred by customers to receive credit under an arrangement with Consumers' Gas.
>
> . . . . .
>
> [37] ... If every sale, performance of services or conveyance of benefits were understood to be and advance of "credit", there would be virtually no limit to the application of s. 347. That section, despite its broad scope, is essentially concerned with regulating the relationship between creditors and debtors, not the relationship between commercial actors in the ordinary course of business.

43 The plaintiff argued that the purpose of the Agreements in this case was to get money into the hands of the defendants, and for JCFS to make a profit. The plaintiff provided a chart reflecting its calculations of the "interest rate" charged by JCFS pursuant to the Agreements, ranging from 63.12% to 338.7%, depending upon the number of days each "loan" was outstanding.

44 The law is clear that s. 347 applies to transactions in which credit is advanced. The court in *Garland* considered the notion of "credit advanced" as including loans of money and deferrals of payment. The court stated specifically that no credit is advanced where a purchase price is due on the date specified in a purchase agreement. In this case, the Agreements took effect when JCFS paid the purchase price to the corporate defendant.

45 The plaintiff pointed to the case of *TCE Capital Corp. v. Lainas* [1999] O.J. No. 1963 (Ont. Gen. Div.) (QL), where the court considered a factoring transaction involving the payment of a flat administrative fee, a discount calculated as a flat daily fee for 30 days, and a holdback to be paid to the assignor if and when the assignee was paid by the debtors. The court characterized the transaction as a loan, and concluded that the annual effective interest rate was between 77.4% and 80.37%.

46 *TCE Capital Corp.* is distinguishable from this case on its facts because the "factoring" arrangement was for a specified term, and included a holdback. Both of those aspects of the transaction are very different than in this case. Moreover, in *TCE Capital Corp.* the assignee sued the assignor on the debts, which is incongruous with an absolute assignment.

47 I cannot conclude on the facts of this case that JCFS either advanced credit to the defendants, or charged them interest as defined in the *Code*. The Agreements simply do not bear out that interpretation of the transactions. Rather, JCFS purchased the Receivables outright and in doing so charged the corporate defendant a fee.

48 For all of these reasons, s. 347 of the *Code* does not apply in this case.

The FCA

49 Section 2 of the *FCA* provides:

> **When conveyances declared void as against creditors**
>
> 2 Every conveyance of ... personal property ... at any time ... made, or at any time hereafter to be ... made, with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties, or forfeitures is void as against such persons and their assigns.

50 In *Royal Bank v. Thiessen*, [1981] M.J. No. 45 (Man. Q.B.) (QL), (1981), 12 Man. R. (2d) 260 (Man. Q.B.), the court stated, with respect to the *FCA*:

> 11 The main question to be determined is that of intent which is the most important aspect of the relevant sections of the Act. Mr. Thiessen testified that the conveyance was made on the advice of the company's and his accountant for tax planning purposes. ...
>
> 12 Planning by individuals or companies to lawfully avoid taxes is not fraud nor is it evidence of intention to defeat creditors. The intention necessary under the Fraudulent Conveyances Act must be established with some certainty. ...

51 In *Bank of Nova Scotia v. Bass*, [1983] M.J. No. 52 (Man. Q.B.) (QL), (1983), 22 Man. R. (2d) 153 (Man. Q.B.), the court stated:

> 7 If a conveyance is made for good consideration which defeats or delays creditors, the plaintiff must show the fraudulent intent of both the grantor and the grantee. If, however, the conveyance is voluntary, it is only necessary to show the fraudulent intent of the grantor.

52 In *Royal Bank v. O'Brien* [1997 CarswellMan 420 (Man. Q.B.)], 1997 CanLII 22778, the court stated:

> 16 Courts and writers have identified typical and suspicious fact situations which are often described as "badges" or "inferences" of fraud. These situations, taken separately, or combined, may (but not necessarily will) result in a finding of fraud, if proven. The following list (and it is not intended to be comprehensive) of "badges" or "inferences" of fraud is summarized from Springman, Stewart and MacNaughton's text, *Fraudulent Conveyances and Preferences* (1994 ed.) and are found at pp. 13-11 to 13-14:
>
> 1) the gift was of most, if not all, of the property owned by a debtor;
>
> 2) the debtor continued in possession and used or benefitted from the property after the conveyance;
>
> 3) the consideration is grossly inadequate;
>
> 4) there is unusual haste to make the transfer;
>
> 5) a close relationship exists between the parties to the conveyance;
>
> 6) the property is transferred to a grantee without his or her knowledge;
>
> 7) the transfer of property creates a trust and trusts are used to conceal or cover a fraud;
>
> To this list I would add the following:
>
> 8) a debtor continues to represent to a lender that the property, or the equity in the property, remains part of the net worth of the debtor for purposes of obtaining financing or further financing (at a point in time after title to the property has been conveyed and without disclosing to the lender that title was transferred).

53 The plaintiff relied upon these badges of fraud in support of its argument that the Agreements were part of a scheme to defeat, hinder and/or delay (but not to defraud) creditors, of which JCFS was the architect and in which JCFS advised or encouraged the defendants to participate "at a time when the corporate defendant was exposed to numerous litigants". The plaintiff contended that the effect of the scheme was to:

a) make the Receivables unavailable to the defendants' creditors, including the plaintiff, and to preserve those funds for JCFS and the defendants; and

b) provide cash to the defendants earlier than would have been the case otherwise, to reduce the risk of the Receivables being executed upon by other creditors.

54 The plaintiff alleged that the individual defendant entered into the Agreements on behalf of the corporate defendant because JCFS told him to do so, he was desperate financially, he had no bargaining power and he wanted to continue his salary from the corporate defendant.

55 The plaintiff also alleged that on November 8, 2018 the individual defendant's wife incorporated ML Design & Contracting Inc. ("ML Design"), to which the corporate defendant's insurance policies were transferred and accounts payable were directed.

56 JCFS denied both that the Agreements were entered into with any fraudulent intent and that there is any evidence of such an intent. JCFS emphasized that it paid for the Receivables and is out-of-pocket the sum of $96,348.27, for which it received no benefit outside the terms of the Agreements.

57 I have already accepted that JCFS paid the purchase price provided in each of the Agreements, of 85% of the Receivables, which was good consideration. I also accept that the effect of the Agreements, if this motion is granted, may be to defeat, delay and/or hinder the plaintiff's claim, to the extent that it cannot otherwise collect on the Loans, if liability is established. As set out in *Bank of Nova Scotia* however, where a conveyance is made for good consideration which defeats or delays creditors, the plaintiff must show the fraudulent intent of both the corporate defendant and JCFS. In assessing the parties' intentions, I must look at the surrounding circumstances including the parties' financial affairs and their relationship, and I must scrutinize their testimony with care and suspicion.[4]

58 The plaintiff tendered evidence regarding a number of claims filed against the defendants, or one of them, including:

a) five claims that were discontinued on or before November 30, 2017. Since those resolutions pre-date the events material to this motion, they are not relevant to the issues before me;

b) three claims filed against the individual defendant, but not the corporate defendant, that were pending as a claim or judgment at the time of his bankruptcy in March 2019. Since the individual defendant was not truly a party to the assignments[5] these claims are also irrelevant to this motion; and

c) one claim filed against both defendants by Isaku Construction, and discontinued on March 1, 2018. This plaintiff was one of the nine creditors with which payment plans were agreed upon, as set out in paragraph 24 above.

59 In my view, the existence of these claims does not support the plaintiff's argument pursuant to the *FCA*. Rather, the claims confirm the defendants' financial difficulties, and their success in addressing some of their debts.

60 Similarly, there is *no* evidence to support the plaintiff's allegations of why the individual defendant entered into the Agreements, or that the Agreements were related to his personal bankruptcy. Those suggestions are speculative.

61 I have also considered the plaintiff's allegations regarding the incorporation of ML Design. The only evidence before me is the plaintiff's belief that the individual defendant and his wife took that step to avoid creditors. There is no evidence that JCFS had any involvement in or knowledge of the incorporation.

62 The plaintiff's evidence regarding the insurance and accounts payable of the corporate defendant is also problematic, because as filed it is hearsay. The plaintiff's representative has no direct knowledge of the events at issue, and has purported to rely upon what others told him to establish the truth of the statements made.

63 Section 2 of the FCA requires the establishment of an intent to defeat, hinder or delay creditors, which is more than knowledge that certain actions may have that effect. In this case, it is clear that:

a) the corporate defendant was experiencing financial difficulties for years before the Agreements were signed;

b) the defendants and JCFS knew that the plaintiff was one the defendants' largest creditors; and

c) JCFS, and presumably the defendants, knew that the plaintiff could file a claim in court.

64 These facts are insufficient to establish the existence of any "scheme" pursuant to the FCA. Rather, I am satisfied that the corporate defendant, with the assistance of JCFS, attempted to make arrangements with various creditors, including the plaintiff, and that it had the right to sell off its assets, including the Receivables, to improve its cash flow, subject to the provisions of the FCA. As set out in *Royal Bank v. Thiessen*, planning does not necessarily constitute fraud. The Agreements documented a mechanism by which the corporate defendant could receive immediate cash flow, and the evidence reflects that payments to creditors were ongoing through the fall of 2018. In fact, JCFS sent part of the purchase price paid under Agreement #7 directly to one of the corporate defendant's creditors.

65 The evidence in this case does not establish an intention to defeat, hinder or delay creditors, or any of the badges of fraud. The JCFS representative acknowledged on cross-examination that the Receivables may have constituted all of the corporate defendant's unencumbered assets, but she was unclear on the details of its assets, and testified that it may have owned equipment. There is no other evidence before me of what other assets, if any, the corporate defendant had, including the details of any other accounts receivable.

66 I accept that while JCFS had, in a sense, a "close relationship" with the defendants because it provided professional services by which it had knowledge of their finances, it was by all accounts an arms length relationship. The JCFS representative testified on cross-examination that the Receivables were chosen for purchase because Bituminex and Maple Leaf are very large companies representing a "pretty good" risk, and JCFS had discussed with them where the payments would be made. These motives do not, in my view, reflect an intent that violates the FCA.

67 I understand the plaintiff's desire to preserve the Funds for application to the Loans, but the plaintiff's allegations that JCFS and the defendants concocted a "scheme" are speculative. The fact is that some of the defendants' creditors were repaid in full or in part, both before and after the defendants retained JCFS to assist them. In my view, the circumstances of this case are not unusual, in that a business struggled for years before ceasing operations, leaving multiple creditors to attempt to collect from a limited pool of assets.

68 In conclusion, I am not satisfied that the defendants and JCFS had a fraudulent intent to defeat, hinder or delay creditors by entering into the Agreements.

The UTRA

69 Section 2 of the UTRA provides that where, in respect of money lent, the court finds that the cost of a loan is excessive, or a transaction is harsh or unconscionable, it may grant a variety of items of relief.

70 Section 1 of the UTRA defines "money lent" as "money advanced on account of any person in any transaction that, whatever its form may be, is substantially one of money lending or securing the repayment of money so advanced ...".

71 The plaintiff argued that factoring is a form of lending, and pointed to s. 3(c) of the UTRA, which provides that the powers of the court set out in s. 2 may be exercised where "... the amount due ... in respect of money lent is in question". The plaintiff asked that the Agreements be set aside in their entirety.

72 I cannot conclude that the payments made by JCFS constituted "money lent" for the same reasons that I determined Agreements #4 through #8 reflected absolute assignments, and not loan agreements under which credit was advanced. Accordingly, s. 2 of the UTRA does not apply in this case.

73 If, however, I am wrong, I note that in *Quick Auto Lease Inc. v. Nordin*, 2014 MBCA 32 (Man. C.A.) (CanLII), at paragraph 14, the court stated, with respect to the UTRA, that "[t]he debtor [6] must demonstrate both the inequality of the parties and the improvidence of the bargain ..." [7]

74 I reject the plaintiff's submission that there was an inequality of bargaining power in this case, because there is no evidence of the relative knowledge and experience levels of the defendants and JCFS. JCFS was a service provider of the corporate defendant and willing to purchase the Receivables and the defendants had financial difficulties, but that combination does not necessarily equate to either an inequality of bargaining power or an improvident bargain.

75 For all of these reasons, I cannot conclude that Agreements #4 through #8 were either harsh or unconscionable.

76 Similarly, while JCFS admitted that the fees charged pursuant to the Agreements (15%) was a "good rate", I am not satisfied that it is excessive in all of the circumstances. JCFS was entitled to charge a fee on account of the risk associated with the Receivables, once assigned, and its administration costs.

Agreements #7 and #8 post-date the Order

77 The plaintiff relied upon *Royal Bank v. Kenward* [1925 CarswellMan 51 (Man. C.A.)], 1925 CanLII 344, in support of the argument that Agreements #7 and #8 post-date, and therefore cannot supersede the Order. In that case, the debtor purported to assign funds to his lawyer approximately four months after garnishment by a judgment creditor. The court held that "... the assignment was subsequent to the garnishment and cannot prevail for that reason" (p. 307).

78 JCFS pointed to *Lane v. Merchants Consolidated Ltd.* [1990 CarswellMan 25 (Man. Q.B.)], 1990 CanLII 7991, at para. 15, where the court characterized garnished funds as "simply moneys of the defendant over which the court had taken temporary control" (para. 15). JCFS argued that the plaintiff, as a creditor, has no greater right to the Funds than the corporate defendant itself. While I do not disagree with these comments, I accept, as set out in *Royal Bank v. Kenward*, that garnished funds cannot be assigned by the debtor.

79 I also accept, as stated in *Best Brand Meats Ltd.*, at para. 10, that "[f]or a debt to be garnisheed before judgment it must be both due and payable *at the time of service of the notice of garnishment.*" [Emphasis added.] In other words, a garnishing order attaches funds at the time of service upon the garnishee. This approach makes good sense, because a garnishment order that is granted but not yet served upon a garnishee cannot and should not attach funds.

80 In this case, the Order issued on October 25, 2018, and notices of garnishment issued on the afternoon of November 1, 2018. There is no evidence before me of when the notices of garnishment were served upon Bituminex and Maple Leaf. At the cross-examination of the plaintiff's representative an undertaking was given to advise of when the notices of garnishment were served, but the undertaking was not answered.

81 As set out at paragraph 37 above, I have determined that the parties intended for the Agreements to take effect when JCFS paid the purchase price to the corporate defendant. The evidence reflects that the effective date of Agreement #7 is October 30, 2018, [8] and the effective date of Agreement #8 is November 2, 2018.

82 Since Agreement #7 took effect before the notices of garnishment were issued and served, the Receivables purchased by JCFS pursuant to that Agreement were not available for attachment by the plaintiff pursuant to the Order.

83 The sequence of events with respect to Agreement #8 is unclear. The notices of garnishment could have been served on November 1 or 2, 2018, prior to it taking effect. Accordingly, I have concluded that JCFS, as the moving party, failed to meet its evidentiary burden with respect to Agreement #8.

No Notice of the Agreements

84 The plaintiff argued that it was prejudiced significantly by JCFS's failure to register its security interest, or otherwise give notice of the Agreements.

85 JCFS argued that the PPR and perfection are irrelevant to this matter, and in the alternative that it is a perfected, secured creditor with priority to the Funds.

86 In *Coulyk v. Coulyk* [1999 CarswellBC 2676 (B.C. S.C.)], 1999 CanLII 5066, the court considered whether an assignment of funds was unperfected because no financing statement was filed in the PPR. The court found that once an interest in funds is assigned, there is no longer an interest to be charged. The court also stated:

> [9] ... The fact that the assignee has not perfected his interest by registration is relevant only to priorities established in that event by the PPSA. It does not invalidate the interest.

87 I am satisfied, therefore, that a PPR registration in this case would be relevant only to a priorities dispute pursuant to *The Personal Property Security Act*, C.C.S.M. c. P35. Since neither the plaintiff nor JCFS had a registered security interest in 2018, no such dispute arose in this case.

88 I acknowledge that JCFS filed PPR registrations in June 2019, and I assume that it did so to enhance its alternative position on this issue. In my view, however, these registrations are irrelevant to my decision because they post-date the time at which the parties' respective interests crystallized.

89 I have also considered whether JCFS should have notified the plaintiff (or any other creditor of the defendants) of the Agreements in some other way. I have been provided with no authority to suggest that JCFS was so obligated, and I have noted the comments of the court in *Evans Coleman* as set out above. I have concluded, therefore, that no notice was required.

The Builders' Liens Act

90 After the hearing in this matter, I asked counsel for additional submissions on the question of whether, given the nature of the corporate defendant's business, s. 6(2) of *The Builders' Liens Act*, C.C.S.M. c. B91 (the "*BL Act*") applies in this case. The relevant sections of the *BL Act* provide as follows:

> **Receipts of sub-contractor constitute trust fund**
>
> 4(2) All sums ... received by a sub-contractor on account of a contract price in the sub-contract, constitute a trust fund for the benefit of
>
> > (a) sub-contractors who have sub-contract with the sub-contractor and other persons who have supplied materials or provided services to the sub-contractor for the purpose of performing the sub-contract;
> >
> > (b) the Workers' Compensation Board;
> >
> > (c) workers who have been employed by the sub-contractor for the purpose of performing the sub-contract; and
> >
> > (d) the contractor or any sub-contractor for any set-off or counterclaim relating to the performance of the sub-contract.

. . . . .

Duties of sub-contractor re trust

4(4) A sub-contractor receiving a sum mentioned in subsection (2) is the trustee of the trust fund and he shall not appropriate or convert any part of the trust fund to or for his own use or to or for any use not authorized by the trust until

(a) all sub-contractors who have sub-contracted with him and all persons who have supplied materials or provided services for the purpose of performing the sub-contract have been paid all amounts then owing to them out of the sum received;

(b) the Workers' Compensation Board has been paid all assessments which the sub-contractor could reasonably anticipate as arising out of work done by workers employed by him in performing the sub-contract to the extent for which the sum was received;

(c) all workers who have been employed by him for the purpose of performing the sub-contract have been paid all amounts then owing to them out of the sum received for work done in performing the sub-contract; and

(d) provision has been made for the payment of other affected beneficiaries of the trust to whom amounts are then owing out of the sum received.

. . . . .

Certain moneys not subject to garnishment

6(2) Where money owing to a contractor or sub-contractor in respect of the contract price under a contract or sub-contract would, if paid to the contractor or sub-contractor, be subject to a trust under section 4, the money is not subject to garnishment under *The Garnishment Act*.

91 The issue, then, is whether the Funds, if paid to the corporate defendant by Bituminex and/or Maple Leaf would have been subject to a trust under s. 4 of the *BL Act*.

92 JCFS submitted that the corporate defendant is a commercial and residential landscaper and that the Receivables reflect both a general description of the work performed and, in most instances, the location at which it was performed. Accordingly, it can be inferred that the corporate defendant was a sub-contractor of Bituminex and Maple Leaf for the purposes of the *BL Act*. JCFS also submitted that there is no evidence of what portion of the Funds were impressed with a trust, such that the Order should not have issued, particularly on a without notice basis, and should be set aside.

93 The plaintiff submitted that there is no evidence before the court that anyone was even potentially entitled to the benefit of the protection of s. 4, and accordingly there is no evidence upon which to find that any part of the Funds were trust funds. JCFS bore the onus of establishing a trust, and it has not done so. In addition, the plaintiff submitted that the purpose of the trust provisions is the protection of the parties identified in s. 4(2), which do not include an assignee of receivables.

94 There is very little jurisprudence regarding s. 6(2) of the *BL Act*, but in *Glenko Enterprises Ltd. v. Keller*, 2000 MBCA 7 (Man. C.A.) (CanLII) the court stated:

37 Section 6(2) indicates that when the contractor receives funds from the owner, those funds which are subject to the statutory trust are exempt from garnishment proceedings against the contractor because, of course, those funds do not belong to the contractor in equity. ...

95 Both parties pointed to *Aebig v. Miller Contracting Ltd.* [1993 CarswellBC 181 (B.C. S.C.)], 1993 CanLII 1168, where the court considered the validity of a garnishing order pursuant to the *Builders Lien Act* of British Columbia, R.S.B.C. 1979, c. 40, which contains trust fund provisions similar to the *BL Act*. The court held that any portion of trust funds that could properly be paid to the contractor itself on the date of a garnishing order could be garnished. This approach is consistent, in my view, with both the duties reflected in s. 4(4) of the *BL Act* and the comments in *Glenko* that trust funds that do not belong to a contractor in equity cannot be garnished.

96 As I have stated, there is no evidence before me from either of the defendants. I am prepared to infer from JCFS's evidence and the information reflected in the Receivables that the corporate defendant was a sub-contractor for the purposes of the *BL Act*. Having said that, I have no evidence of whether any of the potential beneficiaries listed in s. 4(2) of the *BL Act* existed on any of the projects giving rise to the Receivables, and, if so, whether the corporate defendant fulfilled its duties to those beneficiaries as contemplated in s. 4(4).

97 Accordingly, there is no basis upon which I can conclude that the Funds would have been subject to a trust under s. 4 of the *BL Act*, and I am not satisfied that s. 6(2) of the *BL Act* applies to the Receivables.

CONCLUSION

98 JCFS validly purchased receivables pursuant to Agreements #4 through #7 prior to issuance of the notices of garnishment. Accordingly, the Order is rescinded as against Bituminex and Maple Leaf with respect to invoices 188, 193, 195, 196, 199, 200 and 202, and the funds paid in with respect to those receivables will be paid out to JCFS. The Order will stand with respect to invoice 203.

99 If costs cannot be agreed upon, I will hear submissions.

Motion granted in part.

Footnotes

1 The same is true for Agreements #2 and #3, entered into on August 3, 2018 and August 24, 2018, respectively.

2 Another potential issue arising from Agreement #1 is the provision that once JCFS received payment of $17,250 ($15,000 purchase price and $2,250 fee), any additional payments would be applied first to the $16,800 loan referenced above, and then to any accounting fees owing to JCFS, with any further amounts paid to the defendants. This language detracts from the nature of an absolute assignment. None of the subsequent Agreements contained this provision.

3 One of the flaws in the Agreements is that no General Terms and Conditions exist.

4 *India Films Overseas Ltd. v. Keefer Investments Inc.* [1984 CarswellBC 603 (B.C. S.C.)], 1984 CanLII 464, at para. 11.

5 Another flaw in the Agreements is that the individual defendant is named in the recitals as one of the "Contractual Parties". There was no reason for the individual defendant to be so named, because the corporate defendant was the owner and seller of the Receivables.

6 JCFS argued that the plaintiff has no standing to rely upon the *UTRA* because it is not a party to the Agreements. I need not consider this argument to make my decision in this matter.

7 These requirements were established in *Bonnick v. Bonnick* [1983 CarswellMan 97 (Man. C.A.)], 1983 CanLII 2966, at para. 25, and relate to a determination of whether the *UTRA* applies in a given case.

8 The purchase price of Agreement #7 was paid in part on each of October 29 and 30, 2018. Since October 30, 2018 is the date on which the purchase price was paid in full, I have determined that the Agreement took effect on that date.

TAB 3

2024 SCC 31, 2024 CSC 31
Supreme Court of Canada

Aquino v. Bondfield Construction Co.

2024 CarswellOnt 15328, 2024 CarswellOnt 15329, 2024 CSC 31, 2024 SCC 31, 15 C.B.R. (7th) 207, 2024 A.C.W.S. 3397, 496 D.L.R. (4th) 613, 54 B.L.R. (6th) 1

John Aquino, 2304288 Ontario Inc., Marco Caruso, Giuseppe Anastasio, also known as Joe Ana and Lucia Coccia, also known as Lucia Canderle (Appellants) and Ernst & Young Inc., in its capacity as Court-Appointed Monitor of Bondfield Construction Company Limited, and KSV Kofman Inc., in its capacity as Trustee in Bankruptcy of 1033803 Ontario Inc. and 1087507 Ontario Limited (Respondents) and Attorney General of Ontario and Insolvency Institute of Canada (Interveners)

Wagner C.J.C., Karakatsanis, Côté, Rowe, Martin, Jamal, O'Bonsawin JJ.

Heard: December 5, 2023
Judgment: October 11, 2024
Docket: 40166

Proceedings: affirming *Ernst & Young Inc. v. Aquino* (2022), 2022 ONCA 202, (sub nom. *Bondfield Construction Co. (Court-Appointed Monitor of) v. Aquino)* 160 O.R. (3d) 284100 C.B.R. (6th) 182022 CarswellOnt 3170473 D.L.R. (4th) 571, Coroza J.A., P. Lauwers J.A., Sossin J.A. (Ont. C.A.); affirming *Ernst & Young Inc. v. Aquino* (2021), 88 C.B.R. (6th) 60, 2021 CarswellOnt 42212021 ONSC 527, Dietrich J. (Ont. S.C.J.)

Counsel: Terry Corsianos, George Corsianos, Jacob Lee, for Appellants
Alan Merskey, Stephen Taylor, for Respondent, Ernst & Young Inc., in its capacity as court-appointed monitor of Bondfield Construction Company Limited
Jeremy Opolsky, Alex Bogach, for Respondent, KSV Kofman Inc., in its capacity as Trustee in Bankruptcy of 1033803 Ontario Inc. and 1087507 Ontario Limited
Dona Salmon, Jennifer Boyczuk, for Intervener, Attorney General of Ontario
Natasha MacParland, Chanakya A. Sethi, Rui Gao, J. Henry Machum, for Intervener, Insolvency Institute of Canada

Subject: Civil Practice and Procedure; Corporate and Commercial; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency
XI Avoidance of transactions prior to bankruptcy
XI.3 Fraudulent and illegal transactions
Business associations
I Nature of business associations
I.3 Nature of corporation
I.3.a Distinct existence
I.3.a.i From owner
I.3.a.i.B Miscellaneous

Headnote

Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent and illegal transactions
When construction company and its affiliate filed for bankruptcy, trustee and monitor discovered false invoicing scheme perpetrated by A as directing mind of debtor companies, and they sought to recover funds, claiming that transactions were fraudulent — Trustee and monitor successfully applied to have debtor companies repay improperly taken funds and when debtor

companies and A unsuccessfully appealed, Court of Appeal ruled that applicable bankruptcy law could be used by monitor and trustee to recover relevant funds — Debtor companies and A appealed — Appeal dismissed — Application judge did not misapply badges of fraud approach to inferring fraudulent intent — Court may find that debtor intended to defraud, defeat, or delay creditor under s. 96(1)(b)(ii)(B) of Bankruptcy and Insolvency Act (BIA) even if debtor was not insolvent at time of transfer at undervalue so there was no basis to interfere with application judge's conclusion that A intended to defraud, defeat or delay creditor under false invoicing scheme — Section 96(1)(b)(ii)(B) of BIA required party seeking to reverse transfer at undervalue to prove, among other things, debtor's intent to defraud, defeat, or delay creditor, and intent requirement was often proved through evidentiary shortcut of badges of fraud, which were suspicious circumstances from which court might infer debtor's intent to defraud, defeat, or delay creditor — BIA was clear that insolvency was not prerequisite to finding debtor intended to defraud, defeat, or delay creditor — Section 96(1)(b)(ii) of BIA was disjunctive: debtor must either be insolvent at time of transfer (s. 96(1)(b)(ii)(A)) or intend to defraud, defeat, or delay a creditor (s. 96(1)(b)(ii)(B)) — Therefore, it was no answer to application under s. 96(1)(b)(ii)(B) of BIA to say that corporate debtor was not insolvent and was paying its creditors in full and on time at time of transfers — A intended to defraud, defeat, or delay creditor under false invoicing scheme Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s 96; Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s 96(1)(b)(ii)(B).

Business associations --- Nature of business associations — Nature of corporation — Distinct existence — From owner — Miscellaneous

Individual A was directing mind of construction company and its affiliate, and he and his associates carried out false invoicing scheme, taking funds from companies — When companies filed for bankruptcy, trustee and monitor discovered scheme and sought to recover funds, claiming that transactions were fraudulent, and they successfully applied to have debtor companies repay improperly taken funds — Debtor companies and A's appeal was dismissed — Court of Appeal found that actions of A were properly imputed to companies, that to not impute actions to companies would be to force creditors to take responsibility for fraud, and that set-off was not available — Debtor companies and A appealed — Appeal dismissed — A's fraudulent intent should be attributed to debtor companies because he was their directing mind and acted in sector of corporate responsibility assigned to him — Corporate attribution doctrine must be applied purposively, contextually, and pragmatically to give effect to policy goals of law under which party seeks to attribute to corporation actions, knowledge, state of mind, or intent of its directing mind — In context of claim under s. 96 of Bankruptcy and Insolvency Act (BIA), "fraud" and "no benefit" exceptions to corporate attribution should not apply because they would undermine purpose of provision — Test for corporate attribution under s. 96 of BIA was simply whether person was directing mind and whether their actions were performed within sector or corporate responsibility assigned to them Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s 96.

Faillite et insolvabilité --- Annulation des transactions antérieures à la faillite — Transactions frauduleuses et illégales

Lorsqu'une entreprise de construction et sa filiale ont déposé des procédures de faillite, le syndic et le contrôleur ont découvert un système de fausse facturation élaboré par A en tant qu'âme dirigeante des sociétés débitrices et ont cherché à recouvrer les fonds, faisant valoir que les opérations étaient frauduleuses — Syndic et le contrôleur ont eu gain de cause dans leur tentative de faire condamner les sociétés débitrices à rembourser les fonds qui avaient été détournés, et lorsque l'appel des sociétés débitrices et de A a été rejeté, la Cour d'appel a déclaré que le droit applicable en matière de faillite pouvait être invoqué par le contrôleur et le syndic pour recouvrer les fonds en question — Sociétés débitrices et A ont formé un pourvoi — Pourvoi rejeté — Juge saisie des demandes n'a pas mal appliqué l'approche fondée sur les signes de fraude pour inférer l'intention frauduleuse — Tribunal peut conclure qu'un débiteur avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement aux termes de l'art. 96(1)b)(ii)(B) de la Loi sur la faillite et l'insolvabilité (LFI) même s'il n'était pas insolvable au moment de l'opération sous-évaluée, de sorte qu'il n'y avait aucune raison de modifier la conclusion de la juge saisie des demandes selon laquelle A avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement dans le cadre du stratagème de fausses factures — Article 96(1)b)(ii)(B) de la LFI exige que la partie qui cherche à faire annuler une opération sous-évaluée prouve, entre autres, l'intention du débiteur de frauder ou de frustrer un créancier ou d'en retarder le désintéressement, et l'intention exigée est souvent prouvée à l'aide du raccourci en matière de preuve que sont les signes de fraude, lesquels sont des circonstances douteuses à partir desquelles le tribunal peut inférer l'intention du débiteur de frauder ou de frustrer un créancier ou d'en retarder le désintéressement — Il est clair dans la LFI que l'insolvabilité n'est pas une condition préalable pour conclure qu'un débiteur avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement — Article 96(1)b)(ii) de la LFI est disjonctif : le débiteur doit soit être insolvable au moment de l'opération (art. 96(1)b)(ii)(A)), soit avoir l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement (art. 96(1)b)(ii)(B)) — Ainsi, en réponse à une demande fondée sur l'art. 96(1)b)(ii)(B) de la LFI, on ne peut donc dire qu'une société débitrice n'était pas insolvable et payait ses créanciers en entier et à temps au moment des opérations — A avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement dans le cadre du stratagème de fausses factures.

Associations d'affaires --- Nature des associations d'affaires — Nature de la société — Existence propre — Par rapport à celui à qui elle appartient — Divers

Individu A était l'âme dirigeante d'une entreprise de construction et de sa filiale et, en compagnie de ses associés, il a mis au point un système de fausse facturation, détournant des fonds de sociétés — Lorsque les sociétés débitrices ont déposé des procédures de faillite, le syndic et le contrôleur ont découvert le système, ont cherché à recouvrer les fonds, faisant valoir que les opérations étaient frauduleuses et ont eu gain de cause dans leur tentative de faire condamner les sociétés débitrices à rembourser les fonds qui avaient été détournés — Appel des sociétés débitrices et de A a été rejeté — Cour d'appel a déclaré que c'était de manière appropriée que les actions de A avaient été attribuées aux sociétés, que de ne pas attribuer les actions aux sociétés équivaudrait à forcer les créanciers a prendre la responsabilité pour la fraude et qu'il n'était pas possible d'opérer compensation — Sociétés débitrices et A ont formé un pourvoi — Pourvoi rejeté — Intention frauduleuse de A devrait être attribuée aux sociétés débitrices car il était leur âme dirigeante et a agi dans le cadre du secteur de responsabilité des sociétés qui lui était attribué — Théorie de l'attribution d'actes à une société doit être appliquée de manière téléologique, contextuelle et pragmatique afin que se réalisent les objectifs de politique générale de la loi au titre de laquelle une partie cherche à attribuer à une société les actes, la connaissance, l'état d'esprit ou l'intention de son âme dirigeante — Dans le contexte d'une demande formulée au titre de l'art. 96 de la Loi sur la faillite et l'insolvabilité (LFI), les exceptions pour cause de « fraude » et d'« absence d'avantage » à l'attribution d'actes à une société ne devraient pas s'appliquer parce qu'elles mineraient l'objet de cette disposition — Test applicable à l'attribution d'actes à une société au titre de l'art. 96 de la LFI consiste simplement à déterminer si la personne était l'âme dirigeante et si elle a accompli les actes dans le cadre du secteur d'activités de la société qui lui est attribué.

A was the president and directing mind of two family-owned construction companies that worked on large-scale construction projects. When the companies began experiencing serious financial difficulties, restructuring and bankruptcy proceedings were commenced. The monitor and trustee in bankruptcy's investigations revealed that for years, A and several others had been fraudulently taking tens of millions of dollars from the debtor companies through a false invoicing scheme. The monitor and trustee in bankruptcy challenged the transactions and sought to recover the monies on the basis of s. 96(1)(b)(ii)(B) of the Bankruptcy and Insolvency Act (BIA), which provided that a trustee in bankruptcy or, through s. 36.1 of the Companies' Creditors Arrangement Act, a monitor, may apply to a court to impugn and recover from a non-arm's length party to a transaction some or all of the amount of the transfer at undervalue if the trustee can show, among other things, that the debtor intended to "defraud, defeat or delay a creditor."

The application judge held that the false invoice payments were transfers at undervalue and could be recovered by the monitor and trustee in bankruptcy under s. 96(1)(b)(ii)(B) of the BIA. The debtor companies had paid the monies to certain suppliers, who provided nothing in return and had made the payments with the intent to defraud, defeat, or delay a creditor, as revealed by several badges of fraud. The judge rejected the argument that the debtor companies could not have had this intent because the payments were made at a time when the companies were not insolvent or at risk of insolvency. She attributed A's fraudulent intent to the debtor companies and ordered A and the others to pay the monitor and trustee in bankruptcy the monies they received under the false invoicing scheme. The Court of Appeal affirmed the application judge's ruling. A and the debtor companies appealed.

Held: The appeal was dismissed.

Per Jamal J. (Wagner C.J.C., Karakatsanis, Côté, Rowe, Martin, O'Bonsawin JJ. concurring): The application judge did not misapply the badges of fraud approach to inferring fraudulent intent. A court may find that a debtor intended to defraud, defeat, or delay a creditor under s. 96(1)(b)(ii)(B) of the BIA even if the debtor was not insolvent at the time of the transfer at undervalue. Therefore, there was no basis to interfere with the application judge's conclusion that A intended to defraud, defeat or delay a creditor under the false invoicing scheme. As well, A's fraudulent intent should be attributed to the debtor companies because he was their directing mind and acted in the sector of corporate responsibility assigned to him. The corporate attribution doctrine must be applied purposively, contextually, and pragmatically to give effect to the policy goals of the law under which a party seeks to attribute to a corporation the actions, knowledge, state of mind, or intent of its directing mind. In the context of a claim under s. 96 of the BIA, the "fraud" and "no benefit" exceptions to corporate attribution should not apply because these exceptions would undermine the purpose of this provision. The test for corporate attribution under s. 96 was simply whether the person was the directing mind and whether their actions were performed within the sector or corporate responsibility assigned to them. Section 96(1)(b)(ii)(B) of the BIA required the party seeking to reverse a transfer at undervalue to prove, among other things, the debtor's intent to defraud, defeat, or delay a creditor. Because it was often difficult to adduce evidence of a debtor's subjective intent, the intent requirement was often proved through the evidentiary shortcut of badges of fraud, which were suspicious circumstances from which a court may infer the debtor's intent to defraud, defeat, or delay a creditor. The presence of a particular badge of fraud did not require a court to infer an intent to defraud, defeat, or delay a creditor, nor did the absence of a particular badge of fraud require the court to refrain from inferring that intent.

The BIA is clear that insolvency is not a prerequisite to finding a debtor intended to defraud, defeat, or delay a creditor. Section 96(1)(b)(ii) is disjunctive: the debtor must either be insolvent at the time of the transfer (s. 96(1)(b)(ii)(A)) or intend to defraud, defeat, or delay a creditor (s. 96(1)(b)(ii)(B)). It is therefore no answer to an application under s. 96(1)(b)(ii)(B) of the BIA to say that a corporate debtor was not insolvent and was paying its creditors in full and on time at the time of the transfers.

Here, A intended to defraud, defeat, or delay a creditor under the false invoicing scheme. The transfers were made between non-arm's length parties; the debtor companies received no value; the truth about the transfers was hidden behind false invoices describing services that were never provided; the transfers were made with unusual haste; and at the time of the transfers the companies had significant long-term and off-balance sheet liabilities and potential liabilities as guarantors for other companies. However, to satisfy s. 96(1)(b)(ii)(B) of the BIA, the monitor and trustee in bankruptcy must show that the debtor companies intended to defraud, defeat, or delay a creditor. This required showing why it was appropriate to attribute A's fraudulent intent to the debtor companies.

The common law doctrine of corporate attribution provided guiding principles for when the actions, knowledge, state of mind, or intent of the directing mind of a corporation may be attributed or imputed to the corporation. Although a corporation was a separate legal person, it had no mind or will of its own. A directing mind must be identified because a corporation can only act through a human agent. The guiding principles for the common law doctrine of corporate attribution provided that as a general rule, a person's fraudulent acts may be attributed to a corporation if two conditions are met: the wrongdoer was the directing mind of the corporation at the relevant times; and the wrongful actions of the directing mind were performed within the sector of corporate responsibility assigned to them. Attribution will generally be inappropriate when the directing mind acted totally in fraud of the corporation or the directing mind's actions were not by design or result partly for the benefit of the corporation — known as the "fraud" or "no benefit" exceptions. In all cases, courts must apply the common law corporate attribution doctrine purposively, contextually, and pragmatically. The corporate attribution doctrine was not a standalone principle; there was no one-size-fits-all approach. The court must always determine whether the actions, knowledge, state of mind, or intent of a person should be treated as those of the corporation for the purpose of the law under which attribution was sought. This may require the court to tailor the general rule of attribution or its exceptions to the particular legal context. Attribution may be appropriate for one purpose in one context but inappropriate for another purpose in another context.

The fraud and no benefit exceptions to corporate attribution do not apply in the context of a transfer at undervalue under s. 96 of the BIA. These exceptions would undermine rather than promote the purpose of this statutory provision. The purpose of s. 96 was to protect creditors from harmful actions by a debtor that would diminish the assets available for recovery. That purpose was served by attributing the actions, knowledge, state of mind, or intent of the corporation's directing mind to the corporation, so long as those actions were performed within the sector of corporate responsibility assigned to them. This was so even if the directing mind acted in fraud of the corporation, and even if the corporation did not benefit from the actions of the directing mind. By contrast, applying the fraud and no benefit exceptions would render the transfer at undervalue remedy meaningless and would deny third-party creditors a statutory remedy that Parliament intended would be available to protect them.

Here, the fraud and no benefit exceptions were inappropriate and inapplicable and as a result, A's intent should be attributed or imputed to the debtor companies. Attributing A's fraudulent intent to the debtor companies would advance the public policy underlying s. 96 of the BIA as it would allow creditors to recover fraudulently transferred assets that unlawfully reduced the value of the estate available for distribution to creditors.

A était le président et l'âme dirigeante de deux entreprises de construction familiales qui réalisaient des projets de construction à grande échelle. Lorsque les entreprises ont commencé à éprouver de graves difficultés financières, des procédures de restructuration et de faillite ont été introduites. Les enquêtes du contrôleur et du syndic de faillite ont révélé que pendant des années, A et plusieurs autres se sont frauduleusement approprié des dizaines de millions de dollars des compagnies débitrices au moyen d'un stratagème de fausses factures. Le contrôleur et le syndic de faillite ont contesté les opérations et ont cherché à recouvrer cet argent sur le fondement de l'art. 96(1)b)(ii)(B) de la Loi sur la faillite et l'insolvabilité (LFI). Cette disposition prévoit qu'un syndic de faillite ou, par l'intermédiaire de l'art. 36.1 de la Loi sur les arrangements avec les créanciers des compagnies, un contrôleur, peut s'adresser au tribunal pour contester et recouvrer d'une partie à l'opération ayant un lien de dépendance avec le débiteur une partie ou la totalité du montant de l'opération sous-évaluée, s'il peut prouver, entre autres, que le débiteur avait l'intention de « frauder ou de frustrer un créancier ou d'en retarder le désintéressement ».

La juge saisie des demandes a conclu que les paiements de fausses factures étaient des opérations sous-évaluées et pouvaient être recouvrés par le contrôleur et le syndic de faillite au titre de l'art. 96(1)b)(ii)(B) de la LFI. D'abord, les sociétés débitrices avaient payé des sommes d'argent à certains fournisseurs qui n'avaient rien fourni en retour. Ensuite, les sociétés débitrices ont fait ces paiements dans l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement, comme le révélaient plusieurs signes de fraude. La juge a rejeté l'argument selon lequel les sociétés débitrices ne pouvaient pas avoir eu pareille intention car les paiements avaient été faits alors que les sociétés n'étaient pas insolvables ou ne risquaient pas de le devenir. Elle a attribué l'intention frauduleuse de A aux sociétés débitrices et a ordonné à A et aux autres de verser au contrôleur et au syndic de faillite l'argent qu'ils avaient reçu dans le cadre du stratagème de fausses factures. La Cour d'appel a confirmé la décision de la juge saisie des demandes. A et les sociétés débitrices ont formé un pourvoi.

Arrêt: Le pourvoi a été rejeté.

Jamal, J. (Wagner, J.C.C., Karakatsanis, Côté, Rowe, Martin, O'Bonsawin, JJ., souscrivant à son opinion) : La juge saisie des demandes n'a pas mal appliqué l'approche fondée sur les signes de fraude pour inférer l'intention frauduleuse. Un tribunal peut conclure qu'un débiteur avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement aux termes de l'art. 96(1)b)(ii)(B) de la LFI même s'il n'était pas insolvable au moment de l'opération sous-évaluée. Il n'y avait donc aucune raison de modifier la conclusion de la juge saisie des demandes selon laquelle A avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement dans le cadre du stratagème de fausses factures. De plus, l'intention frauduleuse de A devrait être attribuée aux sociétés débitrices car il était leur âme dirigeante et a agi dans le cadre du secteur de responsabilité des sociétés qui lui était attribué. La théorie de l'attribution d'actes à une société doit être appliquée de manière téléologique, contextuelle et pragmatique afin que se réalisent les objectifs de politique générale de la loi au titre de laquelle une partie cherche à attribuer à une société les actes, la connaissance, l'état d'esprit ou l'intention de son âme dirigeante. Dans le contexte d'une demande formulée au titre de l'art. 96 de la LFI, les exceptions pour cause de « fraude » et d'« absence d'avantage » à l'attribution d'actes à une société ne devraient pas s'appliquer parce qu'elles mineraient l'objet de cette disposition; par conséquent, le test applicable à l'attribution d'actes à une société au titre de l'art. 96 consiste simplement à déterminer si la personne était l'âme dirigeante et si elle a accompli les actes dans le cadre du secteur d'activités de la société qui lui est attribué.

L'article 96(1)b)(ii)(B) de la LFI exige que la partie qui cherche à faire annuler une opération sous-évaluée prouve, entre autres, l'intention du débiteur de frauder ou de frustrer un créancier ou d'en retarder le désintéressement. Comme il est souvent difficile de faire la preuve de l'intention subjective d'un débiteur, l'intention exigée est souvent prouvée à l'aide du raccourci en matière de preuve que sont les signes de fraude, lesquels sont des circonstances douteuses à partir desquelles le tribunal peut inférer l'intention du débiteur de frauder ou de frustrer un créancier ou d'en retarder le désintéressement. La présence d'un signe de fraude en particulier ne fait pas en sorte que le tribunal est tenu d'inférer une intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement, et l'absence d'un signe de fraude en particulier n'empêche pas non plus le tribunal d'inférer une telle intention.

Il est clair dans la LFI que l'insolvabilité n'est pas une condition préalable pour conclure qu'un débiteur avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement. L'article 96(1)b)(ii) de la LFI est disjonctif : le débiteur doit soit être insolvable au moment de l'opération (art. 96(1)b)(ii)(A)), soit avoir l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement (art. 96(1)b)(ii)(B)). En réponse à une demande fondée sur l'art. 96(1)b)(ii)(B) de la LFI, on ne peut donc dire qu'une société débitrice n'était pas insolvable et payait ses créanciers en entier et à temps au moment des opérations. En l'espèce, A avait l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement dans le cadre du stratagème de fausses factures. Les opérations ont été effectuées entre des parties ayant un lien de dépendance; les sociétés débitrices n'ont reçu aucune contrepartie; la vérité au sujet des opérations était dissimulée derrière de fausses factures décrivant des services n'ayant jamais été fournis; les opérations ont été effectuées avec un empressement inhabituel; et au moment des opérations, les sociétés avaient d'importants passifs à long terme et engagements hors bilan et des passifs éventuels à titre de cautions pour d'autres entreprises. Toutefois, afin de satisfaire aux conditions de l'art. 96(1)b)(ii)(B) de la LFI, le contrôleur et le syndic de faillite devaient prouver que les sociétés débitrices avaient l'intention de frauder ou de frustrer un créancier ou d'en retarder le désintéressement. Pour ce faire, ils devaient démontrer pourquoi il convenait d'attribuer l'intention frauduleuse de A aux sociétés débitrices.

La théorie de common law de l'attribution d'actes à une société pose les principes directeurs qui permettent de déterminer dans quels cas les actes, les connaissances, l'état d'esprit ou l'intention de l'âme dirigeante d'une société peuvent être attribués ou imputés à cette dernière. Bien qu'une société ait une personnalité juridique distincte, elle n'a pas d'âme ou de volonté qui lui est propre. Une âme dirigeante doit être identifiée parce qu'une société peut agir seulement par l'intermédiaire d'un représentant humain. Les principes directeurs pour l'application de la théorie de common law de l'attribution d'actes à une société prévoient qu'en règle générale, les actes frauduleux d'une personne peuvent être attribués à une société si deux conditions sont remplies : l'auteur de la faute était l'âme dirigeante de la société aux moments pertinents; et les actes fautifs de l'âme dirigeante ont été accomplis dans le cadre du secteur d'activités de la société qui lui est attribué. L'attribution sera généralement inappropriée lorsque l'âme dirigeante a commis un acte complètement frauduleux envers la société ou lorsque les actes que l'âme dirigeante a commis n'avaient pas en partie pour but ou pour conséquence de procurer un avantage à la société — soit les exceptions pour cause de « fraude » et pour cause d'« absence d'avantage ». Dans tous les cas, les tribunaux doivent appliquer la théorie de common law de l'attribution d'actes à une société de manière téléologique, contextuelle et pragmatique. Cette théorie n'est pas une doctrine autonome; il n'y a pas d'approche universelle. Le tribunal doit toujours déterminer si les actes, les connaissances, l'état d'esprit ou l'intention d'une personne devraient être considérés comme ceux de la société pour l'application de la loi au titre de laquelle l'attribution est sollicitée. Cela pourrait l'obliger à adapter la règle générale d'attribution ou ses exceptions au contexte juridique donné. L'attribution peut être appropriée à une fin précise dans un certain contexte, mais inappropriée à une autre fin dans un autre contexte.

Les exceptions pour cause de fraude et d'absence d'avantage à la théorie de l'attribution d'actes à une société ne s'appliquent pas dans le contexte d'une opération sous-évaluée dont il est question à l'art. 96 de la LFI. Ces exceptions mineraient l'objet de cette disposition législative au lieu de le favoriser. L'article 96 a pour objet de protéger les créanciers contre les actes préjudiciables d'un débiteur qui diminueraient les actifs pouvant être recouvrés. Attribuer à la société les actes, la connaissance, l'état d'esprit ou l'intention de son âme dirigeante permet de réaliser cet objet, à condition que ces actes aient été accomplis dans le cadre du secteur d'activités de la société qui lui est attribué. Il en est ainsi même si l'âme dirigeante a agi frauduleusement envers la société, et même si la société n'a pas tiré avantage des actes de l'âme dirigeante. En revanche, appliquer les exceptions pour cause de fraude et d'absence d'avantage viderait de son sens le recours visant l'annulation des opérations sous-évaluées et priverait les tiers créanciers d'un recours prévu par la loi que le Parlement a voulu mettre à leur disposition pour les protéger.

Dans la présente affaire, les exceptions pour cause de fraude et d'absence d'avantage étaient inappropriées et inapplicables et en conséquence, l'intention de A devrait être attribuée ou imputée aux sociétés débitrices. L'attribution de l'intention frauduleuse de A aux sociétés débitrices favoriserait l'atteinte des objectifs de politique générale sous-tendant l'art. 96 de la LFI puisqu'elle permettrait aux créanciers de recouvrer les actifs transférés frauduleusement qui ont réduit illégalement la valeur de l'actif à répartir entre eux.

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9354-9186 Québec inc. v. Callidus Capital Corp. (2020), 2020 SCC 10, 2020 CSC 10, 2020 CarswellQue 3772, 2020 CarswellQue 3773, 78 C.B.R. (6th) 1, 444 D.L.R. (4th) 373, 1 B.L.R. (6th) 1, [2020] 1 S.C.R. 521 (S.C.C.) — referred to

Statutes considered:

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

Generally — referred to

s. 2 "transfer at undervalue" — considered

s. 4 — referred to

s. 96 — considered

s. 96(1)(a) — referred to

s. 96(1)(b)(i) — referred to

s. 96(1)(b)(ii) — considered

s. 96(1)(b)(ii)(A) — referred to

s. 96(1)(b)(ii)(B) — considered

s. 96(3) — referred to

s. 100 — referred to
Business Corporations Act, R.S.A. 2000, c. B-9
s. 16(1) — referred to
Business Corporations Act, S.B.C. 2002, c. 57
s. 30 — referred to
Business Corporations Act, S.N.B. 1981, c. B-9.1
s. 13(1) — referred to
Business Corporations Act, S.N.W.T. 1996, c. 19
s. 15(1) — referred to
Business Corporations Act, R.S.O. 1990, c. B.16
s. 15 — referred to
Business Corporations Act, S.P.E.I. 2018, c. 22
s. 22(1) — referred to
Business Corporations Act, 2021, S.S. 2021, c. 6
s. 3-1(1) — referred to
Business Corporations Act, R.S.Y. 2002, c. 20
s. 18(1) — referred to
Canada Business Corporations Act, R.S.C. 1985, c. C-44
s. 15 — referred to
Companies Act, R.S.N.S. 1989, c. 81
s. 26(8) — referred to
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

s. 36.1 [en. 2007, c. 36, s. 78] — considered
Corporations Act, R.S.M. 1987, c. C225
s. 15(1) — referred to
Corporations Act, R.S.N. 1990, c. C-36
s. 27(1) — referred to
Criminal Code, R.S.C. 1985, c. C-46
Generally — referred to
Sociétés par actions, Loi sur les, RLRQ, c. S-31.1
art. 10 — referred to

Words and phrases considered:

transfer at undervalue

A "transfer at undervalue" is a transaction in which a debtor transfers property or provides services to another person for no consideration or conspicuously less than fair market value ([Bankruptcy and Insolvency Act (BIA)], s. 2). Section 96(1)(b)(ii)(B) of the BIA provides that a trustee in bankruptcy may apply to a court to impugn and recover from a non-arm's length party to a transaction some or all of the amount of the transfer at undervalue, if the trustee can show that the debtor intended to "defraud, defeat or delay a creditor". . . .

A "transfer at undervalue" is defined under s. 2 of the BIA as "a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor" . . .

Termes et locutions cités:

opération sous-évaluée

Une « opération sous-évaluée » s'entend de l'opération par laquelle un débiteur transfère un bien ou fournit des services à une personne sans contrepartie ou pour une contrepartie qui est manifestement inférieure à la juste valeur marchande ([Loi sur la faillite et l'insolvabilité] LFI, art. 2). La division 96(1)b)(ii)(B) de la LFI prévoit qu'un syndic de faillite peut s'adresser au tribunal pour contester et recouvrer d'une partie à l'opération ayant un lien de dépendance avec le débiteur une partie ou la totalité du montant de l'opération sous-évaluée, s'il peut prouver que le débiteur avait l'intention de « frauder ou de frustrer un créancier ou d'en retarder le désintéressement ».

(...)

Selon l'art. 2 de la LFI, une « opération sous-évaluée » s'entend de « [t]oute disposition de biens ou fourniture de services pour laquelle le débiteur ne reçoit aucune contrepartie ou en reçoit une qui est manifestement inférieure à la juste valeur marchande de celle qu'il a lui-même donnée. »

APPEAL of judgment reported at *Ernst & Young Inc. v. Aquino* (2022), 2022 CarswellOnt 3170, 160 O.R. (3d) 284, 2022 ONCA 202, 100 C.B.R. (6th) 18, 473 D.L.R. (4th) 571 (Ont. C.A.), dismissing appeal by debtor companies of application by bankruptcy trustee and monitor trustee to have them repay improperly taken funds.

POURVOI formé à l'encontre d'un jugement publié à *Ernst & Young Inc. v. Aquino* (2022), 2022 CarswellOnt 3170, 160 O.R. (3d) 284, 2022 ONCA 202, 100 C.B.R. (6th) 18, 473 D.L.R. (4th) 571 (Ont. C.A.), ayant rejeté un appel interjeté par les sociétés débitrices à l'encontre d'une requête déposée par le syndic de faillite et le contrôleur visant à les faire condamner à rembourser des fonds détournés.

***Jamal J.* (Wagner C.J. and Karakatsanis, Côté, Rowe, Martin and O'Bonsawin JJ. concurring):**

I. Introduction

1 The common law doctrine of corporate attribution provides guiding principles for when the actions, knowledge, state of mind, or intent of the directing mind of a corporation may be attributed or imputed to the corporation. This Court applied the corporate attribution doctrine in the criminal context in *Canadian Dredge & Dock Co. v. The Queen*, [1985] 1 S.C.R. 662, and in the civil context in *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63, [2017] 2 S.C.R. 855, and *Christine DeJong Medicine Professional Corp. v. DBDC Spadina Ltd.*, 2019 SCC 30, [2019] 2 S.C.R. 530. This appeal requires the Court to apply the corporate attribution doctrine in the bankruptcy and insolvency contexts.

2 The appellants stole tens of millions of dollars from two construction companies through a false invoicing scheme. One of the appellants, John Aquino, was the companies' directing mind. The respondents, in their capacities as trustee in bankruptcy and monitor of the companies, applied to the Ontario Superior Court of Justice to recover some of this money on the basis

that the false invoice transactions were "transfers at undervalue" under s. 96(1)(b)(ii)(B) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

3 A "transfer at undervalue" is a transaction in which a debtor transfers property or provides services to another person for no consideration or conspicuously less than fair market value (*BIA*, s. 2). Section 96(1)(b)(ii)(B) of the *BIA* provides that a trustee in bankruptcy may apply to a court to impugn and recover from a non-arm's length party to a transaction some or all of the amount of the transfer at undervalue, if the trustee can show that the debtor intended to "defraud, defeat or delay a creditor". Section 96 of the *BIA* applies in a corporate restructuring through s. 36.1 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*").

4 The application judge and Court of Appeal for Ontario accepted that the false invoice payments were transfers at undervalue. They applied the doctrine of corporate attribution to attribute Mr. Aquino's fraudulent intent to the debtor companies and ordered the appellants to pay the trustee and monitor the monies they received under the false invoicing scheme.

5 The appellants now revive before this Court two arguments that were rejected by the courts below. First, the appellants argue that the application judge had no basis to conclude that the debtor companies, through the actions of Mr. Aquino, intended to defraud, defeat, or delay a creditor. They say that the companies were paying their creditors in full and on time when the false invoicing scheme was underway and that the companies' financial condition at those times could not be determined on the record before the court. I do not accept this submission. A court may find that a debtor intended to defraud, defeat, or delay a creditor under s. 96(1)(b)(ii)(B) even if the debtor was not insolvent at the time of the transfers at undervalue. I also see no basis to interfere with the findings of the application judge, affirmed by the Court of Appeal, that the record contains many *indicia* or badges of fraud showing that Mr. Aquino misled stakeholders as to the companies' true financial condition, reduced the funds available to pay long-term creditors, and increased the companies' debts.

6 Second, the appellants argue that Mr. Aquino's fraudulent state of mind cannot be attributed to the debtor companies under the corporate attribution doctrine. They invoke the so-called "fraud" and "no benefit" exceptions to corporate attribution previously recognized by this Court (*Canadian Dredge*, at pp. 681-82 and 712-13; *Livent*, at para. 100). They claim that there can be no attribution in this case because Mr. Aquino acted in fraud of the debtor companies and his actions did not benefit the companies. I do not accept this submission either. As the trustee notes, this position amounts to saying that the common law doctrine of corporate attribution allows "a fraudulent directing mind and his accomplices to avoid liability *because* they defrauded the company they ran" (R.F., at para. 1 (emphasis in original)). The corporate attribution doctrine does not countenance — much less require — such a perverse result.

7 This Court has established that the corporate attribution doctrine is not a "standalone" principle (*Livent*, at para. 97); there is no one-size-fits-all approach. The corporate attribution doctrine must be applied purposively, contextually, and pragmatically to give effect to the policy goals of the law under which a party seeks to attribute to a corporation the actions, knowledge, state of mind, or intent of its directing mind. Rules of attribution that may be appropriate in one context for one purpose may be inappropriate in another context for another purpose. When the rules of attribution undermine the purpose of the law under which attribution is sought, the court should adapt the attribution rules to promote the purpose of the relevant law.

8 In my view, the fraud and no benefit exceptions to corporate attribution do not apply in the context of a transfer at undervalue under s. 96 of the *BIA*. These exceptions would undermine rather than promote the purpose of this statutory provision. The purpose of s. 96 is to protect creditors from harmful actions by a debtor that would diminish the assets available for recovery. That purpose is served by attributing the actions, knowledge, state of mind, or intent of the corporation's directing mind to the corporation, even if the directing mind acted in fraud of the corporation, and even if the corporation did not benefit from the actions of the directing mind. By contrast, applying the fraud and no benefit exceptions would deny third-party creditors a statutory remedy that Parliament intended would be available to protect them.

9 Applying these principles to this appeal, Mr. Aquino's fraudulent intent should be attributed to the debtor companies because he was their directing mind and acted in the sector of corporate responsibility assigned to him. I would dismiss the appeal.

II. Background

10 Bondfield Construction Company Limited ("Bondfield") and its affiliate, 1033803 Ontario Inc., known as Forma-Con Construction ("Forma-Con"), were family-owned construction companies that worked on large-scale construction projects in Ontario. At all relevant times, Mr. Aquino was the president and directing mind of Bondfield and Forma-Con.

11 By 2018, Bondfield and Forma-Con were experiencing serious financial difficulties. The respondent Ernst & Young Inc. was retained to review their financial situation, which led to the commencement of restructuring proceedings regarding Bondfield in April 2019 and bankruptcy proceedings regarding Forma-Con in December 2019. The court appointed Ernst & Young Inc. as the monitor of Bondfield, and the respondent KSV Restructuring Inc. as the trustee in bankruptcy of Forma-Con.

12 The monitor and trustee's investigations revealed that, for years, Mr. Aquino and several other appellants had been fraudulently taking tens of millions of dollars from Bondfield and Forma-Con through a false invoicing scheme. The scheme was simple. Mr. Aquino and his accomplices made up false invoices from certain suppliers — including Mr. Aquino's holding company — for services that were never provided. Bondfield and Forma-Con then paid the false invoices promptly, often within a few days, at the direction of Mr. Aquino or other appellants. Bondfield paid more than $21.8 million and Forma-Con paid more than $11.3 million towards false invoices in the five years before the commencement of insolvency proceedings, the period within which alleged transfers at undervalue to non-arm's length parties are reviewable.

13 The trustee and monitor each commenced proceedings before the Ontario Superior Court to challenge the false invoice transactions as transfers at undervalue. Section 96 of the *BIA* provides a trustee and, through s. 36.1 of the *CCAA*, a monitor, with a remedy to unwind or claim reimbursement of some or all the value of the assets transferred from a debtor in circumstances that qualify as a transfer at undervalue.

14 In this case, the applications of the trustee and monitor were brought under s. 96(1)(b)(ii)(B) of the *BIA*, which required them to show that: (a) the false invoice transactions were transfers at undervalue; (b) the transfers occurred in the five-year period preceding the initial bankruptcy event; (c) the recipients of the transfers were not dealing at arm's length with the debtor companies; and (d) the debtor companies intended to defraud, defeat, or delay a creditor.

III. Judicial History

A. Ontario Superior Court of Justice, 2021 ONSC 527, 88 C.B.R. (6th) 60 (Dietrich J.)

15 The application judge held that the false invoice payments made by Bondfield and Forma-Con were transfers at undervalue under s. 96(1)(b)(ii)(B) of the *BIA* and could be recovered by the monitor and trustee. The transfers were at undervalue because Bondfield and Forma-Con had paid tens of millions of dollars to certain suppliers who provided nothing in return. In a separate costs endorsement, the application judge found the payments involved "serious corporate malfeasance and corporate looting" and "reprehensible and scandalous behaviour" (2021 ONSC 7514, at paras. 29 and 33, reproduced in A.R., at pp. 66-67). She also found the appellants were not dealing at arm's length with Bondfield or Forma-Con because they collaborated with them in orchestrating the false invoicing scheme.

16 The application judge ruled that Bondfield and Forma-Con made these payments with the intent to defraud, defeat, or delay a creditor. She rejected the appellants' argument that Bondfield and Forma-Con could not have had this intent because the payments were made at a time when they were not insolvent or at risk of insolvency. When evaluating a corporate debtor's intent to defraud, defeat, or delay a creditor, the corporate debtor's financial health at the time of the transfer is a relevant but not determinative consideration.

17 In the application judge's view, the record revealed several badges of fraud establishing that Mr. Aquino, as the directing mind of Bondfield and Forma-Con, had a fraudulent intent at the time of the false invoice payments. Bondfield and Forma-Con made the payments secretly, in haste, to non-arm's length persons, for no consideration, based on "phony invoices" for "services that were never delivered" (para. 157). Bondfield and Forma-Con also had several actual or potential long-term and off-balance

sheet liabilities and were expanding their activities, even though they knew their lender was not willing to lend them more. In addition, Mr. Aquino was injecting capital into Bondfield to disguise its true financial condition from stakeholders, and unusual accounting practices made it impossible to determine the companies' financial condition. Based on all the circumstances, the application judge found that the false invoice payments reduced the funds available to pay the companies' long-term creditors.

18 Finally, the application judge held that Mr. Aquino's fraudulent intent could be attributed to Bondfield and Forma-Con. The application judge ruled that, as a matter of statutory interpretation and public policy, the corporate attribution doctrine set out in *Canadian Dredge* does not apply under s. 96 of the *BIA*. In her view, because a purpose of the *BIA* is to provide proper redress to creditors, the "intention of the debtor" in s. 96 "should be interpreted liberally to include the intention of individuals in control of the corporation, regardless of whether those individuals had an intent to defraud the corporation itself" (para. 229).

19 The application judge determined that when Mr. Aquino authorized the false invoice payments, he was acting within his area of responsibility of engaging with suppliers and overseeing the provision of services and materials. The appellants, either as bogus suppliers or facilitators of the false invoicing scheme, were all parties or privies to the transfers at undervalue. They were therefore jointly and severally liable to repay the amounts transferred from Bondfield and Forma-Con.

B. Court of Appeal for Ontario, 2022 ONCA 202, 160 O.R. (3d) 284 ***(Lauwers J.A., Coroza and Sossin JJ.A. concurring)***

20 The Court of Appeal affirmed the application judge's ruling that Mr. Aquino intended to defraud, defeat, or delay Bondfield and Forma-Con's creditors, and attributed Mr. Aquino's fraudulent intent to Bondfield and Forma-Con under s. 96(1)(b)(ii)(B) of the *BIA*. Accordingly, the court dismissed the appeal.

21 The court rejected the appellants' attempt to relitigate their position that Mr. Aquino did not intend to defraud, defeat, or delay Bondfield and Forma-Con's creditors because the fraudulent payments were made at times when the companies were financially stable. The court noted that the application judge "mustered a phalanx of facts in support of her conclusions" and "took a pragmatic view on the totality of the evidence" (paras. 38 and 46). The Court of Appeal affirmed that "the interests of creditors were imperilled by the transfers because Bondfield and Forma-Con were already experiencing mounting financial difficulties", and concluded that it would have been "entirely unreasonable" for Mr. Aquino "to believe that, during that time, the interests of the companies' creditors would not be endangered by this fraudulent scheme" (para. 45). The Court of Appeal deferred to the application judge's findings that Mr. Aquino intended to defeat the companies' creditors. At a minimum, Mr. Aquino was reckless as to whether the scheme would have this effect, which also established his fraudulent intent under s. 96.

22 The court attributed Mr. Aquino's fraudulent intent to Bondfield and Forma-Con under the common law corporate attribution doctrine. It distilled three principles from *Canadian Dredge*, *Livent*, and *DeJong*: (1) courts must be sensitive to the legal context in which a directing mind's intent is sought to be imputed to a corporation; (2) corporate attribution is an exercise grounded in public policy, and policy factors that favour imputing a directing mind's wrongdoing to a corporation are based on the social purpose of holding the corporation responsible; and (3) courts have discretion to refrain from attributing the directing mind's intent to the corporation when this would be in the public interest.

23 The court observed that the criminal and civil contexts in which the corporate attribution doctrine has traditionally been applied differ from the bankruptcy context. In the criminal and civil contexts, attributing the directing mind's intent to the corporation might be justified if the corporation benefits from the improper activities of the directing mind, but would be unjustified if the corporation does not benefit. In the bankruptcy context, the court noted, "the policy currents flow rather differently.... [A]ttributing the intent of a company's directing mind to the company itself can hardly be said to unjustly prejudice the company ..., when the company is no longer anything more than a bundle of assets to be liquidated with the proceeds distributed to creditors" (para. 77). The court found that it would make little sense to adopt an approach that would favour fraudsters over legitimate creditors.

24 Based on these considerations, the Court of Appeal reframed the test for corporate attribution in the bankruptcy context as turning on the following question: "[W]ho should bear responsibility for the fraudulent acts of a company's directing mind that are done within the scope of his or her authority — the fraudsters or the creditors?" (para. 78). The court held that it would

be perverse and counter to the purpose of s. 96 of the *BIA* to allow the appellants to benefit at the expense of Bondfield and Forma-Con's creditors. It therefore found that Mr. Aquino's fraudulent intent must be imputed to Bondfield and Forma-Con, even though both companies were also victims of Mr. Aquino's fraud.

IV. Relevant Statutory Provisions

25 Section 2 of the *BIA* defines a "transfer at undervalue":

> ***transfer at undervalue*** means a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor;

26 Section 96 of the *BIA* governs transfers at undervalue:

> **96 (1)** On application by the trustee, a court may declare that a transfer at undervalue is void as against, or, in Quebec, may not be set up against, the trustee — or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor — if
>
> (a) the party was dealing at arm's length with the debtor and
>
> (i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and that ends on the date of the bankruptcy,
>
> (ii) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, and
>
> (iii) the debtor intended to defraud, defeat or delay a creditor; or
>
> (b) the party was not dealing at arm's length with the debtor and
>
> (i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and ends on the date of the bankruptcy, or
>
> (ii) the transfer occurred during the period that begins on the day that is five years before the date of the initial bankruptcy event and ends on the day before the day on which the period referred to in subparagraph (i) begins and
>
> (A) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, or
>
> (B) the debtor intended to defraud, defeat or delay a creditor.
>
> **(2)** In making the application referred to in this section, the trustee shall state what, in the trustee's opinion, was the fair market value of the property or services and what, in the trustee's opinion, was the value of the actual consideration given or received by the debtor, and the values on which the court makes any finding under this section are, in the absence of evidence to the contrary, the values stated by the trustee.
>
> **(3)** In this section, a ***person who is privy*** means a person who is not dealing at arm's length with a party to a transfer and, by reason of the transfer, directly or indirectly, receives a benefit or causes a benefit to be received by another person.

27 Section 36.1 of the *CCAA* applies the *BIA*'s provisions on transfers at undervalue to the *CCAA* "with any modifications that the circumstances require":

36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

(2) For the purposes of subsection (1), a reference in sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act*

(a) to "date of the bankruptcy" is to be read as a reference to "day on which proceedings commence under this Act";

(b) to "trustee" is to be read as a reference to "monitor"; and

(c) to "bankrupt", "insolvent person" or "debtor" is to be read as a reference to "debtor company".

V. Issues

28 This appeal raises two issues:

(1) Is a debtor's financial condition relevant or determinative in establishing the debtor's intent to defraud, defeat, or delay a creditor under s. 96(1)(b)(ii)(B) of the *BIA*?

(2) When can the intent of the directing mind of a corporation to defraud, defeat, or delay a creditor be attributed to the corporate debtor under s. 96(1)(b)(ii)(B) of the *BIA*?

VI. Analysis

29 The key question in this appeal is whether the trustee and monitor established Bondfield and Forma-Con's intent to defraud, defeat, or delay a creditor under s. 96(1)(b)(ii)(B). When the debtor is a corporation, the court must determine whether the corporate debtor's directing mind intended to defraud, defeat, or delay a creditor having regard to the transactions completed by the corporation, and then consider whether the directing mind's intent can be attributed to the corporation. Thus, the Court must first determine whether the evidence established Mr. Aquino's intent to defraud, defeat, or delay a creditor, and then determine whether his intent should have been attributed to Bondfield and Forma-Con. The appellants claim that the courts below erred on both points.

A. Is a Debtor's Financial Condition Relevant or Determinative in Establishing the Debtor's Intent to Defraud, Defeat, or Delay a Creditor Under Section 96(1)(b)(ii)(B) of the BIA?

30 The appellants assert that the application judge made an extricable error of law by concluding that Bondfield and Forma-Con intended to defraud, defeat, or delay a creditor under s. 96(1)(b)(ii)(B) of the *BIA* because the companies were paying their creditors in full and on time and because the court found that it could not determine the companies' financial condition at the time of the transfers at undervalue. The appellants say that the application judge could not make an order under s. 96(1)(b)(ii)(B) of the *BIA* without first determining the companies' financial condition at the time of the impugned transactions.

31 I do not accept this submission. I will first review the legal framework for transfers at undervalue under s. 96 of the *BIA* and address how a debtor's intent to defraud, defeat, or delay a creditor can be proved through the evidentiary shortcut of "badges of fraud". I will then explain why I see no reviewable error in the application judge's conclusion that the requisite intent under s. 96(1)(b)(ii)(B) was established.

(1) Transfers at Undervalue Under the BIA

(a) General Principles

32 A "transfer at undervalue" is defined under s. 2 of the *BIA* as "a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor". Transfers at undervalue reduce the value of the debtor's estate and

diminish the value of the creditors' realizable claims (A. Duggan and T. G. W. Telfer, "Gifts and Transfers at Undervalue", in S. Ben-Ishai and A. Duggan, eds., *Canadian Bankruptcy and Insolvency Law: Bill C-55, Statute c. 47 and Beyond* (2007), 175, at p. 191).

33 Section 96 has been described as "a tool to address 'asset stripping' by a debtor" (*Urbancorp Toronto Management Inc. (Re)* 2019 ONCA 757, 74 C.B.R. (6th) 23, at para. 40; see also *Peoples Department Stores Inc. (Trustee of) v. Wise* 2004 SCC 68, [2004] 3 S.C.R. 461, at para. 91, on the predecessor provision, s. 100 of the *BIA*). Section 96 of the *BIA* provides a remedy to reverse transfers at undervalue that occurred within a specified period of time before the date of bankruptcy (*Urbancorp*, at para. 48; *Estate of Gavin v. Gavin* 2023 PECA 8, 10 C.B.R. (7th) 30, at paras. 14 and 142; *Pitblado LLP v. Houde* 2015 MBQB 85, 318 Man. R. (2d) 39, at para. 35).

34 Section 96 of the *BIA* allows a trustee in bankruptcy to ask a court to review a suspected transfer at undervalue. When the conditions of s. 96 are met, the court may declare the transfer void as against the trustee or grant judgment against the parties or privies to the transfer for the amount of the difference between the consideration given by the debtor and the consideration received. Section 36.1 of the *CCAA* incorporates s. 96 of the *BIA* by reference and allows a monitor to impugn a transfer at undervalue in a corporate restructuring.

35 Because the purpose of s. 96 is to protect creditors rather than to punish debtors, the remedy is directed against the person who received the transfer of property from the debtor and others who were privy to the transfer (R. J. Wood, *Bankruptcy and Insolvency Law* (2nd ed. 2015), at p. 191). A "person who is privy" to the transfer is defined under the *BIA* as "a person who is not dealing at arm's length with a party to a transfer and, by reason of the transfer, directly or indirectly, receives a benefit or causes a benefit to be received by another person" (s. 96(3)).

(b) Transfers at Undervalue Undermine the Integrity of the Bankruptcy Process

36 The two main purposes of the *BIA* are the "equitable distribution of the bankrupt's assets among his or her creditors and the bankrupt's financial rehabilitation" (*Orphan Well Association v. Grant Thornton Ltd.* 2019 SCC 5, [2019] 1 S.C.R. 150, at para. 67, quoting *Alberta (Attorney General) v. Moloney* 2015 SCC 51, [2015] 3 S.C.R. 327, at para. 32, citing *Husky Oil Operations Ltd. v. Minister of National Revenue* [1995] 3 S.C.R. 453, at para. 7; see also *Poonian v. British Columbia (Securities Commission)* 2024 SCC 28, at para. 1). A bankrupt's financial rehabilitation involves allowing "honest but unfortunate debtors to obtain a discharge of their debts and have a 'fresh start', free of debt" (F. Bennett, *Bennett on Bankruptcy* (26th ed. 2024), at p. 37). Other objectives of the bankruptcy system include preserving and maximizing the value of a debtor's assets and protecting the public interest (*9354-9186 Québec inc. v. Callidus Capital Corp.* 2020 SCC 10, [2020] 1 S.C.R. 521, at para. 40).

37 Transfers at undervalue frustrate the purposes of the *BIA*. They prejudice creditors by diminishing the value of a debtor's estate and reducing the funds available for distribution. They can also involve fraudulent debtors abusing the bankruptcy process by seeking a fresh start after trying to place assets beyond the reach of creditors, thereby undermining the integrity of the bankruptcy process (see, generally, Wood (2015), at pp. 188 and 190-91; L. W. Houlden, G. B. Morawetz and J. Sarra, *Bankruptcy and Insolvency Law of Canada* (4th ed. rev. (loose-leaf)), vol. 2, at p. 5-959; J. D. Honsberger and V. W. DaRe, *Honsberger's Bankruptcy in Canada* (5th ed. 2017), at pp. 8-9).

(c) Section 96 of the BIA Establishes Three Classes of Impeachable Transactions

38 Section 96 of the *BIA* establishes three classes of impeachable transactions (R. J. Wood, "Transfers at Undervalue: New Wine in Old Wineskins?", in J. P. Sarra and B. Romaine, eds., *Annual Review of Insolvency Law 2017* (2018), 1, at p. 4).

39 The first class of impeachable transaction involves arm's length dealing between the debtor and a party or privy to the transfer (s. 96(1)(a)). This class of transaction has the most stringent requirements to reverse a transfer. The trustee must show that the transfer at undervalue occurred within one year of the bankruptcy, the debtor was insolvent at the time of the transfer or was rendered insolvent by it, and the debtor intended to defraud, defeat, or delay a creditor.

40 The second class of impeachable transaction involves a transfer at undervalue to a party who was not dealing at arm's length with the debtor and which occurred within one year of the bankruptcy (s. 96(1)(b)(i)). In this context, "the concept of a non-arm's length relationship is one in which there is no incentive for the transferor to maximize the consideration for the property being transferred in negotiations with the transferee" (Houlden, Morawetz and Sarra, at p. 5-966; see also Wood (2015), at p. 204; *BIA*, s. 4). The trustee need not show that the debtor was insolvent at the time of the transfer or that the debtor intended to defraud, defeat, or delay a creditor.

41 The third class of impeachable transaction involves a transfer at undervalue to a party who was not dealing at arm's length with the debtor, which occurred more than one year but less than five years before the bankruptcy (s. 96(1)(b)(ii)). In this class, the trustee may obtain a remedy by proving that the debtor was insolvent at the time of the transfer or was rendered insolvent by it (s. 96(1)(b)(ii)(A)), or by proving that the debtor intended to defraud, defeat, or delay a creditor (s. 96(1)(b)(ii)(B)).

42 This appeal involves the third class of transaction, under s. 96(1)(b)(ii)(B) of the *BIA*.

(d) The Debtor's Intent to Defraud, Defeat, or Delay a Creditor Can Be Proved Through Badges of Fraud

43 Section 96(1)(b)(ii)(B) of the *BIA* requires the party seeking to reverse a transfer at undervalue to prove the debtor's intent to defraud, defeat, or delay a creditor. This is a question of fact to be decided based on all the circumstances that existed at the time of the transfer (*Urbancorp*, at para. 53; *Montor Business Corp. (Trustee of) v. Goldfinger*2016 ONCA 406, 36 C.B.R. (6th) 169 ("*Montor CA*"), at para. 72).

44 Because it is often difficult to adduce evidence of a debtor's subjective intent, the intent requirement is often proved through the evidentiary shortcut of badges of fraud. Badges of fraud are suspicious circumstances from which a court may infer the debtor's intent to defraud, defeat, or delay a creditor (*Urbancorp*, at para. 52; *Montor CA*, at para. 72; Wood (2018), at p. 24). The badges of fraud approach to inferring a debtor's intent to defraud creditors is of ancient vintage, dating back to *Twyne's Case* in 1601 (Wood (2018), at p. 24; *Twyne's Case*, (1601), 3 Co. Rep. 80b, 76 E.R. 809).

45 Case law has recognized the following non-exhaustive examples of badges of fraud: (a) the debtor had few remaining assets after the transfer; (b) the transfer was made to a non-arm's length party; (c) the debtor was facing actual or potential liabilities, was insolvent, or was about to enter a risky undertaking; (d) the consideration for the transaction was grossly inadequate; (e) the debtor remained in possession of the property for their own use after the transfer; (f) the deed of transfer had a self-serving and unusual provision; (g) the transfer was secret; (h) the transfer was made with unusual haste; and (i) the transaction was made despite an outstanding judgment against the debtor (*Montor CA*, at para. 73; see also Wood (2018), at p. 24; Wood (2015), at pp. 223-25 (in the fraudulent conveyance context)).

46 A badge of fraud must be considered in the context of the surrounding circumstances and in relation to the question of the debtor's intention at the time of the transfer (*Urbancorp*, at para. 65). A court must avoid analyzing the debtor's actions with the benefit of hindsight; it "must resist the temptation to inject back into the circumstances surrounding the impugned transaction knowledge about how events unfolded after that time" (*Montor Business Corp. (Trustee of) v. Goldfinger* 2013 ONSC 6635, 8 C.B.R. (6th) 200, at para. 272, aff'd 2016 ONCA 406, 36 C.B.R. (6th) 169). The presence of one or more badges of fraud does not require the court to infer an intent to defraud, defeat, or delay a creditor, nor does the absence of a particular badge of fraud prevent the court from inferring this intent (*Urbancorp*, at paras. 53 and 55; *Montor CA*, at para. 72; see also Wood (2018), at pp. 24-25).

(2) Application to This Case

47 The application judge found that Bondfield and Forma-Con's payments under the false invoicing scheme involved several badges of fraud: the transfers were made between non-arm's length parties; Bondfield and Forma-Con received no value; the truth about the transfers was hidden behind phony invoices describing services that were never provided; the transfers were made with unusual haste when compared to Bondfield and Forma-Con's usual billing cycle; and at the time of the transfers the

companies had significant long-term and off-balance sheet liabilities and potential liabilities as guarantors for other companies (paras. 157-58).

48 Based on these badges of fraud, the application judge found that the evidence as a whole provided "a firm basis for finding that John Aquino, as principal and directing mind of [Bondfield] and Forma-Con, had fraudulent intent — an intent to defraud, defeat or delay creditors" (para. 160). She found that "[i]t was in no way reasonable for him to believe that, throughout the period of the impugned transactions, [Bondfield] and Forma-Con did not have long-term creditors, like lenders, ... who would not be defeated or delayed by the draining of tens of millions of dollars from [Bondfield] and Forma-Con through the false invoicing schemes" (para. 160).

49 Faced with these findings, the appellants contend that the application judge made an extricable error of law by concluding that Mr. Aquino intended to defraud, defeat, or delay Bondfield and Forma-Con's creditors when the record before the court did not allow it to determine the companies' true financial condition at the time of the transfers. They argue that a corporation's financial condition can be determinative on the question of intent, even in the presence of other badges of fraud, if there were enough assets remaining to pay creditors after the transfers at undervalue. The appellants note that Bondfield and Forma-Con "were paying their creditors in full and on time for most of the applicable review periods" (A.F., at para. 77). They ask this Court to remit the case to the application judge with instructions to determine the companies' financial condition at the time of the transfers.

50 I would not give effect to this submission. The application judge did not misapply the badges of fraud approach to inferring fraudulent intent. It is no answer to an application under s. 96(1)(b)(ii)(B) of the *BIA* to say that the debtor was not insolvent and was paying its creditors in full and on time at the time of the transfers. The *BIA* is clear that insolvency is not a prerequisite to finding a debtor intended to defraud, defeat, or delay a creditor. Section 96(1)(b)(ii) is disjunctive: the debtor must *either* be insolvent at the time of the transfer (s. 96(1)(b)(ii)(A)) *or* intend to defraud, defeat, or delay a creditor (s. 96(1)(b)(ii)(B)). The appellants' argument would effectively introduce an insolvency requirement into the latter provision, contrary to Parliament's decision not to do so.

51 The appellants' argument would also give a potentially determinative role to one factor, namely, the debtor's financial condition at the time of the transfer. Although the debtor's financial condition at the time of the transfer is one badge of fraud that may be relevant in inferring an intent to defraud, defeat, or delay a creditor (*Urbancorp*, at para. 64), whether that intent exists must be determined based on all the circumstances. Again, the presence of a particular badge of fraud does not require a court to infer an intent to defraud, defeat, or delay a creditor, nor does the absence of a particular badge of fraud require the court to refrain from inferring that intent (*Urbancorp*, at paras. 53 and 55; *Montor CA*, at para. 72). A court may find that a debtor intended to defraud, defeat, or delay a creditor under s. 96(1)(b)(ii)(B) even if the debtor was not insolvent at the time of the transfer at undervalue.

52 The application judge considered the financial condition of the debtor companies and rejected the appellants' argument that Mr. Aquino did not intend to defraud, defeat, or delay a creditor just because the transfers were made when Bondfield and Forma-Con could meet their liabilities as they became due. She found that Bondfield was already in a precarious financial position at the time of the transfers and noted Mr. Aquino's admission that he and another stakeholder routinely injected capital into Bondfield to mislead stakeholders about the company's financial condition (paras. 191-93). The application judge could not determine the companies' true financial condition because the companies' financial records contained deceptive accounting and were unreliable (para. 193). Ultimately, after considering the companies' financial condition and numerous other badges of fraud, the application judge saw "no innocent explanation for a false invoicing scheme" (para. 162). In these circumstances, the appellants cannot now reproach the court for being unable to draw precise conclusions about the companies' financial condition.

53 I therefore see no basis to interfere with the application judge's conclusion that Mr. Aquino intended to defraud, defeat, or delay a creditor under the false invoicing scheme.

54 Here, however, the debtors are Bondfield and Forma-Con, not Mr. Aquino. To satisfy s. 96(1)(b)(ii)(B), the trustee and monitor must show that Bondfield and Forma-Con intended to defraud, defeat, or delay a creditor. This requires showing that it is appropriate to attribute Mr. Aquino's fraudulent intent to Bondfield and Forma-Con. I address that issue next.

B. When Can the Intent of the Directing Mind of a Corporation to Defraud, Defeat, or Delay a Creditor Be Attributed to the Corporate Debtor Under Section 96 of the BIA?

55 The appellants contend that even if Mr. Aquino intended to defraud, defeat, or delay a creditor, his intent cannot be attributed to Bondfield and Forma-Con under the corporate attribution doctrine. They invoke the fraud and no benefit exceptions to corporate attribution recognized in this Court's decisions in *Canadian Dredge*, *Livent*, and *DeJong*, and they note that the application judge found that Mr. Aquino intended to defraud both companies and the companies did not benefit from his fraud. The appellants say that this Court's jurisprudence imposes minimal criteria for corporate attribution that must be met in every case, regardless of the context, and that the courts below erred by reframing the corporate attribution doctrine to allow for attribution in this case.

56 I do not accept this submission. As I will explain, the corporate attribution doctrine does not prescribe rigid rules to be applied regardless of the legal context. Instead, this Court has directed that the doctrine must be applied purposively, contextually, and pragmatically to promote the purpose of the law under which attribution is sought. The fraud and no benefit exceptions to corporate attribution should not apply to a transfer at undervalue claim under s. 96 of the *BIA* because these exceptions would undermine the purpose of this provision. Consequently, Mr. Aquino's fraudulent intent should be attributed to Bondfield and Forma-Con.

(1) The Need for Rules of Corporate Attribution

57 A corporation is a separate legal person distinct from its founders, shareholders, and directors. The separate legal personality of a corporation has been a "bedrock principle of law" since the House of Lords' seminal decision in *Salomon v. Salomon & Co.*, [1897] A.C. 22 (*Chevron Corp. v. Yaiguaje* 2015 SCC 42, [2015] 3 S.C.R. 69, at para. 80; see also S. Rappos, "A Reframing of the Corporate Attribution Doctrine in the Bankruptcy and Insolvency Context", in J. Corraini and D. B. Nixon, eds., *Annual Review of Insolvency Law 2022* (2023), 1, at p. 1).

58 The separate legal personality of a corporation is recognized by business corporation statutes across Canada, which provide that a corporation has the capacity, rights, powers, and privileges of a natural person (see *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 15; *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 15; *Business Corporations Act*, CQLR, c. S-31.1, s. 10; *Business Corporations Act*, R.S.A. 2000, c. B-9, s. 16(1); *Business Corporations Act*, S.B.C. 2002, c. 57, s. 30; *The Business Corporations Act, 2021*, S.S. 2021, c. 6, s. 3-1(1); *The Corporations Act*, C.C.S.M., c. C225, s. 15(1); *Business Corporations Act*, S.N.B. 1981, c. B-9.1, s. 13(1); *Companies Act*, R.S.N.S. 1989, c. 81, s. 26(8); *Business Corporations Act*, R.S.P.E.I. 1988, c. B-6.01, s. 22(1); *Corporations Act*, R.S.N.L. 1990, c. C-36, s. 27(1); *Business Corporations Act*, R.S.Y. 2002, c. 20, s. 18(1); *Business Corporations Act*, S.N.W.T. 1996, c. 19, s. 15(1)).

59 Although a corporation is a separate legal person, it has no mind or will of its own. As explained by Kevin P. McGuinness and Maurice Coombs, "[e]very single act that involves a corporation, and every decision not to act, is the action or inaction of human beings and only human beings" (*Canadian Business Corporations Law* (4th ed. 2023), vol. 1, at ¶9-11). This has long been recognized by the jurisprudence. In *Canadian Dredge*, for example, this Court said that "a corporation may only act through agents" (p. 675). The Court cited Viscount Haldane L.C.'s speech in *Lennard's Carrying Co. v. Asiatic Petroleum Co.*, [1915] A.C. 705 (H.L.), at pp. 713-14, which explained the need to identify a directing mind because a corporation can only act through a human agent:

> ... a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will may consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation. [pp. 678-79]

60 Professor Darcy L. MacPherson notes that "[t]he attribution of personhood to a corporation in turn necessitates a mechanism to give that person a mental state.... Since so many areas of our law depend on mental states, the law must therefore attribute a mental state to the corporation" ("The Civil and Criminal Applications of the Identification Doctrine: Arguments for Harmonization" (2007), 45 *Alta. L. Rev.* 171, at p. 186; see also E. Ferran, "Corporate Attribution and the Directing Mind and Will" (2011), 127 *Law Q. Rev.* 239, at p. 241).

61 In *Meridian Global Funds Management Asia Ltd. v. The Securities Commission*, [1995] 2 A.C. 500 (P.C.), widely considered to be the leading United Kingdom decision on corporate attribution, Lord Hoffman discussed the need for rules of attribution this way:

> Any proposition about a company necessarily involves reference to a set of rules. A company exists because there is a rule (usually in a statute) which says that a persona ficta shall be deemed to exist and to have certain of the powers, rights and duties of a natural person. But there would be little sense in deeming such a persona ficta to exist unless there were also rules to tell one what acts were to count as acts of the company. It is therefore a necessary part of corporate personality that there should be rules by which acts are attributed to the company. These may be called "the rules of attribution". [p. 506]

62 The rules of attribution, Lord Hoffman elaborated, can arise from three sources: (1) *primary rules of attribution*, contained in a corporation's statutes or constitution, or general company law, stipulating when decisions taken by shareholders or the board of directors are to be treated as decisions of the corporation; (2) *general rules of attribution*, such as under the law of agency or vicarious liability, which also apply to natural persons; and (3) *the common law of corporate attribution*, which requires the court to fashion and apply a special rule of attribution for the particular context in which the question arises (*Meridian*, at p. 507; see also *Bilta (UK) Ltd. v. Nazir*[2015] UKSC 23[2016] A.C. 1, at para. 190, per Lords Toulson and Hodge; *Singularis Holdings Ltd. v. Daiwa Capital Markets Europe Ltd.*, [2019] UKSC 50, [2020] A.C. 1189(U.K. S.C.), at para. 28, per Lady Hale). The last of these three sources, the common law of corporate attribution, is sometimes known as the identification doctrine because it supplies rules for when a corporation may be identified with the actions or intent of its directing mind (see *Canadian Dredge*, at pp. 670, 673, 682-83 and 692-93; MacPherson, at p. 172).

(2) This Court's Corporate Attribution Jurisprudence

63 This Court has addressed the corporate attribution doctrine in three decisions over the last 40 years: *Canadian Dredge* in 1985, in the context of corporate criminal liability for wrongdoing by directing minds; *Livent* in 2017, in the context of an auditor's civil liability to a company's creditors for failing to detect fraud by the company's directing minds; and *DeJong* in 2019, in the context of a civil claim for knowing assistance and knowing receipt in relation to a breach of fiduciary duty.

64 This Court's jurisprudence, like the jurisprudence in the United Kingdom, highlights that there is no uniform rule of corporate attribution. Because the attribution doctrine is rooted in public policy, courts must take a purposive, contextual, and pragmatic approach to questions of attribution consistent with the purpose of the law under which attribution is sought.

(a) Canadian Dredge (1985)

65 In *Canadian Dredge*, this Court applied the corporate attribution doctrine in the criminal context. Four corporations were found criminally liable for the *mens rea* offence of bid-rigging under the *Criminal Code*, R.S.C. 1985, c. C-46. Each corporation had a manager or directing mind who conducted the corporation's business. The corporations denied criminal liability because the managers had acted in fraud of the corporations, for their own benefit, and outside the scope of their employment. Justice Estey rejected these arguments. He found the corporations guilty because the directing minds had not acted wholly for their own benefit and the corporations had received some benefits. He formulated a common law rule for corporate attribution (at pp. 681-82 and 712-13), which this Court later distilled in *Livent*, at para. 100:

> To attribute the fraudulent acts of an employee to its corporate employer, two conditions must be met: (1) the wrongdoer must be the directing mind of the corporation; and (2) the wrongful actions of the directing mind must have been done within the scope of his or her authority; that is, his or her actions must be performed within the sector of corporate operation

> assigned to him. For the purposes of this analysis, an individual will cease to be a directing mind unless the action (1) was not totally in fraud of the corporation; and (2) was by design or result partly for the benefit of the corporation. [Citation omitted.]

66 Justice Estey highlighted that the corporate attribution doctrine was developed "in order to find some pragmatic, acceptable middle ground which would see a corporation under the umbrella of the criminal law of the community but which would not saddle the corporation with the criminal wrongs of all of its employees and agents" (Canadian Dredge, at p. 701). He rejected a test for criminal liability based on total vicarious liability for the conduct of any corporate agents, whatever their level of employment and responsibility, because this would impose criminal liability when "there is neither moral turpitude nor negligence" (p. 691). This, in turn, would not serve the public policy goal of protecting the interests of the community and advancing law and order (pp. 691 and 707-8). Justice Estey also rejected a test for criminal liability that would find a corporation liable only when it commits a criminal act on the express instructions of its board of directors, because this would allow corporations to absolve themselves from criminal consequences "by the simple device of adopting and communicating to its staff a general instruction prohibiting illegal conduct and directing conformity at all times with the law" (p. 699).

67 To respond to these policy concerns, Estey J. formulated the "fraud" and "no benefit" exceptions as public policy-based exceptions to the general principle that a directing mind's knowledge should be attributed to a corporation to establish corporate criminal liability. The exceptions were justified, Estey J. stated, because in both situations "no social purpose is served by convicting a corporation" (Canadian Dredge, at p. 704; see also pp. 707-8). Imposing criminal liability would be unjust if the corporation is totally defrauded by, or does not benefit from, the wrongdoing of its directing mind. As Estey J. explained:

> The identification theory ... loses its basis in rationality when it is applied to condemn a corporation under the criminal law for the conduct of its manager when that manager is acting not in any real sense as its directing mind but rather as its arch enemy.... In my view, the very pragmatic origins of the identification rule militate against its extension to the situation which would have existed here had one or more of the directing minds acted entirely for his own benefit and directed his principal efforts to defrauding the company. Where the corporation benefited or was intended to be benefited from the fraudulent and criminal activities of the directing mind, the *rationale* of the identification rule holds. Where the delegate of the corporation has turned against his principal, the *rationale* fades away. [Emphasis in original; p. 719.]

(b) Livent (2017)

68 In *Livent*, this Court adapted the principles enunciated in Canadian Dredge to the civil context. An auditor had invoked the corporate attribution doctrine to defend against a claim brought by a corporation's receiver for the auditor's negligence in failing to uncover fraud by the corporation's directing minds. The auditor argued that the fraud of the directing minds should be attributed to the corporation to give the auditor a defence of illegality to avoid civil liability to the corporation.

69 Writing for the majority of the Court, Gascon and Brown JJ. noted that although the criteria in Canadian Dredge seemed "[a]t first glance" to be satisfied because the fraud was intended to benefit the corporation by giving it an "artificial extension of its life" (para. 101), they declined to attribute the directing minds' wrongdoing to the corporation. They highlighted that the Canadian Dredge test was "not ... a standalone principle", but rather "a means by which acts may be attributed to a corporation for the particular purpose or defence at issue" (para. 97 (emphasis added)). They emphasized that "corporate identification must be analyzed independently for each defence" (para. 97). Continuing the purposive, contextual, and pragmatic approach developed in Canadian Dredge, Gascon and Brown JJ. noted that the "public policy and judicial necessity" principles that justify attributing the actions of the directing mind to the corporation in the criminal context do not apply in the context of an auditor's negligent preparation of a statutory audit:

> ... the very purpose of a statutory audit is to provide a means by which fraud and wrongdoing may be discovered. It follows that denying liability on the basis that an individual within the corporation has engaged in the very action that the auditor was enlisted to protect against would render the statutory audit meaningless .... [I]t would be perverse to deny auditor's liability for negligently failing to detect fraud "where the harm [to the corporation] is likely to occur and likely to be most serious" .... [Citations omitted; para. 103.]

70 This Court in *Livent* added an important qualification to the "authoritative test" for corporate attribution set out in *Canadian Dredge* (para. 104). The Court recognized a judicial discretion not to attribute a directing mind's actions or intent to a corporation when, in the circumstances of the case, declining attribution would be in the public interest (para. 104). The discretion reflects the rationale of the fraud and no benefit exceptions, that attribution should promote the policy of the law under which attribution is sought. Justices Gascon and Brown stated that when attribution "would render meaningless the very purpose for which a duty of care was recognized, such application [of the corporate attribution doctrine] will rarely be in the public interest" (para. 104).

(c) DeJong (2019)

71 *DeJong* involved a large and complex multimillion-dollar real estate fraud involving two groups of companies that were victims of the fraud. The first group of companies sued the second group, claiming that the latter had knowingly assisted the fraudsters to commit the fraud and seeking to attribute the fraudsters' conduct to them. A majority of the Court of Appeal for Ontario accepted the argument for attribution, reasoning that the corporate attribution doctrine "may be approached in a less demanding fashion" in the civil context than in the criminal context of a *mens rea* offence (*DBDC Spadina Ltd. v. Walton* 2018 ONCA 60, 78 B.L.R. (5th) 183, at para. 70). In dissent, van Rensburg J.A. would have declined to relax the approach to corporate attribution, saying that she saw "no justification in the circumstances of this case to lessen the requirement for knowledge before one victim of a fraud is tagged with the conduct of a fraudster" (para. 237).

72 Speaking for this Court, Brown J. allowed the appeal in brief oral reasons that adopted the dissenting reasons of van Rensburg J.A. Justice Brown observed that "while the presence of public interest concerns may *heighten* the burden on the party seeking to have the actions of a directing mind attributed to a corporation, *Canadian Dredge* states *minimal* criteria that must always be met" (*DeJong*, at para. 2 (emphasis in original)).

73 The appellants interpret Brown J.'s statement that "*Canadian Dredge* states *minimal* criteria that must always be met" as effectively endorsing a mechanical rather than a purposive, contextual, and pragmatic application of the corporate attribution doctrine. They submit that a court cannot attribute the intent or acts of a fraudulent directing mind to a corporation when either the fraud or no benefit exception applies, regardless of the legal context.

74 I would clarify the seemingly inflexible statement in this Court's brief oral reasons in *DeJong*. I respectfully disagree with any suggestion that the criteria in *Canadian Dredge* should be applied mechanically in every case, even if they would be inconsistent with the purpose of the law under which attribution is sought. The Court's principal concern in *DeJong* was to reject the suggestion that courts have an unfettered judicial discretion to relax the approach to corporate attribution based on the factual circumstances of a case. In my view, *DeJong* should not be read as departing from the longstanding purposive, contextual, and pragmatic approach to corporate attribution recognized in *Canadian Dredge* and *Livent*.

(3) Guidance From United Kingdom Jurisprudence

75 In recent years, courts in the United Kingdom have similarly applied the corporate attribution doctrine in a purposive, contextual, and pragmatic manner.

76 The modern history of the corporate attribution doctrine in the United Kingdom must begin with *Meridian* . There, Lord Hoffman explained on behalf of the Privy Council that rules of corporate attribution must be tailored for "the particular substantive rule" under which attribution is sought (p. 507). Lord Hoffman wrote:

> This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was *for this purpose* intended to count as the act etc. of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy. [Emphasis in original; p. 507.]

77 Lord Hoffman added that "[o]nce it is appreciated that the question is one of construction rather than metaphysics" (p. 511), questions of corporate attribution become straightforward. The courts must always apply "an attribution rule for a particular purpose, tailored as it always must be to the terms and policies of the substantive rule" under which attribution is sought (p. 512).

78 Lord Hoffman applied these principles in *Meridian* to conclude that a publicly traded corporation breached disclosure obligations under New Zealand securities legislation. He attributed to the corporation the knowledge of a lower level executive who had been responsible for obtaining a substantial interest in publicly traded securities on the corporation's behalf. "Otherwise", Lord Hoffman said, "the policy of the Act would be defeated":

> Companies would be able to allow employees to acquire interests on their behalf which made them substantial security holders but would not have to report them until the board or someone else in senior management got to know about it. This would put a premium on the board paying as little attention as possible to what its investment managers were doing. [p. 511]

79 Professor Jennifer Payne highlights two important lessons from *Meridian* . The first lesson is that the special rules of attribution under the common law doctrine "do not mean that a company itself has done something or had a particular state of mind" ("Corporate Attribution and the Lessons of *Meridian* ", in P. S. Davies and J. Pila, *The Jurisprudence of Lord Hoffman: A Festschrift in Honour of Lord Leonard Hoffman* (2015), 357, at p. 375). She observes that *Meridian* helpfully "moved away from the anthropomorphic 'metaphysical' approach to company attribution towards a more context-driven approach" (p. 363). The second and related lesson is that "the issue of attribution depends on the context. It is always necessary to ask whether an act or state of mind of a particular individual should be attributed to the company for *this particular purpose*" (p. 375 (emphasis in original)). Professor Eilís Ferran agrees that "contextualization, rather than anthropomorphic inquiry into corporate personality, is the key to answering these questions" of corporate attribution (p. 239).

80 Recent decisions of the Supreme Court of the United Kingdom have affirmed the approach in *Meridian* by applying the corporate attribution doctrine based on the context and purpose of the relevant law under which attribution is sought (see *Bilta*, at para. 9, per Lord Neuberger, at paras. 41-42, per Lord Mance, at para. 92, per Lord Sumption, and at para. 181, per Lords Toulson and Hodge). As Lady Hale stated succinctly in *Singularis*, "the key to any question of attribution [is] always to be found in considerations of the context and the purpose for which the attribution [is] relevant" (para. 30).

81 The Supreme Court of the United Kingdom has also highlighted that because the corporate attribution doctrine must be applied purposively and contextually, a company or the court "can rely on attribution for one purpose, but disclaim attribution for another" (*Bilta*, at para. 43, per Lord Mance). As a result, attribution may be inappropriate in a claim by a corporation against its directors for breach of their duties to the corporation, but may be appropriate when determining the corporation's liability to a third party or for breach of a statutory provision (see *Bilta*, at para. 7, per Lord Neuberger, at para. 43, per Lord Mance, at paras. 67 and 92, per Lord Sumption, and at paras. 208-9, per Lords Toulson and Hodge; Payne, at p. 376).

(4) Summary

82 The guiding principles for the common law doctrine of corporate attribution under Canadian law can be summarized as follows:

> (a) As a general rule, a person's fraudulent acts may be attributed to a corporation if two conditions are met: (1) the wrongdoer was the directing mind of the corporation at the relevant times; and (2) the wrongful actions of the directing mind were performed within the sector of corporate responsibility assigned to them (*Canadian Dredge*, at pp. 681-82; *Livent*, at para. 100).

> (b) Attribution will generally be inappropriate when: (1) the directing mind acted totally in fraud of the corporation (the fraud exception); or (2) the directing mind's actions were not by design or result partly for the benefit of the corporation (the no benefit exception) (*Canadian Dredge*, at pp. 712-13; *Livent*, at para. 100).

(c) In addition to the fraud and no benefit exceptions, courts have discretion to refrain from attributing the actions, knowledge, state of mind, or intent of the directing mind to the corporation when this would be in the public interest, in the sense that it would promote the purpose of the law under which attribution is sought (*Livent*, at para. 104; *DeJong*, at para. 2).

(d) In all cases, courts must apply the common law corporate attribution doctrine purposively, contextually, and pragmatically. The corporate attribution doctrine is not a "standalone principle" (*Livent*, at para. 97); there is no one-size-fits-all approach. The court must always determine whether the actions, knowledge, state of mind, or intent of a person should be treated as those of the corporation for the purpose of the law under which attribution is sought (*Livent*, at paras. 102-3). This may require the court to tailor the general rule of attribution or its exceptions to the particular legal context. Attribution may be appropriate for one purpose in one context but may be inappropriate for another purpose in another context.

83 With these guiding principles in mind, I now consider how the corporate attribution doctrine should be applied to transfers at undervalue under s. 96 of the *BIA*.

(5) Applying the Corporate Attribution Doctrine in the Context of Section 96 of the BIA

84 The respondents urge this Court to apply the corporate attribution doctrine in the context of s. 96 of the *BIA* purposively, contextually, and pragmatically, consistent with this Court's precedents and the persuasive authority from the United Kingdom. They argue that the fraud and no benefit exceptions to corporate attribution should not apply in the context of a claim under s. 96 of the *BIA* for a transfer at undervalue because applying either exception would flout the purpose of s. 96.

85 I agree. Recall that s. 96 of the *BIA* is a tool to remedy asset stripping by a debtor by clawing back assets that were improperly transferred to others before bankruptcy in order to protect the pool of assets available for creditors. The issue is whether and when attributing the actions or intent of the corporation's directing mind to a corporate debtor would promote the purpose of this provision.

86 The remedial purpose of s. 96 of the *BIA* is served by attributing the actions, knowledge, state of mind, or intent of the directing mind to the corporation, even if the directing mind acted in fraud of the corporation, and even if the corporation did not benefit from the actions of the directing mind. Professor Roderick J. Wood has explained that the reason for this conclusion relates to the "highly distinctive nature of the rights at stake" ("*Ernst & Young Inc. v. Aquino*: Attributing Fraudulent Intent to a Defrauded Corporation" (2022), 66 *Can. Bus. L.J.* 250, at p. 259). As he notes, "[t]he underlying goal [of s. 96] is not to punish or deter the debtor or to award damages against the debtor, but rather to protect the interests of creditors" (p. 259). The "social purpose of the legislation ... is served whether or not the directing mind is acting in fraud of the corporation" (p. 259).

87 On the other hand, applying the fraud and no benefit exceptions under s. 96 would deny third-party creditors the benefit of a statutory remedy intended to protect them from asset stripping and would diminish the pool of assets available for their claims. This would undermine the purpose of s. 96.

88 As in *Livent*, where this Court said that "denying liability on the basis that an individual within the corporation has engaged in the very action that the auditor was enlisted to protect against would render the statutory audit meaningless" (para. 103), applying the fraud and no benefit exceptions mechanically under s. 96 of the *BIA* would render the transfer at undervalue remedy meaningless. The purpose of this statutory remedy is to protect creditors from the debtor transferring assets to others for little to no benefit. Applying the exceptions would undermine this purpose. It would result in denying liability on the basis that the corporation's directing mind engaged in the very action that the provision targets. Such an approach would be perverse.

89 Consequently, the test for corporate attribution under s. 96 of the *BIA* is simply whether the person was the directing mind and whether their actions were performed within the sector of corporate responsibility assigned to them. If these criteria are met, the actions, knowledge, state of mind, or intent of the directing mind should be attributed to the corporation, regardless of whether the fraud and no benefit exceptions are engaged (see Wood (2022), at pp. 260-61).

90 It follows that I do not accept the appellants' submission that the principles of statutory interpretation require courts to apply the fraud and no benefit exceptions in this context. The appellants argue that because s. 96 of the *BIA* does not clearly and unambiguously derogate from the common law of corporate attribution, the rules in *Canadian Dredge*, *Livent*, and *DeJong* must be applied without modification, including the fraud and no benefit exceptions. The appellants' submission presupposes that the common law rules of corporate attribution should be applied regardless of the context or purpose of the law under which attribution is sought, unless the legislature expressly derogates from those rules. But that is a false premise. The corporate attribution doctrine must *always* be applied having regard to the context and the purpose of the law under which attribution is sought. This approach has been integral to the Canadian common law of corporate attribution since *Canadian Dredge* .

91 I therefore agree with the conclusion of the Court of Appeal that attributing Mr. Aquino's fraudulent intent to Bondfield and Forma-Con would advance the public policy underlying s. 96 of the *BIA*. Attribution would allow creditors to recover fraudulently transferred assets that unlawfully reduced the value of the estate available for distribution to creditors. I respectfully disagree, however, with two aspects of the Court of Appeal's reasoning on this issue.

92 First, the Court of Appeal stated that attributing the directing mind's knowledge or intent to the company itself "can hardly be said to unjustly prejudice the company in the bankruptcy context, when the company is no longer anything more than a bundle of assets to be liquidated with the proceeds distributed to creditors" (para. 77). The court added that "[a]n approach that would favour the interests of fraudsters over those of creditors seems counterintuitive and should not be quickly adopted" (para. 77).

93 With respect, however, the Court of Appeal's rationale for attribution does not apply to transfers at undervalue in the restructuring context under the *CCAA*. As the appellants correctly explain, "[i]n a *CCAA* monitorship, unlike a traditional bankruptcy, the possibility remains for the debtor company to be rehabilitated and to resume its normal operations at some future date" (A.F., at para. 47). As a result, in the restructuring context, it cannot be said that "the company is no longer anything more than a bundle of assets to be liquidated with the proceeds distributed to creditors" (para. 47).

94 Second, the Court of Appeal reframed the test for corporate attribution in the bankruptcy context by stating that "[t]he underlying question here is who should bear responsibility for the fraudulent acts of a company's directing mind that are done within the scope of his or her authority — the fraudsters or the creditors?" (para. 78). Not surprisingly, the court answered this question in favour of the creditors and attributed Mr. Aquino's fraudulent intent to Bondfield and Forma-Con. The court said that "[p]ermitting the fraudsters to get a benefit at the expense of creditors would be perverse" (para. 79).

95 The Court of Appeal's framing of the question poses a contest between fraudsters and creditors. But as Professor Wood notes, this question is "misconceived" because transfers at undervalue can involve not just fraudsters, but also innocent recipients (Wood (2022), at p. 257). As he explains, the Court of Appeal's question "misdirects the focus of analysis" because in such cases the "contest" is between the corporation's creditors and the recipients of the transfer, who might be just as innocent (p. 257). Professor Wood gives the helpful example of the sale of a house at undervalue to an innocent purchaser, who would be prejudiced if the sale were to be successfully challenged under s. 96 of the *BIA*:

> Consider the case where a house is sold to an innocent buyer in an arm's length dealing for a price that is conspicuously less than its market value. If the debtor intended to defeat creditors and was insolvent at the time of the transfer, the trustee will be able to set aside the sale or require the buyer to pay the difference in value under section 96(1)(a) of the BIA. This holds true even though the buyer may have incurred considerable expense in moving into the house and may also not have the funds to pay the difference in value. Despite searching in the land registration system and finding nothing, the innocent buyer is placed in a precarious position. If fraud is involved it lies with the seller, but the buyer is the party who stands to lose to the seller's creditors. This is not a contest between fraudsters and creditors so an allocation of responsibility on the basis suggested by the [c]ourt is misconceived. [Emphasis added; footnote omitted; p. 257.]

96 As a result, I agree with the Court of Appeal's conclusion that the fraud and no benefit exceptions to corporate attribution do not apply under s. 96 of the *BIA*, but I respectfully disagree with some of the court's reasoning.

97 In sum, the fraud and no benefit exceptions are inappropriate and inapplicable in the context of transfers at undervalue under s. 96 because these exceptions would undermine the creditor protection purpose of this provision.

(6) Application to This Case

98 Mr. Aquino, as the directing mind of Bondfield and Forma-Con, intended to defraud, defeat, or delay creditors of Bondfield and Forma-Con through the false invoicing scheme. In conducting the false invoicing scheme, he acted in his assigned sector of corporate responsibility of engaging with suppliers and overseeing the provision of services and materials. His intent should therefore be attributed or imputed to Bondfield and Forma-Con under s. 96(1)(b)(ii)(B) of the *BIA*.

99 Consequently, I would affirm the application judge's order regarding the appellants' liability for the transfers at undervalue.

VII. Disposition

100 I would dismiss the appeal with costs.

Appeal dismissed.

Pourvoi rejeté.

TAB 4

2002 CarswellOnt 4507
Ontario Superior Court of Justice

Conte Estate v. Alessandro

2002 CarswellOnt 4507, [2002] O.J. No. 5080, [2002] O.T.C. 1035, 119 A.C.W.S. (3d) 951

Elisa Conte, Executrix and Trustee for Cesidio Conte and Elisa Conte, Plaintiffs and Joe Alessandro Also Known as Giuseppe Alessandro, a Bankrupt, Gregorina Alessandro, Alba Alessandro and A. Farber & Partners Inc., Trustee in Bankruptcy of the Estate of the Said Giuseppe (aka) Joe Alessandro, Defendants

Rouleau J.

Heard: September 17-23, 2002
Judgment: December 10, 2002
Docket: 96-CU-114234

Counsel: *Joseph J. Colangelo*, for Plaintiffs
William G. Dingwall, Q.C., for Defendants

Subject: Contracts; Corporate and Commercial; Torts; Property

Related Abridgment Classifications

Debtors and creditors

XII Fraudulent conveyances

XII.10 Fraudulent intent

XII.10.d "Badges of fraud"

Headnote

Fraud and misrepresentation --- Fraudulent conveyances — Fraudulent intent — "Badges of fraud"

Shortly after plaintiff had commenced debt action against defendant JA for $350,000, JA transferred property to wife, defendant GA, for $2 — Plaintiff was awarded $413,768.33 in debt action — Following judgment against JA, GA executed $225,000 charge on transferred property in favour of daughter — Plaintiff brought action to set aside transfer and mortgage as fraudulent conveyances — Defendants brought counterclaim for declaration that property was beneficially owned by GA and mortgage to daughter was valid — Action allowed; transactions set aside — Counterclaim dismissed — Transfer and mortgage were conveyed with fraudulent intent, as evidenced by numerous badges of fraud surrounding both transactions.

Table of Authorities

Cases considered by *Rouleau J.*:

Bank of Montreal v. Jory, 39 C.B.R. (N.S.) 30, 1981 CarswellBC 497 (B.C. S.C.) — considered

Koop v. Smith, 51 S.C.R. 554, 8 W.W.R. 1203, 25 D.L.R. 355, 1915 CarswellBC 151 (S.C.C.) — considered

Petrone v. Jones, 33 C.B.R. (3d) 17, 1995 CarswellOnt 312 (Ont. Gen. Div.) — considered

Prodigy Graphics Group Inc. v. Fitz-Andrews, 2000 CarswellOnt 1178 (Ont. S.C.J.) — referred to

Twyne's Case (1601), 76 E.R. 809, 3 Co. Rep. 80b, [1558-1774] All E.R. Rep. 303 (Eng. K.B.) — referred to

Statutes considered:

Assignments and Preferences Act, R.S.O. 1990, c. A.33

Generally — considered

s. 4(1) — referred to

s. 4(2) — referred to

s. 4(3) — referred to

s. 5(1) — referred to

Fraudulent Conveyances Act, R.S.O. 1990, c. F.29

Generally — considered

s. 2 — referred to

s. 3 — referred to

Statute of Uses, R.S.O. 1897, c. 331

Generally — referred to

ACTION by plaintiff to set aside property transfer and mortgage as fraudulent conveyances; COUNTERCLAIM by defendants for declaration of beneficial ownership of property and validity of mortgage.

***Rouleau J.*:**

I. Introduction

1 This action was brought by Cesidio and Elisa Conte ("Cesidio" and "Elisa" respectively) to set aside two non arm's length transactions and to declare them fraudulent and void. The first non arm's length transaction was a conveyance of 1629 James Street, Tiny, Ontario ("the property") from the defendant Giuseppe Alessandro ("Joe") to his wife, the defendant Gregorina Alessandro ("Gregorina"). The second non arm's length transaction was a $225,000 mortgage placed on the property by Gregorina in favour of her daughter, the defendant Alba Alessandro ("Alba"). The plaintiffs also sought other ancillary relief, and the defendants counterclaimed seeking declarations that the property is in fact beneficially owned by Gregorina and that Alba's mortgage is valid.

2 The issue in this action is whether the two transfers of property were fraudulent conveyances: the transfer of property from an insolvent husband to his wife and the subsequent mortgage of the property by the wife to their daughter. I have concluded that both transactions are fraudulent conveyances.

II. The Facts

3 The plaintiff Cesidio died before trial, and the action was continued by his estate. As his death was anticipated, the parties videotaped his testimony which was admitted at trial.

4 The defendant Joe declared bankruptcy in February 2002 and, by order of Wilson J., the plaintiffs were allowed to continue the present action. The trustee in bankruptcy decided not to continue to defend the action and consented to judgment against the bankrupt. For purposes of the trial, therefore, only the defendants Gregorina and Alba defended.

A) The Debt

5 Cesidio and Joe were former partners with two others in a lumber business. In the late 1980s, Joe bought out Cesidio for $400,000 made up of $50,000 cash and a $350,000 promissory note due February 1, 1993. When the note became due in February 1993, the plaintiffs demanded payment but the debt was not paid. Cesidio brought an action for recovery of the $350,000 which resulted in the judgment of Cameron J. dated April 3, 1996. This judgment awarded Cesidio and Elisa Conte $413,768.33 and solicitor and client costs. The judgment bears interest at 10% annually.

6 Despite repeated attempts at collection including a judgment debtor examination, nothing has been paid on this debt. As at the 17th day of September 2002, I was advised that the value of the judgment, with interest, was $642,831.74.

B) The Property

7 In 1972, a numbered company purchased the property that was, at the time, a vacant cottage lot near Georgian Bay. Shortly thereafter the defendant Joe took title of the property in his name "to uses." Although there is conflicting evidence on the point,

it appears that the property was purchased as part of an arrangement among several partners to acquire a series of properties, divide these into building lots and resell them at a profit. Because the partners were purchasing several adjoining lots, they purchased these in a sort of "checker board" arrangement putting properties in their names, in the names of their spouses or in joint ownership.

8 According to the testimony of one of the partners, Giuseppe Marchese, the property was one of five properties acquired by him and three other partners, the defendant Joe, Raffaele Morano and Domenic Scroll. Four of the properties (the "Block D properties") were adjoining, and these were registered in each of the names of the defendants, Gregorina and Joe, and in the names of Raffaele "to uses" and Mariaella Morano. The property which was not adjoining to the others was, as set out above, registered in the name of the defendant Joe "to uses." The sale of the Block D properties generated sufficient monies to cover the full purchase price of the five properties. Therefore the remaining property held by Joe for the four partners was the "profit" of the four partners.

9 According to Giuseppe Marchese, sometime later Joe bought out the interest in the property owned by the three other partners paying $3,000 to each of them. No transfer was necessary since the property was already in Joe's name.

10 In August 1994 the property was transferred from Joe "to uses" to Gregorina for nominal consideration. The land transfer tax affidavit stated that the consideration was $2.00 and that Gregorina "has been the sole beneficial owner during the entire period the lands had been registered in the name of Joe."

C) The Mortgage

11 In October 1996, Alba registered a mortgage in the amount of $225,000 against the property. Alba testified that the consideration for the mortgage was a series of payments made by her to Gregorina during the period December 1993 to April 3, 1995. This series of advances had been made under an agreement entered into among the three defendants in December 1993 (the "loan agreement"). According to Alba the advances were made because her mother needed the money.

12 There was a series of thirteen cheques totalling $258,500 entered into evidence. The defendants claimed the cheques were advances made pursuant to the loan agreement. Although the cheques were all drawn on Alba's account, Joe signed every cheque but one. The three payees of the cheques were Alessandro Holding Ltd., Joe Alessandro, and Joe and Gregorina Alessandro jointly. Little is known of the source and use of these funds as the bank statements were not entered into evidence. Alba testified that by the time she reached her early twenties, she had made hundreds of thousands of dollars trading in penny stocks. Again, no documentation was provided in support of this. It also appeared from Joe's testimony that he was a member of the Board or may have played some role in one or more of the companies, the stock of which Alba traded and profited from.

13 Pursuant to the terms of the loan agreement, the advances of $258,500 would have become due in April 1997. It appears that there was no repayment of these sums.

14 The mortgage was registered in October 1996, and full payment was due one year later. During the first year of the mortgage, Gregorina paid interest. However, on October 1, 1997, when the balance became due, payments stopped, and the mortgage went into default.

D) Chronology

15 The plaintiffs suggest that much can be inferred from the timing of various events. They have put forward a chronology setting out the dates of various key events. I agree that the timing is important and therefore will set out some of the key dates and events in this judgment. They are as follows:

September 26, 1972	Purchase of the subject property by Joe "to uses"
February 1, 1988	Joe purchases the lumber business from Cesidio and Elisa for $400,000; $50,000 payable in cash and the balance of $350,000 by promissory note
February 11, 1993	Demand for payment by the plaintiffs of the $350,000 note

December 3, 1993	Loan agreement among Alba, Joe and Gregorina pursuant to which Alba agrees to advance sums to Joe and Gregorina in the future. The agreement includes a recital that Joe holds the property in trust for Gregorina
December 6, 1993	First advance made under the loan agreement. It is a $5,000 cheque to Alessandro Holdings Ltd.
June 7, 1994	Statement of Claim issued by Cesidio and Elisa to obtain repayment of the $350,000 debt
August 30, 1994	Transfer of the property from Joe to Gregorina for $2
April 3, 1996	Judgment of Justice Cameron in the debt action granting judgment in the amount of $413,768.33, plus post-judgment interest at 10%. Included in the reasons for Justice Cameron is the statement that alleged oral agreements put forward by Joe did not occur and that Justice Cameron did not believe Joe.
July 3, 1996	Examination in aid of execution of Joe
October 4, 1996	Execution of charge on the property by Gregorina and Joe in favour of their daughter Alba
November 14, 1996	Statement of claim in the present action is issued.

III. Issues

16 The issues in this case are as follows:

(a) was the transfer from Joe to Gregorio a fraudulent conveyance?

(b) was the mortgage from Gregorina to Alba a fraudulent conveyance?

(c) Did the plaintiffs and defendants settle the claim before the trial?

IV. The Law

A) Statutory Framework

17 The plaintiffs rely principally on two statutes, the *Fraudulent Conveyances Act* R.S.O. 1990, c.F-29 and the *Assignments and Preferences Act*, R.S.O. 1990, c.A-33.

18 The relevant portions of the *Fraudulent Conveyances Act* are as follows:

2. Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns. R.S.O. 1990, c. F.29, s. 2.

3. Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge of the intent set forth in that section. R.S.O. 1990, c. F.29, s. 3.

19 The relevant portions of the *Assignments and Preferences Act* are as follows:

Nullity of gifts, transfers, etc., made with intent to defeat or prejudice creditors

4.-(1) Subject to section 5, every gift, conveyance, assignment or transfer, delivery over or payment of goods, chattels or effects, or of bills, bonds, notes or securities, or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made by a person when insolvent or unable to pay the personal, debts in full or when the person knows that he, she or it is on the eve of insolvency, with intent to defeat, hinder, delay or prejudice creditors, or any one or more of them, is void as against the creditor or creditors injured, delayed or prejudiced. R.S.O. 1990, c. A.33, s. 4(1).

(2) Subject to section 5, every such gift, conveyance, assignment or transfer, delivery over or payment made by a person being at the time in insolvent circumstances, or unable to pay his, her or its debts in full, or knowing himself, herself or itself to be on the eve of insolvency, to or for a creditor with the intent to give such creditor an unjust preference over other creditors or over any one or more of them is void as against the creditor or creditors injured, delayed, prejudiced or postponed.

(3) Subject to section 5, if such a transaction with or for a creditor has the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them, it shall, in and with respect to any action or proceeding that, within sixty days thereafter, is brought, had or taken to impeach or set aside such transaction, be presumed, in the absence of evidence to the contrary, to have been made with the intent mentioned in subsection (2), and to be an unjust preference within the meaning of this Act whether it be made voluntarily or under pressure.

Assignments for benefit of creditors and good faith sales, etc., protected.

5.(1) Nothing in section 4 applies to an assignment made to the sheriff for the area in which the debtor resides or carries on business or, with the consent of a majority of the creditors having claims of $100 and upwards computed according to section 24, to another assignee resident in Ontario, for the purpose of paying rateably and proportionately and without preference or priority all the creditors of the debtor their just debts, nor to any sale or payment made in good faith in the ordinary course of trade or calling to an innocent purchaser or person, nor to any payment of money to a creditor, nor to any conveyance, assignment, transfer or delivery over of any goods or property of any kind, that is made in good faith in consideration of a present actual payment in money, or by way of security for a present actual advance of money, or that is made in consideration of a present actual sale or delivery of goods or other property where the money paid or the goods or other property sold or delivered bear a fair and reasonable relative value to the consideration therefor. R.S.O. 1990, c. A.33, s. 5(1).

B) Presumption of Fraud

20 In this type of case it is unusual to find direct proof of intent to defeat, hinder or delay creditors. It is more common to find evidence of suspicious facts or circumstances from which the court infers a fraudulent intent.

21 These suspicious facts or circumstances are sometimes referred to as the "badges of fraud." These badges of fraud are evidentiary indicators of fraudulent intent and their presence can form the *prima facie* case needed to raise a presumption of fraud. These badges of fraud can be traced back to *Twyne's Case* (1601), 3 Co. Rep. 80b (Eng. K.B.) and are elaborated upon in *Prodigy Graphics Group Inc. v. Fitz-Andrews*, [2000] O.J. No. 1203 (Ont. S.C.J.).

22 The presence of one or more of the badges of fraud raises the presumption of fraud. Once there is a presumption, the burden of explaining the circumstantial evidence of fraudulent intent falls on the parties to the conveyance. The persuasive burden of proof stays with the plaintiff; it is only the evidentiary burden that shifts to the defendants.

23 In cases of non arm's length transactions, independent corroborative evidence is strongly recommended but not required if the defendants' evidence is found to be credible. In *Koop v. Smith* (1915), 51 S.C.R. 554 (S.C.C.), Duff J. discussed the need for corroborative evidence in a case involving a transaction between two near relatives for no consideration. Duff J., at p.559 stated as follows:

> I think the true rule is that suspicious circumstances coupled with relationship make a case of *res ipsa loquitur* which the tribunal of fact may and will generally treat as a sufficient *prima facie* case, but that it is not strictly in law bound to do so; and that the question of the necessity of corroboration is strictly a question of fact. Having examined the evidence carefully I am satisfied that the learned trial judge was entitled to take the course he did take and not only that the evidence, as I read it in the record, casts the burden of explanation upon the respondent, but that the testimony given by her brother ought not in the circumstances to be accepted as establishing either the actual existence of the debt or of the *bona fides* of the transaction.

24 Another useful case is *Petrone v. Jones* (1995), 33 C.B.R. (3d) 17 (Ont. Gen. Div.). That case supports the proposition that where, as in the present case, the transferor is transferring the only asset he has remaining with which to pay his debts, there is a presumption of an intent to defeat creditors. Wright J., at p.20, stated the proposition as follows:

> In the absence of any direct proof of intention, if a person owing a debt makes a settlement which subtracts from the property which is the proper fund for the payment of those debts, an amount without which the debts cannot be paid then, since it is the necessary consequence of the settlement that some creditors must remain unpaid, it is the duty of the judge to direct a jury that they must infer the intent of the settlor to have been to defeat or delay his creditors. (*Sun Life Assurance Co. v. Elliott* (1900), 31 S.C.R. 91.)
>
> Even if we consider the direct evidence that the defendant had no intention of defeating, hindering, *et cetera* the claims of the plaintiff, can this evidence remain standing in the face of the undoubted evidence that for the past year the defendant has in fact acted in every way to defeat, hinder or delay the plaintiff's claim?
>
> Even if the defendant had no intention, at the time of the conveyance, of defeating, hindering or delaying the plaintiff's claim, surely his actions since that date, the defence of the claim on the promissory note, the defence of this action, prevent him from raising that lack of specific intent as a defence.
>
> Further: even if the plaintiff did not intend to defeat, hinder or delay this creditor but effected the transfer with a view to defeating, hindering or delaying potential future creditors his defence would still fail.

V. Analysis

25 The plaintiffs' position is that the many suspicious circumstances and badges of fraud surrounding the transfer of the property by Joe to Gregorina and the mortgage by Gregorina to Alba raise the presumption of fraud which has not been rebutted. This leads to the inevitable conclusion that the mortgage and the transfer of the property should both be set aside pursuant to the *Fraudulent Conveyances Act*.

A) Assignments and Preferences Act

26 The plaintiffs have also relied on the *Assignments and Preferences Act* as a basis to set aside the mortgage. For the Act to apply, the transferor (or mortgagor) must be insolvent. It may well be that Joe was insolvent at the time that the mortgage was placed on the property, but the mortgage was granted by Gregorina. No evidence was led suggesting that Gregorina was insolvent. Even though Joe, as spouse, consented to the transaction, I do not believe that this would bring the *Assignment and Preferences Act* into play.

B) Requirements to Prove Fraudulent Conveyance

27 The plaintiffs need to show that both the transfer to Gregorina and the subsequent mortgage to Alba were both part of a scheme to defeat, hinder, delay or defraud the plaintiffs contrary to the *Fraudulent Conveyances Act*.

28 If I find that the conveyances were made with intent to defeat, hinder, delay or defraud creditors it would still not be void if the defendants could establish that the transactions were made for good consideration, were *bona fide* and the transferee or mortgagee was a person not having, at the time of the transaction, notice or knowledge of the intent to defraud. The onus to show this, however, is on the defendants. (*Bank of Montreal v. Jory*, [1981] B.C.J. No. 1014 (B.C. S.C.)).

C) Taking Title "To Uses"

29 The taking of title "to uses" was the subject of much argument. The defendants maintain this has the same effect as taking title "in trust." The plaintiffs maintain that it is simply a form of title that was used at that time to avoid the obligations flowing from dower. While both positions may be sustainable, the real determinant is the intention of the parties. Therefore, I see no need to deal with the *Statute of Uses* R.S.O. 1897, c.331 and its application to the present case.

D) The Defendant's Case

30 The defendants admit that the transfer from Joe to Gregorina was not made for consideration. They take the position that the transfer was simply putting the property into Gregorina's name on the basis that, since the mid-70s, it had been held by Joe on behalf of Gregorina. They point to the fact that title had been taken by Joe "to uses" as evidence of this. If accepted, this is a complete answer to the plaintiffs' claim.

31 If the court sets aside the transfer to Gregorina as a fraudulent conveyance, the defendants take the position that the mortgage on the property is valid and enforceable. It would remain as a charge on the property and take priority over the plaintiffs' claims.

32 Finally, the defendants take the position that the action has been settled and that, as a result, the claim should be dismissed.

E) The Evidence

33 The events surrounding this action date back, in some cases thirty years. As a result, some allowance must be made for faulty memories and for the difficulty in proving certain facts. Similarly, the real estate transactions carried out in the 1970s, including the acquisition of the property by Joe "to uses," involved many different lots contributing to confusion in the testimony and recollection of the parties.

34 Even accounting for this, the evidence put forward by the defendants is far from satisfactory. I noted a number of significant inconsistencies. Some of the more significant inconsistencies surrounding key events were as follows:

1. Gregorina testified that the property had always been in her name. However. there was also evidence that:

- according to land registry records the property was put into the name of Joe "to uses" in 1972 and not transferred to Gregorina till August 1994

- Joe's discovery evidence was that the 1994 transfer of the property was made at Gregorina's request

- Gregorina's discovery evidence was that the property was transferred to her because Joe had problems at the bank and did not want to lose the cottage.

2. Alba testified that she gave her mother a mortgage because her mother needed the money. However, there was also evidence to the effect that:

- the mortgage was placed on the property after all of the funds said to support the mortgage were advanced;

- the advances purportedly supporting the mortgage were not made to Gregorina, they were made principally to Alessandro Holdings Ltd., a company apparently controlled by Joe, and to a lesser degree to Joe and Gregorina jointly.

- Joe's discovery evidence was that some of the money was to pay his debts at the Royal Bank for which Gregorina was co-signer.

- all but one of the cheques drawn on Alba's account were signed and likely initiated by Joe.

- although Alba's testimony on this point is somewhat evasive, it is likely that Gregorina was giving Alba significant gifts, including cash gifts, in the same period that the alleged advances were made and remained outstanding;

- Alba testified that it was her mother that gave the necessary instructions to the lawyer regarding the mortgage, but Gregorina's discovery evidence was that all of the paper work regarding the property was prepared or arranged by Alba;

3. Joe testified that he was never a partner in the venture that acquired the property and the Block D properties. He also testified that there were four partners: Gregorina, Giuseppe Marchese, Domenic Sgro and Raffaele Morano. Other evidence on the point, however, was as follows:

• evidence of Gregorina that there were three partners: her, Morano and Marchese.

• the evidence of Giuseppe Marchese was that there were four partners and that one of those four was Joe and not Gregorina;

• Joe gave previous evidence that there were five partners and that he had never held any property in trust. At trial he changed his testimony and said that these prior sworn statements were made in error.

35 When I review the whole of the evidence and consider the reliability of the various witnesses I find Joe's testimony that he took the property in trust for four partners, including his wife, and that it was Gregorina who, as one of the four beneficiaries, paid out the other three partners thereby becoming the sole beneficial owner of the property to be self-serving and improbable. The evidence is more consistent with Joe being the partner who acquired the complete interest in the property sometime in the mid 70s, and I so find.

36 The 1994 transfer to Gregorina was a non arm's length transaction for no consideration at a time when Joe was insolvent. It was an attempt to put the property out of the reach of his creditors.

37 Support for this conclusion includes the following:

1. The clear and cogent evidence of Giuseppe Marchese. He testified that there were four partners, one of whom was Joe, and that after the Block D properties were sold, Joe bought out his partners by paying each of them $3,000. As a result, Joe became the sole owner of the property.

2. When one reviews all of the transactions shown in the various property registers for the area, it is clear that Joe and his partners bought and sold many properties. It does not seem reasonable that Joe would put this particular property into his name when he had no interest in it. Some properties were put in his name, in Gregorina's name and in their joint names and there seems little logic in his name appearing on title of this particular property if he had no interest in it.

3. The way Joe acted and parts of his testimony suggest that he was directly and intimately involved in these transactions and are more consistent with Joe being a partner than not.

4. Gregorina's discovery evidence read in at trial was that Joe transferred the property into her name because he had problems with the bank and did not want to lose the cottage.

5. The evidence of Cesidio and Sylvio Conte, Cesidio's son, was that Joe had advised them both that the property was "his cottage," that is, Joe's cottage.

38 I turn now to Gregorina's evidence on the question of ownership. As set out previously, her testimony at trial was that the property had always been hers and in her name. She was visibly emotional about it, and it may well be that at the time of trial this was her honest belief. This belief, even if sincere, does not make it so. There were many transactions and payments made in the early 70s. From her testimony, it was clear that Gregorina did not know which specific property would have been put into her name nor which property was put into the name of her husband.

39 She testified repeatedly that the cottage lot she bought was on Ronald Avenue and, after being told that the property was located on James Street, said she must have forgotten that the lots she purchased were scattered on different streets. In fact she and Joe did buy a lot on Ronald Avenue as part of the many transactions in the area, and it is on this lot that they built their first cottage. The Ronald Avenue lot is not, however, the lot that is the subject of the present litigation. The Ronald Avenue cottage

was later sold and a second cottage was built on the property located on James Street which, as stated earlier, was also acquired as part of these transactions but is in the name of Joe "to uses".

40 In my view, the property on which the current cottage is situated, the property that is the subject of this litigation, was not a property that Gregorina bought in the 1970s. Her testimony concerning her alleged purchase of the property is confused, inconsistent and changing. The evidence is more consistent with Joe having acquired that property.

41 I now turn to the transactions themselves — the transfer and subsequent mortgaging of the property.

F) Badges of Fraud

42 From the chronology and facts we can identify a series of "badges of fraud" for both the transfer and mortgaging of the property.

1. Transfer from Joe to Gregorina

43 Based on my earlier finding that Joe did not hold the property in trust and had in fact become the owner of the property in the 70s, the 1994 transaction should be viewed as a simple transfer rather than a transfer to the beneficiary under a trust arrangement. I will therefore turn to a review of some of the badges of fraud and how they relate to the transfer to Gregorina. They are as follows:

a) The transferor has few remaining assets after the transfer:

- the property transferred was the only asset owned by Joe and was done at a time when Joe was insolvent.

b) Transfer to a non arm's length person:

- the transfer was non arm's length from Joe to his wife.

c) There are actual or potential liabilities facing the transferor or he is about to enter upon a risky undertaking:

- the transfer was made very shortly after the plaintiffs issued the statement of claim to recover the $350,000 debt owed by Joe.

d) Grossly inadequate consideration:

- the consideration for the transfer from Joe to Gregorina was nominal.

e) The transferor remains in possession or occupation of the property for his own use after the transfer:

- Joe continued to use and benefit from the property after the transfer to Gregorina.

f) The deed contains a self-serving and unusual provision:

- the land transfer tax affidavit contained a self-serving statement being that the transferee had been the sole beneficial owner during the entire period the lands were registered in the name of Joe.

g) The transfer was effected with unusual haste:

- after holding for over 20 years the transfer is effected shortly after the plaintiffs issued the statement of claim.

44 The presence of one or more of these badges of fraud raises a presumption of fraud. As set out earlier, while the persuasive burden of proof remains with the plaintiffs, the burden of explaining the circumstantial evidence of fraudulent intent now shifts to the defendants.

45 In addition to these badges of fraud there is the evidence of Gregorina which was read in from the discovery transcript. Her evidence was that the transfer was done to take the property out of reach of the bank, one of Joe's creditors. Considering this evidence, not only was there little or no evidence to explain the circumstantial evidence of fraudulent intent and rebut the presumption of fraud, there was direct evidence supporting the fraudulent intent.

2. Mortgage Between Gregorina and Alba

46 When we look for badges of fraud in a mortgage transaction that is alleged to be the second part of a two part scheme to defeat or delay creditors we need to adapt the principles somewhat to take into account the unique circumstances. Some of the badges of fraud and how they relate to the mortgage of the property are as follows:

a) Transfer to a non arm's length person:

- the transaction was non-arm's length, being between Gregorina and her daughter Alba.

b) The effect of the transaction is to delay and defeat creditors:

- there was a risk that the transfer would be set aside and the property seized by creditors, therefore, the mortgage served to protect against that.

c) Payment to a person not a party to the disposition:

- the consideration for the mortgage and the making of the mortgage were not contemporary. The consideration did not go to Gregorina but rather went principally to a company apparently controlled by Joe, and to Joe and Gregorina jointly.

d) The transfer was effected with unusual haste:

- the timing of the loan agreement which underlies the mortgage was shortly after the plaintiffs demanded payment from Joe; and:

- Gregorina and/or Alba registered the mortgage on the property shortly after the date of the judgment debtor examination of Joe.

e) The absence of a sound business or tax reason for the transaction:

- Alba and Gregorina were mother and daughter. Alba had received numerous gifts of money and goods from her mother. There was no business or tax reason for the mortgage and no reason why the mortgage should be placed on the cottage lot rather than Gregorina's home in Toronto.

f) The deed contains a self-serving and unusual provision:

- The loan agreement which deals with the purported loan from Alba to Gregorina and Joe contains a recital describing Joe as the holder in trust of the property, and Gregorina is the beneficial owner.

47 The existence of one or more of these various badges of fraud serves to shift the burden of explaining the circumstantial evidence of fraudulent intent to the defendants.

48 The defendants allege that the mortgage flowed from the loan agreement and that the mortgage was placed on the property as consideration for the advances made pursuant to the loan agreement.

49 When one reviews the mortgage transaction in the context of all of the other facts and events surrounding the property it is, in my view, improbable that the mortgage was a regular financial arrangement between Alba and Gregorina. The mortgage and the loan agreement were part of the scheme to keep the property out of the reach of Joe's creditors.

50 The advances under the loan agreement were to or for the benefit of Joe, and Gregorina did not have much involvement in it. The loan agreement was likely triggered by the plaintiffs' demand for payment from Joe or other creditors' demands. The mortgage was intended to protect the cottage from being seized by creditors and sold to provide money to repay Joe's debts.

51 While Joe, Gregorina and Alba each tried to characterize these transactions as regular and proper, I found the evidence of each of them to be self-serving and unreliable. On the balance of probabilities, I am satisfied that the dominant purpose of both of the transactions was to prevent creditors from having access to the property for payment of Joe's debts. Gregorina and Alba were both well aware of Joe's financial situation. While Gregorina did not appear to me to be sophisticated enough to structure the various transactions, I find that she willingly cooperated with Alba and Joe who undertook to put the property out of the reach of Joe's creditors.

G) Was There Consideration for the Mortgage?

52 If the defendants can establish that either of the transactions was made for good consideration and was a *bona fide* transaction to a person not having notice or knowledge of the intent to defraud, then the grantee may keep the property free of the taint of fraud.

53 With respect to the transfer of the property from Joe to Gregorina, there was no valuable consideration, and I need go no further.

54 With respect to the mortgage, the defendants tried to show that the mortgage was given for good and valuable consideration. The burden was on the defendants to establish consideration. The evidence presented by the defendants is not sufficient to discharge the burden of proof in this case. The production of various cheques, most of which were payable to one of the companies controlled by Joe was unconvincing as it was clear on the whole of the evidence that Joe was controlling the flow of funds. In the absence of the various bank accounts showing the source of the monies and the ultimate disposition of the funds, I am not satisfied that the advances were *bona fide* payments made by Alba to Gregorina in support of the mortgage. In addition, as stated earlier, I find that Alba was well aware of the reason for these various transactions, and it was no coincidence that she sought to place a mortgage on the property rather than on other assets in the name of Gregorina.

55 I find, on a balance of probabilities, that the transfer to Gregorina and the mortgage were done with an intent to defeat, hinder, delay or defraud the creditors. The transfer and the mortgage were not made for consideration nor was the mortgage made in good faith to a person who, at the time of the placing of the mortgage, had no notice or knowledge of the intent to defeat, hinder, delay or defraud the creditor.

H) Alleged Settlement

56 A full and final release, a consent and an agreement to settle the claim, all executed October 7, 1999, were entered into evidence.

57 The defendants allege that the action was settled and that, as a result, the claim ought to be dismissed.

58 In his videotaped evidence, Cesidio confirmed that he did in fact execute the documents but that this had been done on the understanding that the executed documents would be exchanged through intermediaries against payment in full of the debt. He testified that no payment was ever made. As a result, he never authorised the release of the settlement documents, and no settlement was effected.

59 Joe testified that the settlement negotiations were conducted through an intermediary and that he had paid the settlement funds.

60 It is not clear from Joe's evidence what amount was to be paid in settlement of the claim. Other than Joe's testimony, the only evidence of payment of any settlement funds was a certified cheque for $72,000 dated July 13, 1999, payable to J. Sansone, a friend of the families. There was no evidence provided regarding who cashed the cheque in October 1999 nor how the funds were used.

61 The burden is on the defendants to establish that a settlement has been concluded. Given the evidence of Cesidio denying any payment, the proof that the settlement funds were actually paid is essential. Mr. Sansone was never called to testify concerning what the $72,000 payment to him was for nor has any other document been tendered showing that this, or any other sum, was ever paid to the plaintiffs.

62 The defendants have not satisfied me on a balance of probabilities that a settlement was entered into which resolved all of the issues in this action. They offered no satisfactory explanation for the failure to call the payee of the cheque, J. Sansone. By reason of that failure I draw an inference adverse to the defendants that the testimony of that witness would not have assisted the defendants' case.

63 In any event, the amount paid to Mr. Sansone was less than the amount allegedly agreed upon, and other than Joe's testimony, there is no evidence that these sums were paid. The defendants have not satisfied me that any consideration was paid for the alleged settlement. I therefore conclude that this defence must fail.

VI. Conclusion

64 In the result, I grant judgment setting aside the transfer of the property described municipally as 1629 James Street, Tiny, Ontario, from Giuseppe Alessandro to Gregorina Alessandro, Instrument 01263935 dated August 31, 1994. I also grant judgment setting aside the charge granted on that same property by Gregorina Alessandro to Alba Alessandro, instrument 01325897 dated October 11, 1996.

65 In view of my conclusions in respect of the plaintiffs' claims, I dismiss the defendants' counterclaim.

66 If the parties are unable to agree on the issue of costs, the plaintiffs are to provide me with written submissions within 15 days of the release of these reasons, and the defendants are to respond in writing to these within 10 days thereafter.

Action allowed; counterclaim dismissed.

TAB 5

2017 ABCA 429
Alberta Court of Appeal

Beazer v. Tollestrup Estate

2017 CarswellAlta 2689, 2017 ABCA 429, [2018] 4 W.W.R. 513, [2018] A.W.L.D. 871, [2018] A.W.L.D. 925, 288 A.C.W.S. (3d) 584, 63 Alta. L.R. (6th) 25

Harry D. Beazer, Marion I. Beazer, and Leonard Jensen (Respondents / Plaintiffs) and James Tollestrup, Litigation Representative for the Estate of Carol Mary Tollestrup (Appellant / Defendant) and Mark A. Baldry (Respondent / Third Party Defendant)

Ronald Berger, Patricia Rowbotham, Brian O'Ferrall JJ.A.

Heard: May 18, 2017
Judgment: December 15, 2017
Docket: Calgary Appeal 1601-0295-AC

Proceedings: reversing in part *Beazer v. Tollestrup Estate* (2016), [2016] A.J. No. 1040, 2016 CarswellAlta 1946, 2016 ABQB 567, J.H. Langston J. (Alta. Q.B.)

Counsel: K.E. Staroszik, Q.C., A. Louie, for Appellant
D.C. Thompson, for Respondent, Harry D. Beazer and others
E.W. Halt, Q.C., E. Scrimshaw, for Respondent, Mark Baldry

Subject: Civil Practice and Procedure; Contracts; Corporate and Commercial; Estates and Trusts; Insolvency; Property; Public

Related Abridgment Classifications

Contracts
VIII Rectification or reformation
VIII.3 Miscellaneous
Professions and occupations
VIII Lawyers
VIII.7 Negligence
VIII.7.d In real estate transactions
VIII.7.d.iv Mortgages

Headnote

Professions and occupations --- Barristers and solicitors — Negligence — In real estate transactions — Mortgages — Preparation and registration of documents

Mortgagor T granted mortgages and promissory notes to MB, MB's husband HB, KO, and LJ, in order to make them secured creditors until anticipated sale of home, but mortgages referred to future advances — Home was not sold, and mortgagor later prepared another will that did not name MB, KO, and LJ as beneficiaries — MB, HB, and LJ brought action against mortgagor to enforce mortgages and promissory notes and for rectification, and mortgagor passed away before trial — Trial judge ordered mortgages rectified to reflect fact that money had already been lent, and mortgages and promissory notes rectified to reflect enforceability upon disposition of property or death of mortgagor — Trial judge did not find negligence on part of solicitor who drafted mortgage — Litigation representative of estate appealed — Representative sought deletion of interest payable under promissory notes and mortgages, which created charge on land for evaluator and surveyor fees and solicitor client costs for exercising or enforcing remedies under mortgage — Appeal allowed in part — Relief for mistake in common law or in equity could not be granted — Mistake as to value of land did not affect T's intention to repay her obligations and was not fundamental to contract — Trial judge's conclusion that mortgages were valid was reasonable and supported by record — Nothing on record to support conclusion mortgagees not entitled to interest or costs, as of date of default — Trial judge's conclusion that solicitor's conduct in recommending mortgages met standard of care did not show error — Conclusion that solicitor was not negligent was in error — Solicitor did not meet standard of care of reasonably prudent solicitor when he drafted mortgages — Although he knew mortgages were intended to secure past obligations, he did not amend documents to reflect this — Additionally, he did not modify the documents to say the mortgages were only enforceable on sale or death, as was contemplated — Matter remitted for assessment of damages including legal costs of rectifying mortgages.

Contracts — Rectification or reformation — General principles

Mortgagor T granted mortgages and promissory notes to MB, MB's husband HB, KO, and LJ, in order to make them secured creditors until anticipated sale of home, but mortgages referred to future advances — Home was not sold, and mortgagor later prepared another will that did not name MB, KO, and LJ as beneficiaries — MB, HB, and LJ brought action against mortgagor to enforce mortgages and promissory notes and for rectification, and mortgagor passed away before trial — Trial judge ordered mortgages rectified to reflect fact that money had already been lent, and mortgages and promissory notes rectified to reflect enforceability upon disposition of property or death of mortgagor — Representative sought deletion of interest payable under promissory notes and mortgages, which created charge on land for evaluator and surveyor fees, and solicitor client costs for exercising or enforcing remedies under mortgage — Appeal allowed in part on other grounds — Trial judge's conclusion that mortgages were valid was reasonable and supported by record — Nothing on record to support conclusion mortgagees not entitled to interest or costs, as of date of default.

Mortgagor, T, experienced hardship after her divorce, and her only significant asset was her home valued at about $1 million. T's sisters MB and KO, and friend LJ, had all provided mortgagor with help and support. T wanted to repay them, so she prepared a will naming MB, KO, and LJ as beneficiaries, but as she was concerned about her children contesting it she granted mortgages and promissory notes to MB, MB's husband HB, KO, and LJ, in order to make them secured creditors until the anticipated sale of the home. The mortgages referred to future advances. The home was not sold, and T later prepared another will that did not name MB, KO, and LJ as beneficiaries. MB, HB, and LJ brought action against T to enforce the mortgages and promissory notes and for rectification. T died before trial. The trial judge ordered rectification of the mortgage and promissory notes, but did not find T's solicitor negligent. The estate litigation representative appealed.

Held: The appeal was allowed in part regarding claim against lawyer; other grounds were dismissed.

Per Berger and Rowbotham JJ.A.: Relief for mistake in common law or in equity could not be granted. Mistake as to the value of the land did not affect T's intention to repay her obligations and was not fundamental to the contract. The amount of the mortgage was a finding of fact with which the court would not interfere absent palpable and overriding error. Trial judge's conclusion that mortgages were valid was reasonable and was supported by the record.

Given the conclusion that the mortgages were valid, the four conditions for rectification were satisfied. The parties reached a prior agreement whose terms are definite and ascertainable, and the agreement was still effective when the mortgages were executed; the mortgages failed to record accurately that prior agreement (i.e., no new funds were to be advanced); and that, if rectified as proposed (i.e., substituting "to be lent" with "having been lent"), the mortgages would carry out the agreement.

The trial judge was correct in finding that the mortgages were valid and enforceable, and that the solicitor was not negligent recommending the mortgages. However, the solicitor was negligent in his preparation of the mortgages, in that although he knew that the mortgages were intended to secure past obligations, he did not amend the documents to reflect this. Additionally, he did not modify the documents to say the mortgages were only enforceable on sale or death, which was clearly what was contemplated. There were no future funds to be advanced as contemplated by the wording of the mortgages.

Appellant asked deletion of paragraph 8(f) ,which provided that: "The Mortgagee may forthwith take such proceedings to realize on its security created by this Mortgage by foreclosing the same or otherwise as it may be law [sic] be entitled to do." The trial judge found that the mortgages became due and payable at T's death, so the event of default occurred on July 18, 2012. The ability to foreclose earlier was inconsistent with this finding. The respondent mortgagees had no right to foreclose until T's death. Although their foreclosure action was premature, there were no grounds to delete Article 8(f). There was nothing on record to support a conclusion that the mortgagees were not entitled to interest or costs as of the date of default.

Per O'Ferrall J.A. (dissenting): The parties agreed on an arrangement involving promissory notes secured by mortgages, which would only be enforceable on a disposition of the deceased's property, either by sale or by death. The estate did not suffer loss as a consequence of the lawyer's failure to make the appropriate amendments to the standard form of mortgage. The estate suffered a loss because the deceased, MB, HB and J, failed to honour their agreements.

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s. 52 — considered

s. 52(1) — considered

s. 176(1) "promissory note" — considered

s. 186(1) — referred to

Land Titles Act, R.S.A. 2000, c. L-4

Generally — referred to

Law of Property Act, R.S.A. 2000, c. L-7

Generally — referred to

Statutes considered by *Brian O'Ferrall J.A.* (dissenting):

Land Titles Act, R.S.A. 2000, c. L-4

s. 102 — considered

APPEAL from a judgment reported at *Beazer v. Tollestrup Estate* (2016), 2016 ABQB 567, 2016 CarswellAlta 1946, [2016] A.J. No. 1040 (Alta. Q.B.), for mortgages held by three of respondents registered against property owned by estate as valid and enforceable, and for trial judge's decision claim against lawyer.

***Berger, Rowbotham JJ.A.*:**

1 The appellant, James Tollestrup, is the litigation representative of the estate of Carol Tollestrup. He appeals a trial decision which found that mortgages held by three of the respondents registered against property owned by the estate are valid and enforceable: *Beazer v. Tollestrup Estate*, 2016 ABQB 567, [2016] A.J. No. 1040 (Alta. Q.B.) (QL) [Reasons]. He also appeals the trial judge's conclusion that the lawyer who recommended and prepared the disputed mortgages was not negligent in his representation of Ms Tollestrup.

2 The appeal from the finding that the mortgages were valid and enforceable is dismissed. We conclude that there is no reviewable error in the trial judge's conclusion as to the lawyer's advice recommending the mortgages. However, we allow the appeal in relation to the lawyer's negligence in preparing the mortgages. The assessment of damages resulting from that negligence is remitted to the Court of Queen's Bench.

I. Background

3 In September 2008 Ms Tollestrup prepared a will with the assistance of a lawyer, the respondent, Mark Baldry. The will made specific bequests to seven of her children, totalling 40% of the residue of the estate. The remaining 60% was to be divided equally among her friend Leonard Jensen and her two sisters, Marion Beazer and Karen Olsen. Her only significant asset was her home and adjoining property near the City of Lethbridge (the "Property"). Ms Tollestrup believed the Property was worth approximately $6 million but that was not supported by the evidence of the realtors who ultimately listed the Property. One expert estimated the Property to be valued at slightly over $1 million. Mr Baldry did no independent investigation to verify the value of the Property.

4 Ms Tollestrup was concerned about her children interfering with the sale of the Property and the potential for them to contest her will. Ms Tollestrup acknowledged that the Beazers (her sister Marion and her husband Harry) and Mr Jensen had assisted her throughout her life. Ms Tollestrup lived in a cottage on the Beazers' land for five years. The Beazers calculated expenses of $266,948 related to Ms Tollestrup's stay at the cottage and other services they provided or paid for on her behalf. These expenses included food, telephone, insurance, utilities, labour costs, rental of the cottage, and the costs of repairing the cottage once she left. According to the Beazers, Ms Tollestrup told them that she would compensate them for their help. Mr Jensen cleaned and repaired the Property and made mortgage payments on her behalf. He calculated those costs as $36,593 in

2007 and $112,623 in 2008. Included were legal fees, money advanced as loans, expenses, maintenance, travel expenses, and trailer rental. Mr Jensen also gave Mr Baldry a cheque for $42,000 to remove an encumbrance from the title to the Property.

5 Mr Baldry's office prepared promissory notes and mortgages providing security to Marion Beazer and Harry Beazer (the Beazers) in the amount of $400,000, Mr Jensen in the amount of $100,000, and Ms Olsen in the amount of $200,000 (Ms Olsen's mortgage is not an issue in this appeal). Ms Tollestrup executed an additional promissory note and mortgage in favour of Mr Jensen in the amount of $50,000. Mr Jensen testified that he understood that the mortgage for $100,000 was for the money he previously advanced to Ms Tollestrup and the mortgage for $50,000 related to the discharge of the encumbrance and associated costs.

6 In November 2008, Ms Tollestrup listed the Property for $4 million. There was one offer to purchase for $1 million and a counter-offer of $2 million but no sale resulted. In February 2009 she listed the Property for $3 million, and later that month for $4,350,000. Again, no sale resulted.

7 In November 2009, Ms Tollestrup made a new will that made no provisions for Mr Jensen or the Beazers. Mr Jensen and the Beazers became aware of this and consulted a lawyer. In January 2010, the Beazers and Mr Jensen made a demand for the money owing on the mortgages. Ms Tollestrup's new lawyer (not Mr Baldry) responded to the demand, contending that no consideration was provided by the Beazers and Mr Jensen for the mortgages.

8 In March 2010, the Beazers and Mr Jensen issued a statement of claim (Action No 1006-00192, "Beazer action") seeking a declaration that the mortgages were valid and enforceable, and an order for possession or the appointment of a receiver. Ms Tollestrup defended, alleging that the mortgages were invalid as there had been no consideration for them. In the alternative, she alleged that she executed the promissory notes and mortgages under duress or undue influence by the Beazers and Mr Jensen. She also commenced her own action (Action No 1006-01042, "Tollestrup action") seeking a declaration that the mortgages were invalid and that Mr Baldry was negligent. In addition to defending, the Beazers and Mr Jensen third-partied Mr Baldry. In November 2011, the two actions were consolidated.

9 Ms Tollestrup died on July 18, 2012. Her son, James Tollestrup, was appointed litigation representative for the purposes of the consolidated action.

II. Decision on Appeal

10 The trial judge found that the mortgages held by the Beazers and Mr Jensen were valid. He referred to the *Bills of Exchange Act*, RSC 1985, c B-4 [*BEA*], the *Land Titles Act*, RSA 2000, c L-4, and the *Law of Property Act*, RSA 2000, c L-7: Reasons at paras 9-10.

11 Although the trial judge held that the mortgages were valid, he found nothing owing on them because the mortgages referred to the future advancement of funds: Reasons at para 10. He rectified them in two respects. In the preamble, the words "to be lent" were replaced with "having been lent": Reasons at para 95. Paragraph 8(e) of the mortgages was changed from "the whole of the monies hereby secured shall, at the option of the mortgagee, become due and payable" to "the whole of the monies hereby secured shall become due and payable upon the sale of the said land, or upon the death of the mortgagor": Reasons at para 96.

12 The trial judge held that the parties' common intention was that the mortgages would not create new obligations since the money had already been lent to (i.e., benefitted) Ms Tollestrup. As well, the obligations created by the mortgages were only intended to crystallize upon the disposition of the Property, by sale or death: Reasons at para 93.

13 The trial judge found that although the amounts could not be ascertained with specificity, he was "satisfied that Carol did owe the Beazers and Mr Jensen a significant amount of money and . . . she felt an obligation to repay these people": Reasons at para 81. He found that she "proposed the amounts which were used . . . based on Carol's assessment of actual dollars advanced or a combination of such figures plus a 'bonus' for all the trouble she inflicted on these people": *ibid.*

14 In regard to Mr Baldry's alleged negligence, the trial judge found that although "it could have been more thoroughly done," he was not satisfied that Mr Baldry was negligent in his representation of Ms Tollestrup with the solutions he proposed to address her concerns: Reasons at para 88.

15 In the result, after rectifying the mortgages, the trial judge found that the mortgages held by the Beazers and Mr Jensen were valid and enforceable by way of foreclosure proceedings under the *Law of Property Act*. Since the Property had not been sold, the mortgages became due and payable on the date of Ms Tollestrup's death. The third party action against Mr Baldry was dismissed: Reasons at para 97.

III. Grounds of Appeal and Standard of Review

16 The appellant contends that the trial judge erred by:

i. failing to consider that the mortgages were granted based on the mistaken belief that the property was worth $6 million, and failing to consider that the enforcement of the mortgages in these circumstances was unconscionable;

ii. finding that there was sufficient consideration for the mortgages;

iii. rectifying the mortgages to change the consideration and the date of default; or in the alternative, not making further rectifications to the mortgages; and

iv. failing to find Mr Baldry liable for negligence.

17 The appellant does not dispute the validity of Mr Jensen's second mortgage but contends that the amount should be reduced to $42,284 from $50,000. We can address this summarily. The amount of the mortgage is a finding of fact with which we will not interfere absent palpable and overriding error. The trial judge found that the amounts were based upon Ms Tollestrup's estimates and included expenses and in some instances a bonus. This would explain the difference in the amounts.

18 The grounds of appeal involve primarily challenges to the facts and inferences found by the trial judge. Accordingly, the standard of review is palpable and overriding error: *Housen v. Nikolaisen*, 2002 SCC 33 (S.C.C.) at paras 10 and 23, [2002] 2 S.C.R. 235 (S.C.C.). Those issues which involve determining whether the facts satisfy a legal test are also reviewed for palpable and overriding error absent an extricable error of law: *Housen* at paras 36 — 37.

19 The appellant also challenges the interpretation of the mortgages, and their rectification. While the mortgages are standard form in the sense that they were a precedent in the lawyer's office, the circumstances underlying their creation is the main thrust of the litigation. Principles of contractual interpretation are applied to the words of a written contract considered in light of its factual matrix: *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 (S.C.C.) at para 50, [2014] 2 S.C.R. 633 (S.C.C.). Accordingly, we review this issue on a reasonableness standard.

20 As regards the allegations of Mr Baldry's negligence, this ground of appeal, properly characterized, raises an error in the trial judge's application of the law to the facts which is reviewed for palpable and overriding error.

IV. Analysis

A. Mistaken Belief and Unconscionability

21 The appellant submits that the mortgages are based on a common mistake and therefore void *ab initio* or, alternatively, are voidable in equity. "Mistake" arises in two contexts in this appeal. The first is in relation to the rectification of the mortgages. The trial judge's reasons address common mistake in this context. The mistakes were in relation to whether money had been lent and the time of default. We address this ground of appeal later in these reasons.

22 The second context in which "mistake" arises is in relation to the misapprehension of the value of the Property. The trial judge's reasons did not address the doctrine of common mistake or its remedy in this context. The pleadings do not allege

common mistake or seek a contractual remedy for mistake. It appears, therefore, that this argument arises for the first time on appeal.

23 At best, there is some reference to mistake in the context of the appellant's plea of misrepresentation. The appellant alleged that the Beazers and Mr Jensen misrepresented the value of the Property to Ms Tollestrup and Mr Baldry. These allegations are made in the Amended Amended Statement of Defence to the Beazer action and in the Amended Amended Statement of Claim in the Tollestrup action.

24 Some argument strayed into the area of mistake. In his opening remarks, the appellant's counsel submitted, vis-à-vis his statement of defence:

> the mortgages were founded and based on a misrepresentation by the plaintiffs as to the value of Carol's property. The plaintiffs represented to Carol and Mr Baldry that the farm was worth [$]6,000,000. After paying the first mortgage, it was only worth [$]800,000. The plaintiffs . . . knew or ought to have known, **were it not for this misrepresentation, which I really say is a mistake** ... a collective misapprehension as to value, **so we're not alleging that the plaintiffs engaged in a misrepresentation, everybody believed that the property was worth [$]6,000,000 and it wasn't.** ... Carol and Mr Baldry relied on this, and . . . the notes and mortgages would not have been prepared had they known otherwise. (emphasis added)
>
> [T]his is our evolving understanding of the events relating to what happened with respect to the mortgage[s] where we say the question is, are the mortgages invalid by reason of the plaintiffs and Karen Olsen's misrepresentation . . . to Carol and solicitor, Mark Baldry, or in any event, a misapprehension by them that was known to the plaintiffs as to the value of Carol's property, [$]6,000,000 versus [$]1,000,000.

25 There is also some reference to mistake in the context of the allegations of Mr Baldry's alleged negligence.

26 The appellant cannot be granted relief for mistake in common law or in equity, because common mistake as to the Property's value was not fundamental to Ms Tollestrup's intention to grant the mortgages. A mistake cannot render a contract void unless it is fundamental in character and goes to the root of the contract: *Bell v. Lever Brothers Ltd.* (1931), [1932] A.C. 161 (U.K. H.L.) at 225-27, [1931] UKHL 2 (U.K. H.L.) (BAILII); see also GHL Fridman, *The Law of Contract in Canada*, 6th ed (Toronto: Thomson Reuters Canada Limited, 2011) at 242.

27 At common law, mistakes as to the quality or value of the subject matter, rather than the identity of the subject matter, cannot render a contract void *ab initio* unless the mistake is fundamental to the contract: *Bell* at 218; Fridman at 242. Moreover, the mistake must go to the parties' intention to contract rather than the motivation for doing so: Fridman at 243; *Stone's Jewellery Ltd. v. Arora*, 2009 ABQB 656 (Alta. Q.B.) at para 27, (2009), 314 D.L.R. (4th) 166 (Alta. Q.B.). The equitable doctrine of mistake arises when a mistake renders the enforcement of a contract unconscionable: *Solle v. Butcher* (1949), [1950] 1 K.B. 671 (Eng. C.A.) at 692, [1949] 2 All E.R. 1107 (Eng. C.A.). Because of the mistake, the contract is voidable and rescission can be granted. Rescission is a discretionary remedy and available even where the mistake is insufficient to render the contract void *ab initio* at common law: *Stone's Jewellery* at paras 28-30.

28 To invoke the equitable doctrine of mistake, both parties must be "under a common misapprehension either as to facts or as to their relative and respective rights, provided that the misapprehension was fundamental and that the party seeking to set it aside was not himself at fault": *Solle* at 693. The applicability of the equitable doctrine of mistake is uncertain in Canada but it has not been abandoned in Alberta: *Andrews v. Coxe*, 2003 ABCA 52, 320 A.R. 258 (Alta. C.A.).

29 In this case, the mortgages were granted to repay the Beazers and Mr Jensen. A mistake as to the value of the land did not affect Ms Tollestrup's intention to repay her obligations and was not fundamental to the contract.

30 Similarly, the contract is not voidable under the equitable doctrine of mistake. Though the equitable doctrine is available if the mistake is not made out in common law, the mistake must still be fundamental to the contract. Additionally, for the equitable

doctrine of mistake to be invoked, the party seeking to invoke the doctrine must not be at fault. As owner of the property, Ms Tollestrup had some responsibility for ascertaining the Property's true value.

31 The appellant also asks that we exercise our equitable jurisdiction to rescind the contract on the basis of unconscionability. There is a plea of duress as well. There is no basis for equitable relief given the trial judge's clear findings which are amply supported by the record. He found that Ms Tollestrup and Ms Olsen were of the view that the Property was worth $6 million, so any suggestion that the Beazers and Mr Jensen mispresented this is not supported by the evidence. The trial judge also found that it was Ms Tollestrup alone who valued the indebtedness and gave Mr Baldry the instructions regarding her will and the value of each of the mortgages. Moreover, Mr Baldry had no doubt regarding Ms Tollestrup's capacity to instruct him.

32 We also note that on this record there is no plea of mistake in relation to the value of the Property and no proper argument in relation to the doctrine of mistake at common law or in equity.

33 Accordingly, we dismiss this ground of appeal.

B. Validity of the Mortgages

34 Each mortgage was issued as collateral security to a promissory note. In September 2008, Ms Tollestrup executed promissory notes in favour of the Beazers and Mr Jensen for $400,000 and $100,000 respectively. As regards the amount of indebtedness, the trial judge concluded that it was Ms Tollestrup who quantified the debt obligation: Reasons at para 81. He also stated that:

> I am satisfied that many of these costs are not actual costs but rather convenient translations of how a stranger may have dealt with Carol. However, it is clear that Carol was a significant economic burden on all with whom she associated. I am also satisfied that no one did any real calculations upon which Carol's directions to Mr Baldry were based. However, Carol's professed indebtedness to these people was significant (at para 80).

35 The promissory notes provided for interest of 5% per annum from the date of demand to the date of payment. The promissory notes also stated that "the within indebtedness shall not be payable, and the Payee's or Holder's cause of action under this promissory note shall not arise, until such time as the Payee or Holder has made a formal, written demand for payment".

36 Section 176(1) of the *BEA* defines a promissory note as "an unconditional promise in writing made by one person to another person, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer". Section 52 provides that "valuable consideration" for a bill may be constituted by any consideration sufficient to support a simple contract, or an antecedent debt or liability. Although section 52 specifically refers to bills of exchange, the provisions of the *BEA* that apply to bills also apply to promissory notes under Part IV, except as otherwise provided and with such modifications as the circumstances require: s 186(1). Simply put, an antecedent debt is valuable consideration for a promissory note.

37 The Beazers and Mr Jensen performed services and expended money for Ms Tollestrup's benefit before she executed the promissory notes. The promissory notes are based on past debts but stand as independent instruments with valuable consideration in the form of antecedent debt: *BEA*, s 52(1). Accordingly, the promissory notes are valid.

38 The mortgages (titled "Mortgage Collateral to Promissory Note") were collateral security for repayment of the promissory notes.

39 A mortgage is security for a debt. More specifically, a "mortgage is a contract pursuant to which a borrower (mortgagor) pledges his land as security for the repayment of money he has borrowed from a lender (mortgagee): *Daniels v. Mitchell*, 2005 ABCA 271 (Alta. C.A.) at para 20, (2005), 371 A.R. 298 (Alta. C.A.).

40 In addition to the requirements for registration under the *Land Titles Act* (about which there is no complaint), a "mortgage is a contract and the basic laws of contract apply. There must be the proverbial parties, property and price": *Royal Bank v. Exner* (1995), 170 A.R. 1, 1995 CarswellAlta 29 (Alta. Q.B.) (WL Can) at para 31 [*Exner* cited to WL Can].

41 A contract requires consideration. Consideration is "some right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other": *Spruce Grove (Town) v. Yellowhead Regional Library Board* (1982), 1981 ABCA 369 (Alta. C.A.) (CanLII) at para 7, (1982), 143 D.L.R. (3d) 188 (Alta. C.A.). If the act or forbearance has passed and is independent of the giving of the promise, this is "past consideration" which is generally insufficient to create a valid contract: Fridman at 109 citing *Eastwood v. Kenyon* (1840), 11 Ad. & El. 438 (Eng. K.B.)). A moral obligation arising from a past benefit is not good consideration: *Grant v. Von Alvensleben* (1913), 13 D.L.R. 381, 1913 CarswellBC 241 (B.C. C.A.) (WL Can) at para 6 [*Von Alvensleben* cited to WL Can]. A subsequent promise is only binding when the request, the consideration and the promise, form substantially one transaction: *ibid* at para 7.

42 However, even an act done prior to the giving of a promise to make a payment or to confer some other benefit may be consideration for the promise if three conditions are established: *Pao On v. Lau Yiu Long*, [1979] 3 All E.R. 65, [1980] A.C. 614 (Hong Kong P.C.). These three conditions are that:

> [t]he act must have been done at the promisor's request, the parties must have understood that the act was to be remunerated either by payment or the conferment of some other benefit, and payment, or the conferment of a benefit, must have been legally enforceable had it been promised in advance (at 74).

43 With respect to consideration for past debts, if some new factor is introduced this could be a sufficient difference or novelty to entitle a court to hold that there was fresh (not past) consideration for a new promise: Fridman at 110. A mortgage may be valid in such circumstances. For example, forbearance to sue can be valid consideration: *Alberta Drywall Supply Ltd. v. Hauk* (1984), 55 A.R. 226 (Alta. Q.B.), 1984 CanLII 1349. The extension of time for payment can amount to consideration: *Liberty Mortgage Services Ltd. v. 123 Street Investments Ltd.*, 2011 ABQB 542, 523 A.R. 321 (Alta. Q.B.). Lowering an interest rate may be sufficient consideration: *ibid* at para 39. However, merely "allowing the loan to exist without taking collection action" is not: *Lewis v. Central Credit Union Ltd.*, 2012 PECA 9 (P.E.I. C.A.) at para 24, (2012), 323 Nfld. & P.E.I.R. 177 (P.E.I. C.A.).

44 *Scarcella v. Militano*, 2001 MBQB 152, 157 Man. R. (2d) 190 (Man. Q.B.) involved a demand loan between family members secured by a mortgage, which the court found to be valid despite a claim that the mortgage was unenforceable due to a lack of consideration. The 18-month restriction on the mortgagee's demand right provided the mortgagor with a significant benefit: para 35. The court goes on to note at para 34:

> [T]here is law to support a finding that in some situations a promise or undertaking given to support past consideration may be enforceable. Cf. pages 122 through 125 of S.M. Waddams, ***The Law of Contracts*** (3rd ed., 1993). At p. 124, Waddams notes:
>
>> Another case where the distinction between prior debt and subsequent promise became significant was where the subsequent promise was incorporated in a bill of exchange, for example, a promissory note. It was held that the promissory note was enforceable against the maker (even by the promisee) although the consideration was an antecedent debt.
>>
>> [. . .]
>>
>> It is sometimes said by modern commentators that these instances are of no significance since they have been "taken out" of the common law by statute. But the view thereby implied by the relationship between common law and statute seems questionable. These instances of enforcement for past consideration all grew up at common law because justice was seen to require the results reached. Parliament agreed with this conclusion. This would appear to strengthen rather than weaken the argument that there will continue exist instances where justice requires the enforcement of promises because of some antecedent event.

45 Waddams cites no cases for these propositions but *Adams v. Woodland* (1878), 3 O.A.R. 213 (Ont. Co. Ct.) 1878 WL 16702 (WL) is referred to immediately preceding these passages. In *Adams*, Burton JA said that although "payment of the debt

remained simply a voluntary duty, binding only *in foro conscientiae*, still an express promise [in the form of a promissory note] operated to revive the liability . . . ": at 214.

46 The same logic applies here. The funds and benefits advanced to Ms Tollestrup were in the past and repayment was a voluntary duty binding only as a matter of conscience that would not suffice for consideration for the mortgages. However, that changed when the promissory notes were executed. All the mortgages granted by Ms Tollestrup were collateral to the promissory notes and provided that:

> . . . the Mortgagor shall pay to the Mortgagee the sum of [amount varied for each respondent] in lawful money of Canada, at the time and places, in the manner, and with interest thereon at the rate provided in the Promissory Note or any extensions or renewals of or substitutions for the Promissory Note.
>
> In regard to default, the mortgages noted that, "the whole of the moneys hereby secured shall, at the option of the Mortgagee, become due and payable".

47 Having determined that past consideration is good consideration for a promissory note, and that the mortgages were collateral to the promissory note, the promissory notes constitute the consideration necessary to make the mortgages valid.

48 In the alternative, a prohibition on the mortgagee's right to demand payment can provide the mortgagor with a significant benefit and can amount to consideration: *Scarcella*. Although the promissory notes were payable on formal, written demand, the mortgagee's right to demand payment was deferred. The trial judge found that "the obligations created by the mortgages only crystalized upon the disposition of the land, that is, through a sale or the death of the mortgagor.": Reasons at para 93. The deferred right of the mortgagees to demand payment was a benefit to the mortgagor, sufficient to amount to consideration.

49 The trial judge's conclusion that the mortgages were valid is reasonable and supported by the record. We are not persuaded of any reviewable error and dismiss this ground of appeal.

C. Rectification

1. Rectification Generally

50 Rectification is an equitable remedy designed to correct errors in the recording of terms in written legal instruments: *Canada (Attorney General) v. Fairmont Hotels Inc.*, 2016 SCC 56 (S.C.C.) at para 38, [2016] 2 S.C.R. 720 (S.C.C.). It must be used "with great caution" since a "relaxed approach to rectification as a substitute for due diligence at the time a document is signed would undermine the confidence of the commercial world in written contracts": *ibid* para 13.

51 As the Supreme Court held in *Fairmont Hotels* at para 12:

> If by mistake a legal instrument does not accord with the true agreement it was intended to record — because a term has been omitted, an unwanted term included, or a term incorrectly expresses the parties' agreement — a court may exercise its equitable jurisdiction to rectify the instrument so as to make it accord with the parties' true agreement. Alternatively put, rectification allows a court to achieve correspondence between the parties' agreement and the substance of a legal instrument intended to record that agreement, when there is a discrepancy between the two. Its purpose is to give effect to the parties' true intentions, rather than to an erroneous transcription of those true intentions (Swan and Adamski, at]§8.229).

52 While a court may rectify an instrument that inaccurately records an agreement, it may not change the agreement to salvage what a party hoped to achieve, or to cure a party's error in judgment in entering into an agreement: *Fairmont* at paras 3 and 19. The court's task "is to restore the parties to their original bargain, not to rectify a belatedly recognized error of judgment by one party or the other": *Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries Ltd.*, 2002 SCC 19 (S.C.C.) at para 31, [2002] 1 S.C.R. 678 (S.C.C.). It should not be used to "escape, after-the-fact, what has turned out to be a bad bargain" (Geoff R Hall, *Canadian Contractual Interpretation Law*, 2nd ed (Markham, Ont: LexisNexis Canada, 2012) at 167) or because it becomes evident in hindsight that it was a bad deal (Fridman at 777).

53 Typically, a court will require evidence with a "high degree of clarity, persuasiveness and cogency before substituting the terms of a written instrument with those said to form the party's true . . . intended course of action": *Fairmont* at para 36. When there is a common mistake, the party applying for rectification must show that:

> the parties had reached a prior agreement whose terms are definite and ascertainable; that the agreement was still effective when the instrument was executed; that the instrument fails to record accurately that prior agreement; and that, if rectified as proposed, the instrument would carry out the agreement (*Fairmont* at para 14).

54 The jurisdiction to rectify may be exercised in respect of a wide range of contracts, including bills of exchange, transfers of shares, and conveyancing documents: John McGhee, *Snell's Equity*, 31st ed (London, UK: Sweet & Maxwell, 2005) at 333.

2. Rectification of the Mortgages by the Trial Judge

a. Rectification of the Preamble

55 The trial judge rectified the preamble of the mortgages so that "to be lent" was replaced with "having been lent" because he found a common mistake in that "the parties clearly acknowledged that the funds being discussed related to a sum which had already been advanced": Reasons at para 95.

56 Given the conclusion that the mortgages were valid, the four conditions from *Fairmont* are satisfied. The parties reached a prior agreement whose terms are definite and ascertainable and the agreement was still effective when the mortgages were executed; the mortgages failed to record accurately that prior agreement (i.e., no new funds were to be advanced); and that, if rectified as proposed (i.e., substituting "to be lent" with "having been lent"), the mortgages would carry out the agreement.

57 Rectification was appropriate with respect to the preamble because it accurately reflected the parties' common intention. The appellant acknowledges that if this court finds that the mortgages are agreements capable of rectification, no one contemplated future advances and the mortgages should be corrected to reflect this.

b. Rectification of Paragraph 8(e)

58 Paragraph 8 of the mortgages sets out the provisions relating to default:

> That in the event of default in the payment of any part of the moneys secured by this Mortgage, or on breach of any covenant, understanding agreement or stipulation expressed or implied herein; or should there be any event of default or breach of covenant under the Promissory Note, or any extensions or renewals thereof or substitutions therefor:
>
> [. . .]
>
> (e) The whole of the moneys hereby secured shall, at the option of the Mortgagee, become due and payable. . . .

59 The trial judge rectified paragraph 8(e) by replacing the underlined words with "become due and payable upon the sale of the said land, or upon the death of the mortgagor". The trial judge held that the mortgages had to be rectified since they and the promissory notes were created in contemplation of the disposition of the Property. Therefore, the mortgages had to reflect the fact that the obligations created under them only crystallized upon the disposition of the Property, through sale or death.

60 Unfortunately, as rectified, paragraph 8(e) is now inconsistent with paragraph 2 (with emphasis):

> That the Mortgagor shall pay to the Mortgagee the sum of [amount relevant to each mortgage] in lawful money of Canada, at the time and places, in the manner, and with interest thereon at the rate provided in the Promissory Note or any extensions or renewals of or substitutions for the Promissory Note.

61 The promissory notes state that it is payable when "the Payee or Holder has made a formal, written demand for payment". We therefore exercise our equitable discretion to rectify paragraph 2 by deleting the words "in the manner" to mirror the rectification of paragraph 8(e).

3. Further Rectification Requested by the Appellant

62 The appellant requests that we further rectify the mortgages. He asks that we delete paragraph 8(f) which provides that: "The Mortgagee may forthwith take such proceedings to realize on its security created by this Mortgage by foreclosing the same or otherwise as it may be law [sic] be entitled to do."

63 The trial judge found that the mortgages became due and payable at Ms Tollestrup's death. In other words, the event of default occurred on July 18, 2012. The ability to foreclose earlier is inconsistent with this finding. It follows that the respondent mortgagees had no right to foreclose until Ms Tollestrup's death. Although their foreclosure action was premature, we are not persuaded to delete Article 8(f).

64 The appellant also asks that we delete the interest (5%) payable under the Promissory Notes and paragraph 9(g) of the mortgages which creates a charge on the land for evaluator and surveyor fees and solicitor client costs for exercising or enforcing remedies under the mortgage. He submits that the parties did not ask for these terms; indeed no one read the mortgages. The general explanation given by Mr Baldry to Ms Tollestrup did not include a discussion of interest.

65 Although the date of default has been rectified, there is nothing on this record that would support a conclusion that the mortgagees were not entitled to interest or costs, as of the date of default. Both are standard provisions of a mortgage.

66 In conclusion, we deny the appellant's request for further rectification to the mortgages.

D. Solicitor's Negligence

67 Although the trial judge acknowledged that the mortgages which Mr Baldry recommended were "curious" and "unorthodox" and he "could have done more to investigate the information before him," he found no negligence: Reasons at paras 84, 87 — 88.

68 The appellant submits that the trial judge erred in finding that Mr Baldry exercised the knowledge, skill and care of a prudent solicitor in the circumstances. In our view there are two distinct aspects to the alleged negligence: (1) the recommendation that Ms Tollestrup grant mortgages; and (2) the drafting of the mortgages.

1. Evidence of Mr Baldry

69 Mr Baldry has been a member of the Alberta bar since 1985 and practises law in Taber, Alberta. In 2008 his practice consisted of real estate, estate planning, wills, dependent adult work and some civil litigation. His clients were small town clients, families and small corporations. His estate work involved mainly "husband and wife" matters. His real estate practice included conveyancing, granting of security and commercial and agricultural mortgages. He typically referred tax matters to accountants. His trust work involved mainly testamentary trusts for minors and disabled children.

70 Mr Jensen recommended Mr Baldry to Ms Tollestrup. Ms Tollestrup, Mr Jensen, Ms Olsen and the Beazers met Mr Baldry at his office on September 3, 2008. Mr Baldry testified that there were two main topics of discussion: the Property and its proposed sale and the preparation of a will for Ms Tollestrup.

71 Mr Baldry testified that Ms Tollestrup advised him that there was a proposed sale of the Property with the City of Lethbridge, and that the Government of Alberta might be involved as there was a proposed ring road on the west side of Lethbridge, connecting Highway 3 to the west side of Lethbridge. Ms Tollestrup was confident that a sale was imminent. Ms Tollestsrup and Ms Olsen were certain that this was a sought after property. They anticipated a sale price of $6 million. Mr Baldry testified that the two women appeared to have researched the value of the land and were well versed in it, and mentioned

the name of a prominent realtor in Lethbridge. He had no reason to doubt their information or the research they had done. At no time did Mr Baldry conduct an independent investigation of the value of the Property.

72 Ms Tollestrup was concerned about a caveat and certificate of pending litigation on the Property's title filed by McNabb, a financial consultant who had assisted her in the past. She said she was indebted to him for $3,500 but his encumbrances reflected an indebtedness of over $40,000. She asked Mr Baldry to find a way to remove the encumbrances. Mr Baldry advised Ms Tollestrup to retain litigation counsel as he did not do much litigation. Mr Baldry testified that throughout this meeting, Ms Tollestrup spoke with familiarity about other encumbrances on the title, including a bank mortgage. He had the impression that Ms Tollestrup understood the nature of a mortgage.

73 Ms Tollestrup also instructed Mr Baldry that she wished to have a will prepared. She wanted the bulk of her estate to go to the Beazers, Ms Olsen and Mr Jensen, as they had assisted her greatly over the years while her children had not stood by her during her divorce. Mr Baldry testified that Ms Tollestrup said she did not trust her children. Ms Tollestrup also instructed Mr Baldry to prepare an Enduring Power of Attorney and a Personal Directive.

74 Ms Tollestrup returned to Mr Baldry's office on September 12, 2008. She reviewed the draft will and made changes. She expressed a concern regarding her children's ability to get in the way of the planned sale of the Property and in carrying out the bequests. In response to her questions regarding contesting the will, Mr Baldry advised her that anyone could contest a will but that in his opinion the challenge would be unsuccessful. According to Mr Baldry, Ms Tollestrup was very concerned with repaying the Beazers, Ms Olsen and Mr Jensen for their assistance. She asked him for his advice on how to avoid the interference of her children. He suggested securing the obligations by way of mortgages against the Property. He explained that upon its sale or Ms Tollestrup's death, the Beazers, Ms Olsen and Mr Jensen would be paid as secured creditors, despite possible attempts to contest the sale or the will.

75 Ms Tollestrup instructed Mr Baldry to prepare a $400,000 mortgage to the Beazers and a $100,000 mortgage to Mr Jensen. Mr Baldry did not inquire into the calculation of these amounts and assumed they related to past indebtedness. The trial judge found that it was Ms Tollestrup alone who quantified her debt obligations: Reasons at para 81.

76 On September 19, 2008 Ms Tollestrup returned to Mr Baldry's office to execute the documents. Mr Baldry testified that he went over the wording of the promissory notes with her. She understood their terms, the amounts, that they were demand notes and no interest was payable until demand. The mortgage documents were created from precedents. Mr Baldry did not recall reviewing the language of the mortgages as they were seen as temporary and would be discharged upon the sale of the land. Although he assumed the mortgages were intended to secure past obligations, he did not amend the mortgages to reflect that. Mr Baldry also prepared mortgage discharges to be executed by the Beazers and Mr Jensen to be held until the sale closed to ensure that if any of the mortgagees passed away in the interim, the sale of the Property would not be held up by probate.

77 Mr Baldry also dealt with the McNabb matter. He contacted a lawyer who agreed to represent Ms Tollestrup. After negotiations with McNabb as to the amount owed, Mr Jensen advanced the funds necessary to clear the title of McNabb's caveat and certificate of pending litigation. In return, Ms Tollestrup instructed Mr Baldry to prepare an additional promissory note in the amount of $50,000 and another mortgage in favour of Mr Jensen.

78 Mr Baldry acknowledged that he did not inquire into Ms Tollestrup's assets or financial needs when drafting her will, nor did he discuss the impact of taxes payable by her or her estate upon sale of the Property.

79 Mr Baldry acknowledged that at the relevant time, he had never established an alter ego trust for a client. However, he was familiar with the term and understood it to be an *inter vivos* trust established to achieve tax planning goals and to determine who would receive the settlor's assets. It "sound[ed] correct" to Mr Baldry that an alter ego trust allows the property of the settlor to be transferred out of the estate into a trust so that the property is no longer part of the settlor's estate on death.

2. Evidence of Mr Boettger Q.C.

80 Roy Boettger Q.C. was qualified to give expert opinion evidence on the standard of care of a lawyer practising in the area of estate planning and administration, wills, trusts and business transactions, including real estate transactions as they related to estate planning.

81 Mr Boettger's report addressed a number of questions asked by the appellant's counsel regarding the standard of care of a reasonably competent lawyer preparing a will. Specifically, Mr Boettger was asked to consider: (i) the inquiries, if any, that should be made to determine the value of the estate, particularly where the only asset is a large acreage; (ii) the options to prevent delay due to interference in estate administration; (iii) whether a mortgage against the testator's only asset would be recommended; and (iv) what advice should be given where a testator, immediately upon executing a will, instructs the *inter vivos* transfer of a part of the estate to some of the beneficiaries. Mr Boettger reviewed the September 12, 2008 will, the certificate of title as at September 3, 2008, and the mortgages.

82 The thrust of Mr Boettger's evidence was that there were other alternatives which could have addressed Ms Tollestrup's concerns that her children might interfere with the disposition of her estate to the Beazers and Mr Jenson.

83 He stated that the obvious way to address such concerns is to remove the asset from the probate proceeding. In relation to Ms Tollestrup's situation, he suggested joint ownership of the Property, or the creation of an *inter vivos* trust, more specifically an alter ego trust, with the Property as the trust's property. The trust could be administered throughout the client's lifetime with the designation of a successor trustee and beneficiaries that would share in the trust property following the client's death.

84 Mr Boettger opined that an immediate mortgage against the client's only asset in favour of an intended beneficiary would not be a common or prudent recommendation. It would not eliminate delay in the administration of the estate. To the contrary, it could prolong it. The property is still an asset of the estate subject to administration, whether or not there was a mortgage on the property. Moreover, there are many other disadvantages to the mortgage. If the client wished to sell the property for her personal needs, it would be necessary to have the cooperation of the mortgagee. If the client wished to change the beneficiaries under her will, the mortgagee might not be willing to relinquish his or her interest under the mortgage.

85 Mr Boettger acknowledged that he had not considered that the mortgages may have been granted to acknowledge a pre-existing debt, and that his report did not discuss those debts. He agreed that it would be important to know whether a client had been through long and bitter divorce proceedings. He acknowledged that as part of the consideration of the class of beneficiaries, it would be important to know whether the client was estranged from her children, and whether there were others who had provided financial and emotional support. He agreed that knowledge of an imminent sale of a client's property would also be important information. He testified, however, that such knowledge would not necessarily exclude the consideration of the trust vehicles to which he had testified.

86 Mr Boettger opined that if a client came to him with clear instructions on how they wanted to repay a debt, he would not refuse their instructions, but he would use the initial instructions to open a dialogue to determine what the client was trying to achieve. If the client wanted to acknowledge the debt, Mr Boettger would ensure that they understood that the debt reduced the amount left in their estate. If there was an impending sale of the client's property, Mr Boettger would want to know the terms of the sale, the source of the cash to close and whether the client would still be financially solvent after the sale.

87 Mr Boettger acknowledged that while the advice regarding an alter ego trust would likely not be on the mind of the average lawyer in small town Alberta, it is the obligation of a lawyer to remain current with respect to the law.

88 The trial judge found Mr Boettger's evidence to be of some assistance but not determinative because it was "articulated in a vacuum": Reasons at para 88. "He was unaware of the totality of the circumstances confronting Mr Baldry. For example, Mr Boettger did not consider the scenario of acknowledgment of and security for a pre-existing debt, which was a major issue facing Mr Baldry" *ibid.* He found many of the opinions unhelpful in the situation confronting Mr Baldry.

89 The trial judge concluded that it had not been demonstrated that Mr Baldry failed in the exercise of his duty to Ms Tollestrup: Reasons at para 84. As to context, he said:

> When Mr Baldry dealt with Carol and the others in his office, it was apparent that he was being asked to draft a will whose primary focus was the repayment to the individuals who had helped Carol. It is equally clear that the mortgages and promissory notes were in furtherance of that objective. The wisdom of approaching this task as he did may be curious. However, one must view the situation in its proper context. Lawyers are not soothsayers or clairvoyants. They deal with everyday people in everyday situations. Mr Baldry could have done more to investigate the information before him. But he was satisfied that Carol was in charge of her situation. He was satisfied that a sale of Carol's property was imminent, a conclusion which is supported by the evidence of the other parties who testified at trial. It was apparent that all in attendance had Carol's best interest at heart. **It was obvious to Mr Baldry that Carol wanted to ensure that her debt obligations would be satisfied at all costs.** The information available to Mr Baldry was that the property was about to be sold, and none of the parties before him disputed Carol's opinion of the value. His efforts, based on the available facts, were to put in place an immediate and tamper proof method of paying Carol's debts. The paying of the McNabb encumbrance was but one of the steps taken.
>
> . . . Mr Baldry's actions must be viewed in the context of the situation in which he found himself and the information available to him. While his solutions may have been somewhat unorthodox, they must be assessed having regard to the circumstances with which he was confronted. The situation he faced was that of an older client who was apparently focused and who described a poor relationship with family members. She was surrounded by people she obviously trusted and who apparently were focused on her welfare. There was concern expressed about encumbrances on title and the potential for disruptive behaviour from children. And the resources which would be the foundation for the will, and the basis for the mortgages and promissory notes, would soon be liquidated. **It could have been more thoroughly done but I am not satisfied that Mr Baldry was negligent in his representation of Carol Tollestrup with the solutions he proposed to address her concerns. His potential negligence lies in his failure to properly draft the mortgages.** The debt had been long since created. There were no future funds to be advanced, as contemplated by the wording of the mortgages. The inconsistency in the wording resulted in my conclusion that nothing was owing on those mortgages (at paras 87 and 88, emphasis added).

3. Analysis of the Negligence Claim

90 The appellant contends that the trial judge erred by failing to specifically state what constitutes the standard of care of a reasonably competent solicitor. The trial judge can be assumed to know it. The duties owed by a lawyer to his client are:

> . . . as follows: (a) to be skillful and careful; (b) to advise his client in all matters relevant to his retainer, so far as may be reasonably necessary; (c) to protect the interests of his client; (d) to carry out his instructions by all proper means; (e) to consult with his client on all questions of doubt which do not fall within the express or implied discretion left to him; and (f) to keep his client informed to such an extent as may be reasonably necessary, according to the same criteria (*Millican v. Tiffin Holdings Ltd.* (1964), 49 D.L.R. (2d) 216 (Alta. T.D.) (QL) at para 12 [*Millican* cited to QL], rev'd (1965), 53 D.L.R. (2d) 674 (Alta. C.A.), aff'd [1967] S.C.R. 183 (S.C.C.)).

91 Unlike a will which is revocable, the mortgages were not. The appellant's main submission is that the mortgages deprived Ms Tollestrup of any ability to deal with her only asset in the event she needed it. The appellant submits that in meeting the standard of care of a prudent solicitor in these circumstances Mr Baldry ought to have advised Ms Tollestrup of the risks inherent in granting the mortgages and he ought to have considered alternatives to the mortgages. It was clear from the evidence of the expert that in his opinion a mortgage was not prudent in the circumstances.

92 Although this argument has merit, it fails to take into account the unique circumstances faced by Mr Baldry. The trial judge found that Ms Tollestrup's main concern was to ensure that her friends were repaid. The trial judge said, "It was obvious to Mr Baldry that [Ms Tollestrup] wanted to ensure that *her debt obligations would be satisfied at all costs*": Reasons at para 87, emphasis added. The trial judge correctly noted that Mr Baldry's actions were to be viewed in the context of the situation in which he found himself and the information available to him. He was faced with an older client who was focused, who had a poor relationship with her family and was surrounded by people she trusted at that time. She was concerned about the potential

for disruptive behavior from her children. As everyone believed that the sale of the Property was imminent, the Beazers and Mr Jensen would soon receive the amounts that Ms Tollestrup wished them to have. This was the context in which the advice was given. The trial judge concluded that although the solution was unorthodox, it was not negligent. There was ample evidence on this record to support his conclusion. Nor was the trial judge bound to accept the evidence of the expert. He gave clear reasons as to why he did not accept that opinion. Given the standard of appellate review, we are not persuaded of any palpable and overriding error in the trial judge's conclusion that Mr Baldry's conduct in recommending the mortgages met the standard of care.

93 Nevertheless, we are persuaded that Mr Baldry did not meet the standard of care of a reasonably prudent solicitor when he drafted the mortgages. He admitted that he used a precedent, but did not recall reviewing the language of the mortgages. Although he knew that the mortgages were intended to secure past obligations, he did not amend the documents to reflect this. Additionally, he did not modify the documents to say the mortgages were only enforceable on sale or death, which was clearly what was contemplated. The trial judge observed that Mr Baldry's "potential negligence" lay in failing to properly draft the mortgages. There were no future funds to be advanced as contemplated by the wording of the mortgages.

94 We allow the appeal on this narrow ground. By agreement, the trial judge did not assess damages. We direct the matter to the Court of Queen's Bench for an assessment of damages resulting from Mr Baldry's negligence in failing to properly draft the mortgages to reflect that they were given for funds already advanced and were not enforceable until Ms Tollestrup's death or the sale of the Property. These damages would include the legal costs of rectifying the mortgages.

V. Conclusion

95 The promissory notes are valid pursuant to statute. The mortgages are valid because the consideration thereof was the promissory notes or the delay in the ability of the mortgagees to demand payment. Rectification to change the mortgages' preamble from "to be lent" to "having been lent" was appropriate. This reflected the parties' common intentions. The appellant acknowledges that if we found the mortgages capable of rectification, there is agreement that no one contemplated future advances of funds and the mortgages should reflect this. There is no error in rectifying paragraph 8(e) from "the whole of the monies hereby secured shall, at the option of the mortgagee, become due and payable" to "the whole of the monies hereby secured shall become due and payable upon the sale of the said land, or upon the death of the mortgagor". We exercise our discretion to rectify paragraph 2 of the mortgages to accord with this.

96 As articulated at paras 93 and 94, we allow the appeal in part in respect of the trial judge's decision regarding the claim against Mr Baldry. All other grounds of appeal are dismissed.

***O'Ferrall J.A.* (dissenting):**

97 I concur with my colleagues that the appeal of the trial judge's declaration of the validity of the mortgages granted by the deceased to the respondents ought to be dismissed. However, it is because I agree with my colleagues on the validity of the mortgages that I would have dismissed the estate's appeal of the dismissal of its claim that the lawyer who recommended, prepared and registered the mortgages was negligent.

98 This dissent is based on the trial judge's finding of fact that the focus of the lawyer's instructions was on documenting an arrangement whereby the appellant would repay the respondents who had helped her financially. The bequests in the will were simply one of the means by which the deceased chose to repay her debts. Had the trial judge found that the focus of the deceased's instructions was on estate planning, a different conclusion may have ensued.

99 The trial judge found that the lawyer was potentially negligent in his failure to properly draft the mortgage documents; but the "potential negligence", as the trial judge called it, comes to naught because the estate did not suffer loss as a consequence of the lawyer's failure to make the appropriate amendments to the standard form of mortgage. The estate suffered a loss because the deceased, the Beazers and Mr. Jensen failed to honour their agreements.

100 In my view, neither the estate nor the Beazers and Mr. Jensen can be heard to complain about what the lawyer did because what he did is what they instructed him to do. The parties agreed on an arrangement involving promissory notes secured by

mortgages which would only be enforceable on a disposition of the deceased's property, either by sale or by death. In the facts of this case, the parties cannot be heard to complain that they ended up in litigation because the form of the mortgage documents used by the lawyer did not reflect all of the terms of their agreement. And the reason they cannot complain is that they knew full well what their agreement was and what role the mortgage played in that agreement. A *bona fide* third party without notice of the arrangements, such as a purchaser of the mortgages, might have had a complaint, but not the deceased or her estate.

101 The estate was not harmed by what the lawyer did. It was harmed by the actions of the deceased. The fact that the deceased questioned the validity of mortgages which she clearly intended to grant is not something the lawyer should be held responsible for. It might be argued that the lawyer should be held liable to the estate for the costs it incurred in defending the Beazers' and Mr. Jensen's premature mortgage foreclosure actions. But, in my view, it was open to the trial judge to find that the lawyer was not liable in this regard because it was not foreseeable that the Beazers and Mr. Jensen, who well knew their mortgages were not due and payable, would commence foreclosure proceedings before they were entitled to. Nor was it foreseeable that the Beazers and Mr. Jensen would claim amounts in excess of the principal amounts of the promissory notes which the mortgages were intended to secure when they knew they were not entitled to those amounts. The Beazers and Mr. Jensen might have been held liable for the estate's costs in defending those actions and claims, but not the lawyer.

102 The trial judge found that the lawyer was instructed by a deceased whose primary focus was repaying people who had helped her financially and otherwise. It appears that the deceased wanted what she considered to be her debt repaid "at all costs". It was the deceased who wished to characterize her obligations as debts and in order to document them as debts, the lawyer suggested that the deceased sign promissory notes. The trial judge found that the effect of the promissory notes was carefully explained to the deceased. In other words, the deceased knew she was agreeing to create a debt obligation.

103 The deceased also wished to provide the Beazers and Mr. Jensen security for the amounts she promised to pay. One of her motives in providing security was to make sure her promise to make these payments could not be attacked by members of her family should she die. Consequently, in order to unassailably secure payment of the promissory notes, the deceased granted mortgages in certain amounts against her property on the outskirts of Lethbridge.

104 The decision to grant mortgages as security was also driven by the deceased's anticipation that her property would soon sell and that her friends would receive payments out of the proceeds of that sale during her lifetime. Instead of mortgages, the lawyer might have employed another form of encumbrance prescribed in section 102 of the *Land Titles Act*, RSA 2000, c L-4, i.e. a charge on the land to secure payment of a sum of money; but the result would have been the same. Therefore, there was no need for the lawyer to provide detailed explanations of the mortgages to the deceased. These were not conventional mortgages. They were simply intended to be charges on the land in the form of mortgages.

105 The parties also agreed on what would happen if the property did not sell and the deceased died. In that event, the promissory notes would be immediately payable and the mortgages immediately enforceable. Furthermore, the parties agreed on what would happen if one of the mortgagees died before the deceased. The debt would disappear. The Beazers and Mr. Jensen executed discharges of the mortgages which were to be held in trust for that purpose. In the meantime, the mortgages the deceased granted would simply remain fixed charges on her property. They were clearly not conventional mortgages.

106 The lawyer testified that when he took his instructions from the deceased, there was no doubt what those instructions were. He testified that the deceased was completely in charge of her situation and that she wanted to ensure what she considered to be her debt obligations would be satisfied no matter what. The trial judge accepted this evidence and I see no error in such acceptance.

107 The estate cannot now seek to be indemnified by the lawyer for the costs it incurred in denying the enforceability of the mortgages which the deceased willingly granted. Nor, in my view, can the lawyer be held liable to the estate for the costs the estate incurred in defending the excessive claims advanced by the Beazers and Mr. Jensen. I use the phrase excessive claims because the Beazers and Mr. Jensen were well aware that the mortgages in question were never intended to be conventional mortgages enforceable in accordance with their terms. The rectifications which the trial judge and this Court were required to make to the mortgages were only required because the Beazers and Mr. Jensen attempted to enforce these mortgages as

conventional mortgages when they knew that was never intended by the deceased, and because the estate took the position that the mortgages were not valid at all. The need for rectification was not a consequence of the lawyer's negligence. Rectification was necessitated by the fact that the Beazers and Mr. Jensen repudiated their agreement and made more of the mortgages than was intended and by the fact that the deceased repudiated her agreement by seeking to set the mortgages aside altogether. On the facts of this case, neither the estate, the Beazers, nor Mr. Jensen can be heard to claim that the lawyer's choice of instruments or his drafting caused them any loss. Both chose to make claims which did not reflect the agreement they made. And that is why I hold the view that the deceased's estate cannot be heard to claim that it was the lawyer's choice of security instrument or his drafting which caused its loss.

108 In the result, I would have upheld the trial judge's dismissal of the parties' claims against the lawyer.

Appeal allowed in part.

TAB 6

1984 CarswellAlta 261
Alberta Court of Queen's Bench

Alberta Drywall Supply Ltd. v. Hauk

1984 CarswellAlta 261, [1984] A.W.L.D. 758, 27 A.C.W.S. (2d) 468, 53 C.B.R. (N.S.) 62, 55 A.R. 226

ALBERTA DRYWALL SUPPLY LTD. v. HAUK and HAUK

Master Quinn [in Chambers]

Judgment: June 19, 1984
Docket: Edmonton No. 8303-39499

Counsel: *R.A. Philion*, for plaintiff.
D.R. Wieber, for defendants.

Subject: Corporate and Commercial; Insolvency
Related Abridgment Classifications
Bankruptcy and insolvency
X Priorities of claims
X.1 Secured claims
X.1.b Forms of secured interests
X.1.b.ii Mortgages and hypothecs
Headnote
Bankruptcy --- Priorities of claims — Secured claims — Forms of secured interests — Mortgages and hypothecs
Fraudulent transactions — Preferences — Bankrupts not having standing to claim that a mortgage they granted was void as fraudulent preference — Bankrupts' equity in mortgaged property being exempt property and not subject to s. 73 of Bankruptcy Act.
Secured creditors — Mortgages and hypothecs — Forbearance by creditor to sue on guarantee being good consideration for mortgage — Unnecessary that consideration flow to both mortgagors.
The defendant husband signed a personal guarantee in which he promised to pay to the plaintiff the indebtedness of a company of which he and his wife, the other defendant, were the only shareholders. To prevent legal action on the guarantee, the defendants granted a mortgage to the plaintiff but entered into personal bankruptcy within 90 days thereafter. The plaintiff commenced foreclosure proceedings and sought an order nisi/order for sale. The defendants filed a statement of defence alleging: (1) that the plaintiff had obtained an unlawful preference within the meaning of s. 73 of the Bankruptcy Act; (2) that there was never any debt owing by the wife to the plaintiff nor any guarantee on her part regarding the company debt and, therefore, no consideration to support any promise to pay; and (3) that the plaintiff never made a demand from the husband on the guarantee.
Held:
Order nisi/order for sale granted.
The defendants had no status to rely on s. 73 of the Bankruptcy Act because that section only allowed a trustee in bankruptcy to attack a transaction as a fraudulent preference. Moreover, the mortgage covered exempt property to which s. 73 did not apply. There was good consideration for the mortgage in that there was a forbearance by the plaintiff to sue at the time of the granting of the mortgage. It was unnecessary for this consideration to flow to the wife. Since the guarantee was not in evidence, it could not be said that any demand was required. However, the only reasonable inference to be drawn from the statement in the wife's affidavit that the mortgage was granted in consideration of a forbearance to sue on the guarantee was that a demand had been made.
Table of Authorities
Cases considered:
Can. Credit Men's Trust Assn. v. Umbel, 13 C.B.R. 40, [1931] 3 W.W.R. 145 (Alta. S.C.) — *applied*

C.N.R. v. Harnett (1979), 31 C.B.R. (N.S.) 203 (Nfld. C.A.) — *applied*

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3, ss. 12(1), 47, 73.

Authorities considered:

Anson, Law of Contract, 24th ed., p. 97.

Application in mortgage foreclosure action for order nisi/order for sale.

***Master Quinn*:**

1 This is a mortgage foreclosure action in which a statement of defence has been filed by the defendant registered owners, Alfred and Paulette Hauk ("Hauks").

2 The plaintiff makes this application for summary judgment, which would be an order nisi/order for sale.

3 The affidavit of Paulette Hauk has been filed in opposition to the application for summary judgment. The affidavit discloses the following pertinent facts:

4 1. Hauks are the shareholders of Cougar Drywall Ltd. ("Cougar") which at times material to these proceedings was indebted to Alberta Drywall Supply Ltd. ("Drywall").

5 2. In August 1982 Alfred Hauk signed a personal guarantee in favor of Drywall whereby he promised to pay the indebtedness of Cougar to Drywall.

6 3. In or about September 1982 Drywall advised Hauks that Drywall was not satisfied that it was adequately secured by the guarantee of Alfred Hauk and that legal action would be taken by Drywall to collect the balance owing unless the Hauks granted the mortgage which is the subject matter of these proceedings.

7 4. The mortgage in question was executed on 16th November 1982 and registered on 17th November 1982.

8 5. On 26th January 1983 Cougar ceased doing business and the Hauks declared personal bankruptcy.

9 6. The amount of the equity of the Hauks in the subject property is less than the amount of exemption to which they are entitled under the bankruptcy provisions.

10 7. Drywall has not made any claim in the bankruptcy proceedings although it was invited to do so by the trustee in bankruptcy.

11 The defence put forward by the defendants is as follows:

12 1. That the defendants entered into personal bankruptcy within 90 days after the execution of the mortgage, and that Drywall has accordingly obtained an unlawful preference as to its debt having regard to s. 73 of the Bankruptcy Act, R.S.C. 1970, c. B-3.

13 2. That there was never a debt owing by Paulette Hauk to Drywall. That she never guaranteed payment of the Cougar debt to Drywall and that there was no consideration to support any promise to pay Drywall that she may have made.

14 3. That Drywall has never made a demand for payment from Alfred Hauk with reference to the guarantee that he gave to Drywall.

15 Section 73 of the Bankruptcy Act is as follows:

73.(1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving such creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering the same becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in the bankruptcy.

(2) Where any such conveyance, transfer, payment, obligation or judicial proceeding has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed *prima facie* to have been made, incurred, taken, paid or suffered with a view to giving such creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be receivable or avail to support such transaction.

(3) For the purposes of this section, the expression "creditor" includes a surety or guarantor for the debt due to such creditor.

16 It should be noted that a transfer or charge made within the three-month period shall be deemed fraudulent and void as *against the trustee in bankruptcy*. If the transactions is to be attacked, it should be attacked by the trustee in bankruptcy. *C.N.R. v. Harnett* (1979), 31 C.B.R. (N.S.) 203 (Nfld. C.A.), is authority for the proposition that only a trustee can attack a transaction as being a fraudulent preference under s. 73. In the present case it is not the trustee who is attacking the mortgage. In point of fact the trustee has sent a letter dated 15th February 1983 to Drywall in which he states that he is taking no interest in the matter and asking Drywall to accept the letter as the trustee's "statement of no interest". I take it that the trustee intended the said letter to be a disclaimer by the trustee pursuant to s. 12(1) of the Bankruptcy Act. In my opinion the defendants have no status to rely upon s. 73 aforesaid. I do not think it makes any difference that they are raising the matter by way of a statement of defence to the plaintiff's action rather than in proceedings in which they themselves are plaintiffs.

17 Paragraph 13 of the affidavit of Paulette Hauk indicates that the equity in the property in question available to be mortgaged to Drywall was less than the exemption to which the defendants were entitled. By s. 47 of the Bankruptcy Act a bankrupt is entitled to the same exemption he would be entitled to under provincial law. The bankrupts would each be entitled to an exemption of $8,000 on the property in question, which is the house in which they reside. According to the evidence the market value of the house is $35,500 and the amount owing on the first mortgage is $28,000, leaving an equity of $7,000, which is well within the exemption.

18 Section 73 of the Bankruptcy Act does not apply to situations where a bankrupt has been dealing with his exempt property: *Can. Credit Men's Trust Assn. v. Umbel*, 13 C.B.R. 40, [1931] 3 W.W.R. 145 (Alta. S.C.). The bankrupts were dealing with their exempt property when they granted the mortgage in question herein to Drywall, and s. 73 does not apply to the transaction. I am of the opinion that the defendants do not have a good defence based upon s. 73 aforesaid.

19 It is submitted that there was no consideration for the mortgage in question because there was no money advanced to the defendants by the plaintiff at the time the mortgage was signed and registered. The mortgage was given as security for a pre-existing debt. According to the evidence, Alfred Hauk was personally indebted to the plaintiff under a guarantee at the time the mortgage was granted, and the consideration given by the plaintiff for the mortgage was the forbearance of the plaintiff to take action against Alfred Hauk on his guarantee and against Cougar Drywall. It is further submitted on behalf of Paulette Hauk that she was never personally indebted to the plaintiff and that there was no consideration flowing to her.

20 It is trite law that forbearance to sue is good consideration, and there can be no doubt that there was good consideration so far as Alfred Hauk is concerned. The argument advanced for Paulette Hauk is predicated upon the fallacy that consideration must flow from the plaintiff as promisee to Paulette Hauk as promisor. This sort of argument is often advanced in chambers applications. In Anson's Law of Contract, 24th ed. p. 97, the following statement appears:

Consideration must move from the Promisee

> This means that a party who wishes to enforce a contract must be able to show that he himself has furnished consideration for the promise of the other party. It is not, however, necessary that it should have been intended to benefit the other party. So it need not move to the promisor.

21 In the context of the present case this means that consideration must move from Drywall as promisee, but that the consideration (the forbearance to sue) does not necessarily have to flow to Paulette Hauk. In the present case the consideration flowed to Alfred Hauk, but that is no reason for holding that there was no consideration to support Paulette Hauk's promise. I accordingly find that there was good consideration for the mortgage in question and that it is binding upon both of the defendants.

22 It is submitted that no demand has been made on the guarantee granted by Alfred Hauk to the plaintiff. The guarantee is not in the evidence before me, and it therefore cannot be said that any demand is required. The affidavit of Paulette Hauk filed in opposition to the present application indicates that the mortgage in question was granted by the defendants in consideration of the plaintiff, Drywall, forbearing suit against Alfred Hauk on his guarantee. The only reasonable inference that can be made is that a demand was in fact made to Alfred Hauk for payment under the guarantee.

23 I am therefore of the opinion that the defendants do not have a valid defence and that the plaintiff is entitled to an order nisi/order for sale with a redemption period expiring one day from the date of service, the total debt owing on the property exceeding even the market value. Subsequent encumbrancers may be served by ordinary registered mail at the address shown for them at the land titles office. Notice of intention to advertise is dispensed with. Costs will be on a solicitor-client basis. If the subject property is not occupied by the defendants, the plaintiff is hereby appointed as receiver of rents and profits, such appointment to be without bond and such appointment will not operate as a stay of these proceedings.

Order nisi/order for sale granted.

TAB 7

KeyCite treatment

Most Negative Treatment: Reversed

Most Recent Reversed: Winnipeg Mortgage Exchange Ltd. v. Mortgage Holdings Ltd. | 1982 CarswellMan 14, 19 Man. R. (2d) 1, 43 C.B.R. (N.S.) 119, 17 A.C.W.S. (2d) 177, [1983] 1 W.W.R. 213, [1982] M.J. No. 36 | (Man. C.A., Nov 1, 1982)

1982 CarswellMan 10

Manitoba Court of Queen's Bench

Winnipeg Mortgage Exchange Ltd. v. Winnipeg Mortgage Holdings Ltd.

1982 CarswellMan 10, [1982] 4 W.W.R. 16, [1982] M.J. No. 11, 14 A.C.W.S. (2d) 70, 15 Man. R. (2d) 271, 2 P.P.S.A.C. 107, 41 C.B.R. (N.S.) 230

RANJOY SALES AND LEASING LTD. v. DOWN; ALWARD and ALWARD v. DOWN; REGO and REGO v. DOWN; RUDNIK and RUDNIK v. DOWN; SEAVERS v. DOWN

Wright J.

Judgment: March 26, 1982

Docket: Nos. 789/80, 791/80, 1067/81, 1068/81, 1069/81 and 1070/81

Counsel: *R.M. Kozminsky*, for applicant.

H.I. Pollock, Q.C., and *R. Doyle*, for plaintiffs.

R. Scott, Q.C., and *A. Anhang*, for defendant.

R. Scott, Q.C., for unsecured creditors.

V. Savino, for eight creditors.

W.C. Kushneryk, for trustee in bankruptcy.

Subject: Corporate and Commercial; Insolvency; Estates and Trusts; Property

Related Abridgment Classifications

Bankruptcy and insolvency

X Priorities of claims

X.1 Secured claims

X.1.b Forms of secured interests

X.1.b.ii Mortgages and hypothecs

Bankruptcy and insolvency

X Priorities of claims

X.1 Secured claims

X.1.d Dealings with security after bankruptcy

X.1.d.i By secured creditor

X.1.d.i.A Realization of security

Estates and trusts

II Trusts

II.1 General principles

II.1.b Trust distinguished from other relationships

II.1.b.vi Mortgage

Real property

VII Mortgages

VII.2 Nature and form of mortgage

VII.2.g Equitable mortgage

VII.2.g.i What constituting

Headnote

Bankruptcy --- Priorities of claims — Secured claims — Forms of secured interests — Mortgages and hypothecs

Bankruptcy --- Priorities of claims — Secured claims — Dealings with security after bankruptcy — By secured creditor — Realization of security

Mortgages --- Nature and form of mortgage — Equitable mortgage — What constituting

Trusts and Trustees --- Trust distinguished from other relationships — Mortgage — General

Bankruptcy — Secured creditors — Kinds of security — Mortgages and hypothecs — Bankrupt mortgage broker in business of selling and mortgaging principal mortgages in whole or in part — Broker remaining registered owner of principal mortgages — Documents describing sale or mortgage sufficiently identifying investor's investment and principal mortgage charged — Investors having equitable claim against principal mortgage security.

Mortgages — Equitable mortgage — Creation of — Documents, including trust document, delivered by mortgage broker to investor, referring to specific mortgage of mortgage — No actual mortgage document drawn up — Broker estopped from denying existence of mortgage — Alternatively, trust document creating equitable mortgage charge in context of other written material.

Trusts and trustees — Trust distinguished from other relationships — Mortgage — Investors receiving documents from mortgage broker, describing investment in whole or part of principal mortgage — No actual mortgage documents drawn up — Trust agreement declaring that particular mortgage being held in trust for investor, together with other documentation, creating both express trust and equitable mortgage.

Certain mortgage investors with a bankrupt mortgage broker held documentation consisting of three documents: a purchase of mortgage contract; an allocation letter with amortization schedule attached; and a trust agreement indicating that the broker held a particular mortgage, or part of it, in trust for the investor because of a mortgage of the mortgage or part of it, or, in some cases, a sale of the mortgage or part of it. The investors brought representative actions against the trustee in bankruptcy for a determination that the security held by an investor would allow him to claim against the principal mortgage security so as to be a secured creditor within the meaning of s. 2(2) of the Bankruptcy Act, or, alternatively, to claim as a beneficiary of a trust under s. 47(*a*) and s. 59(1) of the Act.

Held:

Actions allowed.

The memorandum evidencing the contract creating the security was sufficient to satisfy the Statute of Frauds, so that both the mortgage of a mortgage and the sale of a mortgage were enforceable as equitable mortgages. Although the mortgage was not actually created in the documentation, the broker was estopped from denying the existence of the mortgage because the trust document assertions were acted upon by the investor. Alternatively, the trust document itself, in the context of the other written material, created the mortgage charge under the equitable doctrine that defects in the issue of a security will be cured where an agreement between the parties shows a clear intention to create the security.

An enforceable trust was created, because certainties of intention, subject matter and objects could be ascertained from the contents of all the documents, except in the case of the declaration of trust of a part of a mortgage of a mortgage which had no certainty of subject matter. In the case of a sale of part of a mortgage, a constructive trust was created.

There was no merit to the argument that it was impossible to trace the investor's funds, because there was no need to; nor that, fraud on the part of the brokers having destroyed some of the mortgage security, not all of the investors would be able to realize their security, because it was irrelevant; nor that investors' rights were limited by Acts regulating trade in securities, because those Acts were not directed towards security-holders; nor that the Personal Property Security Act was applicable, because it was not intended to cover a real property interest. As to the argument that one cannot sue on a promissory estoppel, that doctrine did not apply, because there was no promised future event. Nor was estoppel the cause of action; the action was on the charge created. Further, estoppel could create a right, as in this case, by preventing a denial of the existence of the right.

Table of Authorities

Cases considered:

Banks v. Whittal (1847), 1 De G. & Sm. 536, 63 E.R. 1182 (V.C.) — *considered*

Burkanshaw v. Nicholls (1878), 3 App. Cas. 1004 (H.L.) — *referred to*

C.T.L. Uniforms Ltd. v. ACIM Indust. Ltd. (1981), 33 O.R. (2d) 139, 1 P.P.S.A.C. 308, 123 D.L.R. (3d) 702, affirmed 35 O.R. (2d) 172 (C.A.) — *referred to*

Cadwell's Ltd., Re, [1934] O.R. 178, 15 C.B.R. 293, [1934] 2 D.L.R. 341 (C.A.) — *considered*

Combe v. Combe, [1951] 2 K.B. 215, [1951] 1 All E.R. 767 (C.A.) — *distinguished*

Cozens, Re, [1913] 2 Ch. 478 — *considered*

Darlington v. Pritchard (1842), 4 Man. & G. 783, 134 E.R. 322 (C.P.) — *referred to*

Dundas v. Desjardins Canal Co. (1870), 17 Gr. 27 (Ont. Ch.) — *considered*

Forster v. Hale (1798), 3 Ves. Jun. 697, 30 E.R. 1226, affirmed 5 Ves. Jun. 308, 31 E.R. 603 (L.C.) — *considered*

London & County Banking Co. v. Goddard, [1897] 1 Ch. 642 — *considered*

Middleton v. Pollock; Ex parte Elliott (1876), 2 Ch. D. 104 — *considered*

Northard & Lowe Fruit Co. v. Durno, 59 N.S.R. 310, [1927] 2 D.L.R. 892 (C.A.) — *referred to*

Parkland Mtge. Corp. Ltd. v. Therevan Dev. Corp. Ltd., [1982] 1 W.W.R. 587, 17 Alta. L.R. (2d) 44, 34 A.R. 70 (Q.B.) — *followed*

Peel v. Peel (1918), 15 O.W.N. 297, 42 O.L.R. 165 (Ont. C.A.) — *considered*

Scarlett v. Nattress (1895), 23 O.A.R. 297 — *referred to*

Taylor v. London & County Banking Co.; London & County Banking Co. v. Nixon, [1901] 2 Ch. 231 (C.A.) — *referred to*

Urman, Re (1981), 38 C.B.R. (N.S.) 261, 15 B.L.R. 165, 20 R.P.R. 161, 128 D.L.R. (3d) 33 (Ont. H.C.) — *distinguished*

Yorkshire Trust Co. v. Empire Accept. Corp.; Irwin v. Empire Accept. Corp. (1978), 28 C.B.R. (N.S.) 225 (B.C.S.C.) — *applied*

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3, ss. 2 "secured creditor", 47(*a*), 59(1).

Mortgage Brokers and Mortgage Dealers Act, 1971 (Man.), c. 26 (also C.C.S.M., c. M210).

Personal property Security Act, 1973 (Man.), c. 5 (also C.C.S.M., c. P35).

Personal Property Security Act, R.S.O. 1980, c. 375, s. 1(*m*), (*y*).

Securities Act, C.C.S.M., c. S50.

Trustee Act, 1893 (56 & 57 Vict.), c. 53.

Authorities considered:

26 Can. Abr. (2d) *Mortgages*, p. 61, s 223.

Falconbridge on Mortgages, 3rd ed. (1942), pp. 69, 70.

Falconbridge on Mortgages, 4th ed. (1977), p. 251.

Fisher's Law of Mortgages, Can. ed (1910), pp. 5, 6, 15, 16, 110.

Scott on Trusts, 3rd ed. (1976), vol. 5

Spencer Bower and Turner, Estoppel by Representation, 3rd ed. (1977), pp. 4-5, 20-21, 30.

Waters, Law of Trusts in Canada (1974), pp. 99, 883.

Williams, Canadian Law of Landlord and Tenant (1922), p. 66.

Ziegel, "The Scope of the Ontario Personal Property Security Act — Recent Developments" (1981), 6 Can. Business L.J. 107, pp. 118-28.

Words and phrases considered:

EQUITABLE MORTGAGE

At p. 15 Fisher [A. Underhill and A. Cole, Fisher's Law of Mortgages, Can. ed. by A.C. Forster Boulton (London: Butterworths, 1910)] defines an equitable mortgage as follows:

24. An equitable mortgage is a contract operating as a security, but which, for want of a transfer of the legal estate, can only be enforced under the equitable jurisdiction of the court, which carries it into effect either by giving the creditor immediately the appropriate remedies, or by compelling the debtor to execute a security in accordance with the contract.

The distinction between legal and equitable mortgages is discussed in the following passage from [J.D.] Falconbridge's Law of Mortgages, 3rd ed. ([Toronto; Canada Law Book,] (1942), at p. 69:

It has already been pointed out that it is an essential feature of a legal mortgage that it should vest the legal estate in land in the mortgagee, and it follows that any mortgage which does not transfer the legal estate cannot be a legal mortgage. Equity not only annexed to a legal mortgage certain inevitable terms which it enforced without regard to the contract of the parties, but it recognized as valid charges mortgages other than legal mortgages and annexed to them the same inevitable terms.

An equitable mortgage therefore is a contract which creates in equity a charge on property but does not pass the legal estate to the mortagagee. Its operation is that of an executory assurance, which, as between the parties, and so far as equitable rights and remedies are concerned, is equivalent to an actual assurance, and is enforceable under the equitable jurisdiction of the court.

. . . . .

. . . we are concerned here with the question of an equitable mortgage or charge of the property (the principal mortgage) of a legal owner. Fisher describes this kind of mortgage at p. 16:

Equitable mortgages of the property of legal owners, on the other hand, are created by some instrument or act which is insufficient to pass the legal title, but which, being founded on valuable consideration, shows the intention of the parties to create a security; or in other words, evidences a contract to do so. The following are common examples of such mortgages:

Any written instrument showing the intention of the parties that a security should be thereby creatred, although it contains no general words of charge . . .

LEGAL MORTGAGE

[A. Underhill and A. Cole,] Fisher's Law of Mortgages, Can. ed. [by A.C. Forster Boulton] ([London: Butterworths,] 1910) at p. 5 points out that "A mortgage may be legal or equitable," and at p. 6 describes the essence of a legal mortgage as a "vesting of the legal estate in the mortgagee, together with the right of possession", but subject to conditions including the "equity of redemption".

. . . . .

The distinction between legal and equitable mortgages is discussed in the following passage from [J.D.] Falconbridge's Law of Mortgages, 3rd ed. ([Toronto; Canada Law Book,] 1942), at p. 69:

It has already been pointed out that it is an essential feature of a legal mortgage that it should vest the legal estate in land in the mortgagee, and it follows that any mortgage which does not transfer the legal estate cannot be a legal mortgage. Equity not only annexed to a legal mortgage certain inevitable terms which it enforced without regard to the contract of the parties, but it recognized as valid charges mortgages other than legal mortgages and annexed to them the same inevitable terms.

An equitable mortgage therefore is a contract which creates in equity a charge on property but does not pass the legal estate to the mortgagee. Its operation is that of an executory assurance, which, as between the parties, and so far as equitable rights and remedies are concerned, is equivalent to an actual assurance, and is enforceable under the equitable jurisdiction of the court.

MORTGAGE OF A MORTGAGE

[W.B. Rayner & R.H. McLaren,] Falconbridge on Mortgages, 4th ed. ([Agincourt: Canada Law Book,] 1977), at p. 251 describes a mortgage of a mortgage:

A mortgage of a mortgage is called a submortgage or a derivative mortgage. It may be made by a formal assignment of the mortgage subject to a right of redemption, or it may be made by way of a charge of the mortgage.

Representative Actions for determination that claimants are beneficiaries of trusts, or, alternatively, secured creditors.

***Wright J.*:**

1 On 16th April 1979 Thorne Riddell Inc. was appointed receiver and manager of Winnipeg Mortgage Exchange Ltd. ("Exchange"), Winnipeg Mortgage Holdings Ltd. ("Holdings"), and Pyramid Investment Corporation Ltd. ("Pyramid").

2 Subsequently, assignments in bankruptcy were filed by the three companies, with effect from 15th October 1980. Sydney John Down, a senior officer of the receiver, was appointed the trustee in bankruptcy for each company. By court order, the receivership was permitted to continue.

3 According to the receiver's third report on the bankruptcy (15th June 1981), proofs of claim were filed by approximately 650 persons, of whom approximately 345 filed as secured creditors and the remainder as unsecured creditors. In addition, over 90 persons filed under s. 59(1) of the Bankruptcy Act, R.S.C. 1970, c. B-3, claiming a trust interest in certain mortgage assets taken over by the trustee.

4 For the purposes of the following judgment, I may refer from time to time to the creditor claimants as "investors". However, I want to emphasize that in doing so I place no special connotation on that description. I use it only for the purpose of convenience in reference.

5 In due course the trustee applied to the court for an order that all the claims to security be not recognized as valid. As well, the trustee disallowed the claims under s. 59(1), and *all* the claimants affected appealed that decision to this court.

6 This court on application, by order dated 27th January 1981, directed that two trials of representative claims in these matters take place. Although the findings in these two "test" cases were to be without prejudice to the right of any other investors to have his or her claims adjudicated in this court, the objective was to establish principles or guidelines that might be applied to all claims and might then enable the trustee to distribute or release assets presently administered or controlled by him.

7 The basic issues to be resolved were stated in the order as follows:

(1) Does the document entitled Trust Agreement together with other documents, representations or undertakings received by the investors create a trust entitling the investor to claim the property described in the document entitled Trust Agreement? or alternatively,

(2) Is the investor a secured creditor as defined by the Bankruptcy Act, or an unsecured creditor?

8 The court appointed counsel to represent the unsecured creditors. The claimants in each of the "test" trials were represented by counsel of their own choice. All investors were informed through the trustee of the dates and times of each proceeding and were given the opportunity to participate if desired. In general, however, there was little involvement by investors because of this.

9 The first hearing involved the proceedings commenced by Ranjoy Sales and Leasing Ltd. (formerly known as Pan Am Motors Ltd.) ("Ranjoy"). This claim was separated from the other test cases becuase initially it was believed that the issues involved were essentially questions of law with little factual matters in dispute. However, by the time the hearing was complete, a good deal of evidence had been presented, including testimony from the principals of the bankrupt companies, Don Reid and Ross White.

10 Later it became evident that further evidence from Reid and White was to be submitted at the second hearing involving the remaining "test" cases, and I decided to withhold delivery of my decision on the Ranjoy claim until I was satisfied that *all* the evidence that might have bearing on that claim was before me. Counsel for Ranjoy was informed and given the opportunity to participate in the second hearing, but declined.

11 I am able to say at this point that the rather extensive additional evidence submitted during the two weeks of the second trial and the arguments that followed did not affect the conclusions I had reached following the earlier hearing.

12 I will now deliver judgment in respect of the Ranjoy application, which I have written based on the evidence and arguments submitted at the time of the hearing of that matter, and immediately following I will give my decision in respect of the appeal by Alward, Rego, Rudnik and Seavers et al. Although the two judgments stand independently of each other, they should be read together, as much of the reasoning in one supports conclusions reached in the other, and vice versa.

13 The first three reports of the receiver were before the court in the first hearing. All four reports of the receiver were before the court in the second hearing. It was agreed that the factual information contained in these reports could be accepted by the court, but not opinions or conclusions. That factual information has provided background and detail which has been of considerable assistance in the preparation of the judgments.

14 For the record, I will specifically identify the reports by date:

First report — 15th November 1979

Second report — 3rd June 1980

Third report — 15th June 1981

Fourth report — 5th February 1982

15 I will also record that the judgments which follow have been prepared with due regard for the directions received from the Court of Appeal on the earlier reference by the receiver to this court for advice and direction.

Test Case I

Claim of Ranjoy Sales and Leasing Ltd. (formerly known as Pan Am Motors Ltd.) ("Ranjoy")

16 This claim is based on the submission that the applicant for good and valuable consideration received three mortgages of mortgages from the bankrupts, which mortgages of mortgages were in existence when the bankrupts went into receivership on 16th August 1979.

17 The owner of the applicant (Gauthier) testified on the hearing of the motion as to his dealings with Exchange, which involved a total investment by Ranjoy of $197,000.

18 Gauthier said that at some point in time (which I took to be early in the year 1977) he contacted one of the two principals of Exchange, Don Reid, and told him he wanted to purchase mortgages. Reid told him he could supply a five-year term mortgage at 11 per cent interest (2 per cent above what the bank was then paying). He said Reid told him there would be no risk because his company approved and guaranteed the mortgages and, in the event that payments were not made, they would guarantee payments. He said Reid told him there was a "point spread" between the rate Reid was giving him and the actual mortgage rate, which covered Exchange's charges.

19 Gauthier said he spoke to Reid three or four times — always by telephone — and told Reid he wanted time "to check them out".

20 Gauthier did then check out the company, and learned that it had been in business 20 years, its "clients" had received payments on time, and "it seemed to be very legitimate". Gauthier then told Reid he wanted "whole" mortgages, first mortgages, and wanted three in total. He said Reid telephoned him later (3rd or 4th March 1977) and said he had procured three mortgages for him for a total of $197,000. Gauthier then signed three "purchase agreements" (7th March) and gave Reid a cheque totalling $197,000, broken down into $100,000, $62,000, and $35,000, to cover each of the three mortgages. The cheque is dated 9th March 1977.

21 Gauthier later was told that the mortgages were second mortgages. He said he was given no criteria as to what Reid meant by "approved" mortgages.

22 Reid told him that he (Reid) would look after collection of payments on the mortgages, due to the "point spread". He said he was told by Reid again that if there was trouble the payments would still continue.

23 Toward the end of March 1977 Gauthier received a letter in relation to each "purchase agreement" advising that he had been "allocated" mortgages according to the terms set out in the "purchase agreements".

24 A month later, in April, Gauthier said he received a "trust" agreement for each mortgage. He said he realized that nowhere in these documents did it show that Ranjoy held the mortgages. Instead it referred to Holdings. He said Reid explained that this was to ensure better servicing, that it was better that the people with whom they were doing business did not know whose mortgage it was in order to avoid being bothered by those people, and that the trust agreement was in fact Ranjoy's mortgage security.

25 Gauthier had in mind that he might need the mortgages for security in the event that he had to borrow money in the future, and he said Reid stated there would be no problem in that regard: just to contact him and he would "provide what was required".

26 It is evident that Gauthier accepted this state of affairs — or arrangement.

27 The payments on account of the investment were made each month to the credit of Ranjoy, and in accordance with the payment schedule earlier indicated to Gauthier relative to each mortgage.

28 A few months later Ranjoy borrowed money from the Canadian Imperial Bank of Commerce, and the payments were then assigned and sent each month to the bank until the loan was paid. In March 1979 another loan was obtained from I.A.C. This latter loan was *not* paid out when the receivership occurred. Gauthier said he contacted Reid on the occasion of each loan, and Reid said it was okay to pledge the mortgages. At the request of the Canadian Imperial Bank of Commerce, Gauthier gave the bank a letter instructing Exchange to this effect. In the case of I.A.C., Ranjoy gave an assignment of all its rights and interests in the mortgages, and attached copies of all the documentation it had.

29 On cross-examination, Gauthier acknowledged that in his dealings with Exchange (Reid) he relied on Reid's advice that the mortgages were guaranteed, that there was no risk, the good reputation of the company (as Gauthier had ascertained) and the fact that he had friends who dealt with Exchange and "had received payments for a number of years like clockwork".

30 Gauthier also acknowledged that he had no information to speak of concerning the quality of the mortgages which he said he believed he purchased. He did not know what properties they covered, who the mortgagors were, or where the mortgages were located. He made no inquiries as to — or ascertained in any way — how much the mortgage interest spread was above the interest he was receiving. He stated as well that he had not appreciated the meaning of the reference in the trust document to "mortgage of a mortgage".

31 The combination of the affidavit evidence filed and the testimony of Gauthier at the hearing, in the context of the relevant documentation, clearly reveals that Gauthier decided to place his money with Exchange in order to receive a better return than the banks were offering at the time, and that he did so on the basis of the good financial reputation of Exchange and on the representation and undertaking of Reid that the return on his investment was guaranteed.

32 But I do not conclude that this was the only basis for the investments with Exchange. From my assessment of the evidence in total, including in particular the documentary evidence, I am satisfied that Gauthier's decision to place his funds with Exchange also was founded on the understanding that he would receive mortgages in suitable form as specific security for his investment.

33 Gauthier certainly was hazy and unquestioning about the *kind* of mortgages he would receive. This did not change even *after* he received the documentation from Exchange. Nevertheless he did — at all times — intend to purchase some form of mortgage security. It may be that Gauthier was less concerned about the nature and quality of that security due to the guarantee and reputation of Exchange. Indeed, it was probably because of his understanding of Exchange's good financial reputation, and the representation that the mortgages were approved, that Gauthier paid so little attention to the mortgage details. It is not at all difficult to conclude that these facts would lead Gauthier to assume that the security he was receiving would be reasonably good, at least. Having trust in Reid and Exchange, the details as to the mortgages became less important.

34 Throughout his negotiations with Reid, Gauthier sought security that could be assigned, and, as will be seen later on, the trust agreement (para. 5) given to Gauthier by Holdings contains a clause clearly inferring that the security given could be assigned. In the context of assessing Gauthier's intention in relation to the moneys he turned over to Exchange, whether the security he received could or could not be assigned is not of great significance, although it is interesting to note that two big lending agencies appear to have accepted the security as assignable. However, the important point to emphasize is that Gauthier initially sought to obtain assignable security, and what he received was in fact assigned by him on more than one occasion.

35 Furthermore, although Gauthier had in mind that the payments, if not the investment, were guaranteed, I find it difficult to believe, in all the circumstances surrounding the invitation to invest with Exchange, that Gauthier was led to believe or at any time received the impression that the moneys he was advancing would be pooled for investment purposes on behalf of all investors. I am sure that at no time did he anticipate that any of his investments would or could be available to meet a bad investment of someone else. Although he was not specificially asked, I am equally certain that Gauthier must have appreciated that the Exchange "guarantee" was only as good as the strength of the company. I do not believe it can be inferred from the evidence that he intended to rely on that guarantee alone. I do not accept Mr. Scott's argument that it follows that there was a quid pro quo to the guarantee of Exchange, namely a carte blanche to deal with the principal mortgage as Exchange saw fit.

36 As indicated earlier, both the principals of Exchange/Holdings, Don Reid and Ross White, testified at the hearing, and the transcripts of their examinations for discovery were filed in evidence.

37 I will not go into the details of the evidence of these two men at this time, but I will make the general observation that their evidence, in conjunction with Gauthier's testimony and affidavit, has left me with the impression that both had the intention from the beginning to provide investors with mortgages, of one kind or another, as security for their investments. That Reid and White functioned in an often confusing and conflicting fashion in pursuing this intention cannot be denied. There is much ambiguity and lack of understanding on their own part in respect of the nature and character of the mortgages they sought to supply. Their methods of administration in keeping track of the mortgages purchased and the connection of investors to them was disorganized. The fact that no true trust account was kept contributed greatly to the confusion. Nevertheless they did keep records identifying investors with mortgages standing in the name of Holdings, and it has been possible for the trustee to trace these connections.

38 In the case of Ranjoy specifically, Exchange did produce mortgages which can easily be identified with the investments made by Ranjoy.

39 The representations of Reid and White that there was no risk to the investors was done for the sole purpose of gaining business. I have concluded after hearing their testimony that they followed this policy in the belief that any losses would be minimal and could be paid from Exchange profits. Neither their evidence nor, for that matter, any evidence suggests that they intended to pool the investments on behalf of all (as part of the ordinary scheme of Exchange). Certainly this in tention cannot be found relevant to any of the mortgages connected with Ranjoy.

40 The nature of the business of Exchange was that of mortgage broker or dealer. All the advertising, despite its inaccuracies and misleading statements, was centred around the idea and concept of mortgage sales and mortgage security for those who chose to do business with Exchange. The documentation exchanged with the various investors (which I will refer to in more detail later on) and the main body of the records of Exchange and Holdings reflect the same approach. In other words, when Exchange was operating without the pressure of foreclosures and, no doubt, a near panic environment, the pattern of administration was consistent with providing each investor with individual mortgage security.

41 When bad investments arose and foreclosures occurred, instead of requiring the investors associated with those mortgages to face losses, the losses were paid from whatever funds could be found. I have received the impression that initially this was done in the hope that company profits would be sufficient to deal with the problem. When the losses continued and increased, the situation went from bad to worse, and it is evident that the management of the companies deteriorated rapidly. The irrational and, it appears, improper acts which occurred simply compounded the mess in which Exchange found itself, and led to the receivership. The reports of the receiver indicate some very strange activity indeed relating to properties in the province of British Columbia and involving mortgage "double layering", mortgage "switching", and the placement of mortgages on commercial lands and development lands (in the face of advertisements to investors describing the "approved" mortgages as residential).

42 Nevertheless, this behaviour, these acts, even taken in the very worst light depicted by counsel for the unsecured creditors, do not reveal any overall intention on the part of Exchange to operate as a general investment company with either the right or the objective to pool investment resources. At all times prior to the receivership, both Reid and White knew very well that their dealings with the investors involved the provision of specific security for each investor. The various actions that took place inconsistent with this occurred with full awareness of that inconsistency. The evidence discloses that there could not have been any different understanding on the part of Reid and White.

43 Since the hearing, criminal charges have been laid against Reid and White and are now pending. In these circumstances, the less I say on aspects of this matter that could be related to these charges the better. As it is, I do not find it necessary to make any further analysis of the later actions of Reid and White, or of my own assessment of those actions, in order to deal with the issues presently before me.

44 If, as I find, Gauthier, on the one hand, and Reid and White and Exchange, on the other, did intend that in return for the moneys paid mortgage security would be provided, did they succeed in achieving that mutual objective? That question I will now examine.

45 In dealing with that question, I am treating Exchange and Holdings as one for all purposes. It is clear from the record that Holdings was set up and totally controlled by Exchange. Its purpose was simply to act as a vehicle to hold mortgages on behalf of Exchange which White and Reid understood that Exchange itself could not hold legally.

46 The notice of motion refers to three mortgages incompletely, but I believe it is not in issue that the three principal mortgages in which Ranjoy claims an interest can be shortly identified as follows:

47 (1) mortgage F23882 in the Victoria Land Registry, British Columbia (referred to as "the Nanaimo mortgage");

48 (2) mortgage M11252 in the Kamloops Land Registry, British Columbia (referred to as "the Lower Nicola mortgage"); and

49 (3) mortgage F30851 in the Vancouver Land Registry, British Columbia (referred to as "the Powell River mortgage").

50 Mortgage F30851 is a replacement of an earlier mortgage in which Ranjoy claimed an interest as a result of the payment in March 1977 of $35,000 (indicated by Gauthier in his testimony). The replacement amount remained $35,000.

51 Mortgages M11252 and F23882 are the two original mortgages in which Ranjoy claims an interest because of payments of $100,435.30 and $62,000 respectively, again referred to by Gauthier in his evidence.

52 Before I make any adjudication in respect of the claims pertaining to mortgages F30851 and M11252, I should have before me certified copies of those mortgages and any assignments, as deposited in the relevant land titles offices.

53 That information is before me in the case of mortgage F23882, and it is the documentation relevant to this mortgage that I will now examine. The documents provided by Exchange to Ranjoy relevant to all three mortgages appear to be similar in all material respects. Therefore, my decision relating to mortgage F23882 will apply to mortgages M11252 and F30851, subject to any considerations arising after examining the mortgage documents themselves.

54 The details of mortgage F23882 are as follows:

This mortgage was registered March 4, 1977, as number F23882 in the Victoria Land Registry, Province of British Columbia as indicated. Mortgagors are Amrik Singh Chauhan and Joginder Bhatti and the mortgagee is Thompson Valley Properties (Nanaimo) Ltd. and covers certain lands and premises on Waddington Road in the District of Nanaimo, legally described as Lot 52 of Lot 97-G of suburban lots 51 and 53, New Castle Reserve of section 1, Nanaimo District, Plan 18612. The date of the mortgage is March 4, 1977. and the principal amount secured is $62,000 and the annual interest rate is 16 $^{1}/_{2}$%. The mortgage was assigned by an assignment dated March 14, 1977, registered in the Land Titles office as number F28015 in favour of Holdings.

55 Ranjoy received three documents from Exchange/Holdings: one dated 7th March 1977, entitled "purchase contract" one dated 21st March 1977, referred to as an "allocation letter"; and one, undated. entitled "trust agreement". For easier reference, a copy of each is set out:

Date: *"March 7/77"*

Purchase Contract

I agree to purchase a Real Property mortgage from Winnipeg Mortgage Exchange Ltd. on the understanding that it has been Approved by Winnipeg Mortgage Exchange Ltd. and is on the following terms:

Amount	"$62,000"	Interest to commence	"March 15/77"
Interest rate	"11%"	First payment due	"May 1/77"
Payment	"$601.00"	Term	"Mar. 15/82"
Designation	"Waddington Rd."	Net Cost	"$61,855.00"

To ensure efficient servicing, I appoint Winnipeg Mortgage Holdings Ltd. my nominee and I irrevocably direct it to act on my behalf in the collection and general administration of the moneys repaid pursuant to the terms of the mortgage.

I also agree that, in the event of any default occurring under the said mortgage, Winnipeg Mortgage Holdings Ltd. without the necessity of prior or subsequent consultation or confirmation may act on my behalf in realizing upon the security and in such realization the said Winnipeg Mortgage Holdings Ltd. may in its absolute discretion extend the time for payment or deal in or with the security as it may determine providing that all acts of the said Winnipeg Mortgage Holdings Ltd. are made in good faith.

It is understood that this mortgage is open and may be paid off before the termination date without notice or bonus.

Monthly payments, on this mortgage, are due to me 30 days after the date specified in the mortgage and are to be mailed to:

```
"signature"
-----------------------------------
"Pan Am Motors Ltd."
"signature"               Purchaser
------------------------
"James Edward Gauthier"
"542 Henderson Hwy"       Address
------------------------
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March 21, 1977

Mr. James E. Gauthier

542 Henderson Hwy.

Winnipeg, Manitoba

R2K 2H8

Dear Mr. Gauthier:

Re: Approved Mortgage — Waddington Road

Thank you for your Purchase Contract dated March 7th, 1977, which completes this purchase.

We have now allocated to you an Approved Mortgage on Waddington Road, on the following terms:

Amount $62,000.00

Interest rate 11%

Mo. Payment $601.00

Int. Commences ...... March 15, 1977

Terminates ...... March 15, 1982

We enclose a computerized projected mortgaged statement showing the interest, principal and balance owing under your mortgage to the 15th day of March, 1982 when it terminates. Your Trust Agreement will follow shortly.

Yours truly,

"W. Cormack" for "D.W. Reid."

Trust Agreement

WINNIPEG MORTGAGE HOLDINGS LTD. hereby certifies: —

1. THAT it is named as the owner of a Mortgage dated the 4th day of March A.D. 1977,

and registered in the Land Titles Office as No. F 23882.

2. THAT on the 7th day of March A.D. 1977 it mortgaged the said mortgage to PAN AM MOTORS LTD.,

for the sum of SIXTY-TWO THOUSAND ($62,000.00) Dollars, ________ to bear interest at 11%, to be repayable at $601.00 per month and to terminate the 15th day of March 1982.

3. THAT it now holds and stands possessed of the said mortgage as Trustee for the said purchaser.

4. THAT it shall remit the above mortgage payment monthly to the said purchaser.

5. THAT in the event of the said purchaser assigning his/her interest in the said Mortgage of Mortgage to any person, firm or corporation and giving WINNIPEG MORTGAGE HOLDINGS LTD. written notice of such assignment, that it shall stand possessed of the same interest for the assignee and in the same manner and under the same terms and conditions as herein set forth.

WINNIPEG MORTGAGE HOLDINGS LTD.

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Per:  "signature"    President
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Per:  "signature"    Secretary
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56 In my view, the purchase contract is essentially a commitment by Ranjoy to purchase a mortgage on the terms specified. It reveals "payment details" which confirm the consideration paid to Exchange, and is evidence of the agreement initially entered into between Ranjoy and Exchange. The terms of that agreement are set forth, and indicate that Exchange will produce an approved mortgage for Ranjoy that Holdings will administer.

57 The 21st March letter advises that the mortgage requested has been obtained. Consistent with that advice, a "computerized projected mortgage statement" is enclosed. Ranjoy is advised that a trust agreement will follow.

58 The trust agreement reveals that it is a mortgage of a mortgage that Ranjoy has been allocated, and that the principal mortgage stands in the name of Holdings. It is evident that this is not consistent with the plain language of the purchase agreement and could have been grounds, perhaps, for rejection of the whole deal, but Ranjoy did not choose to follow that course and, by not objecting, acquiesced in the new arrangement.

59 The principal mortgage referred to in the trust agreement as standing in the name of Holdings is described simply as a mortgage registered in a land titles office as mortgage F 23882, dated 4th March 1977. This description, although limited, is, in my opinion, adequate to identify the mortgage in question. The evidence shows that there existed only one mortgage in the portfolio of Holdings with that number and date. The records of Holdings as analyzed by the receiver show Ranjoy as having the only connection with it. A further connecting link, if one were needed, is an abbreviated legal description that appears on the face of the blue backing to the trust document, which corresponds with the mortgage of that number and date.

60 Paragraph 2 of the trust agreement is a certification by Holdings that it has mortgaged the mortgage to Ranjoy on the terms and conditions of the mortgage that was to be purchased for Ranjoy.

61 Falconbridge on Mortgages, 4th ed. (1977), at p. 251 describes a mortgage of a mortgage:

A mortgage of a mortgage is called a sub-mortgage or a derivative mortgage. It may be made by a formal assignment of the mortgage subject to a right of redemption, *or it may be made by way of charge of the mortgage* ... (The italics are mine.)

62 Fisher's Law of Mortgages, Can. ed. (1910), at p. 5 points out that "A mortgage may be legal or *equitable*," and at p. 6 describes the essence of a *legal* mortgage as a "vesting of the legal estate in the mortgagee, together with the right of possession", but subject to conditions including the "equity of redemption".

63 At p. 15 Fisher defines an *equitable* mortgage as follows:

> 24. An equitable mortgage is a contract operating as a security, but which, for want of a transfer of the legal estate, can only be enforced under the equitable jurisdiction of the court, which carries it into effect either by giving the creditor immediately the appropriate remedies, or by compelling the debtor to execute a security in accordance with the contract.

64 The distinction between legal and equitable mortgages is discussed in the following passage from Falconbridge's Law of Mortgages, 3rd ed. (1942), at p. 69:

> It has already been pointed out that it is an essential feature of a legal mortgage that it should vest the legal estate in land in the mortgagee, and it follows that any mortgage which does not transfer the legal estate cannot be a legal mortgage. Equity not only annexed to a legal mortgage certain inevitable terms which it enforced without regard to the contract of the parties, but it recognized as valid charges mortgages other than legal mortgages and annexed to them the same inevitable terms.
>
> An equitable mortgage therefore is a contract which creates in equity a charge on property but does not pass the legal estate to the mortgagee. Its operation is that of an executory assurance, which, as between the parties, and so far as equitable rights and remedies are concerned, is equivalent to an actual assurance, and is enforceable under the equitable jurisdiction of the court.

65 In the present case there is not sufficient evidence from which to conclude that a transfer of the legal ownership of the principal mortgage was effected at any time in favour of Ranjoy. However, the evidence does establish that an equitable mortgage or charge was created.

66 Falconbridge at p. 70 of his text describes the equitable nature of a mortgage as follows:

> The equitable nature of a mortgae may be due either (1) to the fact that the interest mortgaged is equitable or future, or (2) to the fact that the mortgagor has not executed an instrument sufficient to transfer the legal estate. In the first case the mortgage, be it never so formal, cannot be a legal mortgage, in the second case it is the informality of the mortgage which prevents it from being a legal mortgage.

67 In my opinion, we are concerned here with the question of an equitable mortgage or charge of the property (the principal mortgage) of a legal owner. Fisher describes this kind of mortgage at p. 16:

> Equitable mortgages of the property of legal owners, on the other hand, are created by some instrument or act which is insufficient to pass the legal title, but which, being founded on valuable consideration, shows the intention of the parties to create a security; or in other words, evidences a contract to do so. The following are common examples of such mortgages:
>
> ... Any written instrument showing the intention of the parties that a security should be thereby created, although it contains no general words of charge ...

Subject to the situation where documents of title have been deposited with a creditor with intent to create a security thereon, an equitable mortgage of an interest in land is not enforceable by action "unless the agreement upon which such action shall be brought or some memorandum or note thereof shall be in writing and signed by the party to be charged therewith or some person thereunto by him lawfully authorized" in order to meet the requirements of the Statute of Frauds: p. 70 of Falconbridge.

68 In deciding whether this requirement of the Statute of Frauds has been met, I borrow from the judgment in *Forster v. Hale* (1798), 3 Ves. Jun. 697 at 707, 30 E.R. 1226, affirmed 5 Ves. Jun. 308, 31 E.R. 603 (L.C.) (referred to in the argument of counsel for Ranjoy), where the court commented as follows in the matter of a *trust* but used words which are equally applicable, I believe, to the matter of an *equitable mortgage*:

> It is not required by the *Statute*, that a trust should be created by a writing ... but that [it] shall be manifested and proved by writing; plainly meaning, that there should be evidence in writing, proving, there was such a trust.

I interpret from this support for the argument that a memorandum or note in writing *evidencing* the contract is sufficient.

69 In the present case the trust document is such a memorandum. It contains an express declaration by the party charged that a mortgage of a mortgage in specifically described terms has been created. It identifies the investor and sufficiently describes the principal mortgage.

70 The trust document is under seal, but in the context of the purchase agreement and the allocation letter it reveals consideration in any event. It was ultimately delivered to the investor.

71 In my opinion, all of these facts add up to an adequate compliance with the Statute of Frauds requirement for some memorandum or note in writing signed by the party charged evidencing the contract.

72 It is argued that because the evidence does not reveal any specific act or document or declaration actually creating the mortgage off mortgage, as indicated in the trust document, it is not possible to conclude that the parties succeeded in their objective.

73 Since it is evident that the trust document assertions were acted upon and relied upon by Ranjoy, in my opinion the representation as to the existence of the mortgage of mortgage, by the party charged, effectively estops Exchange and Holdings from denying its existence. To this date, neither Reid nor White deny that they proceeded as if the mortgage of a mortgage had been created.

74 If it could be said that the doctrine of estoppel cannot apply in these circumstances, and I am not of that view, as I have said, then it can be concluded fairly, in any event, that the trust document, in the context of the other written material, itself creates the mortgage charge. The declaration of confirmation that a charge has been created that is thereafter acted upon by both parties as if the charge were in effect is enough to reveal in writing a clear intention by the parties to establish a charge. In *Dundas v. Desjardins Canal Co.* (1870), 17 Gr. 27 (Ont. Ch.), the company had executed a bond which did not contain direct words of charge against the company assets. The court, in finding that the bond did create a lien, placed reliance on the intention of the parties indicated by the bond contents. At p. 30, Mowat V.C. expressed the court's view as follows:

> On an interlocutory application, Vice Chancellor *Spragge*, now Chancellor, granted an injunction to restrain a sale of the canal under the execution, holding that it was not saleable; and the only point argued before me was, whether the plaintiffs had a lien under the bond in their favour. That they have a lien as against the company, I have no doubt. The bond shews beyond a question that the object of both parties was to give to the plaintiffs a lien; and the role in equity is, that no formal instrument is necessary for that purpose, and that any writing from which the intent appears, is sufficient.

75 The following summary of a portion of the decision of the Ontario Court of Appeal in *Re Cadwell's Ltd.*, [1934] O.R. 178, 15 C.B.R. 293, [1934] 2 D.L.R. 341 (C.A.), effectively illustrates the court's emphasis on *intention* where the material itself is faulty. It is found at 26 Can. Abr. (2d) *Mortgages*, p. 61, s. 223:

> Pursuant to an agreement in that behalf, certain bonds of a company, secured by mortgage, were delivered to a bank as collateral security for an indebtedness. The company having become bankrupt, the trustee in bankruptcy alleged that the bank could not enforce its security because of defects in the issue of the bonds. *Held*, the bank was entitled to the security. Wright J., (affirmed on appeal) referred to "the equitable doctrine, as expressed in *Re Strand Music Hall Co.* (1865), 3 De G.J. & S. 147, 46 E.R. 594 (Ch.), to the effect that, where the Court is satisfied that it was intended to create a charge and that the parties who intended to create it had power to do so, it will give effect to the intention notwithstanding any mistake which may have occurred in the attempt to effect it." Per Masten J.A., in the Court of Appeal: "... even if one were of opinion that the bonds in question are not for technical reasons enforceable, yet the acts of the parties ... evidence a binding agreement and create a charge in favour of the Bank as collateral security for their claim, which agreement has now become an executed agreement and the charge an enforceable charge." Per Davis J.A.: "Except in cases where there is the intervention of some statutory provision of the giving of a fraudulent preference over other creditors, there has never been any inroad, so far as I know, on the old rule of equity enunciated as early as 1670 in ... *Burgh v. Francis* (1673), 1

Eq. Ca. Abr. 320n, Rem. Temp. Finch, 21 E.R. 1074n, 23 E.R. 16 (Ch.), where it was held that equity would supply a defective mortgage against creditors who acquired a legal title afterwards, because they come in under the very person who is obliged in conscience to make the defective security good."

76 *Banks v. Whittall* (1847), 1 De G. & Sm. 536, 63 E.R. 1182 (V.C.), is the report of a case decided in 1847 where, as consideration for releasing a secured interest in property, the claimant was promised a second mortgage, which was never produced. The court was able to bring the claim within the Statute of Frauds and held that the promise represented an equitable charge. Although the decision might be best considered from the point of view of a promissory estoppel, I believe it adds further support to my conclusion that the documentation received by Ranjoy, in its entirety, shows the creation of a mortgage charge.

77 The case of *Peel v. Peel* (1918), 15 O.W.N. 297 (H.C.), also is an example of a decision where a promise to execute a legal mortgage gave rise to an equitable mortgage.

78 If a promise or undertaking to execute a legal mortgage in the future can be regarded as an equitable mortgage or charge, surely an assurance or confirmation in writing that a mortgage of a mortgage already has been created should be enough to establish an equitable charge even though no such charge was in fact earlier created.

79 It may be that the confirmation document should also make clear the intention of the parties that the charge said to have been created is continuing. If so, I believe a conclusion to this effect can readily be reached from *all* the contents of the trust document, read in conjunction with the other written material exchanged by the parties.

80 Paragraph 2 of the trust document states "the mortgage of mortgage was created on March 7, 1977". The assignment of the mortgage to Holdings is dated 14th March 1977. No comment on this discrepancy was made by either counsel. In any event, I do not consider the discrepancy to be of significance. Although the trust document is not dated, from the documentation exchanged it is reasonable to assume that it was made *after* 31st March 1977. Thus, at the time the trust agreement was made, the assignment to Holdings had been completed, and I am satisfied that that is all that is necessary.

81 Paragraph 3 of the trust document provides additional security to Ranjoy by virtue of the declaration by Holdings that "it now holds and stands possessed of the said mortgage as Trustee for the said purchaser".

82 The statement amounts to a declaration by Holdings that the legal title to the principal mortgage is now held in an express trust for Ranjoy.

83 In his Law of Trusts in Canada (1974), Professor Waters identifies (p. 99) the three certainties of a trust:

1. Certainty of Intention

2. Certainty of Subject-Matter

3. Certainty of Objects.

84 Professor Water says (at p. 99):

> For a trust to come into existence, it must have three essential characteristics. As Lord Langdale M.R. remarked in *Knight v. Knight* (1840), 3 Beav. 148, 49 E.R. 58, affirmed 11 Cl. & Fin. 513, 8 E.R. 1195 (H.L.), in words adopted by Barker J. in *Renehan v. Malone* (1897), 1 N.B. Eq. 506, and considered fundamental in common law Canada, first, the language of the alleged settlor must be imperative; secondly, the subject matter or trust property must be certain; thirdly, the objects of the trust must be certain. This means that the alleged settlor, whether he is giving the property on the terms of a trust or is transferring property on trust in exchange for consideration, must employ language which clearly shows his intention that the recipient should hold on trust. No trust exists if the recipient is to take absolutely, but he is merely put under a moral obligation as to what is to be done with the property. If such imperative language exists, it must secondly be shown that the settlor has so clearly described the property which is to be subject to the trust that it can be definitively ascertained. Thirdly, the objects of the trust must be equally clearly delineated. There must be no uncertainty as to whether a person

is, in fact, a beneficiary. If any one of these three certainties does not exist, the trust fails to come into existence or, to put it differently, is void.

85 I have no difficulty in concluding that the word "purchaser" in the declaration refers to Ranjoy. The object of the trust is clear enough.

86 Although it is not stated, I am satisfied that the contents of all the documents, namely the purchase contract, the allocation letter and the trust agreement, permit — by implication — the addition to para. 3 of the trust document of the words "to the extent to of the investment of Ranjoy". The nature and extent of Ranjoy's investment is well identified from all the documentation, namely, a principal sum earning a specified interest repayable on stated terms. Thus the subject matter of the trust can be easily ascertained.

87 Finally, the intention to create an irrevocable trust is evident from the declaration itself and the fact that the trust agreement was ultimately delivered to the beneficiary Ranjoy. The requirement of certainty of intention therefore exists.

88 The judgments in *Middleton v. Pollock; Ex parte Elliott* (1876), 2 Ch.D. 104, and *Re Cozens; Green v. Brisley*, [1913] 2 Ch. 478, provide support for the conclusion that the trust documents establishes a trust as indicated.

89 In *Middleton*, a solicitor declared himself to be trustee of certain leaseholds mortgaged to him for the benefit of an individual who had given him a sum of money for investment, and identified the trust as security for that investment. The court recognized this as a valid trust. *Re Cozens* considered and approved of the decision in *Middleton*. At p. 486, Neville J. interprets it as follows:

> I cannot but think that the true explanation of *Middleton v. Pollock* [supra] is that given by Chitty L.J., and that it depended upon the fact that where an agent has a duty to purchase securities for his principal and does purchase securitites within his authority which he allocates towards satisfaction of his obligation they belong to the principal whether purchased out of the actual money provided by him or not.

90 The judgment in *Taylor v. London & County Banking Co.; London & County Banking Co. v. Nixon*, [1901] 2 Ch. 231 at 255 (C.A.), is also supportive of my findings here.

91 The case of *London & County Banking Co. v. Goddard*, [1897] 1 Ch. 642, supports the concept of a mortgagor acting as trustee for a mortgagee. That case was decided in the context of the English Trustee Act, 1893 (56 & 57 Vict.), c. 53, but the following comments of North J. are appropriate in the present circumstances [pp. 649-50]:

> Now it is said that by s. 50, the interpretation clause, the expression "trust" does not include the duties incident to an estate conveyed by way of mortgage. This is the old definition of trust from the time of the earliest Trustee Act — a definition well understood in courts of equity. I have always understood it to refer to the principle that during the continuance of a mortgage there is no relationship of trustee and cestui que trust between mortgagor and mortgagee. It is quite clear that if lands in mortgage are sold by the mortgagee there may be surplus proceeds, of which the mortgagee becomes trustee; or after the money has been paid off, if the land had not been reconveyed, there might be a trust of it in the mortgagee. In my opinion this definition relates exclusively to an estate conveyed by way of mortgage while that mortgage security continues to exist as such.
>
> Again, the provision is that a trust does not include the duties incident to the estate. It does not say that no trust shall be created in addition to those incidental duties. I do not see any expression to the effect that a vesting declaration is not applicable to property on mortgage where the instrument of charge contains an express trust. If there is the relationship of trustee and cestui que trust established, there is no reason why the parties should not have the full benefit of the enactment. In my opinion this limitation of the word "trust" does not apply where, in a deed of charge, there is an express declaration that the mortgagor will hold the legal estate on trust. A similar course to that pursued in the case of this mortgage has been adopted for many years in mortgages of leaseholds by demise, where it is desired not to run the risks incident to a mortgage by assignment. Very often a mortgage by under-lease is taken in preference to a mortgage by assignment, and it

> has been usual to insert a declaration that the party mortgaging will hold the immediate reversion in trust for the mortgagee. In the common form, according to my early recollection, the trust was declared in favour of a purchaser under a sale by the mortgagee; but according to precedent books the form of declaration of trust in favour of the mortgagee has been in use for a considerable time.

92 It can be said, therefore, that by virtue of the contents of the trust document Ranjoy has been left with two separate and distinct equitable bases for claiming against the principal mortgage security. The one is pursuant to the mortgage of mortgage, and the other is as beneficiary under the trust. Eash reflects a right to claim against the legal title, which has remained in the name of Holdings. Practically speaking, they offer the same remedy, namely, the right to take action against Holdings in the event of default by Holdings in respect of its obligation to Ranjoy. The nature of that action would involve proceedings to seek legal title to the principal mortgage and then to exercise the legal rights available relative to the principal mortgage security, or, alternatively, to seek directly action by Holdings to exercise its legal rights (on behalf of Ran joy, under the principal mortgage).

93 Under the trust it could be argued further that Ranjoy gained the right to claim legal title to the principal mortgage *at any time*, even though no default in the payments to Ranjoy had occurred. As both Reid and White indicated in their testimony, in view of the interest spread, practical difficulties would arise if the investor had claimed this right. It could also be argued that legal difficulties might arise as well. However, I do not think it is necessary or important to pursue these questions.

94 The important finding is that Ranjoy has two separate and distinct grounds for claim against the principal mortgage security.

95 Insofar as the equitable mortgage or charge is concerned, Ranjoy falls in the category of "secured creditor" as that term is defined by s. 2 of the Bankruptcy Act. The provision reads:

> "Secured creditor" means a person holding a mortgage, hypothec, pledge, charge, lien or privilege on or against the property of the debtor or any part thereof as security for a debt due or accruing due to him from the debtor, or a person whose claim is based upon, or secured by, a negotiable instrument held as collateral security and upon which the debtor is only indirectly or secondarily liable.

Ranjoy is the holder of a mortgage or charge on or against the property or any part thereof (principal mortgage) of the debtor (Holdings) for a debt due or accruing due (the purchase terms) to it from the debtor.

96 As a secured creditor, Ranjoy may then exercise its rights against the main mortgage security in the ordinary course and as permitted by the Bankruptcy Act.

97 If Ranjoy relies on the trust, then it will follow the route identified under s. 47(*a*) and s. 59(1) of the Bankruptcy Act.

98 In either case, the element of tracing is not present in the same way or sense as in the tracing of trust funds. Inasmuch as the mortgage of the mortgage and the trust are connected to a principal mortgage, the principal mortgage of course must be identified with certainty. I have already indicated, I am satisfied from all the information before me that mortgage F23882 easily can be linked to the transaction involving Ranjoy.

99 Thus, for the reasons stated, Ranjoy is entitled to pursue its equitable rights against the mortgage in question.

100 In the event that counsel and the parties cannot reach agreement, the applicant will have the opportunity to submit the further information required in connection with the other two claims advanced in order that formal judgment may be delivered in relation to those claims as well.

101 The matter of costs in relation to this hearing specifically, or to Ranjoy's contribution to the overall costs arising from the bankruptcy/receivership, will have to be resolved in a broader context and upon due representation by interested parties.

102 The same considerations apply to the nature of the accounting, and what interest will be paid, if any, by the trustee/receiver in respect of all moneys related to the Ranjoy security interest which have passed into or through the trustee/receiver's hands.

103 These issues will remain open for the moment, but any party may move to have them settled by the court.

Test Case (2)

Claims of Seavers, Rudnik and Alward et al.

104 The claim involving Walter Seavers is brought by his wife as administratrix of his estate, and relates to a payment by Seavers to Exchange on 16th April 1969 of $2,105.40.

105 The claim by Theodore and Margaret Rudnik relates to four separate payments to Exchange as follows:

18th October 1974 ...... $1,800

25th November 1974 2,000

30th October 1975 2,000

4th August 1977 2,000

106 The claim by Madeleine and Antonio Rego relates to eight separate payments to Exchange as follows:

30th March 1976 ...... $ 7,500

3rd August 1976 10,500

29th December 1976 11,500

16th March 1977 5,000

17th August 1977 30,000

13th September 1977 5,000

26th October 1977 8,500

4th January 1978 10,000

107 The claim by Elizabeth and Harry Alward relates to a payment by them to Exchange of $30,000 on 11th January 1978.

108 In all cases the pattern of behaviour was similar to that which I have found in the Ranjoy matter. Investors came to Exchange because they wanted to purchase a mortgage. On their first contact they usually had preliminary conversations with representatives of Exchange (usually Reid) who offered "approved" mortgages, together with a general guarantee by Exchange. The advertising which contributed to bringing the investors to Exchange included specific representations of guaranteed income and no risk for the investor. The approved mortgages were described as "residential property mortgages".

109 The investors sometimes were given the opportunity to select a mortgage security from a list Reid kept in his office, but usually this responsibility was left entirely to Reid. No investor made any significant inquiries as to the nature, character or quality of the mortgages. Occasionally the investors were told that the mortgage was not a first mortgage, and were given information as to its general location. This, however, was rare, and was not regarded as being of much significance by the investors in any event. Sometimes the investors were told, but not always, that they were going to receive only part of a mortgage. Once again, this does not appear to have been a matter of concern.

110 As with Gauthier, the plaintiffs were influenced in the main by the general reputation of Exchange, by the advertising which I have earlier described in Ranjoy as certainly misleading and inaccurate, and by such incidental details as the fact

that Reid was a lawyer, that the Bank of Nova Scotia was Exchange's banker, and that Deloitte, Haskins and Sells were its accountants. Exchange had been in business since 1950, and Exchange always received a good reference when the investors asked about it. I am satisfied that the plaintiff investors had complete confidence in Exchange and were prepared to rely on the decisions and assertions made by it through its representatives, without any real question. "Trust" was the by-word, as Mr. Scott and Mr. Anhang have argued. "Trust me," said Reid — and the investors did just that.

111 The investors had a limited knowledge of all the facets surrounding a mortgage, and that lack of understanding created a kind of innocence or naivety in their thinking when it came to measure the quality or degree of the security they understood they were receiving.

112 The following excerpts from my notes of the testimony of three investors, Elizabeth Alward, Theordore Rudnik and Madeleine Rego, are representative of the impression I have gained of the attitude or state of mind of the investors that appears to have existed generally.

> *Alward* — As long as it was for an improved [sic] mortgage and for the amount we wanted — that was it — you have to trust them.
>
> I did not understand that Exchange would repay the moneys to us [if default]. I thought they would administer it [the mortgage]. If something earth-shaking happened they would call us in.
>
> We wanted to buy a mortgage. There was security in a mortgage and we liked the idea of the monthly cheque.
>
> Never discussed circumstances where we could lose our money. We didn't see how we could lose.
>
> *Rudnik* — I knew all the while he [Reid] was buying a part of a mortgage. I had no idea how many more there was but in my own mind I knew it was okay because Mr. Reid was in the business and knew what he was doing.
>
> Reid said all the mortgages were good sound investments.
>
> I did not feel it mattered whether fourth or fifth mortgages as long as the value was there.
>
> *Rego* — We were involved in ten mortgages — eight at the time of receivership. When deciding on a mortgage we had a choice from a listng or Mr. Reid would choose it from a blue card.
>
> A good mortgage is a good mortgage no matter where it is.

Despite the reliance on and confidence placed in Exchange and its representatives, I am again satisfied, just as with Gauthier, that the investors with whom we are concerned here at all times sought and intended to obtain a mortgage security. At the time of their first contacts with Reid and/or White, I have no doubt, they thought they would receive a mortgage of a kind they could hold in possession and it could be assigned easily. However, it is evident that later, either during further conversation with Reid or when the trust document (which we will examine in a moment) was forwarded, they realized or ought to have realized, that they were receiving a different kind of security than first they may have anticipated. In *all* cases the investors acquiesced and accepted this.

113 The additional evidence of Reid and White, introduced at this hearing either viva voce or by the reading in of substantial portions of their examinations for discovery, have not changed the conclusion I reached in Ranjoy that both of these individuals intended to provide each of the plaintiff investors with legally enforceable security against a mortgage or mortgages, as the case may be, purchased in the name of Holdings. The same reasons expressed in Ranjoy apply just as forcefully again in the present circumstances.

114 One of those reasons was the evidence of the pattern of operation of Exchange and Holdings. Further information as to the general administration of the office and the exact nature of the records of Exchange is contained in the following two sections of the receiver's fourth report:

Mortgage Files

A separate file was kept for each mortgage owned by WME. These files were, in a sense part of the accounting system, in that they contained the amortization schedule which was the means for determining the balance outstanding as required from time to time. In addition, the mortgage file contains some correspondence, appraisals, credit reports, etc., having to do with the acquisition of the mortgage, and correspondence to and from solicitors in connection with loans in default. They also contain correspondence to and from the mortgagors and other information directly relating to the particular mortgage. On August 15, 1979 we were handed the actual mortgage documents (but not the mortgage files) in the offices of the Manitoba Securities Commission; however, we understand the duplicate mortgage documents (or photocopies) have been kept apart in the office of WME in dockets in a fire-proof filing cabinet. Subsequently, as a matter of convenience, we placed each in the back of the respective mortgage files.

Since August 15, 1979, the same mortgage files have been used and the contents of same have been substantially added to with correspondence resulting from attempts to realize the loans through foreclosure or otherwise, together with copies of the amortization schedules prepared under Thorne Riddell Inc.'s computer program to update the balances from time to time. Also, a mortgage ledger has been instituted in which there is a separate ledger card for each mortgage showing all payments received, disbursements made, and the balance owing as periodically as a new computer statement to determine the balance for the mortgage is prepared.

Investors' Files

There are files for each investor which, as with the mortgage files, form part of the accounting system in that they contain amortization schedules showing the amounts owing to the investor with accrued interest from time to time, provided all monthly installments were paid; as this was invariably the case up to the date of receivership, these amortization schedules represent a reliable record of amounts owing to individual investors. In the investor file, the documents relating to each investment are kept together. They include a copy of the Purchase Contract, a white sheet designated "WME Trust Ledger — Accounting", the so-called "allocation letter", a copy of the typed part of the trust agreement, the amortization schedule, and the typed portions of other form letters sent to investors in connection with the investment. We have used the same investor files since receivership and have added to the contents in the form of letters to and from individual investors.

Generally speaking, and from a strict bookkeeping standpoint, the records were fairly well kept. They appear to have been entered regularly, balanced monthly and it is reasonably easy to identify most entries with their source. The bank accounts appear to have been reconciled monthly, and the Collection Ledger, and the Trust Ledger were regularly balanced with the corresponding controlling accounts in the General Ledger. The notable omission from the system was a mortgage ledger which would have enabled the company to obtain significant information about mortgages which were falling behind, and to keep a running record of the balances receivable, together with accrued interest and other charges.

115 Although it is clear that the absence of a mortgage receivable ledger created an inefficient and sometimes inaccurate recording of the position of the mortgage receivables, the evidence certainly supports the conclusion that a system of sorts was in existence and functioning. Mr. W.T. Reynolds, a chartered accountant called by the plaintiffs, whose testimony I accept as reliable, decribed that the recording system as "antiquated and cumbersome" but "nothing wrong with it". He expressed the view that the amortization schedules and records of the amount due to the investors "would seem to serve the same kind of function".

116 If, then, as I find, the plaintiff investors desired to obtain mortgage security and Exchange and Reid and White intended to provide that kind of security, as I asked in Ranjoy: Can it be said that these parties succeeded in that objective? And that is what I will examine now.

117 The claims filed by the plaintiffs do not make reference in every case to a specific mortgage in which a particular plaintiff claims an interest, but the evidence flied shows that, with one exception, mortgages do (or did) exist standing in the name of Holdings against which the sums earlier identified as paid to Exchange by the plaintiffs are claimed. These mortgages are identified in relation to each plaintiff's payment by the short quasi-legal descriptions used by Holdings, as follows:

Seavers	--	$ 2,105	--	7415 26 A St. SE
The Rudniks	--	1,800	--	Part 10th Avenue NE
		2,000	--	Part 39th Street NE
		2,000	--	Part 35th Avenue NW
		2,000	--	Part Cambie Street (mortgage file not before the court)
The Regos	--	7,500	--	Part Golden No. 3
		10,500	--	Part Pender Harbour
		11,500	--	Part Westlake
		5,000	--	Part Chilliwack No. 1
		30,000	--	Part 148 Street
		5,000	--	Part Salmon Arm PT
		8,500	--	Part 91st Street
		10,000	--	Part 104 Avenue
The Alwards	--	30,000	--	Part Enderby, B.C.

118 I do not need to examine each of the mortgages, as I did in Ranjoy. With the possible exception of "part Cambie Street", they all appear to have been adequately identified and confirmed by the receiver.

119 The records now in the hands of the trustee/receiver indicate the allocation of interests to the plaintiff investors in the various mortgages.

120 Each mortgage is for a sum larger than the amount claimed by the investor. In all cases there are others besides the investors who have been allocated an interest in it. In no case is the sum of the interest allocated greater than the principal amount of the mortgage.

121 Each mortgage carries a rate of interest *higher* than the rate of interest on the investment made by the investor.

122 Generally it can be said that the same kind of documentation, as with Ranjoy, was exchanged with all plaintiffs. This documentation included the purchase contract, an allocation letter with amortization schedule attached and a document entitled "Trust Agreement", which I will continue to refer to as "the trust document".

123 In some instances the original documents have not been produced, but no issue appears to exist in this regard.

124 Except for the purchase contract used in the earliest transaction re Seavers (1969), all the purchase contracts are identical in form to the purchase contracts used in Ranjoy. The document used in Seavers is somewhat different, and contains additional information, but I do not believe the difference is material.

125 The allocation letters in all cases are not exactly the same, in the sense that some often contain more information than the same letters in Ranjoy. However, there is no allocation letter that does not provide *all* of the kind of information provided in Ranjoy.

126 For the purposes of considering the issues before me now, I therefore make the finding that there is no essential difference in the form and nature of the contents of the purchase agreements and allocation letters from those used in Ranjoy.

127 Before leaving the purchase contracts and allocation letters, I should also indicate that their contents would have made it clear enough to any investor, if he did not otherwise know, that his security related to only part of a mortgage.

128 The trust documents reveal a kind of transition from the form used in the 1969 Seavers deal to a different one in 1974, used in two of the Rudnik transactions, to a further variation in 1975 in another Rudnik matter. The 1975 form appears in November 1977 in the Alward matter. It is this form, as well, that was used in Ranjoy and, I have concluded from the evidence, was the form most generally in use in the several years prior to the receivership. For reference I set out a copy of each of the three different forms mentioned, marked "A" (1969 — Seavers); "B" (1974 — Rudnik); and "C" (1975 — Rudnik) (same as Alward and Ranjoy).

129 There is another form of trust document, different from the others, which was used in all the Rego transactions. I have marked as "D" a sample copy of one of those documents.

A.

130

Trust Agreement

WINNIPEG MORTGAGE HOLDINGS LTD. hereby certifies: —

1. THAT it is named as the owner of a Mortgage dated the 17th day of September A.D. 1969, made between STANLEY W. PAWCHUK as Mortgagor, and WESTERN DEVELOPMENT CORPORATION LTD. as Mortgagee, and registered in the Calgary Land Titles Office as No. 7165 K.C. and transferred to WINNIPEG MORTGAGE HOLDINGS LTD. by a Transfer of Mortgage registered in the Calgary Land Titles Office on the 16th day of April A.D. 1969 at 2:08 p.m. as No. 3628 K.J., and affecting the lands described in the above Mortgage and that the said Mortgage secured SIXTY-FOUR HUNDRED and THIRTY AND TWENTY ONE HUNDREDTHS ($6,430.20) DOLLARS, as at the 15th Day of April A.D. 1969.

2. THAT One-third of the said Mortgage was sold to WALTER SEAVERS for the sum of TWENTY-ONE HUNDRED and FIVE and FORTY ONE-HUNDREDTHS ($2,105.40) Dollars.

3. THAT WINNIPEG MORTGAGE HOLDINGS LTD. holds and stands possessed of the said Mortgage as Trustee for the said WALTER SEAVERS.

4. THAT it shall remit one-third of all moneys received by it pursuant to the said Mortgage including the final payment to the said WALTER SEAVERS by forwarding a cheque for the same payable to the order of the said WALTER SEAVERS.

5. THAT in the event of the said WALTER SEAVERS assigning his interest in the said Mortgage to any person, firm or corporation and giving WINNIPEG MORTGAGE HOLDINGS LTD. written notice of such assignment, that it shall stand possessed of the same interest for the said assignee and in the same manner and under the same terms and conditions as herein set forth.

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Winnipeg Mortgage Holdings Ltd.,
   Per: "signature"       President
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   Per: "signature"       Secretary
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B.

131

Trust Agreement

WINNIPEG MORTGAGE HOLDINGS LTD. hereby certifies: —

1. THAT it is named as the owner of a Mortgage dated the 19th day of September A.D. 1974, and registered in the Land Titles Office as No. 74-1090217.

2. THAT on the 18th day of October A.D. 1974 part of the said mortgage was purchased by MARGARET N. RUDNIK and THEODORE J. RUDNIK, (herein called the purchaser) for the sum of ONE THOUSAND and EIGHT HUNDRED ($1,800.00) DOLLARS. That this part of the mortgage bore interest at 12 1/2%, was repayable at $24.60 per month, and terminates the 1st day of October A.D. 1979.

3. THAT WINNIPEG MORTGAGE HOLDINGS LTD. holds and stands possessed of part of the said Mortgage as Trustee for the said purchaser.

4. THAT it shall remit part of all moneys received by it pursuant to the said Mortgage to the said purchaser.

5. THAT in the event of the said purchaser assigning his/her interest in the said Mortgage to any person, firm or corporation and giving WINNIPEG MORTGAGE HOLDINGS LTD. written notice of such assignment, that it shall stand possessed of the same interest for the said assignee and in the same manner and under the same terms and conditions as herein set forth.

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Winnipeg Mortgage Holdings Ltd.,
   Per: "signature"      President
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   Per: "signature"      Secretary
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C.

132

Trust Agreement

WINNIPEG MORTGAGE HOLDINGS LTD. hereby certifies: —

1. THAT it is named as the owner of a Mortgage dated the 17th day of October A.D. 1975, and registered in the Land Titles Office as No. 75-1117023.

2. THAT on the 30th day of October A.D. 1975 it mortgaged the said mortgage to MARGARET N. RUDNIK and THEODORE J. RUDNIK for the sum of TWO THOUSAND ($2,000.00) DOLLARS, to bear interest at 12%, to be repayable at $20.60 per month and to terminate the 1st day of November 1980.

3. THAT it now holds and stands possessed of the said mortgage as Trustee for the said purchaser.

4. THAT it shall remit the above mortgage payment monthly to the said purchaser.

5. THAT in the event of the said purchaser assigning his/her interest in the said Mortgage of Mortgage to any person, firm or corporation and giving WINNIPEG MORTGAGE HOLDINGS LTD. written notice of such assignment, that it shall stand possessed of the same interest for the assignee and in the same manner and under the same terms and conditions as herein set forth.

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Winnipeg Mortgage Holdings Ltd.,
   Per: "signature"      President
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   Per: "signature"      Secretary
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D.

133

Trust Agreement

WINNIPEGMORTGAGE HOLDINGS LTD. hereby certifies: —

1. THAT it is named as the owner of a Mortgage dated the 29th day of August A.D. 1977, made between STANLEY E. ARNOLD, as Mortgagor and SKEENA MORTGAGE & INVESTMENTS LTD. as Mortgagee, and registered in the Land Titles Office as No. M53578 and that such Mortgage has been transferred to THOMPSON VALLEY PROPERTIES LTD. by Transfer of mort-gage No. M53579 and that such mortgage has again been transferred to WINNIPEG MORTGAGE HOLDINGS LTD. by Transfer of Mortgage No. M54936 and affecting the lands described in the above Mortgage and that the said Mortgage secured SIXTY-SEVEN THOUSAND and FIVE HUNDRED ($67,500.00) DOLLARS as at the 15th day of September A.D. 1977 and terminating the 15th day of September A.D. 1982.

2. THAT part of the said Mortgage was mortgaged to MADELINE [sic] REGO and ANTONIO REGO for the sum of FIVE THOUSAND ($5,000.00) DOLLARS, with interest of 10 $^{1}/_{2}$% and monthly payments of $45.00.

3. THAT WINNIPEG MORTGAGE HOLDINGS LTD. holds and stands possessed of part of the said Mortgage of Mortgage as Trustee for the said MADELINE REGO and ANTONIO REGO.

4. THAT it shall remit part of all moneys received by it pursuant to the said Mortgage of Mortgage to the said MADELINE REGO and ANTONIO REGO.

5. THAT in the event of the said MADELINE REGO and ANTONIO REGO assigning their interest in the said Mortgage on Mortgage to any person, firm or corporation and giving WINNIPEG MORTGAGE HOLDINGS LTD. written notice of such assignment, that it shall stand possessed of the same interest for the said assignee and in the same manner and under the same terms and conditions as herein set forth.

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Winnipeg Mortgage Holdings Ltd.,
   Per: "signature"     President
        ---------------
   Per: "signature"     Secretary
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134 These trust documents, examined in conjunction with the facts surrounding each, reveal three main differences from the trust documents and facts in Ranjoy.

135 (1) In all the plaintiffs' cases what is involved is a disposition of *part only of the principal of a principal mortgage*, not a disposition relating to the *whole of the principal of the principal mortgage*, as in Ranjoy.

136 (2) The Seavers and Rudnik trust documents refer *to the purchase (or sale)* of either a specified or an unspecified part of a mortgage, not simply a mortgage of the principal mortgage as in Ranjoy.

137 (3) The Rego trust document (para. 3) declares that Holdings stands possessed of *part of the said mortgage of mortgage* as trustee for the said Regos. This is quite a different wording from that contained in all the other trust documents that have come before the court.

138 Provided that the intention is adequately expressed, I know of no reason why a portion of the principal mortgage may not be transferred. In fact, I have come to this conslusion already in Ranjoy, where the trust document simply refers to a mortgage of a mortgage. Here, although the whole of the principal of the principal mortgage was mortgaged, there was in truth a mortgage of only part of a mortgage, because the right of Holdings to the interest spread was not included in the submortgage.

139 In Ranjoy I found that the trust document, in the context of all the other evidence, made it clear that the intention was to mortgage the principal mortgage only to the extent of the investor's interest (reflected in other parts of the trust document and in the purchase contract). In those present cases where the trust document again, as in Ranjoy, speaks only of a mortgage of a mortgage, it is really referring to a mortgage of a mortgage *to the extent of the investor's interest*, which can be clearly ascertained. The only difference from Ranjoy is that now *a portion* of the principal of the principal mortgage is transferred.

140 In the present examples where the trust document speaks of mortgaging part of the mortgage, the wording is simply more precise and more accurate. It is a better phraseology, but either wording, in my opinion, expresses the intention of the parties.

141 For the purposes of the plaintiffs and Exchange, I see no difference between a disposition creating a mortgage interest in a principal mortgage and a disposition actually selling an interest in a principal mortgage.

142 Although it is evident that the parties did contemplate the transfer of a mortgage interest in the principal mortgage, the essential purpose behind the whole transaction between Exchange and the investor was to provide a real estate security to cover the amount of the investment according to the terms agreed upon. This, together with the clear wording in the trust documents (of Seavers or Rudnik) showing an actual sale (or purchase) and the acceptance of this arrangement by both parties, permits the conclusion that this kind of trust document can be accepted as reflecting the true agreement of the parties.

143 As to the mortgaging or sale of *part* of a principal mortgage, in addition to the reasons advanced in Ranjoy the following is further authority: In Fisher's Law of Mortgages it is stated at p. 110:

> It is sometimes desired to transfer part only of a mortgage debt, but as the mortgagee's remedies by sale, foreclosure, etc., are indivisible, this can only be effected in one of three ways, viz. (1) by the mortgagee declaring himself a trustee for the transferee of so much of the debt as is intended to be assigned ...

Fisher speaks of a mortgage *debt*, but in the next paragraph he says:

> Mortgages are frequently transferred by way of sub-mortgage. In that case the sub-mortgage is a compound mortgage consisting of a mortgage of a chose in action (viz. the original mortgage debt) and of the property which is the security for the original mortgage debt.

144 Read together, I believe the passages by Fisher support the position that a portion of a mortgage may be transferred to another. I interpret that Fisher is using the word "transfer" to describe either a mortgage or a sale.

145 If a part of a mortgage can be mortgaged or sold, then it follows that the part of the mortgage remaining can also be mortgaged or sold. In other words, more than one part of a mortgage may be transferred: see *Scarlett v. Nattress* (1895), 23 O.A.R. 297; and *Northard & Lowe Fruit Co. v. Durno*, 59 N.S.R. 310, [1927] 2 D.L.R. 892 (C.A.).

146 The recent decision of Feehan J. in *Parkland Mtge. Corp. Ltd. v. Therevan Dev. Corp. Ltd.*, [1982] 1 W.W.R. 588, 17 Alta. L.R. (2d) 44, 34 A.R. 70 (Q.B.), is directly on point. There the learned judge identified a group of investors as "holding an unregistered equitable interest" in a mortgage and described each investor as "a beneficial owner of an undivided moiety in the mortgage" [p. 604].

147 I conclude, therefore, that the plaintiff recipients of part of a mortgage, either by way of mortgage or by sale/purchase, gained thereby an equitable interest in the related principal mortgage.

148 The nature of the interest is of course important, because that affects the rights and remedies.

149 The passages earlier quoted from Fisher contemplate the completion of *legal* transfers which would leave the transferee named as owner of the portion transferred. This explains Fisher's reference to the necessity of the mortgagee (of the principal mortgage) declaring himself a trustee "for the transferee of so much of the debt as is intended to be assigned" because of the indivisible nature of the mortgagee's remedies. However, in the case of the plaintiffs here, no legal title resulted immediately from the transactions, legal title remained in the principal mortgagee (Holdings), and there was no need for a trust of the character described by Fisher.

150 Nevertheless, insofar as the transfers involving actual sales were concerned, a *constructive trust* did arise by virtue of the very nature of the transaction, leaving Holdings a bare trustee for the investor of the principal mortgage to the extent of the investor's interest.

151 A transfer of a mortgage interest *by way of a sub-mortgage* only still leaves with the transferor rights relative to that interest which may be exercised on repayment of the moneys advanced that gave rise to the mortgage. A transfer of a portion of the mortgage *by sale* leaves the transferor with no more rights in the interest transferred.

152 Thus, where in the present case the interest arises from a *mortgage* of part of the principal mortgage, the investor is left with exactly the same rights and remedies as I have found were available to Ranjoy as a secured creditor (ante, p. 39).

153 Where the interest arises from *a sale* of a part of the principal mortgage, the investor is left with exactly the same rights and remedies as I have found were available to Ranjoy as the beneficiary of a trust (ante, p. 39).

154 There is one qualification to these statements. Since the interest in both cases is only in relation to a portion of the principal mortgage, the right to claim directly the legal title to that interest, if possible, certainly would be impracticable given the indivisibility of the mortgagee's remedies. The alternative choice of bringing action to cause the mortgagee to enforce the necessary rights is the better and more logical course.

155 With the exception of the Rego trust document, as earlier indicated, all the trust documents contain the same declaration of trust in para. 3 as in Ranjoy. For the reasons expressed in Ranjoy relative to that provision, the plaintiffs (except the Regos) have the same trust rights and remedies that I have found alternatively available to Ranjoy.

156 This express declaration of trust effectively duplicates the constructive trusts which I have found to exist for those plaintffs whose equitable interest in the principal mortgage has been gained by purchase.

157 The Regos, however, cannot take advantage of the trust. In my opinion, the trust declaration in the Rego trust agreement is meaningless. A "part of the mortgage of the mortgage" is nowhere capable of identification, even if it could be said that a trust can be created in relation to an equitable interest of the kind here, and I do not believe it can. Thus the subject matter cannot be ascertained. Nor is this a situation where one can infer a different intention than the plain meaning of the words used. The phraseology is simply too definite, albeit senseless.

158 In summary, all the plaintiffs have at least one ground founded on an equitable base, in respect of each of their claims, to pursue an interest in the principal mortgage with which their claim or claims can be associated.

159 Seavers and the Rudniks (in respect of their two transactions in 1974), who have trust documents providing for the purchase (or sale) of part of a principal mortgage and declarations of trust, have trust claims in respect of which ss. 59(1) and 47(*a*) of the Bankruptcy Act are applicable.

160 The Alwards, the Rudniks (in respect of their two transactions in 1975 and 1977) and the Regos (in respect of all their claims), who have trust documents which provide for the mortgaging of a principal mortgage or for the mortgaging of a part of a principal mortgage, have claims as secured creditors under the Bankruptcy Act.

161 The Alwards, and the Rudniks (in respect of their two transactions in 1975 and 1977), whose trust documents also provide declarations of trust, have the alternative of trust claims in respect of which ss. 59(1) and 47(*a*) of the Bankruptcy Act apply.

162 In reaching my conclusions here, I have considered all the arguments raised by counsel.

163 It should be evident that I have rejected the argument that a trust relationship existed from the beginning between Exchange and the investors. If it did, and I need not go into that question, it terminated when the new relationship was created, as reflected in the trust document. This means that the need to examine the complicated question of "tracing", to the extent sought by the plaintiffs' counsel, does not arise.

164 Nevertheless I will record briefly my conclusion that the manner in which the so-called "trust account" of Exchange was operated would make "tracing", if it were necessary, impossible — according to the legal principles which I believe are applicable and which are reviewed by Professor Waters in his text, Law of Trusts in Canada, commencing at p. 883.

165 The evidence shows that there was no attempt to keep separate the money received from the investors. That money was mixed with many different sources of funds and used without discrimination for the various purposes of the companies, including the purchase of the principal mortgages from time to time. sometimes these mortgags were in existence when an investor made a payment and received security against that mortgage. Other times the investor's money was received before the principal mortgage was purchased, but because of the indiscriminating use of the account into which the investor's money was paid it is simply impractical to consider that the payment could be positively traced into the ultimate security. I agree with the description used by counsel for the unsecured creditors that if a successful tracing could be carried out it would be only as a result of "happenstance".

166 Counsel for the plaintiffs argued that, even though from time to time the trust account was in a negative position, the replacement of funds by way of bank loan still left open the argument that tracing was possible. I disagree. If the situation were one where only one person's money needed to be traced, then perhaps that argument could be supported. However, in the circumstances here, where the funds of many investors were mixed with the company's funds, the argument cannot stand.

167 The description of what he found when he entered upon the scene, given by Mr. Down in para 5(*j*) of an affidavit dated 28th November 1979, a copy of which is contained in the receiver's second report, is appropriate to note at this point:

> (*j*) Winnipeg Mortgage Exchange Ltd. operated with one "trust" account at all material times, without distinction or segregation of trust funds by mortgage investments, or by investors. All moneys received by the companies were handled in such a way that the payment of monthly instalments to investors was a first priority, with little or no regard to the source of funds. No attempt appears to have been made to ensure that payments to a particular investor came only from funds received on a mortgage or mortgages allocated to that investor. New money received from the public for investment, proceeds from sale of foreclosed lands, monthly payments from mortgagors, payouts of mortgages on maturity, money borrowed from Pyramid Investment Corporation Ltd., and whatever profit margin the companies were presumed to be earning were all placed in one "trust bank account" and used to meet monthly payments to all investors, regardless of whether or not the investors were entitled to receive such payments, to make disbursements to protect mortgage equities, to pay regular monthly overhead expenses, and to meet any and all obligations for which cash was required.

168 That Mr. Down's analysis had not changed by February 1982 is illustrated by the fuller relevant comments made in the receiver's fourth report under the heading "Owed to/from Trust and Owed to/from General". He makes the statement:

> Based on the system used, the total amount shown by the trust ledger for monies paid in by investors but not paid out to acquire mortgages would never equal in total the amount the monies in the trust bank account.

169 I might indicate that I found the testimony of Professor Blazouske very helpful and precise in identifying the nature of the proper trust account, and in pointing out the difficulties for tracing purposes, where funds are mixed as here.

170 As indicated in the Ranjoy decision, the kind of "tracing" required, based on the conclusions I have reached as to the nature of the investors' equitable rights against the mortgage security, is simply a matter of establishing that there is (or was) a principal mortgage sufficiently identified with the investors' claim. All the evidence shows that this is not a problem. Indeed,

at the very outset of receivership, in his report, the receiver was able to connect most of the investors with one or more of the principal mortgages held by Holdings.

171 One might have expected the audited financial statements of the companies to be of some assistance in deciding the issues before the court. However, these statements reveal confusion in the minds of the auditors (with some justification) as to the ownership of the principal mortgages. From 1969 to 1977 inclusive there is no mention of the mortgage portfolio at all in the statements. In 1978 the mortgages are suddenly identified as an asset worth almost $13,000,000. The notes to the statement do not explain this change. In 1978 the mortgage portfolio is now described as a "trust asset", again without explanation. The notes to this statement appear conflicting. At best they are ambiguous.

172 The financial statements reveal that no adequate analysis of the true situation existing relative to the mortgages arising from the operations of Exchange/Holdings was made. In consequence, I have not found the financial statements to be of help in reaching my conclusions.

173 A major part of the argument for the unsecured creditors was devoted again to the proposition that the alleged fraud and misrepresentation by the principals of Exchange should invoke a broad finding that no agreements with investors made by Exchange were valid.

174 As I indicated in the Ranjoy judgment, I am well aware of the apparently horrendous behaviour described by the receiver in various of his reports and illustrated most recently in his fourth report, where, by way of example, he succinctly summarizes the reprehensible practice of "double layering":

> **III. "Double Layer Mortgages"**
>
> Reference has been made from time to time during examinations for discovery and otherwise to "double layer" mortgages. This is a term which has been used to refer to mortgages acquired by Winnipeg Mortgage Holdings Ltd. usually for no consideration, to be sold to investors, thus producing cash to refund prior mortgage payouts and/or other foreclosure costs on a mortgage(s) previously held on the same property. For example, when a first mortgagee on a property with WMH Ltd. in second position foreclosed and the redemption date arrived either without the property being sold (or where a sale of the property could only be made for A price sufficient to pay out the first mortgage thus wiping out the equity of WMH Ltd.) WMH Ltd. would pay out the first mortgagee, thus obtaining an assignment of their foreclosure proceedings and their right to apply for Order Absolute vesting title. Title would be placed in the name of WMH Ltd., and transferred to Thompson Valley Properties Ltd. or registered directly in the name of TVP Ltd. TVP Ltd. would then execute and register a new mortgage in favor of WMH Ltd. for an agreed amount, usually equal to the first mortgage paid out plus an amount described as, "to bring the mortgage current".
>
> The result of this foreclosure procedure was that the second mortgage formerly held by WME Ltd. and allocated to a group of investors was extinguished. The investors to whom that mortgage had been allocated do not appear to have been notified and continue to hold trust certificates with registration numbers referring to the mortgage which no longer exists, the property having been acquired by WMH Ltd. by foreclosure. A new set of investors was allocated to the new first mortgage placed by TVP Ltd. as registered owner in favor of WMH Ltd. Often no funds were disbursed for this mortgage, but the proceeds received from investors would be used to replace the cash which had been paid out of the trust account to redeem the first mortgage. WME Ltd. would now show two "mortgage" accounts, one designated with the original name of the extinguished mortgage and still allocated to the same investors, and the new first mortgage designated with the same name followed by "#2". This mortgage would be allocated to a new set of investors, from whom cash equal to its declared value would have been obtained.

Nevertheless, I continue to reject the argument of counsel that even the kind of operation above illustrated, if proved, is a basis for measuring the validity of mortgage security held or claimed by any particular investor.

175 Suppose for the sake of argument that only 30 investors had put up $100,000 each in the last two years of operation of Exchange before receivership, for which they received equal interests in 10 mortgages, each worth $300,000. If fraud on

the part of the companies can be traced to these mortgages, I do not see how those facts can reasonably be argued to have any relationship to the question of the validity of the mortgage security allocated to 900 other investors. I think it is no different if there were 300 investors, instead of 30, whose mortgage security was lost by fraud. The remaining 600 are still entitled to their own security, if it exists, and the fact of the fraud should play no part in assessing that security.

176 Counsel have referred to the fact that to a considerable degree it was a matter of luck whether a security allocated to a particular investor turned out to be good or bad. In my opinion, this proves nothing of importance in this case. Whether one mortgage was good and one was not is surely not a relevant factor in deciding the issue of whether an investor did or did not receive a valid security.

177 I agree with the statement of Anderson J. in *Yorkshire Trust Co. v. Empire Accept. Corp.; Irwin v. Empire Accept. Corp.* (1978), 28 C.B.R. (N.S.) 225 (B.C. S.C.), where he says at p. 231:

> It is, of course, admitted that a trust or "pooling" arrangement will not be inferred merely because some investors have received "good" mortgages and others "bad" mortgages.

178 In their argument, counsel have referred again to the phrases "sharing the burden of loss" and "equality is equity". Both phrases were identified earlier in the submissions of counsel in the Ranjoy matter.

179 I do not believe the idea of "sharing the burden of the loss" has any applicablity. I have examined the cases cited in support of this concept and the references to the American text, Scott on Trusts, 3rd ed. (1967), vol. 5. At most they apply to circumstances where "tracing" of mixed trust funds is necessary or where securities have disappeared.

180 Nor do I agree that in the present circumstances "equality is equity". There is no legal basis for the application of that idea here.

181 Counsel for the unsecured creditors submit that the doctrine of estoppel has no application to the case. As indicated in Ranjoy, I have relied on estoppel, in part, in support of the conclusion that a valid mortgage of mortgage charge was created. I will make a few further comments as to the applicability of the doctrine.

182 The general purpose and benefit of estoppel in the aim of justice is expressed by Lord Blackburn in *Burkinshaw v. Nicholls* (1878), 3 App. Cas. 1004 at 1026 (H.L.), cited in Spencer Bower and Turner's Estoppel by Representation, 3rd ed. (1977), at pp. 20-21:

> Now sometimes there is a degree of odium thrown upon the doctrine of estoppel, because the same word is used occasionally in a very technical sense, and the doctrine of estoppel *in pais* has even been thought to deserve some of the odium of the more technical classes of homologation. But the moment the doctrine is looked at in its true light, it will be found to be a most equitable one, and one without which the law of this country could not be satisfactorily administered. When a person makes to another the representation, I take upon myself to say such and such things do exist, and you may act upon that basis, it seems to me of the very essence of justice that, between these two parties, their rights shall be regulated, not by the real state of facts, by that conventional state of facts which the two parties agree to make the basis of their action; and that is what I apprehend is meant by estoppel in pais or homologation.

At pp. 4-5 of Spencer Bower and Turner's text a definition of estoppel by representation is set out as follows:

> From a careful scrutiny and collation of the various judicial pro nouncements on the subject, of which no single one is, or was perhaps intended to be, quite adequate, and many are incorrect, redundant, or slipshod in expression, the following general statement of the doctrine of estoppel by representation emerges: where one person "the representor" has made a representation to another person "the representee" in words or by acts or conduct, or (being under a duty to the representee to speak or act) by silence or inaction, with the intention (actual or presumptive), and with the result, of inducing the representee on the faith of such representation to alter his position to his detriment, the representor, in any litigation which may afterwards take place between him and the representee, is estopped, as against the representee, from making, or

attempting to establish by evidence, any averment substantially at variance with his former representation, if the representee at the proper time, and in the proper manner, objects thereto. This passage was adopted as accurate by Sir RAYMOND EVERSHED M.R. in 1955 in *Hopgood v. Brown*, [1955] 1 W.L.R. 213, [1955] 1 All E.R. 550 at 559 (C.A.) ... Lord BIRKENHEAD succinctly stated the essentials of the doctrine in *Maclaine v. Gatty*, [1921] 1 A.C. 376 (H.L.), at p. 386, as follows:

> Where A has by his words or conduct justified B in believing that a certain state of facts exists, and B has acted upon such belief to his prejudice, A is not permitted to affirm against B that a different state of facts existed at the same time. Whether one reads the case of *Pickard v. Sears* (1837), 6 Ad. & El. 469, 112 E.R. 179 (K.B.), or the later classic authorities which have illustrated this topic, one will not, I think, greatly vary or extend this simple definition of the doctrine.

183 At p. 30 of Spencer Bower and Turner "representation" is defined as:

> a statement made by, or on behalf of, one person to, or with the intention that it shall come to the notice of, another person, which relates, by way of affirmation, denial, description, or otherwise, to a matter of fact,

and it is added that "a matter of fact means either an existing fact or thing, or a past event".

In all the cases before the court there is a representation of an existing fact or past event in circumstances that will not permit the representor to later deny the fact or event.

184 Counsel for the unsecured creditors rely on the case of *Combe v. Combe*, [1951] 2 K.B. 215, [1951] 1 All E.R. 767 (C.A.). In my view, that case, which deals with "promissory estoppel", or the question of promises or assurances as to future events, has no applicability to the present facts. The estoppel with which we are concerned is not the cause of action itself in the proceedings, for, if it were, the estoppel argument, following *Combe v. Combe*, could not succeed. The cause of action here is not the *representation* that the mortgage of mortgage, or the mortgage or sale of part of the mortgage, occurred at an earlier date. Rather, the cause of action is founded on the charge itself, which Holdings now cannot deny was made.

185 Counsel have argued that estoppel does not operate to create rights which do not exist. On the contrary, the estoppel argument may well result in a right for one party that otherwise would not exist. An example of this is found in Williams, Canadian Law of Landlord and Tenant (1922). At p. 66 it is stated that at common law payment of rent by the assignee of a (void) lease and acceptance of same by the landlord will be treated as a recognition of the assignee by the landlord and will operate as an estoppel as against the landlord. In the absence of evidence to the contrary, a year-to-year tenancy will be presumed: *Darlington v. Pritchard* (1842), 4 Man. & G. 783, 134 E.R. 322 (C.P.)

186 Thus, in that example no lease was created by the assignment, but the acknowledgement by the "party charged" of a landlord/tenant relationship precluded the landlord from denying the existence of the lease.

187 Counsel for the unsecured creditors have made reference to the Mortgage Brokers and Mortgage Dealers Act, 1971 (Man.), c. 26 (also C.C.S.M., c. M210), and the Securities Act, C.C.S.M., c. S50. I find nothing in either to restrict or affect the right of the investors to claim a security interest, as identified, in the principal mortgages.

188 Both statutes have been created for the purpose of protecting the public from potentially misleading and fraudulent schemes to relieve it of its money. The whole tenor of this legislation is to require certain behaviour and conduct by the dealers and traders in their business operations and dealings with the public. If those dealers and traders fail to comply with the law and fail to carry out their obligations, I do not see how that can interfere with the right of an innocent investor to recover against security to which he otherwise is lawfully entitled. That, of course, is subject to any provision in the two Acts that might restrict or nullify the security, but in neither statute do I find any such limitation.

189 In the closing pages of their argument counsel for the unsecured creditors submitted that the Personal Property Security Act, 1973 (Man.), c. 5 (also C.C.S.M., c. P35), applies to transactions of the nature conducted by Exchange and Holdings.

190 That Act requires that "security interests" be registered; otherwise, such interests are not "perfected", and, if not perfected, are subordinate to the claims of general creditors in a bankruptcy or receivership.

191 No security of any investor with Exchange was registered under this statute. The relevant provisions of the Act came into force in September 1978 and, if applicable to mortgage or trust interests, would affect the substantial number of investors who dealt with Exchange.

192 Two recent Ontario decisions interpreting provisions of the Ontario Personal Property Security Act, R.S.O. 1980, c. 375, which is substantially the same, but not exactly the same, as the Manitoba Act, appear to provide authority that mortgage security and even a trust interest require to be registered under the legislation. The citations of the two cases are: *C.T.L. Uniforms Ltd. v. ACIM Indust. Ltd.* (1981), 33 O.R. (2d) 139, 1 P.P.S.A.C. 308, 123 D.L.R. (3d) 702, affirmed 35 O.R. (2d) 172 (C.A.), and *Re Urman* (1981), 38 C.B.R. (N.S.), 261, 15 B.L.R. 165, 20 R.P.R. 161, 128 D.L.R. (3d) 33 (Ont. H.C.).

193 The reasoning in both cases relies heavily on the definition in the Ontario Act [s. 1 (*m*)] of "intangibles" (same as in Manitoba). It is described as meaning *all personal property*. A "security interest" is defined [s. 1(*v*)] to include an interest in "intangibles that secure payment or performance of an obligation". Since real estate mortgage security, which includes both a debt and a conveyance of land, thus includes personal property, and since leasehold interests can be said to be personal property, both judges concluded that these kinds of security were required to be registered under the Ontario legislation. In *Re Urman* the court also concluded that a trust interest in land could be categorized as a "trust receipt" within the meaning of a definition in the Act, and also required registration.

194 *Re Urman* is most directly on point to the facts presently before this court; indeed, the facts in many respects are remarkably similar and support the conclusions I have reached relative to transfer of part of a mortgage and relative to the creation of a trust interest in a principal mortgage.

195 However, after a careful review of the decision I am unable to conlude that it can be relied on as an accurate interpretaton of the Manitoba Personal Property Security Act. Certainly the decision that real property security is subject to either the Manitoba or Ontario Act seems on the face to be totally inconsistent with the nature and intention of the legislation. A reading of the Manitoba statute in full reveals numerous sections where this is evident, and it appears to me that the Manitoba Act at least can reasonably be interpreted as *not* intending to cover real property interest.

196 An interesting article which makes reference to both the *C.T.L. Uniforms* and *Urman* cases, both supra, in a somewhat critical vein, lends support to this conclusion. The article by Jacob Ziegel, Professor of Law, University of Toronto, "The Scope of the Ontario Personal Property Security Act — Recent Developments" (1981), is found at 6 Can. Business L.J. 107, in particular at pp. 118-23.

197 In consequence I hold that the Personal Property Security Act of Manitoba does not apply to the transactions with which we are con cerned here. See also the comments of Stirling L.J. in *Taylor v. London & County Banking Co.*, supra, commencing at the last paragraph on p. 254 and continuing to the end of the second paragraph on p. 255.

198 The plaintiffs, therefore, for the reasons set forth and to the extent indicated earlier, succeed in their claims to pursue the mortgage securities with which their claims are associated.

199 I leave the question of costs, interest and manner of accounting by the trustee/receiver for disposition as indicated at the end of the Ranjoy judgment [ante]. I would suggest that the trustee/receiver and counsel representing the parties and Ranjoy endeavour to reach agreement on a formula to resolve these issues before any further motion is made to the court. In the meantime, no investor may pursue his or her claim against a mortgage security.

Actions allowed.

TAB 8

2006 CarswellOnt 5597
Ontario Court of Appeal

Elias Markets Ltd., Re

2006 CarswellOnt 5597, [2006] O.J. No. 3689, 10 P.P.S.A.C. (3d) 255, 151 A.C.W.S. (3d) 294, 216 O.A.C. 49, 25 C.B.R. (5th) 50, 274 D.L.R. (4th) 166, 47 R.P.R. (4th) 32

IN THE MATTER OF ELIAS MARKETS LTD., ELIAS GROUP LTD. AND ELIAS PROPERTIES LTD. CARRYING ON BUSINESS IN THE CITY OF WINDSOR, COUNTY OF ESSEX AND PROVINCE OF ONTARIO

And IN THE MATTER OF THE BANKRUPTCY AND INSOLVENCY ACT, R.S.C. 1985, c. B-3, SECTION 47(1), AS AMENDED

D. O'Connor A.C.J.O., Doherty, J. MacFarland JJ.A.

Heard: May 10, 2006
Judgment: September 19, 2006
Docket: CA C44161

Proceedings: affirming *Elias Markets Ltd., Re* (2005), 2005 CarswellOnt 3865, 14 C.B.R. (5th) 20, 77 O.R. (3d) 461, 34 R.P.R. (4th) 127, 8 P.P.S.A.C. (3d) 228 (Ont. S.C.J.)

Counsel: A. Duncan Grace for Bank of Montreal
Milton A. Davis, Brett D. Moldaver for Royal Bank of Canada, Royal Trust Corporation of Canada
Fred Myers for RSM Richter Inc.

Subject: Property; Corporate and Commercial; Civil Practice and Procedure; Insolvency

Related Abridgment Classifications

Civil practice and procedure
XXII Judgments and orders
XXII.23 Res judicata and issue estoppel
XXII.23.a Res judicata
XXII.23.a.v Nature of prior proceedings
XXII.23.a.v.E Miscellaneous
Personal property security
IV Priority of security interest
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Real property
VIII Mortgages
VIII.2 Nature and form of mortgage
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VIII.2.g.iv Defective legal mortgage
Real property
VIII Mortgages
VIII.14 Priorities
VIII.14.a Doctrines
VIII.14.a.iii Miscellaneous

Headnote

Real property --- Mortgages — Nature and form of mortgage — Equitable mortgage — Defective legal mortgage

EM Ltd., EP Ltd. and EG Ltd. were related group of companies carrying on retail grocery business — Bank R loaned money to EP Ltd. to be secured by mortgage registered on property — Mortgage contravened Planning Act, because after loan agreement was made but prior to registration of mortgage, predecessor company to EP Ltd. amalgamated with two related companies, one of which owned parcels of land adjacent to property — Bank M agreed to provide credit facility to EM Ltd. and, as security, received general security agreement and guarantee from EP Ltd. — Company made assignment in bankruptcy — Interim receiver brought motion for direction on distribution of proceeds of $1,670,000.00 from sale of property — Motion judge held that bank R had no equitable mortgage entitling it to all of proceeds — When bank M appealed, bank R cross-appealed order denying it equitable mortgage on subject lands — Cross-appeal dismissed — Bank R did not have valid and enforceable equitable mortgage — Predecessor company to EP Ltd. did not have interest in any abutting land at time mortgage commitment agreement was signed and accepted — Predecessor company only acquired interest in abutting land one month later as result of amalgamation — However, mortgage commitment agreement was subject to two conditions precedent, being completion certificate indicating that new building was completed, and report indicating that environmental concerns had been remediated — There was no evidence of compliance with or waiver of two conditions precedent prior to amalgamation — Accordingly, bank R did not have valid and enforceable equitable mortgage.

Real property --- Mortgages — Priorities — General principles — Determination of priority

EM Ltd., EP Ltd. and EG Ltd. were related group of companies carrying on retail grocery business — Bank R loaned money to EP Ltd. to be secured by mortgage registered on property — Mortgage contravened Planning Act, because after loan agreement was made but prior to registration of mortgage, predecessor company to EP Ltd. amalgamated with two related companies, one of which owned parcels of land adjacent to property — Bank M agreed to provide credit facility to EM Ltd. and, as security, received general security agreement and guarantee from EP Ltd. — Companies made assignment in bankruptcy — Interim receiver brought motion for direction on distribution of proceeds of $1,670,000.00 from sale of property — Motion judge held that bank R was entitled to rely on doctrine of subrogation to recover, from proceeds realized by interim receiver from sale of property, monies advanced to pay municipal taxes and to discharge prior mortgages, totalling $854,184.11 — Motion judge determined that subrogation was not dependent on validity of underlying registration and did not violate policy objectives of Planning Act — Bank M appealed claiming that bank R was not entitled to remedy of subrogation and that bank M was entitled to recover under its security — Appeal dismissed — At time bank M advanced its funds and obtained general security agreement it was aware of bank R's mortgage and believed that that mortgage had priority over its general security agreement and was not aware that there was any problem with bank R's mortgage — It was only after receiver was appointed that question was raised by receiver about validity of bank R's security in view of breach of Planning Act — Therefore, bank M was not bona fide purchaser for value without notice as it did not give value for taking first place — In circumstances, there could be no unfairness to bank M if doctrine of subrogation was invoked to give priority to bank R over it to extent of earlier mortgages and municipal taxes paid out of funds advanced by bank R.

Civil practice and procedure --- Judgments and orders — Res judicata and issue estoppel — Res judicata — Nature of prior proceedings — General principles

EM Ltd., EP Ltd. and EG Ltd. were related group of companies carrying on retail grocery business — Bank R loaned money to EP Ltd. to be secured by mortgage registered on property — Mortgage contravened Planning Act, because after loan agreement was made but prior to registration of mortgage, predecessor company to EP Ltd. amalgamated with two related companies, one of which owned parcels of land adjacent to property — On learning of breach of Act, law firm of EP Ltd. brought unsuccessful application to rectify mortgages — Bank M agreed to provide credit facility to EM Ltd. and, as security, received general security agreement and guarantee from EP Ltd. — Companies made assignment in bankruptcy — Interim receiver brought motion for direction on distribution of proceeds of $1,670,000.00 from sale of property — Motions judge determined that principles of res judicata and abuse of process did not preclude bank R from asserting priority claim to net sale proceeds of subject property — Bank M appealed, relying on cause of action estoppel — Bank M contended that evidence in support of equitable mortgage and subrogation remedies sought in judgment appealed from was before court on rectification application — Therefore, bank R could not now in this appeal advance claim to priority on basis of different legal theories which were properly part of and should have been advanced in rectification application — Appeal dismissed — Issue of priorities was irrelevant to issue raised in rectification proceeding — Only when application for rectification was dismissed did it become necessary to determine competing priority claims — Proceeding appealed from was brought by interim receiver for direction of court as to whom monies it had collected should be paid, and this was very different issue from issue on rectification — Very different relief was sought and different evidence heard in each of two proceedings — Doctrine of res judicata simply did not arise, nor was there abuse of process by bringing second application.

Personal property security — Priority of security interest — Miscellaneous

EM Ltd., EP Ltd. and EG Ltd. were related group of companies carrying on retail grocery business — Bank R loaned money to EP Ltd. to be secured by mortgage registered on property — Mortgage contravened Planning Act, because after loan agreement was made but prior to registration of mortgage, predecessor company to EP Ltd. amalgamated with two related companies, one of which owned parcels of land adjacent to property — On learning of breach of Act, law firm of EP Ltd. brought unsuccessful application to rectify mortgages — Bank M agreed to provide credit facility to EM Ltd. and, as security, received general security agreement and guarantee from EP Ltd. — Companies made assignment in bankruptcy — Interim receiver brought motion for direction on distribution of proceeds of $1,670,000.00 from sale of property and monies it had collected from rents — Bank R had been granted assignment of rents by companies, which was registered under both PPSA and Land Titles Act — Bank R registered two financing change statements under PPSA — Bank R conceded before motion judge that registration of assignment of rents under Land Titles Act was also void due to Planning Act breach — However, it contended that PPSA registration remained valid and took priority over any subsequent PPSA registrations, including those of bank M — Bank R was entitled to net rental proceeds — PPSA registrations are not inextricably bound to assignment of rents, but are capable of existing independently such that their valid registrations took priority over bank M's general security agreement registered under PPSA later — PPSA registrations and assignment of rents evidence interest in income stream and therefore are not dependent on validity of underlying registration against title to lands.

Table of Authorities

Cases considered by *J. MacFarland J.A.*:

Crosbie-Hill v. Sayer (1908), [1908] 1 Ch. 866 (Eng. Ch. Div.) — considered

McQuillan v. Native Inter-Tribal Housing Co-operative Inc. (1998), 1998 CarswellOnt 4172, 114 O.A.C. 303, 20 R.P.R. (3d) 198, 42 O.R. (3d) 46 (Ont. C.A.) — considered

Minott v. O'Shanter Development Co. (1999), 1999 CarswellOnt 1, 99 C.L.L.C. 210-013, 40 C.C.E.L. (2d) 1, 168 D.L.R. (4th) 270, 117 O.A.C. 1, 42 O.R. (3d) 321 (Ont. C.A.) — considered

Mutual Trust Co. v. Creditview Estate Homes Ltd. (1997), 34 O.R. (3d) 583, 1997 CarswellOnt 2745, 149 D.L.R. (4th) 385, 12 R.P.R. (3d) 1, 49 C.B.R. (3d) 113, 102 O.A.C. 246 (Ont. C.A.) — considered

Scherer v. Price Waterhouse (August 16, 1985), Sutherland J. (Ont. H.C.) — distinguished

Tessis v. Scherer (1982), 39 O.R. (2d) 149, 19 M.P.L.R. 303, 26 R.P.R. 41, 140 D.L.R. (3d) 101, 1982 CarswellOnt 668 (Ont. C.A.) — considered

Tessis v. Scherer (1982), 39 O.R. (2d) 616n, [1982] 2 S.C.R. xi (S.C.C.) — referred to

Statutes considered:

Land Titles Act, R.S.O. 1990, c. L.5

Generally — referred to

Planning Act, R.S.O. 1990, c. P.13

Generally — referred to

s. 50(3) — referred to

APPEAL and CROSS-APPEAL from judgment reported at *Elias Markets Ltd., Re* (2005), 34 R.P.R. (4th) 127, 14 C.B.R. (5th) 20, 2005 CarswellOnt 3865, 77 O.R. (3d) 461, 8 P.P.S.A.C. (3d) 228 (Ont. S.C.J.), directing interim receiver on interim receiver on distribution of proceeds from sale of property.

***J. MacFarland J.A.*:**

1 The appellant, Bank of Montreal ("BMO") appeals from the order of Rady J. dated August 19, 2005. It asks this court to set aside that part of her order which entitles Royal Bank of Canada and Royal Trust Corporation of Canada (collectively "RBC") to the remedy of subrogation and to recover from the proceeds realized by the interim receiver, RSM Richter Inc. ("Interim

Receiver") from the sale of the property municipally known as 655 and 755 Crawford Avenue, Windsor, Ontario. BMO seeks an order that RBC is not entitled to the remedy of subrogation or to recover any amount from the proceeds realized from the sale of the property and that BMO is entitled to recover under its security the proceeds.

2 BMO also seeks to set aside that part of the order declaring that an assignment of rents to RBC is in priority to the security held by BMO. In its place, BMO seeks an order declaring the BMO security to be in priority to the RBC assignment of rents and directing the Interim Receiver to pay to BMO the rents collected in respect of the property.

3 RBC cross-appeals and asks that this court set aside that portion of the order denying RBC an equitable mortgage on the subject lands. In its place, RBC seeks an order directing that RBC is entitled to the sale proceeds of the subject property in priority to any claim by BMO or any other creditor.

4 By the terms of her order, the motion judge ordered that the Interim Receiver was authorized and directed to distribute on a final basis the proceeds of sale and rental of the property at 655/755 Crawford Avenue, Windsor, Ontario as follows:

(a) to Royal Bank of Canada, the net rental proceeds;

(b) to Royal Bank of Canada, the sum of $854,158.11 from the net sale proceeds;

(c) to Bank of Montreal, the balance of the net proceeds.

5 BMO takes the position that because the mortgage held by RBC violated the provisions of the *Planning Act*, R.S.O. 1990, c. P.13 it is invalid as is the Assignment of Rents, which was taken at the same time and is, by its terms, "additional security" and therefore collateral to the mortgage. If BMO is correct, it would move into a first priority position ahead of RBC and be entitled to the entire net proceeds, both from the sale of the property and the rents collected.

The Facts

6 The facts which give rise to this appeal are complex but must be set out in detail for a proper understanding of the issues.

7 This proceeding arises out of the insolvency of Elias Markets Ltd. ("Markets"), Elias Properties Ltd. ("Properties") and Elias Group Ltd. ("Group") (collectively "the companies"). The companies carried on a retail grocery business in Windsor and surrounding area. Markets operated the grocery stores and Properties owned the real estate, including 655/755 Crawford Avenue. Group was a holding company and did not carry on any active business.

8 The proceeding before Rady J. was an application by the Interim Receiver for directions as to the manner of distribution of the proceeds of the sale of the Crawford Avenue properties ($1,670,000) and rents collected therefrom.

9 On January 6, 1996, one of the Elias companies, 1156712 Ontario Ltd. (hereinafter "1156712") and a predecessor to Properties, bought property at 655 Crawford Avenue, Windsor ("Parcel One").

10 In so doing, 1156712 assumed: an existing mortgage in favour of Royal Trust with a principal balance of $657,700.18 outstanding on closing; and an existing mortgage in favour of Larcon Holdings Inc. ("Larcon") with a principal balance of $340,279.40 outstanding on closing.

11 On June 10, 1997, another Elias Company, 882876 Ontario Ltd. ("882876"), also a predecessor to Properties, purchased four additional parcels of land adjacent to the north boundary of Parcel One. ("Parcels Two, Three, Four and Five").

12 Markets operated a grocery store on Parcel One. In 1998, as part of a plan to develop the entire property, 1156712 and 882876 signed a site Plan Agreement with the City of Windsor. Parcels Four and Five were conveyed to the City. Parcels One, Two and Three remained in the hands of the numbered companies (Parcel One in 1156712 and Parcels Two and Three in 882876). The development proposed a new grocery store building at the south end of Parcel One. The existing building (where

Markets was then operating a grocery store) at the north end of Parcel One was to be leased to a bingo hall operator. Parking was to be on Parcel One between the two buildings and on Parcels 2 and 3.

13 On March 15, 1999, RBC issued a commitment letter agreeing to lend $2,300,000 to 1156712, secured by a first mortgage on Parcel One ("the mortgage commitment agreement" or "MCA"). The MCA required that the existing first mortgage against Parcel One in favour of RBC be discharged from the loan proceeds. As the terms of the MCA required that the security for the loan be a first mortgage on the subject property, any other encumbrances which would otherwise rank in priority to this new mortgage would necessarily have to be discharged.

14 At this point in time, 1156712 did not own any abutting parcels of land; it owned only Parcel One.

15 On March 26, 1999, Joseph Elias, on behalf of 1156712, signed the MCA and accepted its terms.

16 Six days later, by Articles of Amalgamation dated April 1, 1999, 1156712 and 882876 and a third Elias company amalgamated to form Properties ("Properties"). The articles of amalgamation were registered only against title to Parcel One.

17 At this time, Joseph Elias asked RBC to draw on the $2,300,000 of available financing in order to start the construction on Parcel One. As security for the construction financing, Properties granted to RBC a $1,400,000 construction mortgage, registered against Parcel One on May 26,1999.

18 On November 26, 1999, the $2,300,000 mortgage was registered in favour of RBC against Parcel One. $1,400,000 of this money went to discharge the construction mortgage. Another $854,184.11 was paid to satisfy prior encumbrances, which included:

1. Royal Bank of Canada mortgage payout — $574,172.55

2. National Bank of Canada Mortgage payment — $161,000.00

3. City of Windsor taxes — $36,685.20

4. Larcon Holdings Inc. mortgage payout — $82,326.36

19 At the time of the registrations, as a result of the amalgamation, Properties was now the owner of Parcels One, Two and Three. The RBC mortgages — registered May 26, 1999 and November 26, 1999 — were registered only against Parcel One, and thus were void under s. 50(3) of the *Planning Act*. RBC and Properties were unaware at the time that the mortgages were void. All parties to the mortgages had been represented throughout these transactions by the same solicitor, Jeffrey Slopen.

20 On June 26, 2001, BMO granted Markets a revolving line of credit. As security, Properties gave a guarantee and executed a General Security Agreement (GSA) in favour of BMO. By spring of 2002, the companies were in financial difficulty.

21 On May 6, 2002, almost one year later, BMO registered a Notice of Agreement Charging Lands against Parcel's One and Six. On August 18, 2002, it registered a caution against Parcels One and Three. The registrations coincided with BMO's realization that RBC's mortgage was defective, a fact still unknown to RBC. On August 23, 2002, the Interim Receiver was appointed. It was only after the appointment of the Interim Receiver that questions were raised about the validity of the RBC mortgage.

22 BMO admits it was aware of the mortgage financing in place before it granted the line of credit and obtained the GSA. It was also aware there were prior registrations in favour of RBC. BMO admits it granted the demand loan facility to Markets on the assumption the $2,300,000 RBC mortgage was validly registered and would have priority over its security interest.

The Rectification Application

23 On learning of the breach of the *Planning Act*, Jeffrey Slopen's law firm brought an application to rectify the mortgages, so that they would charge Parcels Two and Three in addition to Parcel One. RBC, BMO, Properties and the Interim Receiver were named as respondents to that application, which proceeded before Abbey J.

24 In that application, both Slopen and the principal of the mortgagor filed evidence to the effect that it was their common intention to mortgage all three parcels of land.

25 Abbey J. dismissed the application and, as a result, RBC's mortgage against Parcel One remained void under the *Planning Act*. In his reasons, Abbey J. noted that in March 1999, at the time RBC agreed to advance the $2,300,000, there was no *Planning Act* violation. The pre-amalgamation corporation, 1156712, owned only Parcel One and did not own abutting land at the time. The amalgamation that ultimately affected the validity of the mortgage was effected after the MCA was entered into but before the $2,300,000 RBC mortgage was registered. But for the amalgamation and the effect that triggered under the *Planning Act*, the registered mortgage would be valid.

Issues

26 The appeal and the cross-appeal raise the following issues:

1. Did the motion judge err in failing to find that the principles of *res judicata* and abuse of process precluded RBC from asserting a priority claim to the net sale proceeds of the subject property?

2. If *res judicata* and abuse of process do not apply, should RBC be granted the equitable remedy of either equitable mortgage or subrogation?

3. Does the RBC Assignment of Rents have priority over BMO's security in respect of the net rents collected by the Interim Receiver from the subject property?

27 For the reasons that follow, I am of the opinion that the motion judge did not err when she concluded that neither the principles of *res judicata* nor abuse of process precluded RBC from asserting its priority claim on the basis of equitable mortgage or subrogation; that RBC does not have a valid $2,300,000 equitable mortgage on Parcel One, but is entitled to priority over BMO to the extent of $854,184.11 on the basis of subrogation; and that the RBC Assignment of Rents has priority over BMO's security.

I. Res Judicata and Abuse of Process

28 BMO argues that, on the motion before Rady J., RBC was in substance seeking the same remedy as was sought in the rectification application — priority over the net sale proceeds of the Crawford Avenue property — on the basis of different legal theories. On the basis of the doctrines of *res judicata* and abuse of process, BMO submits that those legal theories ought to have been advanced as part of the rectification application.

29 The motion judge, in her careful reasons, concluded:

> [28] The unsuccessful application for rectification of the mortgage brought by Mr. Slopen's law firm was in the nature of a "salvage" action to rectify the mortgage to reflect what was argued to be the parties' intention. If rectification had been granted, RBC would have enjoyed a priority position and presumably the solicitor's malpractice suit would be avoided. There was no need to raise any argument with respect to equitable principles or the doctrine of subrogation.
>
> [29] The present proceeding is brought by the Interim Receiver, seeking the Court's direction on the issue of priorities, the RBC mortgage having been found to be illegal. Essentially the court is being asked to deal with the consequences of the illegal mortgage. No legal or factual issues are being relitigated and this is not an attempt to impeach, in any way, the findings made by Abbey J.

30 I agree. In *Minott v. O'Shanter Development Co.* (1999), 42 O.R. (3d) 321 (Ont. C.A.), at 329, Laskin J.A. writing on behalf of this court noted:

> *Res judicata* itself is a form of estoppel and embraces both cause of action estoppel and issue estoppel. Cause of action estoppel prevents a party from relitigating a claim that was decided or could have been raised in an earlier proceeding.

31 In this appeal, BMO relies on cause of action estoppel.

32 BMO submits that the evidence in support of the equitable mortgage and subrogation remedies sought before Rady J. was before the court on the rectification application. Having sought to advance RBC's claim to priority in the rectification application solely on the basis of rectification, BMO submits that RBC cannot now in this proceeding advance a claim to priority on the basis of different legal theories. Those legal theories were properly part of and ought to have been advanced in the rectification application.

33 The rectification application was concerned with the mortgage itself, where it was argued that it was always the intention of the parties — both RBC and Properties — that the mortgage was intended to apply to Parcels One, Two and Three. That application was brought by the solicitors who acted for both parties to the mortgage. Had the application been successful, the mortgage would no longer be in breach of the *Planning Act* and an action against the solicitors would have been avoided. When the application failed, the adversity of interest between the solicitors and RBC crystallized. An action against the solicitors in negligence and breach of contract has been instituted and remains outstanding.

34 Had RBC sought to have the issue of priorities as between it and BMO adjudicated in the proceedings before Abbey J., it would have been obliged to bring a separate application — an application to which the solicitors would not be a party and to obtain an order to have its application heard immediately following the rectification application. The issue of priorities was, in my view, irrelevant to the issue raised in the rectification proceeding. Only when the application for rectification was dismissed did it become necessary to determine the competing priority claims.

35 The proceeding before Rady J. was brought by the Interim Receiver and sought the direction of the court as to whom the monies it had collected from the sale of the property and the collection of rents should be paid. This was a very different issue than the one determined by Abbey J.

36 While some of the evidence before Abbey J. was necessarily led before Rady J. to provide context and background, the evidence that specifically related to the priorities issue was new. Clearly relevant to the priorities claim was evidence about what BMO knew about prior encumbrances, specifically the RBC mortgage, when it made its decision to loan money and take a GSA as security. Such was not evidence before Abbey J., nor could it be.

37 In *McQuillan v. Native Inter-Tribal Housing Co-operative Inc.* (1998), 42 O.R. (3d) 46 (Ont. C.A.), Charron J.A. writing for this court, wrote at p. 50:

> The respondent does not contend that the cause of action is the same in both applications. Indeed, it is not. The respondent relies rather on a wider principle, often treated as covered by the plea of *res judicata*. The doctrine of *res judicata*, in its wider application, prevents a person from relying on a claim or defence which he or she had the opportunity of putting before the court in the earlier proceedings but failed to do so. This principle was adopted by the Supreme Court of Canada in *Maynard v. Maynard*, [1951] S.C.R. 346 at pp. 358-9 ... (citing the often-quoted words of Wigram V.C. in *Henderson v. Henderson* (1843), 67 E.R. 313, 3 Hare 100 (Eng. V.C.)):
>
>> ... where a given matter becomes the subject of litigation in and of adjudication by a court of competent jurisdiction, the Court requires the parties to that litigation to bring forward their whole case and will not (except under special circumstances) permit the same parties to open the same subject of litigation in respect of a matter which might have been brought forward as part of the subject in contest, but which was not brought forward only because they have from negligence, inadvertence or even accident, omitted part of their case. The plea of *res judicata* applies, except

> in special cases, not only to points upon which the Court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which properly belonged to the subject of litigation and which the parties, exercising reasonable diligence, might have brought forward at the time.

38 In McQuillan, the appellant was seeking a prescriptive easement over a two-foot strip of land on the respondent's property. In earlier proceedings, the appellant had sought a declaration of possessory title to the same two-foot strip of land based on much the same evidence. In the circumstances, the court had no difficulty concluding that the second application was precluded by the doctrine of *res judicata*. The court noted, at p. 51:

> Upon careful review of the material filed in support of each application in this case, I am persuaded that the respondent's position should be adopted. Although, in a strict legal sense, a different cause of action is advanced on this application, the appellant is in effect seeking an analogous remedy based on virtually identical facts. In each application, the appellant asserted a right to continue to use the two-foot strip of land on the respondent's property as part of her driveway. It does not appear that it would make any practical difference to the appellant whether this right was asserted by way of possessory title or by way of prescriptive easement. On the facts as presented on the earlier application, it would have been open to advance not only the claim for possessory title but also, in the alternative, the claim to a prescriptive easement. In my view, the appellant's second application falls clearly within the scope of the doctrine of *res judicata* in its wider application.

39 In my view, that is not this case. Very different relief was sought and different evidence heard in each of the two proceedings.

40 Clearly, the Interim Receiver had to have the priorities issue resolved before it could disburse funds, and the rectification application did not and could not deal with that issue. The doctrine of *res judicata* simply does not arise nor is there any abuse of process by bringing the second application.

II. A) Subrogation

41 BMO argues that when it acquired its security interest (some two years after the RBC mortgage had been granted) in the Crawford property, there were no other valid encumbrances affecting the Crawford property. It says that the RBC mortgage, although registered, was void and of no effect and as a result, BMO acquired a first priority position in the Crawford property. As a purchaser for value, the only equities enforceable against BMO are those of which it had notice at the time it acquired its interest in the Crawford Property. And BMO submits that it had no notice of RBC's equity of subrogation.

42 The fallacy in BMO's argument is that at the time it advanced funds and obtained the GSA which secured those funds, it was aware of the RBC $2,300,000 mortgage, believed that that mortgage had priority over its GSA and was not aware that there was any problem with the RBC mortgage. It advanced funds believing that its GSA ranked behind the RBC $2,300,000 mortgage. It was only after the companies fell into financial difficulty and the receiver appointed that a question was raised (by the Interim Receiver and not BMO) about the validity of RBC's security in view of the apparent breach of the provisions of the Planning Act. Only after it became aware of the Elias financial difficulties. Thus, BMO was not in the position of a *bona fide* purchaser for value without notice as it did not give value for taking first place. It got what it paid for, and that did not include ranking as first mortgagee on the property.

43 In *Mutual Trust Co. v. Creditview Estate Homes Ltd.* (1997), 34 O.R. (3d) 583 (Ont. C.A.), this court considered the equitable remedy of subrogation. The facts in that case are as follows. The subject property was a family home purchased by IS and BS as joint tenants in December, 1988. As part of the purchase, IS and BS granted a first mortgage to Scotia Mortgage for $220,000. On April 23, 1990, IS and BS gave a further mortgage to the Bank of Nova Scotia in the sum of $15,000.

44 In June 1991, RS, the son of IS and BS, was a commercial tenant of Creditview. On June 7, 1991, Creditview commenced an action against RS claiming damages for breach of lease. IS was also named a defendant in that action as the indemnifier of RS with respect to his obligations under the lease. IS transferred his interest in the home property to BS on March 12, 1991.

45 On February 28, 1992, Creditview commenced an action against IS and BS for a declaration that the transfer from IS to BS was a fraudulent conveyance and void as against Creditview.

46 On March 2, 1992, Creditview obtained a certificate of pending litigation (CPL) and registered it against the title to the home property.

47 On September 3, 1992, Mutual Trust agreed to provide $230,000 to refinance the home property to be secured by a first charge. A solicitor retained by Mutual Trust to act on its behalf did not report the existence of the CPL to Mutual Trust.

48 The Mutual Trust refinancing charge was registered September 16 th, 1992, which secured the principal sum of $229,500. Discharges of the Scotia Mortgage and Bank charges were also registered. No request was made to Creditview to subordinate its CPL to the Mutual Trust charge.

49 A total of $228,863.37 was advanced under the Mutual Trust charge. Of that sum, $227,967.14 was paid to Scotia Mortgage and the Bank for discharges of their charges.

50 Following its discovery of the CPL on title, Mutual Trust brought an application for an order declaring that the CPL was subordinate to the Mutual Trust charge. The application succeeded on the ground that the Mutual Trust charge was subrogated to the Scotia Mortgage and the Bank charges that it replaced and, accordingly, it ranked ahead of the CPL. This court noted, at pp. 586-587:

> In granting Mutual Trust's application, Adams J. held that the doctrine of subrogation applied, that it was not proscribed by the *Registry Act*, R.S.O. 1990, c. R.20, that the fundamental principle underlying the doctrine was one of fairness in light of all the circumstances, that it applied to certificates of pending litigation, that the negligence of the party claiming subrogation was not determinative of the issue, that subrogation is not precluded by the fact that the lands in question are in the land titles system, and the fact that IS was only a guarantor of Mutual Trust's charge presented no obstacle to granting the declaration sought. I agree entirely with his reasoning and his conclusions of these points [citation omitted].

51 The court went on to quote with approval the following reasoning of Adams J:

> The fundamental principle underlying the equitable doctrine of subrogation is one of fairness in light of all the circumstances. Within this principle is an understanding that no injustice is done by the appropriate subrogation of a party to the rights of original mortgages. Thus Street J. in *Brown v. McLean* (1889), 18 O.R. 533 (H.C.) at p. 536, stated:
>
>> I think, however, that the plaintiff here is entitled upon the ground of mistake to be subrogated to the rights of the original mortgagees to the extent of allowing him a priority over the defendant for the amount he paid to discharge their mortgages. It is clear beyond question that he would not have discharged these mortgages had he been aware of the existence of the Defendant's *fi fa.* He would either have refused to make the advance altogether, or he would have had the mortgages assigned to him instead of discharging them.
>>
>> It is equally clear that the defendant has not been in any way prejudiced by what has happened, and that no injustice will be done by replacing him in his former position.
>
> .....
>
> This is because the equity of subrogation affixes to the land in relation to which the third party advanced the mortgage funds. Further, it is not determinative that the entire situation arises because of the negligence of the party claiming subrogation. ... In fact, the doctrine is usually called into play because of a mistake or inadvertence. Accordingly, it is not enough to point to negligent conduct to defeat the doctrine's application. The issue remains one of fairness between the affected parties having regard to all the circumstances.

52 The motion judge in this case concluded that RBC was entitled to rely on the doctrine of subrogation to recover monies advanced to pay municipal taxes and to discharge prior mortgages on Parcel One, all of which totalled $854,184.11. She concluded there was ample authority for the proposition that a mortgagee who pays off earlier encumbrances is entitled to the priority position of those earlier charges. She quoted from *Crosbie-Hill v. Sayer*, [1908] 1 Ch. 866 (Eng. Ch. Div.), as follows:

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

53 The motion judge reasoned:

[47] ... In my view, it would be simply unfair in the circumstances of this case to deny RBC its subrogation rights. BMO did not rely on the abstract of title to its detriment. Indeed, BMO was aware of the prior advances made by RBC and it assumed that RBC's security was validly registered. This is made evident by the candid testimony of James Graham, a representative of BMO, during the course of his cross-examination. The transcript reveals the following questions and answers.

> 58Q. And you were aware of the mortgage financing that had been put in place before Bank of Montreal got involved?
>
> A. That's right, yes.
>
> 125Q. And so Bank of Montreal knew that there were prior registrations including registrations in favour of Royal Bank, right?
>
> A. That's right.
>
> 127Q. Now can we agree, Mr. Graham, that when the Bank of Montreal first lent its money to or granted demand loan facility to Elias it assumed that Royal Trust mortgage of 2.3 million dollars was validly registered?
>
> A. Yes, that's right.

[48] As a result, BMO made its lending decision knowing of RBCs prior registered interest. Presumably, it was content to rank behind the RBC mortgage of $2.3 million. That was a business decision that it was entitled to make after weighing the relative risks and benefits.

[49] BMO may suffer a loss but it seems to me that this was a risk undertaken by BMO in making the loan in question. Its loss is not, strictly speaking, caused by RBC's right of subrogation, but rather by reason of the deficiency in the value of the security and the underlying covenant. Moreover, to deny subrogation would give BMO an unanticipated windfall. BMO would be unjustly enriched ... In other words, BMO would receive the value of RBC's advances totalling $854,184 which increased the equity in the property and it would be unjustly enriched as a result. This windfall is made more unfair because BMO only discovered that there might be a defect in RBC's security in the spring of 2002, more than a year after its registrations under the PPSA. It was at that time that BMO took steps to register its GSA against Parcels 1 and 3. BMO also registered its Notices of Agreement Charging Land and Caution in May, August and October 2002, all after it became aware of the potential defect in the RBC mortgage.

[50] I pause here to note that RBC is entitled to subrogation not only for the mortgages that it retired but also for the City taxes it paid on behalf of the mortgagor. Authority for this is found in *Traders Realty Ltd. v. Huron Heights Shopping Plaza Ltd.*, [1967] 64 D.L.R. (2d) 278 (H.C.J.) and the rationale is consistent with the reasoning expressed in the *Creditview* trilogy reviewed above.

[51] Before leaving the subject, I should deal with BMO's submissions on the issue. It asserts that the doctrine does not appear to have been applied to give a claimant priority over a creditor whose claim did not exist at the time of the payment or advance in question. I can see no reason, in principle, why subrogation should not apply in such a case, particularly where the subsequent creditor has not been misled or has not relied on an abstract of title to its detriment.

> [52] BMO asserts that subrogation cannot arise because the RBC mortgage was void. I disagree. Subrogation does not depend on the validity of the underlying registration but arises by virtue of the advance of funds to pay out prior encumbrances.

54 I agree with her reasoning. On the facts, there is no question that BMO assumed that RBC's security had priority to the extent of $2,300,000 over its GSA. It made its loan to the companies on that basis and, at the time, had no basis to question the validity of the RBC mortgage. It advanced its funds on the assumption that the RBC mortgage was valid and had priority over the GSA.

55 In such circumstances, there can be no unfairness to BMO if the doctrine of subrogation is invoked to give priority to RBC over BMO to the extent of the earlier mortgages and municipal taxes paid out from the funds advanced by RBC.

B) Equitable Mortgage

56 On cross-appeal, RBC argues that it has a valid equitable mortgage for $2,300,000 on Parcel One, which was created on March 26, 1999 when 1156712 accepted the terms of the RBC MCA dated March 15, 1999. When that equitable mortgage was created, title to Parcel One was in the name of 1156712, which owned no abutting land. Thus, RBC submits, there was no violation of the *Planning Act*.

57 The motion judge rejected this argument. In reaching this conclusion, the motion judge relied on the decision of this court in *Tessis v. Scherer* (1982), 39 O.R. (2d) 149 (Ont. C.A.), leave to appeal to S.C.C. refused, [1982] 2 S.C.R. xi (S.C.C.). In that case, a mortgagee sought to enforce a mortgage that had been made in violation of the *Planning Act*; the mortgagor owned abutting parcels of land at the time of the mortgage. This court concluded that the mortgage conveyed no interest as a result of this breach. It does not appear that an argument was made about whether the loan agreement between the parties created an equitable mortgage.

58 That issue was raised specifically in the related matter before Sutherland J. in *Scherer v. Price Waterhouse*, [1985] O.J. No. 881 (Ont. H.C.). In his decision, Sutherland J. carefully reviewed the law on equitable mortgages and concluded that an equitable mortgage had not arisen on the facts of that case. At para. 22, he wrote:

> The highest interest in the land that can have been conferred on Tessis by the loan agreement is the right to an equitable mortgage after the required planning consent had been obtained. In no true sense of the term can Tessis be said to have had an equitable mortgage before that consent was obtained. This is not a case of a want of formalities in the mortgage document or a case of the refusal by the borrower to execute a mortgage. Although there undoubtedly was a mistake the usual equitable remedies are not available if to purport to make them available would be to contravene the statute. No equitable mortgage arises upon the entry into the loan agreement. To put the matter another way, in the absence of the required consent the loan agreement does not create an equitable mortgage any more than a legal mortgage document, correct in all its documentary formalities, creates a legal mortgage. At the material times, Tessis was not an equitable mortgagee.

59 Because the loan agreement was entered into at a time when the mortgagor owned abutting parcels of land and consent had not been obtained under the *Planning Act*, there was no equitable mortgage because to recognize one would have been in contravention of the statute.

60 In the instant case, after reviewing the law on equitable mortgages, the motion judge concluded:

> This is not a case involving a want of formalities, an inadvertent omission or misdescription or a refusal on the part of the mortgagor to provide a mortgage. In fact, a mortgage was duly prepared, executed and registered as the parties had agreed. The wrinkle was that no planning consent was obtained and the mortgage was void as a result. I agree ... that an equitable mortgage cannot arise upon acceptance of the commitment letter unless a consent is obtained because to hold otherwise would permit a contravention of the statute.

[40] Moreover, if an equitable mortgage confers the same rights as a legal mortgage, it follows that the mortgagee could foreclose or sell the property. This would result in a change in ownership, the very thing the Planning Act seeks to prevent or at least, regulate. As a result, I am not persuaded that the commitment letter gave rise to an equitable mortgage in the circumstances of this case.

61 I agree with the motion judge that there was no enforceable equitable mortgage on Parcel One. However, I reach this conclusion for different reasons.

62 As noted by the motion judge, "[t]he legal concept of an equitable mortgage has existed for hundreds of years." Despite this long history, there is a dearth of recent jurisprudence in Ontario on this concept. As such, some comment is in order on the nature of an equitable mortgage, the manner by which an equitable mortgage is created, and the priorities of enforcement.

1) The nature of an equitable mortgage

63 An equitable mortgage is distinct from a legal mortgage. "An equitable mortgage is one that does not transfer the legal estate in the property to the mortgagee, but creates in equity a charge upon the property": A.H. Oosterhoff & W.B. Rayner, *Anger and Honsberger: Law of Real Property*, 2d ed. (Aurora, Ont.: Canada Law Book) at 1643.

64 The concept of an equitable mortgage would seem to find its foundation in the equitable maxim that "equity looks on that as done which ought to be done". Historically, the courts of equity mitigated the rigour of the common law, tempering its rules to the needs of particular cases on principles of justice and equity. The common law courts were primarily concerned with enforcing the strict legal rights of the parties, whereas equity was a court of conscience; it would step in to prevent an injustice that would otherwise arise from the strict application of the law.

65 In essence, the concept of an equitable mortgage seeks to enforce a common intention of the mortgagor and mortgagee to secure property for either a past debt or future advances, where that common intention is unenforceable under the strict demands of the common law.

2) How is an equitable mortgage created?

66 In Scherer v. Price Waterhouse, Sutherland J. discussed the manner in which an equitable mortgage is created, at para. 20:

> In one part of his submissions the applicant claimed to be an equitable mortgagee, citing, among other things, the following passage from *Fisher and Lightwood's Law of Mortgage*, 7th ed., at p. 16:
>
> > Equitable mortgages of the property of legal owners ... are created by some instrument or act which is insufficient to confer a legal estate, but which, being founded on valuable consideration, shows the intention of the parties to create a security; or in other words, evidences a contract to do so.
>
> In *Falconbridge, Law of Mortgages*, 4th ed., at p. 80, the following statement is made about equitable mortgages:
>
> > An equitable mortgage therefore is a contract which creates in equity a charge on property but does not pass the legal estate to the mortgagee. Its operation is that of an executory assurance, which, as between the parties, and so far as equitable rights and remedies are concerned, is equivalent to an actual assurance, and is enforceable under the equitable jurisdiction of the court.
> >
> > **5.2 How an Equitable Mortgage is Created**
> >
> > The equitable nature of a mortgage may be due either (1) to the fact that the interest mortgaged is equitable or future, or (2) to the fact that the mortgagor has not executed an instrument sufficient to transfer the legal estate. In the first case the mortgage, be it [ever] so formal, cannot be a legal mortgage; in the second case it is the informality of

> the mortgage which prevents it from being a legal mortgage. These alternatives will be discussed separately. (3) An equitable mortgage may also be created by deposit of title deeds.

It is clear that neither (1) nor (3) above have any application to the facts of this matter and that we need be concerned only with (2) above. In the same publication there appears, at p. 83, under the heading "Mortgage by Instrument not Sufficient to Convey the Legal Estate", the following passage:

> **(1) Conveyance defective in form**
>
> If a document in the form of a legal mortgage is signed but not sealed, or for any other reason is not sufficient to transfer the legal estate, it is an equitable mortgage.
>
> An instrument intended to operate as a legal mortgage, which fails so to operate for want of some formality, is valid as an equitable charge and gives the mortgagee a right to a perfected assurance.
>
> **(2) Agreement to give a Mortgage**
>
> An agreement in writing duly signed to execute a legal mortgage is an equitable mortgage, operating as a present charge on the lands described in the agreement.

67 In this case, we are concerned with a mortgage by an instrument that is insufficient to convey the legal estate — the MCA.

3) Priorities

68 Given that this cross-appeal essentially involves a contest of priority between RBC and BMO to the funds realized upon the sale of the Crawford Avenue property, it is necessary to briefly consider the priorities of enforcement as they relate to equitable mortgages.

69 In this regard, I adopt the following equitable "rules" as summarized in *Falconbridge on Mortgages*, 5th ed., looseleaf (Agincourt, Ont.: Canada Law Book, 2003) at paras. 7:20-7:40:

> Rule 1. *As between two equitable mortgages the first in time has priority, unless the second mortgagee, taking in good faith for value and without notice, has been misled by the fraud or negligence of the first mortgagee, or by a representation of the first mortgagee which estops him or her from claiming priority over the second mortgage.*
>
> Rule 2. *As between a first legal mortgage and a second equitable mortgage, the first mortgage has priority, unless the second mortgagee, being a mortgagee in good faith for value and without notice, has been misled by the fraud or negligence of the first mortgagee in connection with the taking of the first mortgage or the subsequent fraud (as distinguished from mere negligence) of the first mortgagee, or unless the first mortgagee is estopped from claiming priority.*
>
> Rule 3. *As between a first equitable mortgage and a second legal mortgage, the second mortgage has priority if the mortgagee has acquired the legal estate in good faith for value and without notice* [emphasis added].

4) Does the commitment letter give rise to an enforceable equitable mortgage?

70 In order for the MCA to give rise to an enforceable equitable mortgage in this case, it must have arisen prior to April 1, 1999 — the date of amalgamation.

71 With respect, I disagree with the motion judge that a *Planning Act* consent was required before the MCA could give rise to an equitable mortgage. In reaching this conclusion, the motion judge appears to have been wrongly influenced by the conclusion of Sutherland J. in *Scherer v. Price Waterhouse*.

72 Importantly, in *Scherer*, the loan agreement contravened the *Planning Act* because the mortgagor owned an interest in an abutting parcel of land at the time the loan agreement was signed and accepted. Here, however, 1156712 did not have any

interest in any abutting land at the time the MCA was signed and accepted on March 26, 1999. It only acquired an interest in abutting land on April 1, 1999 as a result of amalgamation. Consequently, if an enforceable equitable mortgage is found to have arisen prior to amalgamation, there would be no violation of the *Planning Act*; no consent was required at that time. Unlike *Scherer*, this would not be a case in which provisions of the *Planning Act* were not complied with.

73 With that in mind, I turn to the consideration of whether an enforceable equitable mortgage actually arose prior to the date of amalgamation.

74 RBC signed the MCA on March 15, 1999. It was accepted and signed back to RBC on March 26, 1999. Under the heading "SECURITY", the mortgagor and mortgagee agreed as follows:

The security for this loan, registered or recorded as required by [RBC], shall be:

- A first charge/mortgage on the freehold property owned by [1156712] and known as 655 Crawford Avenue, in the City of Windsor, being Conc 1, Part 1, Ref Plan 12RI0596 (the "Property").

- A first ranking security interest in an assignment of rentals payable by all tenants of the Property, present and future.

A first and specific registered assignment of the current leases to those tenants as outlined on Form J attached.

Further, [1156712] will provide [RBC], on request, with a first and specific assignment of such other present and future leases of the Property which [RBC] may designate in writing from time to time.

75 The MCA was subject to the following conditions precedent:

Prior to an advance of funds hereunder, at [1156712's] expense, [1156712 is] to provide [RBC] with:

- Completion Certificate indicating the new building is completed and that the renovations are completed on the existing building.

- A Remediation Report from Agra Earth & Environmental indicating that the environmental concerns outlined in the Agra Report of December 13, 1995 have been remediated in accordance with MOE guidelines.

76 Thus, before it can be considered a binding contract, the two conditions must have been either satisfied or waived. And the finding of an enforceable equitable mortgage on Parcel One is dependent on satisfaction or waiver prior to April 1, 1999.

77 On the record before this court, there is no evidence of compliance with or waiver of the two conditions prior to the date of amalgamation. As a result, RBC does not have a valid and enforceable equitable mortgage on Parcel One.

78 I conclude with the following observations. Had the conditions precedent been satisfied or waived prior to April 1, 1999, I would have concluded that the MCA gave rise to a valid equitable mortgage for $2,300,000 on Parcel One. But for the conditions, the MCA evidenced a common intention to secure property, which was supported by the valuable consideration of the exchange of promises between RBC and 1156712 regarding the security of that property and the future advance of $2,300,000.

79 In that context, the equitable mortgage would not have been in violation of the *Planning Act*, because it would have arisen prior to amalgamation. As already discussed, this is a key factual difference between this case and *Scherer v. Price Waterhouse*.

80 In addition, the equitable mortgage would have been enforceable in priority to BMO's GSA. This is because, as already discussed, BMO acquired its legal charge with notice of RBC's mortgage financing. In this context, it makes no difference that BMO was not aware of the equitable mortgage, given its knowledge of the registered, albeit invalid, mortgage. As a result, and in accordance with the third rule of priorities already described, the equitable mortgage would rank in priority to BMO's subsequent legal interest.

81 If that were the case, RBC would be entitled to that portion of the $1,670,000 realized upon the sale of 655/755 Crawford Avenue that can be attributed to Parcel One. This would not, as the motion judge feared, "result in a change in ownership [to Parcel One], the very thing the *Planning Act* seeks to prevent or at least, regulate."

III. Net Rental Proceeds

82 In addition to the money it collected from the sale of the property, the Interim Receiver also collected money in rental proceeds from Parcel One.

83 As noted by the motion judge, RBC was granted an Assignment of Rents by Properties, which was registered under both the *PPSA* and the *Land Titles Act*. RBC registered two Financing Change Statements under the *PPSA*. The first was dated April 7, 1998 and referred to an assignment of rents in respect of Parcel One. The second, dated August 31, 2000, referred to a general and specific assignment of rents.

84 RBC conceded before the motion judge that the registration of the Assignment of Rents under the *Land Titles Act* was also void because of the *Planning Act* breach. It argued, however, that the registration under the *PPSA* remained valid and binding and took priority over any subsequent *PPSA* registrations, including those of BMO.

85 I agree with the motion judge's conclusion that the *PPSA* registrations are not inextricably bound to the Assignment of Rents. They are capable of existing independently, such that their valid registrations take priority over BMO's GSA registered under the *PPSA* in 2001. The *PPSA* registrations and the Assignment of Rents evidence an interest in an income stream and, as a result, are not dependent on the validity of the underlying registration against title to the lands. RBC is entitled to the net rental proceeds.

Disposition

86 In the result, the appeal is dismissed and the cross-appeal is dismissed. Counsel agree that the successful party on the appeal should have costs fixed in the sum of $10,000 and, on the cross-appeal, in the sum of $5000.

87 Accordingly, RBC is entitled to costs of the appeal fixed in the sum of $10,000 and BMO is entitled to costs of the cross-appeal fixed in the sum of $5000. Both figures are inclusive of disbursements and G.S.T.

***O'Connor J.A.*:**

I agree.

***Doherty J.A.*:**

I agree.

Appeal dismissed.

End of Document

TAB 9

1986 CarswellAlta 388
Alberta Court of Queen's Bench

Bank of Montreal v. Wolchansky

1986 CarswellAlta 388, [1986] A.J. No. 1038, [1987] A.W.L.D. 017, [1987] C.L.D. 038, 2 A.C.W.S. (3d) 225, 74 A.R. 144

Bank of Montreal Plaintiff v. Victor Wolchansky, Doane Raymond Limited, Trustee of the Property of Victor Wolchansky, The Royal Bank of Canada, North West Trust Company and Settlers Savings and Mortgage Corporation Defendants

M. Funduk, Master [In Chambers]

Judgment: November 25, 1986
Docket: Doc. Edmonton 8603-05653

Counsel: *Durocher Maccagno*, Counsel for the Plaintiff.
E. Johnson, Q.C. Koshman and Johnson, Counsel for Settlers Savings & Mortgage Corporation.
J.M. Culkin Berzins and Co., Counsel for the Royal Bank of Canada.

Subject: Corporate and Commercial
Related Abridgment Classifications
Real property
VIII Mortgages
VIII.14 Priorities
VIII.14.c Determining priorities between types of creditors
VIII.14.c.vi Mortgagee and execution creditor

Headnote

Mortgages — Priorities — Between types of creditors — Mortgagee and execution creditor

Debtor executing document in favour of bank whereby title deeds and certificates of title given to bank to secure current and future indebtedness of debtor -- Debtor owing income tax to federal Crown and arranging for bank to execute guarantee for outstanding amount of taxes -- Subsequently, three creditors filing writs of execution against debtor's lands -- Following demand by Crown for payment of income tax debt, bank paying outstanding amount -- Bank filing caveat against debtor's lands, claiming to be equitable mortgagee -- Debtor making assignment in bankruptcy and bank commencing action for declaration that its equitable mortgage taking priority over writs of execution -- Declaration granted -- Hypothecation agreement constituting equitable mortgage for any indebtedness owing by debtor to bank -- When bank giving guarantee to Crown, debtor already indebted to Crown and bank becoming bound to Crown as additional party -- Accordingly, liability of bank to Crown arising before writs of execution registered -- Bank's claim against debtor for amount of payment to Crown constituting claim for liquidated debt within context of equitable mortgage.

Priorities — Tacking.

The defendant V.W. entered into a hypothecation agreement in favour of the plaintiff bank covering certain lands and accompanied by delivery of the duplicate certificates of title. At the time of making the hypothecation agreement there were no debts or other liabilities owed by V.W. to the plaintiff. V.W. became indebted to Revenue Canada for income tax and later requested the plaintiff to issue a guarantee for the debt to Revenue Canada. The plaintiff gave the guarantee to the Crown in which the plaintiff became liable to make payments to the Receiver General upon demand. The defendant trust company, mortgage corporation and another bank subsequently filed at the land titles offices writs of execution against V.W. Later, the Crown made a demand on the plaintiff. The plaintiff complied and then filed a caveat against the lands claiming an equitable mortgage based on the payment to Revenue Canada. V.W. subsequently went bankrupt. The plaintiff sought a declaration that its equitable mortgage had priority over the writs of execution. *Held*, equitable mortgage having priority. The defendants did not rely on the land title register in suing V.W. and obtaining judgments. The fact that the writs were registered before the caveat protecting the equitable mortgage was filed did not advance the execution creditors' position, as the advances by the plaintiff fell within the scope of the prior hypothecation agreement. Although the definition of encumbrance under the Land Titles Act includes any charge on land inclusive of mortgage and executions against land, a mortgage and a writ of execution are not thereby deemed to be the same and the Act does not advance execution creditors to positions of priority over prior interests or claims. The hypothecation agreement constituted an equitable mortgage for any indebtedness owing by V.W. to the plaintiff from time to time and a possible liability to the Crown arose before the writs were filed. The advances made when the plaintiff paid the Crown were involuntary because of the pre-existing obligation under the guarantee. Therefore, the principle of tacking, allowing a mortgagee to tack a later payment to a mortgage for priority purposes, applied, and any notice of the writs that the plaintiff had when it made payment to the Crown was irrelevant.

Reasons for Decision of *M. Funduk*, Master [In Chambers]:

1 This is a dispute between the Plaintiff and two execution creditors of the Defendant Wolchansky.

2 On October 22, 1980 Wolchansky executed a document, in favour of the Plaintiff, which says:

> Herewith I hand you Title Deeds and Certificates of Title covering:
>
> (legal description)
>
> These documents are delivered to you as security for my present indebtedness, both direct and indirect, either individually or jointly with any other person, and I hereby charge the above described property with payment of said indebtedness and interest thereon. They are also delivered as security for any new advance I may obtain in the future, and I hereby charge the said property for any indebtedness I may have at the Bank of Montreal from time to time. No surrender of the said documents to any Registrar of Land Titles or any person other than myself or some person on my behalf shall operate as a discharge, release or waiver of this security.
>
> IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal the day and year above written.

3 Counsel for the Plaintiff concedes that at the time of the agreement there were no debts or other liabilities by Wolchansky to the Plaintiff.

4 Wolchansky was indebted to Her Majesty for income tax. By a written request to the Plaintiff, dated April 30, 1984 he asked:

> The undersigned requests the Bank of Montreal to issue on its (his/her) behalf a Guarantee for $38,966.68 in favour of the Receiver General for Canada, for the payment of arrears of Income Tax, (penalties) and (interest) claimed by the Minister of National Revenue, a copy of which appears on the reverse side hereof; in consideration of the Bank of Montreal issuing such Guarantee, the undersigned agrees to reimburse the Bank in respect of any payment or payments that it may be called upon to make in implementation of the said Guarantee.

5 On the same date the Plaintiff gave a guarantee to the Crown in which the Plaintiff does:

> ...covenant, promise and agree as follows:
>
> > 1. We hereby unconditionally and irrevocably guarantee that the taxpayer will pay on account of the said indebtedness to the Receiver General for Canada the sum of Dollars ($38,966.68) plus interest.
> >
> > 2. We undertake to pay the guaranteed amount ... after receipt by us, before the expiration of the period referred to in paragraph 4, of a written demand...
> >
> > . . . .
> >
> > 4. This Guarantee expires on the 11th day of May, 1985...
> >
> > . . . .
> >
> > 8. Our total liability hereunder shall not exceed the sum of $41,074.57...

6 On December 7, 1984 North West filed a writ of execution against Wolchansky, followed by Settlers on December 10, 1984 and by the Royal Bank on April 25, 1985.

7 By a letter dated May 7, 1985 the Crown made demand on the Plaintiff for $38,966.68 and interest.

8 By a letter dated May 15, 1985 the Plaintiff paid $41,074.57 to the Crown.

9 On May 16, 1985 the Plaintiff filed a caveat against the lands claiming to be an equitable mortgagee for $41,074.57.

10 In December 1985 Wolchanski made an assignment into bankruptcy.

11 This action was started in March 1986.

12 The three execution creditors were added as defendants to the action by order of the Court, and in its amended statement of claim the Plaintiff asks, as against them, for a declaration that its "equitable mortgage" is prior to the writs of execution.

Registration

13 The effect of the registration of a writ of execution at Land Titles is spelled out in section 122(2) of the Land Titles Act, which provides:

(2) On and after the receipt by the Registrar of the copy of the writ,

(a) all legal and equitable interests of the execution debtor in any land there or thereafter registered in his name and including his interest, if any, as an unpaid vendor of the land, are bound by the execution, and

(b) no certificate of title shall be granted and no transfer, mortgage encumbrance lease or other instrument executed by the execution debtor of the land is effectual except subject to the rights of the execution creditor under the writ while it is legally in force,

and the Registrar, on granting a certificate of title and on registering any transfer, mortgage or other instrument executed by the debtor affecting the land, shall by memorandum on the certificate of title in the register and on the duplicate issued by him, express that the certificate, transfer, mortgage, or other instrument is subject to those rights.

14 Counsel for the Plaintiff cited *Price v. Materials Testing Laboratories*, [1976] 5 W.W.R. 280 (Alta S.C.); *Sterk v. Madison Development Corporation*, 39 Alta. L.R. (2d) 78 (Q.B.); *Kingsway Electric v. 330604 Ontario*, 11 R.P.R. 96 (Ont. S.C.); *Re Sheriff of Newfoundland*, 40 C.B.R. (ns) 149 (Nfld S.C.T.D.).

15 In *Price* Laycraft J. points out that execution creditors do not rely on the register. He states at pp. 284-85, after referring to *Jellett v. Wilkie*;

...He pointed out that an execution creditor is not a bona fide purchaser; that is he is not one who relied on the register. As Freedman J.A. later expressed it in *Dominion Lumber Winnipeg Ltd. v. Winnipeg District Registrar* [1963], 41 W.W.R. 343 at 347, 37 D.L.R. (2d) 283 (Man. C.A.):

...the registration of such certificates, liens or charges in the land titles office need not, and often does not, proceed from reliance upon the register. The act of a creditor who makes such registration in the hope that it will attach upon land which may already by owned or which may later be acquired by his debtor is not on the same level as, or to be equated with, the act of one who purchases land, or lends money by way of mortgage thereon, on the faith of the register.

16 As a matter of plain logic it cannot be said that the three execution creditors here relied on the register in suing Wolchansky, getting judgments against him and then registering writs of execution. In fact, only one of the writs of execution was endorsed against one of the titles, and also in the general register, and the other two writs were registered only in the general register.

17 In my view, the fact the writs were registered before the caveat was filed does not advance the execution creditor's position if the advance made by the Plaintiff falls within the scope of the agreement.

18 An execution creditor's position, as against persons who have recognizable claims relating to the land which arose before the writs were registered, is no better than the position of the execution debtor. As against prior interests and claims the execution creditor is in the shoes of the execution debtor, regardless whether or not the prior interests and claims were registered.

19 *Price* holds that *Jellett* is still the law in Alberta. Both decisions involve a dispute between a purchaser of the land, who failed to register anything, and an execution creditor of the vendor. Here the dispute is between an equitable mortgagee and execution creditors of the mortgagor.

20 However, *Jellett* clearly indicates that an execution creditor's position against other classes of prior interests and claims is still the same, unless the legislation changes that.

21 In delivering the judgment of the Court the Chief Justice states at pp. 288-89:

> By the North-west Territories Act the law of England as it existed on the 15th of July, 1870, so far as it has not been altered or varied by competent legislative authority is, by the 11th section of the Act, made the rule of decision in those territories.
>
> No proposition of law can be more amply supported by authority than that which the respondents invoke as the basis of the judgment under appeal, namely, that an execution creditor can only sell the property of his debtor subject to all such charges, liens and equities as the same was subject to in the hands of his debtor. In a dissenting opinion delivered in the case of *Miller v. Duggan*, I brought together a number of authorities bearing on this point. I may here refer to the following cases as conclusively establishing the principle in question, viz: *Eyre v. McDowell; Beaven v. Lord Oxford; Whitworth v. Gaugain; Kimderley v. Jervis; Benham v. Keane; Wickham v. The New Brunswick Railway Co.; Watts v. Porter; Langton v. Horton; McMaster v. Phipps*; and *Strong v. Lewis*.

22 The Alberta Act continued "all laws and all orders and regulations" of the Northwest Territories' legislators, subject to whatever the Alberta Legislature might later do.

23 I believe it can be safely taken that the passage of the first Alberta Land Titles Act disposed of any land titles laws passed by the Northwest Territories, with the end result that it becomes a question whether the Alberta legislation alters the proposition enunciated by the Chief Justice.

24 The land registry act considered in *Jellett* provided in part:

> .94 Every sheriff or other officer charged with the execution thereof shall after the delivery to him of any writ or process affecting land or lien, mortgage or encumbrance or other interest there in deliver a copy of every such writ or process so in his hands or that may thereafter be delivered to him, certified under his hands, together with a memorandum in writing of the lands intended to be charged thereby, to the registrar within whose district such lands are situate, and no land shall be bound by any such writ or other process unless such copy and memorandum have been so delivered; and the registrar shall thereupon, if the title has been registered, or so soon as the title has been registered under the provisions of this Act, enter a memorandum thereof in the register; and from and after the delivery of a copy of any such writ or other process and memorandum to the registrar the same shall operate as a caveat against the transfer by the owner of the land mentioned in such memorandum or of any interest he has therein, and no transfer shall be made by him of such land or interest therein except subject to such writ or other process.

25 In commenting on that section the Chief Justice states, at pp. 290-92:

> *...According to the ordinary rules of courts of equity the appellant could have made his execution a charge on, and have sold for the satisfaction of his judgment, just what beneficial interest the execution debtor had in these lands and nothing more. And this, which is said to be a "broad rule of justice"* and to depend, as is well pointed out by Wood V.C. in *Benham*

v. Kenne, upon the obvious distinction between a purchaser who pays his money relying on getting the specific land he buys and a creditor who is in no such position, *was from early times enforced by courts of equity in order to protect the title of equitable owners and charges*. And it must have been the obvious right of the respondents to have the benefit of this protection in the way in which the judgment now impugned afforded it to them, unless the statute has abrogated the principle.

Had there been no difference of opinion I should have thought that there could be no reasonable ground for the pretense of the appellant that this 94th section gives him any priority.

The construction of it seems to me to be obviously plain. The effect to be given to the entry on the register to the memorandum of the writ of execution is clearly and precisely stated in the section itself to be to operate as a caveat or warning to persons who might subsequently purchase or be about to purchase from the execution debtor, that he could only sell or transfer an interest subject to the lien of the writ. This in so many words is what Parliament has declared to be the effect and consequence of the registering of an execution. *Surely there is nothing in this abrogating or pointing to the abrogation of prior interests. It follows therefore that the rights of prior parties remain as they were before the execution was registered*, and these entitled the respondents to have their transfers registered without any reference being made in the certificate to the execution, and to have the sheriff's sale restrained. I have been through all the sections of the amended Lands Act, and I find nothing abridging the equitable rights of the respondents as they stood when the statute was passed. So far from equities being shut out there are numerous indications, as pointed out in Mr. Justice Maguire's judgment, that it was the intention to conserve them particularly the right to specific performance which applies here to Erratt's case is conserved. As regards authority the *National Bank v. Morrow*, appears to me directly in point. In that case the Supreme Court of Victoria held that an unregistered equitable mortgagee was entitled to priority over a registered execution, and not only over the execution creditor but also over a purchaser from the sheriff under the execution but whose transfer had not been registered.

The 106th section of the Victoria Act is substantially identical with section 94 of the amended Lands Act, the object of both being, not to give the execution creditor any superiority of title over prior unregistered transferees, but merely to protect the land against intermediate sales and dispositions by the execution debtor....

(emphasis mine)

26 A different result was arrived at by the same Court in *Bank of Hamilton v. Hartery*, [1917-19] 58 S.C.R. 338. However, the result was dictated as it had to be, by the relevant British Columbia legislation.

27 In *Bank of Hamilton* the owner had given a mortgage prior to a judgment against him being registered at the land registry. The mortgage was registered after the judgment. The Court held that the judgment was prior to the mortgage.

28 The result was dictated by a combination of section 27 of the Execution Act and sections 2 and 73 of the Land Registry Act.

29 Section 27 provided in part:

(1) Immediately upon any judgment being entered or recovered in this Province, such judgment may be registered in any or all of the Land Registry Offices in the Province, *and from the time of registering the same the said judgment shall form a lien and charge on all the lands of the judgment debtor* in several land registry districts in which such judgment is registered, *in the same manner as if charged in writing by the judgment debtor under his hand and seal*; and after the registering of such judgment the judgment creditor may, if he wish to do so, forthwith proceed upon the lien and charge thereby created.

(emphasis mine)

30 Section 2 provided that:

"Charge" means and shall include any less estate than an absolute fee, or any equitable interest whatever in real estate, and shall include any incumbrance, Crown debt, judgment, mortgage, or claim to or upon any real estate:

31 Section 73 provided that:

> When two or more charges appear entered upon the register affecting the same land, the charges shall, as between themselves, have priority according to the dates at which the applications respectively were made, and not according to the dates of the creation of the estates or interests.

32 The Chief Justice states at p. 339:

> -I think the judgment appealed from correctly interprets the meaning of section 73 of the "Land Registry Act" of British Columbia on which this appeal depends. That section gives priority to charges according to date of their registration, not of their execution. As put by Mr. Justice Martin, could there possibly be any doubt as to the meaning and effect of that section in a dispute between two charges of the same kind, e.g., mortgages, or as to the priority that ought to be declared between them? I think not, and am unable to see how a contrary conclusion could be reached as to charges of a different kind.
>
> I agree with the Chief Justice that the cases relied upon by Mr. Justice McPhillips, *Entwisle v. Lenz* and *Jellett v. Wilkie*, do not govern or apply to the case before us, which is simply one is to the priority of charges under section 73 of the "Land Registry Act" and the rule which should govern in a contest on that point and is not one as between an equitable right to the fee as against a charge.

33 Anglin J. states at pp. 345-46:

> But the case now before us may, I think, be disposed of under section 27 of the "Execution Act" and section 73 of the "Land Registry Act" without actually overruling *Entwistle v. Lenz*, by merely declining to apply it to facts not absolutely identical with those there dealt with. Even if some estate or interest was created in the debtor's land by the appellant's unregistered mortgage upon its execution, as against another chargee who had registered his charge before that mortgage was registered, the interest or estate so created could not avail. Section 73 in terms so provides, unless it be entirely meaningless. As Mr. Justice Martin says:-
>
>> If this were a case between two charges of the same kind, e.g. mortgages, would there be any doubt as to the priority that ought to be declared?
>
> But by section 27 of the "Execution Act" the lien created by a judgment when registered is the same as if such judgment had been
>
>> charged in writing by the judgment debtor under his hand and seal.
>
> i.e., *is the same as the lien created by a registered mortgage*. Reading these two statutory provisions together, as they must be read, I entertain no doubt that the judgment appealed from is correct and should be upheld.
>
> (emphasis mine)

34 Brodeur J. states at pp. 347-48:

> But it is contended by the appellant that a judgment can affect only the interest which the judgment debtor actually had in the lands, relying, in that respect, on a judgment rendered in this court in the case of *Jellett v. Wilkie*.
>
> In that case of Jellett, Sir Henry Strong C.J. stated that the common law rule is that
>
>> an execution creditor can only sell the property of his debtor subject to all such charges, liens and equities as the same was subject to in the hands of his debtor;
>
> and he adds that this law has become the law in the North West Territories

unless it has been displaced by some statutory provision to the contrary.

The provisions of the "Land Registry Act" which I have quoted above shew conclusively that *the registration of the mortgage and of the judgment creates two charges upon the land; that those charges are to be treated alike*; and there is no distinction made in that statute with regard to the beneficial interest of the judgment debtor or not as it was under the common law. *The statute has superseded the old rule* and the priority of the charge is to be determined by the dates at which they are registered.

(emphasis mine)

35 Has the Alberta Land Titles Act "superseded the old rule"? In my view it has not.

36 The execution creditors might draw some comfort from what was said by Laycraft J. in *Price*, at p. 287:

Upon facts similar to those in *Jellett v. Wilkie*, the decision in Bank of *Hamilton v. Hartery* reached the opposite conclusion. The writs of execution subsequent in time to the equitable interests but registered first were given priority. The legislation interpreted, however, had a notable difference as to the effect of a writ of execution from that interpreted in *Jellett v. Wilkie*. In the Bank of Hamilton case a writ operated as a charge on the land; a mortgage was also defined as a charge, *and it was further provided that where two charge conflict, priority would be determined by registration and not by the dates of the charges*. In *Jellett v. Wilkie*, on the other hand, under s. 94 of the Territories Real Property Act the writ of execution had the effect of a caveat. The change to a provision more closely resembling the present s. 128 was made in 1894 (c. 28, s. 92). *Jellett v. Wilkie* was not expressly overruled by the Bank of Hamilton case...

(emphasis mine)

37 In my view that cannot be used to treat a mortgage and a writ of execution alike, for priority purposes, under the Land Titles Act.

38 Section 1(f) of the Act states that "encumbrance means any charge on land ... inclusive of mortgage ... and executions against land..."

39 That definition does not mean that a mortgage and a writ of execution are deemed to be the same.

40 Section 1(1) defines "instrument" to mean, among other things a "mortgage or encumbrance".

41 Section 16(5) says:

For purposes of priority between mortgagees, transferees and others, the serial number assigned to the instrument or caveat shall determine the priority of the instrument or caveat filed or registered.

42 Those definitions and the subsection cannot be treated as analogous to the legislation in *Bank of Hamilton*. Whatever the effect of subsection (5) is, it does not advance execution creditors to positions of priority over prior interests or claims. If it did the result in *Price* would have been the opposite.

43 The critical section is section 122, and it does not displace the general equitable rule laid out in *Jellett*.

44 In *Price* Laycraft J. states at pp. 285-86:

One change was made by the Legislature to the sections of the statute dealing with writs of execution. In 1917 s. 77 of The Land Titles Act which was similar to s. 94 of the Territories Real Property Act quoted above was amended [1917, c. 3, s. 5] by adding the words:

> ...and upon and from the receipt by the registrar of such copy all lands and interests in lands whether such interests be legal or equitable and any interests of an unpaid vendor of land shall be bound by such execution.

In my view this addition to the section is an express recognition by the Legislature of the principle of *Jellett v. Wilkie*. The amendment states the effect of filing the writ; it contains within it a recognition of the existence of equitable interests in land. ...

45 The amendment has been carried forward into the present section 122(2)(a), so it still recognizes *Jellett*.

46 The same result was also arrived at by Veit J. in *Sterk*. In that case the owner had given an equitable mortgage, which was not caveated, prior to a writ of execution being registered. Veit J. states at p. 82:

> ...This dispute must be characterized as one relating to the rights of the execution creditor versus the rights of the equitable mortgagee. As has been stated in much of the jurisprudence, the Torrens system has created a code relating to rights in real property and much of our common law theory relating to such matters as mortgages must be abondoned in favour of the statutory right.
>
> According to s. 123 of the Land Titles Act, an execution creditor is specifically limited to those legal and equitable interests held by the registered owner at the time of the filing of the writ of execution. By statute, the equitable mortgage must be recognized by the execution creditor; this is diametrically opposed to the situation relating to the mortgagee who is specifically required under Alberta legislation to proceed by way of a foreclosure to obtain the transfer or possession of mortgaged property if there is an issue which arises in that context.
>
> It is perhaps anomalous that equitable rights are specifically recognized in connection with writs of execution under a system in which it might have been supposed that in order to be effective any interest must be registered. However, it is not our position to determine legislative policy but merely to interpret the legislation as it stands.

47 Without more, the writs of execution do not take priority to the Plaintiff's claim based on the hypothecation agreement.

48 "Whatever in law it [a writ of execution] catches, why, it just catches and what it does not catch, it does not catch, that is all":

49 Stuart J. in *Marshall Wells Alta. v. Alliance Trust*, [1920] 1 W.W.R. 907 at 911.

Equitable Mortgage

50 I am satisfied that the hypothecation agreement constitutes an equitable mortgage for any "indebtedness" owing by Wolchansky to the Plaintiff from time to time. In *The Royal Bank of Canada v. Donsdale Construction*, (Edmonton Q. B. 8203-42399, November 13, 1986) Andrekson J. states in part:

> It has been recognized in Alberta that a deposit of a Certificate of Title as security for a loan constitutes and equitable mortgage, notwithstanding provisions in the applicable Land Titles Act which state that "no instrument until registered under this Act shall be effectual to pass any estate or interest in any land". *Fialkowski v. Fialkowski* and Traders Bank of Canada [1911] 1 W.W.R. 216 (Alta. S.C.); *The Royal Bank of Canada v. Waclaw Filipek*, also known as Walter Filipek and Hilda R. Filipek, May 6, 1983 unreported decision of Mr. Funduk, Master in Chambers; *The Royal Bank of Canada v. Grobman et al* (1977) 18 O.R. (2d) 636 (Ont. H.C.).

51 The uncontradicted evidence of Alan Cosford, on behalf of the Plaintiff, is that Wolchansky did deliver the duplicate certificates of title to the Plaintiff when the hypothecation agreement was entered into.

Advance

52 Counsel for the Plaintiff submits that it advanced the $41,074.57 to or on behalf of Wolchansky on the date it gave the guarantee to the Crown. That date precedes the dates the writs of execution were registered.

53 I do not agree.

54 On the date the Plaintiff gave the guarantee Wolchansky was indebted to the Crown. What happened when the Plaintiff gave the guarantee is that is became bound to the Crown as an additional party.

55 Rowlatt on the Law of Principal and Surety (4th ed.) states at pp. 2-3:

> The liability of a surety is often spoken of as a liability to pay "if the principal does not." This does not mean that his liability is necessarily only conditionally enforceable but merely that it is collateral. Being collateral the liability of a surety is in substance from the surety's point of view certainly contingent, because if the principal pays, the debt is satisfied, and the surety is free. What is contemplated is that the principal shall pay. This may be so, although the undertaking of the surety is as absolute as that of the principal. To say, therefore, that a debtor is surety only does not necessarily imply more than that he has become bound as an additional party, and only as security for another, the principal debtor, who alone has enjoyed or is to enjoy the consideration, and upon the terms, express or implied, of being indemnified by him. The rights which a surety can claim at the hands of a creditor depend not upon any term in the contract between them but upon an equity arising out of the knowledge of the creditor of the relation between the surety debtor and the principal debtor, which binds him to respect, subject to his own right to exact payment from either, the right of the surety to have the money found by the principal.

56 To accept the submission would mean that in law every guarantor would be considered to have made a loan to the debtor when he, the guarantor, gave the guarantee.

57 As a fact that is not tenable. No money in fact passes from the guarantor to the debtor or to the creditor on the debtor's behalf. If the debtor fulfills his obligations to his creditor no money will need to be paid by the guarantor to anyone.

58 The co-extensive liability by a guarantor to a creditor cannot in law be deemed to be a payment by the guarantor to or on behalf of the debtor *when the guarantee is given.*

59 In this case the advance was in fact made when the Plaintiff paid the Crown.

60 *Kingsway Electric* does not assist the Plaintiff on this point.

61 In *Kingsway Electric* the facts, much simplified, are that the plaintiff gave an irrevocable letter of credit to Western to accommodate Grand Banks. Kondo gave a first mortgage to the plaintiff to protect it on its liability on the letter of credit. A second mortgage was registered. Western later made demand on the plaintiff pursuant to the letter of credit, and the plaintiff paid Western. The dispute was as to priorities *between the two mortgagees.*

62 The Court held the plaintiff had priority. There are two planks for the decision. The first is section 72 of the Registry Act which provided:

> 72 A registered mortgage is, as against the mortgagor, his heirs, executors, administrators, assigns and every other person claiming by, through or under him, a security upon the land comprised therein to the extent of the money or money's worth actually advanced or supplied under the mortgage, not exceeding the amount for which the mortgage is expressed to be a security, notwithstanding that the money or money's worth, or some part thereof, was advanced or supplied after the registration of a conveyance, mortgage or other instrument affecting the mortgaged land, executed by the mortgagor, his heirs, executors or administrators, and registered subsequently to the first-mentioned mortgage, unless before advancing or supplying the money or money's worth, the mortgagee in the first-mentioned mortgage had actual notice of the execution and registration of such conveyance, mortgage or other instrument, and the registration of such conveyance, mortgage or other instrument after the registration of the first-mentioned mortgage, does not constitute actual notice.

63 The Court decided that the giving of the letter of credit was "money's worth" and that the notice provision was not relevant because the Plaintiff had to advance the money because of the pre-existing obligation.

64 Lovekin L.J.S.C. states at p. 99

> The position advanced by counsel on behalf of the second mortgagee in time, namely the Guaranty Trust Company of Canada, is that under s. 72 of The Registry Act, R.S.O. 1970, c. 409, no moneys having been advanced by the Toronto-Dominion Bank prior to receiving actual notice of the second mortgage, no priority can be claimed for moneys advanced by the Toronto-Dominion Bank after they were fixed with actual notice of registration of the second mortgage. This, in simple terms, reverses the priority of the mortgages established by time of registration. Thus moneys secured by a mortgage registered first chronologically become second in priority; a situation that is acceptable where the first mortgagee is free to advance funds or not to advance funds. The question posed herein is whether s. 72 must be construed so that the result is the same where the first mortgagee has no choice but to advance funds on demand.

65 He also states at p. 101:

> The key issue herein, then, is whether an irrevocable letter of credit can be deemed to be money's worth actually advanced or supplied within the meaning of s. 72 of The Registry Act and therefore a priority fund.

66 That is a matter of interpretation of statute and is of no assistance to the Plaintiff.

67 There is nothing comparable in the Alberta Land Titles Act. The closest is section 106.1(1), which cannot apply here. Leaving aside any question of registration of the mortgage, the hypothecation agreement is not for a "specific principal sum". Section 106.1(1) cannot assist mortgagees who have mortgages for all "past, present and future liabilities" of the mortgagor to the mortgagee.

68 However, that does not conclude the matter in favour of the execution creditors.

Tacking

69 The tacking I refer to here is the ability of the mortgagee to tack a later payment to the mortgage for priority purposes.

70 *Kingsway Electric* does go on to say that section 72 is a "statutory embodiment of common law practice found in jurisprudence concerning the common law practice of tacking". Whether it is or not, is irrelevant to the issue before me.

71 However, the Court does go on to then consider the issue before it on the basis of tacking. It states at pp. 103-105:

> ...The starting point, which in itself contains the seeds of subsequent misinterpretation, may be taken as *Hopkinson v. Rolt* (1861), 9 H.L. Cas. 514, 11 E.R. 829. The words of the Lord Chancellor (Lord Campbell) at p. 833 are as true today as they were then:
>
> > My Lords, this appeal raises a question of great importance to bankers, and to the mercantile interests of the country.
>
> The question raised is defined in that case, also in the Lord Chancellor's judgment:
>
> > I think the question is accurately as well as tersely stated by Lord Chancellor Chelmsford in the judgment appealed against. 'A prior mortgage for present and future advances; a subsequent mortgage of the same description; each mortgagee has notice of the other's deeds; advances are made by the prior mortgagee after the date of the subsequent mortgage, and with full knowledge of it; is the prior mortgagee entitled to priority for these advances over the antecedent advance made by the subsequent mortgagee?
>
> The issue is therefore defined with crystal clarity in 1861 with only one component missing. In my respectful opinion it deals only with voluntary advances and not with involuntary advances. Had it dealt with involuntary advances as well as voluntary advances the question now sought to be determined would have been settled in 1861. All the Canadian authorities that appear to be of assistance are British Columbia authorities. The oldest authority, which considers and distinguishes the Rolt decision in the House of Lords, is *Royal Bank v. Doering*, 33 B.C.R. 257, [1924] 1 W.W.R. 251, [1924] 1 D.L.R. 488

(S.C., Macdonald J., 27 December 1923). This decision is authority for the proposition that there is a distinction between advances voluntarily made after notice of a second mortgage and advances involuntarily made upon a liability already contingent at the time of execution of the second mortgage.

In the Doering case, Macdonald J. comments on *Hopkinson v. Rolt*, supra, and finds as follows at pp. 492 and 493 [D.L.R.]:

> In my opinion ... the principle of *Hopkinson v. Rolt* is, ... inapplicable.

The most recent authority on point appears to be *Spence v. Graham* (1978), 9 B.C.L.R. 161, 7 R.P.R. 297, 95 D.L.R. (3d) 163 (per Taylor J., S.C., November 27, 1978) where the learned Judge cites *I.W.A. Credit Union v. Johnson* (1978), 6 B.C.L.R. 271, 4 R.P.R. 181 (S.C.). These decisions serve to illustrate that the principle in the Hopkinson decision is not as all embracing or definitive as it has been thought to be in some circles.

The Toronto-Dominion Bank could not have had actual or constructive notice of the second mortgage herein when it put the money irrevocably pledged by the letter of credit at risk, which was the very moment of the issuance of the letter of credit. It therefore follows that as first or prior mortgagee they may claim priority up to the face amount of their mortgage over funds advanced by the second mortgagee.

In the I.W.A. case, supra, Hinds Co. Ct. J. says [B.C.L.R. at p. 276]:

> The majority decisions recognized that if unrestricted tacking were permitted no unfair hardship would be visited upon the second mortgagee who obtained his security with notice of the first mortgage but the unfair prejudice could result to the mortgagor. If the first mortgage was made to secure advances which could be made or withheld, at the option of the first mortgagee, it would place a serious constraint upon the mortgagor in raising money on his equity of redemption.

I do not have any objection to that logic, but the particular facts of the case at Bar take it out of the exception. There is no hardship to the mortgagor when the mortgage is given to secure the collateral irrevocable letter of credit, for the first mortgagee does not have the option to make or withhold the advances which in this case are payments required to be made on demand without option under the letter of credit. The mortgagor knows his line of credit and does not need to raise money on his equity of redemption. Indeed, all parties involved in transactions such at this should know precisely what their position is at all times if the distinction between voluntary and involuntary advances is clarified.

72 In *Sterk* the Court also applied tacking as against the execution creditors. The facts in that case are as follows.

In March 1983 the owner hypothecated his titles to his solicitor for all present and future indebtedness for legal fees. In October 1983 a writ of execution was registered. In November 1983 the solicitor registered a caveat.

Veit J. states at p. 83:

> There was no discussion by counsel of the survival of the doctrine of tacking under the Torrens system. Although this might have been a very thorny issue *in another type of situation*, given the explicit language of s. 123 of the Land Titles Act, I am of the view that that section also recognizes the equitable right of tacking and, therefore, that the agreement of March 1983 was effective with respect to future accounts for law work.
>
> (emphasis mine)

The emphasized part leaves it to another day whether tacking can apply when the contest is between a mortgagee and someone other than an execution creditor of the mortgagor. In such a case section 106.1(1) might play a part.

The liability of the Plaintiff to the Crown arose before the writs of execution were registered. The payment by the Plaintiff to the Crown was involuntary because the Plaintiff was under a legal obligation to pay if demand was made. I would adopt the approach in *Kingsway Electric* on this point and hold that the deemed notice the Plaintiff had, when it made the payment to the Crown, of the writs of execution is irrelevant. The Plaintiff did not have a choice whether or not it would pay the Crown. It had to regardless of the writs of execution.

73 The issue comes down to whether or not the Plaintiff can, *as against Wolchansky*, use the mortgage to recover what it paid to the Crown. In other words, as between the Plaintiff and Wolchansky does the payment fall within the scope of the mortgage? If it does the Plaintiff is then, as against the execution creditors entitled to tack the payment to the mortgage because the execution creditors are in the same position as Wolchansky as against the Plaintiff.

74 The intention of the Plaintiff and Wolchansky is to be gathered from the terms of the equitable mortgage. Wolchansky charges the land "for any indebtedness" he may have from time to time with the Plaintiff.

75 The amount that the Plaintiff would claim against Wolchansky would be whatever amount it paid to the Crown. The amount claimed against Wolchansky would be a liquidated amount, based on Wolchansky's promise to "reimburse" the Plaintiff for any payment it might make based on the guarantee. The promise to reimburse is found in the April 30, 1984 request by him to the Plaintiff for the issuance of the guarantee.

76 "Debt" is latin for debitum, which is a sum of money due by one person to another.

77 Jowitt's Dictionary of English Law states:

> An action of debt lay where a person claimed the recovery of a liquidated or certain sum of money affirmed to be due to him; it was generally founded on some contract alleged to have taken place between the parties, or on some matter of fact from which the law would imply a contract between them. This was debt in the debet, which was the principal and only common form. There is another species mentioned in the books, called debt in the detinet, which lay for the specific recovery of goods, under a contract to deliver them. An action of debt as a technical term is now obsolete. See PLEADINGS.
>
> A debt exists when a certain sum of money is owing from one person (the debtor) to another (the creditor). Hence "debt" is properly opposed to unliquidated damages (see DAMAGES); to liabilitiy, when used in the sense of an inchoate or contingent debt; and to certain obligations not enforceable by ordinary process (see OBLIGATION). "Debt" denotes not only the obligation of the debtor to pay, but also the right of the creditor to receive and enforce payment

78 The Plaintiff's claim against Wolchansky, being a claim for a liquidated amount, is a debt within the context of the mortgage.

Conclusion

79 I find the Plaintiff's claim under its equitable mortgage is prior to the writs of execution.

80 The Plaintiff will have costs against Settlers and The Royal Bank on column 4 relative to the issues between them. There will be one set of costs against Settlers and the Royal Bank, and each shall be liable for 50%.

81 The Court file indicates The Royal Bank was noted in default. If that is the case how can it now appear and contest the Plaintiff's claim against it.

End of Document

TAB 10

1979 CarswellMan 17
Manitoba Court of Queen's Bench

Little Souris Holdings Ltd., Re

1979 CarswellMan 17, 32 C.B.R. (N.S.) 178

RE LITTLE SOURIS HOLDINGS LTD.; KELLEHER v. WESTOBA CREDIT UNION LIMITED

Hewak J.

Judgment: September 19, 1979

Counsel: *W. G. Barber* , for trustee.
P. Roy , for respondent.

Subject: Corporate and Commercial; Insolvency
Related Abridgment Classifications
Bankruptcy and insolvency
X Priorities of claims
X.1 Secured claims
X.1.b Forms of secured interests
X.1.b.ii Mortgages and hypothecs
Headnote
Bankruptcy --- Priorities of claims — Secured claims — Forms of secured interests — Mortgages and hypothecs
Equitable mortgage created by delivery of certificate of title upheld.
The trustee of a bankrupt estate brought an application for an order disallowing a credit union from ranking as a secured creditor against the bankrupt estate. The trustee alleged that the hypothecation of title document relied on by the credit union was invalid on the grounds that the owner of the property was incorrectly described in it and that the document was signed by the signing authority for the bankrupt company in his personal capacity rather than on behalf of the bankrupt company.
Held:
Application dismissed.
The credit union held an equitable mortgage and thus was a secured creditor of the bankrupt. Parol evidence was admissible to establish the intention to create an equitable mortgage by the delivery of the certificate of title. On the occasion of the last loan and on previous occasions, both the bankrupt company and the credit union intended the execution of a promissory note and the hypothecation of title document followed by the delivery and deposit of the certificate of title covering the mortgage to create an equitable mortgage with all the legal ramifications which flowed therefrom.
Table of Authorities
Cases considered:
Zimmerman v. Sproat (1912), 26 O.L.R. 448, 5 D.L.R. 452 — *followed*

Application to declare credit union not entitled to rank as secured creditor against bankrupt estate.

***Hewak J.* :**

1 This is an application for an order disallowing a claim by the respondent to rank as a secured creditor against the estate of Little Souris Holdings Ltd. ("Souris"), a bankrupt in the sum of $11,082.72.

2 Before dealing with that issue, it is necessary to review the facts surrounding the transaction in question in order to categorize the transaction itself.

3 The position of the applicant is that the respondent relies upon a hypothecation of title document to establish its position as a secured creditor of Souris. The applicant takes the position that the document is invalid and that therefore it cannot confer secured creditor status on the respondent.

4 The document, in part, reads as follows:

> I, W. O. R. 'Fred' Gastonguay, *being the registered owner* of the lands hereinafter described and *being indebted to Westoba Credit Union Limited* (hereinafter called the Credit Union), hereby deliver to the Credit Union, duplicate certificate of title No. 133542 covering ...

(The italics are mine.)

5 The document is dated 2nd August 1977 and is signed by W. O. R. Gastonguay.

6 The title to which the document refers, i.e., certificate of title 133542, stands in the name of "Little Souris Holdings Ltd." and not in the name of Gastonguay. In addition, the debt to Westoba Credit Union Limited was incurred for and on behalf of Souris and not on behalf of Gastonguay in his personal capacity. Consequently, the applicant submits, this hypothecation is invalid and the credit union must rank as an ordinary creditor along with other creditors of the bankrupt, Souris.

7 The respondent, on the other hand, takes the position that the transaction referred to created an equitable mortgage given by Souris to the credit union. The respondent admits that the hypothecation of title document was signed by Gastonguay and covered property described in certificate of title 133542 in the name of Souris but states that Gastonguay was only delivering that certificate of title to deposit it as security for the moneys advanced by the respondent to Souris and with the intention of creating an equitable mortgage.

8 The law recognizes that parol evidence is admissible to establish the intention to create an equitable mortgage. I refer particularly to *Zimmerman v. Sproat* (1912), 26 O.L.R. 448, 5 D.L.R. 452 . Riddell J., in reviewing the law dealing with equitable mortgages, stated at p. 453:

> The intent to create an equitable mortgage by delivery or deposit of writings *may be established by parol evidence alone: Russel v. Russel* (1783), 1 Bro. C.C. 269, 28 E.R. 1121 ; *Ex parte Kensington* (1813), 2 V. & B. 79, 35 E.R. 249; *Ex parte Haigh* (1805), 11 Ves. Jun. 403, 32 E.R. 1143; *Ex parte Mountfort* (1808), 14 Ves. Jun. 606, 33 E.R. 653. *And it is sufficient if only some or one of the material documents of title be so delivered: Re Daintry; Ex parte Arkwright* (1843), 3 Mont. D. & De G. 129; *Lacon v. Allen* (1856), 3 Drewry 579, 61 E.R. 1024 .

(The italics are mine.)

9 According to the material filed in opposition to the motion by Mervin George Exner, an officer of the respondent credit union (which I accept as being such parol evidence), it appears that this very procedure was followed by Gastonguay on behalf of Souris and by the respondent credit union not only on this occasion but on several occasions in the past. With one exception, the respondent credit union in the past advanced moneys to Souris following an application for a loan made by Gastonguay on behalf of Souris, following the execution of a promissory note and hypothecation of title document signed by Gastonguay, following the delivery and deposit by Gastonguay of a certificate of title covering property in the name of Souris as security for the loan. On those occasions, both Souris and the credit union recognized and accepted that an equitable mortgage was created with all the legal ramifications that flowed therefrom. Only on the one occasion was there a real property mortgage executed by the officers of Souris in favour of the respondent credit union.

10 I do not think that it can seriously be contended by the applicant that the transaction with which we are dealing here was something other than an equitable mortgage.

11 Aside from delivery of the certificate of title by Gastonguay to the respondent credit union, by virtue of past dealings between Souris and the credit union one could say that there developed an accepted custom and usage between the two parties

whereby Gastonguay on behalf of Souris would make application to the respondent credit union for a loan. The loan application would then be reviewed and approved by the respondent credit union on the understanding that a certificate of title to Souris property would be deposited as security with the credit union. In addition, a promissory note would be signed by Gastonguay on behalf of Souris together with a hypothecation of title document.

12 Obviously in the past this procedure did not present a problem, as the loans were paid off or satisfactory arrangements were made for repayment. In this particular instance, it was only after Souris declared bankruptcy and a trustee was appointed that the hypothecation document was attacked as being invalid in an attempt to rank the respondent credit union as an ordinary creditor.

13 I find as a fact that Gastonguay was the primary signing authority on behalf of Souris and indeed the moving force behind the activities of Souris during the course of its operation. All negotiations of loans, signing of documents (with the one exception already mentioned), cheques and other business transactions were handled by Gastonguay on behalf of Souris, undoubtedly as agent for Souris. As a result, in the past just as in this case, when it was necessary to deposit documents of title in the name of Souris as security with the credit union, Gastonguay did so. The intention of the parties on those occasions, including this one, was to create an equitable mortgage position covering such an advance of moneys.

14 Accordingly, I find that the respondent holds an equitable mortgage and is therefore a secured creditor of Souris.

15 The motion is dismissed with costs.

Application dismissed.

TAB 11

2006 NBBR 133, 2006 NBQB 133
New Brunswick Court of Queen's Bench

Citifinancial Canada East Corp. v. Hurley Estate (Trustee of)

2005 CarswellNB 808, 2005 CarswellNB 945, 2006 NBBR 133, 2006 NBQB 133, [2006] N.B.J. No. 172, 147 A.C.W.S. (3d) 550, 20 C.B.R. (5th) 74, 302 N.B.R. (2d) 284, 44 R.P.R. (4th) 137, 784 A.P.R. 284

CitiFinancial Canada East Corporation, a body corporate, duly incorporated under the laws of New Brunswick (Applicant) and A.C. Poirier & Associates Inc., a body corporate, in its capacity as Trustee in Bankruptcy of the Bankruptcy Estate of Larry Wade Hurley (Respondent)

Glennie J.

Heard: May 9, 2005
Oral reasons: May 9, 2005
Written reasons: February 21, 2006
Docket: NB 10525, Estate No. 51-114544

Proceedings: reversing *Citifinancial Canada East Corp. v. Hurley Estate (Trustee of)* (2004), 6 C.B.R. (5th) 168, (sub nom. *Citifinancial Canada East Corp. v. Hurley (Bankrupt)*) 285 N.B.R. (2d) 325, (sub nom. *Citifinancial Canada East Corp. v. Hurley (Bankrupt)*) 744 A.P.R. 325, 2004 NBQB 431, 2004 CarswellNB 593 (N.B. Q.B.)

Counsel: Frederick A. Welsford for Applicant
H. David McLellan for Respondent

Subject: Insolvency; Corporate and Commercial; Property; Contracts

Related Abridgment Classifications

Bankruptcy and insolvency
IX Proving claim
IX.2 Disallowance of claim
Estoppel
III Estoppel by deed
III.8 "Feeding the estoppel"
III.8.c Mortgages
Real property
VIII Mortgages
VIII.3 Change of ownership
VIII.3.c Miscellaneous

Headnote

Bankruptcy and insolvency --- Proving claim — Disallowance of claim — General principles

Spouses signed mortgage in favour of mortgagee in November 2002 — Mortgage was registered pursuant to Land Titles Act (LTA) in November 2003 and re-registered in February 2004 — At time mortgage was registered, wife and her mother were registered owners of property — Property was conveyed from wife and mother to wife and her husband in November 2002 and was registered in February 2004 — Spouses' proposals to creditors under Bankruptcy and Insolvency Act (BIA) were rejected — Spouses were deemed bankrupt — Mortgagee's claim for security interest was disallowed by trustee on basis that mortgage was invalid as it was filed after date of initial bankruptcy event — Mortgagee's appeal to registrar was dismissed — Mortgagee appealed from decision of registrar — Appeal allowed — Registrar erred because transfer in November 2002 was sufficient to make property real property of bankrupt as defined in s. 67 of BIA, and that real property was subject to mortgage of mortgagee — Section 97 of BIA was not applicable as both deed and mortgage were signed well before date of proposal, and mortgage funds were fully advanced by mortgagee to spouses pursuant to November 2002 mortgage, well before date of proposal — Trustee would have had actual notice of mortgagee's mortgage by virtue of fact that it would have prepared spouses' proposals under BIA — Principle that trustee in bankruptcy cannot obtain greater interest in goods or property than bankrupt is modified only if there is clear statutory language saying so, and LTA does not contain such language — Section 15 of LTA allows that unregistered mortgage is effective as against mortgagor; therefore, it is equally effective as against trustee in bankruptcy.

Mortgages --- Change of ownership — Miscellaneous issues

Spouses signed mortgage in favour of mortgagee in November 2002 — Mortgage was registered pursuant to Land Titles Act in November 2003 and re-registered in February 2004 — At time mortgage was registered, wife and her mother were registered owners of property — Property was conveyed from wife and mother to wife and her husband in November 2002 and was registered in February 2004 — Spouses' proposals to creditors under Bankruptcy and Insolvency Act (BIA) were rejected — Spouses were deemed bankrupt — Mortgagee's claim for security interest was disallowed by trustee on basis that mortgage was invalid as it was filed after date of initial bankruptcy event — Mortgagee's appeal to registrar was dismissed — Mortgagee appealed from decision of registrar — Appeal allowed — Registrar erred because transfer in November 2002 was sufficient to make property real property of bankrupt as defined in s. 67 of BIA, and that real property was subject to mortgage of mortgagee — At time of making of proposal, husband had received interest in property even though deed was unregistered and that interest was subject to executed mortgage made in favour of mortgagee — Mortgage did not need to be registered to be effective as against trustee in bankruptcy, as trustee has same status as person making mortgage — Once transfer to husband was registered on title in February 2004, benefit of transfer went automatically to benefit of earlier mortgagee, effective as of date mortgage was registered in November 2003 — If deed had not been registered by mortgagee, trustee would have had obligation to do so — Once deed was registered, estoppel would be fed and mortgagee's interest would be valid as against rest of world.

Estoppel --- Estoppel by deed — "Feeding the estoppel" — Mortgages

Spouses signed mortgage in favour of mortgagee in November 2002 — Mortgage was registered pursuant to Land Titles Act in November 2003 and re-registered in February 2004 — At time mortgage was registered, wife and her mother were registered owners of property — Property was conveyed from wife and mother to wife and her husband in November 2002, and was registered in February 2004 — Spouses' proposals to creditors under Bankruptcy and Insolvency Act (BIA) were rejected — Spouses were deemed bankrupt — Mortgagee's claim for security interest was disallowed by Trustee on basis that mortgage was invalid as it was filed after date of initial bankruptcy event — Mortgagee's appeal to registrar was dismissed — Mortgagee appealed from decision of registrar — Appeal allowed — Registrar erred because transfer in November 2002 was sufficient to make property real property of bankrupt as defined in s. 67 of BIA, and that real property was subject to mortgage of mortgagee — Doctrine of "feeding the estoppel" was applicable — At time proposals were made, husband had received interest in property even though deed was unregistered, and that interest was subject to executed mortgage made in favour of mortgagee — If deed had not been registered by mortgagee, trustee would have had obligation to do so — Once deed was registered, estoppel would be fed and mortgagee's interest would be valid as against rest of world — In context of bankruptcy, it would then become valid secured claim — Once transfer to husband was registered on title in February 2004, benefit of transfer went automatically to earlier mortgagee, or "fed the estoppel", effective as of date mortgage was registered under LTA in November 2003.

Table of Authorities

Cases considered by *Glennie J.*:

Bank of Montreal v. Chedore (1986), 34 D.L.R. (4th) 177, 76 N.B.R. (2d) 99, 192 A.P.R. 99, 1986 CarswellNB 379 (N.B. C.A.) — referred to

Canadian Engineering & Contracting Co., Re (1994), 28 C.B.R. (3d) 136, 1994 CarswellOnt 305 (Ont. Bktcy.) — referred to

Certain Titles to Land in Ontario, Re (1973), [1973] 2 O.R. 613, 35 D.L.R. (3d) 10, 1973 CarswellOnt 853 (Ont. C.A.) — considered

Citifinancial Canada East Corp. v. Morrow Estate (Trustee of) (2004), 6 C.B.R. (5th) 285, (sub nom. *Citifinancial Canada East Corp. v. Morrow (Bankrupt)*) 285 N.B.R. (2d) 317, (sub nom. *Citifinancial Canada East Corp. v. Morrow (Bankrupt)*) 744 A.P.R. 317, 2004 NBQB 432, 2004 CarswellNB 594 (N.B. Q.B.) — considered

Federal Business Development Bank v. Northern Hydraulic & Equipment Ltd. (1983), 49 N.B.R. (2d) 174, 129 A.P.R. 174, 1983 CarswellNB 302, 1983 CarswellNB 349 (N.B. Q.B.) — considered

Flintoft v. Royal Bank (1964), [1964] S.C.R. 631, 7 C.B.R. (N.S.) 78, 49 W.W.R. 301, 47 D.L.R. (2d) 141, 1964 CarswellMan 3 (S.C.C.) — referred to

Giffen, Re (1998), 45 B.C.L.R. (3d) 1, 155 D.L.R. (4th) 332, 222 N.R. 29, 1998 CarswellBC 147, 1998 CarswellBC 148, [1998] 1 S.C.R. 91, (sub nom. *Giffen (Bankrupt), Re)* 101 B.C.A.C. 161, (sub nom. *Giffen (Bankrupt), Re)* 164 W.A.C. 161, 1 C.B.R. (4th) 115, [1998] 7 W.W.R. 1, 13 P.P.S.A.C. (2d) 255 (S.C.C.) — considered

Guimond v. Hébert (1997), 1997 CarswellNB 529, 15 R.P.R. (3d) 42, 195 N.B.R. (2d) 194, 499 A.P.R. 194 (N.B. C.A.) — considered

Lefebvre, Re (2004), (sub nom. *Lefebvre (Trustee of), Re)* 244 D.L.R. (4th) 513, (sub nom. *Lefebvre (Bankrupt), Re)* 326 N.R. 253 (Eng.), (sub nom. *Lefebvre (Bankrupt), Re)* 326 N.R. 353 (Fr.), (sub nom. *Lefebvre (Trustee of), Re)* [2004] 3 S.C.R. 326, 1 B.L.R. (4th) 19, 7 C.B.R. (5th) 243, 2004 SCC 63, 2004 CarswellQue 2831, 2004 CarswellQue 2832 (S.C.C.) — considered

Little Souris Holdings Ltd., Re (1979), 32 C.B.R. (N.S.) 178, 1979 CarswellMan 17 (Man. Q.B.) — considered

Poirier, Re (1989), 2 R.P.R. (2d) 162, 95 N.B.R. (2d) 91, 241 A.P.R. 91, 1989 CarswellNB 38 (N.B. Q.B.) — referred to

W. & R. Gillespie Ltd. v. Larrow (2000), 2000 CarswellNB 57 (N.B. Q.B.) — referred to

Weyman, Re (1929), 10 C.B.R. 547, 1929 CarswellOnt 15 (Ont. S.C.) — referred to

Yale v. MacMaster (1974), 3 O.R. (2d) 547, 18 C.B.R. (N.S.) 225, 46 D.L.R. (3d) 167, 18 R.F.L. 27, 1974 CarswellOnt 58 (Ont. H.C.) — considered

Statutes considered:

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

Generally — referred to

s. 2 "secured creditor" — considered

s. 16(3) — considered

s. 67 — considered

s. 69(1)(d) — considered

s. 74(2) — referred to

s. 97 — considered

s. 97(1) — considered

Land Titles Act, S.N.B. 1981, c. L-1.1

Generally — referred to

s. 15(1) — considered

Personal Property Security Act, S.B.C. 1989, c. 36

Generally — referred to

s. 20(b)(i) — considered

Personal Property Security Act, S.N.B. 1993, c. P-7.1

Generally — referred to

s. 20(2) — considered

APPEAL by mortgagee from judgment reported at *Citifinancial Canada East Corp. v. Hurley Estate (Trustee of)* (2004), 6 C.B.R. (5th) 168, (sub nom. *Citifinancial Canada East Corp. v. Hurley (Bankrupt))* 285 N.B.R. (2d) 325, (sub nom. *Citifinancial Canada East Corp. v. Hurley (Bankrupt))* 744 A.P.R. 325, 2004 NBQB 431, 2004 CarswellNB 593 (N.B. Q.B.), dismissing appeal from notice of disallowance of claim issued by trustee in bankruptcy.

***Glennie J.* (orally):**

1 CitiFinancial Canada East Corporation ("CitiFinancial") seeks to reverse a decision of the Registrar in Bankruptcy (2004 NBQB 431 (N.B. Q.B.)) in which the Registrar dismissed an appeal of a Notice of Disallowance of Claim issued by a Trustee in Bankruptcy. The Trustee had concluded that CitiFinancial's mortgage was not valid pursuant to Section 97 of the *Bankruptcy and Insolvency Act* (the "*BIA*"). The Registrar's Decision is reported at 2004 CarswellNB 593, 6 C.B.R. (5th) 168, 285 N.B.R. (2d) 325, 744 A.P.R. 325 (N.B. Q.B.).

Overview

2 The facts, as set forth by the Registrar in his decision are as follows:

On November 7, 2002 Larry Wade Hurley and Charline Hurley signed a mortgage in favour of Citifinancial on a residence located at 46 McKay Avenue in the City of Moncton and identified as PID 790865 ("the Property"). The November 7, 2002 mortgage was registered pursuant to the **Land and Titles Act** *on November 17, 2003 as Number 17456857 and re registered on February 18, 2004.*

The Property in question at the time of registration of the mortgage showed Marie Germaine Robichaud and Charline Robichaud (Charline Hurley) as registered owners.

The Property was conveyed from Charline Robichaud (Hurley) and Marie Germaine Robichaud to Charline Hurley and Larry Wade Hurley as joint tenants by a Transfer dated November 7, 2002 and registered on February 18, 2004 as Number 17918161.

The Bankrupt and his spouse, Charline Robichaud-Hurley filed Proposals pursuant to section 50 of the BIA on February 6, 2004. These Proposals failed to be accepted by the required majority of the voting creditors at a meeting on February 26, 2004 and the Bankrupt and his spouse were accordingly deemed bankrupt.

Citifinancial's claim for a security interest in the Property was disallowed by the Trustee with respect to the 50% interest of the Bankrupt because the mortgage was filed after the date of the initial bankruptcy event.

3 The issue before the Registrar was whether the Trustee erred in determining that the failure by CitiFinancial to re-register the mortgage pursuant to the *Land Titles Act* prior to the date of the initial bankruptcy event was fatal to its claim as a secured creditor under the *BIA* for the purposes of the mortgage.

4 For similar reasons to those in *Citifinancial Canada East Corp. v. Morrow Estate (Trustee of)*, 2004 NBQB 432, 2004 CarswellNB 594, 6 C.B.R. (5th) 285, 285 N.B.R. (2d) 317, 744 A.P.R. 317 (N.B. Q.B.), the Registrar dismissed CitiFinancial's appeal and held that the Trustee did not err in issuing the Notice of Disallowance.

5 In addition, the Registrar held that the transfer of the Property on November 7, 2002 did not pass the interest of Charline Robichaud and Marie Germaine Robichaud to the Bankrupt and his spouse until registration of the transfer on February 18, 2004. As a result, the Registrar held that the Bankrupt had no legal estate to pass to CitiFinancial at the time of executing the mortgage on November 7, 2002.

6 It is from that decision that CitiFinancial now appeals. For the reasons that follow, I would allow the appeal.

The Trustee's Disallowance of Claim

7 The Trustee of the Bankrupt Estate of Larry Wade Hurley, A.C. Poirier & Associates Inc. issued the following Notice of Disallowance of Claim to CitiFinancial on May 21, 2004:

TAKE NOTICE THAT as trustee acting in the matter of the bankruptcy of the Debtor, I have disallowed your mortgage security on the Debtor's 50% interest in 46 McKay Avenue, Moncton, NB in whole, pursuant to subsection 135(2) of the Act, for the following reason:

> The mortgage was registered against the Debtor's interest in 46 McKay Avenue, Moncton, NB after the initial bankruptcy event which was the filing of a proposal pursuant to section 50 of the Bankruptcy and Insolvency Act (the "BIA") on February 6, 2004. Pursuant to section 97 of the BIA, the mortgage security is not valid. Your claim has been admitted, in its entirety, as an unsecured claim.

8 Mr. Hurley became a bankrupt on February 6, 2004 by virtue of the rejection of a proposal in bankruptcy he had made to his creditors.

9 Robert Powell, a Trustee in Bankruptcy practicing with the A.C. Poirier & Associates Inc. trustee firm provides the background information and his reasoning for disallowing CitiFinancial's mortgage as a secured claim in an affidavit as follows:

> *Following the filing of assignments in bankruptcy, and pursuant to our duties as Trustee, I investigated the nature and extent of the assets of the estate of Larry and Charline Robichaud-Hurley available to satisfy outstanding claims of both secured and unsecured creditors.*
>
> *One of the possible assets at issue was the residence occupied by Larry Hurley and Charline Robichaud-Hurley, located at 46 McKay Avenue in the City of Moncton, having PID 790865 (the "Property").*
>
> *On or about March 8, 2004, the trustee wrote to the Applicant requesting an explanation of the timing of the registration of various transactions.*
>
> *On or about March 31, 2004, the Trustee received a response on behalf of the Applicant by First Canadian Title dated March 31, 2004.*
>
> *In considering the validity of the mortgage, I reviewed numerous documents including title and mortgage documentation. I also consulted with legal counsel and was advised that, under the Land Titles system, no document purporting to transfer an interest in a property or charge a property is valid until such document is actually registered. The Property is subject to the Land Titles system.*
>
> *After considering the facts of the situation and pursuant to the Trustee's duty, on May 21, 2004, I caused the Trustee to send a Notice of Disallowance by registered mail to the Applicant Citifinancial in which the Trustee advised that Citifinacial did not have a valid security interest in the Property because the Applicant's mortgage was registered* after *the date of the initial bankruptcy event.*
>
> *My understanding is that prior to November 7, 2002, Charline Robichaud-Hurley and her mother, Marie Germain Robichaud, owned the Property jointly.*
>
> *On November 7, 2002, Marie Germain Robichaud allegedly executed a deed in which she transferred her interest in the Property to Larry Hurley. However, this deed was not registered until February 18, 2004, after the date of the initial bankruptcy event.*
>
> *Also on November 7, 2002, Larry Hurley and Charline Robichaud-Hurley apparently attempted to grant a mortgage in favour of Citifinancial on the Property. However, this mortgage was not registered until November 17, 2003, over a year later, at a time when title of the Property was in the name of Charline Robichaud-Hurley and her mother. It was then re-registered on February 18, 2004, after the date of the initial bankruptcy event.*
>
> *In reviewing the facts of this matter, I determined that:*
>
> - *the mortgage granted by Larry Hurley and Charline Robichaud-Hurley was not effective against Larry Hurley upon registration on November 17, 2003. At that time, Charline Robichaud-Hurley had an interest to mortgage in the Property but Larry Hurley did not.*

• *The interest of Marie Germain Robichaud passed to Larry Hurley upon registration of the deed on February 18, 2004.*

• *The mortgage registered by Citifinancial was not valid pursuant to* section 97 of the Bankruptcy and Insolvency Act *as it occurred between the date of the initial bankruptcy event and the date of bankruptcy and because no adequate valuable consideration was given after the date of the initial bankruptcy event.*

• *Larry Hurley's interest in the Property vested in the Trustee on February 26, 2004 (the date of the bankruptcy) pursuant to 67 of the* Bankruptcy and Insolvency Act.

The Registrar's Decision

10 In his decision the Registrar writes as follows:

The Transfer dated November 7, 2002 did not pass the estate or interest of Charline Robichaud (Hurley) and Marie Germaine Robichaud to the Bankrupt and his spouse until registration on February 18, 2004.

An equitable mortgage by common law was valid and enforceable by foreclosure and sale. Common law practices, however, are subject to statutory enactment and to ignore the clear provisions of subsection 15(1) *of the LTA would be contrary to the legislative purpose of this statute.*

15(1) Except as against the person making the instrument, no instrument shall, until registered, pass any estate or interest in registered land or render the land liable as security for the payment of money.

At the time of executing the mortgage, the Bankrupt had no legal estate to pass to the mortgagee. It may be inferred that his intention was to mortgage a future interest and thus create an equitable mortgage.

The LTA does not run contrary to the provisions of the Act with reference to secured creditors and the provincial legislation is effective in determination of secured claims within matters of provincial jurisdiction. "Secured creditor" may be defined in subsection 2(1) of the Act as a person holding a mortgage but the definition and regulation of both deeds and mortgages falls within provincial civil law jurisdiction.

Section 75 of the Act is not applicable here because we are not faced with the registration by a bona fide purchaser or mortgage subsequent to the assignment and without notice thereof.

Subsection 15(1) *of the LTA is clear in determining that no interest or title in registered land passes nor is the land liable as security until the instrument in question is registered.*

The Section 97 Argument

11 As to the Section 97 of the *BIA* argument advanced by the Trustee, I am of the view that this is not a Section 97 situation. Section 97 of the *BIA* provides as follows:

97. (1) No payment, contract, dealing or transaction to, by or with a bankrupt made between the date of the initial bankruptcy event and the date of the bankruptcy is valid, except the following, which are valid if made in good faith, subject to the foregoing provisions of this Act with respect to the effect of bankruptcy on an execution, attachment or other process against property, and subject to the provisions of this Act respecting settlements, preferences and reviewable transactions:

(a) a payment by the bankrupt to any of the bankrupt's creditors;

(b) a payment or delivery to the bankrupt;

(c) a transfer by the bankrupt for adequate valuable consideration; and

> (d) a contract, dealing or transaction, including any giving of security, by or with the bankrupt for adequate valuable consideration.

12 Section 97(1) applies to payments, conveyances, *etc.*, which take place between the date of the initial bankruptcy event and the date of bankruptcy.

13 The Trustee in this case says the mortgage *"occurred"* between the date of the initial bankruptcy event and the date of bankruptcy and because no adequate valuable consideration was given after the date of the initial bankruptcy event. The mortgage was executed on November 7, 2002. It was initially registered on November 17, 2003. The mortgage funds were fully advanced in November of 2002. Mr. and Mrs. Hurley did not go bankrupt until February of 2004. The only event that occurred after the initial bankruptcy event was the re-registration of the mortgage.

14 According to an affidavit deposed to by a lawyer for CitiFinancial, the mortgage funds secured by the November 7, 2002 mortgage on the Property from Mr. and Mrs. Hurley to CitiFinancial were fully advanced by CitiFinancial on November 7, 2002 as follows:

> the sum of Sixty-five Thousand Eight Hundred Thirty-eight Dollars ($65,838.00) was paid to the Royal Bank in satisfaction of an existing Mortgage to Royal Bank; the sum of Eighteen Thousand Eight Hundred Sixty-nine Dollars and Thirty-two Cents ($18,869.32) was advanced to Larry Hurley, and Charline Hurley; the balance of the mortgage advance was applied against other Hurley debts and/or the expenses involved in the establishment of the Mortgage security.

15 In my opinion, Section 97 of the *BIA* is not applicable to this situation as both the deed and the mortgage were signed well before the date of the proposal and the mortgage funds were fully advanced by CitiFinancial to the Hurleys pursuant to the November 7, 2002 mortgage to CitiFinancial, well before the date of the proposal.

Actual Notice

16 It should be noted the Trustee would have had actual notice of CitiFinancial's mortgage by virtue of the fact that it would have prepared Mr. and Mrs. Hurley's proposals under the *BIA*.

17 Mr. Hurley's proposal dated February 6, 2004 states as follows under the heading '*Secured Creditors.*':

> *Secured Creditors, if any, must prove their secured claim to the Trustee. The provisions of the BIA with respect to proofs of claim and secured proofs of claim shall apply.*
>
> *The Debtor shall continue to pay the claims of Secured Creditors in accordance with the following:*
>
> > • CitFinancial, as mortgagee under a loan secured by 46 McKay Avenue, Moncton, shall continue to be paid in accordance with the existing loan terms
>
> *However, nothing herein shall prevent a Secured Creditor from realizing on their security and ranking for any shortfall as an Ordinary Creditor. If there is a surplus remaining after realization, the Secured Creditor shall return the surplus to the Debtor.*

18 This appeal, like the appeal considered in *Citifinancial Canada East Corp. v. Morrow Estate (Trustee of)*, *supra* raises the issue of the interplay between the *BIA* and the New Brunswick *Land Titles Act* and in particular whether a trustee is a third party acquirer or simply stands in the place and stead of the bankrupt.

19 A '*secured creditor*' is defined in Section 2 of the *BIA* to mean "... *a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property*...".

20 The general rule is that a trustee in bankruptcy takes no better title to the property than the bankrupt had. A bankrupt's property passes to the trustee in the same plight and condition in which it was in the bankrupt's hands and is subject to all the

equities and liabilities which affected it in the bankrupt's hands; to all dispositions which have been validly made by the bankrupt, and to all rights which have been validly acquired by third persons at the commencement of the bankruptcy. See; *Halsbury's* (4th Ed.) Vol. 3(2), paragraph 394; Houlden and Morowitz, *Bankruptcy & Insolvency in Canada* (3d) Vol. 1, page 3-11.

21 Section 69(1)(d) of the *BIA* provides as follows:

> The property of a bankrupt ... shall comprise ...
>
> (d) such powers in or over, or in respect of the property as might have been exercised by the bankrupt for his own benefit.

22 In *Yale v. MacMaster* (1974), 46 D.L.R. (3d) 167 (Ont. H.C.), at 185, Justice Gilligen writes:

> It is worth noting that there is nothing in that provision which in any way gives the trustee any higher or greater right than that which the bankrupt had.

23 A trustee in bankruptcy is not a purchaser for value without notice of the property of the bankrupt but only a successor in interest: *Flintoft v. Royal Bank* (1964), 7 C.B.R. (N.S.) 78, [1964] S.C.R. 631 (S.C.C.). Consequently, with respect to real property of the bankrupt, the trustee, subject to Section 74(2) of the *BIA*, only acquires whatever interest the bankrupt may have had and takes the property subject to unregistered deeds or equitable mortgages: *Weyman, Re* (1929), 10 C.B.R. 547 (Ont. S.C.); *Canadian Engineering & Contracting Co., Re* (1994), 28 C.B.R. (3d) 136, 1994 CarswellOnt 305 (Ont. Bktcy.). Houlden & Morawetz, *Bankruptcy and Insolvency Law of Canada*, Vol. 2, F§33.1, page 3.122.

24 The holder of an equitable mortgage is a secured creditor in the bankruptcy of the mortgagor: *Little Souris Holdings Ltd., Re* (1979), 32 C.B.R. (N.S.) 178 (Man. Q.B.) , Houlden & Morawetz, *Bankruptcy and Insolvency Law of Canada*, Vol. 2, F§33.1, page 3-123.

25 In *Flintoft v. Royal Bank* (1964), 47 D.L.R. (2d) 141 (S.C.C.), the Court held that the trustee in bankruptcy was not entitled to book debts which had been assigned to a bank notwithstanding the bank's assignment was void for want of timely registration. It was held the trustee had no higher rights than the bankrupt and it took its property as a successor in interest and not as an innocent purchaser for value without notice.

26 In *Giffen, Re*, [1998] 1 S.C.R. 91 (S.C.C.), the Supreme Court of Canada considered the situation where a car leasing company leased a car to a company which in turn leased it to one of its employees. That employee subsequently went bankrupt. Neither the leasing company nor the employer had registered financing statements under the British Columbia *Personal Property Security Act* with the result that the lessor's security interest in the car was not perfected. Paragraph 20(b)(i) of the British Columbia *Personal Property Security Act* stated that a security interest in collateral is not effective against a trustee in bankruptcy if the security interest is unperfected at the date of the bankruptcy. The Supreme Court of Canada stated at ¶50 of its decision:

> *I accept that there is a principle which provides that a trustee in bankruptcy cannot obtain a greater interest to the goods in the bankrupt (beyond the context of a trust where the goods are not the property of the bankrupt). However, Section 20(b)(i) itself modifies that principle.*

27 The Supreme Court of Canada held that in light of the statutory provision the lessor's unperfected security interest was ineffective against the interest acquired by the trustee.

28 It is noteworthy that Section 20(2) of the *Personal Property Security Act* of New Brunswick, S.N.B. 1993, c. P-7.1 has almost identical wording to that of the British Columbia *Personal Property Security Act*. Section 20(2) of the New Brunswick *Personal Property Security Act* provides as follows:

> An unperfected security interest in collateral is not effective against ... a trustee in bankruptcy if the security interest is unperfected at the time of bankruptcy.

29 In my opinion, the principle that a trustee in bankruptcy cannot obtain a greater interest in goods or property than the bankrupt is only modified if there is clear statutory language saying so and the New Brunswick *Land Titles Act* does not contain such language. It would have been open to the Legislature Assembly of New Brunswick to use such language, as it did in the *Personal Property Security Act*, if it had intended that consequence.

30 In *Lefebvre, Re*, 2004 CarswellQue 2831, 244 D.L.R. (4th) 513, [2004] 3 S.C.R. 326, 7 C.B.R. (5th) 243 (S.C.C.), the Supreme Court of Canada considered the situation where individuals had leased motor vehicles pursuant to leases which were not published in the Registry of Personal and Movable Real Rights in Quebec. The individuals subsequently went bankrupt. Justice LeBel writes at ¶37:

> *When the trustee takes control or becomes seized of the universality of property defined in Section 67 B.I.A., his or her seisin is limited to the property in the debtor's patrimony. Apart from the special powers accorded by law to the trustee, as representative of the creditors, to restore the patrimony to be liquidated in its entirety, the trustee has no more rights with respect to the debtor's property than did the debtor, of whom the trustee remains a successor in this regard. This principle is well established in relation to the application of Section 67 B.I.A. It was laid down by Judson, J., in Flintoft v. Royal Bank [1964] S.C.R. 631 at page 634. More recently, Iacobucci J. confirmed the validity of the principle in Giffen. In my view, the trustee has no greater interest in the property under his or her responsibility than that of the bankrupt, unless otherwise provided for by legislation. (Giffen, at para. 50)*
>
> [Emphasis added.]

31 It is a fundamental principle that a trustee in bankruptcy has no greater interest in property than the bankrupt. There is no wording in the *Land Titles Act* such as is found in the *Personal Property Security Act* sufficient to alter that fundamental principle. Section 15(1) of the *Land Titles Act* allows that an unregistered mortgage is effective as against the mortgagor, therefore it is equally effective as against the trustee in bankruptcy.

32 The trustee in bankruptcy is in the same position as the bankrupt. At the time of making of the proposal, the Bankrupt in this case had received an interest in the property even though the deed at that time was unregistered and that interest was subject to the mortgage made in favour of CitFinancial.

33 In the *2006 Annotated Bankruptcy & Insolvency Act*, the authors, Honourable Lloyd W. Houlden and Honourable Geoffrey B. Morawetz write at ¶F§24(2):

> *In International Harvester Credit Corp. of Canada v. Touche Ross Ltd. (1986), 30 D.L.R. (4th) 387, 34 B.L.R. 76, 61 C.B.R. (N.S.) 193, 6 P.P.S.A.C. 138, [1986] 6 W.W.R. 161, 50 Sask. R. 177 (*sub nom. International Harvester Credit Corp. Ltd. v. Bell's Dairy Ltd. (Trustee of)*, the Saskatchewan Court of Appeal held that by virtue of the* PPSA, *a trustee in bankruptcy acquired a higher interest in property than that possessed by the bankrupt, and if a security interest was unperfected at the date of bankruptcy, it was extinguished as against a trustee in bankruptcy. The decision in* Re International Credit Corp. *was followed by the Supreme Court of Canada in* Re Giffen *(1998), 222 N.R. 29, 1 C.B.R. (4th) 115, 1998 CarswellBC 147, 1998 CarswellBC 148 (S.C.C.), and even if the bankrupt has only a right of use and enjoyment of leased property, where the lease was unperfected at the date of bankruptcy, the Supreme Court held that a trustee in bankruptcy acquires by the* Bankruptcy and Insolvency Act *and the provincial* PPSA *legislation full rights to the leased property because of the failure to perfect the security interest.*
>
> Giffen *was distinguished by the Supreme Court in* Re Lefebvre *(2004), 2004 CarswellQue 2831, 2004 CarswellQue 2832, (*sub nom. Lefebvre (Trustee of), Re*) 244 D.L.R. (4th) 513, (*sub nom. Lefebvre (Bankrupt), Re*) 326 N.R. 253 (Eng.), 326 N.R. (353 (Fr.), 2004 SCC 63, holding that absent express legislative provisions to the contrary, the trustee has no greater interest in property than that held by the bankrupt before his or her assignment.*
>
> [Emphasis added.]

The Doctrine of Feeding the Estoppel

34 The Trustee argues that a security interest does not encumber a real property interest until it is registered and that this is one of the foundations of the land titles system.

35 The Trustee refers to *Bank of Montreal v. Chedore* (1986), 34 D.L.R. (4th) 177 (N.B. C.A.) in support of its proposition.

36 But in this case, it must be remembered that the mortgage to CitFinancial from Mr. and Mrs. Hurley was in fact registered on November 17, 2003, well before the effective date of bankruptcy. It was re-registered on February 18, 2004.

37 It is the transfer dated November 7, 2002 from Charlene Robichaud (Charlene Hurley) and Marie Germane Robichaud and Larry Wade Hurley, as spouse of Charlene Hurley, to Charlene Hurley and Larry Wade Hurley as joint tenants that was not registered against title until February 18, 2004 as Number 17918161.

38 It is noteworthy to observe on the face of the transfer that it had been attempted to have been registered on four occasions prior to February 18, 2004, namely, on December 6, 2002; May 23, 2003; June 9, 2003 and January 15, 2004.

39 The mortgage from Larry Wade Hurley and Charlene Hurley to CitiFinancial is dated November 7, 2002 which is the same date as the transfer and, as found by the Registrar in his decision, was registered on November 17, 2003 (pre-bankruptcy) as Number 1745687 and re-registered on February 18, 2004 (post bankruptcy) as Number 17918187.

40 At the hearing of this action, the Court raised the issue of the doctrine of feeding the estoppel with respect to the fact situation in this case.

41 This doctrine was not argued before the Registrar and accordingly Counsel for CitiFinancial and the Trustee were given the opportunity to argue this issue.

42 For the reasons that follow, I am of the opinion that the doctrine of feeding the estoppel is applicable to the fact situation in this case.

43 In *Certain Titles to Land in Ontario, Re* (1973), 35 D.L.R. (3d) 10 (Ont. C.A.), the Court states at page 26:

> An interest in land is created by estoppel when the grantor has no legal estate or interest therein at the time of the grant, and although a title by estoppel is not good as against all the world but only against the grantor, who is estopped by his own deed as against him, it has all the elements of a real title. Where the grantor subsequently acquires a legal title to the premises which he has purported to grant that legal estate or interest is said to feed the estoppel, and the original grant then takes effect in interest and not be estoppel, but the grantor is estopped from saying that he had not interest at the time of the grant. Thus through the instrumentality of what is a pure legal fiction, ie: by operation of law, the grantee's erstwhile estate by estoppel valid as against the rest of the world without the necessity of the grantee obtaining a further or supplementary grant from the grantor, or without any other of further documentation.

44 In *Canadian Encyclopedic Digest Estoppel IV — Estoppel by Deed*, the authors write:

> When a grantor has purported to grant an interest in land which he or she did not at the time posses, but subsequently acquires, the benefit of the subsequent acquisition goes automatically to the benefit of the earlier grantee or, as it is usually expressed, "feeds the estoppel".

45 In *Federal Business Development Bank v. Northern Hydraulic & Equipment Ltd.* (1983), 49 N.B.R. (2d) 174 (N.B. Q.B.), the Court considered a situation where a lot was conveyed to Northern Hydraulic & Equipment Ltd. ("Northern") which mortgaged the property to the Federal Business Development Bank ("FBDB"). Following this, the description of the lands was revised to comply with a survey plan. Northern signed a mortgage amending agreement with FBDB to use the new description. The next day a deed of correction was signed by the individuals who had conveyed the property to Northern, which deed

used the new description. The description in the amended documents was not accurate. FBDB applied for a rectification of the description.

46 The Court considered, among other things, the effect of the execution of the amended mortgage before the deed of correction and held at page 178 of its decision:

> *It is necessary, however, to decide the effects of the conveyances for, as noted, although Northern had executed the Agreement Amending Mortgage it was not until the next day that the Deed of Correction was signed by the LeCouters. I am of the opinion that the mortgagee in such circumstances would normally acquire good title through operation of law. The doctrine of "feeding the estoppel" is applicable. The implications of this principle are succinctly explained in Reference, Re Certain Titles to Land in Ontario, 35 D.L.R. (3rd) 10, at page 26*
>
>> An interest in land is created by estoppel when the grantor has no legal estate or interest therein at the time of the grant, and although a title by estoppel is not good as against all the world but only against the grantor, who is estopped by his own deed as against him, it has all the elements of a real title. Where the grantor subsequently acquires a legal title to the premises which he has purported to grant that legal estate or interest is said to feed the estoppel, and the original grant then takes effect in interest and not by estoppel, but the grantor is estopped from saying that he had no interest at the time of the grant. Thus through the instrumentality of what is a pure legal fiction, i.e., by operation of law, the grantee's erstwhile estate by estoppel valid only as against his grantor became an estate in interest valid as against the rest of the world without the necessity of the grantee obtaining a further or supplementary grant from the grantor, or without any other or further documentation.

47 See also *Poirier, Re*, [1989] N.B.J. No. 44 (N.B. Q.B.) and *Guimond v. Hébert*, [1997] N.B.J. No. 519, 1997 CarswellNB 529 (N.B. C.A.).

48 Citibank's main argument in this case is that Section 15(1) of the *Land Titles Act* applies. It reads as follows:

> *Except as against the person making instrument, no instrument shall, until registered, pass any estate or interest in registered land or render the land liable as security for the payment of money.*
>
> [emphasis added]

49 In my opinion, the mortgage does not need to be registered to be effective as against the trustee in bankruptcy as he has the same status as the person making the mortgage.

50 To the extent that it is considered necessary for a document to be registered for it to pass title, I am of the view that the mortgagor, as against the mortgagee, would be estopped from denying that he had good title when the mortgage was registered even if the deed had not been registered. As the trustee stands in the shoes of the bankrupt, the trustee as well would be estopped from denying the validity of the mortgage as against the mortgagee.

51 There is nothing in the *BIA* to make ineffective the registration of a deed executed before the bankrupt was insolvent, or committed an act of bankruptcy.

52 In fact, Section 16(3) of the *BIA* imposes an obligation on the trustee to register any unregistered title documents in the bankrupt's possession.

53 In my opinion, if the deed had not been registered by CitiFinancial, the trustee would have had an obligation to do so. Once the deed was registered, the estoppel would be *'fed'* and the mortgagee's interest would be valid as against the rest of the world. In the context of bankruptcy, it would then become a valid secured claim.

54 In *Guimond v. Hébert*, *supra*, Justice Wallace Turnbull discusses the doctrine of estoppel, sometimes referred to as *'feeding the estoppel'* at ¶13:

13 The doctrine of estoppel is a pure legal fiction that evolved under the Common Law of England and is part of the real property law of Canada. Both the trial Judge and the appellant's counsel cite the following statement of a five member panel of the Ontario Court of Appeal in Re Certain Titles to Land in Ontario *(1973), 35 D.L.R. (3d) 10 (Ont. C.A.) at page 26 as correctly setting out the essential features of the doctrine. It reads:*

> Perhaps a brief word should be said about the implications flowing from the expression "feeding the estoppel". An interest in land is created by estoppel when the grantor has no legal estate or interest therein at the time of the grant, and although a title by estoppel is not good as against all the world but only against the grantor, who is estopped by his own deed as against him, it has all the elements of a real title. Where the grantor subsequently acquires a legal title to the premises which he has purported to grant that legal estate or interest is said to feed the estoppel, and the original grant then takes effect in interest and not by estoppel, but the grantor is estopped from saying that he had no interest at the time of the grant. Thus through the instrumentality of what is a pure legal fiction, i.e., by operation of law, the grantee's erstwhile estate by estoppel valid only as against his grantor became an estate in interest valid as against the rest of the world without the necessity of the grantee obtaining a further or supplementary grant from the grantor, or without any other or further documentation.

55 As stated in *Anger and Honsburger Real Property*, Second Edition, Volume 2 at 1475:

> Where an estate by estoppel exists, and the grantor subsequently acquires the legal title originally purported to be grated, the estoppel is said to be "fed", that is, by a legal fiction, the grantee's estate in estoppel becomes an estate in interest by operation of law. This estate is valid against the world and is created without any further grant or other documentation.

See also: *W. & R. Gillespie Ltd. v. Larrow*, 2000 CarswellNB 57 (N.B. Q.B.) at ¶17.

56 For the purposes of Mr. Hurley, he had a transfer dated November 7, 2002 and would have the benefit of the property conveyed by that transfer. The Trustee, standing in the bankrupt's shoes, would also have the benefit of that transfer at the moment of bankruptcy. The mortgage to CitiFinancial was registered on November 17, 2003 and, at that time, Mrs. Hurley had a 50% registered interest. The problem was that Mr. Hurley's 50% interest pursuant to the transfer had not yet been registered on the Land Titles System.

57 However, in my opinion, once the transfer to Mr. Hurley was registered on Land Titles on February 18, 2004, the benefit of the transfer went automatically to the benefit of the earlier mortgagee, namely, CitiFinancial, or as it is usually expressed, it "*fed the estoppel*" effective the date the CitiFinancial mortgage was registered, namely November 17, 2003.

58 As well as having actual notice of the CitiFinancial mortgage, the Trustee was, at the moment of bankruptcy, already caught by Mrs. Hurley's 50% interest being mortgaged through the CitiFinancial mortgage and by virtue of the doctrine of feeding the estoppel and standing in the shoes of Mr. Hurley, the Trustee became caught by Mr. Hurley's 50% being mortgaged to CitiFinancial upon registration of the transfer pursuant to the doctrine of feeding the estoppel.

59 In his decision, the Registrar held as follows:

> *8. The Transfer dated November 7, 2002 did not pass the estate or interest of Charlin Robichaud (Hurley) and Marie Germaine Robichaud to the Bankrupt and his spouse until registration on February 18, 2004.*
>
> *9. An equitable mortgage by common law was valid and enforceable by foreclosure and sale. Common law practices, however, are subject to statutory enactment and to ignore the clear provisions of* subsection 15(1) *of the LTA would be contrary to the legislative purpose of the statute.*
>
>> 15(1) Except as against the person making the instrument, no instrument shall, until registered, pass any estate or interest in registered land or render the land liable as security for the payment as money.

10. At the time of executing the mortgage, the Bankrupt had no legal estate to pass to the mortgagee. It may be inferred that his intention was to mortgage a future interest and thus create an equitable mortgage.

60 In my opinion, pursuant to Section 15(1) of the *Land Titles Act*, as against the Transferors in the November 7, 2002 Transfer, namely Charlene (Robichaud) Hurley and Marie Germaine Robichaud, Larry Wade Hurley, as of November 7, 2002, had an estate or interest in registered land. On bankruptcy, the Trustee stepped into the bankrupt's shoes.

61 In my opinion, the Registrar erred because the Transfer dated November 7, 2002 was sufficient to make the Hurley property the real property of the Bankrupt as defined in Section 67 of the *BIA* and that real property was subject to the mortgage to CitiFinancial. As the Trustee takes the position of the Bankrupt, the Trustee has a right to the property subject to the CitiFinancial mortgage.

62 The Trustee in bankruptcy is in the same position as the bankrupt. At the time of the making of the proposal, the Bankrupt in this case had received an interest in the property even though the deed was unregistered and that interest was subject to the executed mortgage made in favour of CitiFinancial.

63 If the deed had not been registered by CitiFinancial, the Trustee would have had an obligation to do so. Once the deed was registered the estoppel would be fed and the mortgagee's interest would be valid as against the rest of the world. In the context of bankruptcy, it would become a valid secured claim.

64 Once the transfer to Mr. Hurley was registered on February 18, 2004 under the *Land Titles Act*, the benefit of that transfer went automatically to the benefit of the earlier holder of a registered mortgage, namely CitiFinancial, or in other words, the estoppel was fed effective as of the date of registration of the CitFinancial mortgage under the *Land Titles Act*, namely November 17, 2003.

Conclusion and Disposition

65 In the result, an order will issue allowing the appeal, reversing the decision of the Registrar and setting aside the Trustee's Notice of Disallowance and declaring CitiFinancial to be a secured creditor of Larry Wade Hurley pursuant to the Hurley's mortgage to CitiFinancial dated November 7, 2002. In the circumstances, I make no order as to costs.

Appeal allowed.

End of Document

TAB 12

1929 CarswellOnt 15
Ontario Supreme Court, In Bankruptcy

Weyman, Re

1929 CarswellOnt 15, 10 C.B.R. 547

In re Joseph Weyman

Ex parte Anna Weyman

W. J. Reilley, Esq., Registrar

Judgment: April 27, 1929

Counsel: *V. H. Hattin*, for trustee, Walter D. Inrig.
O. M. Walsh, for Anna Weyman.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency
X Priorities of claims
X.1 Secured claims
X.1.b Forms of secured interests
X.1.b.ii Mortgages and hypothecs

Headnote

Bankruptcy — Priorities of claims — Secured claims — Forms of secured interests — Mortgages and hypothecs

Transfer of Property From Debtor to His Mother Subsequent to Debtor's Assignment — Alleged Preference — Equitable Mortgage Given By Debtor Prior to Assignment — Right of Mother to Set Up Any Claim She Had Prior to the Bankruptcy — The Registry Act, R.S.O., 1927, Ch. 155, Sec. 72.

An agreement to deliver a deed of a farm and certain insurance policies as security for a debt followed by delivery of these securities was sufficient to set up an equitable mortgage. The intent to create an equitable mortgage by delivery or deposit of writings may be established by parol evidence and it is sufficient if only some of the material documents of title are delivered. An equitable mortgage may be created by a deposit of a deed even where the legal title is outstanding in another than the depositor of the deed (*Zimmerman v. Sproat* (1912), 26 O.L.R. 448).

A trustee is not a purchaser for value but he acquires only whatever interest the debtor may have had and a registration of a copy of the assignment on which he relies is not a registration of an instrument which, within the meaning of sec. 72 of *The Registry Act*, would deprive another party of his rights under a lien (*City of Toronto v. Jarvis* (1895), 25 S.C.R. 237, and *Ihde v. Starr* (1909), 19 O.L.R. 471, 21 O.L.R. 407, inapplicable).

***Reilley, Esq.* (Registrar):**

1 This is an application by the trustee to set aside a conveyance made to Anna Weyman, the mother of the debtor, by the debtor, on June 27, 1928, and registered on June 28, 1928. The assignment was made by the debtor on June 18, 1928. The reason given for the transfer was that the debtor had given an equitable mortgage to his mother in respect to the property concerned and had agreed to give her a transfer of the same if the moneys advanced under the equitable mortgage were not repaid.

2 However, as at the time of the bankruptcy the property still stood in the name of the debtor, it was obvious that he had no authority or right whatsoever to make the transfer, after his assignment, and consequently the transfer in itself cannot stand as against the trustee.

3 However wrong the debtor may have been in giving, or his mother in accepting, the transfer, as a matter of right, yet that fact would not estop Mrs. Weyman from setting up any right that she might have had prior to the bankruptcy.

4 The facts at issue appear to be: that a considerable time before, the debtor purchased a dairy business in the town of Waterloo. After running this business for some little time, he found that the buildings on the property which he took over were not what he wanted, and so on or about the beginning of December, 1927, he negotiated for the purchase of a vacant lot, on which it was his intention to erect a plant to continue on with his dairy business. On the original purchase he had borrowed some $3,500 from his mother for which no security was given and for which a claim has been filed by his mother against the estate. At the time of the purchase of the vacant lot, however, he again asked his mother for help, and she loaned him $900 to make the purchase. Apparently she took some objection to making the loan, because the debtor was continually draining her of what money she had, and so on this occasion she appears to have demanded from him that he give her some sort of security.

5 The Weymans originally came from Poland, some twenty or more years ago, and during a great deal of that time have resided in Waterloo. The children have been educated here and speak English fluently, but Mrs. Weyman still is unable to converse, except in a very broken way, in the English language, and appears to understand little or nothing of Canadian customs. She did not appear, however, to be an ignorant person, but still looked back to follow the customs which prevailed in her home land. With that idea in mind, a note was given by the son to his mother, on the occasion of the loan, dated December 6, 1927, and is as follows: —

> 900.00 ...... December 6, 1927.
>
> Nine Hundred Dollars after date *** promise to pay to the order of Anna Weyman. Mother has loaned me on this lot on Waterloo Street, Kitchener, the lot number 417, with interest 3 per cent. Nine Hundred Dollars, with interest at the rate of ** per cent. as well after as before maturity, for value received.
>
> **Witness**
>
> Joseph Weyman, Frank Weyman, Josefa Stusarck, Stefan Stusarck.

6 In addition to Mrs. Weyman taking the note, she also demanded that her son should hand over to her the title deed of the property.

7 Counsel for Mrs. Weyman now contends that the note, together with the delivery of the title deed, created an equitable mortgage which Mrs. Weyman is now entitled to enforce.

8 Evidence was adduced, *viva voce*, before me and it mainly centred about the making of the note. The evidence given was to the effect that the note was made on the evening of this particular day, after the family had finished their supper, between five and six o'clock. There were certain witnesses to the transaction, namely, another brother, Frank Weyman, and a certain Stefan Stusarck and his wife, whom it appears obtained rooms with the Weymans that morning and had moved in for occupation during the course of the afternoon. The evidence given varied but little, but the transaction itself undoubtedly leaves itself open to much suspicion. However much suspicion — and it is suspicion only — might be held with regard to the evidence of the three Weymans, that is the debtor, his mother and brother Frank, I was more or less impressed with the demeanour and reliability of the Stusarcks. The husband was able to give his evidence in broken English; he appeared to be frank and open in all he said, and I have no hesitation in believing what he said. Likewise, his wife, Josefa, was equally straightforward and I am unable to think that she and her husband would be willing parties to manufacture a story of this transaction without any basis of truth at all.

9 Both these witnesses said very definitely that they saw the money counted out and handed to the son and the title deed handed over as well to Mrs. Weyman. Whatever intimacy may have grown up later on among these people, I think I should not omit to state that at this particular date, it was the first time they had ever met or known one another. It may be strongly coincidental that they should have only appeared on the scene at that time, but I have no reason to doubt their honesty in this respect.

10 Certain reliance was placed by the trustee on the fact that the disclosure of this property was not made by the debtor to the trustee in the proper way. The trustee admits that there is no equity in the property whatever and no matter what criticism might be made of the debtor for not saying anything to the trustee about it, yet that fact in itself would not affect the validity of the transaction which took place about seven months before the bankruptcy.

11 I am also fortified in my conclusions that the note was actually made in the way it was and at the time stated, by reason of the fact that it was left with Mr. Nicol Jeffrey, K.C., now Mr. Justice Jeffrey, shortly after the assignment, when a demand was made by the trustee on Mrs. Weyman to give him a quit-claim deed of the property.

12 The trustee relies very strongly on the fact that at that time no mention of the note or deposit of the title deed was made to him, but that in itself may be somewhat excused by the lack of knowledge on the part of Mrs. Weyman.

13 The right to set up an equitable mortgage in the manner herein set forth is supported by the case of *Zimmerman v. Sproat* (1912), 26 O.L.R. 448, where it was held by Riddell, J., on conflicting evidence, that an agreement to deliver a deed of a farm and certain insurance policies as security for a debt was sufficient and where delivery of these securities was made it was sufficient to set up an equitable mortgage. It is there stated that the intent to create an equitable mortgage by delivery or deposit of writings may be established by parol evidence, and it is sufficient if only some of the material documents of title are delivered. It is further held that an equitable mortgage may be created by a deposit of a deed, even where the legal title is outstanding in another than the depositor of the deed.

14 Counsel for the trustee maintains, however, that to set up a mortgage of this sort is in conflict with sec. 72 of *The Registry Act*, R.S.O., 1927, ch. 155, where registration of a document is presumed to establish priority over any unregistered lien. I do not think that that provision applies here. The trustee is not a purchaser in the sense of the word for value. He only acquires whatever interest the debtor may have had and a registration of a copy of the assignment on which he now relies is not a registration of an instrument which, within the meaning of the Act, would deprive another party of his rights under a lien. For instance, if such were the case, a holder of an unregistered deed might equally be said to be debarred in this way.

15 Counsel for the trustee referred to the case of *City of Toronto v. Jarvis* (1895), 25 S.C.R. 237, but I do not think that the case is applicable. It merely affirms the principle that an unregistered instrument shall not prevail over a title obtained through a registered instrument, if taken without notice, but it does not deny the affirmative right to set up an equitable mortgage, such as the one in question. *Ilde v. Starr* (1909), 19 O.L.R. 471, affirmed 21 O.L.R. 407, was also referred to, but I do not think it is applicable at all.

16 I find accordingly that Mrs. Weyman is entitled to an equitable mortgage on the land in question for $900 with interest at three per cent. from December 6, 1927. The transfer made by the debtor to his mother cannot stand and must be set aside. There is no equity in the property for the trustee, and as the trustee has registered a copy of the assignment, which would be a cloud on the title, it will be left to the solicitors to work out some method to remove this defect.

17 The trustee was quite justified in questioning the validity of this transaction, and as there were undoubtedly suspicious circumstances surrounding the matter, for which the Weymans are themselves responsible, there will be no costs either way.

18 The trustee will be entitled to his costs out of the estate.

TAB 13

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

Interpretation

Definitions
2 In this Act,

date of the bankruptcy, in respect of a person, means the date of

(a) the granting of a bankruptcy order against the person,

(b) the filing of an assignment in respect of the person, or

(c) the event that causes an assignment by the person to be deemed;

...

date of the initial bankruptcy event, in respect of a person, means the earliest of the day on which any one of the following is made, filed or commenced, as the case may be:

(a) an assignment by or in respect of the person,

(b) a proposal by or in respect of the person,

(c) a notice of intention by the person,

(d) the first application for a bankruptcy order against the person, in any case

i. referred to in paragraph 50.4(8)(a) or 57(a) or subsection 61(2), or

ii. in which a notice of intention to make a proposal has been filed under section 50.4 or a proposal has been filed under section 62 in respect of the person and the person files an assignment before the court has approved the proposal,

(e) the application in respect of which a bankruptcy order is made, in the case of an application other than one referred to in paragraph (d), or

(f) proceedings under the *Companies' Creditors Arrangement Act*;

...

Duty of Good Faith

Good faith
4.2 (1) Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.

Good faith — powers of court

(2) If the court is satisfied that an interested person fails to act in good faith, on application by any interested person, the court may make any order that it considers appropriate in the circumstances.

...

Preferences

95 (1) A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person

(a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy;

TAB 14

2005 NBCA 55
New Brunswick Court of Appeal

St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.

2005 CarswellNB 285, 2005 CarswellNB 286, 2005 NBCA 55, [2005] A.N.B. No. 204, [2005] N.B.J. No. 204, 139 A.C.W.S. (3d) 803, 13 C.B.R. (5th) 125, 255 D.L.R. (4th) 137, 286 N.B.R. (2d) 95, 748 A.P.R. 95, 9 B.L.R. (4th) 1

In the Matter of the Bankruptcy of St. Anne Nackawic Pulp Company Ltd.

Logistec Stevedoring (Atlantic) Inc. (Respondent / Appellant) and A.C. Poirier & Associates Inc., Trustee in Bankruptcy of St. Anne Nackawic Pulp Company Ltd. (Applicant / Respondent)

Turnbull, Deschênes, Robertson JJ.A.

Heard: March 22, 2005
Judgment: June 2, 2005
Docket: 186/04/CA

Proceedings: reversing *A. C. Poirier & Associates Inc. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2004), 2004 CarswellNB 633, *(sub nom. St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 276 N.B.R. (2d) 147, *(sub nom. St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 724 A.P.R. 147, 7 C.B.R. (5th) 1, 2004 NBQB 457 (N.B. Q.B.)

Counsel: D. Leslie Smith, Q.C. for Appellant
G. Patrick Gorman, Q.C. for Respondent

Subject: Contracts; Corporate and Commercial; Torts; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency
XI Avoidance of transactions prior to bankruptcy
XI.1 Fraudulent preferences
XI.1.e View to prefer
Debtors and creditors
XII Fraudulent conveyances
XII.3 What constituting

Headnote

Debtors and creditors --- Fraudulent conveyances — What constituting

LS Inc. provided storage and loading services to bankrupt — At date of bankruptcy, bankrupt had paper stored in warehouses of LS Inc. — On date bankruptcy declared, bankrupt paid LS Inc. $562,574.72 — Trustee moved successfully for declaration that payment was fraudulent conveyance within meaning of s. 95 of Bankruptcy and Insolvency Act ("BIA") — LS Inc. appealed — Appeal allowed — Mere establishment of preference in fact does not lead to conclusion that payment qualifies as fraudulent preference within meaning of s. 95 of BIA — Where insolvent debtor pays one creditor at expense of another for purposes of carrying on business, payment will more likely than not be deemed not to constitute fraudulent preference — Bankrupt made payment in order to honour its contractual obligations to its customers who had purchased pulp and, hence, to ensure that goods were duly shipped — Bankrupt's dominant intent was to maximize its recovery on its secured debt — Transaction between bankrupt and LS Inc. made good commercial sense.

Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Intention other than to prefer — Transaction in ordinary course of business

LS Inc. provided storage and loading services to bankrupt — At date of bankruptcy, bankrupt had paper stored in warehouses of LS Inc. — On date bankruptcy declared, bankrupt paid LS Inc. $562,574.72 — Trustee moved successfully for declaration that payment was fraudulent conveyance within meaning of s. 95 of Bankruptcy and Insolvency Act ("BIA") — LS Inc. appealed — Appeal allowed — Mere establishment of preference in fact does not lead to conclusion that payment qualifies as fraudulent preference within meaning of s. 95 of BIA — Where insolvent debtor pays one creditor at expense of another for purposes of carrying on business, payment will more likely than not be deemed not to constitute fraudulent preference — Bankrupt made payment in order to honour its contractual obligations to its customers who had purchased pulp and, hence, to ensure that goods were duly shipped — Bankrupt's dominant intent was to maximize its recovery on its secured debt — Transaction between bankrupt and LS Inc. made good commercial sense.

Table of Authorities

Cases considered by *Robertson J.A.*:

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Davis v. Ducan Industries Ltd. (1983), 45 C.B.R. (N.S.) 290, 1983 CarswellAlta 249 (Alta. Q.B.) — considered

Econ Consulting Ltd. (Trustee of) v. Deloitte Haskins & Sells (1985), 56 C.B.R. (N.S.) 60, (sub nom. *Coopers & Lybrand Ltd. v. Deloitte Haskins & Sells)* 31 Man. R. (2d) 313, 1985 CarswellMan 23 (Man. C.A.) — considered

Hudson v. Benallack (1975), [1976] 2 S.C.R. 168, 21 C.B.R. (N.S.) 111, [1975] 6 W.W.R. 109, 7 N.R. 119, 59 D.L.R. (3d) 1, 1975 CarswellAlta 157, 1975 CarswellAlta 139 (S.C.C.) — referred to

Norris, Re (1996), 45 Alta. L.R. (3d) 1, [1997] 2 W.W.R. 281, (sub nom. *Norris (Bankrupt), Re)* 193 A.R. 15, 135 W.A.C. 15, 44 C.B.R. (3d) 218, 1996 CarswellAlta 884 (Alta. C.A.) — referred to

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Statutes considered:

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

s. 95 — considered

s. 95(1) — considered

s. 95(2) — considered

Fraudulent Conveyances Act, 1571 (13 Eliz. 1), c. 5

Generally — referred to

APPEAL by creditor from judgment reported at *St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2004), 2004 CarswellNB 633, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 276 N.B.R. (2d) 147, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 724 A.P.R. 147, 7 C.B.R. (5th) 1, 2004 NBQB 457 (N.B. Q.B.), declaring that payment made by bankrupt was fraudulent preference within meaning of s. 95 of *Bankruptcy and Insolvency Act*.

***Robertson J.A.*:**

1 We are asked to decide whether the application judge erred in holding that a $500,000 payment made by an insolvent debtor to one of its creditors qualifies as a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (BIA). In my respectful view, the application judge erred. Specifically, he failed to ask whether the impugned payment was made with the "dominant intent" of preferring one creditor over the others. When that test is applied to the facts of the present case, it is evident that the debtor harboured no such intent. Admittedly, the creditor in receipt of the payment received a "preference in fact", but that is not a sufficient basis for declaring the payment a fraudulent preference. As will be explained, s. 95 has no application in circumstances where the insolvent debtor is effecting a payment with a view to generating income to be applied against the debts of both secured and unsecured creditors. This remains true even if it were unrealistic to expect that the unsecured creditors would share in the income generated.

2 The essential facts are as follows. Until September 15, 2004, St. Anne Nackawic Pulp Company Ltd. had been operating a pulp mill in Nackawic, New Brunswick. That corporation is a wholly owned subsidiary of St. Anne Industries Ltd. St. Anne Industries is also the primary secured creditor of St. Anne Pulp under a registered general security agreement, the validity of which is being challenged in other proceedings. Finally, St. Anne Industries is a wholly owned subsidiary of Parsons & Whittemore Inc. of New York. On September 15, 2004, St. Anne Pulp made a voluntary assignment in bankruptcy. A trustee was appointed on that date, but later replaced by the respondent, A.C. Poirier & Associates Inc. Prior to the bankruptcy, it was customary for St. Anne Pulp to transport its pulp to Saint John where it was stored in a dockside warehouse belonging to the appellant, Logistec Stevedoring (Atlantic) Inc. Logistec was also responsible for loading of pulp onto ships and trucks. On September 14, 2004, one day prior to the filing for bankruptcy, Logistec was informed by St. Anne Pulp that it would be ceasing operations but that it wanted to ensure that the 10,800 tonnes of pulp, being presently stored in Logistec's warehouse, would be released and loaded onto two ships that were to arrive in Saint John on or about September 18, 2004. As well, one shipment was to be effected by truck. In response, Logistec asserted that it possessed a warehouseman's lien on the goods and refused to release and load any pulp unless it received prior payment, in full, with respect to past due accounts. Logistec informed St. Anne Pulp that it was owed $562,574.72 plus amounts not yet posted to the account. Initially, Logistec demanded payment from anyone other than St. Anne Pulp in order to avoid the possibility of someone alleging the payment was a fraudulent preference. Eventually, Parsons & Whittemore agreed to indemnify Logistec in the event the payment from St. Anne Pulp to Logistec was successfully challenged. The impugned payment was made on September 14, 2004. The next day St. Anne Pulp made a voluntary assignment in bankruptcy. On the same date, St. Anne Industries appointed a receiver under the terms of its security agreement. On September 16, 2004, Logistec determined that a further $232,945.91 would be needed to settle the account. The receiver paid this amount with funds drawn on St. Anne Pulp's bank account, over which St. Anne Industries had taken security. As of September 27, 2004, all the pulp in the warehouse had been shipped.

3 On December 10, 2004, the respondent trustee filed an application for a declaration that the $562,574.72 payment was fraudulent and void under s. 95 of the BIA. Correlatively, the trustee sought judgment for that amount. On December 21, 2004, the application was heard. On the same date the application judge granted the relief requested. His decision is now reported at [2004] N.B.J. No. 477 (N.B. Q.B.). The reasons for judgment address two issues. The first was whether the application proceedings should be converted into an action. On this issue, the application judge ruled in favour of the trustee. Although Logistec pursued this issue on appeal, there is no need to convert this matter into an action. The only factual matter which the parties failed to resolve concerns the extent to which the $500,000 payment related to work already performed, as opposed to work to be performed. However, that factual determination is only relevant if the payment in question were declared a fraudulent preference, in which case part of the payment may have been valid. As I find that the payment in question does not constitute a fraudulent preference, there is no need to dwell on the first issue. As to the second issue, I turn to s. 95. At the relevant time, ss. 95(1) and (2) read as follows:

> **95.** (1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in the bankruptcy.
>
> (2) Where any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.
>
> **95.** (1) Sont tenus pour frauduleux et inopposables au syndic dans la faillite tout transport ou transfert de biens ou charge les grevant, tout paiement fait, toute obligation contractée et toute instance judiciaire intentée ou subie par une personne insolvable en faveur d'un créancier ou d'une personne en fiducie pour un créancier, en vue de procurer

> à celui-ci une préférence sur les autres créanciers, s'ils surviennent au cours de la période allant du premier jour du troisième mois précédant l'ouverture de la faillite jusqu'à la date de la faillite inclusivement.
>
> (2) Lorsqu'un tel transport, transfert, charge, paiement, obligation ou instance judiciaire a pour effet de procurer à un créancier une préférence sur d'autres créanciers, ou sur un ou plusieurs d'entre eux, il est réputé, sauf preuve contraire, avoir été fait, contracté, intenté, payé ou subi en vue de procurer à ce créancier une préférence sur d'autres créanciers, qu'il ait été fait ou non volontairement ou par contrainte, et la preuve de la contrainte ne sera pas recevable pour justifier pareille transaction.

[Note that the wording of ss. 95(1) and 95(2) was amended, effective December 15, 2004, but those changes have no effect on the disposition of this case.]

4 The law is settled with respect to the interpretation and application of s. 95 of the BIA. In order for a payment to a creditor to qualify as a fraudulent preference three conditions precedent must be met: (1) the payment must have been made within three months of bankruptcy; (2) the debtor must have been insolvent at the date of the payment; and (3) as a result of the payment the creditor must have in fact received a preference over other creditors (see *Van der Liek, Re* (1970), 14 C.B.R. (N.S.) 229 (Ont. S.C.).

5 Once the three conditions precedent have been met, a presumption arises that the payment was made "with a view to giving that creditor a preference over the other creditors." However, it is a rebuttable presumption. In that regard, the courts have interpreted the above-quoted phrase as placing an onus on the creditor to establish that the debtor's dominant intent was not to prefer that creditor. The genesis of the dominant intent test is invariably traced to the following passage in *Van der Liek, Re*, at pages 231-32:

> When the trustee has proved these three essentials, he need proceed no further and the onus is then on the creditor to satisfy the court, if he can, that there was no intent on the part of the debtor to give a preference. If the creditor can show on the balance of probabilities that the dominant intent of the debtor was not to prefer the creditor but was some other purpose, then the application will be dismissed, but if the creditor fails to meet the onus, then the trustee succeeds.

6 Certain factors may or not be relevant to the task of ascertaining the debtor's dominant intent. Based on the Supreme Court's decision in *Hudson v. Benallack* (1975), [1976] 2 S.C.R. 168 (S.C.C.), it is settled law that the creditor's knowledge of the debtor's insolvency at the time of the payment is an irrelevant consideration. On the other hand, it is relevant that the corporate debtor knew of its insolvency at the date of the payment. If the debtor is related to the creditor the payment will be scrutinized with greater care and suspicion. However, it is no defence to an allegation of fraudulent preference that the creditor exerted pressure on the insolvent debtor to secure the payment. According to s. 95(2), pressure is no longer a ground for upholding a transaction which is otherwise preferential within the meaning of s. 95(1). Finally, as the dominant intent test is an objective one, we need not be concerned with the subjective intent of the insolvent debtor at the time of the payment. The requisite intent will be drawn from all of the relevant circumstances, as opposed to the debtor's personal ruminations. See generally Lloyd W. Houlden & Geoffrey B. Morawetz, *Bankruptcy & Insolvency Law of Canada*, looseleaf (Toronto: Carswell, 1992) at 4-66 to 4-67, 4-79.

7 Returning to the facts of the present case, the parties agree that conditions precedent (1) and (2) have been met. However, Logistec argues that it was not the beneficiary of a preference in fact and, therefore, s. 95 has no application. A concise and accurate statement of the law as to the relationship between the concept of preference in fact and dominant intent is found in *Norris, Re* (1996), 193 A.R. 15 (Alta. C.A.) at para. 16:

> In considering this section, it is well to keep in mind the distinction between preference in fact and fraudulent preference as that latter is defined in the **Act**. There can be no doubt in this case that Revenue Canada received a preference in fact from the payment of tax made by this debtor on November 25, 1992. Its debt was paid where the debt owing to other ordinary creditors were not. What would render that preference in fact a fraudulent one under s. 95 is the accompanying intent of the insolvent debtor who in the face of imminent bankruptcy is moved to prefer or favour, before losing control over his assets, a particular creditor over others who will have to wait for and accept as full payment their rateable share

on distribution by the Trustee in the ensuing bankruptcy. It is called fraudulent because it prejudices other creditors who will receive proportionately less, or nothing at all, and upsets the fundamental scheme of the **Act** for equal sharing among creditors. That accompanying intent to favour one creditor over another is what makes a preference in fact a fraudulent preference and is referred to in the cases as the "dominant intent". ...

8 In my view, Logistec's argument would have been persuasive had the impugned payment related solely to work or services to be performed in regard to the pulp that was being stored in Logistec's warehouse at the time of the payment. In other words, had the entire $500,000 payment related to the storage and shipping of the 10,800 tonnes of pulp in Logistec's warehouse, Logistec's argument would have been well founded. The situation would be no different had Logistec sold St. Anne Pulp a piece of machinery within the three months preceding the bankruptcy and St. Anne Pulp paid in cash. Such a payment would not qualify as a preference, but rather as a purchase and sale made in the ordinary course of business. However, counsel for Logistec conceded that part of the $500,000 was to be applied against amounts already owing for work undertaken in the past. In these circumstances, Logistec did receive a preference in fact when contrasted with St. Anne Pulp's other creditors who were also awaiting payment of their outstanding accounts. That said, the mere establishment of a preference in fact does not lead to the conclusion that the payment qualifies as a fraudulent preference within the meaning of s. 95 of the BIA. What we are left with is a rebuttable presumption that the payment in question so qualifies.

9 Logistec bore the onus of establishing that St. Anne Pulp's dominant intent was not to prefer Logistec over the other creditors. Alternatively stated, the onus was on Logistec to establish that St. Anne Pulp's dominant intent was to achieve a purpose other than to prefer Logistec. Regrettably, the application judge did not address that issue. For this reason, this court must draw the necessary inference from the primary findings of fact, as found by the application judge. Those facts are not in dispute.

10 St. Anne Pulp's dominant intent may be formulated in at least one of four ways. First, it can be argued that it intended to bestow a preference on Logistec over the other creditors. This is the position of the trustee in bankruptcy. Second, it can be argued that St. Anne Pulp made the payment in order to honour its contractual obligations to its customers who had purchased the pulp and, hence, to ensure that the goods were duly shipped. This is the position of Logistec. The third and fourth characterizations flow from the second. Third, it can be argued that St. Anne Pulp's dominant intent was to generate income in the form of accounts receivable. Moneys collected would be applied against amounts owing to creditors and in the order of priority established at law. Fourth, it can be argued that St. Anne Pulp's dominant intent was to maximize St. Anne Industries' recovery on its secured debt. This characterization is a logical extension of the reality that, as the primary secured creditor, St. Anne Industries is entitled to the proceeds arising from the sale of inventory in priority to the unsecured creditors. If it can be fairly said that St. Anne Pulp's dominant intent falls within either the second, third or fourth formulations, it is my view that the payment in question does not qualify as a fraudulent preference under s. 95 of the BIA. I so find. My formal reasoning is as follows.

11 At common law and even after passage of the *Statute of Elizabeth* in 1570 (fraudulent conveyances) there was no impediment against an insolvent debtor preferring one creditor over another. The question of why a debtor would prefer one creditor over another goes to the question of the debtor's underlying motive, which text writers point out is irrelevant to the issue of dominant intent. Admittedly, it is easy to blur the legal distinctions often drawn between motive, intent, purpose or object. Be that as it may, one cannot help but ask why a debtor would prefer one creditor over another. In some cases the answer is self-evident. The common law allowed an insolvent debtor to engage in selective generosity by paying first those he liked most. Thus, payment to a creditor who is a family member or friend is more apt than not to qualify as a fraudulent preference within the meaning of s. 95 of the BIA: see *Craig (Trustee of) v. Devlin Estate* (1989), 63 Man. R. (2d) 122 (Man. C.A.). Ironically, there is also a reported case in which the debtor allegedly made the payment to a non-related creditor (Revenue Canada) in order to prefer a creditor who was a close but distant relative: see *Norris, Re*. But even if there is no close relationship between the debtor and the preferred creditor, the payment may be caught by s. 95. For example, where the payment is made to a creditor with respect to an indebtedness that had been guaranteed by the debtor's spouse, the payment has been held to be a fraudulent preference: see *Speedy Roofing Ltd., Re* (1990), 74 O.R. (2d) 633 (Ont. C.A.) and also *Royal City Chrysler Plymouth Ltd., Re* (1998), 38 O.R. (3d) 380 (Ont. C.A.).

12 As a general observation, it is evident that the cases in which the creditor has been unable to rebut the presumption arising under s. 95 of the BIA generally involve two factual patterns. First, the insolvent debtor and the creditor in receipt of

the payment are somehow related (e.g., family members). Second, the payment to an arm's length creditor has the subsidiary effect of conferring an unjustified benefit or advantage on the insolvent debtor or a family member. While these factual patterns are not exhaustive, it is clear that the facts of the present case do not support a finding that St. Anne Pulp's dominant intent was to prefer Logistec over the other creditors. But that is not the end of the matter. It is still necessary to isolate, by inference, St. Anne Pulp's dominant intent. In my view, its ultimate goal was to generate income from its accounts receivable, the proceeds of which would be applied first against the debt owing to St. Anne Industries, the primary secured creditor. In brief, St. Anne Pulp's dominant intent was to maximize the amount that the receiver would recover on behalf of St. Anne Industries from the sale of the existing inventory. Does this inference support the allegation of fraudulent preference under s. 95 of the BIA? In my view, it does not for two reasons. First, s. 95 speaks of fraudulent preference in terms of the creditor who received the payment. In this case, it was Logistec who received the payment, not St. Anne Industries. Second, and more importantly, St. Anne Industries cannot be accused of obtaining a fraudulent preference when as a matter of law it is entitled to a preference as a secured creditor of St. Anne Pulp. It is St. Anne Industries that has priority over the unsecured creditors by virtue of its security agreement. St. Anne Industries is to be paid first. If the income generated resulted in a surplus that surplus would be shared pro-rata amongst the unsecured creditors. The fact that St. Anne Pulp made the impugned payment to Logistec with a view to generating income which would be applied first against the debt owing to the secured creditor, St. Anne Industries, and then against amounts owing to the unsecured creditors, cannot be regarded as a valid basis on which to declare the payment to Logistec a fraudulent preference.

13 My understanding of the law is that in circumstances where an insolvent debtor pays one creditor at the expense of another for purposes of carrying on business, the payment will more likely than not be deemed not to constitute a fraudulent preference within the meaning of s. 95 of the BIA. I need only refer to two cases in support of this proposition. In *Davis v. Ducan Industries Ltd.* (1983), 45 C.B.R. (N.S.) 290 (Alta. Q.B.) the bankrupt was a manufacturer of recreational vehicles. The creditor who received the questionable payment was a supplier of parts that the debtor used in its business. The supplier refused to continue to do business with the debtor unless payments were made towards its large outstanding account. Less than three months before the bankruptcy, the debtor made payments to the supplier. Once the debtor became bankrupt, another creditor challenged this transaction as a fraudulent preference. The court found that the dominant intent of the bankrupt in making the payments to the supplier was to secure supplies to continue to run its business and not to give the creditor a preference. Similarly, in *Econ Consulting Ltd. (Trustee of) v. Deloitte Haskins & Sells* (1985), 31 Man. R. (2d) 313 (Man. C.A.) the bankrupt made a payment of $10,000 to accountants in respect of an outstanding account sixteen days prior to making an assignment in bankruptcy. The debtor's income tax returns were due and the accountants required the payment before they would prepare income tax returns for the debtor. The Court of Appeal cited this finding of the application judge with approval:

> I am satisfied that Econ made this payment not to give a preference to Deloitte but to get what it needed and required, i.e. its income tax returns prepared. I think that Deloitte would not have received payment if it had not been necessary for Econ to do so in order to persuade Deloitte to do the work that had to be done.

14 Under Canadian law, if a creditor refuses to perform an act for an insolvent debtor, such as delivering goods or preparing income tax returns, unless its existing account is paid in full or in part, and the account is so paid in order to have the act performed, the transaction will not be deemed a fraudulent preference. This is because the debtor made the payment, not for purposes of preferring the creditor, but rather to obtain the performance of an act which is consistent with what is expected of someone who is acting in the ordinary course of business: see Houlden & Morawetz at 4-79 to 4-80.

15 I admit that in the present case St. Anne Pulp did not make the payment for purposes of carrying on its pulp business in the long term. The impugned payment was made one day prior to St. Anne Pulp's voluntary assignment in bankruptcy. In the interim, however, it was entitled to carry on business albeit for a day. The truth of the matter is that St. Anne Pulp was acting in the best interests of all concerned when it made the payment to Logistec. Let me explain.

16 It would have been irresponsible for either St. Anne Pulp, the trustee or the privately appointed receiver to allow the inventory of pulp to sit in Logistec's warehouse. St. Anne Pulp had entered into binding contracts for the sale of this product. The goods had to be shipped, otherwise St. Anne Pulp would have been in breach of its contractual obligations and liable for any consequential damages. When completed, those contracts generated income for St. Anne Pulp. The net amount invoiced

on the three contracts in question was $1.3 million (U.S.), $2.3 million (U.S.) and $300,000 (Cdn.). Together, the shipment of the pulp generated more than $4.6 million (Cdn.) in accounts receivable. That amount is net of the $800,000 paid to Logistec to ensure the shipment of the pulp ($562,574.72 + $232,945.91 = $795,520.63). In effect, for every $1 paid to Logistec, St. Anne Pulp generated at least $5 in accounts receivable. In addition, by fulfilling the pulp contracts, future pulp sales might not otherwise be jeopardized if the trustee or the receiver decided to operate St. Anne Pulp pending a disposition of the mill.

17 What the trustee fails to appreciate is that although a debtor is insolvent, it is entitled to carry on in the ordinary course of business even if only for a day, so long as it is acting in a commercially reasonable manner and, therefore, in the best interests of all concerned. As well, the trustee appears to be proceeding on the mistaken assumption that prior to the voluntary assignment in bankruptcy any moneys held in St. Anne Pulp's bank account could be used only for purposes of effecting a settlement of all debts on a pro-rata basis. The reality is that if anyone possessed a priority with respect to moneys in St. Anne Pulp's bank account, it was St. Anne Industries under its general security agreement. That security extended not only to St. Anne Pulp's accounts receivable and inventory, but also to all moneys held on St. Anne Pulp's account. It is out of that bank account that the receiver paid Logistec $232,000 in order to secure shipment of the pulp. Had St. Anne Pulp not made the payment to Logistec on September 14, 2004, here is what would have happened. On the following day, the newly appointed receiver would have seized the moneys held in St Anne Pulp's bank account. From that account the receiver would have paid the full amount owing to Logistec, for both past and present work. As it happens, the fact that a substantial payment was made one day prior to the bankruptcy is of no moment. Finally, I should point out that the payment to Logistec will work to the benefit of the unsecured creditors in the event St. Anne Industries' security agreement is successfully challenged and declared invalid. The income generated by that payment ($5 for every $1 paid to Logistec) would become available to all unsecured creditors.

18 At first blush the "optics" of this case cast a long shadow over the actions of St. Anne Pulp, St. Anne Industries and, ultimately, Parsons & Whittemore. It is understandable that Logistec was adamant that it receive an indemnity from Parsons & Whittemore with respect to the possibility the payment in question would be successfully challenged as a fraudulent preference under s. 95 of the BIA. The fact that the payment was made one day prior to the voluntary assignment in bankruptcy, and that both Logistec and St. Anne Pulp were aware of the latter's insolvency, threw suspicion over the transaction. However, when properly viewed, the transaction made good commercial sense. There is no doubt that St. Anne Industries was the true beneficiary of St Anne Pulp's payment to Logistec. But no one can complain of the preferential treatment being accorded that secured creditor. The preference arises as a matter of the security contract and is sanctioned by both the common law and the BIA.

19 For these reasons, I would allow the appeal, set aside the order dated January 7, 2005 and dismiss the application for declaratory and ancillary relief. The appellant is entitled to costs of $3,000 throughout.

Appeal allowed.

End of Document

TAB 15

KeyCite treatment
Most Negative Treatment: Recently added (treatment not yet designated)
Most Recent Recently added (treatment not yet designated): Razor Energy Corp, Razor Holdings Gp Corp., and Blade Energy Services Corp (Re) | 2025 ABKB 30, 2025 CarswellAlta 124, [2025] A.W.L.D. 1095 | (Alta. K.B., Jan 17, 2025)

2021 ABQB 137
Alberta Court of Queen's Bench

CWB Maxium Financial Inc v. 2026998 Alberta Ltd

2021 CarswellAlta 392, 2021 ABQB 137, [2021] 7 W.W.R. 299, [2021] A.W.L.D. 2089, [2021] A.W.L.D. 2090, [2021] A.W.L.D. 2091, [2021] A.W.L.D. 2092, [2021] A.W.L.D. 2093, [2021] A.W.L.D. 2126, [2021] A.W.L.D. 2127, [2021] A.W.L.D. 2128, [2021] A.W.L.D. 2135, [2021] A.W.L.D. 2152, 25 Alta. L.R. (7th) 3, 331 A.C.W.S. (3d) 229, 88 C.B.R. (6th) 196

CWB Maxium Financial Inc. and Canadian Western Bank (Plaintiffs) and 2026998 Alberta Ltd., Grandin Prescription Centre Inc., 517751 Alberta Ltd., 1396987Alberta Ltd., 1396966 Alberta Ltd. and Harold Douglas Loder (Defendants)

Douglas R. Mah J.

Heard: January 11-12, 2021
Judgment: February 23, 2021
Docket: Edmonton 2003-04457

Counsel: Terrence M. Warner, Spencer Norris, for Plaintiffs
Jim Schmidt, for Defendants
Ryan F.T. Quinlan, for Interim Receiver, MNP Ltd.

Subject: Civil Practice and Procedure; Contracts; Corporate and Commercial; Evidence; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency
III Applications for bankruptcy orders
III.2 Application by only creditor
Bankruptcy and insolvency
III Applications for bankruptcy orders
III.5 Practice and procedure on application
Bankruptcy and insolvency
V Bankruptcy and receiving orders
Bankruptcy and insolvency
XVII Practice and procedure in courts
XVII.2 Orders
Bankruptcy and insolvency
XX Miscellaneous
Estoppel
IV Practice and procedure
IV.3 Miscellaneous
Evidence
VI Witnesses
VI.4 Credibility
VI.4.a Duty of judge in assessing

Evidence
VII Examination of witnesses
VII.4 Cross-examination
VII.4.m Effect of failure to cross-examine
Guarantee and indemnity
II Guarantee
II.1 Contract of guarantee
II.1.d Consideration
II.1.d.ii Forbearance to sue
Personal property security
I Nature and scope of legislation
I.10 Miscellaneous

Headnote

Bankruptcy and insolvency --- Bankruptcy petitions for receiving orders — Petition by only creditor

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — Application of good faith doctrines in contractual context may lead to finding that transgressing party was liable in damages for breach of contract, and adopting those doctrines to inform good faith requirement in s. 4.2 of Bankruptcy and Insolvency Act (BIA) may lead to invocation of broad discretionary authority to grant "any order that it considers appropriate in the circumstances" — Secured creditor seeking Receivership Order was "interested person" subject to good faith requirement, and its conduct in events preceding application was covered by that requirement, where that conduct was factually and temporally connected to proceedings, i.e. such conduct is "with respect to" BIA proceeding — Remedy, at least in this case and given broad discretion of court under s. 4.2 of BIA, may include denial of Receivership Order, and conduct of party alleged to have breached good faith requirement should be assessed in light of intent and policy objectives of BIA .

Personal property security --- Nature and scope of legislation — Miscellaneous

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — Defendants relied on s. 66(1) of Alberta Personal Property Security Act (PPSA) regarding good faith requirement, and requirement of good faith here was joined with concurrent duty to act in commercially reasonable manner — Requirement as it appeared in s. 66(1) of PPSA, with regard to secured creditor acquiring or discharging right as described in that section, would not be different than good faith requirement in s. 4.2 of BIA, as it pertained to conduct of creditors, i.e. it prohibited dishonesty and misrepresentation in acquisition or exercise of right — Since standards of good faith and commercial reasonableness were conjunctive, breach of one of them was enough to attract consequences .

Bankruptcy and insolvency --- Bankruptcy petitions for receiving orders — Practice and procedure on petition — Evidentiary issues

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — Evidentiary objection was valid with respect to some of documents, as hearing of matter was cast as summary trial — It was ruled that viva voce evidence was not necessary and that trial would be on record and evidence that was extraneous to record should not be entered — In summary trial of this nature, record consisted of various affidavits filed by parties, transcripts of questioning that occurred on those affidavits, exhibits entered or referred to during questioning and responses to undertakings, if any, and, accordingly, court was confined to record.

Evidence --- Examination of witnesses — Cross-examination — Effect of failure to cross-examine

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to

$970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Plaintiffs brought application for final receivership order — Application granted — L was cross-examined on core contradictory matters, which included origin of residual indebtedness, whether he had been misled in 2019-2020 about whether restructuring would occur, and what he knew about roles of M Inc. and CWB in approving restructuring — It was found that much of objection related to detail, not necessarily central issue, plaintiffs' counsel chose not to cross-examine but rather to challenge L's evidence with reference to other evidence, and uncontradicted evidence did not necessarily mean that it must be accepted for its truth — It was found that M Inc. did not engage in misrepresentation or dishonesty in dealing with L's refinancing request, M Inc. did approve restructuring, and it was just not on terms that L wanted, and in particular, in end, L rejected concept of using forbearance agreement as framework for restructuring.

Evidence --- Witnesses — Credibility — Duty of judge in assessing

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Plaintiffs brought application for final receivership order — Application granted — It could not be seen in evidence where L was promised particular form of restructuring, and evidence showed that M Inc., throughout fall of 2019 and into early 2020, was working assiduously toward restructuring that L was seeking — It was also apparent that there were concerns expressed at M Inc. about pharmacy's ongoing viability which resulted in ultimate decision-maker at CWB approving revised form of restructuring premised on executed forbearance agreement — McG, who was manager at M Inc., was also clear that any refinancing proposal required higher approval, and while McG certainly made recommendation to credit committee, it could not be seen where either M Inc. or McG promised specific outcome to refinancing request — It was found that M Inc. did what it said it would do and did not take steps to enforce its demands until it had reached tend of road with L with regard to restructuring discussions, and when such discussions failed, both sides expected, as reasonable commercial parties would expect, that suspension of enforcement action would end.

Guarantee and indemnity --- Guarantee — Contract of guarantee — Consideration — Forbearance to sue

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — It was found that when M Inc. said it would not resile from major components, L's signing of forbearance agreement was left on "take it or leave it" basis — From M Inc.'s perspective, L wanted M Inc. to strip away some of core components which, it seemed, it felt was necessary to protect its interests — It was not believed that M Inc., in failing to give in to L's objections to forbearance agreement, engaged in bad faith, as M Inc. was entitled to do what it felt was reasonably necessary, such as insist on "essence" of agreement, to protect its interests — L was similarly entitled to do what he believed was necessary to protect his interests, and both did so, and that was why matter was now in litigation.

Bankruptcy and insolvency --- Practice and procedure in courts — Orders — Miscellaneous

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — It was found satisfactory that statement made by M Inc.'s counsel before Associate Chief Justice, concerning retention of management during period of Interim Receivership, was not misleading, intended to mislead or recklessly made — It aligned with what happened with regard to day-to-day management of pharmacy, and it was acknowledged that L did lose his salary as result of business decision made by Interim Receiver — In these circumstances, it could not be seen how failure to disclose exact steps involved in internal approval process or levels of authority within organization, in case of private lender, amounted to breach of good-faith requirement — Good faith in private commercial relations was not same as duty of fairness and transparency with regard to decision-making in public law realm.

Estoppel --- Practice and procedure — Miscellaneous

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — Defendants relied on M

Inc.'s promise of restructuring and McG's advice to L that October 2019 demands would not be enforced as constituting words and conduct that altered existing legal relationship — Context was that parties were in midst of restructuring discussions and McG was in process of putting together restructuring proposal, and those words could not possibly be construed by reasonable commercial persons as meaning that M Inc. had forever relinquished its enforcement rights — Estoppel failed as defence in this case.

Bankruptcy and insolvency --- Bankruptcy and receiving orders — Miscellaneous

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — It was accepted that transparent, Court-supervised process under which Receiver uses its expertise and professional contacts provided best option for selling pharmacy as going concerned and maximizing recovery for all concerned, including L and it was just and convenient to appoint receiver — It was found that L's allegations against M Inc., did not constitute grounds on which to refuse final order of receivership based on "just and convenient" test — Given factual findings, it was further found there had been no breach of good-faith requirement in either context because neither M Inc. nor its representatives engaged in dishonesty or lying in its dealings with L, either at time of initiating loans in 2017 or during restructuring talks.

Bankruptcy and insolvency --- Miscellaneous

Plaintiffs, which were comprised of M Inc. and CWB, with M Inc. being wholly owned subsidiary of CWB, were creditors, and defendant, which included L Group, which owned and operated pharmacies, were debtors — M Inc. was incorporated in Ontario in 2016 in conjunction with CWB's acquisition of certain assets of M Financial Services Inc. (MFSI) and D Financial Services (DFS), and MFSI and DFS were related companies but operated as one larger enterprise — In 2014, L, who was principal of corporate defendant, moved entirety of L Group's loan portfolio to major bank, and L had granted personal guarantees to bank and guaranteed L Group's indebtedness, L Group's cash flow was reduced, L unsuccessfully requested that bank consider refinancing, and recovery action was started — 195 (which was amalgamation of MFSI and DFS) acquired bank's debt and security, and DFS, had acquired loan related to purchase of L Group, and it was agreed between L and DFS that 114 (L Group company that owned C pharmacy) would execute new promissory note and amount was not paid — Drug supplier, K had one outstanding loan guarantee and this was part of bank's security for L Group indebtedness, it was assigned to 195, and having acquired bank's debt and security, 195 carried on with receivership application, causing PwC to be court-appointed as Receiver over L Group in 2016 — PwC reported in 2017 that shortfall to 195 was $2.37 million, and M Inc. said amount remaining unpaid from C Pharmacy, that had been converted to unpaid new promissory note, was part of shortfall, that amount was reduced to $970,000, after 195 reached settlement of $1.4 million with K in respect of its $2 million guarantee of L — Interim receivership order has been in place since March 2020 and extended several times, pending final determination, and M Ltd. was appointed interim receiver — Plaintiffs brought application for final receivership order — Application granted — It was found that M Inc. had failed to disclose that CWB had ultimate decision-making authority with regard to restructuring, however it was also found that L would have some general understanding, as businessperson of his experience, that there was approval process beyond McG — In result, there was no defence based on lack of good faith, and no remedy was available to defendants under s. 4.2 of BIA or s. 66(1) of PPSA, and conclusion regarding s. 4.2 took into account intent and policy objectives of BIA — Here, proceedings have not been invoked for some oblique or improper purpose but rather to subject assets of insolvent debtor to orderly, Court-supervised process for benefit of interested parties — These reasons should not be read as ringing endorsement of M Inc.'s conduct and gaps in communication no doubt contributed to L's suspicions and what now has been year's worth of costly litigation.

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R. v. MacKinnon (1992), 72 C.C.C. (3d) 113, 12 B.C.A.C. 302, 23 W.A.C. 302, 1992 CarswellBC 1093 (B.C. C.A.) — considered

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Statutes considered:

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Generally — referred to

s. 4.2 [en. 2019, c. 29, s. 133] — considered

s. 244 — referred to
Code civil du Québec, L.Q. 1991, c. 64
en général — referred to
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

s. 18.6 [en. 1997, c. 12, s. 125] — considered
Personal Property Security Act, R.S.A. 2000, c. P-7
s. 66(1) — considered
Rules considered:
Alberta Rules of Court, Alta. Reg. 124/2010
R. 7.5-7.11 — referred to
Words and phrases considered:

Good faith

Requirement of good faith as expressed in s. 66 (1) of the *PPSA* relates to a secured creditor's acquisition of or exercise of rights under a security agreement. In relation to section 4.2 of the *BIA*, the good-faith requirement relates to a secured creditor's invoking and conduct of insolvency proceedings under the *BIA*.

APPLICATION by plaintiff creditors for final receivership order.

***Douglas R. Mah J.*:**

A. Background

1 The plaintiff lenders seek a final order of receivership against the defendant debtors. An interim receivership order has been in place since March 2, 2020 and extended several times, pending a final determination. MNP Ltd was appointed as Interim Receiver under that order.

2 The hearing of this matter was delayed for two primary reasons. The first was this Court's response to the COVID pandemic, which resulted in a temporary suspension of some Court proceedings, including this one. The second was my direction that this matter proceed by way of summary trial, in light of the defences to the receivership action raised by the debtors. My oral reasons delivered October 6, 2020 fully set out my thinking in this regard and, in particular, how I felt the record at that time was insufficient to decide the case fairly.

3 The defendants collectively own and operate a pharmacy in St. Albert, Alberta, although Grandin Prescription Centre is the operating entity and 202 is the main borrower. The pharmacy has continued to conduct business under the watchful auspices of MNP Ltd as Court-appointed Interim Receiver of the corporate defendants.

4 In the meantime, Mr. Loder, the principal of the corporate defendants and the personal defendant and guarantor, has been actively trying to sell the pharmacy as a going concern. He deposed in his September 29, 2020 affidavit of his efforts of in that regard. The possibility of sale was mentioned in my October 6, 2020 reasons and discussed at the conclusion of the summary trial on January 12, 2021. A collateral consequence of the delay in the final determination of the receivership has been to give Mr. Loder more time to sell the business.

5 As of the completion of this decision on the evening of February 18, 2021, I have not been advised that he was successful in doing so.

B. A Brief History of the Plaintiffs

6 In these reasons, I refer to the plaintiff CWB Maxium Financial Inc as Maxium and the plaintiff Canadian Western Bank as CWB.

7 Maxium is a wholly owned subsidiary of CWB.

8 Maxium was incorporated in Ontario in February 2016 in conjunction with CWB's acquisition of certain assets of Maxium Financial Services Inc (MFSI) and DeSante Financial Services (DFS).

9 MFSI and DFS were related companies but operated as one larger enterprise. DFS was the specialty healthcare lender, and MFSI did the other business.

10 Following the partial divestiture to CWB, MFSI and DFS were amalgamated and continued as 195. DFS had a portfolio of accounts not acquired by CWB. However, DFS's former staff and infrastructure were absorbed by CWB and, by agreement, shared with 195 so that 195's accounts could be serviced.

11 Mr. Gilchrist and Mr. Wyett, both Maxium vice-presidents, stated during questioning that 195's accounts were in "run-off mode", which meant that the loans were being serviced and collected but that no new loans were initiated.

12 Mr. Gilchrist, Maxium's vice-president of sales, related in his questioning that following the acquisition by CWB, Maxium had a loan approval limit. Maxium's local credit committee (in Toronto) would vet the loan proposal and could approve it if it fell within the limit. If a proposed loan exceeded that limit, the credit committee could recommend support but the proposal then had to be sent to CWB's head office in Edmonton for review and final approval.

C. The Defendants

13 Each of the defendants had these roles in the operation of the pharmacy and its relationship with its lenders:

- 202 is the primary debtor for two loans: the first is a debt, in the form of two promissory notes in favour of Maxium, with a current balance of slightly more than \$3.4 million and relates to the purchase of the pharmacy, and the second is comprised of a series of operating loans for the pharmacy made by CWB in an aggregate amount slightly exceeding \$251,000;

- Grandin Pharmacy Centre owns the pharmacy assets, operates the pharmacy, and is a guarantor of both loans;

- the other numbered companies are related to 202 through the ownership structure and each are also guarantors of both loans;

- Mr. Loder is the principal of all the corporate defendants and a personal guarantor of both loans;

- Mr. Loder was also part of the management of the pharmacy business (although not a pharmacist himself) and did the deliveries, receiving a salary of \$180,000 per annum from the pharmacy;

- 202 and each of the guarantors, among other security, provided a general security agreement to each lender to support their obligations in respect of the two loans.

14 The form of GSA in each case contractually provides for the appointment of a receiver in the event of default, as a remedy.

15 Mr. Loder was 67 years old when he swore his March 2, 2020 affidavit. He has 25 years of experience in the pharmacy industry on both the wholesale and retail sides. Mr. Loder operated the business of Grandin in conjunction with a licensed pharmacist.

D. Background related to the Loder Group

1. Mr. Loder's history and founding of the Loder Group

16 Mr. Loder's 25 years of experience in the pharmacy business includes:

• 14 years with McKesson Canada, a national pharmaceutical distributer, ultimately becoming the director of sales and marketing for western Canada;

• founding the Loder Group of pharmacies in 2008, and operating it until its receivership in 2016;

• acquiring Grandin in 2017 and operating it until the interim receivership in March 2020.

17 The Loder Group owned and operated a series of pharmacies in Alberta, including one in Consort. DFS financed all of the Loder Group stores except for the two locations in Sundre, Alberta, which were financed by CIT.

2. Loder Group moves to BMO

18 In 2014, Mr. Loder was persuaded to move the entirety of the Loder Group's loan portfolio to BMO. Mr. Loder acknowledges having granted personal guarantees to BMO, guaranteeing the Loder Group's indebtedness to BMO.

19 Within a few months of this move, Mr. Loder described how a confluence of negative events conspired to reduce the Loder Group's cash flow, prompting him to request that BMO consider refinancing. BMO was not agreeable and commenced recovery action against the various corporate debtors and Mr. Loder personally.

20 Mr. Loder entered into a forbearance agreement with BMO and engaged a consultant to assist in finding a lender willing to refinance the Loder Group loans, but was unsuccessful. On the eve of BMO's receivership application, 195 acquired BMO's debt and security.

3. Proper nomenclature for Maxium entities

21 195, at the time, was operating under the name Maxium Financial Services. Mr. Loder testified that he did not appreciate that there is a distinction between 195 (which also called itself Maxium) and CWB Maxium, one of the present plaintiffs. The use of the name "Maxium" to describe several different entities involved in this case has been a source of confusion.

22 During the proceedings, 195 operating as Maxium Financial Services was referred to as "old Maxium" and CWB Maxium (which I refer to as simply "Maxium" in these reasons) was referred to as "new Maxium".

23 They are different entities but related by the fact that CWB owns new Maxium and by virtue of CWB's sharing agreement with 195.

4. Missed Balloon Payment on Consort Pharmacy

24 One of the DFS loans acquired by BMO related to the purchase by the Loder Group of the Consort pharmacy. When BMO refinanced the Loder Group portfolio, DFS provided a payout figure that included an amount owed in respect of the Consort pharmacy but, through oversight (only discovered by way of later audit), had quoted only the remaining monthly payments and had omitted a balloon payment of $751,504.

25 As explained in Mr. Gilchrist's October 15, 2020 affidavit, rather than have Mr. Loder request BMO for further funds or reverse the entire transaction with BMO, it was agreed between DFS and Mr. Loder that 114 (the Loder Group company that owned the Consort pharmacy) would execute a new promissory note for $741,501 (the amount owed less $10,000 for legal and administrative costs), which would be guaranteed by Mr. Loder personally. The promissory note and guarantee were in fact executed and delivered and due to be paid on the original due date in July 2014.

26 When the amount owing was not paid, DFS brought separate proceedings against 114 and Mr. Loder. Those proceedings were subsumed into the receivership proceedings that 195 would later bring.

5. McKesson Indemnity

27 Mr. Loder explained that the drug supplier, McKesson, was concerned about independent pharmacies being bought up by the Shoppers Drug Mart chain, which would cause McKesson to lose business. As an incentive to pharmacies to remain independent, McKesson initiated an indemnity program whereby it would provide loan guarantees to the lenders of independent pharmacy owners. He stated that he himself, while a McKesson employee, had been partially responsible for setting up the program.

28 Mr. Loder testified that at the time BMO called its loans, McKesson had only one outstanding loan guarantee to BMO in respect of only one Loder Group pharmacy, that being the North East Pharmacy. That McKesson guarantee was part of BMO's security for the Loder Group indebtedness, and was assigned to 195.

6. Receivership of Loder Group and Residual Indebtedness

29 Having acquired BMO's debt and security, 195 carried on with BMO's receivership application, causing PwC to be Court-appointed as Receiver over the Loder Group on August 26, 2016.

30 In its second and final report to the Court on November 14, 2017, PwC reported that at the conclusion of the receivership, the shortfall to 195 was $2.37 million. Maxium says the amount remaining unpaid from the Consort Pharmacy, that had been converted to the unpaid new promissory note, was part of the shortfall.

31 That amount was reduced to $970,000, after 195 reached a settlement of $1.4 million with McKesson in respect of its $2.0 million guarantee of the Loder Group in November 2017.

E. The Plaintiffs' Application for a Final Receivership Order

32 The plaintiffs say that the defendants have defaulted on their loans. They base their application on these events:

• Maxium issued demands for payment of its loans on both the principal debtor, 202, and the guarantors on October 18, 2019 and concurrently served Notices of Intention to Enforce Security under section 244 of the *BIA*. CWB served its demands, through counsel, on 202 as debtor and on Grandin as guarantor on February 26, 2020, concurrently serving section 244 Notices of Intention to Enforce Security.

• Neither or Maxium nor CWB have been paid.

• On February 27, 2020 CWB received a Requirement to Pay from Canada Revenue Agency with respect to 202's unremitted source deductions to July 31, 2019 for the sum of $301,188.69. On February 28, 2020, Maxium received an RTP for 202's unpaid income taxes for the sum of $14,074.59. Maxium says that the effect of receipt of these RTPs was to freeze the operating accounts of the corporate defendants, thereby depriving 202 of operating funds.

• The Second Report of the Interim Receiver (MNP Ltd), covering the period March 2, 2020 to August 25, 2020, shows the Grandin Pharmacy would have an unfunded operating loss of $277,515.96 if it had been required to pay the Maxium loan payments for that period, even after the costs of the Interim Receiver and its legal counsel are factored out.

• The loss does not include amounts payable to CWB during the period nor any of the pre-interim receivership arrears to either Maxium or CRA.

• Despite his efforts, Mr. Loder, as of this writing, has been unable to find a buyer for the pharmacy as a going concern.

33 The plaintiffs contend that the pharmacy's operation is unsustainable and that, in the absence of receivership or a sale of the pharmacy, Mr. Loder has no plan for dealing with defendants' obligations to any of Maxium, CWB and CRA. They say that not placing the pharmacy in receivership would put their security in grave jeopardy, that a Receiver is best positioned to sell the pharmacy at the most advantageous price and that, having regard to the factors set out in *Paragon Capital Corp v Merchants & Traders AssuranceCo*, 2002 ABQB 430 at para 27, it is "just and convenient" for the Court to exercise its discretion in favour of granting the receivership order.

F. The Defendants' Position

34 For the defendants, this case is about misrepresentation by or on behalf of the plaintiffs, whether deliberate or reckless, which:

• with respect to entering into the Maxium loans in the first place, induced the defendants to take on liability which they say was already paid;

• with respect to restructuring of the loans, lulled Mr. Loder into a false sense of security and prevented him from taking steps by which the defendants could have avoided the current predicament of this litigation; and

• finally, with respect to what was said in Court when the Interim Receiver was appointed on March 2, 2020, caused Nielsen ACJ to make the Interim Receivership Order.

35 In my October 6, 2020 oral reasons, I summarized the allegations as follows:

• First, that Maxium mischaracterized to Mr. Loder the purpose of the $500,000 promissory note signed by 202 on June 29, 2017, saying it was to settle Mr. Loder's indebtedness to McKesson related to his former Loder Group enterprise. In reality, Maxium was recovering what it calls a residual liability related to the receivership of the Loder Group which had been originally financed by DFS, then taken over by BMO and then assigned to 195.

• Second, Mr. Loder says that, even so, the so-called residual indebtedness did not exist. It had been paid off in the previous receivership by specific allocation made by the previous Receiver.

• Third, Mr. Loder says that Maxium represented to him in 2019 and into 2020 that his entire loan portfolio would be restructured. Such a restructuring contemplated re-amortization of the $5000,000 loan segment from a three-year to a ten-year term and increase of the LOC with CWB from $75,000 to $150,000, along with an overall restructuring of the main debt and funds to cover CRA. Mr. Loder contends that he relied upon these representations by not seeking alternative financing elsewhere.

• Fourth, he says that Maxium told him the first set of demands of October 18, 2019 were a mere formality and would not be acted upon, which of course turned out not to be the case, as evidenced by these proceedings.

• Fifth, Mr. Loder alleges that the forbearance agreement he was asked to sign in February 2020 was sprung on him out of the blue, presented to him as a *fait accompli* and he had no opportunity to negotiate its terms.

• Sixth, Mr. Loder says there is a discrepancy between what was said in Court on March 2, 2020 as part of the plaintiffs' counsel's submissions as to what would happen in the interim receivership and what actually happened. The representation made by counsel that current management would remain in place during the interim receivership is wholly contradicted, Mr. Loder contends, by the fact that he (Mr. Loder) was terminated as the pharmacy's manager by the Interim Receiver.

36 Counsel were unable to agree to the language of an Order emanating from my October 6, 2020 decision, and no Order was entered. As a result, submissions during the summary trial were not restricted to the matters outlined above. Mr. Loder's counsel also argued:

• Seventh, Maxium's failure to disclose to Mr. Loder that it did not have the authority on its own to approve the restructuring of 202's loans in 2019-2020, but had to obtain approval from CWB's head office in Edmonton, was a material omission that is also indicative of bad faith.

37 Legally, Mr. Loder contends that:

• Maxium's promises to re-amortize the smaller loan, increase the LOC and restructure 202's overall financing lulled him into a false sense of security. Had Maxium not made those commitments, or had he known they would not be honoured, he would have taken steps to refinance the pharmacy operation elsewhere and would not currently be staring down this receivership application. In other words, the defendants have established an estoppel by words or conduct that precludes the plaintiffs from relying upon their strict legal rights under their security: *Vision West Development Ltd v McIvor Properties Ltd* 2012 BCSC 302 at paras 63-65.

• Maxium's conduct, in the form of misrepresentations and material omissions, disentitle the plaintiffs from the remedy of a final order of receivership because of lack of good faith, invoking section 4.2 of the *BIA* and section 66(1) of the *PPSA*.

• Finally, because receivership is an equitable remedy, having regard to the equities, it would not be just and convenient to grant the remedy in this case.

G. What does 'Good Faith' mean in this case?

1. Section 4.2 of the BIA

38 The defendants invoke section 4.2 of the *BIA* to say a receivership order should not be granted. This recently enacted provision has two components:

• first, any interested person in any proceedings under the *BIA* shall act in good faith with respect to those proceedings; and

• second, if the Court is satisfied that an interested person fails to act in good faith, on application by any interested person, the Court may make any order that it considers appropriate in the circumstances.

39 Here, the defendants say that the plaintiffs have through misrepresentation, mistruth or omission not acted in good faith and that the remedy that flows should be a denial of the receivership order.

40 As a new provision, there is a dearth of case law to guide its application. However, it is obvious that the debtors and the secured creditors here are interested parties within the meaning of the section and that "with respect to" means invoking and conducting insolvency proceedings under the *BIA*.

41 It is less obvious what is meant by "good faith" itself. There is no statutory definition. In the insolvency context, the Supreme Court of Canada in *Century Services Inc v Canada (Attorney General)* 2010 SCC 60 at para 70 said that good faith, along with appropriateness and due diligence, are "baseline considerations" for the Court when exercising authority under the *CCAA*, without elaborating on the nature of good faith.

42 More specifically, the duty to act in good faith in Court-supervised proceedings under Quebec's Civil Code, was recently considered by the Supreme Court of Canada in *9354-9186 Québec Inc. v Callidus Capital Corp*, 2020 SCC 10. In that case, the Court held a secured creditor's refusal to value its security before a proposal vote, so as to enable it to vote as an unsecured creditor and control the outcome of the vote, was done for an improper purpose and therefore in bad faith. The result in *Callidus* is consistent with the earlier decision of the Court of Appeal of Quebec in *Uniforêt Inc, Re*, (2002), 119 ACWS (3d) 185, another restructuring case, to deny special status to a debenture-holder's group due to self-serving motives.

43 In both of these Quebec cases, it can be fairly said that the respective Courts in impugning the motives of the unsuccessful parties were concerned with upholding the intent and policy objectives of the *CCAA*: *Callidus* at paras 78 and 79; *Uniforêt Inc, Re* (2002), QJ No. 5457 (Quebec Superior Court) at para 95 aff'd by Quebec CA.

44 The Quebec cases shed some light on acceptable creditor behaviour during the course of restructuring proceedings. Overall, given the comments of the Supreme Court of Canada in *Callidus* I am prepared to say that the intent and policy objectives of the *BIA* should inform the Court's consideration of the propriety of creditor behaviour in invoking and during receivership proceedings.

45 I need to comment on one further Quebec case concerning *when* the good faith requirement arises. The addition of section 4.2 to the *BIA* was concurrent with insertion of the identically-worded section 18.6 in the *CCAA*. In *Arrangement Relating to Nemaska Lithium Inc*, 2020 QCCS 1884, Gouin JCS held at paras 23-25 that the good faith requirement in section 18.6 arises only *after* the proceedings (in this case, restructuring) are initiated. This runs counter to my statement above that the good faith requirement in the section 4.2 covers previous conduct where it involves events precipitating Court involvement.

46 Importantly, in *Nemaska*, Gouin JCS was dealing with an application by an unsecured creditor for payment of an unpaid account for the manufacture of custom equipment, incurred prior to the granting of the initial Order under the *CCAA*, which Order included the usual stay provision. The applicant alleged that Nemaska's representatives had engaged in bad faith during the negotiations for the manufacturing contract and relied on section 18.6 to avoid operation of the stay and get paid before any other creditors.

47 Gouin CJS, in my view, rightly rejected the application on the basis that awarding payment to the creditor at this stage would seriously thwart the reorganization effort and was antithetical to the purpose of the *CCAA*. The creditor's remedy was to file a claim in the proceedings, not to skirt the proceedings by means of section 18.6.

48 In *Nemaska*, the conduct of Nemaska alleged by the creditor was unconnected to the *CCAA* proceedings. Here, the defendants are saying, in effect, that the *bringing* of a receivership application, in the circumstances they allege, lacks good faith. Within this context, I am prepared to say that section 4.2 of the *BIA* applies.

49 Still, the effect of section 4.2 should not reach back into time indefinitely. The conduct in question must be connected to the proceedings. The prospect of receivership proceedings first materialized with the sending of the first set of demand letters in October 2019. The sending of the demand letters and Maxium's conduct in relation to the loans thereafter, when receivership loomed, can be said factually and temporally to be connected to or "in respect of" the proceedings.

50 The next question is: where does one look to find the content of this good faith requirement?

51 In the contractual context, in *Bhasin v Hrynew* 2014 SCC 71 at para 33, the Court recognized good faith as a general organizing principle under the common law of contract, which (at para 66):

> ... manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines. But we should also recognize that this list is not closed ...

52 In this context (at para 65), the Supreme Court of Canada comments that the duty of good faith does not require one party to serve the interests of the other but rather not to undermine the other's interests in bad faith. It is not elevated to a fiduciary duty. Then at para 73, the Court imposes a duty of honesty in contractual performance as a key aspect of the duty of good faith:

> ... I would hold that there is a general duty of honesty in contractual performance. This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract; it is a simple requirement not to lie or mislead the other party about one's contractual performance. Recognizing a duty of honest performance flowing directly from the common law organizing principle of good faith is a modest, incremental step. The

requirement to act honestly is one of the most widely recognized aspects of the organizing principle of good faith: see Swan and Adamski, at § 8.135; O'Byrne, "Good Faith in Contractual Performance: Recent Developments", at p. 78; Belobaba; ***Greenberg v. Meffert*** (1985), 1985 CanLII 1975(ON CA), 50 O.R. (2d) 755 (C.A.), at p. 764; Gateway Realty, at para. 38, *per* Kelly J.; ***Shelanu Inc. v. Print Three Franchising Corp***. (2003), 2003 CanLII 52151 (ON CA), 64 O.R. (3d) 533 (C.A.), at para. 69. For example, the duty of honesty was a key component of the good faith requirements which have been recognized in relation to termination of employment contracts: ***Wallace***, at para. 98; ***Honda Canada***, at para. 58.

53 A closer analogy to the present case is found in the Supreme Court of Canada's recent decision in *CM Callow Inc v Zollinger*, 2020 SCC 45 where the Court agreed with the trial judge who found that the defendant condo corporations (through their agent Zollinger) had by means of omission or silence misled the plaintiff into believing its snow removal contract would be renewed, when in actuality the decision had been made months earlier to terminate it. By making the plaintiff believe that the contract would be renewed, the defendants induced the plaintiff to provide an entire summer season of free services as an incentive for renewal.

54 In *Callow*, the Court extended the general duty of honesty in contractual performance to the exercise of discretionary decisions, even where the decision-maker has an absolute right by contract to make the decision.

55 In speaking for the majority, Kassirer J helpfully observes with regard to modes of dishonesty:

> [90] These examples encourage the view that the requirements of honesty in performance can, and often do, go further than prohibiting outright lies. Indeed, the concept of "misleading" one's counterparty — the term invoked separately by Cromwell J. — will in some circumstances capture forms of silence or omissions. One can mislead through action, for example, by saying something directly to its counterparty, or through inaction, by failing to correct a misapprehension caused by one's own misleading conduct. To me these are close cousins in the catalogue of deceptive contractual practices (see, e.g., *Yam Seng Pte Ltd. v. International Trade Corp. Ltd.*, [2013] E.W.H.C. 111, [2013] 1 All E.R. (Comm.) 1321 (Q.B.), at para. 141).
>
> [91] At the end of the day, whether or not a party has "knowingly misled" its counterparty is a highly fact-specific determination, and can include lies, half- truths, omissions, and even silence, depending on the circumstances. I stress that this list is not closed; it merely exemplifies that dishonesty or misleading conduct is not confined to direct lies. ...

56 The relationship between lender and debtor is contractual. The remedy of receivership sought from the Court is a contractual component and its initiation is subject to the exercise of the lender's discretion, although the legal test is statutory. The good faith to be exhibited must be "in respect of" *BIA* proceedings which, as I concluded, encompasses not only conduct in the course of such proceedings but also the conduct that precipitated the proceedings, as it relates to the indebtedness in question and the relationship between lender and borrower.

57 The application of good faith doctrines in the contractual context may lead to a Court finding that the transgressing party is liable in damages for breach of contract. Adopting those doctrines to inform the good faith requirement in section 4.2 of the *BIA* may lead to the Court invoking a broad discretionary authority to grant "any order that it considers appropriate in the circumstances", which presumably includes denial of the requested receivership order.

58 At least so far as a creditor invoking insolvency proceedings is concerned, I find it appropriate to import common law concepts stated in *Bhasin* and developed in *Callow* [1], as cited above, to give content to the notion of "good faith" as found in section 4.2 of the *BIA*. I temper that statement only by saying that the Court must also remain cognizant of and seek to advance the policy objectives underlying the *BIA*.

59 I summarize and conclude on this point as follows:

- Interested persons in proceedings under the *BIA* are statutorily required to act in good faith with respect to those proceedings.

• A secured creditor seeking a Receivership Order is an "interested person" subject to the good faith requirement, and its conduct in events preceding the application is covered by that requirement, where that conduct is factually and temporally connected to the proceedings, i.e. such conduct is "with respect to" *BIA* proceedings.

• Based on previous caselaw, the statutory requirement of good faith in the insolvency context requires that an interested party not bring or conduct proceedings for an oblique motive or improper purpose.

• Further, since there is no statutory definition of "good faith", the common law relating to the organizing principle of good faith in contractual performance may be used to inform the good faith requirement in section 4.2 of the *BIA* in the present circumstances, that is, the relationship between lender and borrower being essentially contractual in nature and, in this case, the contract includes a right on the lender's part to appoint a receiver or to seek such appointment.

• The duty of good faith, in this case, requires the parties not to lie to or mislead the other with respect to the status of the loan or the state of the lender-borrower relationship. It does not impose a duty of loyalty or disclosure, or require the subordination of one's own interests to the other, and falls short of a fiduciary duty.

• Whether dishonesty has occurred in a given case is fact-specific and may, depending on the circumstances, include lies, half-truths, omissions and even silence.

• A remedy, at least in this case and given the broad discretion of the Court under s. 4.2, may include denial of the Receivership Order.

• The conduct of the party alleged to have breached the good faith requirement should be assessed in light of the intent and policy objectives of the *BIA*.

60 I emphasize that I am dealing here only with a situation of allegations of lack of good faith in respect of a secured lender's conduct in the events that precipitated the bringing of an application to appoint a receiver. The content or degree of the good faith requirement will necessarily vary with different *BIA* actors and different facts.

2. Section 66(1) of the PPSA

61 The defendants also cite and rely on section 66(1) of *PPSA*, which provides that all rights, duties or obligations arising under a security agreement must be exercised or discharged in good faith and in a commercially reasonable manner. Again, there is no statutory guidance as to what is meant by "good faith". The authorities have considered the good faith requirement in section 66(1) of Alberta's *PPSA* in these contexts:

• Whether a supposed *bona fide* purchaser for value had a role in improperly discharging a true secured creditor's security interest registration, so as to acquire clear title to stolen trucks, was a question of good faith for determination at trial: *E Dehr Delivery Ltd v Dehr* 2018 ABQB 846 at para 71;

• The duty informs the exercise of a secured party's manner of disposing of the collateral: *Edmonton Kenworth Ltd v Kos* 2018 ABQB 439 at paras 80-81; and whether such realization is provident or improvident: *Farm Credit Canada v Fenton* 2008 ABQB 268 at paras 11-16;

• The good faith requirement applies to the way a Court-appointed Receiver conducts a bid process: *Cobrico Developments Inc v Tucker Industries Inc* 2000 ABQB 766 at para 35;

• Professor Rod Wood gives this example in his 2017 paper "A Guide to the Alberta Personal Property Act" [2] at para 8.2.3:

> Subsection 66(1) imposes an obligation on parties to act in good faith and in a commercially reasonable manner. A failure to meet the good faith standard might occur where the secured party misled the other secured party into thinking that its security interest was properly perfected (by misrepresenting the name of the debtor) or by performing some

> act which had the effect of delaying the perfection of the other party's security interest. In such a case, the failure to act in good faith will preclude the secured party from relying upon the priority that would otherwise be available to it.

62 I note that the requirement of good faith here is joined with a concurrent duty to act in a commercially reasonable manner. The latter seems particularly apt for cases where improvident realization is alleged. Apart from that, the specific examples relating to good faith in *E Dehr* and by Professor Wood lead me to conclude that the requirement as it appears in section 66(1) of the *PPSA*, with regard to a secured creditor acquiring or discharging a right as described in that section, would not be different than the good faith requirement in section 4.2 of the *BIA*, as it pertains to the conduct of creditors, i.e. it prohibits dishonesty and misrepresentation in the acquisition or exercise of a right.

63 Since the standards of good faith and commercial reasonableness are conjunctive, the breach of one of them is enough to attract consequences. In this case, I am concerned only with the good faith standard.

H. Evidentiary Objections

64 As part of its case at the summary trial, the defendants took the position that some of the evidence relied upon by the plaintiffs was inadmissible, and therefore the submissions based on that evidence should be given no weight.

65 The objections broadly took two forms:

- First, that certain documents relied on were not part of the record before the Court; and

- Second, that some of the conclusions urged upon the Court with respect to Mr. Loder's state of mind should be disregarded because he was not cross-examined on those specific points as required by the rule in *Browne v Dunn*, (1893), 6 R 67 at 70 (UK HL).

1. Documents Not in the Record

66 In the first respect, the objection is valid with regard to some of the documents. The hearing of this matter was cast as a summary trial. Although the Rules set out in some detail the process for applying for summary trial (see Rules 7.5 through 7.11), there is nothing that dictates precisely what is to happen at a summary trial.

67 At one point in the lead-up to the summary trial, I ruled that *viva voce* evidence was not necessary and that the trial would be on the record. In fact, the very reason for ordering a summary trial was so that a more robust record could be produced.

68 Mr. Schmidt argued that a summary trial is still a trial, and only admissible evidence should be entered. Evidence that is extraneous to the record should not be entered. In a summary trial of this nature the record consists of the various affidavits filed by the parties, the transcripts of the questioning that occurred on those affidavits, the exhibits entered or referred to during the questioning and responses to undertakings, if any.

69 I agree with Mr. Schmidt that the Court is confined to the record. Mr. Warner, on behalf of the plaintiffs, appeared to mostly agree with that proposition and conceded that some of the documents included in the plaintiff's evidence book were not part of the record and therefore not properly before the Court.

2. The Rule in Browne v Dunn

70 With regard to the second class of objections based on the rule in *Browne v Dunn*, I acknowledge that a witness should generally be confronted during cross-examination, with the contrary version of the facts, if the adverse party intends to rely on that contrary version. The intent behind the rule is to give notice to a witness of cross-examining counsel's intention to later impeach. The Supreme Court of Canada says in *R v Lyttle* 2004 SCC 5 at para 64:

> The rule in ***Browne v Dunn*** requires counsel to give notice to those witnesses whom the cross-examiner intends later to impeach. The rationale for the rule was explained by Lord Herschell, at pp. 70-71:

> Now, my Lords, I cannot help saying that it seems to me to be absolutely essential to the proper conduct of a cause, where it is intended to suggest that a witness is not speaking the truth on a particular point, to direct his attention to the fact by some questions put in cross-examination showing that that imputation is intended to be made, and not to take his evidence and pass it by as a matter altogether unchallenged, and then, when it is impossible for him to explain, as perhaps he might have been able to do if such questions had been put to him, the circumstances which it is suggested indicate that the story he tells ought not to be believed, to argue that he is a witness unworthy of credit. My Lords, I have always understood that if you intend to impeach a witness you are bound, whilst he is in the box, to give him an opportunity of making any explanation which is open to him; and, as it seems to me, that is not only a rule of professional practice in the conduct of a case, but is essential to fair play and fair dealing with witnesses. Sometimes reflections have been made upon excessive cross-examination of witnesses, and it has been complained of as undue; but it seems to me that a cross-examination of a witness which errs in the direction of excess may be far more fair to him than to leave him without cross-examination, and afterwards to suggest that he is not a witness of truth, I mean upon a point on which it is not otherwise perfectly clear that he has had full notice beforehand that there is an intention to impeach the credibility of the story which he is telling.

71 In this regard, as revealed in the transcript, Mr. Loder was cross-examined on the core contradictory matters, namely:

- The origin of the residual indebtedness (whether it stemmed from his McKesson guarantee or not);

- Whether he had been misled in 2019-2020 about whether a restructuring would occur, including his version of the discussion about the re-amortization of the $500,000 debt and the increase to the LOC;

- Whether Mr. Loder had been told the October 2019 demands would not be acted upon;

- The circumstances of the tendering of the draft forbearance agreement;

- What he knew about the roles of Maxium and CWB in approving the restructuring;

72 Here, counsel for the plaintiffs submits that Mr. Loder is not telling the truth about his state of mind on certain points. The cross-examination of Mr. Loder was directed at the plaintiffs' contrary factual theory of the main points listed just above.

73 Another important aspect is whether the point is core or merely detail. Ontario Court of Appeal Justice David Paciocco and his co-author Dean Lee Stuesser in their text *The Law of Evidence* (Toronto, Irwin Law:2015) at page 473 say:

> In order to comply with the rule, counsel is not required to slog through every single detail to be contradicted. The necessary unfairness that triggers the rule only arises where there is a failure to cross-examine on central features or significant matters. Arguably all of the examples above concern "central" issues. The fundamental question is whether the witness was given an opportunity to respond to the cross examiner's contrary position and not necessarily all the details.

74 The objection on this score was premised on the lack of cross-examination, or the perceived lack of adequate cross-examination, on certain factual points in dispute, and then plaintiffs' counsel's reliance upon contrary evidence advanced by the plaintiff and making of submissions based on that contrary evidence. However, the trier of fact is not required by any rule of law to accept a party's evidence on which there has been no (or no adequate cross- examination). The Court of Appeal of Appeal observes in *R v Nielson* 2019 ABCA 403 at para 37:

> [37] Choosing not to cross-examine a witness, but instead asking the trier of fact to disbelieve a witness based on other evidence adduced in the trial, is a valid exercise and does not invoke the rule from ***Browne v Dunn***. It is illogical for a trier of fact to be expected to accept evidence which they disbelieve just because it has not been subject to cross-examination: ***R v Mete*** (1971), [1973] 3 WWR 709 at 712, 1971 CanLII 1422 (BCCA).

75 Further, at para 38, the Court of Appeal notes that the rule in *Browne v Dunn* has its limitations:

> [38] This was not a case where Crown counsel "ambushed" the appellant by impeaching his credibility in closing argument. As stated in ***R v Quansah***, 2015 ONCA 237 at para 82, 125 OR (3d) 81:
>
> > [i]n some cases, it may be apparent from the tenor of counsel's cross-examination of a witness that the cross-examining party does not accept the witness's version of events. Where the confrontation is general, known to the witness and the witness's view on the contradictory matter is apparent, there is no need for confrontation and no unfairness to the witness in any failure to do so.

76 As acknowledged in *R v Neilson* at para 53, the rule in *Browne v Dunn* can also apply to final argument. The Court of Appeal noted in *R v Sawatzky*, 2017 ABCA 179 (at paras 26 and 69), the Court has many options to deal with a breach of *Browne v Dunne* and the trial judge is left with discretion as to remedy. The nature of the remedy depends on the severity of the breach and the degree to which it prejudices the witness or the opposing party: *R v Quansah* 2015 ONCA 237 at para 117.

77 The Court's discretion includes whether to weigh the failure to cross-examine against the cross-examining party. It may, but as a matter of law, is not obliged to do so: Paciocco and Stusser at pp 473-474, citing *R v McKinnon*, (1992), 72 CCC (3d) 113 (BCCA). The discretion inherent in the rule is described by the Supreme Court of Canada at para 65 of *R v Lyttle* as follows:

> The rule, although designed to provide fairness to witnesses and the parties, is not fixed. The extent of its application is within the discretion of the trial judge after taking into account all the circumstances of the case. See ***Palmer v The Queen***, 1979 CanLII 8 (SCC), [1980] 1 S.C.R. 759, at pp. 781-82; J. Soyinka, S. N. Lederman and A. W. Bryant, *The Law of Evidence in Canada* (2nd ed. 1999), at pp. 954-57.

78 By far the bulk of the evidentiary objections related to *Browne v Dunn*, can be answered on these grounds:

- Mr. Loder was cross-examined on the core contradictory matters;
- Much of the objection relates to a detail, not necessarily a central issue;
- Plaintiffs' counsel chose not to cross-examine but rather to challenge Mr. Loder's evidence with reference to other evidence (both documentary and other witness evidence);
- Mr. Loder's view on contradictory matters was generally known (from his affidavits);
- Mr. Loder was not ambushed or surprised by plaintiffs' counsel final argument, since the plaintiffs' position on the contradictory matters was clearly set out in their evidence; and
- Uncontradicted evidence does not necessarily mean that it must be accepted for its truth.

79 Finally, when encountering a breach of the rule in *Browne v Dunn* on a central issue, I will exercise discretion in weighing the evidence against the plaintiffs or not.

I. Credibility

80 Both sides say that this case will be decided on its facts and the facts rest on the credibility of the individuals involved.

81 The plaintiffs say that Mr. Loder, for himself and on behalf of the corporate defendants, as an experienced businessman could not have misapprehended the basis for the $500,000 promissory note, nor the state of his relationship with Maxium as it approached the initiation of the receivership application, as Maxium and CWB were as open and transparent with him as required. The plaintiffs say that the evidence put forward by their representatives should be preferred.

82 Mr. Loder and the other defendants contend (through counsel) that the affidavit evidence of the plaintiffs' representatives does not align with their actual recollection of the events as shown in cross-examination. The defendants also say that the

plaintiffs' representatives attempt to gloss over or minimize what they did or said to mislead Mr. Loder. Much of their evidence, says Mr. Loder, therefore cannot safely be relied upon by the Court.

83 In considering credibility in a commercial case, the trier of fact may have regard to factors such as:

• what reasonable commercial parties acting in good faith might do or say;

• whether a person's words or actions align with what the Court knows about the individuals and institutions in question, and the way the world works;

• whether the evidence is internally consistent, that is, whether the evidence changes or evolves from one telling to the next;

• whether the evidence is externally consistent, that is, whether the evidence aligns with other witness evidence or facts that are accepted;

• whether there has been an embellishment or tailoring, or whether the evidence sounds convenient or coincidental;

• whether the witness can adequately explain things that are or should be within that witness's knowledge.

84 It is an exercise in determining what is more likely than not to have happened, based on the documents presented to the Court and the testimony of witnesses. The factors named above are generally applicable to a credibility inquiry in any case, with regard paid in a commercial case to the knowledge and experience of the particular commercial actors, their relationship with one another and what is overall plausible in terms of to how reasonable commercial parties would act.

J. Factual Findings

1. Was Mr. Loder told by Maxium that the $500,000 promissory note was to pay back the McKesson indebtedness?

85 The gist of Mr. Loder's position on this issue is that the $500,000 promissory note was extracted from 202 (and guaranteed by him) based on false pretenses. In effect, he says, Maxium misrepresented to him that he was required to resolve some pre-existing indebtedness to McKesson (by way of this $500,000 promissory note in favour of Maxium) as a condition of the $3 million loan for the acquisition of Grandin.

86 Maxium is clear that the $500,000 promissory note was proposed in compromise of Mr. Loder's pre-existing debt to 195, in relation to the residual indebtedness remaining from the previous receivership, and by virtue of his guarantees to 195 and BMO.

87 Mr. Loder's own evidence evolves on this point. At para 10 of his March 2, 2020 affidavit, Mr. Loder deposes:

> However, quite late in the process, CWB-Maxium told me that, in order for the financing to go forward, I needed to pay out $500,000 CWB-Maxium alleged was owing by me in the context of a previous pharmacy business I operated. It was put to me that CWB would loan the $500,000 to discharge what was allegedly owed to Maxium, and this amount would be "tacked on" to what was owed in connection with the financing of the purchase of the Pharmacy.

88 This is Mr. Loder's evidence about his telephone conversation with Mr. Gilchrist in June 2017 concerning resolution of the residual indebtedness as part of the financing transaction for Grandin. What is notable about this evidence is that it aligns exactly with Maxium's position, that is, the current lender required the promissory note to deal with indebtedness to the previous lender in relation to the previous business. Earlier in that same affidavit (at para 4), Mr. Loder correctly distinguishes between the current lender and the previous lender and comments that they are related. This affidavit shows that Mr. Loder, by his own words, clearly differentiated between old Maxium and new Maxium and understood the origin of the $500,000 loan. It also shows he was not mistaken, as has been argued on his behalf, about to whom the residual indebtedness was owed.

89 In his subsequent affidavit of September 29, 2020, Mr. Loder makes the transition to his McKesson indebtedness as the reason given by Maxium for requiring the $500,000 promissory note. He says at para 11:

> In fact, in 2017 I was told by Dan Gilchrist, Maxium's representative dealing with the financing of the Pharmacy (i.e. the Grandin Prescription Centre), that the Secondary Loan was related to Maxium's take-out of all or part of a debt allegedly owing by me, as guarantor, to the McKesson organization ("McKesson").

90 In his November 24, 2020 questioning on affidavit, Mr. Loder was asked whether it made sense to him that Maxium would be seeking payment on a guarantee that Mr. Loder had given to a third party. He responded that he did not make a judgment and made no further inquiries. He said he simply accepted it, and was more concerned about the amortization period than anything.

91 McKesson's guarantee to BMO was assigned to 195. Mr. Loder's guarantee to McKesson was not assigned. We know that because McKesson still held Mr. Loder's guarantee and later tried to collect on it.

92 The defendants' theory is that Maxium, on behalf of 195, was collecting the shortfall on the guarantee that McKesson had given to BMO (and then assigned to 195). Since 195 had settled with McKesson for $1.4 million on a $2.0 million guarantee, it was seeking the balance form Mr. Loder. The problem with this theory is that Mr. Loder agreed to the $500,000 promissory note in June 2017, some five months before 195 settled with McKesson and before 195 knew there would be a shortfall and what amount it would be.

93 Further, Mr. Loder knew that 195 had reached a settlement with McKesson with regard to the indemnity which McKesson had given to BMO in respect of the Loder Group's former North East Pharmacy. He knew this because he was provided with a copy of the settlement details in an email from Tracy Babiuk of McKesson on November 16, 2017 (which date was, incidentally, prior to the date of the issuance of the promissory note). Ms. Babiuk's email indicates that McKesson sustained a $1.4 million loss and reminded him that he had given personal guarantees to McKesson, including for the store in question that had generated the loss. The subject line of that email was: "Doug Loder personal gtee recovery."

94 One would expect that Mr. Loder would have contacted either Maxium or McKesson to say that he had already agreed to pay $500,000 to Maxium to retire that personal guarantee indebtedness. There is no such communication in evidence. Certainly, there should also have been hesitancy on Mr. Loder's part to sign the promissory note (which he did on December 1, 2017) since McKesson itself, around the same point in time, had signalled that it was looking to him to pay on his guarantee for that store.

95 As it turns out, McKesson and Mr. Loder are now engaged in litigation on that guarantee.

96 The June 8, 2017 credit application submitted by Mr. Gilchrist to Maxium states that

> CWB Maxium Financial ("CM") has been requested to provide (i) $3,000M in loan financing to assist with the share purchase of Grandin Prescription Centre Inc. and 517751 Alberta Inc. located in St Albert, AB and (ii) $500,000 to clear personal obligations of the principal of the Borrower owing to Maxium Financial Services.

97 Both Mr. Gilchrist's affidavit and the credit application contain calculations indicating that Grandin's proposed cash flow was sufficient to service both the $3 million facility and the $500,000 facility. Mr. Gilchrist says in his affidavit that he made it clear to Mr. Loder since June 2017 that dealing with the previous indebtedness stemming from the Loder group was part of the financing of the acquisition of Grandin. Maxium's documents bear out this position.

98 Mr. Loder recalls only one conversation about the $500,000 indebtedness. He says that it took place on June 20, 2017 and it was with Mr. Gilchrist. It is quite possible that one party or the other mentioned McKesson since 195 was still looking to McKesson on its guarantee to reduce the Loder Group shortfall. However, I cannot and do not conclude that Mr. Gilchrist mistakenly or deliberately told Mr. Loder that Maxium required another $500,000 commitment from him on account of his guarantee to McKesson, for the following reasons:

- The first iteration of the conversation as recounted in Mr. Loder's first affidavit aligns with Maxium's position. Mr. Loder's evidence then changes as he provides a second and different version, now invoking McKesson, in the second affidavit.

• Why Maxium would call on Mr. Loder to pay on a liability he had to a third party does not make sense. This is particularly so because Mr. Loder, besides being an experienced businessman in the retail drug sector, was himself in part responsible for designing McKesson's indemnity program for independent pharmacies. He understood the program well. He also understood what a personal guarantee is and how it works. In this regard, 195 did not hold Mr. Loder's guarantee to McKesson. It was retained by McKesson. It is totally unclear why he thought Maxium could collect on his guarantee to McKesson. His only response is that he didn't question it. That is not a plausible answer to me.

• The defendants' theory that Maxium was attempting to collect the shortfall from the McKesson guarantee to BMO by making Mr. Loder sign the promissory note does not work because the timing does not line up. Maxium asked Mr. Loder for the promissory note in June 2017. It did not know until November 2017 that there would be a shortfall.

• He was notified by McKesson on November 16, 2017, about two weeks before he signed the promissory note, that McKesson still held his personal guarantee. In the very least, this should have prompted some inquiry on his part to ensure he was not being asked to pay the same debt twice.

• Furthermore, Mr. Loder was represented by counsel at Bishop & McKenzie LLP in respect of the acquisition and financing of Grandin. He had access to legal counsel with regard to the promissory note at the relevant time. After learning on November 16, 2017 of McKesson's settlement with Maxium and McKesson's interest in looking to his McKesson guarantee, Mr. Loder still signed the promissory note on December 1, 2017, without apparently raising any alarm.

• Maxium's documents support Maxium's position.

99 To be sure, in terms of customer service, Maxium could have done more to document the transaction with Mr. Loder by, for example, sending him a letter in or after June 2017 confirming the purpose of the loan. Nonetheless, it cannot be said that factually Maxium misled Mr. Loder as to the purpose of the loan.

2. Did the residual indebtedness actually exist?

100 Mr. Loder takes exception to the notion, first expressed in Mr. Wyett's affidavit of March 16, 2020, that he owed any money in respect of the Consort pharmacy that could comprise the residual indebtedness. He notes in his own affidavit of September 29, 2020 that a purchase price $994,964 was allocated to the Consort pharmacy. Mr. Loder asserts that this amount extinguishes any debt owing in respect of that pharmacy.

101 In response, the plaintiff's counsel points out that the allocation figure comes from the purchaser of the Consort pharmacy, in the form of a schedule attached to the purchase and sale agreement. Counsel says there is no evidence before the Court as to the actual allocation made by the Receiver (PwC) in respect of that pharmacy.

102 The remaining shortfall of $2.4 million from that receivership, as said, was reduced by the $1.4 million payment by McKesson under its guarantee in November 2017, leaving a final shortfall of $970,000.

103 Maxium's evidence concerning the residual indebtedness also underwent somewhat of an evolution. In Mr. Wyett's affidavit of March 16, 2020, it was deposed that the residual indebtedness stemmed from the missed balloon payment. Mr. Gilchrist expanded on that evidence in his affidavit, indicating that Mr. Wyett's evidence was not quite accurate. While the missed balloon payment (via the new promissory note for $741,500 and Loder guarantee) was folded into the Loder Group receivership, the resulting shortfall was an overall shortfall in the receivership, attributable in some measure but not in total to the missed Consort balloon payment.

104 Mr. Wyett came on the scene in the latter part of 2019 and his evidence about the residual indebtedness came from a review of historical credit files, and discussions with Mr. Gilchrist and Mr. MacLellan. Mr. Gilchrist, on the other hand, had worked for Maxium or its predecessors for all the relevant years and had first-hand knowledge of all of Mr. Loder's accounts through the years.

105 While it requires some digging through the evidence, I accept that on December 1, 2017 when Mr. Loder issued the promissory note for $500,000 to Maxium, that there was a shortfall of $970,000 to 195. Although the money did not pass through Mr. Loder's or 202's hands, I accept that by way of direction to pay, the sum of $500,000 was in fact advanced and paid to retire residual indebtedness of $970,000.

106 I do not think that Mr. Loder can deny the fact that the balloon payment on the Consort pharmacy had been missed because he had that debtor company sign a further promissory note and he signed a new guarantee, both in favour of 195, to cover that indebtedness. As the director of the Loder Group of companies, he should have been aware of the state of the Loder Group receivership and the final amount that remained unpaid. That would have been the reason for providing him with information about 195's settlement with McKesson.

107 There are some small points that can be argued. For example, Mr. Schmidt disputes that there was ever a "negotiation" by Maxium with Mr. Loder. I do note that $500,000 was deemed sufficient by Maxium to settle a remaining debt of what eventually turned out to be $970,000. Further, Mr. Loder had requested a certain amount of financing so he could acquire the Grandin pharmacy. In the course of those discussions, the question of residual indebtedness was raised and the $500,00 loan proposed by Maxium. Mr. Loder was free to walk away at any time before making a commitment. There may have been no course of negotiations but no-one forced him either.

108 Mr. Schmidt also disputes that Mr. Loder was informed about the residual indebtedness from the outset. He notes that Mr. Loder first contacted Mr. McGillivray in January 2017 about financing the purchase of Grandin, and that the residual indebtedness was not raised until June 2017. This is semantical. It depends on what one means by "outset". Mr. Gilchrist was brought into the discussions in June 2017. Mr. McGillivray had told Mr. Loder that Mr. Gilchrist wanted to talk to him. When the two were finally able to connect, Mr. Gilchrist raised the matter of the residual indebtedness. I accept that Mr. McGillivray may not have discussed the residual indebtedness with Mr. Loder and that Mr. Gilchrist raised it in his first encounter with Mr. Loder concerning the Grandin acquisition. Neither of these points causes me to question the veracity of Maxium's position that it required the $500,000 promissory note to retire the residual indebtedness from the previous receivership.

109 Although Mr. Schmidt chose not to pursue the duress line of argument at the summary trial, it was nonetheless urged upon me that Mr. Loder was pressured into agreeing to the $500,000 promissory note in June 2017 because of the deadline for making a commitment to the vendors of the Grandin Pharmacy. There may well have been pressure on Mr. Loder to make a commitment, or lose the deal, but that was not placed on him by Maxium. Further, the transaction did not close until November 2017 and he did not sign the promissory note until December 1, 2017. I do not know what other options, if any, apart from Maxium that Mr. Loader may have had to finance this transaction, but certainly if he thought the $500,000 was of suspect validity, he did not have to go through with the transaction. In fact, he says at para 11 of his September 29, 2020 affidavit that regardless of any pressure he might have felt, he would never have signed a document obligating him to pay money that he did not owe.

110 It may well be that Mr. Gilchrist did not specifically mention the Consort pharmacy to Mr. Loder in their June 2017 telephone conversation. However, from Mr. Loder's own recounting of that conversation at para 10 of his March 2, 2020 affidavit, he clearly understood why the request for the additional $500,000 obligation was made.

111 Mr. Wyett's not completely accurate rendition of the origin of the $500,000 obligation should not have occurred and the history should have been more definitively researched before being put in an affidavit before the Court. With Mr. Gilchrist's additional information, the picture is complete. The deficiency in Mr. Wyett's affidavit in 2020 does not mean that Mr. Loder was misled in 2017 or that the residual indebtedness did not exist.

112 Overall, I do not find that there was misrepresentation, misstatement or dishonesty on Maxium's part so as to constitute bad faith under section 66 (1) of the *PPSA* in the acquisition of its rights in the assets of the corporate debtors in this action. I further conclude that what happened in June 2017 is too remote in time to constitute lack of good faith for the purposes of section 4.2 of the *BIA*, but even if not, is insufficient to be bad faith.

113 Mr. Wyett's affidavit evidence about the Consort pharmacy is an example of mistaken or incomplete research but is not an attempt to mislead the Court in these proceedings. It has been corrected by Mr. Gilchrist.

114 Finally, 202 and Mr. Loder did receive value for the promissory note, namely the advance of $500,000 to 195 to retire Mr. Loder's personal obligation to 195. Whether it was the guarantee given to BMO or the guarantee given to 195 for the balloon payment, or more likely some combination, Mr. Loder was still indebted to 195 for the whole of the residual indebtedness. As Mr. Loder rightly points out, but for executing this promissory note of $500,000, 202 would not have been granted the $3 million in financing to buy Grandin.

3. Did Maxium mislead Mr. Loder regarding the restructuring of the loan portfolio?

115 It is clear from the evidence that Mr. Loder and Maxium (first, through Mr. McGillivray, and then subsequently through Mr. Wyett) held serious discussions regarding a restructuring of 202's entire loan portfolio.

116 By 2019, Mr. Loder perceived that the servicing of the $500,000 loan was an undue drag on the pharmacy's cash flow, confirming his earlier fears. He says the burden of this loan was the proximate cause of the business' default on its CRA obligations. Mr. Loder did his own calculations and suggested that a re-amortization of the $500,000 segment from a 3-year term to a 10-year term would reduce the pharmacy's finance costs by more than $10,000 per month. By way of illustration, Mr. Loder said the business paid over $318,000 in respect of this loan since its exception, exceeding what was owed to CRA.

Line of Credit

117 A series of emails were exchanged between Mr. Loder and Mr. McGillivray in the latter half of 2019 in pursuance of this restructuring. From the tenor of these emails, it is apparent that both sides were serious about a restructuring. Mr. Loder had made Mr. McGillivray aware that the pharmacy owed some $200,000 in source reductions to CRA. Mr. McGillivray in turn created a restructuring proposal that included the main acquisition loan, the secondary loan for the previous indebtedness, the CRA liability and an increase in the LOC to $300,000, the latter facility to be carried by CWB not Maxium. The entirety of this restructured indebtedness would be amortized over 10 years. All of this is contained in an email from Mr. McGillivray to Mr. Loder of October 21, 2019.

118 As this email discussion was carried out, Maxium required further and better information from Mr. Loder concerning the pharmacy's financial situation. Maxium submits that Mr. Loder was reticent in providing this information which resulted in delay in getting the restructuring proposal approved. Mr. Loder says he provided all the information that was requested. It does appear that there was some delay in getting accountant-prepared financial information to Maxium but in the end, a restructuring was approved.

119 Email communication does show that Mr. Loder was told that the proposal would be considered by Maxium's credit committee and that the increase to the LOC had been approved. Mr. McGillivray's email of February 1, 2019 to Mr. Loder is clear that the increase to the LOC had been approved. I do not find the email to be cryptic as Maxium's counsel and representatives have suggested.

120 Mr. Thomas, a CWB senior manager at the virtual branch who was in charge of the LOC account, contacted Mr. Loder later in February 2019 and advised that finalization of the increase required receipt of further financial information. Mr. Thomas sent Mr. Loder emails on February 22, 2019 and then March 5, 2019. The first of the February 22 emails is an introductory email. The second of the February 22 emails states:

> Hi Doug, I forgot to remind you in my introductory email that I will require the April 30, 2018 financial statements for the pharmacy. Thanks, Neil Thomas.

121 The March 5, 2019 email requests even further information about the pharmacy business and 202.

122 Over the course of the next few months, Mr. Thomas continued to request further information in support of the request for increase. These emails are exhibited to Mr. Thomas's affidavit of October 15, 2020. It is clear that as late as May 2019, CWB was still not satisfied with the state of the information provided. Mr. Thomas says that it was never fully provided.

123 Mr. Thomas was cross-examined closely about the February 2019 telephone conversation and the emails sent on February 22, 2019 and March 5, 2019. Mr. Schmidt submits that Mr. Thomas' evidence that he told Mr. Loder the LOC increase approval was conditional upon receipt of other information should be rejected outright. He says that Mr. Thomas is simply not believable.

124 Logically, the two February 22 emails could only have been sent after an earlier telephone conversation between Mr. Loder and Mr. Thomas. In the first of the emails, described as an introductory email, no mention is made of additional information. In the second of the emails, Mr. Thomas says that he forgot to remind Mr. Loder that the financial statements for the pharmacy were required to be submitted. From that use of language, the two of them had obviously discussed this requirement before. Since there was only one telephone conversation prior to February 22, the discussion about the need to produce the financial statements must have occurred in that conversation.

125 Mr. Loder responded with some financial information on February 25 but it led to further questions. The March 5 email shows that Mr. Thomas was seeking further information about 202, the actual borrower, including why corporate filings were not up-to-date. Mr. Loder would have known from his previous application for the original amount of $75,000 in LOC that CWB goes through a due diligence process.

126 It therefore seems to me, more likely than not, although not robustly documented, that Mr. Thomas did make Mr. Loder aware that there were certain informational requirements. It also seems that as Mr. Loder provided some information, additional questions arose for which CWB required answers.

127 The evidence shows that the LOC at its $75,000 level began to operate in significant overdraft, starting February 2019. In fact, for the period from April 30, 2019 to March 31, 2020, there were several months where the overdraft position exceeded $150,000, in some months significantly. A June 21, 2019 email from Mr. McGillivray to Mr. Thomas stated that the requested LOC increase was still "pending" but there was concern that the overdraft was trending in the wrong direction.

128 Mr. Thomas noted that for periods in 2018, CWB granted temporary increases to the LOC.

129 It seems that Mr. McGillivray jumped the gun in proclaiming on February 1, 2019 that the requested LOC increase had been granted. However, it should have been obvious to Mr. Loder from the content of the subsequent contact and emails from Mr. Thomas and Mr. McGillivray, and his previous experience with CWB, that final and formal approval was still pending because of the outstanding financial information and the overdraft situation.

130 After Mr. Thomas' involvement, it appears that the issue of an LOC increase merged with the discussions between Mr. Loder and Maxium regarding the overall restructuring.

Restructuring first rejected

131 Starting in June 2019, Mr. Loder engaged with Mr. McGillivray in what he (Mr. Loder) thought were good faith discussions regarding an overall restructuring. Mr. Loder alleges that he was led to believe that the restructuring would occur, that Maxium would take no steps to enforce its security and that Maxium itself (through its credit committee) had the authority to approve the restructuring. This latter allegation takes the form of Mr. Loder's assertion that Maxium failed to tell him that final approval for the restructuring proposal had to be exercised by CWB's head office in Edmonton.

132 Two things are apparent from the various emails that are attached as exhibits D and F to Mr. McGillivray's affidavit of October 15, 2020. The first is that Mr. McGillivray had to make a submission to the credit committee and the second is that Maxium throughout was pressing Mr. Loder for information required to complete the proposal. In a November 29, 2019 email Mr. McGillivray advised Mr. Loder that "finally things are going to the credit committee to get the restructure done."

133 Mr. Loder then deposes at paragraph 27 of his March 2, 2020 affidavit:

> However, the restructuring never happened. Instead, earlier this month, I received, through my solicitor, a demand from CWB-Maximum that I enter into a forbearance agreement. I had no warning of this and was astonished considering what had been told to me about the anticipated restructuring. To put it bluntly, I considered that CWB-Maxium had led me down the garden path, with no intention of actually restructuring the indebtedness. Unfortunately, I believed what CWB-Maxium had told me. Had I known differently, I would have sought refinancing of the indebtedness many months ago and I am confident I would have obtained it.

134 On October 3, 2019, Mr. Loder formed the view that Mr. Gilchrist and Mr. MacLellan, who were higher-ups in the Maxium hierarchy, had decided not to support his restructuring request. Alarmed, he contacted Mr. McGillivray who was the Maxium salesperson or agent with whom he had been dealing. Mr. McGillivray's job was to generate and compile applications for financing. Mr. Loder wrote in an email on that date:

> I only wish you had told me sooner that Darrell and Dan have no intention of refinancing the loan so that I could have moved sooner locally.

135 Mr. McGillivray responded later that day:

> Just found out last couple of days. Came as a surprise.

136 In his questioning on affidavit, Mr. McGillivray was not sure whether he had had any discussions with Mr. Gilchrist and Mr. McClellan concerning their intent, or whether it was a specific refinancing proposal that had been rejected. This turned out to be a temporary setback, as later in October 2019, discussions between Mr. McGillivray and Mr. Loder concerning the refinancing resumed.

137 In the midst of these resumed discussions, Mr. Wyett caused Maxium to send demands to 202 and its guarantors on the two loans. I will discuss the demands further in the section after next.

Restructuring then approved

138 It turns out that Maxium eventually did, in fact, approve a restructuring. It was just not on the terms that Mr. Loder wanted. In particular, in the end Mr. Loder rejected the concept of using a forbearance agreement as the framework for the restructuring.

139 In order to place Mr. Loder's reaction in context, it is necessary to examine three documents relating to the approval of the restructuring. The first is the risk assessment summary dated December 12, 2019, prepared by Mr. Gilchrist and others, and which is exhibit Q to Mr. Gilchrist's affidavit of October 15, 2020. The second is the credit submission addendum, found at tab 42 of the defendants' book of evidence, and referred to at page 79 of Mr. Gilchrist questioning on affidavit of November 17, 2020. The third is the actual CWB approval document, entitled CRM review of CWB Maxium Financial Inc Finance Request, dated February 24, 2020 and found at exhibit R of Mr. Gilchrist's October 15, 2020 affidavit.

140 The risk assessment summary recommends:

> • restructuring the existing debt by recapitalizing the sum of $3.1 million to cover the balance of the main loan ($2.6 million), the balance owing on the secondary loan ($200,000) and the balance owing to CRA ($300,000), and amortizing that that sum over 96 months (8 years);
>
> • replacing the then existing LOC of $75,000 with a LOC of up to $250,000 through CWB's virtual bank.

141 At page 2 of the risk assessment summary, the authors note the pharmacy's cash flow problems, stemming from:

> • The maintenance of an employment contract with the vendor at $180,000 per year representing a premium of $70,000 per year (contract ended in November 2019); and

• The required cash to service the $500,000 loan on a short 36 month amortization.

142 The analysis of cash flow in the summary addresses how the pharmacy's cash flow can sufficiently handle debt service and other cash requirements.

143 The addendum, prepared by Mr. Wyett and another, contains these entries as the first two bullet points under the heading "December 29, 2019 call with Ben Wyett, Mike McGillivray and Loder":

• Loder is receptive to a restructure of his CM debt, pursuant to an FA (subject to CRM approval).

• Loder agrees to pledge his personal residence (wholly owned by him) as security.

144 CM refers to Maxium and FA refers to a forbearance agreement.

145 Mr. Loder was cross-examined on this point of when he first learned of the prospect of a forbearance agreement. He says it was not in a telephone conversation in December 2019 but rather in an email on January 29, 2020. Mr. Wyett testified in his cross-examination that the forbearance agreement was raised in the December 2019 telephone call.

146 I conclude that Mr. Wyett discussed the forthcoming forbearance agreement with Mr. Loder during the December 2019 telephone conversation. I have been given no reason to believe that Mr. Wyett completely fabricated this statement and put it in the addendum.

147 Based on the recommendation of December 12, 2019 and the addendum of January 9, 2020, CWB Senior VP Dave Thomson formally approved the restructuring. The recapitalized amount was $3,117,690, amortized over 8 years. The funds were to be used to pay out the existing Maxium indebtedness and the existing LOC. No new LOC was to be extended and no payment was specifically earmarked for CRA, although there was an expectation that the CRA indebtedness would be stabilized or reduced. This restructuring was premised on the borrower and guarantors providing a forbearance agreement.

148 Clearly, this final restructuring that was approved by CWB was not as favourable to Mr. Loder as the terms that had been proposed by Mr. McGillivray. The internal Maxium email exhibited at N, O and P of Mr. Gilchrist's October 15, 2020 affidavit reveal:

• there were some concerns about Grandin's viability as a business, to the extent that appointing a monitor was suggested as an option;

• as late as December 2, 2019, Maxium was still seeking financial information from Mr. Loder to inform its decision; and

• notwithstanding the concerns about viability, Maxium was still willing to consider different restructuring scenarios to assist Mr. Loder.

149 The final determination at the CWB level was that Grandin's risk profile was such that a forbearance agreement had to form the framework for restructuring on the revised terms.

150 In the end, Maxium was prepared to refinance 202's existing debt and provide a longer- term horizon for repayment of what owing on the $500,000 promissory note, which was Mr. Loder's major complaint. Mr. Loder was not prepared to accept the terms.

151 I do not see anywhere in the evidence where Mr. Loder was promised a particular form of restructuring. The evidence shows that Maxium throughout the fall of 2019 and into early 2020 was working assiduously toward the restructuring that Mr. Loder was seeking. It is also apparent that there were concerns expressed at Maxium about the pharmacy's ongoing viability which resulted in the ultimate decision-maker at CWB approving a revised form of restructuring premised on an executed forbearance agreement. Mr. McGillivray was also clear that any refinancing proposal required higher approval. While Mr.

McGillivray certainly made a recommendation to the credit committee, I do not see where either Maxium or Mr. McGillivray promised a specific outcome to the refinancing request.

152 CWB, as the final approving authority, was entitled to modify the terms of refinancing in accordance with what it felt was in the lender's best interest. Neither CWB nor Maxium were required to subordinate their interests to Mr. Loder by approving a form of restructuring that they felt would jeopardize their security.

153 I find that Maxium did not engage in misrepresentation or dishonesty in dealing with Mr. Loder's refinancing request.

4. Did Maxium represent that it would not enforce its demand?

154 As noted, Maxium sent its demands for payment to 202 and its guarantors on October 18, 2019 with respect to the main loan. This was done at the instance of Mr. Wyett. He testified that 202 had defaulted on both loan segments in that there were insufficient funds in 202's bank accounts to make the payments. Further, Mr. Wyett indicated that Maxium was concerned about the CRA indebtedness that Mr. Loder had disclosed.

155 Mr. Loder contacted Mr. McGillivray upon receipt of the demands. Mr. McGillivray did make a representation at that time that Maxium was not seeking to enforce those demands. He is not sure that he told Mr. Loder "not to worry" and that the demands were only required for Maxium's file, but does not deny that he may have done so. Mr. McGillivray said his intent at the time was to assure Mr. Loder that Maxium was still interested in pursuing a restructuring and working toward that end, although by the demands it was signalling that it was keeping its options open.

156 Mr. Loder argues that this was a false assurance that prejudiced him.

157 Maxium did not act immediately on the demands following the expiry of the payment deadline. Rather, it waited until Mr. Loder decided not to sign the forbearance agreement, which meant that he was rejecting the revised refinancing proposal put forward by Maxium. On February 27, 2020, Mr. Loder's then counsel advised Maxium's counsel by email that the forbearance agreement would not be signed, and provided directions about where the statement of claim could be sent.

158 February 27, 2020 was also the same day that CWB received the RTP from CRA for a sum in excess of $300,000 in respect of 202's unremitted source deductions. Maxium received the other RTP for 202's unpaid income taxes the next day.

159 From the above, it is clear that Maxium did not act on its demands for a period of four months after issuance, and only after it had reached an impasse with Mr. Loder following some eight to nine months of restructuring discussions. Maxium had done its due diligence on the restructuring proposal put forward by Mr. McGillivray, had it vetted by its credit committee and made a recommendation to the final decision-maker, CWB in Edmonton. The revised proposal coming from CWB's head office was premised on a forbearance agreement, which Mr. Loder was not prepared to sign.

160 In the meantime, 202 had remained in default of its loans since November of the previous year. The information that Maxium had gathered posed concern about the pharmacy's sustainability. Then, the RTPs were served and prevented any payments from 202's bank account.

161 Whatever Mr. McGillivray said to Mr. Loder back in October 2019, giving it the most generous reading in favour of Mr. Loder, could not be construed to mean that Maxium would never take enforcement action. Not ever taking enforcement steps on defaulting loans could not be within the contemplation of reasonable commercial parties.

162 I find that Maxium did what it said it would do, that is, it did not take steps to enforce its October 18, 2019 demands until it had reached the end of the road with Mr. Loder with regard to the restructuring discussions. I find that when such discussions failed, both sides expected, as reasonable commercial parties would expect, that the suspension of enforcement action would end.

5. Was the forbearance agreement non-negotiable?

163 Mr. Loder next contends that he and his then counsel were afforded no opportunity to provide input into the forbearance agreement and that it was presented to him on a take it or leave it basis. Foisting the forbearance agreement upon him in this manner is, Mr. Loder argues, further evidence of bad faith.

164 This argument can be resolved by examining the communications exchange between Mr. Wyett and Mr. Loder (found at document 45 of the defendant's book of evidence) and between counsel concerning forbearance agreement (found at exhibit F of Mr. Loder September 29, 2020 affidavit), and some of the preceding events.

165 As recounted earlier, Mr. Loder was alerted to Maxium's request for a forbearance agreement in a December 29, 2019 telephone conversation with Mr. Loder, documented in the February 24, 2020 addendum document. On January 29, 2020 Mr. Wyett wrote to Mr. Loder by email as follows:

> I do not believe I have heard back from you from this request below.
>
> I hope to have a draft forbearance agreement to you this week, so please give your counsel a heads up.

166 The first sentence in the above email refers to financial statements requested but not provided. Mr. Loder testified in questioning that the second sentence was the very first mention to him of a forbearance agreement. If so, it seems quite an abrupt way to introduce the concept of a forbearance agreement. The language used here is more suggestive of the idea of a forbearance agreement having been previously discussed.

167 Mr. Wyett followed up with Mr. Loder in a February 5, 2020 email:

> Further to my voicemail, please provide me with the contact information for your legal counsel. I am hoping to have our counsel send a draft forbearance agreement.

168 Mr. Loder responded the same day with the contact information for Mr. Banack, his then legal counsel. One would think that if the forbearance agreement had been suddenly sprung on Mr. Loder, he might be asking questions about it.

169 It appears that the draft forbearance agreement was sent by Maxium's counsel, Mr. Warner, to Mr. Loder's counsel, Mr. Banack, on February 6, 2020. On February 13, 2020, Mr. Warner was in contact with Mr. Banack by email, looking for a response:

> Jason, the forbearance agreements were sent you a week ago. There has been no response. That is not acceptable. The forbearance agreement has to be properly executed and returned to her office if your client wants to preserve his business. In the event we do not have the executed forbearance and related documents in our office by the close of business today, we will seek instructions to take the next step in this matter.

170 Then another thirteen days went by. On February 26, 2020, Mr. Banack wrote back to Mr. Warner as follows:

> As Doug continues to actively market the Grandin pharmacy for sale and make efforts to bring the outstanding payments up to date, he (and I) have become much less comfortable with the forbearance agreement as presented.
>
> The stricter covenants combined with the various consent orders and absence of revolving credit, in our opinion, put Doug and his business at greater risk than a creditor enforcement proceeding initiated by CWB and/or Maxium (which Doug would contest). If you are instructed to send new demands and/or notices to enforce, I would ask that you copy Jim Schmidt and I.
>
> To reiterate, Doug is actively seeking an exit from the business and part of that sale transaction would necessarily involve a payout of the debt owed to CWB and Maxium (and, so I am told, a settlement offer for McKesson). I have been engaged to act for Doug on the sale and am instructed to make this happen as quickly as possible, and also to provide whatever reasonable assurances your client may request to show that the sale process is progressing.

Let me know your thoughts?

171 Mr. Warner responded on February 27, 2020 with this email:

> Jason, I have discussed your email with CWB Maxium and I have been instructed to advise you that the Forbearance Agreement, as drafted, must be signed and returned to our office by no later than noon tomorrow, failing which we will proceed with a Statement of Claim and proceed with enforcement. We are also in the process of issuing demands on behalf of Canadian Western Bank. While there may be a few minor nits with the documents, the essence of the documents is the basis upon which CWB Maxium is prepared to continue to do business with your client. Your client has a decision to make.

172 As mentioned in the previous section, Mr. Banack advised Mr. Warner later on February 27, 2020 that the forbearance agreement as prepared would not be signed by Mr. Loder, and that litigation could ensue.

173 From the foregoing, the following can be gleaned:

• first, the forbearance agreement as sent was intended as a draft, at least at first;

• second, Mr. Warner received no feedback from Mr. Banack for a period of 20 days;

• third, the "stricter covenants", along with the consent orders and lack of revolving credit were not acceptable to Mr. Loder; and

• last, Maxium was insisting on the "essence" of the forbearance agreement as drafted.

174 Mr. Wyett in his affidavit suggested that the forbearance agreement was favourable to Mr. Loder and addressed his needs. The actual forbearance agreement is not in evidence before me so I will not comment further on its content. It seems evident that Mr. Loder disagreed with some of the major features of the forbearance agreement and that Maxium was not prepared to relent on those points.

175 I think it fair to say that, at the end of the day, when Maxium said it would not resile from those major components, Mr. Loder's signing of the forbearance agreement was left on a "take it or leave it" basis. From Maxium's perspective, Mr. Loder wanted Maxium to strip away some of the core components which, it seems, it felt was necessary to protect its interests.

176 I do not think that Maxium, in failing to give in to Mr. Loder's objections to the forbearance agreement, engaged in bad faith. Maxium is entitled to do what it feels is reasonably necessary, such as insist on the "essence" of an agreement, to protect its interests. Mr. Loder is similarly entitled to do what he believes is necessary to protect his interests. Both did so, and that is why the matter is now in litigation.

6. Did Maxium's mislead the Court on March 2, 2020

177 It is next asserted, on behalf of Mr. Loder, that comments made by Maxium's counsel before Nielsen ACJ on March 2, 2020, in procurement of the Interim Receivership order, were misleading and, at least in part, induced Nielsen ACJ to make the order. Here are counsel's comments:

> I mean, there's just too much left to speculation here that — and the Interim Receiver, the only thing that the Interim Receiver is going to do is to ensure that this continues to run smoothly. As I said on Friday, and as is set out in Mr. Wyett's affidavit, the existing management will stay in place. The pharmacy will continue to run as it would, would normally in the ordinary course. All that will happen is that funding will be provided from a reliable source to deal with ongoing operations, and the payments that are being made from insurance companies will be intercepted and utilized to offset ongoing operations. That is not that intrusive, in my submission. The management stays there. They continue to operate as they are — ordinarily would. It's just making allowance or making provisions for the preservation of the security of CWB Maxium.

178 Mr. Loder points to the submission that "the existing management will stay in place" and that the pharmacy would continue to operate as it has, and says that is not the reality of what happened. Rather, Mr. Loder alleges that he was effectively fired as the manager of the pharmacy by the Interim Receiver. As evidence, he tenders this email from Mr. Sirrs of MNP Ltd dated March 6, 2020:

> Hello Doug,
>
> As we review the projected cashflows of the Pharmacy we wanted to advise you that amounts typically paid to you in the monthly payroll will not be distributed going forward due to the cash flow deficit the pharmacy is experiencing. We have also discussed with the pharmacists at the clinic and confirmed that they can manage the delivery of the prescriptions (something I understand you were assisting with).
>
> Should you require any further details on this please do not hesitate to contact me.

179 In argument, Mr. Schmidt contended that counsel's statement at the hearing about existing management remaining in place was part of a course of conduct by or on behalf of Maxium that evinces bad faith. If not deliberately misleading, the comment is at best reckless as to its truth and ought not to have been made. Mr. Schmidt said that taking away someone's salary is the very hallmark of wrongful termination.

180 Mr. Warner, in addressing this submission, took great umbrage with Mr. Schmidt's characterization of his comments before Nielsen ACJ, saying the comments were made in good faith. He pointed out that neither he nor Maxium had any control over the actions or decisions of the Interim Receiver, an independent officer of the Court, and that the decision made in respect of Mr. Loder's salary was within the Interim Receiver's powers as conferred by the Court. Mr. Warner further stated that his comments were based on his experience as an insolvency practitioner with regard to Interim Receivership situations. Finally, Mr. Warner submitted that Mr. Loder continues to function at the pharmacy as he previously did. He simply no longer collects the salary.

181 Mr. Schmidt, on Mr. Loder's behalf, takes no objection to anything done by the Interim Receiver.

182 The Interim Receiver's second report to the Court, dated August 25, 2020 indicates that Mr. Cameron Santer is the pharmacy manager. The report also states that "Mr. Loder has continued daily involvement with the company through delivery of prescriptions to customers as required."

183 I am satisfied from the above that the statement made by Mr. Warner to Nielsen ACJ concerning the retention of management during the period of Interim Receivership was not misleading, intended to mislead or recklessly made. It aligns with what happened with regard to the day-to-day management of the pharmacy. I acknowledge that Mr. Loder did lose his salary as a result of a business decision made by the Interim Receiver.

7. Did Maxium fail to disclose to that CWB was the final decision-maker on the restructuring?

184 Here, Mr. Loder argues that Maxium's failure to advise him of CWB's ultimate authority is part of a pattern of conduct that amounts to a breach of statutory good-faith requirements.

185 Mr. Loder knew about CWB's final authority in some aspects of 202's borrowings. For example, he knew that CWB in Edmonton had to grant final authority for the terms of the 2017 $500,000 secondary loan related to the residual indebtedness. During his questioning, Mr. Loder said at page 37, lines 20 to 24:

> ... Also during that conversation in relation to the 500,000, Dan explained to me that there had been back and forth on this particular loan with CWB in Edmonton who had to sign off on this particular loan, and it was in relation to the term.

186 He recounts that Mr. McGillivray had requested a 10 year term, then a 5 year term, but ultimately CWB wanted a 3 year term.

187 In his attempt to obtain an increased LOC from CWB's virtual branch in Edmonton, Mr. Loder similarly understood by May 1, 2019 that CWB had the final sign-off (see transcript, page 78, lines 14 to 18).

188 However, I do not find anywhere in the record of the summary trial where Mr. Loder was explicitly told by Mr. McGillivray or anyone else that the overall restructuring could only be approved by the CWB head office in Edmonton. Many of the emails between Mr. McGillivray and Mr. Loder indicate that Mr. McGillivray was making his submission to the credit committee of Maxium. Mr. Loder also testified to his belief that the Maxium office in Toronto was responsible for administering his loans.

189 Maxium suggests that Mr. Loder, as a sophisticated businessman with extensive experience with banking institutions, would realize there are levels of authority within every lender. That may be so and that may be a reasonable assumption to make about Mr. Loder. However, based on the record, I agree that Mr. Loder was not told explicitly that CWB in Edmonton was the ultimate decision-maker.

190 Having said that, it does not appear to me that this lack of disclosure had any sort of material consequence for Mr. Loder. From the whole course of communications between Mr. McGillivray and Mr. Loder, I think it fair to say that the restructuring proposal prepared by Mr. McGillivray had to be approved by a higher level authority of some sort. Whether was the credit committee in Toronto doing that approval, or the credit committee in Toronto making a recommendation for approval and sending the request to a final decision-maker at CWB in Edmonton, would not have made a difference.

191 Mr. Loder says that he would have conducted himself differently, that had he known it was CWB in Edmonton rather than the credit committee in Toronto, he would have sought earlier refinancing from a different source. How or why he would have done that is completely unknown or unexplained. Mr. Loder offers no evidence beyond the mere assertion. To me, that does not establish proof on a balance of probabilities that he would have obtained refinancing from another lender had he known about CWB.

192 In these circumstances, I do not see how the failure to disclose the exact steps involved in an internal approval process or the levels of authority within an organization, in the case of the private lender, amounts to a breach of the good-faith requirement. Good faith in private commercial relations is not the same as a duty of fairness and transparency with regard to decision-making in the public law realm.

K. Application of Factual Findings to the Law

1. Summary of the Findings

193 I have concluded the following on a balance of probabilities:

• Mr. Loder was not told that the purpose of the secondary loan of $500,000 (evidenced by promissory note) was to deal with his guarantee to McKesson Canada.

• The residual indebtedness actually existed, based on the shortfall of $970,000 left from the Loder Group receivership and, at least in part, remaining from the unpaid balloon payment in relation to the Consort pharmacy. Mr. Loder understood that the secondary loan was funded to eliminate the remaining debt from the previous receivership, which had been guaranteed by him.

• Maxium did not mislead Mr. Loder about whether a restructuring would materialize and did not promise a particular form of restructuring. In the end, Maxium offered a restructuring, but it was not on terms that Mr. Loder found acceptable (particularly as it did not involve any revolving credit, let alone an increase, and required a forbearance agreement).

• Maxium did represent to Mr. Loder (through Mr. McGillivray) that it would not enforce its October 2019 demands. This representation could not reasonably be construed to mean that Maxium would never enforce the demand. Once Mr. Loder and Maxium reached an impasse on the form of restructuring, it was reasonable for the parties to expect that Maxium would proceed with enforcement.

- The forbearance agreement was presented as a draft. The parties could not agree as to the critical elements, including the giving of consent orders. Only at the point when the parties reached impasse, the critical elements became non- negotiable.

- Maxium's counsel did not mislead the Court, deliberately or recklessly, on March 2, 2020 with the submission that the existing pharmacy management would remain in place.

- Maxium did not specifically disclose to Mr. Loder that, beyond Maxium's credit committee in Toronto, CWB's head office in Edmonton was required to give final approval to restructuring. However, Mr. Loder has not proven to the Court's satisfaction that anything would have been different had this fact been specifically disclosed.

2. Estoppel

194 The parties are agreed on the elements of estoppel. The plaintiffs cite *B & R Development Corporation Ltd v Trail South Developments Inc* 2012 ABCA 351 at para 23 for this statement of the law:

> There are two components to an action in promissory estoppel: (1) the party invoking the doctrine must prove that the other party made, by virtue of word or deed, a promise or assurance intended to alter their existing legal relationship and to be acted upon by the party receiving the assurance; and (2) the recipient of the assurance acted upon it in a manner which changed his or her position.

195 The defendants cited *Vision West Development Ltd v McIvor Properties Ltd* 2012 BCSC 302 at paras 63-65 for the same proposition.

196 The defendants rely on Maxium's promise of restructuring and Mr. McGillivray's advice to Mr. Loder that the October 2019 demands would not be enforced as constituting the words and conduct that altered the existing legal relationship. Mr. Loder says that these words and conduct were interpreted by him to mean that the existing legal relationship was changed in that Maxium's legal rights of enforcement would not be relied upon. Detrimental reliance is shown, Mr. Loder says, when he did not pursue other refinancing options that surely would have been successful.

197 As I found, Maxium did not go back on its word in this regard. It actually did offer a form of restructuring to Mr. Loder.

198 Further, Mr. McGillivray's words that Maxium would not call the loan must be placed in context. That context was that the parties were in the midst of restructuring discussions and Mr. McGillivray was in the process of putting together a restructuring proposal. Those words could not possibly be construed by reasonable commercial persons as meaning that Maxium had forever relinquished its enforcement rights. It would be obvious to reasonable commercial parties that when the impasse was reached with regard to the forbearance agreement and Mr. Loder expressed a preference to litigate instead of sign the forbearance agreement as presented, any previous words regarding not enforcing remedies on Maxium's part no longer applied.

199 Indeed, at para 38 of the defendants' January 8, 2021 brief, Mr. McGillivray's remarks were characterized as a "deferral of enforcement steps". That, to me, is an accurate description of what Mr. McGillivray said. It was a deferral not a relinquishment. The deferral lasted four months.

200 Finally, as I stated above, Mr. Loder has not satisfied me that other successful refinancing options were forgone as a result of Maxium's words, conduct or omissions.

201 In consequence, estoppel fails as a defence.

3. Lack of Good Faith

202 I stated above that, for the purposes of a secured creditor's conduct in the circumstances at hand, the standard of good faith should be consonant with that expressed by the Supreme Court of Canada in pronouncing upon the organizing principle

of good faith in contract law in cases such as *Bhasin* and *Callow*. That standard requires the actor to avoid dishonesty or lying. It does not bind the actor to a duty of loyalty or disclosure. It does not require a party to subordinate its interests.

203 As said, such a requirement of good faith as expressed in section 66 (1) of the *PPSA* relates to a secured creditor's acquisition of or exercise of rights under a security agreement. In relation to section 4.2 of the *BIA*, the good-faith requirement relates to a secured creditor's invoking and conduct of insolvency proceedings under the *BIA*.

204 Given my factual findings above, I further find there has been no breach of the good-faith requirement in either context because neither Maxium nor its representatives engaged in dishonesty or lying in its dealings with Mr. Loder, either at the time of initiating the loans in 2017 or during the restructuring talks throughout 2019 and early into 2020.

205 I did find that Maxium had failed to disclose that CWB had ultimate decision-making authority with regard to the restructuring. However, I also found that Mr. Loder would have some general understanding, as a business person of his experience, that there was an approval process beyond Mr. McGillivray. I also accept Mr. Warner's submission (see para 48 of reply brief dated January 20, 2021) that it is not industry practice to advise a customer exactly who within the organization has the authority to approve a particular credit submission, nor does the good faith requirement imply such an obligation.

206 This is not a case like *Callow* where one party, through silence, misled the other about the state of relations between the two and thereby received the benefit of free services. In this case, Maxium was always engaged in a process of working toward a restructuring, but in the end, the parties could not reach consensus on what the restructuring should entail.

207 Furthermore, some of events occurring between January 2019 and October 18, 2019 (the date on which the Maxium demands were sent) are too remote in time to be "with respect to" these proceedings within the meaning of section 4.2 of the *BIA*, but even if not, for the reasons stated above still fall short of bad faith. I do consider the course of events in 2017 to be too remote in time for the purposes of section 4.2 of the *BIA* and therefore confine my analysis of the good faith requirement in that timeframe to Maxium's acquisition of its security interest for the purposes of section 66(1) of the *PPSA*.

208 In the result, there is no defence based on lack of good faith, and no remedy is available to the defendants under section 4.2 of the *BIA* or section 66(1) of the *PPSA*. My conclusion regarding section 4.2 takes into account the intent and policy objectives of the *BIA*. Here, the proceedings have not been invoked for some oblique or improper purpose but rather to subject the assets of an insolvent debtor to an orderly, Court-supervised process for the benefit of interested parties.

L. Should the Final Order of Receivership be granted on "just and convenient" grounds?

209 Even though I have rejected the defendant's defences, the onus remains on the plaintiffs to establish that a final order of receivership is "just and convenient". Romaine J in *MTM Commercial Trust v Statesmen and Riverside Quays Ltd*, 2010 ABQ B647 at para 11 described the test in this manner:

> As has been noted in ***Anderson v. Hunking***, 2010 ONSC 4008 (CanLII), [2010] O.J. No. 3042 at para. 15, the test for the appointment of a receiver is comparable to the test for injunctive relief. Determining whether it is "just and convenient" to grant a receivership requires the Court to consider and attempt to balance the rights of both the applicant and the respondent, with the onus on the applicant to establish that such an order is required: ***BG International*** at para. 17. The factors set out to be considered in a receivership application are focused on the same ultimate question that the Court must determine in considering an application for an interlocutory injunction: what are the relative risks to the parties of granting or withholding the remedy?

210 The factors to be considered are enumerated in the oft-cited *Paragon* case, at para 27, relying on the list assembled by Frank Bennett in *Bennett on Receiverships*, 2nd edition, (1995), Thomson Canada Ltd, page 130, from various cases:

> The factors a Court may consider in determining whether it is appropriate to appoint a receiver include the following:

a) whether irreparable harm might be caused if no order were made, although it is not essential for a creditor to establish irreparable harm if a receiver is not appointed, particularly where the appointment of a receiver is authorized by the security documentation;

b) the risk to the security holder taking into consideration the size of the debtor's equity in the assets and the need for protection or safeguarding of the assets while litigation takes place;

c) the nature of the property;

d) the apprehended or actual waste of the debtor's assets;

e) the preservation and protection of the property pending judicial resolution;

f) the balance of convenience to the parties;

g) the fact that the creditor has the right to appoint a receiver under the documentation provided for the loan;

h) the enforcement of rights under a security instrument where the security-holder encounters or expects to encounter difficulty with the debtor and others;

i) the principle that the appointment of a receiver is extraordinary relief which should be granted cautiously and sparingly;

j) the consideration of whether a Court appointment is necessary to enable the receiver to carry out its' duties more efficiently;

k) the effect of the order upon the parties;

l) the conduct of the parties;

m) the length of time that a receiver may be in place;

n) the cost to the parties;

o) the likelihood of maximizing return to the parties;

p) the goal of facilitating the duties of the receiver.

211 Further, at para 28, Romaine J comments on the effect of a contractual right to appoint a receiver:

In cases where the security documentation provides for the appointment of a receiver, which is the case here with respect to the General Security Agreement and the Extension Agreement, the extraordinary nature of the remedy sought is less essential to the inquiry: ***Bank of Nova Scotia v. Freure Village on Clair Creek***, 1996 CanLII 8258 (ON SC), [1996] O.J. No. 5088, paragraph 12.

212 Having regard to the *Paragon* factors, I note:

• Service of the Requirements to Pay has effectively eliminated the pharmacy's cash flow. The receivables were intercepted. No new advances or draws are permissible unless the funds are sent to CRA to satisfy its indebtedness. There is no evidence before the Court as to how Mr. Loder intends to pay off the CRA indebtedness, in order to procure release of the bank accounts or any other receivables that may be payable.

• The pharmacy has only been able to operate during the Interim Receivership because the order stays the RTPs and allows operations to be financed through the Interim Receivers' borrowings.

• The information before the Court shows the prospects for the pharmacy's continuing viability are grim. As noted in the Interim Receiver's Second report, during the first six months of operation following the Interim Receivership order, the pharmacy would have sustained an operating loss of $277,515.96 if it had been required to make monthly loan payments to Maxium, even after the Interim Receiver's costs and professional fees are backed out. This loss does not account for the arrears owed to Maxium or the CRA indebtedness.

• There is no information before the Court as to any plan on Mr. Loder's part to pay out either Maxium or CRA. Mr. Loder raised prospects for take out of Maxium and CWB by refinancing with another lender back on February 28, 2020. A year has gone by and there is no further information, let alone a feasible refinancing option on the table. In a September 29, 2020 affidavit, Mr. Loder adverted to his attempts to find a buyer for the pharmacy. In the ensuing five months, nothing has materialized before the Court as to a realistic sale.

• In the absence of any viable or realistic plan on Mr. Loder's part as to how he intends to extricate the pharmacy from its current predicament, and given the length of time that has elapsed since the Interim Receivership order, I am left with the conclusion that he has run out of options.

• No payments have been made on any of the Maxium loans or CWB indebtedness for a period of over a year.

• Maxium says, and it is not disputed by Mr. Loder, that the best avenue for maximizing recovery is a sale of the pharmacy as a going concern. Maxium's counsel suggests, and I accept, that the major asset is the goodwill associated with the pharmacy's business.

• The purpose of the Interim Receivership was to preserve the assets pending a final determination one way or the other. Based on the foregoing, I conclude that the pharmacy with its present indebtedness would have little or no chance of survival if the Interim Receiver were discharged and the pharmacy business turned back over to Mr. Loder. Maxium's security is therefore in jeopardy.

• Maxium's security documentation contractually provides for the appointment of receiver. The extraordinary nature of the receivership remedy is attenuated somewhat by such a provision.

213 I find that Mr. Loder's allegations against Maxium, which I have dealt with at length above and even where supported, do not constitute grounds on which to refuse a final order of receivership based on the "just and convenient" test.

214 I accept Maxium's argument that a transparent, Court-supervised process under which a Receiver uses its expertise and professional contacts provides the best option for selling the pharmacy as a going concern and maximizing recovery for all concerned, including Mr. Loder. I find that it is just and convenient to appoint a receiver over the assets of the corporate defendants.

M. Coda

215 These reasons should not be read as a ringing endorsement of Maxium's conduct. I did find that Maxium did not engage in deception or dishonesty in its dealings with Mr. Loder but that is not to say that it achieved high levels of customer service in its handling of this account.

216 First, Maxium could have saved itself a lot of grief by simply sending Mr. Loder a letter back in June 2017 to confirm the purpose of the $500,000 loan and promissory note, rather than only documenting it internally.

217 Second, Maxium did itself no favours by having different individuals within the organization send him apparently mixed messages. Mr. Wyett sent Mr. Loder demand letters in October 2019 during the midst of Mr. McGillivray attempting to put together a restructuring proposal for the pharmacy business. While I realize that Maxium was "keeping its options open" by sending the demand letters when the loans were in default, it gave the impression that Maxium was working at cross purposes

with itself, or that one hand did not know what the other was doing. Maxium would have been better off telling Mr. Loder about the demand letters in advance and properly contextualizing them for him, so as to avoid any confusion on his part.

218 Third, while I found there was no duty of disclosure and no industry established practice, the experience of this case might suggest to Maxium that, as a matter of practice not of law, it might well be beneficial for all to consider explaining to customers the limits and levels of authority for approval of credit submissions, if only to set and manage expectations.

219 These gaps in communication no doubt contributed to Mr. Loder's suspicions and what now has been a year's worth of costly litigation.

220 If the parties require a further brief hearing to settle the contents of the final order of receivership, they should contact the commercial coordinator to obtain a date.

221 Mr. Quinlan, on behalf of the Interim Receiver, appeared briefly at the start of the first day of hearing and was excused for the balance of the two days.

Application granted.

Footnotes

1 Since the hearing of this matter, the Supreme Court of Canada delivered its decision in *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7, which further elaborates on the nature of the duty of good faith in exercising discretion conferred by the contract.

2 Wood, Roderick J., A Guide to the Alberta Personal Property Security Act (February 22, 2017). Available at SSRN: https://ssrn.com/abstract=2922196.

TAB 16

2009 NLTD 148
Newfoundland and Labrador Supreme Court (Trial Division)

Lloyd's Non-Marine Underwriters v. J.J. Lacey Insurance Ltd.

2009 CarswellNfld 244, 2009 NLTD 148, 181 A.C.W.S. (3d) 420, 291 Nfld. & P.E.I.R. 149, 58 C.B.R. (5th) 199, 78 C.C.L.I. (4th) 16, 898 A.P.R. 149

IN THE MATTER of an Appeal by M.J. Oppenheim, Attorney in Fact in Canada for Lloyd's Non-Marine Underwriters, from the allowance of a claim of Hiland Insurance Limited by the Trustee of the Estate in Bankruptcy of J.J. Lacey Insurance Ltd.

M.J. OPPENHEIM, Attorney in Fact in Canada For LLOYD'S NON-MARINE UNDERWRITERS (PLAINTIFF) AND J.J. LACEY INSURANCE LIMITED (First Defendant) and HILAND INSURANCE COMPANY LIMITED (Second Defendant)

Robert M. Hall J.

Heard: February 12-15, 18-21, 2008; May 28-30, 2008; June 2, 5, 2008
Judgment: October 8, 2009
Docket: 19940116856

Counsel: Philip J. Buckingham for M.J. Oppenheim, Attorney in Fact in Canada for Lloyd's Non-Marine Underwriters
Neil L. Jacobs for Trustee in Bankruptcy of J.J. Lacey Insurance Limited
D. Mark Pike for Provisional Liquidator of Hiland Insurance Company Limited

Subject: Corporate and Commercial; Insolvency; Insurance; Civil Practice and Procedure

Related Abridgment Classifications

Bankruptcy and insolvency
X Priorities of claims
X.6 Restricted and postponed claims
Business associations
I Nature of business associations
I.3 Nature of corporation
I.3.a Distinct existence
I.3.a.ii From related corporations
Equity
III Equitable doctrines
III.12 Miscellaneous

Headnote

Business associations — Nature of business associations — Nature of corporation — Distinct existence — From related corporations

J Ltd. was corporation controlled by G — J Ltd. acted as insurance broker and agent on behalf of insurer — Policies were written by J Ltd. on insurer's policy forms but were not reported to insurer and premiums paid by insureds were not remitted to insurer — Insurer advised J Ltd. that it would stop writing policies in province on December 31, 1992 — G cancelled policies written on insurer's forms and reissued them in name of affiliate of J Ltd., H Ltd., without consent of insurer or insureds — H Ltd. was incorporated at end of December 1992 and received license to carry on business as insurance company in January 1993 — Trustee in bankruptcy of J Ltd. was subsequently appointed — Trustee accepted claim by H Ltd. in amount of $3,258,961.16 and paid dividends as payment of trust funds received by J Ltd. from H Ltd. — Net claim by H Ltd. in bankruptcy of J Ltd. after payments was $2,529,975.66 — Insurer brought action against J Ltd. and H Ltd. seeking disallowance of H Ltd.'s claim —

Action allowed — Claim of H Ltd. in bankruptcy of J Ltd. was to be subordinated until all other unsecured claims were satisfied — Policies earning total of $3,110,100 in premiums were written by J Ltd. on insurer's forms and not reported to insurer — L Ltd., G and H Ltd. were one and same entity in perpetuating fraud — H Ltd. was party to fraud even though its corporate existence occurred after initial fraud occurred — Fraud process continued with involvement of H Ltd. — Cover-up of fraud was aided and abetted by H Ltd. by way of rewriting of insurer's policies in H Ltd.'s name — H Ltd. benefited by receiving part of insurer's book of business and its premium revenue — H Ltd. knew of deception because G was its sole directing mind.
Bankruptcy and insolvency --- Priorities of claims — Restricted and postponed claims — Miscellaneous
Equitable subordination — J Ltd. was corporation controlled by G — J Ltd. acted as insurance broker and agent on behalf of insurer — Policies were written by J Ltd. on insurer's forms but were not reported to insurer and premiums paid by insureds were not remitted to insurer — Insurer advised J Ltd. that it was going to stop writing policies in province — G cancelled policies written on insurer's forms and reissued them in name of affiliate of J Ltd., H Ltd., without consent of insurer or insureds — Trustee in bankruptcy of J Ltd. was subsequently appointed — Trustee accepted claim by H Ltd. in amount of $3,258,961.16 and paid dividends as payment of trust funds received by J Ltd. from H Ltd. — Net claim by H Ltd. in bankruptcy of J Ltd. after payments was $2,529,975.66 — Insurer brought action against J Ltd. and H Ltd. seeking disallowance of H Ltd.'s claim — Action allowed — Claim of H Ltd. in bankruptcy of J Ltd. was to be subordinated until all other unsecured claims were satisfied — J Ltd., G and H Ltd. were one and same entity in perpetuating fraud upon insurer — H Ltd.'s claim could not be disallowed because no evidence was presented as to nature of J Ltd.'s debt to H Ltd. — It was appropriate to apply three-part test for equitable subordination to circumstances — H Ltd., G and J Ltd. engaged in inequitable conduct when J Ltd. illegally appropriated premium revenue of insurer and funnelled it to H Ltd. — This conduct resulted in injury to insurer and conferred unfair advantage on H Ltd. — Equitable subordination of H Ltd.'s claim did not interfere significantly with objects of Bankruptcy and Insolvency Act and did not interfere with secured creditors — By allowing doctrine of equitable subordination to apply to unsecured creditors inter se, only delay in distribution would be to that creditor who was sought to be found subordinate — There was no inequity in postponing claim of H Ltd. to J Ltd.'s other unsecured creditors.
Equity --- Equitable doctrines — General principles
Equitable subordination — J Ltd. was corporation controlled by G — J Ltd. acted as insurance broker and agent on behalf of insurer — Policies were written by J Ltd. on insurer's forms but were not reported to insurer and premiums paid by insureds were not remitted to insurer — Insurer advised J Ltd. that it was going to stop writing policies in province — G cancelled policies written on insurer's forms and reissued them in name of affiliate of J Ltd., H Ltd., without consent of insurer or insureds — Trustee in bankruptcy of J Ltd. was subsequently appointed — Trustee accepted claim by H Ltd. in amount of $3,258,961.16 and paid dividends as payment of trust funds received by J Ltd. from H Ltd. — Net claim by H Ltd. in bankruptcy of J Ltd. after payments was $2,529,975.66 — Insurer brought action against J Ltd. and H Ltd. seeking disallowance of H Ltd.'s claim — Action allowed — Claim of H Ltd. in bankruptcy of J Ltd. was to be subordinated until all other unsecured claims were satisfied — J Ltd., G and H Ltd. were one and same entity in perpetuating fraud upon insurer — H Ltd.'s claim could not be disallowed because no evidence was presented as to nature of J Ltd.'s debt to H Ltd. — It was appropriate to apply three-part test for equitable subordination to circumstances — H Ltd., G and J Ltd. engaged in inequitable conduct when J Ltd. illegally appropriated premium revenue of insurer and funnelled it to H Ltd. — This conduct resulted in injury to insurer and conferred unfair advantage on H Ltd. — Equitable subordination of H Ltd.'s claim did not interfere significantly with objects of Bankruptcy and Insolvency Act and did not interfere with secured creditors — By allowing doctrine of equitable subordination to apply to unsecured creditors inter se, only delay in distribution would be to that creditor who was sought to be found subordinate — There was no inequity in postponing claim of H Ltd. to J Ltd.'s other unsecured creditors.

Table of Authorities

Cases considered by *Robert M. Hall J.*:

AEVO Co. v. D & A Macleod Co. (1991), 7 C.B.R. (3d) 33, 4 O.R. (3d) 368, 1991 CarswellOnt 206 (Ont. Bktcy.) — considered

Bow Valley Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd. (1995), 130 Nfld. & P.E.I.R. 92, 1995 CarswellNfld 44, 405 A.P.R. 92, 126 D.L.R. (4th) 1, 21 B.L.R. (2d) 265 (Nfld. C.A.) — considered

Canada Deposit Insurance Corp. v. Canadian Commercial Bank (1992), 5 Alta. L.R. (3d) 193, [1992] 3 S.C.R. 558, 16 C.B.R. (3d) 154, 7 B.L.R. (2d) 113, (sub nom. *Canada Deposit Insurance Corp. v. Canadian Commercial Bank (No. 3)*) 131 A.R. 321, (sub nom. *Canada Deposit Insurance Corp. v. Canadian Commercial Bank (No. 3)*) 25 W.A.C. 321, 1992

CarswellAlta 790, 97 D.L.R. (4th) 385, (sub nom. *Canada Deposit Insurance Corp. v. Canadian Commercial Bank (No. 3))* 143 N.R. 321, 1992 CarswellAlta 298 (S.C.C.) — followed

Clarkson Co. v. Zhelka (1967), [1967] 2 O.R. 565, 64 D.L.R. (2d) 457, 1967 CarswellOnt 144 (Ont. H.C.) — considered

Kosmopoulos v. Constitution Insurance Co. of Canada (1987), 22 C.C.L.I. 296, [1987] 1 S.C.R. 2, (sub nom. *Constitution Insurance Co. of Canada v. Kosmopoulos)* 34 D.L.R. (4th) 208, 74 N.R. 360, 21 O.A.C. 4, (sub nom. *Kosmopoulos v. Constitution Insurance Co.)* 36 B.L.R. 233, 1987 CarswellOnt 132, [1987] I.L.R. 1-2147, 1987 CarswellOnt 1054 (S.C.C.) — considered

Laronge Realty Ltd. v. Golconda Investments Ltd. (1986), 7 B.C.L.R. (2d) 90, 63 C.B.R. (N.S.) 74, 1986 CarswellBC 496 (B.C. C.A.) — considered

Lifschultz Fast Freight, Re (1997), 132 F.3d 339 (U.S. C.A. 7th Cir.) — referred to

Matter of Mobile Steel Co. (1977), 563 F.2d 692 (U.S. C.A. 5th Cir.) — considered

Matticks v. B. & M Construction Inc. (Trustee of) (1992), 15 C.B.R. (3d) 224, (sub nom. *B & M Construction Inc., Re)* 11 O.R. (3d) 156, 1992 CarswellOnt 193 (Ont. Bktcy.) — considered

Pepper v. Litton (1939), 308 U.S. 295, 84 L.Ed. 281, 60 S.Ct. 238 (U.S. Va.) — referred to

Re/Max Metro-City Realty Ltd. v. Baker (Trustee of) (1993), 1993 CarswellOnt 180, 16 C.B.R. (3d) 308 (Ont. Bktcy.) — considered

S-Marque Inc. v. Homburg Industries Ltd. (September 2, 1998), Doc. 113589, 113762, 116298 (N.S. S.C.) — considered

Salomon v. Salomon & Co. (1896), [1897] A.C. 22, [1895-99] All E.R. Rep. 33, 66 L.J. Ch. 35, 13 T.L.R. 46, 45 W.R. 193 (U.K. H.L.) — referred to

Taylor v. Standard Gas & Electric Co. (1939), 306 U.S. 307 (U.S. Sup. Ct.) — considered

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3

Generally — referred to

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

Generally — referred to

s. 38 — referred to

s. 81(1) — referred to

s. 136 — referred to

ss. 136-141 — referred to

s. 141 — referred to

s. 183 — referred to

Corporations Act, R.S.N. 1990, c. C-36

s. 2(b) "affiliate" — considered

s. 7 — considered

s. 8 — considered

Insurance Adjusters, Agents and Brokers Act, R.S.N. 1990, c. I-9

Generally — referred to

s. 30 — referred to

Insurance Companies Act, R.S.N. 1990, c. I-10

Generally — referred to

s. 74 — referred to

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11

Generally — referred to

ACTION by insurer against agent and its affiliate seeking disallowance of affiliate's claim in bankruptcy of agent.

***Robert M. Hall J.*:**

Background

1 J.J. Lacey Insurance Limited ("Lacey") was a body corporate incorporated under the laws of Newfoundland and Labrador and licensed as an insurance broker under the *Insurance Adjusters, Agents and Brokers Act*, R.S.N.L. 1990, c. I-9 (the "IAABA") and Hiland Insurance Company Limited ("Hiland") was a body corporate incorporated under the laws of Newfoundland and Labrador and licensed as an insurance company under the *Insurance Companies Act*, R.S.N.L. 1990, c. I-10. I am satisfied Lacey and Hiland were affiliates of each other as that term is defined in sections 2, 7 and 8 of the *Corporations Act*, R.S.N.L. 1990, c. C-36, which sections read as follows:

2.(b) "affiliate" means an affiliated body within the meaning of section 7;

. . .

Affiliated corporations

7. (1) One body corporate is affiliated with another body corporate where 1 of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person.

(2) Where 2 bodies corporate are affiliated with the same body corporate at the same time, they are affiliated with each other.

Control of a body corporate

8. A body corporate is controlled by a person where shares of the body corporate carrying voting rights sufficient to elect a majority of the directors of the body corporate are held, directly or indirectly, except by way of security only, by or on behalf of that person.

2 Attached as Schedule "A" to this judgment is a chart showing the affiliated relationship of Lacey to Hiland as well as the relationship of both Hiland and Lacey to Mr. Clayton Gillingham ("Gillingham") in whom I am satisfied control of these corporations was vested, as well as control of A & P Realty Limited, The Porte Village Limited, Central Insurance Services Limited ("Central"), C.W.G. Enterprises Limited and P & G Realty Limited. Neither the solicitor for the Trustee in Bankruptcy of Lacey nor the solicitor for the provisional liquidator of Hiland took any exception in this proceeding to the argument that all of the corporations shown in Schedule "A" attached to this judgment were affiliated with each other and were controlled by Gillingham, who was either president or a director or controlling shareholder (directly or indirectly) of each of those corporations.

3 In September 1994, pursuant to section 30 of the IAABA and section 74 of the *Insurance Companies Act*, the Superintendent of Insurance ("the Superintendent") for the Province of Newfoundland and Labrador ordered an examination of the accounts of Lacey and Hiland as well as those of Central. The results of that investigation, in so far as they relate to Central, are not relevant in this matter.

4 As a result of irregularities discovered by the staff of the Superintendent during the course of this examination, Hiland's license as an insurance company was cancelled on October 3, 1994, and Coopers and Lybrand Limited were appointed as provisional liquidator of Hiland, pursuant to the provisions of the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11. Additionally, the provisional liquidator of Hiland successfully petitioned for the bankruptcy of Lacey and Central and on December 30, 1994, Peat Marwick Thorne Inc. (currently KPMG Inc.) was appointed Trustee in Bankruptcy of Lacey. Lacey had acted as an insurance broker and agent on behalf of the Plaintiff herein ("Lloyd's") and subsequently as broker and agent for Hiland. Hiland was incorporated in December of 1992 and received its license as an insurance company late in January

of 1993. Prior to the incorporation of Hiland, Lacey carried on business as agent and broker of automobile and property and casualty insurance, principally on behalf of Lloyd's, but it also acted for some other insurers. Due to the relationship of Lacey as broker or agent for Hiland, and the apparent receipt by Lacey of funds which constituted premiums for insurance and thus trust funds in the hands of Lacey pursuant to the IAABA, the provisional liquidator of Hiland filed a proof of claim (property) pursuant to section 81(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA") in the amount of $1,647,939 and a further unsecured claim in the amount of $2,910,459 for a total claim of Hiland in the bankruptcy of Lacey in the amount of $4,558,398. Ultimately, the claim of Hiland in the bankruptcy of Lacey was accepted by the trustee at $3,258,961.16. The trustee paid two dividends, firstly in the amount of $149,545.10 on March 1, 1996, and secondly in the amount of $523,374.00 on July 6, 1999, recognizing these dividends as payment of trust funds received by Lacey as agent and broker on behalf of Hiland. This left a net claim in the bankruptcy of Hiland in the amount of $2,586,042.06 accepted by the trustee as owing to Hiland on which a dividend of $56,066.40 was paid to Hiland and a superintendent's levee of $2,803.32 levied thereon, leaving at present a net claim by Hiland in the bankruptcy of Lacey of $2,529,975.66.

5 Lloyd's is an unsecured creditor of Lacey and it appealed the decision of the trustee of Lacey to allow the proof of claim of Hiland in the bankruptcy of Lacey. After much delay, pursuant to an interlocutory application heard December 18, 2007, I ordered that Lloyd's appeal to this Court seeking a disallowance of the claim of Hiland in the bankruptcy of Lacey should proceed by way of a *trial de novo* and that fresh evidence over and above that produced by Lloyd's to that date would be allowed, either by *viva voce* evidence or through any other appropriate evidentiary process. As a result, a statement of claim was issued by Lloyd's as plaintiff, which was subsequently amended by an amended statement of claim filed December 6, 2007. In its statement of claim Lloyd's states that from January 1, 1992, until December 31, 1992, Lacey as cover holder had two Binding Authority Agreements under which it was authorized to sell automobile and residential insurance for Lloyd's. The persons authorized under the 1992 Binding Authority Agreements were Gillingham and an employee and subsequent wife of Gillingham, namely Carol Scott. Lloyd's claims that between June 1, 1991, and December 31, 1992, certain insurance policies were entered into by Lacey in the name of certain underwriters at Lloyd's but these policies were either not reported to (Lloyd's or Lacey failed to remit the premiums to Lloyd's in accordance with the terms of the Binding Authority Agreements as referenced herein, or both. It was later during the same time period that Gillingham had applied for a provincial insurance company license for Hiland under the *Insurance Companies Act*.

6 Lloyd's claimed that during these periods the Defendants, by their directors, officers, servants and agents, unduly, unlawfully and maliciously and lacking *bona fides* conspired and agreed together, one with the other, or with persons unknown to:

1) submit false, inaccurate and misleading information to Lloyd's for the purposes of obtaining, without authorization, and to convert to their own use or the use of directors, officers or shareholders, the benefit of premiums otherwise due and owing to Lloyd's on policies issued pursuant to the Binding Authority Agreements;

2) submit false, inaccurate and misleading information to Lloyd's, the purpose of which was to mislead, misstate and otherwise mislead Lloyd's as to the true nature of the potential exposure to Lloyd's from the issuance of insurance policies pursuant to the Binding Authority Agreements;

3) misled Lloyd's as to the premiums written and the potential exposure incurred as a result of the generation of policies of insurance pursuant to the Binding Authority Agreements aforesaid; and

4) conceal from Lloyd's a true reflection of the insurance risks that Lloyd's, by operation of law, was otherwise obliged to provide cover notwithstanding the failure of the Defendants to remit the premiums.

7 Lloyd's claimed in its amended statement of claim that the Defendants were motivated to conspire and that their predominant purpose and concern was to obtain capital generated by the premiums for the operation of one or other Defendant, or for the use of the directors, officers or directing minds thereof for their own use and benefit, either jointly or in part. Lloyd's claims that this scheme was designed in the manner and fashion to conceal from Lloyd's material facts necessary in order for Lloyd's to properly provide for the underwriting in relation to the policies written and thus was in violation of the Binding Authority Agreements. This resulted in denying to Lloyd's the ability to use the premiums that had been converted by the Defendants.

8 Lloyd's says that because of this scheme, under the common law of the Province of Newfoundland and Labrador, the Defendants are liable both for their own acts and for the acts or omissions of their subsidiaries and/or directors, officers or shareholders in as much as the Defendants operated their corporate entities as one entity with the sole and singular purpose of defrauding the Plaintiff of its lawful entitlement to the premiums collected. Lloyd's pleads that these activities, both intra-company (as between Hiland and Lacey) and inter-company (between Hiland and Lacey), were such as to deny the Defendants any reliance on the basic principles of corporate law to suggest that Hiland and Lacey should be treated as separate operating enterprises. Lloyd's says that to treat Hiland and Lacey as separate operating enterprises will unjustly deprive Lloyd's of its rights by means of the Defendant's very own misconduct and, in particular, would result in the allowance of the Hiland claim against the estate of Lacey to the detriment not only of Lloyd's but to the detriment of all legitimate creditors of the bankrupt estate of Lacey. Lloyd's claims that at all material times the Defendants were not operating as separate corporations but were essentially one and the same under the directing mind of Gillingham and that Gillingham directly controlled the day-to-day operations of Hiland and Lacey through common offices and common management and that he oversaw, directed, managed and coordinated all operations and developed the scheme by which Lloyd's was denied its lawfully entitled premiums.

9 As the result of the fraud committed against Lloyd's by the Defendants, Hiland and Lacey, either acting in concert through their directors, officers or shareholders or as a result of the activities and/or the directing mind of Gillingham, Lloyd's requests that the Court pierce the corporate veils of Hiland and Lacey, and Lloyd's further requests that the notice of claim filed with the Trustee in Bankruptcy by Hiland against the Estate of Lacey, be deemed invalid and be disallowed and the declaratory relief of the Plaintiff's claim be granted.

Defense of Lacey

10 Counsel for Lacey filed a defense pleading that the allegations of Lloyd's with respect to failure to notify Lloyd's by Lacey of the writing of policies and the failure to remit premiums for those policies to Lloyd's, had no bearing on the matter which is presently under appeal i.e., the trustee's decision to allow the Hiland proof of claim. In particular, Lacey pleads that the alleged conspiracy between Lacey and Hiland, are matters which were not under appeal and are new matters arising in the bankruptcy estate and that the Plaintiff is out of time in raising these issues, some thirteen years after the receiving order was issued. Lacey's counsel claims that the only matter under appeal is fraud of Hiland and that the trustee of Lacey takes a position that, in determining whether to pierce the corporate veil of Hiland, the Court should restrict itself to considering whether Hiland was created as a sham to defraud Lloyd's and should determine what the effect of such a decision would be upon the legitimate creditors of Hiland. With respect, I disagree with these positions of the counsel for the trustee of Lacey. I am satisfied that in appealing the decision of the trustee, Lloyd's is saying that the trustee did not investigate the claim of Hiland but simply relied upon the evidence provided by the provisional liquidator. In this regard, the trustee of Lacey did not have the evidence of fraud and/or conspiracy on the part of Hiland, Lacey and Gillingham. Indeed, normal estate administration practice and procedure under the BIA would not see such an investigation taking place by the trustee. I am of the view that Lloyd's should not be prejudiced in having the fraud, conspiracy and lifting of the corporate veil arguments made before this Court even though there has been a very significant lapse of time. As indicated in my earlier judgment in this matter filed January 24, 2008, in relation to converting this matter to a *trial de novo*, I was of the view that efficacy, expedition and concerns over extra expense and delay or increased formality should not be allowed to trump fairness and should certainly not allow the claims determination process to constitute a *de facto* "good housekeeping seal of approval" upon activities surrounding which there is a serious allegation of criminality.

11 The provisional liquidator for Hiland likewise asserts that the notice of appeal from the allowance of the claim of Hiland only asserted that there was a fraud committed by Hiland as against Lloyd's. Hiland denies that any fraud took place and put Lloyd's to strict proof thereof. It denies that there was any grand scheme of deception or conspiracy such as to give rise to the remedy sought by Lloyd's, which would defeat the interest of the legitimate creditors of Hiland and that the appeal of the allowance of the claim of Hiland should only be based on grounds advanced by Lloyd's at the time of the decision of the trustee and not upon new and extended grounds raised by Lloyd's in its statement of claim.

12 With respect, I similarly disagree with this position. Lloyd's cannot know and was not privy to the information which the trustee used in arriving at his decision to allow the claim of Hiland. The somewhat abridged process under which claims in bankruptcy are evaluated by a trustee cannot, in my view, be used as a shield to protect a fraudulent creditor from making a claim against a bankrupt corporation. I repeat my earlier comments that efficacy, expedition and concerns over extra expense and delay and increased formality should not be permitted to trump the fairness of the claims evaluation process where there is serious allegation of criminality.

Fraud Perpetrated Against Lloyd's

13 The investigation initiated by the Superintendent of the affairs of Lacey and Hiland revealed that a number of policies were written by Lacey on the policy forms provided to Lacey by Lloyd's, that these policies appear not to have been reported to Lloyd's, and that the premiums paid thereon by the insureds were not remitted to Lloyd's. A preliminary sample list of policies was prepared by Karen Legge, C.A., (who had conducted this portion of the investigation on behalf of the Superintendent) and submitted by her to Lloyd's. Lloyd's confirmed that the listed policies had not been reported and the premiums not remitted. This resulted in the furthering of the Superintendent's examination of the affairs of Lacey in this regard.

14 Under the contractual arrangements in place between Lloyd's and Lacey, all policies written for Lloyd's were to have a numeric identification number, i.e., no letters of the alphabet were to be used in the policy number. However, the policies written on Lloyd's forms and not reported to Lloyd's all had an alpha identifier inserted in the policy number.

15 Additionally, any claims which arose under these alpha policies were assigned a claim file number using an "x" in that claim number. This practice was different from what it was with respect to policies which had been reported to the insurers. All of the "x"-numbered claim files were administered directly by Gillingham and did not go through the normal claims process at Lacey, as agreed with Lloyd's under the Binding Authority Agreements.

16 I am satisfied from the evidence of Karen Legge, C.A. that the claims made by insureds against these alpha policies (not reported to Lloyd's) were paid out of the retained premiums, which had not been remitted by Lacey to Lloyd's. Only one exception was the policy related to one Freake where an alpha policy was cancelled after a claim was received and a new policy written properly on Lloyd's forms but dated prior to the claim. The policy and claim were then sent to Lloyd's. There was no compelling evidence to rebut the existence of these alpha policy files and "x" claim files and I am satisfied that this practice was extensively carried out by Lacey at the direction of Gillingham. I accept the evidence of Karen Legge, C.A. that her investigation indicated that policies earning a total of $3,110,100 in premiums were written in this manner between November of 1991 and December 31 of 1992 and were not reported to Lloyd's. On December 31, 1992, the Binding Authority Agreements between Lloyd's and Lacey expired. I am satisfied on the evidence that such activities constituted a fraud upon Lloyd's by Lacey and that the directing mind in the planning, organization and carrying out of that fraud was Gillingham. In her evidence, Carol Scott, the common law spouse of Gillingham, who had been a claims supervisor at Lacey's, confirmed that these alpha policies were managed by, and "x" file claims under them resolved, directly by Gillingham. In meetings held early on in the Superintendent's investigation of Hiland and Lacey, Gillingham confirmed to Karen Legge, C.A. that claims against the alpha policies were paid out of the premiums retained by Lacey and which were payable to Lloyd's on policies not reported to Lloyd's. In his evidence at trial Gillingham did not rebut this evidence of Ms. Legge, which evidence she had recorded contemporaneously with Gillingham making the statements to her. I therefore accept the quantum established by Ms. Legge in her investigation as to the amount of policy fraudulently written by Lacey on Lloyd's paper and the premiums resulting therefrom as $3,110,100.

Hiland - Incorporation and Role in Fraud Upon Lloyd's

17 Hiland was incorporated at the end of December 1992. It did not receive its license to carry on business as an insurance company under the *Insurance Companies Act* until late January 1993.

18 Lloyd's had advised Lacey several months prior to the incorporation of Hiland that Lloyd's would not be writing any more automotive and property policies in Newfoundland and Labrador after the expiry of the Binding Authority Agreements then in place between Lloyd's and Lacey. These agreements expired December 31, 1992. Gillingham had expected to receive

approval for the licensing of Hiland as an insurance company prior to these agreements expiring. This was important as Lloyd's was the major insurance company for which Lacey had authority to sell. Loss of the Lloyd's account was to be a serious loss to Lacey. Additionally, Gillingham was confident that Hiland, as an insurance company controlled by him, would be profitable as he would be able to write insurance through Hiland for customers to whom he had previously issued Lloyd's policies.

19 However, there existed in Lacey the problem of the unreported Lloyd's policies. Gillingham wanted to get these policies into Hiland. The vehicle he chose was simply to cancel these policies and reissue them in Hiland's name for the balance of the policy terms originally issued through Lloyd's. He did this without the consent of either Lloyd's or the named insureds in the policy. This provided a means of covering up the illegally issued Lloyd's policies and the fraud perpetrated by Lacey and Gillingham upon Lloyd's and additionally to get premium money into Hiland. These transfers all occurred after Hiland had received its license to sell insurance in January of 1993 and after all of the unreported Lloyd's policies had been written.

20 The parties opposed to Lloyd's appeal in this matter argue that Hiland could not have been a party to the fraud occasioned by the unreported policies, as its corporate existence did not occur until after the initial fraud upon Lloyd's by Lacey had occurred. I cannot accept this argument. The cover up of the fraud was aided and abetted by Hiland by way of the rewriting of the Lloyd's policy in Hiland's name without the consent of either the insureds or Lloyd's. Thus the fraud process continued with the involvement of Hiland. Hiland received the proportionate share of the premiums on these policies which should have gone to Lloyd's. Hiland therefore benefited by receiving part of Lloyd's book of business and its premium revenue. In my view, this makes it every bit a party to the fraud as were Lacey and Gillingham.

Lifting the Corporate Veil

21 In its statement of claim Lloyd's asserts that at all material times Hiland and Lacey, as well as the affiliated companies and persons set out in the organizational chart of Hiland, and those companies set out in paragraph 2 hereof, as well as the directors and officers thereof, shared a common purpose of designing and putting into place the plan of action so as to deny Lloyd's of their lawful entitlement to the premiums collected on insurance policies generated pursuant to the Binding Authority Agreements. Lloyd's contends that under the common law of Newfoundland and Labrador the Defendants are liable both for their own acts and the acts and/or omissions of their subsidiaries and/or directors, officers or shareholders, in as much as the Defendants operated their corporate entities as one entity with the sole and singular purpose of defrauding the Plaintiff of its lawful entitlement to premiums collected pursuant to policies of insurance issued under those Binding Authority Agreements. Lloyd's further asserts that Gillingham as the sole owner of a hundred issued common shares of Hiland and *de facto* sole owner of Lacey, at all times material hereto controlled the day-to-day operations of both Hiland and Lacey and in particular directed the staff of one or both of these corporate entities and/or affiliates to set in place this fraudulent scheme.

22 It is the position of Lloyd's that these fraudulent activities are such as to deny Lacey and Hiland any reliance on the basic principles of corporate law to suggest that Hiland and Lacey should now be treated as separate operating entities, as to do so will unjustly deprive Lloyd's of its rights by means of the Defendant's very own misconduct and, in particular, would result in allowance of the claim against the estate of Lacey by Hiland to the detriment not only of Lloyd's but as against all legitimate creditors of Lacey.

Does the Law Support Lifting the Corporate Veil of Hiland and Lacey?

23 The Supreme Court of Canada in *Kosmopoulos v. Constitution Insurance Co. of Canada*, [1987] 1 S.C.R. 2 (S.C.C.), dealt with a case of a fire loss in a leather goods business. The respondent Andreas Kosmopoulos had incorporated his leather goods business and became the sole shareholder and director of the company. Virtually all of the documentation required in the business continued to refer to it as being a sole proprietorship and made no reference to the company. The lease in which the business was carried on continued in Kosmopoulos' personal name and the landlord's approval to assign the lease to Kosmopoulos' company was not obtained. The fire insurance policies all showed the insured as being the sole proprietor Kosmopoulos, even though the insurance agency was well aware of the fact that the business was being carried on by the incorporated company. A fire in the adjoining premises damaged the company's assets and the rented premises. The insurance companies refused payment on proof of loss and Kosmopoulos and his corporation sued. One of the arguments made was that the Court should lift the corporate

veil as between Kosmopoulos personally and his corporation to find that he personally had an insurable interest. Wilson, J. on behalf of the Court at paragraphs 12 and 13 considered this argument as followed:

> 12 As a general rule a corporation is a legal entity distinct from its shareholders: *Salomon v. Salomon & Co.*, [1897] A.C. 22 (H.L.). The law on when a court may-disregard this principle by "lifting the corporate veil" and regarding the company as a mere "agent" or "puppet" of its controlling shareholder or parent corporation follows no consistent principle. The best that can be said is that the "separate entities" principle is not enforced when it would yield a result "too flagrantly opposed to justice, convenience or the interests of the Revenue": L.C.B. Gower, Modern Company Law (4th ed. 1979) at p. 112. I have no doubt that theoretically the veil could be lifted in this case to do justice, as was done in *American Indemnity Co. v. Southern Missionary College*, supra, cited by the Court of Appeal of Ontario. But a number of factors lead me to think it would be unwise to do so.
>
> 13 There is a persuasive argument that "those who have chosen the benefits of incorporation must bear the corresponding burdens, so that if the veil is to be lifted at all that should only be done in the interests of third parties who would otherwise suffer as a result of that choice": Gower, supra, at p. 138. Mr. Kosmopoulos was advised by a competent solicitor to incorporate his business in order to protect his personal assets and there is nothing in the evidence to indicate that his decision to secure the benefits of incorporation was not a genuine one. Having chosen to receive the benefits of incorporation, he should not be allowed to escape its burdens. He should not be permitted to "blow hot and cold" at the same time.

24 The Newfoundland and Labrador Court of Appeal in *Bow Valley Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd.* (1995), 130 Nfld. & P.E.I.R. 92 (Nfld. C.A.), dealt *inter alia* with whether the corporate veil should be lifted in a situation where a single enterprise joint venture corporation had been incorporated by two of the principle actors in the matter. The Court considered the equities of the matter concerning the real relationship between the joint venture partners. The appellants however advocated the traditional approach, one consistent with the view that a corporation is a separate legal personality from its shareholders and that those shareholders were liable for the undertakings of the corporation or the acts of its servants, agents or employees. In this regard, the Court cited *Salomon v. Salomon & Co.* (1896), [1897] A.C. 22 (U.K. H.L.). At paragraphs 39 and 40 the Court of Appeal noted that there were exceptions to this traditional rule and stated:

> 40 One circumstance where the corporate veil is lifted is where it is established that the corporation is an instrument for fraud or improper conduct by the shareholder. There is no such allegation here. ....BVHB was established for a valid business reason: to obtain financing of a certain type. It was not incorporated to create a false impression.

25 At paragraph 41 the Court of Appeal cited with approval *Gower's Principles of Modern Company Law*, 5th ed. (London: Sweet & Maxwell, 1992) as follows:

> 41 L.C.B. Gower, in Gower's Principles of Modern Company Law 5th ed. (London: Sweet & Maxwell, 1992), concludes, at page 133, that there are only three circumstances where the corporate veil may be lifted:
>
> (1) When the court is construing a statute, contract or other document;
>
> (2) When the court is satisfied that a company is a "mere façade" concealing the true facts;
>
> (3) When it can be established that the company is an authorised agent of its controllers or its members, corporate or human.

26 In *The Law and Practice of Canadian Business* (Vancouver: Butterworths, 1999) the author Kevin Patrick McGuinness, commencing at page 28, deals with piercing or lifting the corporate veil. At paragraphs 1.47 and 1.48 he states as follows:

> 1.47 Thus the courts are generally unwilling to pierce the corporate veil and will normally do so only where required to do so by statute or where extraordinary circumstances exist. Cases falling within the latter category are confined within a narrow compass. Taking advantage of the limited liability of a corporation *per se* is not improper. If a person

chooses to deal with a corporation, then he or she is limited in recourse to whatever assets the corporation may itself own. The occasional judgment suggests that courts are particularly unwilling to pierce the corporate veil where the corporation concerned has been in business for a considerable period of time, it is solvent, and there is no evidence of dishonesty relating to the conduct of its business or affairs. The courts are also unwilling to lift the corporate veil where to do so would contravene the express terms of a contract entered into by the party who is seeking to have it lifted. However, the weight of these facts and the circumstances when they will apply are not at all clear.

1.48 Indeed, it is difficult to discern any general principle that the courts have followed in the handling of such cases. The situations in which a court will pierce the veil are based on no principle of universal application, save perhaps the one unifying thread that the separate personality of a corporation will not be respected where the corporation is being used as a cover for deliberate wrong-doing. In addition, the courts will ignore the separate personality of a company in the following situations:

(1) where it is expressly authorized to do so by statute — many such situations are specified under tax legislation, but some are found in the corporate context, as where the company fails to describe itself as a "limited" company;

(2) where the company may correctly be characterized as having acted as an agent;

(3) where it is necessary to determine the residence of the company;

(4) where the company has been used as a cloak for fraud or manifestly improper conduct — although in such cases there is no need to lift the corporate veil in order to affix liability on the shareholder who perpetrated the fraud, as the shareholder will be personally liable for the fraud as a co-party;

(5) where there is a trust relationship;

(6) where the company is involved in criminal activity directed by its shareholders;

(7) in the interest of defence or national security;

(8) where to recognize the veil would be contrary to public policy.

Finding Re Lifting Corporate Veil

27 I am satisfied on the evidence that frauds were perpetrated jointly by Lacey, Gillingham and Hiland and included the use of monies from Hiland to purchase an asset in the name of an affiliated company, P & G Realty Limited, a cash advance from Hiland of $135,000 to Gillingham, and a cash advance of $17,000 to an affiliated company, CWG Enterprises, and a mortgage loan of $135,000 to another affiliated company, The Porte Village Limited. These transfers appear to have impaired the assets of Hiland as well as did other monies funneled directly to the account of Nesbitt Thompson, an investment broker, with whom Lacey, Hiland, Gillingham and related companies had funneled money. These transactions point to the use of Hiland as a corporate vehicle to further wrongful acts. Gillingham in his evidence stated that premiums of insurance paid to Hiland included premiums not reported to Lloyd's. It is therefore likely that at least part of the monies used by Hiland was lawfully that of Lloyd's and I am satisfied on the evidence that Hiland was used by Gillingham and Lacey as a façade to conceal the true facts, namely the non-reporting of premiums to Lloyd's and the non-reporting of policies issued in Lloyd's name, both actions constituting a fraud upon Lloyd's by Lacey, Gillingham and Hiland. Gillingham had the ability to bind Lloyd's and he did so through Lacey. The Hiland replacement policies were used to cover this deception. The guiding hand in all of this deception was Gillingham and, as such, Hiland knew of this because Gillingham was the sole directing mind of Hiland, just as Gillingham was the sole directing mind of Lacey. They were in effect all one and the same entity. In *Clarkson Co. v. Zhelka*, [1967] 2 O.R. 565 (Ont. H.C.), the trustee in bankruptcy of one Zhelka sought a declaration that certain lands in North York, Ontario were held by the defendants or one of them as trustee for the plaintiff and that a certain mortgage thereon from the defendant Zhelka to the defendant Industrial Sites & Locations Ltd. as mortgagee did not constitute a valid charge. The Ontario High Court of Justice stated:

> 80 If a company is formed for the express purpose of doing a wrongful or
>
> 81 unlawful act, or, if when formed, those in control expressly direct a wrongful thing to be done, the individuals as well as the company are responsible to those to whom liability is legally owed.
>
> [emphasis added]

28 Having stated the above principle, however, the Ontario High Court of Justice found that the evidence fell short of establishing whether there was any fraud upon Zhelka's personal creditors perpetrated by the operation of the company and Zhelka's conduct with relation thereto.

29 Lloyd's has argued, and I agree, that the initial appointment of the provisional liquidator can not cleanse the activities of Hiland which was previously used as a vehicle to perpetuate fraud upon Lloyd's, nor can the appointment of the provisional liquidator bestow a legitimacy on what were *ab initio* fraudulent acts by Lacey, Hiland and Gillingham acting in my view as one entity.

Equitable Subordination of Hiland Claim in Lacey's Bankruptcy

30 Having concluded that Lacey, Gillingham and Hiland were one and the same entity in perpetrating the frauds upon Lloyd's previously described in this judgment, the question now arises as to what use can be made of that conclusion.

31 The claim for relief contained in paragraphs 23 and 24 of the statement of claim of Lloyd's issued in this matter asks this Court to pierce the corporate veil of Hiland and Lacey as a consequence of the frauds committed against Lloyd's by Hiland and Lacey and, as a result of having so found, to deem the claim filed with the Trustee in Bankruptcy of Lacey by the provisional liquidator of Hiland against the estate of Lacey invalid and to disallow it.

32 No evidence was presented to me as to the nature of the debts existing between Lacey as debtor and Hiland as creditor. I must, therefore, in the absence of evidence assume that the claim of Hiland in the bankruptcy of Lacey is for legitimately incurred debt owing from Lacey to Hiland. Therefore, I can not absolutely disallow that debt. The question therefore arises: notwithstanding the assumed position that the debt existing from Lacey to Hiland is a legitimate debt, can this debt can be postponed in favour of the debts of the other creditors of Lacey until these creditors receive their full entitlement in the Lacey bankruptcy? Such full payment is unlikely to occur, particularly with respect to the: unsecured creditors. This then brings us to the question of whether the codified scheme of distribution of the assets of a bankrupt, under the BIA, can be modified by a court on the basis of equitable principles, in particular the proposed notion of equitable subordination. Professor Thomas G.W. Telfer of the University of Western Ontario has published an extensive article entitled "Transplanting Equitable Subordination: The New Free-Wheeling Equitable Discretion in Canadian Insolvency Law?" (2002) 36 Can. Bus. L.J., 36. At page 36 of his article, Professor Telfer adopts the following definition of equitable subordination as it appears in the decision of the Seventh Circuit Court of the United States *Lifschultz Fast Freight, Re*, 132 F.3d 339 (U.S. C.A. 7th Cir. 1997), at 349 , quoting from D. Skeel, "Markets, Courts, and the Brave New World of Bankruptcy Theory" [1993] Wisc. L. Rev. 465 at 506 as follows:

> Equitable subordination relies on courts' peering behind the veil of formally unimpeachable legal arrangements to detect the economic reality beneath. This task by nature "require[s] the court to make extremely subjective judgments as to whether a party has acted opportunistically".

33 Professor Telfer indicates that in the United States most academic commentators trace the origins of the use of equitable powers in United States bankruptcy matters to the "seminal cases" of *Taylor v. Standard Gas & Electric Co.*, 306 U.S. 307 (U.S. Sup. Ct. 1939) and *Pepper v. Litton*, 308 U.S. 295 (U.S. Va. 1939). In *Taylor* Douglas, J. firmly based his decision upon the Court's broad equitable powers as a "court of equity". Bankruptcy courts have invoked equitable powers "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done."

34 According to Professor Telfer these rulings began a long debate over the meaning of these highly abstract concepts and he observed that one author had suggested that it was impossible to extract from the decision in *Pepper* a basic rule that could be followed consistently.

35 At page 42 of the article, Professor Telfer points out that in 1977 the Fifth Circuit Court in *Matter of Mobile Steel Co.*, 563 F.2d 692 (U.S. C.A. 5th Cir. 1977), distilled the principles of the earlier case law and developed a three-part test for equitable subordination. Professor Telfer describes that test as follows:

> Before exercising the power of equitable subordination, a court must be satisfied that:
>
> (ii) The claimant must have engaged in some type of inequitable misconduct;
>
> (iii) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant;
>
> (iv) Equitable subordination of the claim must not be inconsistent with the provisions of the *Bankruptcy Act*.

36 Professor Telfer goes on to discuss United States' limitations on judicial discretion to alter priorities on insolvency and at page 48 states:

> While the **Mobile Steel** three-part test has been influential in setting out the broad parameters of the doctrine, in many respects the doctrine continues to operate under the rubric of an open-ended standard. Judicial attempts to further define or elaborate upon the meaning of misconduct, for example, "substitute equally vague terms for the root concept". The open-ended nature of the doctrine has sparked a debate in the United States over the merits of granting the judiciary the power to alter statutory priorities. ... this part examines a recent trend in the United States jurisprudence to curtail Douglas J.'s abstract notions "rules of fair play and good conscience". In interpreting the principles of equitable subordination, courts have focused the inquiry on the contractual rights of the parties and recognized the importance of not altering legislative policy choices on any kind of a categorical basis.

37 At pages 49 and 50 Professor Telfer discusses several techniques which have been used to mark off or set boundaries for the operation of equitable subordination and comments at page 50 as follows:

> Some American courts have adopted a restrictive approach, or what one author has called the "formalist contract-rights presumption", for cases involving non-management creditors.

38 At page 51 Professor Telfer discusses arguments propounded by A. DeNatale and P. Abram in their article "The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors" (1985), 40 Bus. Lawyer 417, with respect to the third element from the *Matter of Mobile Steel Co.* test. He states:

> DeNatale and Abram argue that the third element from the *Mobile Steel* test (equitable subordination must not be inconsistent with the provisions of the bankruptcy statute) "acknowledges that the equitable powers of the bankruptcy court may not be used to alter the statutory scheme but rather must be used only to conform the results of a particular case to the statutorily mandated bankruptcy results. The United States Supreme Court in *Noland* recently adopted the following statement from these two authors as the rationale supporting the third element:
>
> > Simply stated, the third criterion is a reminder to the bankruptcy court that although it is a court of equity, it is not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable. (see DeNatale and Abram footnote 40 at pages 427-428)
>
> [emphasis added]

39 At page 53 of his article, before embarking upon the discussion of whether equitable subordination is available is part of Canadian law, Professor Telfer proposes the following as the question to be answered:

> If equitable subordination is available as a matter of Canadian law, a question for the Canadian courts is whether these two major limitations upon the doctrine are acceptable policy limits upon a broad discretionary remedy.

Equitable Subordination in Canadian Law

40 Professor Telfer states that there is no statutory provision in the BIA that expressly permits the application of equitable subordination. However, he points out that under section 183 of the BIA courts exercising jurisdiction in Canada are "invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy".

41 At page 55 of his article Professor Telfer summarizes the conflicting positions in Canadian legal commentary regarding the doctrine. He states:

> Beyond the precise legal authority for the doctrine, Canadian commentators have also taken up the normative debate of whether such judicial intrusion into commercial affairs is desirable. Some authors assert that there are instances "where the facts are so compelling that fairness dictates some adjustment of priorities".[citation omitted] Bankruptcy courts require the discretion in equity "to subordinate the claim of a creditor whose conduct prejudiced an estate". [citation omitted] On a general level, the failure to intervene with an equitable remedy may "permit conduct which is morally offensive to go unpunished and, indeed to be rewarded."[citation omitted]
>
> Poised against the argument in favour of intervention stands the need for commercial certainty in commercial lending. Departure from the legal scheme of priorities "in favour of a discretionary scheme simply aggravates the uncertainty of result".[citation omitted] If courts resorted to equitable remedies, including equitable subordination, the effect would be to alter the priority scheme of the provincial personal property security legislation. This would subvert the PPSAs' purpose, which is to provide a statutory scheme to give certainty and predictability to secured transactions. The introduction of a discretionary regime, it is argued, would create costly litigation, drive up the cost of credit and make reorganizations more difficult as parties jockey to alter legal priorities.

42 Prior to 1992 three Canadian decisions were divided on the issue as to whether the doctrine equitable subordination existed in Canada. In 1992 the Supreme Court of Canada expressly refrained from providing an answer on the issue. In 1986 the British Columbia Court of Appeal in *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 7 B.C.L.R. (2d) 90 (B.C. C.A.), dealt with a case where a creditor sought to have certain shareholder loans postponed. While the court ultimately ruled in favour of the creditor on other grounds, it did consider whether there existed an equitable jurisdiction to subordinate the loans. It was argued on behalf of the creditor that when the court sat as a bankruptcy court it was a court of equity and as such was bound to give equitable relief. The Respondent relied upon the United States Supreme Court decision in *Pepper* and argued that *Pepper* "is said to establish the principle that, where a claim in bankruptcy has violated the rules of fair play in good conscience, the claim may be disallowed". The British Columbia Court of Appeal, however, declined to rule on this point and stated that it was unnecessary to reach any firm views as to whether the doctrine was part of Canadian law. Referring to the fact that the then *Bankruptcy Act* conferred upon the courts "such jurisdiction at law and at equity as well enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy" the court continued as follows:

> 29 The respondent has referred to some cases which appear to have applied the rules of equity but, in view of the conclusion I have reached on the firs: two grounds I prefer to say no more than that it should not be inferred that there is no such jurisdiction available. I would not wish to say anything which would encourage the view that the court does not have a long arm to prevent the kind of grossly unjust results which I think would have been achieved had the appellants succeeded in the position they took.

43 Professor Telfer at page 59 of his article describes this dictum as having "been characterized by one author as 'embrac[ing] the doctrine of equitable subordination'."[citation omitted]

44 Continuing at page 60 of his article, however, Professor Telfer points out two Ontario judgments prior to 1992 and the *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.), decision of the Supreme Court, which two cases clearly expressed the view that equitable subordination did not form part of the Canadian law. In *AEVO Co. v. D & A Macleod Co.* (1991), 4 O.R. (3d) 368 (Ont. Bktcy.), Chadwick J. set out the accepted three-part test for equitable subordination established by American case law but concluded that he could not agree that the doctrine of equitable subordination has any application in Canadian law. He states at page 372:

> [t]he *Bankruptcy Act* itself provides how claims are to be identified and how the estate is to be distributed.
>
> To incorporate the doctrine of equitable subordination into the *Bankruptcy Act* would create chaos and lead to challenges of security agreements based on the conduct of the secured creditor.
>
> If the Parliament of Canada felt that this doctrine had some application I am confident that in their wisdom they would have incorporated similar provisions into our statute.

45 Subsequent to his decision in *AEVO*, Chadwick J. in *Matticks v. B. & M Construction Inc. (Trustee of)* (1992), 11 O.R. (3d) 156 (Ont. Bktcy.), referred to his earlier ruling in *AEVO*. Although equitable subordination was not directly relevant to that case at hand, he stated at paragraph 11 in *Matticks* that the *Bankruptcy Act* "provided a specific code for the determination of bankruptcy matters. (There was no room in the interpretation of the Act for that equitable doctrine". In 1992 the question of equitable subordination came before the Supreme Court of Canada in the *Canadian* Commercial *Bank* ("the *CCB*") case. Before CCB was wound up, the governments of Canada and Alberta, the six major Canadian banks and the Canada Deposit Insurance Corporation entered into a complex financial arrangement in an attempt to prevent the demise of the CCB. The characterization of the monies advanced by the parties was crucial to the determination of how the proceeds of the liquidation of the assets of CCB were to be distributed. The Supreme Court of Canada had first to determine whether or not $255,000,000 advanced by these parties was in the nature of a loan or in the nature of an investment of capital. If the transaction was to be characterized as a loan, these parties were creditors of CCB and would be entitled to rank on an equal footing with the other ordinary creditors in the distribution of CCB's assets. The court concluded that the transaction was in fact a loan, thus giving rise to the issue of whether the doctrine of equitable subordination ought to be applied to postpone that loan in favour of the other creditors. It is not necessary here for the purposes of this decision to set out in detail the considerations of the Supreme Court of Canada in that regard. Suffice to say the Supreme Court of Canada did not accept the formulation of a broad equitable jurisdiction and refused to decide whether the United States doctrine of equitable subordination was a part of Canadian insolvency law. Without referring to the earlier conflicting Canadian authorities on this issue, as set out above, Iacobucci J. stated:

> 90 ... As I see the matter, however, it is not necessary in the circumstances of this case to answer the question of whether a comparable equitable doctrine should exist in Canadian law and I expressly refrain from doing so. ...

46 The Supreme Court of Canada then went on to say in paragraph 96 that it was leaving a ruling on applicability of the doctrine of equitable subordination for "another day". Despite not making a clear ruling on whether a comparable doctrine existed in Canada, Iacobucci, J. did refer to American authorities which set out the general parameters of equitable subordination in the United States. He stated:

> 91 As I understand it, in the United States there are three requirements for a successful claim of equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

47 Subsequent to the *CCB* decision in the Supreme Court of Canada, the issue has not come back before that Court. However, it has been considered in numerous decisions subsequently, in virtually all cases in contests between secured creditors or as between an unsecured creditor and a secured creditor.

48 In *Re/Max Metro-City Realty Ltd. v. Baker (Trustee of)* (1993), 16 C.B.R. (3d) 308 (Ont. Bktcy.), Chadwick, J. at page 313 acknowledged that the "*Bankruptcy Act* itself requires application of equitable consideration in dealing with various claims and classes of claims." However, Chadwick, J. denied the claim for equitable setoff in this case, remaining firm to his earlier rulings in *AVEO* and *Mattick*s to refuse to allow equitable principles to upset the statutory form of distribution stating, "The statutory provisions of the *Bankruptcy Act* do not go so far as making an unsecured creditor secured or providing one creditor with a preference over another by application of equitable principles".

49 In other cases, such as *S-Marque Inc. v. Homburg Industries Ltd.*, [1998] N.S.J. No. 550 (N.S. S.C.) Hood, J. of the Nova Scotia Supreme Court in a decision described by Professor Telfer as "one of the clearest applications of the doctrine of equitable subordination by a trial court" dealt with a dispute with respect to the proceeds of transactions that had been successfully set aside by a creditor in an action pursuant to section 38 of the BIA. S-Marque Inc., the successful section 38 applicant, sought to rely upon the doctrine of equitable subordination to preclude a secured creditor from having recourse to the proceeds of the transactions. Dover Capital Corporation, the secured creditor and a related party to the defendants in the section 38 action, argued that any funds that became available as a result of the transactions being set aside were assets which would have been seized by it under a debenture held by it, if they had been there at the time of the seizure. On the principle issue of whether Dover Capital Corporation had any rights to the funds, the authorities clearly indicated that where a transaction is overturned the property does not become available for the benefit of a secured creditor. Notwithstanding that legal position Hood, J. concluded that if Dover Capital Corporation had a valid secured claim to the proceeds, it was to be equitably subordinated. Hood, J. stated that if he was wrong on his finding that the secured creditor had no claim to the funds, then he would invoke the principles of equity to prevent Dover Capital Corporation from benefiting from the reversal of transactions that were improperly entered into by companies related to it within the meaning of the BIA. Hood, J. applied the three-part test set out in *CCB* and concluded that the relevant inequitable conduct was the conduct resulting in reviewable transactions which have now been declared void. With respect to one such transaction, the Court found that it was the very conduct of Dover Capital Corporation that lead to the setting aside of the transfer by the debtor company. In other cases, it was the conduct of the companies related to Dover Capital Corporation that had lead to the wording of the transactions. Here the misconduct was considered by the court as resulting in injury to S-Margue Inc. and conferred an unfair advantage upon Dover Capital Corporation (see paragraph 184 of *S-Marque Inc.*).

Conclusions Re Applicability of Equitable Subordination Doctrine

50 As can be seen by my brief consideration of the various Canadian authorities respecting equitable subordination, it is clear that the history of Canadian trial courts applying this doctrine, or the doctrine being accepted by courts of appeal, has been sketchy. Professor Telfer's article deals in far greater detail than I have with respect to the approximately 20 subsequent cases on this doctrine as of the time of his article in 2002. This sketchy record has continued subsequent to Professor Telfer's article.

51 In considering the three requirements of a successful claim of equitable subordination, as considered by Iacobucci, J. in *CCB*, I am satisfied as follows:

> 1) That Hiland together with Gillingham and Lacey clearly engaged in a form of inequitable conduct. Lacey illegally appropriated the premium revenue of Lloyd's and either directly or indirectly funneled that premium revenue to Hiland which accepted it;
>
> 2) This conduct resulted in injury to Lloyd's and conferred an unfair advantage on Hiland.

52 The important question in this matter, I having found that the first two branches of the three-part *CCB* test have been met, is whether to allow equitable subordination in this fact situation would be inconsistent with the provisions of the BIA. Were we not dealing with an insolvency situation, I am more than satisfied that the common law of equity would subordinate the claim of Hiland to the claim of Lloyd's as against Lacey. In P.V. Baker & P. St. J. Langan, *Snell's Principles of Equity*, 29th ed.

(London: Sweet & Maxwell, 1990), page 57 sets out situations where the authors explain the circumstances in which a holder of *prima facie* priority can lose it as follows:

> A person with a prima facie claim to priority for his interest may lose it through his own misconduct. The owner of a legal interest may be postponed to a subsequent equitable interest owing to his fraud, or by estoppel, or through his gross negligence; and the owner of a prior equitable interest may be postponed if his conduct is inequitable.

53 Would I, by equitably subordinating the claim of Hiland to the claim of Lloyd's as against the bankrupt estate of Lacey, be doing something inconsistent with the provisions of the BIA? Sections 136-141 of the BIA set out the scheme of distribution of the assets of a bankrupt and section 141 specifies that subject to the BIA all claims proved in a bankruptcy shall be paid rateably. This means that the priority of claims set out in section 136 and following sections will have priority over general creditors. However, general creditors are to be paid rateably. By applying equitable subordination to the unsecured claim of Hiland in the bankruptcy of Lacey, would I be doing something which is inconsistent with the provisions of the Bankruptcy statute? Clearly by subordinating the claim of one unsecured creditor to the claims of all other unsecured creditors, I would not be bringing into bankruptcy matters the chaos envisaged by Chadwick, J. in *AVEO* or *Mattieks*. While indeed the scheme of distribution in the BIA may have as objects the avoidance of litigation and promotion of expeditious distribution, in my view equitable subordination of the claim of Hiland in this particular matter does not interfere significantly with these objects nor does it have the effect of challenging or interfering with secured creditors because we are dealing only with the rights of unsecured creditors relative to each other. It is true that by allowing the doctrine of equitable subordination to apply to unsecured creditors *inter se* that litigation about postponing the claims of unsecured creditors would result in the delay of the distribution of dividends from the bankrupt estate to such disputing creditors. However, it would only delay distribution to the creditor who is sought to be found subordinate. All other unsecured creditors would receive their dividends as they would have received them in the ordinary course of events. Trustees in bankruptcy would simply determine their preliminary distributions based upon the challenged unsecured claim not being subordinated but would not distribute the dividend to that impugned unsecured creditor but would distribute to all other unsecured creditors their rateable share. After the subordination challenge was litigated a trustee could simply adjust payouts in accordance with the result of the subordination litigation. If the subordination argument were unsuccessful, the harm caused to the creditors sought to be subordinated could be mitigated by solicitor and client costs and interest at the statutory rate from the time of the initial dividend, such interest being chargeable against the creditor seeking the subordination. None of the chaos envisaged by Chadwick, J. would result in such a situation.

Conclusion

54 I am therefore satisfied that the three-part test for equitable subordination as postulated by Iacobucci, J. in *CCB* is appropriate to be applied in the circumstances of this matter and conclude that the claim of Hiland in the bankruptcy of Lacey is to be subordinated until all other unsecured claims have been satisfied. In doing so I see no inequity being caused. It has been argued that to allow equitable subordination would punish the creditors of the insolvent estate of Hiland, principally policy holders. In my view, this is not an appropriate consideration. The creditors of Hiland have no status in the bankruptcy of Lacey. The creditor of Lacey is Hiland itself, not the creditors of Hiland. Hiland the corporation participated in a fraud against Lloyd's. The creditors of Hiland should not be indirectly rewarded by the criminal activity of the Hiland corporation. Thus, I see no inequity in postponing the claim of Hiland to the other unsecured creditors of Lacey. I acknowledge that there is difficulty in limiting the scope of equitable subordination but I cannot defer from finding unfair conduct simply because such conduct is generally difficult to define. In the case at bar, it is not at all difficult to find unfair, unconscionable and criminal activity on the part of Hiland, Gillingham and Lacey. Difficulty in limiting the scope of the doctrine should not stop courts from expanding the law so that the law responds to those clear cases where right-thinking persons can clearly and easily discern oppressive unfairness as having occurred.

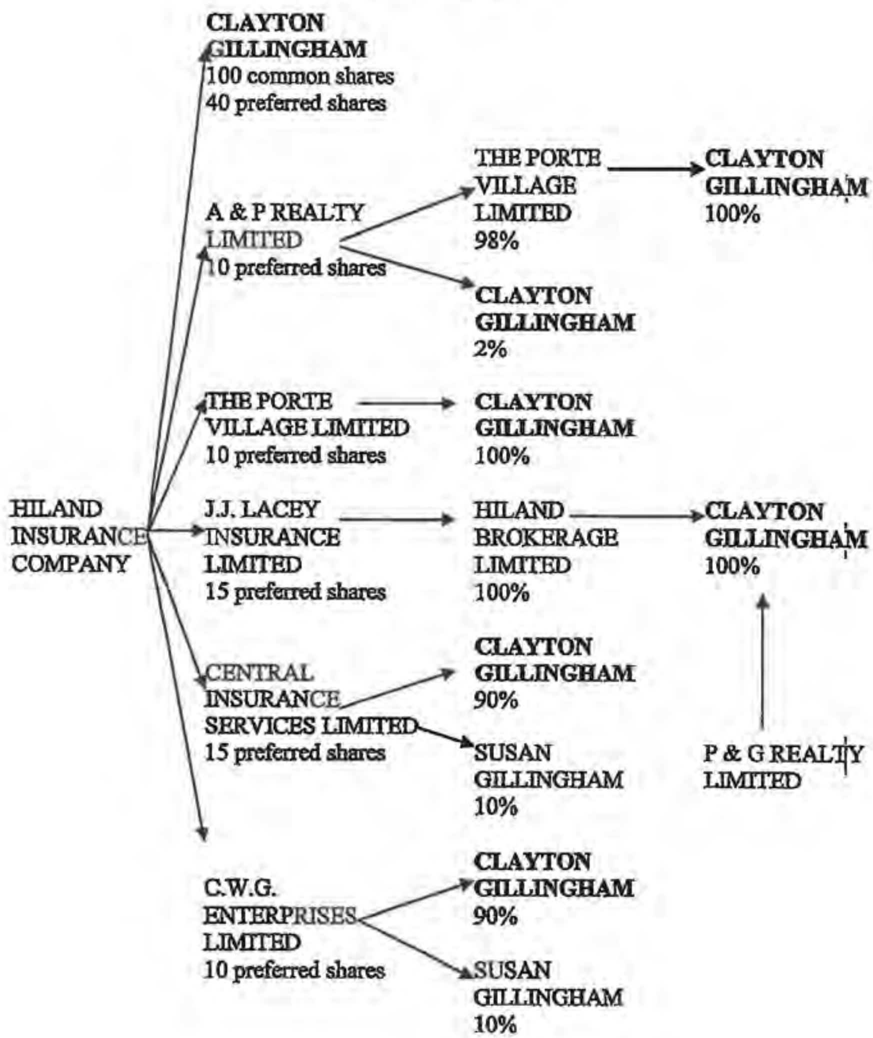
55 Lloyd's shall be entitled to its costs in this matter as against the estate of Lacey and the provisional liquidator of Hiland.

56 Additionally, Lloyd's sought an order that the provisional liquidator of Hiland return to the trustee of Lacey a dividend paid as of December 23, 1996, in the amount of $56,066.40. There was no evidence before me as to whether the provisional liquidator was in possession of any funds to effect this repayment or any part of it. In light of the fact that the dividend was paid

to the provisional liquidator in 1996, there is a real chance it does not possess funds sufficient to make such repayment. I will therefore reserve judgment on whether I will order such repayment pending further evidence and argument.

Action allowed.

Schedule"A"



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TAB 17

2016 ONCA 662
Ontario Court of Appeal

U.S. Steel Canada Inc., Re

2016 CarswellOnt 14104, 2016 ONCA 662, [2016] O.J. No. 4688, 270 A.C.W.S. (3d) 471, 39 C.B.R. (6th) 173, 402 D.L.R. (4th) 450, 61 B.L.R. (5th) 1

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, As Amended

In the Matter of a Proposed Plan of Compromise or Arrangement with Respect to U.S. Steel Canada Inc.

George R. Strathy C.J.O., P. Lauwers, M.L. Benotto JJ.A.

Heard: March 17, 2016
Judgment: September 9, 2016
Docket: CA C61331

Counsel: Gordon Capern, Kristian Borg-Olivier, Denise Cooney for Appellant, United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union
Andrew Hatnay, Barbara Walancik for SSPO and non-union retirees and active employees of U.S. Steel Canada Inc.
Tamryn Jacobson for Her Majesty the Queen in Right of Ontario and Superintendent of Financial Services (Ontario)
Michael E. Barrack, Jeff Galway, John Mather for Respondent, United States Steel Corporation
Sharon Kour for U.S. Steel Canada Inc.

Subject: Civil Practice and Procedure; Insolvency

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — General principles — Jurisdiction — Court

Company was in Companies' Creditors Arrangement Act (CCAA) protection — Former employees of company claimed its American parent company ran company into insolvency to further its own interests — Former employees sought to have CCAA judge apply American legal doctrine of "equitable subordination" to subordinate parent company's claims to former employee's claims — CCAA judge held that he had no jurisdiction to apply doctrine of equitable subordination — Union appealed — Appeal dismissed — Nowhere in words of CCAA was there authority, express or implied, to apply doctrine of equitable subordination, nor did it fall within scheme of statute, which focused on implementation of plan of arrangement or compromise — Words "may make any order it considers appropriate in circumstances" in s. 11 of CCAA must be read as "may in furtherance of purposes of act make any order it considers appropriate in circumstances" — There was no support for concept that phrase "any order" in s. 11 provided at-large equitable jurisdiction to reorder priorities or to grant remedies as between creditors — Section 6(8) of CCAA effectively subordinates "equity claims", as defined, to claims of all other creditors — "Equitable subordination" is form of equitable relief to subordinate claim of creditor who has engaged in inequitable conduct, such claim was not "equity claim" as defined — There was no "gap" in legislative scheme to be filled by equitable subordination through exercise of discretion, common law, court's inherent jurisdiction or by equitable principles Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s 11; Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s 6.

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Bell ExpressVu Ltd. Partnership v. Rex (2002), 2002 SCC 42, 2002 CarswellBC 851, 2002 CarswellBC 852, 100 B.C.L.R. (3d) 1, [2002] 5 W.W.R. 1, 212 D.L.R. (4th) 1, 287 N.R. 248, 18 C.P.R. (4th) 289, 166 B.C.A.C. 1, 271 W.A.C. 1, 93 C.R.R. (2d) 189, [2002] 2 S.C.R. 559, 2002 CSC 42 (S.C.C.) — considered

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Stelco Inc., Re (2005), 2005 CarswellOnt 1188, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 196 O.A.C. 142, 253 D.L.R. (4th) 109, 75 O.R. (3d) 5 (Ont. C.A.) — considered

Ted Leroy Trucking Ltd., Re (2010), 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 12 B.C.L.R. (5th) 1, (sub nom. *Century Services Inc. v. A.G. of Canada*) 2011 D.T.C. 5006 (Eng.), (sub nom. *Century Services Inc. v. A.G. of Canada*) 2011 G.T.C. 2006 (Eng.), [2011] 2 W.W.R. 383, 72 C.B.R. (5th) 170, 409 N.R. 201, (sub nom. *Ted LeRoy Trucking Ltd., Re*) 326 D.L.R. (4th) 577, (sub nom. *Century Services Inc. v. Canada (A.G.)*) [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, (sub nom. *Leroy (Ted) Trucking Ltd., Re*) 296 B.C.A.C. 1, (sub nom. *Leroy (Ted) Trucking Ltd., Re*) 503 W.A.C. 1 (S.C.C.) — followed

U.S. Steel Canada Inc., Re (2016), 2016 ONSC 569, 2016 CarswellOnt 3816, 34 C.B.R. (6th) 226, 5 P.P.S.A.C. (4th) 157 (Ont. S.C.J.) — considered

Statutes considered:

Bankruptcy Code, 11 U.S.C.

s. 105(a) — considered

s. 510(c)(1) — referred to

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

Generally — referred to

s. 38 — considered

s. 121 — considered

s. 121(1) — considered

s. 183 — considered

ss. 95-101 — referred to

Canada Business Corporations Act, R.S.C. 1985, c. C-44

s. 241 — considered

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

Generally — referred to

Pt. I — referred to

Pt. II — referred to

Pt. III — referred to

s. 2(1) "claim" — considered

s. 2(1) "equity claim" — considered

s. 2(1) "equity interest" — considered

s. 6(8) — considered

s. 11 — considered

s. 11.02 [en. 2005, c. 47, s. 128] — considered

s. 11.8(8) [en. 1997, c. 12, s. 124] — considered

s. 19 — considered

s. 19(1) — considered

s. 20 — considered

s. 22 — considered

s. 22.1 [en. 2007, c. 36, s. 71] — considered

s. 36.1 [en. 2007, c. 36, s. 78] — considered

s. 36.1(1) [en. 2007, c. 36, s. 78] — considered

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11

Generally — referred to

APPEAL by union of judgment finding that court had no jurisdiction to apply American doctrine of equitable subordination.

***George R. Strathy C.J.O.*:**

1 U.S. Steel Canada Inc. ("USSC") is in CCAA [1] protection. Its former employees claim that its American parent, United States Steel Corporation ("USS"), ran the company into insolvency to further its own interests. An issue arose in the court below as to whether the CCAA judge could apply an American legal doctrine called "equitable subordination" to subordinate USS's claims to the appellant's claims.

2 The CCAA judge held he had no jurisdiction to do so. For reasons different than the ones he gave, I agree, and would dismiss the appeal.

FACTUAL BACKGROUND

3 USS is one of the largest steel producers in North America. In 2007, it acquired Stelco, which was in CCAA protection at the time, and changed its name to USSC.

4 Seven years later, on September 16, 2014, USSC was again granted CCAA protection by order of the Superior Court of Justice (Commercial List).

5 The CCAA judge made a Claims Process Order on November 13, 2014, establishing a procedure for filing, reviewing and resolving creditors' claims against USSC.

6 The order set out a separate procedure for resolving claims of approximately $2.2 billion by USS against USSC. Most of the claims arose from USS's acquisition and reorganization of Stelco and from advances of working capital. Those claims were to be determined by the court, rather than by the Monitor.

7 USS filed its proofs of claims. The Monitor recommended they be approved and USS moved for court approval of the claims.

8 Notices of Objection were filed by four parties: (a) the Province of Ontario and the Superintendent of Financial Services in his capacity as administrator of the Pension Benefits Guarantee Fund; (b) the United Steelworkers, Locals 8782 and 1005; (c) Representative Counsel to the Non-USW Active Salaried Employees and Non-USW Salaried Retirees; and (d) Robert Milbourne, a former president of Stelco, and his wife, Sharon Milbourne, both of whom are beneficiaries of a pension agreement with USSC.

9 These objections overlapped to some extent. The CCAA judge had to develop a procedure to address the objections. He had to decide whether they should be dealt with within the CCAA process, outside it, or not at all.

10 The Province made two allegations. The first was that loans by USS to USSC should be characterized as shareholders' equity, because of the circumstances in which they were made. They should therefore be subordinated to all other claims pursuant to s. 6(8) of the CCAA [2] (the "Debt/Equity Objection"). Second, the Province argued that the security for the loans should be invalidated pursuant to provincial and federal fraudulent assignment and fraudulent preference legislation (the "Security Objection"). USS disputed both allegations, but was content to have the issues determined under the Claims Process Order.

11 The Union made objections similar to the Province's, but it added a third based on oppression and breach of fiduciary duty arising out of USS's conduct in relation to the Canadian plants, pensioners, pension plan members and beneficiaries (the "Conduct Objections").

12 The CCAA judge described the Conduct Objections as allegations that USS caused USSC to underperform, thereby requiring it to incur significant debt and to be unable to meet its pension obligations. The Union sought, among other things, an order subordinating the USS claims in whole or in part to its claims.

13 The Milbournes' objections were based on USS's alleged conduct and relied primarily on the doctrine of equitable subordination. They asked that the USS claims be dismissed entirely or subordinated to the claims of the other unsecured creditors.

14 The CCAA judge scheduled a motion to establish a litigation plan for USS's motion for approval of its claims against USSC. The parties agreed that the Security Objection and the Debt/Equity Objection could be determined pursuant to the Claims Process Order and within the CCAA proceedings. [3]

15 The primary disagreement concerned the procedure and timing for the determination of the other objections. The Union argued that the Conduct Objections should be resolved as part of the Claims Process Order and that an evidentiary record was required to do so. USS and USSC took the position that the Conduct Objections should be litigated outside the CCAA claims process.

16 The CCAA judge found that some of the claims of the Union and the Milbournes could be approached as third party claims against USS for oppression for the purpose of s. 241 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, and for breach of fiduciary duty. He found that neither the Claims Process Order nor the CCAA contemplated that such claims would be addressed by or would be relevant to a plan of arrangement or compromise under the CCAA. The third party claims fell outside the claims process unless specifically incorporated into the restructuring plan as approved by the parties or otherwise ordered.

17 The CCAA, he said at para. 65, "is directed towards the creation, approval and implementation of a plan of arrangement or compromise proposed between a debtor company and its secured and unsecured creditors". It did not contemplate incorporation of inter-creditor claims into any plan of arrangement or compromise or into the voting process in respect of any proposed plan.

18 He concluded, at para. 84, that under s. 11 the court had authority to order the remaining claims of the Union and the Milbournes, except the claim for equitable subordination, to be "determined by a process within the CCAA proceedings, other than the process contemplated by the Claims Process Order, if the Court is of the opinion that, on balance, such action is likely to further the remedial purpose of the CCAA." He held that those claims could be determined within the CCAA proceedings, rather than in a separate action in the Superior Court, but not under the Claims Process Order. He noted that the court retained jurisdiction to order that the claims be continued outside the CCAA if it was determined that pursuing them within the process would no longer further the remedial process of the CCAA.

19 He held, however, that he had no jurisdiction under the CCAA to apply the doctrine of equitable subordination. Before turning to his reasons, I will explain the doctrine of equitable subordination.

EQUITABLE SUBORDINATION

20 Equitable subordination was developed as an equitable remedy in American insolvency law to subordinate a creditor's claim based on its inequitable conduct. The principles were articulated in *Mobile Steel Co., Re* 563 F.2d 692(U.S. C.A. 5th Cir. 1977), which set out a three-part test:

a. the claimant must have engaged in some type of inequitable conduct;

b. the misconduct must have resulted in injury to creditors of the bankrupt or conferred an unfair advantage on the claimant; and

c. equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

21 Paragraph 105(a) of the U.S. *Bankruptcy Code* authorizes bankruptcy courts to use equitable principles to alter the provisions of Title 11 or to prevent an abuse of process. One year after *Mobile Steel*, the *Code* was amended to give legislative effect to equitable subordination: *Bankruptcy Reform Act*, 11 U.S.C. §510(c)(1).

22 The Supreme Court of Canada considered the doctrine on two occasions. In both, the court found it unnecessary to determine whether equitable subordination should be applied, because the underlying facts did not meet the test: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.), at p. 609; and *Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271(S.C.C.), at para. 77. This court also found it unnecessary to decide the issue in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 14 O.R. (3d) 1 (Ont. C.A.).

23 The availability of the doctrine has been considered in various Canadian superior courts at the trial level, in various contexts and with inconclusive results: see *General Chemical Canada Ltd., Re*, [2006] O.J. No. 3087 (Ont. S.C.J. [Commercial List]), (in the context of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3); *Christian Brothers of Ireland in Canada, Re* (2004), 69 O.R. (3d) 507 (Ont. S.C.J. [Commercial List]), (in the context of the *Winding-up and Restructuring Act*, R.S.C. 1985, C. W-11, as amended).

24 In *AEVO Co. v. D & A Macleod Co.* (1991), 4 O.R. (3d) 368 (Ont. Bktcy.), Chadwick J. rejected the application of equitable subordination in Canadian law, observing, at p. 372, that to introduce the doctrine would create chaos and would lead to challenges to security agreements based on the conduct of the secured creditor. In *I. Waxman & Sons Ltd., Re* (2008), 89 O.R. (3d) 427 (Ont. S.C.J. [Commercial List]), Pepall J. queried, at para. 33, whether statutory priorities should be upset by a doctrine "divorced from its legal home". This observation was followed, however, with the comment that "a vibrant legal system must be responsive to new developments in the law and the need for reform. Jurisprudence from other jurisdictions often provides the impetus or basis for much needed legal developments."

25 On the other hand, the Newfoundland and Labrador Supreme Court (Trial Division) applied the doctrine in a bankruptcy case in *Lloyd's Non-Marine Underwriters v. J.J. Lacey Insurance Ltd.*, 2009 NLTD 148, 291 Nfld. & P.E.I.R. 149 (N.L. T.D.).

26 The Supreme Court of Canada's silence on the issue of equitable subordination in *CDIC* and *Indalex* cannot be taken, as the *CCAA* judge appears to have thought, as an outright rejection of the doctrine. In my view, the Supreme Court simply left the issue for another day.

27 It is unnecessary to decide that issue in order to resolve this appeal. The only issue is whether the *CCAA* judge was right in deciding that he had no jurisdiction to grant equitable subordination under the *CCAA*, assuming the remedy is available in Canadian law.

SUBMISSIONS AND ANALYSIS

A. PROCEDURAL OBJECTION

28 The appellant's first submission is procedural. It claims that it was unnecessary for the *CCAA* judge to determine whether he had jurisdiction to grant equitable subordination. The Union essentially says it was blindsided. It says it made no submissions on the doctrine of equitable subordination and the *CCAA* judge did not indicate that he was going to address the issue in the context of the scheduling motion. It was inappropriate and unnecessary for the court to shut the door on a novel and controversial remedy without a full factual record.

29 The respondent acknowledges that equitable subordination was not a central issue in the oral submissions before the *CCAA* judge, but points out that it was raised in some of the factums and memoranda filed before and after the hearing. The *CCAA* judge was required to determine what conduct-based inter-creditor claims would be litigated, either under the Claims Process Order or under the *CCAA*. He was entitled to determine whether he had jurisdiction to grant equitable subordination within the *CCAA*.

30 I do not accept the appellant's submission. The issue of equitable subordination was plainly before the *CCAA* judge in submissions made before and after the hearing. The Milbournes' factum made extensive submissions on equitable subordination and argued that it, along with fiduciary duty and oppression, were "live issues which should be the subject matter of a robust evidentiary record and subject to a fair and thorough due process in this court". The Union's factum suggested that some of USS's unsecured claim could be subordinated to the claims of other creditors "on account of a breach of fiduciary duty, a finding

of oppression, *or otherwise*." USSC's factum argued that the Union's claim for equitable subordination should be rejected and that suitable remedies were available outside the Claims Process. In supplementary written submissions, the Union argued, in response to USSC's submissions, that the determination of the issue of equitable subordination should await an evidentiary record.

31 Moreover, the issue before the CCAA judge was not simply scheduling. The motion sought directions on the extent and nature of production and discovery with respect to the various objections. The Union argued that the objections had to be resolved before there could be approval of a plan of restructuring, a sale process or a distribution to creditors. The allegations that USS's claims should be re-characterized, invalidated, disallowed or subordinated had to be resolved and the CCAA judge had to determine a process for their resolution. Some might be dealt with under the Claims Process Order and some might be dealt with outside that Order but nevertheless in the CCAA proceedings. Some might not be dealt with under the CCAA at all.

32 The CCAA judge was plainly aware that a determination of the inter-creditor claims could have implications for the approval of any subsequent reorganization, sale of the business or credit bid. It was appropriate for him to consider whether the court had jurisdiction to address those claims and, if so, how and when.

33 An evidentiary record was unnecessary. The CCAA judge was not deciding whether equitable subordination applied on the facts of this case. The issue was whether he had jurisdiction to grant equitable subordination under the CCAA.

34 I turn now to the question whether the CCAA judge correctly held that he had no jurisdiction under the CCAA to order equitable subordination of USS's claims.

B. JURISDICTION TO ORDER EQUITABLE SUBORDINATION

35 I will begin by summarizing the CCAA judge's reasons on this issue. I will then set out the submissions of the parties, identify the standard of review, describe the methodology I will use and apply that methodology to the legislation.

(1) The CCAA judge's reasons

36 The CCAA judge noted that although the CCAA gives authority to re-characterize debt as equity and to invalidate a preference or assignment, there is no express provision conferring jurisdiction to grant equitable subordination. He was of the view that any jurisdiction to do so would have to be found in s. 11, which provides that "the court ... may, subject to the restrictions set out in this Act ... make any order that it considers appropriate in the circumstances."

37 He observed that there is no Canadian case law supporting that authority and, when given the occasion to confirm the existence of equitable subordination on two occasions, the Supreme Court of Canada had declined to do so: *Canada Deposit Insurance Corp.*; and *Indalex*. He suggested that one might infer from this that the Supreme Court had rejected the principle of equitable subordination.

38 He found, however, that to the extent the issue remained open, the CCAA evidenced an intention to exclude equitable subordination. When Parliament amended the legislation in 2009, it gave authority under s. 6(8) to subordinate debt as being in substance equity, but it did not enact any provision to subordinate a claim based on the conduct of the creditor. Nor had it drafted s. 36.1, which permitted the court to invalidate preferences and assignments, broadly enough to permit the court to make an order for equitable subordination. These provisions, he said, were "restrictions set out in this Act", limiting the court's broad discretion under s. 11. Parliament's failure to include equitable subordination in the remedies introduced in 2009 must be taken as indicative of an intention to exclude the operation of the doctrine under the CCAA. This, he said, was a policy decision the court must respect.

(2) The submissions of the parties

39 The appellant submits the CCAA judge had jurisdiction to grant equitable subordination pursuant to s. 11 of the CCAA in the absence of express "restrictions" on that jurisdiction. He erred in implying restrictions based on Parliament's failure to amend the legislation.

40 The respondent submits that Canadian courts have all the tools they need to assess, review and, where necessary, subordinate or invalidate creditors' claims in a manner consistent with the underlying legislation, without the need for equitable subordination. Some of these tools are the result of the 2009 amendments to the *BIA* and the *CCAA*. Parliament might have expanded those amendments to incorporate equitable subordination or some other conduct-based remedy, but declined to do so. The court should not invoke a controversial doctrine that Parliament declined to adopt when it had the opportunity to do so.

(3) The standard of review

41 The parties agree that the applicable standard of review is correctness: *Housen v. Nikolaisen*, 2002 SCC 33 (S.C.C.), at para. 8; and *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 40.

(4) Framework for analysis

42 In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) [hereinafter Century Services], at paras. 65ff., the Supreme Court of Canada gave guidance on the approach to the scope of statutory remedies under the *CCAA*, and, if need be, under related sources of judicial authority. The court adopted the analysis proposed by Justice Georgina R. Jackson of the Court of Appeal for Saskatchewan and Professor Janis Sarra in an article entitled, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in Sarra, ed., *Annual Review of Insolvency Law, 2007* (Toronto: Thomson Carswell, 2007), at p. 41. Blair J.A. also approved of this approach in *Metcalfe & Mansfield*, at paras. 48-49.

43 Jackson and Sarra note that the *CCAA* is skeletal legislation and advocate a transparent and consistent methodology as judges define the scope of their jurisdiction under the statute. They propose that the courts should take a hierarchical view of the powers at their disposal, adopting a broad, liberal and purposive interpretation of the statute and applying the principles of statutory interpretation before turning to other tools such as the common law or the exercise of inherent jurisdiction.

44 At para. 66 of *Century Services*, the Supreme Court held that in most cases, the search for jurisdiction under the *CCAA* should be an exercise in statutory interpretation. The starting point is the "big picture" principles of statutory interpretation.

45 Driedger's modern principle is the crucial tool for construing skeletal legislation such as the *CCAA*. A court must go beyond an examination of the wording of the statute and consider the scheme of the Act, its object or the intention of the legislature and the context of the words in issue:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

See: Jackson and Sarra, at p. 47; Elmer A. Driedger, *The Construction of Statutes*, 2d ed (Toronto: Butterworths, 1983) at p. 87, cited in *Bell ExpressVu Ltd. Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559(S.C.C.), at para. 26. See also *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.), at paras. 23, 40.

46 With this in mind, I will apply the framework in *Century Services* to the search for jurisdiction. I turn first to a consideration of the purpose and scheme of the *CCAA*, before considering the language of the statute.

(5) Application of the framework

(i) The purpose of the CCAA

47 There is no dispute about the purpose of the *CCAA*. It describes itself as "An Act to facilitate compromises and arrangements between companies and their creditors". Its purpose is to avoid the devastating social and economic effects of commercial

bankruptcies. It permits the debtor to continue to carry on business and allows the court to preserve the status quo while "attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all": *Century Services*, at para. 77.

48 The CCAA has proven to be a flexible and successful tool to enable businesses to avoid bankruptcy. As Professor Sarra notes, "[i]t has been the statute of choice for debtor corporations in every major Canadian restructuring in the past quarter century, including national airlines, major steel and forestry companies, telecommunications companies, major retail chains, real estate and development groups, and the national blood delivery system": Janis P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2d ed. (Toronto: Carswell, 2013), at p. 1.

49 The CCAA achieves its goals through a summary procedure for the compromise or arrangement of creditors' claims against the company. It was described in *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.), at para. 36, as:

> a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders.

50 The process has been effective because it is summary, it is practical, it is supervised by an independent expert monitor and it is managed in real time by an experienced commercial judge.

51 *Century Services* is a good example of how the purpose of the CCAA informs the exercise of the court's authority. At issue in that case were the reconciliation of another federal statute with the CCAA and the scope of a CCAA judge's discretion. At para. 70, the orders of the CCAA judge were considered squarely within the context of the purpose of the Act:

> The general language of the CCAA should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising CCAA authority. Appropriateness under the CCAA is assessed by inquiring whether the order sought advances the policy objectives underlying the CCAA. The question is whether the order will usefully further efforts to achieve the remedial purpose of the CCAA — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.
>
> [emphasis added]

52 The Supreme Court concluded, at para. 75, that the order advanced the underlying purpose of the CCAA.

(ii) The scheme of the CCAA

53 The CCAA has been described as "skeletal" or "under-inclusive" legislation, (Jackson and Sarra at p. 48) which grants broad powers to the courts in general terms.

54 The Act has five parts. Part I, entitled "Compromises and Arrangements" permits the court to sanction a compromise or arrangement between a company and its secured or unsecured creditors, or both.

55 The powers of the court are found in Part II, entitled "Jurisdiction of Courts". The statute gives the court jurisdiction to receive applications, order stays, approve debtor-in-possession financing and appoint a monitor, among other things. Proceedings are commenced by an application to the Superior Court. The court generally grants an initial stay, appoints a monitor with authority to repudiate leases and other agreements and authorizes debtor in possession financing. A process is established for the identification and review of creditors' claims by the monitor and to deal with disputed claims, with the ultimate purpose of establishing classes of creditors who will vote, by class, on the compromise or arrangement.

56 One possible outcome is the preparation of a plan of arrangement. Creditors vote by class on the plan at a meeting called for that purpose. A majority by number of creditors in each class, together with two-thirds of the creditors in that class by dollar value, must approve the plan. If a class of creditors approves the plan, it is binding on all creditors within the class, subject to the court's approval of the plan. If all classes of creditors approve the plan, the court must then approve the plan as a final step.

57 Part III, entitled "General", deals with such issues as the determination of the amount of creditors' claims, classes of creditors, the duties of monitors, the disclaimer of agreements between the company and third parties and preferences and transfers at undervalue.

58 Section 19 identifies "claims" that may be dealt with in a compromise or arrangement. Those are claims provable in bankruptcy that relate to debts or liabilities, present or future, to which the *debtor company* is subject or may become subject before the compromise or arrangement is sanctioned.[4]

59 The significance of this definition is that the focus of the plan of arrangement is claims against the *debtor company* that are provable in bankruptcy. The *CCAA* judge identified this significance at para. 59 of his reasons, where he noted that s. 19(1) of the *CCAA* provides, effectively, "that a plan of compromise or arrangement may only deal with claims that relate to debts or liabilities to which a debtor company is subject at the time of commencement of proceedings under the *CCAA*". At para. 61, he noted that neither the Claims Process Order nor the *CCAA* contemplated that inter-creditor claims would be addressed by or be relevant to a plan of arrangement.

60 Section 20 sets out the method for determining the amount of the claim of any secured or unsecured creditors. In most cases, it will be the amount "determined by the court on summary application by the company or by the creditor".

61 Section 22 provides for the establishment of classes of creditors for the purpose of voting on a compromise or arrangement, based on, among other things, the nature of their claims, the nature of the security in respect of their claims and the remedies available to them in relation to their claims. Creditors may be included in the same class "if their interests or rights are sufficiently similar to give them a commonality of interest".

62 Part IV deals with Cross-Border Insolvencies. Its stated purposes are to give mechanisms to provide for the fair and efficient administration of such insolvencies, to promote cooperation with courts of other jurisdictions, to promote "the rescue of financially troubled businesses to protect investment and preserve employment" and to protect the interests of creditors, of other interested persons and of the debtor company. Part V deals with Administration.

63 The *CCAA* was amended in 2009. The amendments were the product of extensive discussion of the *BIA* and the *CCAA* in the Standing Senate Committee on Banking, Trade and Commerce. The Committee recommended amendments to the legislation, including an expanded power to review, invalidate or subordinate creditors' claims under the *CCAA*.

64 These recommendations were reflected in the 2009 amendments in two respects. First, s. 6(8) provides that a compromise or arrangement will not be approved unless it provides that all other claims are to be paid in full before an equity claim is paid.

65 This provision, coupled with the definition of "equity interest"[5] and "equity claim"[6] in s. 2(1), permits the court to determine whether a creditor's claim is in substance a share, warrant or option. This is the underpinning of the Debt/Equity Objection, an objection based on a disagreement as to the proper characterization of the disputed claims.

66 Section 22.1, also added in 2009, provides that all creditors with equity claims are to be in the same class unless the court otherwise orders, and may not, as members of that class, vote at any meeting unless the court otherwise orders.

67 Second, the 2009 amendments harmonized the rules of reviewable transactions under the *BIA* and the *CCAA*. Creditors in a *CCAA* proceeding are now entitled to invoke the provisions of the *BIA* to invalidate security granted by a debtor corporation to a creditor where a fraudulent preference or transfer at undervalue is established. Section 36.1 of the *CCAA* provides that ss.

38 and 95 to 101 of the *BIA* apply, with any required modifications, in respect of a compromise or arrangement, unless the compromise or arrangement provides otherwise.

68 USS says that the 2009 amendments reflected Parliament's decision concerning the extent of the court's jurisdiction over "reviewable transactions" in *CCAA* proceedings and the extent to which a creditor's claim can be subordinated to other claims as a result of its conduct. It says Parliament might have included jurisdiction to rearrange priorities between creditors, for example through equitable subordination, but it declined to do so.

69 The scheme of the *CCAA* focuses on the determination of the validity of claims of creditors against the company and the determination of classes of claims for the purpose of voting on a compromise or arrangement. Except as contemplated by ss. 2(1), 6(8), 22.1 and 36.1, the statute does not address either conflicts between creditors or the order of priorities of creditors. Priorities are, however, part of the background against which the plan of compromise or arrangement is negotiated.

70 There is nothing in the record before us to indicate that the issue of equitable subordination was given serious consideration at the time of the 2009 amendments or that those amendments were intended to import other remedies.

(iii) Interpreting the particular provisions before the court

71 I now turn to the words of the statute itself, considered in context and having regard to the scheme of the *CCAA*, the object of the act and the intentions of Parliament.

72 As Blair J.A. put it when deciding whether the *CCAA* granted the court the power to sanction the disputed order in *Metcalfe & Mansfield*, at para. 58, "[w]here in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases?" The question before us is "where (if at all) in the words of the statute is the court (implicitly or explicitly) clothed with authority to make an order for equitable subordination of the USS claims?"

(a) Section 11: "The engine that drives the statutory scheme"

73 The parties focussed their arguments on whether the powers granted by s. 11 include the power to grant the remedy of equitable subordination. In order to inform the scope of s. 11, they urge us to consider the treatment of "equity" claims in s. 6(8) of the *CCAA* and the remedies available under s. 36.1.

74 In *Stelco*, at para. 36, Blair J.A. described s. 11 as "the engine that drives this broad and flexible statutory scheme". Section 11 states, in full:

> Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.
>
> [Emphasis added.]

75 Prior to amendment in 2005 (S.C. 2005, c. 47, s. 128), the underlined portion above had read "subject to this Act". In *Century Services*, the Supreme Court, at paras. 67-68, interpreted this amendment as being an endorsement of the broad reading of *CCAA* jurisdiction that had been developed in the jurisprudence.

76 The jurisdiction under s. 11 has two express limitations. First, the court must find that the order is "appropriate in the circumstances". Second, even if the court considers the order appropriate in the circumstances, it must consider whether there are "restrictions set out in" the *CCAA* that preclude it.

77 As I have noted, the *CCAA* judge held that s. 11 did not confer jurisdiction to apply the doctrine of equitable subordination. The statute could have provided the authority to subordinate claims on this basis, as it did with equity claims, but it did not.

He also held that the definition of "equity claim" and the option to bring proceedings under s. 36.1 were "restrictions" within the meaning of s. 11.

78 In my view, the interpretative process should start with the scope of s. 11 before the restrictions are considered in the analysis. The broad powers exercised by CCAA judges evolved in the jurisprudence before the concept of "restrictions" was legislated.

79 Moreover, it is inconsistent with the anatomy and history of the CCAA to maintain that if Parliament had intended that a CCAA judge would have the authority to make a certain type of order, it would have said so. The Supreme Court has made it clear that "[t]he general language of the CCAA should not be read as being restricted by the availability of more specific orders": *Century Services*, at para. 70.

80 What is apparent from the many creative orders that have been made, before and since the 2009 amendments, is that such orders are made squarely in furtherance of the legislature's objectives. In *Century Services*, at para. 59, the Supreme Court observed that "[j]udicial discretion must of course be exercised in furtherance of the CCAA's purposes", to avoid the devastating social and economic effects of bankruptcy while an attempt is made to organize the affairs of the debtor under court supervision.

81 The words "may ... make any order it considers appropriate in the circumstances" in s. 11 must, in my view, be read as "may ... *in furtherance of the purposes of this act*, make any order it considers appropriate in the circumstances."

82 There is no support for the concept that the phrase "any order" in s. 11 provides an at-large equitable jurisdiction to reorder priorities or to grant remedies as between creditors. The orders reflected in the case law have addressed the business at hand: the compromise or arrangement.

83 I turn to the second limit on the court's jurisdiction under s. 11, the "restrictions set out in this Act". The first question is whether such restrictions must be express or can be implied.

84 It bears noting that there are numerous express restrictions on the court's jurisdiction contained within the CCAA itself. Some are contained in Part II (Jurisdiction of Courts) and some are actually preceded by the heading "Restriction". In *North American Tungsten Corp. v. Global Tungsten and Powders Corp.*, 2015 BCCA 426, 81 B.C.L.R. (5th) 102 (B.C. C.A.), at para. 34, the British Columbia Court of Appeal observed that "where other provisions of the statute are intended to restrict the powers under ss. 11 and 11.02 of the statute, they do so in unequivocal terms."

85 The CCAA judge found that there were "restrictions set out" in the CCAA that prevented the court from applying equitable subordination, namely the definition of "equity claim" in s. 2(1) and the provisions of s. 36.1. Essentially, he found that Parliament could have introduced equitable subordination into the CCAA when it amended the legislation in 2009, but declined to do so. "The court must respect that policy decision", he said at para. 53. The respondent supports this interpretation.

86 I agree with the appellant that "equity claim" is not a restriction at all, but a definition. Together with s. 6(8), it codifies what was essentially the law before the 2009 amendments. The purpose of this involvement in the priority of claims is to remove shareholders from the process of arriving at a compromise or arrangement, absent permission of the court. It has nothing to do with any wrongdoing by the person with the equity interest. The only "restriction", if any, would be the lack of flexibility to reverse this statutory subordination, as Pepall J. pointed out in *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229, 75 B.L.R. (4th) 302 (Ont. S.C.J. [Commercial List]), at para. 34. However, this has to do only with subordination flowing from the characterization of a claim and not equitable subordination.

87 I also agree that the plain meaning of the words "subject to the restrictions *set out* in this Act" refers to express restrictions, of which there are a number.

(b) Subsection 6(8): Subordination of "equity claims"

88 In the court below, and in the appellant's submissions in this court, there was a blurring of the distinction between the separate concepts of "equity claim" and the doctrine of "equitable subordination". The CCAA judge's reasons referred at times

to the "subordination claims" of the Union and the Milbournes as including the equitable subordination claims and the claims for oppression and breach of fiduciary duty.

89 As explained earlier, s. 6(8) of the CCAA effectively subordinates "equity claims", as defined, to the claims of all other creditors. No compromise or arrangement can be approved unless it provides for other claims to be paid, in full, before equity claims are paid.

90 With the exception of environmental claims, ss. 6(8) and 22.1 are the only provisions of the CCAA to deal expressly with priorities between creditors.[7] There is a clear rationale for these provisions. In E. Patrick Shea, *BIA, CCAA & WEPPA: A Guide to the New Bankruptcy & Insolvency Regime* (Markham: LexisNexis Group, 2009), at p. 89, the author explains that "[t]he intention of these amendments is to remove the shareholder/creditor from the reorganization process, unless the court orders that they have a seat at the table."

91 "Equitable subordination", on the other hand, refers to the doctrine at issue here: a form of equitable relief to subordinate the claim of a creditor who has engaged in inequitable conduct. Such a claim is not an "equity claim", as defined. If it were, it would be subordinated without the need for intervention by the court.

92 Pepall J. dealt with these different principles and distinguished them clearly in *I. Waxman & Sons Ltd.*, a Commercial List decision that predated the 2009 amendments. There, a trustee in bankruptcy brought a motion for advice and directions as to whether a judgment creditor's claim should be allowed. Other creditors argued that his claim was rooted in equity and was not a debt claim. In the alternative, they argued that even if it was a debt claim, it should be subordinated to their claims pursuant to the doctrine of equitable subordination.

93 Pepall J. addressed the argument that the judgment creditor's claim was an equity claim under the heading "Characterization" (paras. 18-26), because the issue was whether his claim was properly characterized as one of equity or debt, with the attendant priority consequences. Next she considered whether, even though she had found that the claim was a debt claim, it should be subordinated pursuant to the doctrine of equitable subordination (paras. 27-35). She noted, at para. 27, that "[a]s its name suggests, the basis for development of the doctrine is the equitable jurisdiction of the court". She held that even if it applied in Canada, which was not established, there was no evidence on which to apply it in that case.

94 By contrast, the CCAA judge in this case disposed of these issues under one heading, "The Authority of the Court to Adjudicate Claims for Debt Re-Characterization and for Equitable Subordination", at paras. 38-53. He found, at para. 51, that the absence of any provision in the CCAA that would permit the application of equitable subordination was indicative of an intention to exclude the operation of the doctrine.

95 The CCAA judge appears to have treated equitable subordination as akin to equity claims as defined in s. 2(1), the subordination of equity claims in s. 6(8) and the remedies under s. 36.1. He found that because equitable subordination is not mentioned in the context of these remedies, Parliament must have intended to exclude it.

96 The distinction between these terms undermines the argument that equitable subordination does not exist because it was not included as part of the definition of (or together with the subordination of) equity claims. Equity claims are subordinated in order to keep shareholders away from the table while the claims of other creditors are being sorted out. Even prior to being explicitly subordinated by statute in 2009, they generally ranked lower than general creditors: *Sino-Forest Corp., Re*, 2012 ONCA 816, 114 O.R. (3d) 304 (Ont. C.A.), at para. 30. The purpose of the 2009 amendments appears to have been to confirm and clarify the law: see The Report of the Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa, November 2003), at p. 158-59.

(c) Section 36.1: Preferences and Assignments

97 Section 36.1, which was part of the 2009 amendments, incorporates by reference provisions of the BIA permitting the court to invalidate prior fraudulent preferences or fraudulent assignments.

> 36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

98 The respondent argues that the inclusion of these express provisions implies that no other form of equitable remedy was contemplated. Its argument is that, had Parliament wished to invalidate or subordinate claims of creditors who had engaged in inequitable conduct in relation to other creditors, it could have expressly included that remedy.

99 I would not read anything into s. 36.1, one way or the other. Nor would I regard it as a "restriction" set out in the Act within the meaning of s. 11.

(6) Summary

100 The appellant requested "a declaration that the CCAA contains no restrictions within the meaning of s. 11 on the court's ability to apply the doctrine of equitable subordination." In my view, this is the wrong inquiry and this is why I reach the same result as the CCAA judge, but for different reasons.

101 I would not grant the relief sought because, applying the principles of statutory interpretation, nowhere in the words of the CCAA is there authority, express or implied, to apply the doctrine of equitable subordination. Nor does it fall within the scheme of the statute, which focuses on the implementation of a plan of arrangement or compromise. The CCAA does not legislate a scheme of priorities or distribution, because these are to be worked out in each plan of compromise or arrangement. The subordination of "equity claims" is directed towards a specific group, shareholders, or those with similar claims. It also has a specific function, consistent with the purpose of the CCAA: to facilitate the arrangement or compromise without shareholders' involvement.

102 The success of the CCAA in fulfilling its statutory purpose has been in large measure due to the ability of judges to fashion creative solutions, for which there is no express authority, through the exercise of their jurisdiction under s. 11. As Blair J.A. noted in *Metcalfe and Mansfield*, however, the court's powers are not limitless. They are shaped by the purpose and scheme of the CCAA. The appellant has not identified how equitable subordination would further the remedial purpose of the CCAA.

103 At this stage of the analysis, I am mindful of the Supreme Court's observation in *Century Services* that in most cases the court's jurisdiction in CCAA matters will be found through statutory interpretation. I am also mindful of its observation in *Indalex*, at para. 82, that courts should not use an equitable remedy to do what they wish Parliament had done through legislation. In my view, there is no "gap" in the legislative scheme to be filled by equitable subordination through the exercise of discretion, the common law, the court's inherent jurisdiction or by equitable principles.

104 There is no provision in the CCAA equivalent to s. 183 of the *BIA* or §105(a) of the U.S. *Bankruptcy Code*. Section 183 invests the bankruptcy court with "such jurisdiction at law and in equity" as will enable it to exercise its bankruptcy jurisdiction. This is significant, because if equitable subordination is to become a part of Canadian law, it would appear that the *BIA* gives the bankruptcy court explicit jurisdiction as a court of equity to ground such a remedy and a legislative purpose that is more relevant to the potential reordering of priorities.

CONCLUSION

105 For these reasons, I would dismiss the appeal. I would order that counsel may make written submissions as to costs, not to exceed five pages in length, excluding costs outlines. I would assume counsel can agree on a timetable for delivery of all costs submissions within 30 days of the release of these reasons.

P. Lauwers J.A.:

I agree

M.L. Benotto J.A.:

I agree

Appeal dismissed.

Footnotes

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

2 6(8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

3 In a subsequent ruling, *U.S. Steel Canada Inc., Re*, 2016 ONSC 569 (Ont. S.C.J.), the *CCAA* judge dismissed the Debt/Equity objection, finding that approximately $2 billion of USSC's unsecured claims and $73 million in secured claims were properly characterized as debt rather than equity. He also dismissed the objection that approximately $118 million in secured claims should be invalidated due to lack of consideration or as a fraudulent preference.

4 *CCAA*, s. 2(1): "*claim* means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*." Section 121 of the *BIA* states that claims provable in bankruptcy are those to which the bankrupt is subject: "121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act."

5 "*Equity interest* means (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt."

6 "*Equity claim* means a claim that is in respect of an equity interest, including a claim for, among others, (a) a dividend or similar payment, (b) a return of capital, (c) a redemption or retraction obligation, (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)."

7 Subsection 11.8(8) gives the federal and provincial Crowns priorities for environmental claims against the debtor.

TAB 18

KeyCite treatment
Most Negative Treatment: Distinguished
Most Recent Distinguished: The City of Fredericton et al. v. Fredericton Police Association, Local 911 United Brotherhood of Carpenters and Joiners of America et al. | 2021 NBCA 30, 2021 CarswellNB 524, 2021 CarswellNB 525 | (N.B. C.A., Jun 17, 2021)

2013 SCC 6
Supreme Court of Canada

Indalex Ltd., Re

2013 CarswellOnt 734, 2013 CarswellOnt 733, 2013 SCC 6, [2013] 1 S.C.R. 271, [2013] W.D.F.L. 1591, [2013] W.D.F.L. 1592, [2013] S.C.J. No. 6, 20 P.P.S.A.C. (3d) 1, 223 A.C.W.S. (3d) 1049, 2 C.C.P.B. (2nd) 1, 301 O.A.C. 1, 354 D.L.R. (4th) 581, 439 N.R. 235, 8 B.L.R. (5th) 1, 96 C.B.R. (5th) 171, J.E. 2013-185, D.T.E. 2013T-97

Sun Indalex Finance, LLC (Appellant) and United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville (Respondents)

George L. Miller, the Chapter 7 Trustee of the Bankruptcy Estates of the U.S. Indalex Debtors (Appellant) and United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville (Respondents)

FTI Consulting Canada ULC, in its capacity as court-appointed monitor of Indalex Limited, on behalf of Indalex Limited (Appellant) and United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville (Respondents)

United Steelworkers (Appellant) and Morneau Shepell Ltd. (formerly known as Morneau Sobeco Limited Partnership) and Superintendent of Financial Services (Respondents) and Superintendent of Financial Services, Insolvency Institute of Canada, Canadian Labour Congress, Canadian Federation of Pensioners, Canadian Association of Insolvency and Restructuring Professionals and Canadian Bankers Association (Interveners)

McLachlin C.J.C., LeBel, Deschamps, Abella, Rothstein, Cromwell, Moldaver JJ.

Heard: June 5, 2012
Judgment: February 1, 2013
Docket: 34308

Proceedings: reversing *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.); reversing *Indalex Ltd., Re* (2010), 79 C.C.P.B. 301, 2010 ONSC 1114, 2010 CarswellOnt 893 (Ont. S.C.J. [Commercial List]); and reversing in part *Indalex Ltd., Re* (2011), 81 C.B.R. (5th) 165, 92 C.C.P.B. 277, 2011 ONCA 578, 2011 CarswellOnt 9077 (Ont. C.A.); additional reasons to *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.)

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Hugh O'Reilly, Amanda Darrach, for Respondent, Morneau Shepell Ltd. (formerly known as Morneau Sobeco Limited Partnership)
Mark Bailey, Leonard Marsello, William MacLarkey, for Respondent / Intervener, Superintendent of Financial Services
Robert I. Thornton, D.J. Miller, for Intervener, Insolvency Institute of Canada
Steven Barrett, Ethan Poskanzer, for Intervener, Canadian Labour Congress
Kenneth T. Rosenberg, Andrew K. Lokan, Massimo Starnino, for Intervener, Canadian Federation of Pensioners
Éric Vallières, Alexandre Forest, Yoine Goldstein, for Intervener, Canadian Association of Insolvency and Restructuring Professionals
Mahmud Jamal, Jeremy Dacks, Tony Devir, for Intervener, Canadian Bankers Association

Subject: Insolvency; Estates and Trusts; Family; Property; Corporate and Commercial; Employment; Civil Practice and Procedure; Constitutional; International

Related Abridgment Classifications

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I Bankruptcy and insolvency jurisdiction
I.1 Constitutional jurisdiction of federal government and provinces
Bankruptcy and insolvency
VIII Property of bankrupt
VIII.3 Trust property
Bankruptcy and insolvency
VIII Property of bankrupt
VIII.8 Miscellaneous
Bankruptcy and insolvency
X Priorities of claims
X.2 Preferred claims
Bankruptcy and insolvency
XIV Administration of estate
XIV.4 Sale of assets
Bankruptcy and insolvency
XVII Practice and procedure in courts
XVII.4 Appeals
XVII.4.b Miscellaneous
Bankruptcy and insolvency
XVII Practice and procedure in courts
XVII.5 Costs
XVII.5.d Miscellaneous
Civil practice and procedure
XXIV Costs
XXIV.13 Costs of appeals
XXIV.13.i Miscellaneous
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VI.4 Relation between federal and provincial powers
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II.3 Constructive trust
II.3.b Gains by fiduciaries
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I.1.c.ii.B Miscellaneous
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I.1.g.iii Deficiency
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Pensions
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Personal property security
IV Priority of security interest
IV.6 Security interests versus other interests
IV.6.b Under provincial law
IV.6.b.iii Statutory and deemed trusts

Headnote

Bankruptcy and insolvency --- Property of bankrupt — Trust property — Miscellaneous

Pensions — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Bankruptcy and insolvency --- Property of bankrupt — Pension funds

Trusts — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Pensions --- Administration of pension plans — Administrators, trustees and custodians — Fiduciary duties — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Pensions --- Administration of pension plans — Administrators, trustees and custodians — Fiduciary duties — Liabilities for breach

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — Constructive trust remedy was not available, as required condition was not met — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Pensions --- Administration of pension plans — Administrators, trustees and custodians — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — Miscellaneous

Collateral attack doctrine — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — It could not be argued that plan members were barred from defending their interests by collateral attack doctrine — Argument that plan members should have appealed amended initial order authorizing DIP charge, and were precluded from subsequently arguing that their claim ranked in priority to that of DIP lenders, was not convincing — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Miscellaneous

Distribution of proceeds — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Personal property security --- Priority of security interest — Security interests versus other interests — Under provincial law — Statutory and deemed trusts

Companies' Creditors Arrangement Act — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Bankruptcy and insolvency --- Priorities of claims — Preferred claims — Wages and salaries of employees — Creation of statutory trust

Pension plans — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Bankruptcy and insolvency --- Bankruptcy and insolvency jurisdiction — Constitutional jurisdiction of Federal government and provinces — Paramountcy of Federal legislation

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act ("CCAA") proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy — Federal and provincial laws were inconsistent, as they gave rise to different, and conflicting, orders of priority — Section 30(7) of Personal Property Security Act required part of proceeds from asset sale to be paid to plan's administrator before other secured creditors were paid — However, amended initial order provided that DIP charge ranked in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise — This court-ordered priority based on CCAA had same effect as statutory priority.

Estates and trusts --- Trusts — Constructive trust — Gains by fiduciaries

Breach of fiduciary duty — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — Constructive trust remedy was not available, as required condition was not met — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Constitutional law --- Distribution of legislative powers — Relation between federal and provincial powers — Paramountcy of federal legislation — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act ("CCAA") proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy — Federal and provincial laws were inconsistent, as they gave rise to different, and conflicting, orders of priority — Section 30(7) of Personal Property Security Act required part of proceeds from asset sale to be paid to plan's administrator before other secured creditors were paid — However, amended initial order provided that DIP charge ranked in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise — This court-ordered priority based on CCAA had same effect as statutory priority.

Bankruptcy and insolvency --- Practice and procedure in courts — Costs — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — Court also issued costs endorsement that approved payment of costs of executive plan's members from that plan's fund, but declined to order payment of costs to union from fund of salaried plan — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order, and union appealed costs endorsement — Appeal from order allowed; appeal from costs endorsement dismissed; Court of Appeal's orders with respect to costs of that appeal set aside, and all parties to bear their own costs in Court of Appeal and present appeal — There was no error in principle in Court of Appeal's refusal to order union costs to be paid out of pension fund, particularly in light of disposition of present appeal — Union's submissions as to costs were largely based on inaccurate reading of Court of Appeal's costs endorsement.
Pensions --- Practice in pension actions — Costs
I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — Court also issued costs endorsement that approved payment of costs of executive plan's members from that plan's fund, but declined to order payment of costs to union from fund of salaried plan — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order, and union appealed costs endorsement — Appeal from order allowed; appeal from costs endorsement dismissed; Court of Appeal's orders with respect to costs of that appeal set aside, and all parties to bear their own costs in Court of Appeal and present appeal — There was no error in principle in Court of Appeal's refusal to order union costs to be paid out of pension fund, particularly in light of disposition of present appeal — Union's submissions as to costs were largely based on inaccurate reading of Court of Appeal's costs endorsement.
Pensions --- Payment of pension — Bankruptcy or insolvency of employer — Registered plans
Deficiency in plans' funding.
Pensions --- Administration of pension plans — Valuation and funding of plans — Deficiency
Insolvency of employer.
Civil practice and procedure --- Costs — Costs of appeals — Miscellaneous
Faillite et insolvabilité --- Biens du failli — Biens détenus en fiducie — Divers
Régimes de retraite — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.
Faillite et insolvabilité --- Biens du failli — Fonds de pension
Fiducies — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours

de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Régimes de retraite — Administration des régimes de retraite — Administrateurs, fiduciaires et dépositaires — Obligations fiduciaires — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Régimes de retraite — Administration des régimes de retraite — Administrateurs, fiduciaires et dépositaires — Obligations fiduciaires — Responsabilité découlant de la violation

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — Exigences permettant de reconnaître l'application d'une fiducie par interprétation à titre de mesure réparatrice n'étaient pas satisfaites — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Régimes de retraite — Administration des régimes de retraite — Administrateurs, fiduciaires et dépositaires — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Procédure devant les tribunaux — Appels — Divers

Règle interdisant les contestations indirectes — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — On ne pouvait pas affirmer que les participants au régme ne pouvaient pas défendre leurs intérêts en raison de la règle interdisant les contestations indirectes — Prétention selon laquelle les participants auraient dû interjeter appel de l'ordonnance initiale modifiée autorisant la charge DE et qu'ils ne devaient pas être admis à prétendre plus tard que leur créance avait priorité sur celle des prêteurs DE n'était pas convaincante — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Administration de l'actif — Vente des actifs — Divers

Partage du produit de la vente — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Sûretés mobilières --- Ordre de priorité de la sûreté — Sûreté par rapport à d'autres intérêts — En vertu de la législation provinciale — Fiducies d'origine législative et présumées

Loi sur les arrangements avec les créanciers des compagnies — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Priorité des créances — Réclamations privilégiées — Traitements et salaires des employés — Création d'une fiducie par la loi

Régimes de retraite — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Compétence en matière de faillite et d'insolvabilité — Compétence constitutionnelle du gouvernement fédéral et des provinces — Prépondérance de la compétence fédérale

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies (« LACC ») ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée — Dispositions fédérales et provinciales étaient inconciliables, car elles produisaient des ordres de priorité différents et conflictuels — Article 30(7) de la Loi sur les sûretés mobilières exigeait qu'une partie du produit de la vente soit versée à l'administrateur du régime de retraite par priorité sur les paiements aux autres créanciers garantis — Or, l'ordonnance initiale amendée prévoyait que la sûreté accordée aux prêteurs DE prenait rang devant toutes les autres sûretés, y compris les fiducies, privilèges, charges et grèvements, d'origine législative ou autre — Cette priorité d'origine judiciaire fondée sur la LACC avait le même effet qu'une priorité d'origine législative.

Successions et fiducies --- Fiducies — Fiducie par interprétation — Profits des fiduciaires

Manquement à l'obligation fiduciaire — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — Exigences permettant de reconnaître l'application d'une fiducie par interprétation à titre de mesure réparatrice n'étaient pas satisfaites — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Droit constitutionnel --- Partage des compétences législatives — Rapport entre les compétences fédérales et compétences provinciales — Prépondérance des lois fédérales — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies (« LACC ») ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée — Dispositions fédérales et provinciales étaient inconciliables, car elles produisaient des ordres de priorité différents et conflictuels — Article 30(7) de la Loi sur les sûretés mobilières exigeait qu'une partie du produit de la vente soit versée à l'administrateur du régime de retraite par priorité sur les paiements aux autres créanciers garantis — Or, l'ordonnance initiale amendée prévoyait que la sûreté accordée aux prêteurs DE prenait rang devant toutes les autres sûretés, y compris les fiducies, privilèges, charges et grèvements, d'origine législative ou autre — Cette priorité d'origine judiciaire fondée sur la LACC avait le même effet qu'une priorité d'origine législative.

Faillite et insolvabilité --- Procédure devant les tribunaux — Frais — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — Cour a également rendu une décision concernant les frais qui approuvait le paiement des dépens des participants au régime des cadres sur leur caisse de retraite, mais a refusé d'ordonner que les dépens du syndicat soient acquittés sur la caisse de retraite du régime des salariés — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance, et le syndicat a interjeté appel à l'encontre de la décision concernant les frais — Pourvoi à l'encontre de l'ordonnance accueilli; pourvoi à l'encontre de l'adjudication des dépens rejeté; ordonnances de la Cour d'appel relatives aux dépens afférents aux appels interjetés devant elle annulées, et il a été ordonné que chacune des parties paie ses propres dépens devant la Cour d'appel et devant la Cour suprême du Canada — Décision de la Cour d'appel de refuser d'ordonner que les frais du syndicat soient acquittés sur la caisse de retraite n'était entachée d'aucune erreur de principe, surtout considérant l'issue du présent pourvoi — Prétentions du syndicat relativement aux frais reposaient en grande partie sur une interprétation erronée de la décision de la Cour d'appel concernant les frais.

Régimes de retraite --- Procédure dans le cadre d'actions concernant des régimes de retraite — Frais

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies (« LACC ») ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — Cour a également rendu une décision concernant les frais qui approuvait le paiement des dépens des participants au régime des cadres sur leur caisse de retraite mais a refusé d'ordonner que les dépens du syndicat soient acquittés sur la caisse de retraite du régime des salariés — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance, et le syndicat a interjeté appel à l'encontre de la décision concernant les frais — Pourvoi à l'encontre de l'ordonnance accueilli; pourvoi à l'encontre de l'adjudication des dépens rejeté; ordonnances de la Cour d'appel relatives aux dépens afférents aux appels interjetés devant elle annulées, et il a été ordonné que chacune des parties paie ses propres dépens devant la Cour d'appel et devant la Cour suprême du Canada — Décision de la Cour d'appel de refuser d'ordonner que les frais du syndicat soient acquittés sur la caisse de retraite n'était entachée d'aucune erreur de principe, surtout considérant l'issue du présent pourvoi — Prétentions du syndicat relativement aux frais reposaient en grande partie sur une interprétation erronée de la décision de la Cour d'appel concernant les frais.

Régimes de retraite --- Paiement de la rente — Faillite ou insolvabilité de l'employeur — Régimes enregistrés

Déficit dans le financement des régimes.

Régimes de retraite --- Administration des régimes de retraite — Évaluation et financement des régimes — Déficit

Insolvabilité de l'employeur.

Procédure civile --- Frais — Frais d'appel — Divers

I Ltd. was a Canadian subsidiary of I Corp. U.S. The I Ltd. group became insolvent. I Corp. U.S. sought bankruptcy protection. I Ltd. obtained a stay under the Companies' Creditors Arrangement Act ("CCAA"). I Ltd. was the administrator of two registered pension plans. The salaried plan was in the process of being wound up when the CCAA proceedings began. The executive plan was closed but not wound up. Protection under the CCAA was obtained, and both plans faced funding deficiencies. An amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors. I Ltd. sold its assets. Plan members brought motions for a declaration that a deemed trust equal in amount to the unfunded pension liability was enforceable against the proceeds of sale.

In dismissing the motions, the court found that the deemed trust did not apply to the wind-up deficiencies, because the associated payments were not "due" or "accruing due" as of the date of the wind-up. The court found that the executive plan did not have a wind-up deficiency, since it had not yet been wound up. The plan members appealed successfully. The Court of Appeal found that the deemed trust created by s. 57(4) of the Pension Benefits Act ("PBA") applied to all amounts due with respect to plan wind-up deficiencies. The Court of Appeal found that executive plan members had a claim arising from I Ltd.'s breach of fiduciary obligations in failing to adequately protect plan members' interests. The Court of Appeal found that imposing a constructive trust over the reserved fund in favour of plan members was an appropriate remedy. The Court of Appeal found that the deemed trust had priority over the DIP charge because the issue of federal paramountcy had not been raised when the amended initial order was issued, and that I Ltd. had stated that it intended to comply with any deemed trust requirements. The Court of appeal ordered the court-appointed monitor to make a distribution from the reserve fund in order to pay the amount of each plan's deficiency. It also issued a costs endorsement that approved payment of the costs of the executive plan's members from that plan's fund, but declined to order the payment of costs to the union from the fund of the salaried plan. I Ltd., the monitor, a secured creditor, and I Corp. U.S.'s trustee in bankruptcy appealed the main order, and the union appealed the costs endorsement.

Held: The appeal of the main order was allowed, and the union's appeal of the costs endorsement was dismissed. The Court of Appeal's orders with respect to the costs of appeal before that court were set aside, and it was ordered that all parties bear their own costs in the Court of Appeal and in the Supreme Court of Canada.

Per Deschamps J. (Moldaver J. concurring): The Court of Appeal correctly held with respect to the salaried plan, which had been wound up, that I Ltd. was deemed to hold in trust the amount necessary to satisfy the wind-up deficiency. The relevant provisions, legislative history and purpose were all consistent with inclusion of the wind-up deficiency in the protection afforded to members with respect to employer contributions upon the wind up of their pension plan. The deemed trust did not apply to the employer's wind-up deficiency with respect to the executive plan. Unlike s. 57(3) of the PBA, which provides that the deemed trust protecting employer contributions exists while a plan is ongoing, s. 57(4) provides that the wind-up deemed trust comes into existence only when the plan is wound up.

As a result of the application of the doctrine of federal paramountcy, the DIP charge superseded the deemed trust. Subject to the application of the rules on the admissibility of new evidence, the doctrine of paramountcy could be raised even if it was not invoked in an initial proceeding. The federal and provincial laws in this case were inconsistent, as they gave rise to different, and conflicting, orders of priority. Section 30(7) of the (provincial) Personal Property Security Act required a part of the proceeds from the sale to be paid to the plan's administrator before other secured creditors were paid. However, the amended initial order provided that the DIP charge ranked in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise. This court-ordered priority based on the (federal) CCAA had the same effect as a statutory priority.

I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in the best interests of the corporation. The fact that I Ltd., as plan administrator, might have to claim accrued contributions from itself meant that it would have to simultaneously adopt conflicting positions on whether contributions had accrued as of the date of liquidation and whether a deemed trust had arisen in respect of wind-up deficiencies. This was indicative of a clear conflict between I Ltd.'s interests and those of the plan members. I Ltd. should have taken steps to ensure that the interests of the plan members were protected, but did not do so. On the contrary, it contested the position that the plan members advanced.

It could not be argued that the plan members were barred from defending their interests by the collateral attack doctrine. The argument that the plan members should have appealed the amended initial order authorizing the DIP charge, and were precluded from subsequently arguing that their claim ranked in priority to that of the DIP lenders, was not convincing. Among other things, the plan members did not receive notice of the motion to approve the DIP financing.

Even though I Ltd. breached its fiduciary duty to notify the plan members of the motion that resulted in the amended initial order, their claim remained subordinate to that of I Corp. U.S. (subrogated, as I Corp. U.S. was, to the DIP lenders' priority). In terms of an equitable remedy, there was no evidence that the lenders committed a wrong or that they engaged in inequitable conduct. The constructive trust remedy was not available, because proprietary remedies are generally awarded only with respect to property that is directly related to a wrong or that can be traced to such property. There was agreement with Cromwell J. that this condition was not met. It was unreasonable for the Court of Appeal to re-order the priorities in this case. It was difficult to see what gains the plan members would have secured had they received notice of the motion that resulted in the amended initial order. The plan members were allowed to fully argue their case.

There was agreement with Cromwell J. on the appeal from the costs endorsement.

Per Cromwell J. (concurring in the result) (McLachlin C.J.C., Rothstein J. concurring): The deemed trust did not apply to the disputed funds. The Court of Appeal erred in finding that the s. 57(4) (PBA) deemed trust applied to the wind-up deficiency. There could be no deemed trust for the executive plan, because the plan had not been wound up at the relevant date. At issue was the salaried plan. The most plausible grammatical and ordinary sense of the words "accrued to the date of the wind-up" was that the amounts referred to were precisely ascertained immediately before the effective date of the plan's wind-up. The wind-up deficiency only arose upon wind-up and it was neither ascertained nor ascertainable on the date fixed for wind-up. The broader statutory context reinforced this view: the language of the deemed trusts in s. 57(3) and (4) was virtually exactly repeated in s. 75(1)(a), suggesting that both deemed trusts referred to the liability on wind-up referred to in s. 75(1)(a) and not to the further and distinct wind-up deficiency liability created under s. 75(1)(b). The legislative evolution and history of these provisions showed that the legislature never intended to include the wind-up deficiency in a statutory deemed trust. There was disagreement with Deschamps J.'s position that the wind-up deficiency could be said to have accrued to the date of wind-up.

The corporation failed in its duty to the plan beneficiaries as their administrator, and the beneficiaries ought to have been afforded more procedural protections in the CCAA proceedings. The Court of Appeal took too expansive a view of the fiduciary duties owed by I Ltd. as plan administrator. The only breach of fiduciary duty occurred when, upon insolvency, I Ltd.'s corporate interests were in obvious conflict with its fiduciary duty as plan administrator to ensure that all contributions were made to the plans when due. The breach was not in failing to avoid this conflict — the conflict itself was unavoidable. The breach was in failing to address the conflict to ensure that the plan beneficiaries had the opportunity to have representation in the CCAA proceedings as if there were independent plan administrators.

The Court of Appeal erred in using the equitable remedy of constructive trust to defeat the super priority ordered by the CCAA judge. The Court of Appeal erred in principle in finding that the asset in this case resulted from the breach of fiduciary duty such that it would be unjust for the party in breach to retain it. I Ltd.'s failure to meaningfully address conflicts of interest that arose during the CCAA proceedings did not result in any such asset. Imposing a constructive trust was wholly disproportionate to I Ltd.'s breach of fiduciary duty.

Although there was disagreement with Deschamps J. with respect to the scope of the s. 57(4) deemed trust, there was agreement that if there was a deemed trust in this case, it would have been superseded by the DIP loan because of the operation of the doctrine of federal paramountcy.

The union's submissions as to costs were largely based on an inaccurate reading of the Court of Appeal's costs endorsement. The Court of Appeal did not require the consent of plan beneficiaries as a prerequisite to ordering payment of costs from the fund. It was not correct to suggest that the costs endorsement would restrict recovery of beneficiary costs to instances when there is a surplus in the pension trust fund or preclude financing of beneficiary action when a fund was in deficit. The costs endorsement did not lay down a rule that a union representing pension beneficiaries cannot recover costs from the fund because the union itself is not a beneficiary. The litigation raised novel points of law with all of the uncertainty and risk inherent in such an undertaking. The failure of that litigation left no basis to impose the costs consequences of taking the risk on all of the plan members of an already underfunded plan. The union's apparent premise that if the executive plan members had their costs paid out of the fund, so too should the salaried plan members, was not an accurate statement of the order made with respect to the executive plan. The Court of Appeal did not apply what the union referred to as the "costs payment test" to the executive plan because the costs order was the product of an agreement and did not order payment of costs out of the fund as a whole. In the case of the union request, there was no such agreement and no such limitation of risk to the supporters of the litigation. There was no error in principle in the Court of Appeal's refusal to order the union costs to be paid out of the pension fund, particularly in light of the disposition of the present appeal.

Per LeBel J. (dissenting) (Abella J. concurring): There was agreement that no deemed trust could arise under s. 57(4) of the PBA in the case of the executive plan because that plan had not been wound up when the CCAA proceedings were initiated. In the case of the salaried plan, there was agreement with Deschamps J. that a deemed trust arose in respect of the wind-up deficiency, but also that the DIP super-priority prevailed because of the federal paramountcy doctrine.

However, the remedy of a constructive trust was available and it was appropriate to impose it in the circumstances of this case. A view different from that of the majority in the present decision was taken with regard to the nature and extent of the fiduciary duties of an employer who elects to act as administrator of a pension plan governed by the PBA. This dual status did not entitle the employer to greater leniency in the determination and exercise of its fiduciary duties or excuse wrongful actions. I Ltd. not only neglected its obligations towards the beneficiaries, but took a course of action that was actively inimical to their interests. The seriousness of these breaches amply justified the decision of the Court of Appeal to impose a constructive trust. The conditions that generally justify the imposition of a constructive trust were met. The imposition of the trust did not disregard the different corporate personalities of I Ltd. and I Corp. U.S. It properly acknowledged the close relationship between the two companies, the second in effect controlling the first. This relationship needed to be taken into consideration.

I Ltd. était une filiale canadienne de la société I É.-U. Le groupe I Ltd. est devenu insolvable. I É.-U. s'est placée sous la protection des règles applicables en matière de faillite. I Ltd. a obtenu une ordonnance de suspension sous le régime de la Loi sur les arrangements avec les créanciers des compagnies (« LACC »). I Ltd. administrait deux régimes de retraite enregistrés. Le régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la LACC ont été engagées. Le régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé. La protection du régime de la LACC a été accordée, et les deux régimes de retraite accusaient un déficit de capitalisation. Une ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers. I Ltd. a vendu tous ses actifs. Les participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions.

En rejetant les requêtes, le tribunal a conclu que la fiducie présumée ne s'appliquait pas aux déficits de liquidation parce que les paiements afférents n'étaient pas [TRADUCTION] « échus » ou « à échoir » à la date de la liquidation. Le tribunal a conclu que l'on ne pouvait pas parler de déficit de liquidation relativement au régime des cadres puisqu'il n'était pas encore liquidé. Les participants des régimes ont interjeté appel avec succès. La Cour d'appel a conclu que la fiducie présumée créée à l'art. 57(4) de la Loi sur les régimes de retraite (« LRR ») s'appliquait à toutes les sommes dues au titre des déficits de liquidation des régimes. La Cour d'appel a conclu que les participants au régime des cadres pouvaient faire valoir une réclamation contre I Ltd. pour manquement à son obligation fiduciaire de protéger adéquatement leurs intérêts. La Cour d'appel a jugé que d'imposer une fiducie par interprétation grevant le fonds de réserve au profit des participants était une réparation appropriée. La Cour d'appel a conclu que la fiducie présumée avait priorité sur la charge DE parce que la question de la prépondérance fédérale n'avait pas été invoquée lorsque l'ordonnance initiale modifiée a été rendue et qu'I Ltd. avait déclaré qu'elle allait se conformer à toutes les exigences d'une fiducie présumée. La Cour d'appel a ordonné au contrôleur désigné par le tribunal de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve. Dans sa décision relative à l'adjudication des dépens, elle a également approuvé le paiement des dépens des participants au régime des cadres sur leur caisse de retraite, mais elle a refusé d'ordonner que les dépens du syndicat soient acquittés sur la caisse de retraite du régime des salariés. I Ltd., le contrôleur, un créancier garanti et le syndic de faillite d'I É.-U. ont formé un pourvoi à l'encontre de l'ordonnance principale et le syndicat a formé un pourvoi à l'encontre de l'adjudication des dépens.

Arrêt: Le pourvoi à l'encontre de l'ordonnance principale a été accueillie et le pourvoi du syndicat à l'encontre de l'adjudication des dépens a été rejeté. Les ordonnances de la Cour d'appel relatives aux dépens afférents aux appels interjetés devant elle ont été annulées et il a été ordonné que chacune des parties paie ses propres dépens devant la Cour d'appel et devant la Cour suprême du Canada.

Deschamps, J. (Moldaver, J., souscrivant à son opinion) : C'était à bon droit que la Cour d'appel a jugé qu'I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation du régime des salariés, dont la liquidation avait pris effet. Le texte, l'historique législatif et l'objet des dispositions pertinentes concordaient tous avec l'inclusion du déficit de liquidation dans la protection offerte aux participants à l'égard des cotisations de l'employeur à la liquidation des régimes. La fiducie présumée ne s'appliquait pas au déficit de liquidation de l'employeur relativement au régime des cadres. Contrairement à l'art. 57(3) de la LRR, selon lequel la fiducie présumée protégeant les cotisations de l'employeur existe pendant que le régime est en vigueur, l'art. 57(4) prévoit que la fiducie présumée en cas de liquidation ne prend naissance qu'à la liquidation du régime. L'application de la doctrine de la prépondérance fédérale donnait à la charge DE priorité sur la fiducie présumée. Sous réserve de l'application des règles régissant l'admissibilité de nouveaux éléments de preuve, la doctrine de la prépondérance fédérale pouvait être soulevée même si elle n'avait pas été invoquée dans une procédure initiale. En l'espèce, les dispositions fédérales et provinciales étaient inconciliables, car elles produisaient des ordres de priorité différents et conflictuels. L'article 30(7) de la Loi sur les sûretés mobilières (provinciale) exigeait qu'une partie du produit de la vente soit versée à l'administrateur du régime de retraite par priorité sur les paiements aux autres créanciers garantis. Toutefois, l'ordonnance initiale modifiée accordait à la charge DE priorité sur toutes les autres sûretés, y compris les fiducies, privilèges, charges et grèvements, d'origine législative ou autre. Cette priorité d'origine judiciaire fondée sur la LACC (fédérale) avait le même effet qu'une priorité d'origine législative. Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société. Le fait qu'I Ltd. pouvait, en sa qualité d'administrateur des régimes de retraite, avoir à se réclamer à elle-même les cotisations accumulées l'amènerait à devoir adopter simultanément des positions opposées quant à savoir si des cotisations s'étaient accumulées à la date de la liquidation et si les déficits de capitalisation étaient protégés par une fiducie présumée. Cet exemple démontrait qu'il existait manifestement un conflit entre les intérêts d'I Ltd. et ceux des participants au régime. I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait. Elle a, au contraire, contesté la position défendue par les participants au régime.

La règle interdisant les contestations indirectes ne pouvait donc être invoquée pour empêcher les participants de défendre leurs intérêts. La prétention selon laquelle les participants auraient dû interjeter appel de l'ordonnance initiale modifiée autorisant la charge DE et qu'ils ne devaient pas être admis à prétendre plus tard que leur créance avait priorité sur celle des prêteurs DE n'était pas convaincante. Entre autres choses, les participants n'ont pas reçu avis de la requête demandant au tribunal d'autoriser le financement DE.

Bien qu'I Ltd. ait manqué à son obligation fiduciaire d'informer les participants de la requête en modification de l'ordonnance initiale, leur créance demeurait subordonnée à celle d'I É.-U. (I É.-U. étant subrogée aux prêteurs DE en conséquence de la priorité). À propos d'une réparation en equity, la preuve ne révélait aucune inconduite ni injustice de la part des prêteurs. La fiducie par interprétation n'était pas une réparation que l'on pouvait imposer, car la réparation de la nature d'un droit de propriété n'était généralement accordée qu'à l'égard d'un bien ayant un lien direct avec un acte fautif ou d'un bien qui pouvait être rattaché à un tel bien. On partageait l'avis du juge Cromwell que cette condition n'était pas remplie. Il était déraisonnable pour la Cour d'appel de modifier l'ordre de priorité en l'espèce. Il était difficile de voir comment les participants auraient pu améliorer leur position même s'ils avaient reçu avis de la requête en modification de l'ordonnance initiale. Les participants ont pu faire valoir pleinement leur position.

On convenait avec le juge Cromwell au sujet de l'adjudication des dépens.

Cromwell, J. (souscrivant au résultat des juges majoritaires) (McLachlin, J.C.C., Rothstein, J., souscrivant à son opinion) : La fiducie présumée ne visait pas les fonds en cause. La Cour d'appel a commis une erreur en concluant que la fiducie présumée prévue à l'art. 57(4) de la LRR s'appliquait au déficit de liquidation. Il ne pouvait y avoir de fiducie présumée au bénéfice du régime des cadres, car celui-ci n'avait pas encore été liquidé à la date considérée. Le litige ne portait que sur le régime des salariés. Suivant son sens ordinaire et grammatical le plus plausible, l'expression « accumulées à la date de la liquidation » renvoyait aux sommes déterminées de façon précise immédiatement avant la date de prise d'effet de la liquidation du régime. Le déficit de liquidation n'était constaté qu'à l'issue de la liquidation, et il n'était ni déterminé ni déterminable à la date de liquidation prévue. Le contexte législatif général confortait ce point de vue. Le texte de l'art. 57(3) et (4) qui dispose qu'il y a fiducie présumée est repris presque en tous points à l'art. 75(1)a), ce qui permettait de conclure que, dans les deux cas de fiducie présumée, le législateur renvoyait à l'obligation qui existait à la liquidation suivant l'art. 75(1)a) et non à celle, supplémentaire et distincte, qui était liée au déficit de liquidation et qui découlait de l'art. 75(1)b). L'évolution et l'historique de ces dispositions laissaient croire que le législateur n'a jamais voulu que le déficit de liquidation fasse l'objet d'une fiducie présumée d'origine législative. On ne partageait pas l'opinion de la juge Deschamps selon laquelle on pouvait considérer que le déficit de liquidation était accumulé à la date de la liquidation.

La société a manqué à ses obligations d'administrateur des régimes, et les bénéficiaires auraient dû obtenir de meilleures garanties procédurales dans le cadre de la procédure fondée sur la LACC. La Cour d'appel a conféré une portée excessive aux obligations fiduciaires d'I Ltd. en tant qu'administrateur des régimes. I Ltd. a seulement manqué à son obligation fiduciaire lorsque, une fois devenue insolvable, ses intérêts sont clairement entrés en conflit avec son obligation fiduciaire d'administrateur d'assurer le versement aux régimes de toutes les cotisations devenues exigibles. Son manquement résidait dans l'omission non pas d'éviter ce conflit, qui était en soi inévitable, mais de pallier le problème en veillant à ce que les bénéficiaires des régimes puissent être représentés dans le cadre de la procédure fondée sur la LACC comme si l'administrateur des régimes avait été indépendant.

La Cour d'appel a eu tort de recourir à la fiducie par interprétation, une réparation en equity, pour écarter la superpriorité accordée par le tribunal saisi sur le fondement de la LACC. La Cour d'appel a commis une erreur de principe lorsqu'elle a conclu que l'actif convoité résultait du manquement à l'obligation fiduciaire, de sorte qu'il serait injuste que la partie fautive se l'approprie. L'omission d'I Ltd. de véritablement pallier les conflits d'intérêts auxquels donnait lieu la procédure fondée sur la LACC n'a pas donné lieu à un tel actif. L'imposition d'une fiducie par interprétation était clairement une mesure disproportionnée par rapport au manquement d'I Ltd. à son obligation fiduciaire.

Bien que l'on ne partageait pas l'opinion de la juge Deschamps concernant la portée de la fiducie présumée prévue à l'art. 57(4), on s'accordait avec elle pour affirmer que si l'on devait conclure à l'existence d'une fiducie présumée dans le présent dossier, elle devait prendre rang avant la créance DE en application de la doctrine de la prépondérance fédérale.

Les prétentions du syndicat au sujet des frais reposaient en grande partie sur une interprétation erronée de la décision de la Cour d'appel à cet égard. La Cour d'appel ne considérait pas que le consentement des bénéficiaires du régime était une condition préalable au paiement des dépens à partir de la caisse de retraite. Il était erroné de laisser entendre que la décision relative aux dépens faisait en sorte que les bénéficiaires ne pouvaient être indemnisés des dépens que lorsqu'il existait un surplus dans la caisse de retraite en fiducie ou qu'ils ne pouvaient financer l'exercice d'un recours lorsque la caisse était déficitaire. La décision de la Cour d'appel relativement aux frais n'établissait pas la règle qu'un syndicat représentant les bénéficiaires d'une caisse de retraite ne pouvait être indemnisé de ses dépens par la caisse de retraite parce qu'il n'était pas lui-même bénéficiaire. Comme l'instance engagée en l'espèce portait sur des points de droit nouveaux, il était entendu que son issue était incertaine. L'échec du recours ne saurait justifier que tous les participants d'un régime déjà sous-capitalisé subissent les conséquences pécuniaires du risque couru. L'argument du syndicat reposait apparemment sur la prémisse que les participants du régime des salariés devraient obtenir paiement de leurs dépens à partir de leur caisse de retraite puisque c'est ce à quoi les participants au régime des cadres avaient droit. Or, telle n'était pas la teneur exacte de l'ordonnance de la Cour d'appel relative au régime des cadres. La Cour d'appel n'appliquait pas au régime des cadres le critère qui, selon le syndicat, vaudrait pour le paiement des dépens, car l'ordonnance relative aux dépens découlait d'un accord et elle ne prévoyait pas le paiement des dépens par prélèvement sur la caisse de retraite dans sa globalité. S'agissant de la demande du syndicat, nul accord n'était intervenu au même effet, et ce n'était pas seulement les participants derrière le recours qui s'exposaient au risque lié à l'issue de celui-ci. Il n'y avait aucune erreur de principe dans le refus de la Cour d'appel d'ordonner que les dépens du syndicat soient payés à partir de la caisse de retraite, étant donné surtout l'issue du présent appel.

LeBel, J. (dissident) (Abella, J., souscrivant à son opinion) : On s'accordait à dire que le régime des cadres ne pouvait être protégé par aucune fiducie présumée résultant de l'application de l'art. 57(4) de la LRR, puisque ce régime n'avait pas été liquidé lorsque la procédure fondée sur la LACC a été enclenchée. On partageait l'opinion de la juge Deschamps, laquelle reconnaissait l'existence d'une fiducie présumée dans le cas du déficit de liquidation du régime des salariés mais aussi que la créance des prêteurs DE avait priorité sur toutes les autres créances, par application du principe de la prépondérance fédérale.

Toutefois, la fiducie par interprétation pouvait s'appliquer aux présentes circonstances et devrait être imposée en l'espèce. On a adopté un point de vue différent de celui des juges majoritaires en ce qui a trait à la nature et la portée des obligations fiduciaires d'un employeur qui choisit d'administrer un régime de retraite régi par la LRR. Sa double fonction n'autorisait pas l'employeur à faire preuve de laxisme dans la définition et l'exercice de ses obligations fiduciaires, ni ne justifiait ses actes répréhensibles. I Ltd. a non seulement manqué à ses obligations envers les bénéficiaires, mais a adopté en fait une démarche qui allait à l'encontre de leurs intérêts. La gravité de ces manquements justifiait amplement la décision de la Cour d'appel d'imposer une fiducie par interprétation. Les conditions qui justifient généralement l'imposition d'une fiducie par interprétation étaient satisfaites. En imposant la fiducie, la Cour n'a pas négligé le fait qu'I Ltd. et I É.-U. constituaient des personnes morales distinctes. Elle a tenu compte à juste titre de leurs rapports étroits, la seconde contrôlant dans les faits la première. Il fallait prendre ces rapports en compte.

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Generally — referred to

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Chapter 7 — referred to

Chapter 11 — referred to

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Generally — referred to

s. 2(1) "secured creditor" — considered

Pension Benefits Act, 1965, S.O. 1965, c. 96

s. 22(2) — considered

s. 23a [en. 1973, c. 113, s. 6] — considered

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Generally — referred to

Pension Benefits Act, R.S.O. 1980, c. 373

s. 23(4)(a) [en. 1983, c. 2, s. 3] — considered

s. 23(4)(b) [en. 1983, c. 2, s. 3] — considered

Pension Benefits Act, R.S.O. 1990, c. P.8

Generally — referred to

s. 1(1) "administrator" — considered

s. 8(1)(a) — considered

s. 22(4) — considered

s. 56(1) — considered

s. 56(2) — considered

s. 57(3) — considered

s. 57(4) — considered

s. 59 — considered

s. 69(1) — considered

s. 69(1)(d) — considered

s. 75(1)(a) — considered

s. 75(1)(b) — considered

s. 75(1)(b)(i) — considered

s. 75(1)(b)(ii) — considered

s. 75(1)(b)(iii) — considered

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Generally — referred to

Personal Property Security Act, R.S.O. 1990, c. P.10
s. 30(7) — considered

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Bankruptcy Code, 11 U.S.C.
Chapter 11 — referred to

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s. 122(1)(a) — referred to

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s. 11(1) — considered

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s. 23a(1) [en. 1973, c. 113, s. 6] — considered

s. 23a(3) [en. 1973, c. 113, s. 6] — considered

Pension Benefits Act, 1987, S.O. 1987, c. 35
Generally — referred to

s. 23(4)(a) — considered

s. 23(4)(b) — considered

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Generally — referred to

s. 21(2) — considered

s. 21(2)(a) — considered

s. 23(3) — considered

s. 23(4) [en. 1983, c. 2, s. 3] — considered

s. 23(4)(a)(i) [en. 1983, c. 2, s. 3] — considered

s. 23(4)(a)(ii) [en. 1983, c. 2, s. 3] — considered

s. 23(4)(b) [en. 1983, c. 2, s. 3] — considered

s. 23(5) [en. 1983, c. 2, s. 3] — considered

s. 32 — considered

s. 32(2) — considered

Pension Benefits Act, R.S.O. 1990, c. P.8

Generally — referred to

s. 1(1) "wind up" — considered

s. 8(1)(a) — considered

s. 9 — referred to

s. 10(1) ¶ 12 — referred to

s. 12 — referred to

s. 19 — referred to

s. 20 — referred to

s. 22(1) — considered

s. 22(2) — considered

s. 22(4) — considered

s. 25 — referred to

s. 26 — referred to

s. 42 — referred to

s. 56 — considered

s. 57 — considered

s. 57(3) — considered

s. 57(4) — considered

s. 58(1) — considered

s. 58(3) — considered

s. 58(4) — considered

s. 59 — referred to

s. 68(2)(c) — considered

s. 70 — referred to

s. 70(1) — considered

s. 70(6) — considered

s. 73 — referred to

s. 74 — considered

s. 75 — considered

s. 75(1) — considered

s. 75(1)(a) — considered

s. 75(1)(b) — considered

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Generally — referred to

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Generally — referred to

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Generally — referred to

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s. 9 — considered

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Generally — referred to

s. 22(4) — considered

s. 57(4) — considered

Regulations considered by *Deschamps J.*:

Pension Benefits Act, R.S.O. 1990, c. P.8
General, R.R.O. 1990, Reg. 909

s. 31 — considered

Regulations considered by *Cromwell J.*:

Pension Benefits Act, R.S.O. 1990, c. P.8
General, R.R.O. 1990, Reg. 909

s. 4(4) ¶ 3 — considered

s. 5(1)(b) — considered

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s. 29 — referred to

s. 31 — considered

s. 31(2) — considered

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Words and phrases considered:

amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations

[Per Deschamps J. (Moldaver J. concurring):] Since both the amount with respect to payments (s. 75(1)(a)) [*Pension Benefits Act*, R.S.O. 1990, c. P.8] and the one ascertained by subtracting the assets from the liabilities accrued as of the date of the wind up (s. 75(1)(b)) are to be paid upon wind up as employer contributions, they are both included in the ordinary meaning of the words of s. 57(4) of the *PBA*: "amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". . .

. . . . .

[A] contribution has "accrued" when the liabilities are completely constituted, even if the payment itself will not fall due until a later date. If this principle is applied to the facts of this case, the liabilities related to contributions to the fund allocated for payment of the pension benefits contemplated in s. 75(1)(b) are completely constituted at the time of the wind up, because no pension entitlements arise after that date. In other words, no new liabilities accrue at the time of or after the wind up. Even the portion of the contributions that is related to the elections plan members may make upon wind up has "accrued to the date of the wind up", because it is based on rights employees earned before the wind-up date.

The fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes (*Canadian Pacific Ltd. v. Ontario (Minister of Revenue)* (1998), 41 O.R. (3d) 606 (Ont. C.A.), at p. 621). The use of the word "accrued" does not limit liabilities to amounts that can be determined with precision. As a result, the words "contributions accrued" can encompass the contributions mandated by s. 75(1)(b) of the *PBA*.

accrued to the date of the wind up

[Per Cromwell J. (concurring in the result) (McLachlin C.J.C. and Rothstein J. concurring):] [T]he most plausible grammatical and ordinary sense of the words "accrued to the date of the wind up" is that the amounts referred to are precisely ascertained immediately before the effective date of the plan's wind-up. The wind-up deficiency only arises upon wind-up and it is neither ascertained nor ascertainable on the date fixed for wind-up. . . . the broader statutory context reinforces this view: the language of the deemed trusts in s. 57(3) and (4) [*Pension Benefits Act*, R.S.O. 1990, c. P.8] is virtually exactly repeated in s. 75(1)(a), suggesting that both deemed trusts refer to the liability on wind-up referred to in s. 75(1)(a) and not to the further and distinct wind-up deficiency liability created under s. 75(1)(b). . . . the legislative evolution and history of these provisions show, in my view, that the legislature never intended to include the wind-up deficiency in a statutory deemed trust.

. . . . .

In my view, the most plausible grammatical and ordinary sense of the phrase "accrued to the date of the wind up" in s. 57(4) is that it refers to the sums that are ascertained immediately before the effective wind-up date of the plan.

In the context of s. 57(4), the grammatical and ordinary sense of the term "accrued" is that the amount of the obligation is "fully constituted" and "ascertained" although it may not yet be payable. The amount of the wind-up deficiency is not fully constituted or ascertained (or even ascertainable) before or even on the date fixed for wind up and therefore cannot fall under s. 57(4).

Of course, the meaning of the word "accrued" may vary with context. In general, when the term "accrued" is used in relation to legal rights, its common meaning is that the right has become fully constituted even though the monetary implications of its enforcement are not yet known or knowable. Thus, we speak of the "accrual" of a cause of action in tort when all of the elements of the cause of action come into existence, even though the extent of the damage may well not be known or knowable at that time: see, e.g., *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53 (S.C.C.). However, when the term is used in relation to a sum of money, it will generally refer to an amount that is at the present time either quantified or exactly quantifiable but which may or may not be due.

. . . . .

In other contexts, an amount which has accrued may not yet be due. For example, we speak of "accrued interest" meaning a precise, quantified amount of interest that has been earned but may not yet be payable. The term "accrual" is used in the same way in "accrual accounting". In accrual method accounting, "transactions that give rise to revenue or costs are recognized in the accounts when they are earned and incurred respectively": B. J. Arnold, *Timing and Income Taxation: The Principles of Income*

Measurement for Tax Purposes (1983), at p. 44. Revenue is earned when the recipient "substantially completes performance of everything he or she is required to do as long as the amount due is ascertainable and there is no uncertainty about its collection": P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (7th ed., 2010), at s. 6.5(b); see also Canadian Institute of Chartered Accountants, *CICA Handbook — Accounting*, Part II, s. 1000, at paras. 41-44. In this context, the amount must be ascertained at the time of accrual.

. . . . .

I turn next to the ordinary and grammatical sense of the words "to the date of the wind up" in s. 57(4). In my view, these words indicate that only those contributions that accrue before the date of wind up, and not those amounts the liability for which arises only on the day of wind up — that is, the wind-up deficiency — are included.

Where the legislature intends to include the date of wind up, it has used suitable language to effect that purpose. For example, the English version of a provision amending the *PBA* in 2010 (c. 24, s. 21(2)), s. 68(2)(c), indicates which trade unions are entitled to notice of the wind up:

(2) If the employer or the administrator, as the case may be, intends to wind up the pension plan, the administrator shall give written notice of the intended wind up to,

. . . . .

(c) each trade union that represents members of the pension plan or that, on the date of the wind up, represented the members, former members or retired members of the pension plan;

In contrast to the phrase "to the date of wind up", "on the date of wind up" clearly includes the date of wind up. (The French version does not indicate a different intention.) Similarly, s. 70(6), which formed part of the *PBA* until 2012 (rep. S.O. 2010, c. 9, s. 52(5)), read as follows:

(6) On the partial wind up of a pension plan, members, former members and other persons entitled to benefits under the pension plan shall have rights and benefits that are not less than the rights and benefits they would have on a full wind up of the pension plan on the effective date of the partial wind up.

The words "on the effective date of the partial wind up" indicate that the members are entitled to those benefits from the date of the partial wind up, in the sense that members can claim their benefits beginning on the date of the wind up itself. This is how the legislature expresses itself when it wants to speak of a period of time including a specific date. By comparison, "to the date of the wind up" is devoid of language that would include the actual date of wind up.

To sum up with respect to the ordinary and grammatical meaning of the phrase "accrued to the date of the wind up", the most plausible ordinary and grammatical meaning is that such amounts are fully constituted and precisely ascertained immediately before the date fixed as the date of wind up. Thus, according to the ordinary and grammatical meaning of the words, the wind-up deficiency obligation set out in s. 75(1)(b) has not "*accrued* to the date of the wind up" as required by s. 57(4). Moreover, the liability for the wind-up deficiency arises where a pension plan is wound up (s. 75(1)(b)) and so it cannot be a liability that "accrued *to the date of the wind up*" (s. 57(4)).

fiduciary relationship

[Per LeBel J. (dissenting) (Abella J. concurring):] A fiduciary relationship is a relationship, grounded in fact and law, between a vulnerable beneficiary and a fiduciary who holds and may exercise power over the beneficiary in situations recognized by law.

Termes et locutions cités:

montant égal aux cotisations de l'employeur qui sont accumulées à la date de la liquidation, mais qui ne sont pas encore dues aux termes du régime ou des règlements

[Deschamps, J. (Moldaver, J., souscrivant à son opinion):] Puisque le montant des paiements (al. 75(1)a) [*Loi sur les régimes de retraite*, L.R.O. 1990, ch. P.8] et le montant établi en soustrayant l'actif du passif accumulé à la date de la liquidation (al. 75(1)b)) doivent tous les deux être versés à la liquidation à titre de cotisations de l'employeur, ils entrent tous les deux dans le sens ordinaire des mots employés au par. 57(4) de la *LRR*: montant égal aux cotisations de l'employeur qui sont accumulées à la date de la liquidation, mais qui ne sont pas encore dues aux termes du régime ou des règlements ». . . .

. . . . .

[U]ne cotisation est « accumulée » lorsque le passif est entièrement constitué, même si le paiement lui-même ne devient exigible que plus tard. Cela signifie en l'espèce que le passif au titre des cotisations à la caisse destinée au paiement des prestations de retraite visées à l'al. 75(1)b) est entièrement constitué lorsque la liquidation a lieu, parce qu'aucun droit au titre de la pension ne prend naissance après cette date. Autrement dit, aucun passif ne s'accumule pendant ni après la liquidation. Même la portion des cotisations afférente aux options que les participants peuvent exercer lorsqu'il y a liquidation est « accumulé[e] à la date de la liquidation » parce qu'elle est fondée sur des droits que les employés ont acquis avant la date de la liquidation.

Le fait que le montant précis des cotisations n'est pas établi au moment de la liquidation ne confère pas aux cotisations un caractère éventuel qui ferait en sorte qu'elles ne seraient pas accumulées d'un point de vue comptable (*Canadian Pacific Ltd. c. M.N.R.* (1998), 41 O.R. (3d) 606 (C.A.), p. 621). L'emploi du mot « accumulé » ne limite pas le passif aux seuls montants qui peuvent être établis avec précision. On peut donc considérer que le passif « accumulé » englobe les cotisations exigées au par. 75(1)b) de la *LRR*.

accumulées à la date de la liquidation

[Cromwell, J. (souscrivant au résultat des juges majoritaires) (McLachlin, J.C.C., Rothstein, J., souscrivant à son opinion):] [S]uivant son sens ordinaire et grammatical le plus plausible, l'expression « accumulées à la date de la liquidation » renvoie aux sommes déterminées de façon précise immédiatement avant la date de prise d'effet de la liquidation du régime. Le déficit de liquidation n'est constaté qu'à l'issue de la liquidation, et il n'est ni déterminé ni déterminable à la date de liquidation prévue. . . . [L]e contexte législatif général me conforte dans ce point de vue. Le texte des par. 57(3) et (4) [*Loi sur les régimes de retraite*, L.R.O. 1990, ch. P.8] qui dispose qu'il y a fiducie réputée est repris presque en tous points à l'al. 75(1)a), ce qui permet de conclure que, dans les deux cas de fiducie réputée, le législateur renvoie à l'obligation qui existe à la liquidation suivant l'al. 75(1)a) et non à celle, supplémentaire et distincte, qui est liée au déficit de liquidation et qui découle de l'al. 75(1)b). . . . [I]l appert à mon sens de l'évolution et de l'historique de ces dispositions que le législateur n'a jamais voulu que le déficit de liquidation fasse l'objet d'une fiducie réputée d'origine législative.

. . . . .

À mon avis, suivant son sens ordinaire et grammatical le plus plausible, l'expression « accumulées à la date de la liquidation » employée au par. 57(4) renvoie aux sommes déterminées immédiatement avant la date de prise d'effet de la liquidation du régime.

Dans le contexte du par. 57(4), le sens ordinaire et grammatical d'« accumulées » veut que l'obligation soit « entièrement constituée » et que son montant soit « déterminé », même si elle peut ne pas être encore payable. Le déficit de liquidation n'est pas entièrement constitué ni son montant déterminé (ou déterminable) avant la date prévue pour la liquidation, ou le jour même, et ne peut donc pas être visé au par. 57(4).

Certes, le sens du terme « accumulées » [et plus encore celui de son équivalent anglais « accrued »] peut varier selon le contexte. En général, lorsque ce terme est employé de pair avec des droits légaux, son sens courant veut que le droit soit entièrement constitué, même si les répercussions financières de son exécution ne sont pas encore connues et ne peuvent l'être. Ainsi, en responsabilité délictuelle, on parle d'accumulation (au sens d'acquisition ou de naissance) de la cause d'action lorsque tous ses éléments sont réunis, même lorsque l'étendue du préjudice n'est pas encore connue ou ne peut l'être (voir, p. ex., *Ryan c. Moore*

2005 CSC 38, [2005] 2 R.C.S. 53 (S.C.C.). Toutefois, lorsque le terme qualifie une somme, il renvoie généralement à un élément dont la valeur est actuellement mesurée ou mesurable, mais qui peut ou non être dû.

. . . . .

Dans d'autres cas, la somme qui s'est accumulée [en anglais, « accrued »] peut ne pas être encore exigible. Par exemple, on parle d'« intérêts accumulés » [« accrued interests »] au sens du montant précis des intérêts qui sont courus, mais qui ne sont pas encore exigibles. En anglais, accrual est utilisé dans le même sens dans l'expression « accrual accounting » (en français, comptabilité d'exercice). Suivant cette méthode, les [traduction] « opérations qui génèrent des revenus ou occasionnent des dépenses sont comptabilisées lorsque les revenus sont gagnés ou que les dépenses sont engagées » (B. J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes* (1983), à la p. 44). Le revenu est gagné lorsque le bénéficiaire [traduction] « a essentiellement accompli tout ce qu'il devait accomplir, à condition que la somme due puisse être déterminée et que sa perception ne fasse l'objet d'aucune incertitude » (P. W. Hogg, J. E. Magee et J. Li, *Principles of Canadian Income Tax Law* (7e éd. 2010), à l'al. 6.5b); voir également le Manuel de l'Institut canadien des comptables agréés, *Manuel de l'ICCA - Comptabilité*, partie II, ch. 1000, aux par. 41 à 44). La somme en cause doit alors être déterminée au moment où le droit de la toucher est acquis [« accrued »].

. . . . .

J'examine maintenant le sens ordinaire et grammatical des mots « à la date de la liquidation » (en anglais, « to the date of the wind up ») employés au par. 57(4). À mon avis, cette expression fait en sorte que seules sont visées les cotisations accumulées avant la date de la liquidation, et non les sommes qui font l'objet d'une obligation qui ne prend naissance que le jour de la liquidation (en anglais, « on the date of the wind up ») et qui correspondent au déficit de liquidation.

Si l'intention du législateur avait été d'englober la date de la liquidation, il aurait employé le libellé voulu. Par exemple, l'al. 68(2)c) de la *LRR*, modifié en 2010 (ch. 24, par. 21(2)), précise dans sa version anglaise quels syndicats doivent recevoir avis de la liquidation:

(2) If the employer or the administrator, as the case may be, intends to wind up the pension plan, the administrator shall give written notice of the intended wind up to,

. . . . .

(c) each trade union that represents members of the pension plan or that, on the date of the wind up [à la date de la liquidation], represented the members, former members or retired members of the pension plan;

Contrairement à la formule « to the date of wind up », l'expression « on the date of wind up » englobe clairement la date de la liquidation. (La version française ne se prête pas à une autre interprétation.) De même, le par. 70(6), qui figurait dans la *LRR* jusqu'en 2012 (abr. L.O. 2010, ch. 9, par. 52(5)), énonce ce qui suit:

(6) À la liquidation partielle d'un régime de retraite, les participants, les anciens participants et les autres personnes qui ont droit à des prestations en vertu du régime de retraite ont des droits et prestations qui ne sont pas inférieurs aux droits et prestations qu'ils auraient à la liquidation totale du régime de retraite à la date de prise d'effet de la liquidation partielle [on the effective date of the partial wind up].

Il appert de l'expression anglaise « on the effective date of the partial wind up » que les participants ont droit aux prestations à compter de la date de la liquidation partielle, c'est-à-dire qu'ils peuvent les réclamer à compter de la liquidation elle-même. Le législateur s'exprime ainsi lorsqu'il veut qu'une période englobe une date précise. À l'opposé, lorsqu'il dit en anglais « to the date of the wind up » (en français, à la date de la liquidation), il n'entend pas englober la date où survient la liquidation.

Bref, le sens ordinaire et grammatical le plus plausible d'« accumulées à la date [to the date] de la liquidation » veut que soient visées les sommes entièrement constituées et déterminées immédiatement avant la date prévue de liquidation. Ainsi, l'obligation liée au déficit de liquidation visé à l'al. 75(1)b) n'est donc pas « accumul[é] à la date [to the date] de la liquidation » comme l'exige le par. 57(4). De plus, comme cette obligation naît lorsque le régime de retraite est liquidé (al. 75(1)b)), son objet ne peut donc pas être « accumul[é] à la date de la liquidation » (par. 57(4)).

relation fiduciaire

[LeBel, J. (dissident) (Abella, J., souscrivant à son opinion):] Une relation fiduciaire s'entend de la relation factuelle et juridique entre un bénéficiaire vulnérable et un fiduciaire qui détient et peut exercer un pouvoir sur le bénéficiaire dans les situations prévues par la loi.

APPEAL by company, monitor, secured creditor, and trustee in bankruptcy from judgment reported at *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.), ordering distribution from reserve fund to pay amount of pension plan deficiencies; APPEAL by union from judgment reported at *Indalex Ltd., Re* (2011), 81 C.B.R. (5th) 165, 92 C.C.P.B. 277, 2011 ONCA 578, 2011 CarswellOnt 9077 (Ont. C.A.), issuing costs endorsement.

POURVOI formé par une société, un contrôleur, un créancier garanti et un syndic de faillite à l'encontre d'une décision publiée à *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.), ayant ordonné de combler le déficit des régimes par prélèvement sur le fonds de réserve; POURVOI formé par un syndicat à l'encontre d'un jugement publié à *Indalex Ltd., Re* (2011), 81 C.B.R. (5th) 165, 92 C.C.P.B. 277, 2011 ONCA 578, 2011 CarswellOnt 9077 (Ont. C.A.), ayant adjugé les dépens.

***Deschamps J.*:**

1 Insolvency can trigger catastrophic consequences. Often, large claims of ordinary creditors are left unpaid. In insolvency situations, the promise of defined benefits made to employees during their employment is put at risk. These appeals illustrate the materialization of such a risk. Although the employer in this case breached a fiduciary duty, the harm suffered by the pension plans' beneficiaries results not from that breach, but from the employer's insolvency. For the following reasons, I would allow the appeals of the appellants Sun Indalex Finance, LLC; George L. Miller, Indalex U.S.'s trustee in bankruptcy and FTI Consulting Canada ULC.

2 To improve the prospect of pensioners receiving their full benefits after a pension plan is wound up, the Ontario legislature has protected contributions to the pension fund that have accrued but are not yet due at the time of the wind up by providing for a deemed trust that supersedes all other provincial priorities over certain assets of the plan sponsor (s. 57(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), and s. 30(7) of the *Personal Property Security Act*, R.S.O. 1990, c. P.10 ("*PPSA*")). The parties disagree on the scope of the deemed trust. In my view, the relevant provisions and the context lead to the conclusion that it extends to contributions the employer must make to ensure that the pension fund is sufficient to cover liabilities upon wind up. In the instant case, however, the deemed trust is superseded by the security granted to the creditor that loaned money to the employer, Indalex Limited ("Indalex"), during the insolvency proceedings. In addition, although the employer, as plan administrator, may have put itself in a position of conflict of interest by failing to give the plan's members proper notice of a motion requesting financing of its operations during a restructuring process, there was no realistic possibility that, had the members received notice and had the *CCAA* court found that they were secured creditors, it would have ordered the priorities differently. Consequently, it would not be appropriate to order an equitable remedy such as the constructive trust ordered by the Court of Appeal.

I. Facts

3 Indalex is a wholly owned Canadian subsidiary of a U.S. company, Indalex Holding Corp. ("Indalex U.S."). Indalex and its related companies formed a corporate group (the "Indalex Group") that manufactured aluminum extrusions. The U.S. and Canadian operations were closely linked.

4 In 2009, a combination of high commodity prices and the economic recession's impact on the end-user market for aluminum extrusions plunged the Indalex Group into insolvency. On March 20, 2009, Indalex U.S. filed for Chapter 11 bankruptcy protection in Delaware. On April 3, 2009, Indalex applied for a stay under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), and Morawetz J. granted the stay in an initial order. He also appointed FTI Consulting Canada ULC (the "Monitor") to act as monitor.

5 At that time, Indalex was the administrator of two registered pension plans. One was for its salaried employees (the "Salaried Plan"), the other for its executives (the "Executive Plan"). Members of the Salaried Plan included seven employees for whom the United Steelworkers ("USW") acted as bargaining agent. The Salaried Plan was in the process of being wound up when the *CCAA* proceedings began. The effective date of the wind up was December 31, 2006. The Executive Plan had been closed but not wound up. Overall, the deficiencies of the pension plans' funds concern 49 persons (members of the Salaried Plan and the Executive Plan are referred to collectively as the "Plan Members").

6 Pursuant to the initial order made by Morawetz J. on April 3, 2009, Indalex obtained protection under the *CCAA*. Both plans faced funding deficiencies when Indalex filed for the *CCAA* stay. The wind-up deficiency of the Salaried Plan was estimated at $1.8 million as of December 31, 2008. The funding deficiency of the Executive Plan was estimated at $3.0 million on a wind-up basis as of January 1, 2008.

7 From the beginning of the insolvency proceedings, the Indalex Group's reorganization strategy was to sell both Indalex and Indalex U.S. as a going concern while they were under *CCAA* and Chapter 11 protection. To this end, Indalex and Indalex U.S. sought to enter into a common agreement for debtor-in-possession ("DIP") financing under which the two companies could draw from joint credit facilities and would guarantee each other's liabilities.

8 Indalex's financial distress threatened the interests of all the Plan Members. If the reorganization failed and Indalex were liquidated under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), they would not have recovered any of their claims against Indalex for the underfunded pension liabilities, because the priority created by the provincial statute would not be recognized under the federal legislation: *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453 (S.C.C.). Although the priority was not rendered ineffective by the *CCAA*, the Plan Members' position was uncertain.

9 The Indalex Group solicited terms from a variety of possible DIP lenders. In the end, it negotiated an agreement with a syndicate consisting of the pre-filing senior secured creditors. On April 8, 2009, the *CCAA* court issued an Amended and Restated Initial Order ("Amended Initial Order") authorizing Indalex to borrow US$24.4 million from the DIP lenders and grant them priority over all other creditors ("DIP charge") in that amount. In his endorsement of the order, Morawetz J. made a finding that Indalex would be unable to achieve a going-concern solution without DIP financing. Such financing was necessary to support Indalex's business until the sale could be completed.

10 The Plan Members did not participate in the initial proceedings. The initial stay had been granted *ex parte*. The *CCAA* judge ordered Indalex to serve a copy of the stay order on every creditor owed $5,000 or more within 10 days of the initial order of April 3. As of April 8, when the motion to amend the initial order was heard, none of the Executive Plan's members had been served with that order; nor did any of them receive notice of the motion to amend it. The USW did receive short notice, but chose not to attend. Morawetz J. authorized Indalex to proceed on the basis of an abridged time for service. The Plan Members were given notice of all subsequent proceedings. None of the Plan Members appealed the Amended Initial Order to contest the DIP charge.

11 On June 12, 2009, Indalex applied for authorization to increase the DIP loan amount to US$29.5 million. At the hearing, the Executive Plan's members initially opposed the motion, seeking to reserve their rights. After it was confirmed that the motion was merely to increase the amount of the DIP charge (without changing the terms of the loan), they withdrew their opposition and the court granted the motion.

12 On April 22, 2009, the court extended the stay of proceedings and approved a marketing process for the sale of Indalex's assets. The Plan Members did not oppose the application to approve the marketing process. Under the approved bidding procedure, the Indalex Group solicited a wide variety of potential buyers.

13 Indalex received a bid from SAPA Holding AB ("SAPA"). It was for approximately US$30 million, and SAPA did not assume responsibility for the pension plans' wind-up deficiencies. According to the Monitor's estimate, the liquidation value of Indalex's assets was US$44.7 million. Indalex brought an application for an order approving a bidding procedure for a competitive auction and deeming SAPA's bid to be a qualifying bid. The Executive Plan's members opposed the application, expressing concern that the pension liabilities would not be assumed. Morawetz J. nevertheless issued the order on July 2, 2009; in it, he approved the bidding procedure for sale, noting that the Executive Plan's members could raise their objections at the time of approval of the final bid.

14 The bidding procedure did not trigger any competing bids. On July 20, 2009, Indalex and Indalex U.S. brought motions before their respective courts to approve the sale of substantially all their assets under the terms of SAPA's bid. Indalex also moved for approval of an interim distribution of the sale proceeds to the DIP lenders. The Plan Members opposed Indalex's motion. First, they argued that it was estimated that a forced liquidation would produce greater proceeds than SAPA's bid. Second, they contended that their claims had priority over that of the DIP lenders because the unfunded pension liabilities were subject to a statutory deemed trust under the *PBA*. They also contended that Indalex had breached its fiduciary obligations by failing to meet its obligations as a plan administrator throughout the insolvency proceedings.

15 The court dismissed the Plan Members' first objection, holding that there was no evidence supporting the argument that a forced liquidation would be more beneficial to suppliers, customers and the 950 employees. It approved the sale on July 20, 2009. The order in which it did so directed the Monitor to make a distribution to the DIP lenders. With respect to the second objection, however, Campbell J. ordered the Monitor to hold a reserve in an amount to be determined by the Monitor, leaving the Plan Members' arguments based on their right to the proceeds of the sale open for determination at a later date.

16 The sale to SAPA closed on July 31, 2009. The Monitor collected $30.9 million in proceeds. It distributed US$17 million to the DIP lenders, paid certain fees, withheld a portion to cover various costs and retained $6.75 million in reserve pending determination of the Plan Members' rights. At the closing, Indalex owed US$27 million to the DIP lenders. The payment of US $17 million left a US$10 million shortfall in the amount owed to these lenders. The DIP lenders called on Indalex U.S. to cover this shortfall under the guarantee contained in the DIP lending agreement. Indalex U.S. paid the amount of the shortfall. Since Indalex U.S. was, as a term of the guarantee, subrogated to the DIP lenders' priority, it became the highest ranking creditor of Indalex, with a claim for US$10 million.

17 Following the sale of Indalex's assets, its directors resigned. Indalex U.S., a part of Indalex Group, took over the management of Indalex, whose assets were limited to the sale proceeds held by the Monitor. A Unanimous Shareholder Declaration was executed on August 12, 2009; in it, Mr. Keith Cooper was appointed to manage Indalex's affairs. Mr. Cooper was an employee of FTI Consulting Inc.

18 In accordance with the right reserved by the court on July 20, 2009, the Plan Members brought motions on August 28, 2009 for a declaration that a deemed trust equal in amount to the unfunded pension liability was enforceable against the proceeds of the sale. They contended that they had priority over the secured creditors pursuant to s. 57(4) of the PBA and s. 30(7) of the *PPSA*. Indalex, in turn, brought a motion for an assignment in bankruptcy to secure the priority regime it argued for in opposing the Plan Members' motions.

19 On October 14, 2009, while judgment was pending, Indalex U.S. converted the Chapter 11 restructuring proceeding in the U.S. into a Chapter 7 liquidation proceeding. On November 5, 2009, the Superintendent of Financial Services ("Superintendent") appointed the actuarial firm of Morneau Sobeco Limited Partnership ("Morneau") to replace Indalex as administrator of the plans.

20 On February 18, 2010, Campbell J. dismissed the Plan Members' motions, concluding that the deemed trust did not apply to the wind-up deficiencies, because the associated payments were not "due" or "accruing due" as of the date of the wind up. He found that the Executive Plan did not have a wind-up deficiency, since it had not yet been wound up. He thus found it unnecessary to rule on Indalex's motion for an assignment in bankruptcy (2010 ONSC 1114, 79 C.C.P.B. 301 (Ont. S.C.J. [Commercial List])). The Plan Members appealed the dismissal of their motions.

21 The Ontario Court of Appeal allowed the Plan Members' appeals. It found that the deemed trust created by s. 57(4) of the *PBA* applies to all amounts due with respect to plan wind-up deficiencies. Although the court noted that it was likely that no deemed trust existed for the Executive Plan on the plain meaning of the provision, it declined to address this question, because it found that the Executive Plan's members had a claim arising from Indalex's breach of its fiduciary obligations in failing to adequately protect the Plan Members' interests (2011 ONCA 265, 104 O.R. (3d) 641 (Ont. C.A.)).

22 The Court of Appeal concluded that a constructive trust was an appropriate remedy for Indalex's breach of its fiduciary obligations. The court was of the view that this remedy did not harm the DIP lenders, but affected only Indalex U.S. It imposed a constructive trust over the reserved fund in favour of the Plan Members. Turning to the question of distribution, it also found that the deemed trust had priority over the DIP charge because the issue of federal paramountcy had not been raised when the Amended Initial Order was issued, and that Indalex had stated that it intended to comply with any deemed trust requirements. The Court of Appeal found that there was nothing in the record to suggest that not applying the paramountcy doctrine would frustrate Indalex's ability to restructure.

23 The Court of Appeal ordered the Monitor to make a distribution from the reserve fund in order to pay the amount of each plan's deficiency. It also issued a costs endorsement that approved payment of the costs of the Executive Plan's members from that plan's fund, but declined to order the payment of costs to the USW from the fund of the Salaried Plan (2011 ONCA 578, 81 C.B.R. (5th) 165 (Ont. C.A.)).

24 The Monitor, together with Sun Indalex, a secured creditor of Indalex U.S., and George L. Miller, Indalex U.S.'s trustee in bankruptcy, appeals the Court of Appeal's order. Both the Superintendent and Morneau support the Plan Members' position as respondents. A number of stakeholders are also participating in the appeals to this Court. In addition, USW appeals the costs endorsement. As I agree with my colleague Cromwell J. on the appeal from the costs endorsement, I will not deal with it in these reasons.

II. Issues

25 The appeals raise four issues:

1. Does the deemed trust provided for in s. 57(4) of the *PBA* apply to wind-up deficiencies?

2. If so, does the deemed trust supersede the DIP charge?

3. Did Indalex have any fiduciary obligations to the Plan Members when making decisions in the context of the insolvency proceedings?

4. Did the Court of Appeal properly exercise its discretion in imposing a constructive trust to remedy the breaches of fiduciary duties?

III. Analysis

A. Does the Deemed Trust Provided for in Section 57(4) of the PBA Apply to Windup Deficiencies?

26 The first issue is whether the statutory deemed trust provided for in s. 57(4) of the *PBA* extends to wind-up deficiencies. This question is one of statutory interpretation, which requires examination of both the wording and context of the relevant

provisions of the *PBA*. Section 57(4) of the *PBA* affords protection to members of a pension plan with respect to their employer's contributions upon wind up of the plan. The provision reads:

> **57.** . . .
>
> (4) Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

27 The most obvious interpretation is that where a plan is wound up, this provision protects all contributions that have accrued but are not yet due. The words used appear to include the contribution the employer is to make where a plan being wound up is in a deficit position. This quite straightforward interpretation, which is consistent with both the historical broadening of the protection and the remedial purpose of the provision, is being challenged on the basis of a narrow definition of the word "accrued". I do not find that this argument justifies limiting the protection afforded to plan members by the Ontario legislature.

28 The *PBA* sets out the rules for the operation of funded contributory defined benefit pension plans in Ontario. In an ongoing plan, an employer must pay into a fund all contributions it withholds from its employees' salaries. In addition, while the plan is ongoing, the employer must make two kinds of payments. One relates to current service contributions — the employer's own regular contributions to the pension fund as required by the plan. The other ensures that the fund is sufficient to meet the plan's liabilities. The employees' interest in having the contributions made while the plan is ongoing is protected by a deemed trust provided for in s. 57(3) of the *PBA*.

29 The *PBA* also establishes a comprehensive scheme for winding up a pension plan. Section 75(1)(a) imposes on the employer the obligation to "pay" an amount equal to the total of all "payments" that are due or that have accrued and have not been paid into the fund. In addition, s. 75(1)(b) sets out a formula for calculating the amount that must be paid to ensure that the fund is sufficient to cover all liabilities upon wind up. Within six months after the effective date of the wind up, the plan administrator must file a wind-up report that lists the plan's assets and liabilities as of the date of the wind up. If the wind-up report shows an actuarial deficit, the employer must make wind-up deficiency payments. Consequently, s. 75(1)(a) and (b) jointly determine the amount of the contributions owed when a plan is wound up.

30 It is common ground that the contributions provided for in s. 75(1)(a) are covered by the wind-up deemed trust. The only question is whether it also applies to the deficiency payments required by s. 75(1)(b). I would answer this question in the affirmative in view of the provision's wording, context and purpose.

31 It is readily apparent that the wind-up deemed trust provision (s. 57(4) PBA) does not place an express limit on the "employer contributions accrued to the date of the wind up but not yet due", and I find no reason to exclude contributions paid under s. 75(1)(b). Section 75(1)(a) explicitly refers to "an amount equal to the total of all payments" that have *accrued*, even those that were not yet due as of the date of the wind up, whereas s. 75(1)(b) contemplates an "amount" that is calculated on the basis of the value of assets and of liabilities that have *accrued* when the plan is wound up. Section 75(1) reads as follows:

> **75.** (1) Where a pension plan is wound up, the employer shall pay into the pension fund,
>
> (a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and
>
> (b) an amount equal to the amount by which,
>
> (i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,
>
> (ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and

> (iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,
>
> exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

32 Since both the amount with respect to payments (s. 75(1)(a)) and the one ascertained by subtracting the assets from the liabilities accrued as of the date of the wind up (s. 75(1)(b)) are to be paid upon wind up as employer contributions, they are both included in the ordinary meaning of the words of s. 57(4) of the *PBA*: "amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". As I mentioned above, this reasoning is challenged in respect of s. 75(1)(b), not of s. 75(1)(a).

33 The appellant Sun Indalex argues that since the deficiency is not finally quantified until well after the effective date of the wind up, the liability of the employer cannot be said to have accrued. The Monitor adds that the payments the employer must make to satisfy its wind-up obligations may change over the five-year period within which s. 31 of the *PBA* Regulations, R.R.O. 1990, Reg. 909, requires that they be made. These parties illustrate their argument by referring to what occurred to the Salaried Plan's fund in the case at bar. In 2007-8, Indalex paid down the vast majority of the $1.6 million wind-up deficiency associated with the Salaried Plan as estimated in 2006. By the end of 2008, however, this deficiency had risen back up to $1.8 million as a result of a decline in the fund's asset value. According to this argument, the amount could not have accrued as of the date of the wind up, because it could not be calculated with certainty.

34 Unlike my colleague Cromwell J., I find this argument unconvincing. I instead agree with the Court of Appeal on this point. The wind-up deemed trust concerns "employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". Since the employees cease to accumulate entitlements when the plan is wound up, the entitlements that are used to calculate the contributions have all been accumulated before the wind-up date. Thus the liabilities of the employer are complete — have accrued — before the wind up. The distinction between my approach and the one Cromwell J. takes is that he requires that it be possible to perform the calculation before the date of the wind up, whereas I am of the view that the time when the calculation is actually made is not relevant as long as the liabilities are assessed as of the date of the wind up. The date at which the liabilities are *reported* or the employer's *option* to spread its contributions as allowed by the regulations does not change the legal nature of the contributions.

35 In *Ontario Hydro-Electric Power Commission v. Albright* (1922), 64 S.C.R. 306 (S.C.C.), Duff J. considered the meaning of the word "accrued" in interpreting the scope of a covenant. He found that

> the word "accrued" according to well recognized usage has, as applied to rights or liabilities the meaning simply of completely constituted — and it may have this meaning although it appears from the context that the right completely constituted or the liability completely constituted is one which is only exercisable or enforceable *in futuro* — a debt for example which is *debitum in praesenti solvendum in futuro*.
>
> [Emphasis added; pp. 312-13.]

36 Thus, a contribution has "accrued" when the liabilities are completely constituted, even if the payment itself will not fall due until a later date. If this principle is applied to the facts of this case, the liabilities related to contributions to the fund allocated for payment of the pension benefits contemplated in s. 75(1)(b) are completely constituted at the time of the wind up, because no pension entitlements arise after that date. In other words, no new liabilities accrue at the time of or after the wind up. Even the portion of the contributions that is related to the elections plan members may make upon wind up has "accrued to the date of the wind up", because it is based on rights employees earned before the wind-up date.

37 The fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes (*Canadian Pacific Ltd. v. Ontario (Minister of Revenue)* (1998), 41 O.R. (3d) 606 (Ont. C.A.), at p. 621). The use of the word "accrued" does not limit liabilities to amounts

that can be determined with precision. As a result, the words "contributions accrued" can encompass the contributions mandated by s. 75(1)(b) of the *PBA*.

38 The legislative history supports my conclusion that wind-up deficiency contributions are protected by the deemed trust provision. The Ontario legislature has consistently expanded the protection afforded in respect of pension plan contributions. I cannot therefore accept an interpretation that would represent a drawback from the protection extended to employees. I will not reproduce the relevant provisions, since my colleague Cromwell J. quotes them.

39 The original statute provided solely for the employer's obligation to pay all amounts required to be paid to meet the test for solvency (*The Pension Benefits Act, 1965*, S.O. 1965, c. 96, s. 22(2)), but the legislature subsequently afforded employees the protection of a deemed trust on the employer's assets in an amount equal to the sums withheld from employees as contributions and sums due from the employer as service contributions (s. 23*a*, added by *The Pension Benefits Amendment Act, 1973*, S.O. 1973, c. 113, s. 6). In a later version, it protected not only contributions that were due, but also those that had accrued, with the amounts being calculated as if the plan had been wound up (*The Pension Benefits Amendment Act, 1980*, S.O. 1980, c. 80).

40 Whereas *all* employer contributions were originally covered by a single provision, the legislature crafted a separate provision in 1980 that specifically imposed on the employer the obligation to fund the wind-up deficiency. At the time, it was clear from the words used in the provision that the amount related to the wind-up deficiency was excluded from the deemed trust protection (*The Pension Benefits Amendment Act, 1980*). In 1983, the legislature made a distinction between the deemed trust for ongoing employer contributions and the one for certain payments to be made upon wind up (ss. 23(4)(a) and 23(4)(b), added by *Pension Benefits Amendment Act, 1983*, S.O. 1983, c. 2, s. 3). In that version, the wind-up deficiency payments were still excluded from the deemed trust. However, the legislature once again made changes to the protection in 1987. The 1987 version is, in substance, the one that applies in the case at bar. In the *Pension Benefits Act, 1987*, S.O. 1987, c. 35, a specific wind-up deemed trust was maintained, but the wind up deficiency payments were no longer excluded from it, because the limitation that had been imposed until then with respect to payments that were due or had accrued while the plan was ongoing had been eliminated. My comments to the effect that the previous versions excluded the wind-up deficiency payments do not therefore apply to the 1987 statute, since it was materially different.

41 Whereas it is clear from the 1983 amendments that the deemed trust provided for in s. 23(4)(b) was intended to include only current service costs and special payments, this is less clear from the subsequent versions of the *PBA*. To give meaning to the 1987 amendment, I have to conclude that the words refer to a deemed trust in respect of *all* "employer contributions accrued to the date of the wind up but not yet due under the plan or regulations".

42 The employer's liability upon wind up is now set out in a single section which elegantly parallels the wind-up deemed trust provision. It can be seen from the legislative history that the protection has expanded from (1) only the service contributions that were due, to (2) amounts payable calculated as if the plan had been wound up, to (3) amounts that were due and had accrued upon wind up but excluding the wind-up deficiency payments, to (4) all amounts due and accrued upon wind up.

43 Therefore, in my view, the legislative history leads to the conclusion that adopting a narrow interpretation that would dissociate the employer's payment provided for in s. 75(1)(b) of the *PBA* from the one provided for in s. 75(1)(a) would be contrary to the Ontario legislature's trend toward broadening the protection. Since the provision respecting wind-up payments sets out the amounts that are owed upon wind up, I see no historical, legal or logical reason to conclude that the wind-up deemed trust provision does not encompass all of them.

44 Thus, I am of the view that the words and context of s. 57(4) lend themselves easily to an interpretation that includes the wind-up deficiency payments, and I find additional support for this in the purpose of the provision. The deemed trust provision is a remedial one. Its purpose is to protect the interests of plan members. This purpose militates against adopting the limited scope proposed by Indalex and some of the interveners. In the case of competing priorities between creditors, the remedial purpose favours an approach that includes all wind-up payments in the value of the deemed trust in order to achieve a broad protection.

45 In sum, the relevant provisions, the legislative history and the purpose are all consistent with inclusion of the wind-up deficiency in the protection afforded to members with respect to employer contributions upon the wind up of their pension plan. I therefore find that the Court of Appeal correctly held with respect to the Salaried Plan, which had been wound up as of December 31, 2006, that Indalex was deemed to hold in trust the amount necessary to satisfy the wind-up deficiency.

46 The situation is different with respect to the Executive Plan. Unlike s. 57(3), which provides that the deemed trust protecting employer contributions exists while a plan is ongoing, s. 57(4) provides that the wind-up deemed trust comes into existence only when the plan is wound up. This is a choice made by the Ontario legislature. I would not interfere with it. Thus, the deemed trust entitlement arises only once the condition precedent of the plan being wound up has been fulfilled. This is true even if it is certain that the plan will be wound up in the future. At the time of the sale, the Executive Plan was in the process of being, but had not yet been, wound up. Consequently, the deemed trust provision does not apply to the employer's wind-up deficiency payments in respect of that plan.

47 The Court of Appeal declined to decide whether a deemed trust arose in relation to the Executive Plan, stating that it was unnecessary to decide this issue. However, the court expressed concern that a reasoning that deprived the Executive Plan's members of the benefit of a deemed trust would mean that a company under *CCAA* protection could avoid the priority of the *PBA* deemed trust simply by not winding up an underfunded pension plan. The fear was that Indalex could have relied on its own inaction to avoid the consequences that flow from a wind up. I am not convinced that the Court of Appeal's concern has any impact on the question whether a deemed trust exists, and I doubt that an employer could avoid the consequences of such a security interest simply by refusing to wind up a pension plan. The Superintendent may take a number of steps, including ordering the wind up of a pension plan under s. 69(1) of the *PBA* in a variety of circumstances (see s. 69(1)(d), *PBA*). The Superintendent did not choose to order that the plan be wound up in this case.

B. Does the Deemed Trust Supersede the DIP Charge?

48 The finding that the interests of the Salaried Plan's members in all the employer's wind-up contributions to the Salaried Plan are protected by a deemed trust does not mean that part of the money reserved by the Monitor from the sale proceeds must be remitted to the Salaried Plan's fund. This will be the case only if the provincial priorities provided for in s. 30(7) of the *PPSA* ensure that the claim of the Salaried Plan's members has priority over the DIP charge. Section 30(7) reads as follows:

> (7) A security interest in an account or inventory and its proceeds is subordinate to the interest of a person who is the beneficiary of a deemed trust arising under the *Employment Standards Act* or under the *Pension Benefits Act*.

The effect of s. 30(7) is to enable the Salaried Plan's members to recover from the reserve fund, insofar as it relates to an account or inventory and its proceeds in Ontario, ahead of all other secured creditors.

49 The Appellants argue that any provincial deemed trust is subordinate to the DIP charge authorized by the *CCAA* order. They put forward two central arguments to support their contention. First, they submit that the *PBA* deemed trust does not apply in *CCAA* proceedings because the relevant priorities are those of the federal insolvency scheme, which do not include provincial deemed trusts. Second, they argue that by virtue of the doctrine of federal paramountcy the DIP charge supersedes the *PBA* deemed trust.

50 The Appellants' first argument would expand the holding of *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.), so as to apply federal bankruptcy priorities to *CCAA* proceedings, with the effect that claims would be treated similarly under the *CCAA* and the *BIA*. In *Century Services*, the Court noted that there are points at which the two schemes converge:

> Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. [para. 23]

51 In order to avoid a race to liquidation under the *BIA*, courts will favour an interpretation of the *CCAA* that affords creditors analogous entitlements. Yet this does not mean that courts may read bankruptcy priorities into the *CCAA* at will. Provincial legislation defines the priorities to which creditors are entitled until that legislation is ousted by Parliament. Parliament did not expressly apply all bankruptcy priorities either to *CCAA* proceedings or to proposals under the *BIA*. Although the creditors of a corporation that is attempting to reorganize may bargain in the shadow of their bankruptcy entitlements, those entitlements remain only shadows until bankruptcy occurs. At the outset of the insolvency proceedings, Indalex opted for a process governed by the *CCAA*, leaving no doubt that although it wanted to protect its employees' jobs, it would not survive as their employer. This was not a case in which a failed arrangement forced a company into liquidation under the *BIA*. Indalex achieved the goal it was pursuing. It chose to sell its assets under the *CCAA*, not the *BIA*.

52 The provincial deemed trust under the *PBA* continues to apply in *CCAA* proceedings, subject to the doctrine of federal paramountcy (*Crystalline Investments* Ltd. v. Domgroup Ltd., 2004 SCC 3, [2004] 1 S.C.R. 60 (S.C.C.), at para. 43). The Court of Appeal therefore did not err in finding that at the end of a *CCAA* liquidation proceeding, priorities may be determined by the *PPSA*'s scheme rather than the federal scheme set out in the *BIA*.

53 The Appellants' second argument is that an order granting priority to the plan's members on the basis of the deemed trust provided for by the Ontario legislature would be unconstitutional in that it would conflict with the order granting priority to the DIP lenders that was made under the *CCAA*. They argue that the doctrine of paramountcy resolves this conflict, as it would render the provincial law inoperative to the extent that it is incompatible with the federal law.

54 There is a preliminary question that must be addressed before determining whether the doctrine of paramountcy applies in this context. This question arises because the Court of Appeal found that although the *CCAA* court had the power to authorize a DIP charge that would supersede the deemed trust, the order in this case did not have such an effect because paramountcy had not been invoked. As a result, the priority of the deemed trust over secured creditors by virtue of s. 30(7) of the *PPSA* remained in effect, and the Plan Members' claim ranked in priority to the claim of the DIP lenders established in the *CCAA* order.

55 With respect, I cannot accept this approach to the doctrine of federal paramountcy. This doctrine resolves conflicts in the application of overlapping valid provincial and federal legislation (*Canadian Western Bank v. Alberta*, 2007 SCC 22, [2007] 2 S.C.R. 3 (S.C.C.), at paras. 32 and 69). Paramountcy is a question of law. As a result, subject to the application of the rules on the admissibility of new evidence, it can be raised even if it was not invoked in an initial proceeding.

56 A party relying on paramountcy must "demonstrate that the federal and provincial laws are in fact incompatible by establishing either that it is impossible to comply with both laws or that to apply the provincial law would frustrate the purpose of the federal law" (*Canadian Western Bank*, at para. 75). This Court has in fact applied the doctrine of paramountcy in the area of bankruptcy and insolvency to come to the conclusion that a provincial legislature cannot, through measures such as a deemed trust, affect priorities granted under federal legislation (*Husky Oil*).

57 None of the parties question the validity of either the federal provision that enables a *CCAA* court to make an order authorizing a DIP charge or the provincial provision that establishes the priority of the deemed trust. However, in considering whether the *CCAA* court has, in exercising its discretion to assess a claim, validly affected a provincial priority, the reviewing court should remind itself of the rule of interpretation stated in *Canada (Attorney General) v. Law Society (British Columbia)*, [1982] 2 S.C.R. 307 (S.C.C.) (at p. 356), and reproduced in *Canadian Western Bank* (at para. 75):

> When a federal statute can be properly interpreted so as not to interfere with a provincial statute, such an interpretation is to be applied in preference to another applicable construction which would bring about a conflict between the two statutes.

58 In the instant case, the *CCAA* judge, in authorizing the DIP charge, did not consider the fact that the Salaried Plan's members had a claim that was protected by a deemed trust, nor did he explicitly note that ordinary creditors, such as the Executive Plan's members, had not received notice of the DIP loan motion. However, he did consider factors that were relevant to the remedial objective of the *CCAA* and found that Indalex had in fact demonstrated that the *CCAA*'s purpose would be frustrated without

the DIP charge. It will be helpful to quote the reasons he gave on April 17, 2009 in authorizing the DIP charge ((2009), 52 C.B.R. (5th) 61 (Ont. S.C.J. [Commercial List])):

> (a) the Applicants are in need of the additional financing in order to support operations during the period of a going concern restructuring;
>
> (b) there is a benefit to the breathing space that would be afforded by the DIP Financing that will permit the Applicants to identify a going concern solution;
>
> (c) there is no other alternative available to the Applicants for a going concern solution;
>
> (d) a stand-alone solution is impractical given the integrated nature of the business of Indalex Canada and Indalex U.S.;
>
> (e) given the collateral base of Indalex U.S., the Monitor is satisfied that it is unlikely that the Post-Filing Guarantee with respect to the U.S. Additional Advances will ever be called and the Monitor is also satisfied that the benefits to stakeholders far outweighs the risk associated with this aspect of the Post-Filing Guarantee;
>
> (f) the benefit to stakeholders and creditors of the DIP Financing outweighs any potential prejudice to unsecured creditors that may arise as a result of the granting of super-priority secured financing against the assets of the Applicants;
>
> (g) the Pre-Filing Security has been reviewed by counsel to the Monitor and it appears that the unsecured creditors of the Canadian debtors will be in no worse position as a result of the Post-Filing Guarantee than they were otherwise, prior to the CCAA filing, as a result of the limitation of the Canadian guarantee set forth in the draft Amended and Restated Initial Order ...; and
>
> (h) the balancing of the prejudice weighs in favour of the approval of the DIP Financing. [para. 9]

59 Given that there was no alternative for a going-concern solution, it is difficult to accept the Court of Appeal's sweeping intimation that the DIP lenders would have accepted that their claim ranked below claims resulting from the deemed trust. There is no evidence in the record that gives credence to this suggestion. Not only is it contradicted by the CCAA judge's findings of fact, but case after case has shown that "the priming of the DIP facility is a key aspect of the debtor's ability to attempt a workout" (J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at p. 97). The harsh reality is that lending is governed by the commercial imperatives of the lenders, not by the interests of the plan members or the policy considerations that lead provincial governments to legislate in favour of pension fund beneficiaries. The reasons given by Morawetz J. in response to the first attempt of the Executive Plan's members to reserve their rights on June 12, 2009 are instructive. He indicated that any uncertainty as to whether the lenders would withhold advances or whether they would have priority if advances were made did "not represent a positive development". He found that, in the absence of any alternative, the relief sought was "necessary and appropriate" (2009 CanLII 37906 [2009 CarswellOnt 4263 (Ont. S.C.J.)], at paras. 7 and 8).

60 In this case, compliance with the provincial law necessarily entails defiance of the order made under federal law. On the one hand, s. 30(7) of the *PPSA* required a part of the proceeds from the sale related to assets described in the provincial statute to be paid to the plan's administrator before other secured creditors were paid. On the other hand, the Amended Initial Order provided that the DIP charge ranked in priority to "all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise" (para. 45). Granting priority to the DIP lenders subordinates the claims of other stakeholders, including the Plan Members. This court-ordered priority based on the CCAA has the same effect as a statutory priority. The federal and provincial laws are inconsistent, as they give rise to different, and conflicting, orders of priority. As a result of the application of the doctrine of federal paramountcy, the DIP charge supersedes the deemed trust.

C. Did Indalex Have Fiduciary Obligations to the Plan Members?

61 The fact that the DIP financing charge supersedes the deemed trust or that the interests of the Executive Plan's members are not protected by the deemed trust does not mean that Plan Members have no right to receive money out of the reserve fund.

What remains to be considered is whether an equitable remedy, which could override all priorities, can and should be granted for a breach by Indalex of a fiduciary duty.

62 The first stage of a fiduciary duty analysis is to determine whether and when fiduciary obligations arise. The Court has recognized that there are circumstances in which a pension plan administrator has fiduciary obligations to plan members both at common law and under statute (*Burke v. Hudson's Bay Co.*, 2010 SCC 34, [2010] 2 S.C.R. 273 (S.C.C.), at para. 41). It is clear that the indicia of a fiduciary relationship attach in this case between the Plan Members and Indalex as plan administrator. Sun Indalex and the Monitor do not dispute this proposition.

63 However, Sun Indalex and the Monitor argue that the employer has a fiduciary duty only when it acts as plan administrator — when it is wearing its administrator's "hat". They contend that, outside the plan administration context, when directors make decisions in the best interests of the corporation, the employer is wearing solely its "corporate hat". On this view, decisions made by the employer in its corporate capacity are not burdened by the corporation's fiduciary obligations to its pension plan members and, consequently, cannot be found to conflict with plan members' interests. This is not the correct approach to take in determining the scope of the fiduciary obligations of an employer acting as plan administrator.

64 Only persons or entities authorized by the *PBA* can act as plan administrators (ss. 1(1) and 8(1)(a)). The employer is one of them. A corporate employer that chooses to act as plan administrator accepts the fiduciary obligations attached to that function. Since the directors of a corporation also have a fiduciary duty to the corporation, the fact that the corporate employer can act as administrator of a pension plan means that s. 8(1)(a) of the *PBA* is based on the assumption that not all decisions taken by directors in managing a corporation will result in conflict with the corporation's duties to the plan's members. However, the corporate employer must be prepared to resolve conflicts where they arise. Reorganization proceedings place considerable burdens on any debtor, but these burdens do not release an employer that acts as plan administrator from its fiduciary obligations.

65 Section 22(4) of the *PBA* explicitly provides that a plan administrator must not permit its own interest to conflict with its duties in respect of the pension fund. Thus, where an employer's own interests do not converge with those of the plan's members, it must ask itself whether there is a potential conflict and, if so, what can be done to resolve the conflict. Where interests do conflict, I do not find the two hats metaphor helpful. The solution is not to determine whether a given decision can be classified as being related to either the management of the corporation or the administration of the pension plan. The employer may well take a sound management decision, and yet do something that harms the interests of the plan's members. An employer acting as a plan administrator is not permitted to disregard its fiduciary obligations to plan members and favour the competing interests of the corporation on the basis that it is wearing a "corporate hat". What is important is to consider the consequences of the decision, not its nature.

66 When the interests the employer seeks to advance on behalf of the corporation conflict with interests the employer has a duty to preserve as plan administrator, a solution must be found to ensure that the plan members' interests are taken care of. This may mean that the corporation puts the members on notice, or that it finds a replacement administrator, appoints representative counsel or finds some other means to resolve the conflict. The solution has to fit the problem, and the same solution may not be appropriate in every case.

67 In the instant case, Indalex's fiduciary obligations as plan administrator did in fact conflict with management decisions that needed to be taken in the best interests of the corporation. Indalex had a number of responsibilities as plan administrator. For example, s. 56(1) of the *PBA* required it to ensure that contributions were paid when due. Section 56(2) required that it notify the Superintendent if contributions were not paid when due. It was also up to Indalex under s. 59 to commence proceedings to obtain payment of contributions that were due but not paid. Indalex, as an employer, paid all the contributions that were due. However, its insolvency put contributions that had accrued to the date of the wind up at risk. In an insolvency context, the administrator's claim for contributions that have accrued is a provable claim.

68 In the context of this case, the fact that Indalex, as plan administrator, might have to claim accrued contributions from itself means that it would have to simultaneously adopt conflicting positions on whether contributions had accrued as of the date of liquidation and whether a deemed trust had arisen in respect of wind-up deficiencies. This is indicative of a clear conflict

between Indalex's interests and those of the Plan Members. As soon as it saw, or ought to have seen, a potential for conflict, Indalex should have taken steps to ensure that the interests of the Plan Members were protected. It did not do so. On the contrary, it contested the position the Plan Members advanced. At the very least, Indalex breached its duty to avoid conflicts of interest (s. 22(4), *PBA*).

69 Since the Plan Members seek an equitable remedy, it is important to identify the point at which Indalex should have moved to ensure that their interests were safeguarded. Before doing so, I would stress that factual contexts are needed to analyse conflicts between interests, and that it is neither necessary nor useful to attempt to map out all the situations in which conflicts may arise.

70 As I mentioned above, insolvency puts the employer's contributions at risk. This does not mean that the decision to commence insolvency proceedings entails on its own a breach of a fiduciary obligation. The commencement of insolvency proceedings in this case on April 3, 2009 in an emergency situation was explained by Timothy R. J. Stubbs, the then-president of Indalex. The company was in default to its lender, it faced legal proceedings for unpaid bills, it had received a termination notice effective April 6 from its insurers, and suppliers had stopped supplying on credit. These circumstances called for urgent action by Indalex lest a creditor start bankruptcy proceedings and in so doing jeopardize ongoing operations and jobs. Several facts lead me to conclude that the stay sought in this case did not, in and of itself, put Indalex in a conflict of interest.

71 First, a stay operates only to freeze the parties' rights. In most cases, stays are obtained *ex parte*. One of the reasons for refraining from giving notice of the initial stay motion is to avert a situation in which creditors race to court to secure benefits that they would not enjoy in insolvency. Subjecting as many creditors as possible to a single process is seen as a way to treat all of them more equitably. In this context, plan members are placed on the same footing as the other creditors and have no special entitlement to notice. Second, one of the conclusions of the order Indalex sought was that it was to be served on all creditors, with a few exceptions, within 10 days. The notice allowed any interested party to apply to vary the order. Third, Indalex was permitted to pay all pension benefits. Although the order excluded special solvency payments, no ruling was made at that point on the merits of the creditors' competing claims, and a stay gave the Plan Members the possibility of presenting their arguments on the deemed trust rather than losing it altogether as a result of a bankruptcy proceeding, which was the alternative.

72 Whereas the stay itself did not put Indalex in a conflict of interest, the proceedings that followed had adverse consequences. On April 8, 2009, Indalex brought a motion to amend and restate the initial order in order to apply for DIP financing. This motion had been foreseen. Mr. Stubbs had mentioned in the affidavit he signed in support of the initial order that the lenders had agreed to extend their financing, but that Indalex would be in need of authorization in order to secure financing to continue its operations. However, the initial order had not yet been served on the Plan Members as of April 8. Short notice of the motion was given to the USW rather than to all the individual Plan Members, but the USW did not appear. The Plan Members were quite simply not represented on the motion to amend the initial stay order requesting authorization to grant the DIP charge.

73 In seeking to have a court approve a form of financing by which one creditor was granted priority over all other creditors, Indalex was asking the *CCAA* court to override the Plan Members' priority. This was a case in which Indalex's directors permitted the corporation's best interests to be put ahead of those of the Plan Members. The directors may have fulfilled their fiduciary duty to Indalex, but they placed Indalex in the position of failing to fulfil its obligations as plan administrator. The corporation's interest was to seek the best possible avenue to survive in an insolvency context. The pursuit of this interest was not compatible with the plan administrator's duty to the Plan Members to ensure that all contributions were paid into the funds. In the context of this case, the plan administrator's duty to the Plan Members meant, in particular, that it should at least have given them the opportunity to present their arguments. This duty meant, at the very least, that they were entitled to reasonable notice of the DIP financing motion. The terms of that motion, presented without appropriate notice, conflicted with the interests of the Plan Members. Because Indalex supported the motion asking that a priority be granted to its lender, it could not at the same time argue for a priority based on the deemed trust.

74 The Court of Appeal found a number of other breaches. I agree with Cromwell J. that none of the subsequent proceedings had a negative impact on the Plan Members' rights. The events that occurred, in particular the second DIP financing motion and the sale process, were predictable and, in a way, typical of reorganizations. Notice was given in all cases. The Plan Members

were represented by able counsel. More importantly, the court ordered that funds be reserved and that a full hearing be held to argue the issues.

75 The Monitor and George Miller, Indalex U.S.'s trustee in bankruptcy, argue that the Plan Members should have appealed the Amended Initial Order authorizing the DIP charge, and were precluded from subsequently arguing that their claim ranked in priority to that of the DIP lenders. They take the position that the collateral attack doctrine bars the Plan Members from challenging the DIP financing order. This argument is not convincing. The Plan Members did not receive notice of the motion to approve the DIP financing. Counsel for the Executive Plan's members presented the argument of that plan's members at the first opportunity and repeated it each time he had an occasion to do so. The only time he withdrew their opposition was at the hearing of the motion for authorization to increase the DIP loan amount after being told that the only purpose of the motion was to increase the amount of the authorized loan. The CCAA judge set a hearing date for the very purpose of presenting the arguments that Indalex, as plan administrator, could have presented when it requested the amendment to the initial order. It cannot now be argued, therefore, that the Plan Members are barred from defending their interests by the collateral attack doctrine.

D. Would an Equitable Remedy Be Appropriate in the Circumstances?

76 The definition of "secured creditor" in s. 2 of the CCAA includes a trust in respect of the debtor's property. The Amended Initial Order (at para. 45) provided that the DIP lenders' claims ranked in priority to all trusts, "statutory or otherwise". Indalex U.S. was subrogated to the DIP lenders' claim by operation of the guarantee in the DIP lending agreement.

77 Counsel for the Executive Plan's members argues that the doctrine of equitable subordination should apply to subordinate Indalex U.S.'s subrogated claim to those of the Plan Members. This Court discussed the doctrine of equitable subordination in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.), but did not endorse it, leaving it for future determination (p. 609). I do not need to endorse it here either. Suffice to say that there is no evidence that the lenders committed a wrong or that they engaged in inequitable conduct, and no party has contested the validity of Indalex U.S.'s payment of the US$10 million shortfall.

78 This leaves the constructive trust remedy ordered by the Court of Appeal. It is settled law that proprietary remedies are generally awarded only with respect to property that is directly related to a wrong or that can be traced to such property. I agree with my colleague Cromwell J. that this condition is not met in the case at bar. I adopt his reasoning on this issue.

79 Moreover, I am of the view that it was unreasonable for the Court of Appeal to reorder the priorities in this case. The breach of fiduciary duty identified in this case is, in substance, the lack of notice. Since the Plan Members were allowed to fully argue their case at a hearing specifically held to adjudicate their rights, the CCAA court was in a position to fully appreciate the parties' positions.

80 It is difficult to see what gains the Plan Members would have secured had they received notice of the motion that resulted in the Amended Initial Order. The CCAA judge made it clear, and his finding is supported by logic, that there was no alternative to the DIP loan that would allow for the sale of the assets on a going-concern basis. The Plan Members presented no evidence to the contrary. They rely on conjecture alone. The Plan Members invoke other cases in which notice was given to plan members and in which the members were able to fully argue their positions. However, in none of those cases were plan members able to secure any additional benefits. Furthermore, the Plan Members were allowed to fully argue their case. As a result, even though Indalex breached its fiduciary duty to notify the Plan Members of the motion that resulted in the Amended Initial Order, their claim remains subordinate to that of Indalex U.S.

IV. Conclusion

81 There are good reasons for giving special protection to members of pension plans in insolvency proceedings. Parliament considered doing so before enacting the most recent amendments to the *CCAA*, but chose not to (*An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, S.C. 2007, c. 36, in force September 18, 2009, SI/2009-68; see also Bill C-501, *An Act to amend the Bankruptcy and Insolvency Act and other Acts (pension protection)*, 3rd Sess., 40th Parl., March 24, 2010 (subsequently

amended by the Standing Committee on Industry, Science and Technology, March 1, 2011)). A report of the Standing Senate Committee on Banking, Trade and Commerce gave the following reasons for this choice:

> Although the Committee recognizes the vulnerability of current pensioners, we do not believe that changes to the BIA regarding pension claims should be made at this time. Current pensioners can also access retirement benefits from the Canada/Quebec Pension Plan, and the Old Age Security and Guaranteed Income Supplement programs, and may have private savings and Registered Retirement Savings Plans that can provide income for them in retirement. The desire expressed by some of our witnesses for greater protection for pensioners and for employees currently participating in an occupational pension plan must be balanced against the interests of others. As we noted earlier, insolvency — at its essence — is characterized by insufficient assets to satisfy everyone, and choices must be made.
>
> The Committee believes that granting the pension protection sought by some of the witnesses would be sufficiently unfair to other stakeholders that we cannot recommend the changes requested. For example, we feel that super priority status could unnecessarily reduce the moneys available for distribution to creditors. In turn, credit availability and the cost of credit could be negatively affected, and all those seeking credit in Canada would be disadvantaged. *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2003), at p. 98; see also p. 88.)

82 In an insolvency process, a CCAA court must consider the employer's fiduciary obligations to plan members as their plan administrator. It must grant a remedy where appropriate. However, courts should not use equity to do what they wish Parliament had done through legislation.

83 In view of the fact that the Plan Members were successful on the deemed trust and fiduciary duty issues, I would not order costs against them either in the Court of Appeal or in this Court.

84 I would therefore allow the main appeals without costs in this Court, set aside the orders made by the Court of Appeal, except with respect to orders contained in paras. 9 and 10 of the judgment of the Court of Appeal in the former executive members' appeal and restore the orders of Campbell J. dated February 18, 2010. I would dismiss USW's costs appeal without costs.

***Cromwell J.*:**

I. Introduction

85 When a business becomes insolvent, many interests are at risk. Creditors may not be able to recover their debts, investors may lose their investments and employees may lose their jobs. If the business is the sponsor of an employee pension plan, the benefits promised by the plan are not immune from that risk. The circumstances leading to these appeals show how that risk can materialize. Pension plans and creditors find themselves in a zero-sum game with not enough money to go around. At a very general level, this case raises the issue of how the law balances the interests of pension plan beneficiaries with those of other creditors.

86 Indalex Limited, the sponsor and administrator of employee pension plans, became insolvent and sought protection from its creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). Although all current contributions were up to date, the company's pension plans did not have sufficient assets to fulfill the pension promises made to their members. In a series of court-sanctioned steps, which were judged to be in the best interests of all stakeholders, the company borrowed a great deal of money to allow it to continue to operate. The parties injecting the operating money were given a super priority over the claims by other creditors. When the business was sold, thereby preserving hundreds of jobs, there was a shortfall between the sale proceeds and the debt. The pension plan beneficiaries thus found themselves in a dispute about the priority of their claims. The appellant, Sun Indalex Finance LLC, claimed it had priority by virtue of the super priority granted in the CCAA proceedings. The trustee in bankruptcy of the U.S. Debtors (George Miller) and the Monitor (FTI Consulting) joined in the appeal. The plan beneficiaries claimed that they had priority by virtue of a statutory deemed trust under the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), and a constructive trust arising from the company's alleged breaches of fiduciary duty.

87 The Ontario Court of Appeal sided with the plan beneficiaries and Sun Indalex, the trustee in bankruptcy and the Monitor all appeal. The specific legal points in issue are:

A. Did the Court of Appeal err in finding that the statutory deemed trust provided for in s. 57(4) of the PBA applied to the salaried plan's wind-up deficiency?

B. Did the Court of Appeal err in finding that Indalex breached the fiduciary duties it owed to the pension plan beneficiaries as the plans' administrator and in imposing a constructive trust as a remedy?

C. Did the Court of Appeal err in concluding that the super priority granted in the CCAA proceedings did not have priority by virtue of the doctrine of federal paramountcy?

D. Did the Court of Appeal err in its cost endorsement respecting the United Steelworkers ("USW")?

88 My view is that the deemed trust does not apply to the disputed funds, and even if it did, the super priority would override it. I conclude that the corporation failed in its duty to the plan beneficiaries as their administrator and that the beneficiaries ought to have been afforded more procedural protections in the CCAA proceedings. However, I also conclude that the Court of Appeal erred in using the equitable remedy of a constructive trust to defeat the super priority ordered by the CCAA judge. I would therefore allow the main appeals.

II. Facts and Proceedings Below

A. Overview

89 These appeals concern claims by pension fund members for amounts owed to them by the plans' sponsor and administrator which became insolvent.

90 Indalex Limited is the parent company of three non-operating Canadian companies. I will refer to both Indalex Limited individually and to the group of companies collectively as "Indalex", unless the context requires further clarity. Indalex Limited is the wholly owned subsidiary of its U.S. parent, Indalex Holding Corp. which owned and conducted related operations in the U.S. through its U.S. subsidiaries which I will refer to as the "U.S. debtors".

91 In late March and early April of 2009, Indalex and the U.S. debtors were insolvent and sought protection from their creditors, the former under the Canadian CCAA, and the latter under the United States Bankruptcy Code, 11 U.S.C., Chapter 11. The dispute giving rise to these appeals concern the priority granted to lenders in the CCAA process for funds advanced to Indalex and whether that priority overrides the claims of two of Indalex's pension plans for funds owed to them.

92 Indalex was the sponsor and administrator of two registered pension plans relevant to these proceedings, one for salaried employees and the other for executive employees. At the time of seeking CCAA protection, the salaried plan was being wound up (with a wind-up date of December 31, 2006) and was estimated to have a wind-up deficiency (as of the end of 2007) of roughly $2.252 million. The executive plan, while it was not being wound up, had been closed to new members since 2005. It was estimated to have a deficiency of roughly $2.996 million on wind up. At the time the CCAA proceedings were started, all regular current service contributions had been made to both plans.

93 Shortly after Indalex received CCAA protection, the CCAA judge authorized the company to enter into debtor in possession ("DIP") financing in order to allow it to continue to operate. The court granted the DIP lenders, a syndicate of banks, a "super priority" over "all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise": initial order, at para. 35 (joint A.R., vol. I, at pp. 123-24). Repayment of these amounts was guaranteed by the U.S. debtors.

94 Ultimately, with the approval of the CCAA court, Indalex sold its business; the purchaser did not assume pension liabilities. A reserve fund was established by the CCAA Monitor to answer any outstanding claims. The proceeds of the sale were not

sufficient to pay back the DIP lenders and so the U.S. debtors, as guarantors, paid the shortfall and stepped into the shoes of the DIP lenders in terms of priority.

95 The appellant Sun Indalex is a pre-*CCAA* secured creditor of both Indalex and the U.S. debtors. It claims the reserve fund on the basis that the US$10.75 million paid by the guarantors would otherwise have been available to Sun Indalex as a secured creditor of the U.S. debtors in the U.S. bankruptcy proceedings. The respondent plan beneficiaries claim the reserve fund on the basis that they have a wind-up deficiency which is covered by a deemed trust created by s. 57(4) of the *PBA*. This deemed trust includes "an amount of money equal to employer contributions *accrued to the date of the wind up but not yet due* under the plan or regulations" (s. 57(4)). They also claim the reserve fund on the basis of a constructive trust arising from Indalex's failure to live up to its fiduciary duties as plan administrator.

96 The reserve fund is not sufficient to pay back both Sun Indalex and the pension plans and so the main question on the main appeals is which of the creditors is entitled to priority for their respective claims.

97 The judge at first instance rejected the plan beneficiaries' deemed trust arguments and held that, with respect to the wind-up deficiency, the plan beneficiaries were unsecured creditors, ranking behind those benefitting from the "super priority" and secured creditors (2010 ONSC 1114, 79 C.C.P.B. 301 (Ont. S.C.J. [Commercial List])). The Court of Appeal reversed this ruling and held that pension plan deficiencies were subject to deemed and constructive trusts which had priority over the DIP financing and over other secured creditors (2011 ONCA 265, 104 O.R. (3d) 641 (Ont. C.A.)). Sun Indalex, the trustee in bankruptcy and the Monitor appeal.

B. Indalex's CCAA Proceedings

(1) The Initial Order (Joint A.R., vol. I, at p. 112)

98 As noted earlier, Indalex was in financial trouble and, on April 3, 2009, sought and obtained protection from its creditors under the *CCAA*. The order (which I will refer to as the initial order) also contained directions for service on creditors and others: paras. 39-41. The order also contained a so-called "comeback clause" allowing any interested party to apply for a variation of the order, provided that that party served notice on any other party likely to be affected by any such variation: para. 46. It is common ground that the plan beneficiaries did not receive notice of the application for the initial order but the *CCAA* court nevertheless approved the method of and time for service. Full particulars of the deficiencies in the pension plans were before the court in the motion material and the initial order addressed payment of the employer's current service pension contributions.

(2) The DIP Order (Joint A.R., vol. I, at p. 129)

99 On April 8, 2009, in what I will refer to as the DIP order, the *CCAA* judge, Morawetz J., authorized Indalex to borrow funds pursuant to a DIP credit agreement. The judge ordered among many other things, the following:

- He approved abridged notice: para. 1;
- He allowed Indalex to continue making current service contributions to the pension plans, but not special payments: paras. 7(a) and 9(b);
- He barred all proceedings against Indalex, except by consent of Indalex and the Monitor or leave of the court, until May 1, 2009: para. 15;
- He granted the DIP lenders a so-called super priority:

> THIS COURT ORDERS that each of the Administration Charge, the Directors' Charge and the DIP Lenders Charge (all as constituted and defined herein) shall constitute a charge on the Property and such Charges shall rank in priority to all other security interests, trust, liens, charges and encumbrances, statutory or otherwise (collectively, "Encumbrances") in favour of any Person. [Emphasis added; para. 45.]

• He required Indalex to send notice of the order to all known creditors, other than employees and creditors to which Indalex owed less than $5,000 and stated that Indalex and the Monitor were "at liberty" to serve the Initial Order to interested parties: paras. 49-50.

100 In his endorsement for the DIP order, Morawetz J. found that "there is no other alternative available to the Applicants [Indalex] for a going concern solution" and that DIP financing was necessary: (2009), 52 C.B.R. (5th) 61 (Ont. S.C.J. [Commercial List]), at para. 9(c). He noted that the Monitor in its report was of the view that approval of the DIP agreement was both necessary and in the best interests of Indalex and its stakeholders, including its creditors, employees, suppliers and customers: paras. 14-16.

101 The USW, which represented some of the members of the salaried plan, was served with notice of the motion that led to the DIP order, but did not appear. Morawetz J. specifically ordered as follows with regard to service:

> THIS COURT ORDERS that the time for service of the Notice of Application and the Application Record is hereby abridged so that this Application is properly returnable today and hereby dispenses with further service thereof. [DIP order, at para. 1]

(3) The DIP Extension Order (Joint A.R., vol. I, at p. 156)

102 On June 12, 2009, Morawetz J. heard and granted an application by Indalex to allow them to borrow approximately $5 million more from the DIP lenders, thus raising the allowed total to US$29.5 million.

103 Counsel for the former executives received the motion material the night before. Counsel for USW was also served with notice. At the motion, the former executives (along with second priority secured noteholders) sought to "reserve their rights with respect to the relief sought": 2009 CanLII 37906 [2009 CarswellOnt 4263 (Ont. S.C.J.)], at para. 4. Morawetz J. wrote that any "reservation of rights" would create uncertainty for the DIP lenders with regard to priority, and may prevent them from extending further advances. Moreover, the parties had presented no alternative to increased DIP financing, which was both "necessary and appropriate" and would, it was to be hoped, "improve the position of the stakeholders": paras. 5-9.

(4) The Bidding Order ((2009), 79 C.C.P.B. 101 (Ont. S.C.J. [Commercial List]))

104 On July 2, 2009, Indalex brought a motion for approval of proposed bidding procedures for Indalex's assets. Morawetz J. decided that a stalking horse bid by SAPA Holding AB ("SAPA") for Indalex's assets could count as a qualifying bid. Counsel on behalf of the members of the executive plan appeared, with the concern that "their position and views have not been considered in this process": para. 8. In his decision, Morawetz J. decided that these arguments could be dealt with later, at a sale approval motion: para. 10. The judge said:

> The position facing the retirees is unfortunate. The retirees are currently not receiving what they bargained for. <u>However, reality cannot be ignored and the nature of the Applicants' insolvency is such that there are insufficient assets to meet its liabilities. The retirees are not alone in this respect. The objective of these proceedings is to achieve the best possible outcome for the stakeholders.</u>
>
> [Emphasis added; para. 9.]

(5) The Sale Approval Order (Joint A.R., vol. I, at p. 166)

105 On July 20, 2009, Indalex brought two motions before Campbell J.

106 The first motion sought approval for the sale of Indalex's assets as a going concern to SAPA. SAPA was not to assume any pension liabilities. Campbell J. granted an order approving this sale.

107 The second motion sought approval for an interim distribution of the sale proceeds to the DIP lenders. Counsel on behalf of the executive plan members and the USW, representing some of the salaried employees, objected to the planned distribution of the sale proceeds on grounds that a statutory deemed trust applied to the deficiencies in their plans and that Indalex had breached fiduciary duties that it owed to them. Campbell J. ordered the Monitor to pay the DIP agent from the sale proceeds, but also ordered the Monitor to set up a reserve fund in an amount sufficient to answer, among other things, the claims of the plan beneficiaries pending resolution of those matters. Campbell J. ordered that the U.S. debtors be subrogated to the DIP lenders to the extent that the U.S. debtors were required under the guarantee to satisfy the DIP lenders' claims: para. 14.

(6) The Sale and Distribution of Funds

108 SAPA bought Indalex's assets on July 31, 2009. Taking the reserve fund into account, the sale did not produce sufficient funds to repay the DIP lenders in full and so the U.S. debtors paid US$10,751,247 as guarantor to the DIP lenders: C.A. reasons, at para. 65.

(7) The Order Under Appeal

109 On August 28, 2009, Campbell J. heard claims by the USW (appearing on behalf of some members of the salaried plan) and counsel appearing on behalf of the executive plan members that the wind-up deficiency was subject to a deemed trust. He rejected these claims in a written decision on February 18, 2010. He decided that the s. 57(4) *PBA* deemed trust did not apply to wind-up deficiencies. The executive plan had not been wound up, and therefore there was no wind-up deficiency to be the subject of the deemed trust. As for the salaried plan, Campbell J. held that the windup deficiency was not an obligation that had "accrued to the date of the wind up" and as a result did not fall within the terms of the s. 57(4) deemed trust.

110 Indalex had asked for the stay granted under the initial order to be lifted so that it could assign itself into bankruptcy. Because he did not find a deemed trust, Campbell J. did not feel that he needed to decide on the motion to lift the stay.

(8) The Decision of the Ontario Court of Appeal

111 The Ontario Court of Appeal allowed an appeal from the decision of Campbell J.

112 Writing for a unanimous panel, Gillese J.A. decided that the s. 57(4) deemed trust is applicable to wind-up deficiencies. She took the view that s. 57(4)'s reference to "employer contributions accrued to the date of the wind up but not yet due" included all amounts that the employer owed on the wind-up of its pension plan: para. 101. In particular, she concluded that the deemed trust applied to the wind-up deficiency in the salaried plan. Gillese J.A. declined, however, to decide whether the deemed trust also applied to deficiencies in the executive plan, which had not been wound up by the relevant date: paras. 110-12. A decision on this latter point was unnecessary given her finding on the applicability of a constructive trust in this case.

113 Gillese J.A. found that the super priority provided for in the DIP order did not trump the deemed trust over the salaried plan's wind-up deficiency. Morawetz J. had not "invoked" the issue of paramountcy or made an explicit finding that the requirements of federal law required that the provincially created deemed trust must be overridden: paras. 178-79. Gillese J.A. also took the view that this Court's decision in *Ted Leroy Trucking Ltd., Re*. 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.), did not mean that provincially created priorities that would be ineffective under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA"), were also ineffective under the *CCAA*: paras. 185-96. The deemed trust therefore ranked ahead of the DIP security.

114 In addition to her findings regarding deemed trusts, Gillese J.A. granted the plan beneficiaries a constructive trust over the amount of the reserve fund on the ground that Indalex, as pension plan administrator, had breached fiduciary duties that it owed to the plan beneficiaries during the *CCAA* proceedings.

115 She held that as a plan administrator who was also an employer, Indalex had fiduciary duties both to the plan beneficiaries and to the corporation: para. 129. In her view, Indalex was subject to both sets of duties throughout the *CCAA* proceedings and it had breached its duties to the plan beneficiaries in several ways. While Indalex had the right to initiate *CCAA* proceedings, this action made the plan beneficiaries vulnerable and therefore triggered its fiduciary obligations as plan administrator: paras.

132-33. Gillese J.A. enumerated the many ways in which she thought Indalex subsequently failed as plan administrator: it did nothing in the CCAA proceedings to fund the deficit in the underfunded plans; it applied for CCAA protection without notice to the beneficiaries; it obtained DIP financing on the condition that DIP lenders be granted a super priority over "statutory trusts"; it obtained this financing without notice to the plan beneficiaries; it sold its assets knowing the purchaser was not taking over the plans; and it attempted to enter into voluntary bankruptcy, which would defeat any deemed trust claims the beneficiaries might have asserted: para. 139. Gillese J.A. also noted that throughout the CCAA proceedings Indalex was in a conflict of interest because it was acting for both the corporation and the beneficiaries.

116 Indalex's failure to live up to its fiduciary duties meant that the plan beneficiaries were entitled to a constructive trust over the amount of the reserve fund: para. 204. Since the beneficiaries had been wronged by Indalex, and the U.S. debtors were not, with respect to Indalex, an "arm's length innocent third party" the appropriate response was to grant the beneficiaries a constructive trust: para. 204. Her conclusion on this point applied equally to the salaried and executive plans.

III. Analysis

A. First Issue: Did the Court of Appeal Err in Finding That the Deemed Statutory Trust Provided for in Section 57(4) of the PBA Applied to the Salaried Plan's Wind-up Deficiency?

(1) Introduction

117 The main issue addressed here concerns whether the statutory deemed trust provided for in s. 57(4) of the PBA applies to wind-up deficiencies, the payment of which is provided for in s. 75(1)(b).

118 The deemed trust created by s. 57(4) applies to "employer contributions accrued to the date of the wind-up but not yet due under the plan or regulations". Thus, to be subject to the deemed trust, the pension plan must be wound up and the amounts in question must meet three requirements. They must be (1) "employer contributions", (2) "accrued to the date of the wind-up" and (3) "not yet due". A wind-up deficiency arises "[w]here a pension plan is wound up": s. 75(1). I agree with my colleagues that there can be no deemed trust for the executive plan, because that plan had not been wound up at the relevant date. What follows, therefore, is relevant only to the salaried plan.

119 The wind-up deficiency payments are "employer contributions" which are "not yet due" as of the date of wind-up within the meaning of the PBA. The main issue before us, therefore, boils down to the narrow interpretative question of whether the wind-up deficiency described in s. 75(1)(b) is "accrued to the date of the windup".

120 Campbell J. at first instance found that it was not, while the Court of Appeal reached the opposite conclusion. In essence, the Court of Appeal reasoned that the deemed trust in s. 57(4) "applies to all employer contributions that are required to be made pursuant to s. 75", that is, to "all amounts owed by the employer on the wind-up of its pension plan": para. 101.

121 I respectfully disagree with the Court of Appeal's conclusion for three main reasons. First, the most plausible grammatical and ordinary sense of the words "accrued to the date of the wind up" is that the amounts referred to are precisely ascertained immediately before the effective date of the plan's wind-up. The wind-up deficiency only arises upon wind-up and it is neither ascertained nor ascertainable on the date fixed for wind-up. Second, the broader statutory context reinforces this view: the language of the deemed trusts in s. 57(3) and (4) is virtually exactly repeated in s. 75(1)(a), suggesting that both deemed trusts refer to the liability on wind-up referred to in s. 75(1)(a) and not to the further and distinct wind-up deficiency liability created under s. 75(1)(b). Finally, the legislative evolution and history of these provisions show, in my view, that the legislature never intended to include the wind-up deficiency in a statutory deemed trust.

122 Before turning to the precise interpretative issue, it will be helpful to provide some context about the employer's wind-up obligations and the deemed trust provisions that are the subject of this dispute.

(2) Employer Obligations on Wind Up

123 A "wind up" means that the plan is terminated and the plan assets are distributed: see PBA, s. 1(1), definition of "wind up". The employer's liability on wind-up consists of two main components. The first is provided for in s. 75(1)(a) and includes "an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund". This liability applies to contributions that were due as at the wind-up date but does *not* include payments required by s. 75(1)(b) that arise as a result of the wind up: A. N. Kaplan, *Pension Law* (2006), at pp. 541-42. This second liability is known as the wind-up deficiency amount. The employer must pay all additional sums to the extent that the assets of the pension fund are insufficient to cover the value of all immediately vested and accelerated benefits and grow-in benefits: Kaplan, at p. 542. Without going into detail, there are certain statutory benefits that may arise only on wind-up, such as certain benefit enhancements and the potential for acceleration of pension entitlements. Thus, wind-up will usually result in additional employer liabilities over and above those arising from the obligation to pay all benefits provided for in the plan itself: see, e.g., ss. 73 and 74; Kaplan, at p. 542. As the Court of Appeal concluded, the payments provided for under s. 75(1)(a) are those which the employer had to make while the plan was ongoing, while s. 75(1)(b) refers to the employer's obligation to make up for any wind-up deficiency: paras. 90-91.

124 For convenience, the provision as it then stood is set out here.

> **75.** (1) Where a pension plan is wound up in whole or in part, the employer shall pay into the pension fund,
>
> (a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and
>
> (b) an amount equal to the amount by which,
>
> (i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,
>
> (ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and
>
> (iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,
>
> exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

125 While a wind up is effective as of a fixed date, a wind up is nonetheless best thought of not simply as a moment or a single event, but as a process. It begins by a triggering event and continues until all of the plan assets have been distributed. To oversimplify somewhat, the wind-up process involves the following components.

126 The assets and liabilities of the plan as of the wind-up date must be determined. As noted earlier, the precise extent of the liability, while *fixed as of that date*, will not be ascertained or ascertainable *on that date*. The extent of the liability may depend on choices open to plan beneficiaries under the plan and on the exercise by them of certain statutory rights beyond the options that would otherwise have been available under the plan itself. The plan members must be notified of the wind-up and have their entitlements and options set out for them and given an opportunity to make their choices. The plan administrator must file a wind-up report which includes a statement of the plan's assets and liabilities, the benefits payable under the terms of the plan, and the method of allocating and distributing the assets including the priorities for the payment of benefits: PBA, s. 70(1), and R.R.O. 1990, Reg. 909, s. 29 (the "*PBA* Regulations").

127 Benefits to members may take the form of "cash refunds, immediate or deferred annuities, transfers to registered retirement saving plans, [etc.] ... In principle, the value of these benefits is the present value of the benefits accrued to the date of plan termination": The *Mercer Pension Manual* (loose-leaf), vol. 1, at p. 10-41. That present value is an actuarial calculation performed on the basis of various assumptions including assumptions about investment return, mortality and so forth.

128 If, when the assets and liabilities are calculated, the assets are insufficient to satisfy the liabilities, the employer (i.e. the plan sponsor) must make up for any wind-up deficiency: *PBA*, s. 75(1)(b). An employer can elect to space these payments out over the course of five years: *PBA* Regulations, s. 31(2). Because these payments are based on the extent to which there is a deficit between assets in the pension plan and the benefits owed to beneficiaries, their amount varies with the market and other assumed elements of the calculation over the course of the permitted five years.

129 To take the salaried plan as an example, at the time of wind-up, all regular current service contributions had been made: C.A. reasons, at para. 33. The wind-up deficiency was initially estimated to be $1,655,200. Indalex made special wind-up payments of $709,013 in 2007 and $875,313 in 2008, but as of December 31, 2008, the wind-up deficiency was $1,795,600 — i.e. higher than it had been two years before, notwithstanding that payments of roughly $1.6 million had been made: C.A. reasons, at para. 32. Indalex made another payment of $601,000 in April 2009: C.A. reasons, at para. 32.

(3) The Deemed Trust Provisions

130 The *PBA* contains provisions whose purpose is to exempt money owing to a pension plan, and which is held or owing by the employer, from being seized or attached by the employer's other creditors: Kaplan, at p. 395. This is accomplished by creating a "deemed trust" with respect to certain pension contributions such that these amounts are held by the employer in trust for the employees or pension beneficiaries.

131 There are two deemed trusts that we must examine here, one relating to employer contributions that are *due but have not been paid* and another relating to employer contributions *accrued but not due*. This second deemed trust is the one in issue here, but it is important to understand how the two fit together.

132 The deemed trust relating to employer contributions "due and not paid" is found in s. 57(3). The *PBA* and *PBA* regulations contain many provisions relating to contributions required by employers, the due dates for which are specified. Briefly, the required contributions are these.

133 When a pension is ongoing, employers need to make regular current service cost contributions. These are made monthly, within 30 days after the month to which they relate: *PBA* Regulations, s. 4(4)3. There are also special payments, which relate to deficiencies between a pension plan's assets and liabilities. There are "going-concern" deficiencies and "solvency" deficiencies, the distinction between which is unimportant for the purposes of these appeals. A plan administrator must regularly file actuarial reports, which may disclose deficiencies: *PBA* Regulations, s. 14. Where there is a going-concern deficiency the employer must make equal monthly payments over a 15-year period to rectify it: *PBA* Regulations, s. 5(1)(b). Where there is a solvency deficiency, the employer must make equal monthly payments over a five-year period to rectify it: *PBA* Regulations, s. 5(1)(e). Once these regular or special payments become due but have not been paid, they are subject to the s. 57(3) deemed trust.

134 I turn next to the s. 57(4) deemed trust, which gives rise to the question before us. The subsection provides that "[w]here a pension plan is wound up ... an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan *an amount of money equal to employer contributions accrued to the date of the wind up but not yet due* under the plan or regulations."

135 When a pension plan is wound up there will be an interrupted monthly payment period, which is sometimes referred to as the stub period. During this stub period regular and special liabilities will have accrued but not yet become due. Section 58(1) provides that money that an employer is required to pay "accrues on a daily basis". Because the amounts referred to in s. 57(4) are not yet due, they are not covered by the s. 57(3) deemed trust, which applies only to payments that are *due*. The two provisions, then, operate in tandem to create a trust over an employer's unfulfilled obligations, which are "due and not paid" as well as those which have "accrued to the date of the wind up but [are] not yet due".

(4) The Interpretative Approach

136 The issue we confront is one of statutory interpretation and the well-settled approach is that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87; *Bell ExpressVu Ltd. Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559 (S.C.C.), at para. 26. Taking this approach it is clear to me that the sponsor's obligation to pay a wind-up deficiency is not covered by the statutory deemed trust provided for in s. 57(4) of the *PBA*. In my view, the deficiency neither "accrued", nor did it arise within the period referred to by the words "to the date of the wind up".

(a) Grammatical and Ordinary Sense of the Words "Accrued" and "to the Date of the Wind Up"

137 The Court of Appeal failed to take sufficient account of the ordinary and grammatical meaning of the text of the provisions. It held that "the deemed trust in s. 57(4) applies *to all employer contributions that are required to be made pursuant to* s. 75": para. 101 (emphasis added). However, the plain words of the section show that this conclusion is erroneous. Section 75(1)(a) refers to liability for employer contributions that "*are due* ... and that have not been paid". These amounts are thus *not* included in the s. 57(4) deemed trust, because it addresses only amounts that have "accrued to the date of the wind up *but [are] not yet due*". Amounts "due" are covered by the s. 57(3) deemed trust and not, as the Court of Appeal concluded by the deemed trust created by s. 57(4). The Court of Appeal therefore erred in finding, in effect, that amounts which "are due" could be included in a deemed trust covering amounts "not yet due".

138 In my view, the most plausible grammatical and ordinary sense of the phrase "accrued to the date of the wind up" in s. 57(4) is that it refers to the sums that are ascertained immediately before the effective wind-up date of the plan.

139 In the context of s. 57(4), the grammatical and ordinary sense of the term "accrued" is that the amount of the obligation is "fully constituted" and "ascertained" although it may not yet be payable. The amount of the wind-up deficiency is not fully constituted or ascertained (or even ascertainable) before or even on the date fixed for wind up and therefore cannot fall under s. 57(4).

140 Of course, the meaning of the word "accrued" may vary with context. In general, when the term "accrued" is used in relation to legal rights, its common meaning is that the right has become fully constituted even though the monetary implications of its enforcement are not yet known or knowable. Thus, we speak of the "accrual" of a cause of action in tort when all of the elements of the cause of action come into existence, even though the extent of the damage may well not be known or knowable at that time: see, e.g., *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53 (S.C.C.). However, when the term is used in relation to a sum of money, it will generally refer to an amount that is at the present time either quantified or exactly quantifiable but which may or may not be due.

141 In some contexts, a liability is said to accrue when it becomes due. An accrued liability is said to be "properly chargeable" or "owing on a given day" or "completely constituted": see, e.g., *Black's Law Dictionary* (9th ed. 2009), at p. 997, "accrued liability"; D.A. Dukelow, *The Dictionary of Canadian Law* (4th ed. 2011), at p. 13, "accrued liability"; *Ontario Hydro-Electric Power Commission v. Albright* (1922), 64 S.C.R. 306 (S.C.C.).

142 In other contexts, an amount which has accrued may not yet be due. For example, we speak of "accrued interest" meaning a precise, quantified amount of interest that has been earned but may not yet be payable. The term "accrual" is used in the same way in "accrual accounting". In accrual method accounting, "transactions that give rise to revenue or costs are recognized in the accounts when they are earned and incurred respectively": B. J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes* (1983), at p. 44. Revenue is earned when the recipient "substantially completes performance of everything he or she is required to do as long as the amount due is ascertainable and there is no uncertainty about its collection": P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (7th ed., 2010), at s. 6.5(b); see also Canadian Institute of Chartered Accountants, *CICA Handbook — Accounting*, Part II, s. 1000, at paras. 41-44. In this context, the amount must be ascertained at the time of accrual.

143 The *Hydro-Electric Power Commission* case offers a helpful definition of the word "accrued" in this sense. On a sale of shares, the vendor undertook to provide on completion "a sum estimated by him to be equal to sinking fund payments [on the bonds and debentures] *which shall have accrued but shall not be due* at the time for completion": p. 344 (emphasis added). The bonds and debentures required the company to pay on July 1 of each year a fixed sum for each electrical horsepower sold and paid for during the preceding calendar year. A dispute arose as to what amounts were payable in this respect on completion. Duff J. held that in this context accrued meant "completely constituted", referring to this as a "well recognized usage": p. 312. He went on:

> Where ... a lump sum is made payable on a specified date and where, having regard to the purposes of the payment or to the terms of the instrument, this sum must be considered to be made up of an accumulation of sums in respect of which the right to receive payment is completely constituted before the date fixed for payment, then it is quite within the settled usage of lawyers to describe each of such accumulated parts as a sum accrued or accrued due before the date of payment: p. 316.

Thus, at every point at which a liability to pay a fixed sum arose under the terms of the contract, that liability accrued. It was fully constituted even though not yet due because the obligation to make the payment was in the future. In reaching this conclusion, Duff J. noted that the bonds and debentures used the word "accrued" in contrast to "due" and that this strengthened the interpretation of "accrued" as an obligation fully constituted but not yet payable. Similarly in s. 57(4), the word "accrued" is used in contrast to the word "due".

144 Given my understanding of the ordinary meaning of the word "accrued", I must respectfully disagree with my colleague, Justice Deschamps' position that the wind-up deficiency can be said to have "accrued" to the date of wind up. In her view, "[s]ince the employees cease to accumulate entitlements when the plan is wound up, the entitlements that are used to calculate the contributions have all been accumulated before the wind-up date" (para. 34) and "no new liabilities accrue at the time of or after the wind up" (para. 36). My colleague maintains that "[t]he fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes" (para. 37 referring to *Canadian Pacific Ltd. v. Ontario (Minister of Revenue)* (1998), 41 O.R. (3d) 606 (Ont. C.A.)).

145 I cannot agree that no new liability accrues on or after the wind up. As discussed in more detail earlier, the wind-up deficiency in s. 75(1)(b) is made up of the difference between the plan's assets and liabilities calculated as of the date of wind up. On wind up, the *PBA* accords statutory entitlements and protections to employees that would not otherwise be available: Kaplan, at p. 532. Wind up therefore gives rise to new liabilities. In particular, on wind up, and only on wind up, plan beneficiaries are entitled, under s. 74, to make elections regarding the payment of their benefits. The plan's liabilities cannot be determined until those elections are made. Contrary to what my colleague Justice Deschamps suggests, the extent of the wind-up deficiency depends on employee rights that arise only upon wind up and with respect to which employees make elections only after wind up.

146 Moreover, the wind-up deficiency will vary after wind up because the amount of money necessary to provide for the payment of the plan sponsor's liabilities will vary with the market. Section 31 of the *PBA* Regulations allows s. 75 payments to be spaced out over the course of five years. As we have seen, the amount of the wind-up deficiency will fluctuate over this period (I set out earlier how this amount in fact fluctuated markedly in the case of the salaried plan in issue here). Thus, while estimates are periodically made and reported after the wind up to determine how much the employer needs to pay, the precise amount of the wind-up deficiency is not ascertained or ascertainable on the date of the wind up.

147 I turn next to the ordinary and grammatical sense of the words "to the date of the wind up" in s. 57(4). In my view, these words indicate that only those contributions that accrue before the date of wind up, and not those amounts the liability for which arises only on the day of wind up — that is, the wind-up deficiency — are included.

148 Where the legislature intends to include the date of wind up, it has used suitable language to effect that purpose. For example, the English version of a provision amending the *PBA* in 2010 (c. 24, s. 21(2)), s. 68(2)(e), indicates which trade unions are entitled to notice of the wind up:

> (2) If the employer or the administrator, as the case may be, intends to wind up the pension plan, the administrator shall give written notice of the intended wind up to,
>
> . . . . .
>
> (c) each trade union that represents members of the pension plan or that, on the date of the wind up, represented the members, former members or retired members of the pension plan;

In contrast to the phrase "to the date of wind up", "on the date of wind up" clearly includes the date of wind up. (The French version does not indicate a different intention.) Similarly, s. 70(6), which formed part of the PBA until 2012 (rep. S.O. 2010, c. 9, s. 52(5)), read as follows:

> (6) On the partial wind up of a pension plan, members, former members and other persons entitled to benefits under the pension plan shall have rights and benefits that are not less than the rights and benefits they would have on a full wind up of the pension plan on the effective date of the partial wind up.

The words "on the effective date of the partial wind up" indicate that the members are entitled to those benefits from the date of the partial wind up, in the sense that members can claim their benefits beginning on the date of the wind up itself. This is how the legislature expresses itself when it wants to speak of a period of time including a specific date. By comparison, "to the date of the wind up" is devoid of language that would include the actual date of wind up. This conclusion is further supported by the structure of the PBA and its legislative history and evolution, to which I will turn shortly.

149 To sum up with respect to the ordinary and grammatical meaning of the phrase "accrued to the date of the wind up", the most plausible ordinary and grammatical meaning is that such amounts are fully constituted and precisely ascertained immediately before the date fixed as the date of wind up. Thus, according to the ordinary and grammatical meaning of the words, the wind-up deficiency obligation set out in s. 75(1)(b) has not "*accrued* to the date of the wind up" as required by s. 57(4). Moreover, the liability for the wind-up deficiency arises where a pension plan is wound up (s. 75(1)(b)) and so it cannot be a liability that "accrued *to the date of the wind up*" (s. 57(4)).

(b) The Scheme of the Act

150 As discussed earlier, s. 57 establishes deemed trusts over funds which must be contributed to a pension plan, including the one in s. 57(4), which is at issue here. It is helpful to consider these deemed trusts in the context of the obligations to pay funds which give rise to them. Specifically, the relationship between the deemed trust provisions in s. 57(3) and (4), on one hand, and s. 75(1), which sets out liabilities on wind up on the other. According to my colleague Justice Deschamps, s. 75(1) "elegantly parallels the wind-up deemed trust provision" (para. 42) such that the deemed trusts must include the wind-up deficiency. I disagree. In my view, the deemed trusts parallel only s. 75(1)(a), which does not relate to the wind-up deficiency. The correspondence between the deemed trusts and s. 75(1)(a), and the absence of any such correspondence with s. 75(1)(b), makes it clear that the wind-up deficiency is not covered by the deemed trust provisions.

151 I would recall here the difference between the deemed trusts created by s. 57(3) and (4). While a plan is ongoing, there may be payments which the employer is required to, but has failed to make. The s. 57(3) trust applies to these payments because they are "*due and not paid*". When a plan is wound up, however, there will be payments that are outstanding in the sense that they are fully constituted, but not yet due. This occurs with respect to the so-called stub period referred to earlier. During this stub period, regular and special liabilities will accrue on a daily basis, as provided for in s. 58(1), but may not be due at the time of wind up. While s. 57(3) cannot apply to these payments because they are not yet due, the deemed trust under s. 57(4) applies to these payments because liability for them has "accrued to the date of the wind up" and they are "*not yet due*".

152 The important point is how these two deemed trust provisions relate to the wind-up liabilities as described in ss. 75(1)(a) and 75(1)(b). The two paragraphs refer to sums of money that are different in kind: while s. 75(1)(a) refers to liabilities that accrue before wind up and that are created elsewhere in the Act, s. 75(1)(b) creates a completely new liability that comes into existence only once the plan is wound up. There is no dispute, as I understand it, that these two paragraphs refer to different

liabilities and that it is the liability described in s. 75(1)(b) that is the wind-up deficiency in issue here. The parties do not dispute that s. 75(1)(a) does *not* include wind-up deficiency payments.

153 It is striking how closely the text of s. 75(1)(a) — which does not relate to the wind-up deficiency — tracks the language of the deemed trust provisions in s. 57(3) and (4). As noted, s. 57(3) deals with "employer contributions due and not paid", while s. 57(4) deals with "employer contributions accrued to the date of the wind up but not yet due." Section 75(1)(a) includes both of these types of employer contributions. It refers to "payments that ... are due ... and that have not been paid" (i.e. subject to the deemed trust under s. 57(3)) or that have "accrued and that have not been paid" (i.e. subject to the deemed trust under s. 57(4) to the extent that these payments accrued to the date of wind up). This very close tracking of the language between s. 57(3) and (4) on the one hand and s. 75(1)(a) on the other, and the absence of any correspondence between the language of these deemed trust provisions with s. 75(1)(b), suggests that the s. 57(3) and (4) deemed trusts refer to the liability described in s. 75(1)(a) and not to the wind-up deficiency created by s. 75(1)(b). It is difficult to understand why, if the intention had been for s. 57(4) to capture the windup deficiency liability under s. 75(1)(b), the legislature would have so closely tracked the language of s. 75(1)(a) alone in creating the deemed trusts. Thus, in my respectful view, the elegant parallel to which my colleague, Justice Deschamps refers exists only between the deemed trust and s. 75(1)(a), and not between the deemed trust and the wind-up deficiency.

154 I conclude that the scheme of the *PBA* reinforces my conclusion that the ordinary grammatical sense of the words in s. 57(4) does not extend to the wind-up deficiency provided for in s. 75(1)(b).

(c) Legislative History and Evolution

155 Legislative history and evolution may form an important part of the overall context within which a provision should be interpreted. Legislative evolution refers to the various formulations of the provision while legislative history refers to evidence about the provision's conception, preparation and enactment: see, e.g., *Canada (Attorney General) v. Mowat*, 2011 SCC 53, [2011] 3 S.C.R. 471 (S.C.C.), at para. 43.

156 Both the legislative evolution and history of the *PBA* show that it was never the legislature's intention to include the wind-up deficiency in the deemed trust. The evolution and history of the *PBA* are rather intricate and sometimes difficult to follow so I will review them briefly here before delving into a more detailed analysis.

157 The deemed trust was first introduced into the *PBA* in 1973. At that time, it covered employee contributions held by the employer and employer contributions that were due but not paid. In 1980, the *PBA* was amended so that the deemed trust was expanded to include employer contributions whether they were due or not. Also, new provisions were added allowing for employee elections and requiring additional payments by the employer where a plan was wound up. The 1980 amendments gave rise to confusion on two fronts: first, it was unclear whether the payments that were required on wind up were subject to the deemed trust; second, it was unclear whether a lien over some employer contributions covered the same amount as the deemed trust. In 1983, both these points were clarified. The sections were reworded and rearranged to make it clear that the wind-up deficiency was distinct from the amounts covered by the deemed trust, and that the lien and the deemed trust covered the same amount. A statement by the responsible Minister in 1982 confirms that *the deemed trusts were never intended to cover the wind-up deficiency*.

158 My colleague, Justice Deschamps maintains that this history suggests an evolution in the intention of the legislature from protecting "only the service contributions that were due ... to all amounts due and accrued upon wind up" (para. 42). I respectfully disagree. In my view, the history and evolution of the *PBA* leading up to and including 1983 show that the legislature never intended to include the windup deficiency in the deemed trust. Moreover, legislative evolution after 1983 confirms that this intention did not change.

(i) The Pension Benefits Amendment Act, 1973, S.O. 1973, c. 113

159 So far as I can determine, statutory deemed trusts were first introduced into the *PBA* by *The Pension Benefits Amendment Act, 1973*, S.O. 1973, c. 113, s. 6. Those amendments created deemed trusts over two amounts: employee pension contributions received by employers (s. 23*a*(1), similar to the deemed trust in the current s. 57(1)) and employer contributions that had fallen

due under the plan (s. 23*a*(3), similar to the current s. 57(3) deemed trust for employer contributions "due and not paid"). The full text of these provisions and those referred to below, up to the current version of the 1990 Act, are found in the Appendix.

(ii) The Pension Benefits Amendment Act, 1980, S.O. 1980, c. 80

160 Ontario undertook significant pension reform leading to *The Pension Benefits Amendment Act, 1980*, S.O. 1980, c. 80; see Kaplan at pp. 54-56. I will concentrate on the deemed trust provisions and how they related to the liabilities on wind up and, for ease of reference, I will refer to the sections as they were renumbered in the 1980 consolidation: R.S.O. 1980, c. 373. The 1980 legislation expanded the deemed trust relating to employer contributions. Although far from clear, the new provisions appear to have created a deemed trust and lien over the employer contributions whether otherwise payable or not and calculated as if the plan had been wound up on the relevant date.

161 It was unclear after the reforms of 1980 whether the deemed trust applied to all employer contributions that arose on wind up. According to s. 23(4), on any given date, the trust extended to an amount to be determined "as if the plan had been wound up on that date". However, the provisions of the 1980 version of the Act did not explicitly state what such a calculation would include. Under s. 21(2) of the 1980 statute, the employer was obligated to pay on wind up "all amounts that would otherwise have been required to be paid to meet the tests for solvency ..., up to the date of such termination or winding up". Under s. 32, however, the employer had to make a payment on wind up that was to be "[i]n addition" to that due under s. 21(2). Whether the legislature intended that the trust should cover this latter payment was left unclear.

162 It was also unclear whether the lien applied to a different amount than was subject to the deemed trust. According to s. 23(3), "the members have a lien upon the assets of the employer in such amount that in the ordinary course of business would be entered into the books of account whether so entered or not". This comes in the middle of two portions of the provision which explicitly refer to the deemed trust, but it is not clear whether the legislature intended to refer to the same amount throughout the provision.

(iii) The Pension Benefits Amendment Act, 1983, S.O. 1983, c. 2

163 The 1983 amendments substantially clarified the scope of the deemed trust and lien for employer contributions. They make clear that neither the deemed trust nor the lien applied to the wind-up deficiency; the responsible Minister confirmed that this was the intention of the amendments.

164 The new provision was amended by s. 3 of the 1983 amendments and is found in s. 23(4) which provided:

> (4) An employer who is required by a pension plan to contribute to the pension plan shall be deemed to hold in trust for the members of the pension plan an amount of money equal to the total of,
>
> (a) all moneys that the employer is required to pay into the pension plan to meet,
>
> (i) <u>the current service cost</u>, and
>
> (ii) <u>the special payments</u> prescribed by the regulations,
>
> that are due under the pension plan or the regulations and have not been paid into the pension plan; and
>
> (b) <u>where the pension plan is terminated or wound up, any other money that the employer is liable to pay under clause 21 (2) (a)</u>.

Section 21(2)(a) provides that on wind up, the employers must pay an amount equal to *the current service cost and the special payments* that "have accrued to and including the date of the termination winding up but, under the terms of the pension plan or the regulations, are not due on that date"; the provision adds that these amounts shall be deemed to accrue on a daily basis. These provisions make it clear that the s. 23(4) deemed trust applies only to the special payments and current service costs that have accrued, on a daily basis, up to and including the date of wind up. The deemed trust clearly does not extend to the wind-up deficiency.

165 The provision referring to the additional payments required on wind up also makes clear that those payments are not within the scope of the deemed trust. These additional liabilities were described by s. 32, a provision very similar to s. 75(1)(b). These amounts are first, the amount guaranteed by the Guarantee Fund and, second, the value of pension benefits vested under the plan that exceed the value of the assets of the plan. Section 32(2) specifies that these amounts *are "in addition* to the amounts that the employer is liable to pay under subsection 21(2)" (which are the payments comparable to the current s. 75(1)(a) payments) and that *only the latter* fall within the deemed trust. The inevitable conclusion is that, in 1983, the wind-up deficiency was not included in the scope of the deemed trust.

166 The 1983 amendments also clarified the scope of the lien. They indicated that the scope of the lien was identical to the scope of the deemed trust. Section 23(5) specified that the lien extended only to the amounts that were deemed to be held in trust under s. 23(4) (i.e. the *current service costs and special payments that had accrued to and including the date of the wind up but are not yet due)*.

167 This makes two things clear: that the lien covers the same amounts as the deemed trust, and that neither covers the wind-up deficiency.

168 A brief, but significant piece of legislative history seems to me to dispel any possible doubt. In speaking at first reading of the 1983 amendments, the Minister responsible, the Honourable Robert Elgie said this:

> The first group of today's amendments makes up the housekeeping changes needed for us to do what we set out to do in late 1980; that is, to guarantee pension benefits following the windup of a defined pension benefit plan. These amendments will clarify the ways in which we can attain that goal.
>
> In Bill 214 [i.e. the 1980 amendments] the employees were given a lien on the employer's assets for employee contributions to a pension plan collected by the employer, as well as accrued employer contributions....
>
> Unfortunately, this protection has resulted in different legal interpretations on the extent of the lien. <u>An argument has been advanced that the amount of the lien includes an employer's potential future liability on the windup of a pension plan. This was never intended and is not necessary to provide the required protection. The amendment to section 23 clarified the intent of Bill 214.</u> [Emphasis added.]
>
> (*Legislature of Ontario Debates: Official Report (Hansard)*, No. 99, 2nd Sess., 32nd Parl., July 7, 1982, p. 3568)

The 1983 amendments made the scope of the lien correspond precisely to the scope of the deemed trust over the employer's accrued contributions. It is thus clear from this statement that it was never the legislative intention that either should apply to "an employer's potential future liability" on wind up (i.e. the wind-up deficiency). In 1983, there is therefore, in my view, virtually irrefutable evidence of legislative intent to do exactly the opposite of what the Court of Appeal held in this case had been done.

169 Subsequent legislative evolution shows no change in this legislative intent. In fact, subsequent amendments demonstrate a clear legislative intent to exclude from the deemed trust employer liabilities that arise only upon wind up of the plan.

(iv) Pension Benefits Act, 1987, S.O. 1987, c. 35

170 Amendments to the PBA in 1987 resulted in it being substantially in its current form. With those amendments, the extent of the deemed trusts was further clarified. The provision in the 1983 version of the Act combined within a single subsection a deemed trust for employer contributions that were due and not paid (s. 23(4)(a)) and employer contributions that had accrued to and including the date of wind up but which were not yet due (s. 23(4)(b), referring to s. 21(2)(a)). In the 1987 amendments, these two trusts were each given their own subsection and their scope was further clarified. Moreover, after the 1987 revision, one no longer had to refer to a separate provision (formerly s. 21(2)(a)) to determine the scope of the trust covering payments that were accrued but not yet due. Thus, while the substance of the provisions did not change in 1987, their form was simplified.

171 The new s. 58(3) (which is exactly the same as the current s. 57(3)) replaced the former s. 23(4)(a). This created a trust for employer contributions due and not paid. Section 58(4) (which is exactly the same as s. 57(4) stood at the time) replaced the former s. 23(4)(b) and part of s. 21(2)(a) and created a trust that arises on wind up and covers "employer contributions accrued *to the date of the wind up* but not yet due".

172 The 1987 amendment also shows that the legislature adverted to the difference between "to the date of the wind up" and "to and including" the date of wind up and chose the former. This is reflected in a small but significant change in the wording of the relevant provisions. The former provision, s. 23(4)(b), by referring to s. 21(2)(a) captured current service costs and special payments that "have *accrued to and including* the date of the termination or winding up." The new version in s. 58(4) deletes the words "and including", putting the section in its present form. This deletion, to my way of thinking, reinforces the legislative intent to *exclude* from the deemed trust liabilities that arise only *on* the date of wind up. Respectfully, the legislative record does not support Deschamps J.'s view that there was a legislative evolution towards a more expanded deemed trust. Quite the opposite.

173 To sum up, I draw the following conclusions from this review of the legislative evolution and history. The legislation differentiates between two types of employer liability relevant to this case. The first is the contributions required to cover current service costs and any other payments that are either due or have accrued on a daily basis up to the relevant time. These are the payments referred to in the current s. 75(1)(a), that is, payments due or accrued but not paid. The second relates to additional contributions required when a plan is wound up which I have referred to as the wind-up deficiency. These payments are addressed in s. 75(1)(b). The legislative history and evolution show that the deemed trusts under s. 57(3) and (4) were intended to apply only to the former amounts and that it was never the intention that there should be a deemed trust or a lien with respect to an employer's potential future liabilities that arise once the plan is wound up.

(d) The Purpose of the Legislation

174 Excluding the wind-up deficiency from the deemed trust is consistent with the broader purposes of the legislation. Pension legislation aims at important protective purposes. These protective purposes, however, are not pursued at all costs and are clearly intended to be balanced with other important interests within the context of a carefully calibrated scheme: *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, 2004 SCC 54, [2004] 3 S.C.R. 152 (S.C.C.), at paras. 13-14.

175 In this instance, the legislature has created trusts over contributions that were due or accrued to the date of the wind up in order to protect, to some degree, the rights of pension plan beneficiaries and employees from the claims of the employer's other creditors. However, there is also good reason to think that the legislature had in mind other competing objectives in not extending the deemed trust to the wind-up deficiency.

176 First, if there were to be a deemed trust over all employer liabilities that arise when a plan is wound up, much simpler and clearer words could readily be found to achieve that objective.

177 Second, extending the deemed trust protections to the wind-up deficiency might well be viewed as counter-productive in the greater scheme of things. A deemed trust of that nature might give rise to considerable uncertainty on the part of other creditors and potential lenders. This uncertainty might not only complicate creditors' rights, but it might also affect the availability of funds from lenders. The wind-up liability is potentially large and, while the business is ongoing, the extent of the liability is unknown and unknowable for up to five years. Its amount may, as the facts of this case disclose, fluctuate dramatically during this time. A liability of this nature could make it very difficult to assess the creditworthiness of a borrower and make an appropriate apportionment of payment among creditors extremely difficult.

178 While I agree that the protection of pension plans is an important objective, it is not for this Court to decide the extent to which that objective will be pursued and at what cost to other interests. In her conclusion, Justice Deschamps notes that although the protection of pension plans is a worthy objective, courts should not use the law of equity to re-arrange the priorities that Parliament has established under the CCAA. This is a matter of policy where courts must defer to legislatures (reasons of Justice Deschamps, at para. 82). In my view, my colleague's comments on this point are equally applicable to the policy decisions reflected in the text of the PBA. The decision as to the level of protection that should be provided to pension beneficiaries is

one to be left to the Ontario legislature. Faced with the language in the PBA, I would be slow to infer that the broader protective purpose, with all its potential disadvantages, was intended. In short, the interpretation I would adopt is consistent with a balanced approach to protection of benefits which the legislature intended.

179 For these reasons, I am of the respectful view that the Court of Appeal erred in finding that the s. 57(4) deemed trust applied to the wind-up deficiency.

B. Second Issue: Did the Court of Appeal Err in Finding That Indalex Breached the Fiduciary Duties it Owed to the Pension Beneficiaries as the Plans' Administrator and in Imposing a Constructive Trust as a Remedy?

(1) Introduction

180 The Court of Appeal found that during the CCAA proceedings Indalex breached its fiduciary obligations as administrator of the pension plans: para. 116. As a remedy, it imposed a remedial constructive trust over the reserve fund, effectively giving the plan beneficiaries recovery of 100 cents on the dollar in priority to all other creditors, including creditors entitled to the super priority ordered by the CCAA court.

181 The breaches identified by the Court of Appeal fall into three categories. First, Indalex breached the prohibition against a fiduciary being in a position of conflict of interest because its interests in dealing with its insolvency conflicted with its duties as plan administrator to act in the best interests of the plans' members and beneficiaries: para. 142. According to the Court of Appeal, the simple fact that Indalex found itself in this position of conflict of interest was, of itself, a breach of its fiduciary duty as plan administrator. Second, Indalex breached its fiduciary duty by applying, without notice to the plans' beneficiaries, for CCAA protection: para. 139. Third, Indalex breached its fiduciary duty by seeking and/or obtaining various relief in the CCAA proceedings including the "super priority" in favour of the DIP lenders, approval of the sale of the business knowing that no payment would be made to the underfunded plans over the statutory deemed trusts and seeking to be put into bankruptcy with the intention of defeating the deemed trust claims: para. 139. As a remedy for these breaches of fiduciary duty the court imposed a constructive trust.

182 In my view, the Court of Appeal took much too expansive a view of the fiduciary duties owed by Indalex as plan administrator and found breaches where there were none. As I see it, the only breach of fiduciary duty committed by Indalex occurred when, upon insolvency, Indalex's corporate interests were in obvious conflict with its fiduciary duty as plan administrator to ensure that all contributions were made to the plans when due. The breach was not in failing to avoid this conflict — the conflict itself was unavoidable. Its breach was in failing to address the conflict to ensure that the plan beneficiaries had the opportunity to have representation in the CCAA proceedings as if there were independent plan administrators. I also conclude that a remedial constructive trust is not available as a remedy for this breach.

183 This part of the appeals requires us to answer two questions which I will address in turn:

(i) What fiduciary duties did Indalex have in its role as plan administrator and did it breach them?

(ii) If so, was imposition of a constructive trust an appropriate remedy?

(2) What Fiduciary Duties did Indalex Have in its Role as Plan Administrator and Did it Breach Those Duties?

(a) Legal Principles

184 The appellants do not dispute that Indalex, in its role of administrator of the plans, had fiduciary duties to the members of the plan and that when it is acting in that role it can only act in the interests of the plans' beneficiaries. It is not necessary for present purposes to decide whether a pension plan administrator is a *per se* or *ad hoc* fiduciary, although it must surely be rare that a pension plan administrator would not have fiduciary duties in carrying out that role: *Burke v. Hudson's Bay Co.*, 2010 SCC 34, [2010] 2 S.C.R. 273 (S.C.C.), at para. 41, aff'g 2008 ONCA 394, 67 C.C.P.B. 1 (Ont. C.A.), at para. 55.

185 However, the conclusion that Indalex as plan administrator had fiduciary duties to the plan beneficiaries is the beginning, not the end of the inquiry. This is because fiduciary duties do not exist at large, but arise from and relate to the specific legal interests at stake: *Elder Advocates of Alberta Society v. Alberta*, 2011 SCC 24, [2011] 2 S.C.R. 261 (S.C.C.), at para. 31. As La Forest J. put it in *International Corona Resources Ltd. v. LAC Minerals Ltd.*, [1989] 2 S.C.R. 574 (S.C.C.):

> The obligation imposed [on a fiduciary] may vary in its specific substance depending on the relationship ... [N]ot every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for breach of fiduciary duty.... It is only in relation to breaches of the specific obligations imposed because the relationship is one characterized as fiduciary that a claim for breach of fiduciary duty can be founded.
>
> [Emphasis added; pp. 646-47.]

186 The nature and scope of the fiduciary duty must, therefore, be assessed in the legal framework governing the relationship out of which the fiduciary duty arises: see, e.g., *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23, [2011] 2 S.C.R. 175 (S.C.C.), at para. 141; *Perez v. Galambos*, 2009 SCC 48, [2009] 3 S.C.R. 247 (S.C.C.), at paras. 36-37; *B. (K.L.) v. British Columbia*, 2003 SCC 51, [2003] 2 S.C.R. 403 (S.C.C.), at para. 41. So, for example, as a general rule, a fiduciary has a duty of loyalty including the duty to avoid conflicts of interest: see, e.g., *3464920 Canada Inc. v. Strother*, 2007 SCC 24, [2007] 2 S.C.R. 177 (S.C.C.), at para. 35; *Lac Minerals*, at pp. 646-47. However, this general rule may have to be modified in light of the legal framework within which a particular fiduciary duty must be exercised. In my respectful view, this is such a case.

(b) The Legal Framework of Indalex's Dual Role as a Plan Administrator and Employer

187 In order to define the nature and scope of Indalex's role and fiduciary obligations as a plan administrator, we must examine the legal framework within which the administrator functions. This framework is established primarily by the plan documents and the relevant provisions of the *PBA*. It is to these sources, first and foremost, that we look in order to shape the specific fiduciary duties owed in this context.

188 Turning first to the plan documents, I take the salaried plan as an example. Under it, the company is appointed the plan administrator: art. 13.01. The term "Company" is defined to mean Indalex Limited and any reference in the plan to actions taken or discretion to be exercised by the Company means Indalex acting through the board of directors or any person authorized by the board for the purposes of the plan: art. 2.09. Article 13.01 provides that the "Management Committee of the Board of Directors of the Company will appoint a Pension and Benefits Committee to act on behalf of the Company in its capacity as administrator of the Plan. The Pension and Benefits Committee will decide conclusively all matters relating to the operation, interpretation and application of the Plan." Thus, the Pension and Benefits Committee is to act on behalf of the company and by virtue of art. 2.09 its acts are considered those of the company. Article 13.02 sets out the duties of the Pension and Benefits Committee which include the "performance of all administrative functions not performed by the Funding Agent, the Actuary or any group annuity contract issuer": art. 13.02(1).

189 The plan administrator also has statutory powers and duties by virtue of the *PBA*. Section 22 lists the general duties of plan administrators, three of which are particularly relevant to these appeals:

> **22.** (1) [Care, diligence and skill] The administrator of a pension plan shall exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.
>
> (2) [Special knowledge and skill] The administrator of a pension plan shall use in the administration of the pension plan and in the administration and investment of the pension fund all relevant knowledge and skill that the administrator possesses or, by reason of the administrator's profession, business or calling, ought to possess.
>
> . . . .

(4) [Conflict of interest] An administrator or, if the administrator is a pension committee or a board of trustees, a member of the committee or board that is the administrator of a pension plan shall not knowingly permit the administrator's interest to conflict with the administrator's duties and powers in respect of the pension fund.

190 Not surprisingly, the powers and duties conferred on the administrator by the legislation are administrative in nature. For the most part they pertain to the internal management of the pension fund and to the relationship among the pension administrator, the beneficiaries, and the Superintendent of Financial Services ("Superintendent"). The list includes: applying to the Superintendent for registration of the plan and any amendments to it as well as filing annual information returns: ss. 9, 12 and 20 of the *PBA*; providing beneficiaries and eligible potential beneficiaries with information and documents: ss. 10(1)12 and 25; ensuring that the plan is administered in accordance with the *PBA* and its regulations and plan documents: s. 19; notifying beneficiaries of proposed amendments to the plan that would reduce benefits: s. 26; paying commuted value for pensions: s. 42; and filing wind-up reports if the plan is terminated: s. 70.

191 Of special relevance for this case are two additional provisions. Under s. 56, the administrator has a duty to ensure that pension payments are made when due and to notify the Superintendent if they are not and, under s. 59, the administrator has the authority to commence court proceedings when pension payments are not made.

192 The fiduciary duties that employer-administrators owe to plan beneficiaries relate to the statutory and other tasks described above; these are the "specific legal interests" with respect to which the employer-administrator's fiduciary duties attach.

193 Another important aspect of the legal context for Indalex's fiduciary duties as a plan administrator is that it was acting in the dual role of an employer-administrator. This dual role is expressly permitted under s. 8(1)(a) of the *PBA*, but this provision creates a situation where a single entity potentially owes two sets of fiduciary duties (one to the corporation and the other to the plan members).

194 This was the case for Indalex. As an employer-administrator, Indalex acted through its board of directors and so it was that body which owed fiduciary duties to the plan members. The board of directors also owed a fiduciary duty to the company to act in its best interests: *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 122(1)(*a*); *BCE Inc., Re*, 2008 SCC 69, [2008] 3 S.C.R. 560 (S.C.C.), at para. 36. In deciding what is in the best interests of the corporation, a board may look to the interests of shareholders, employees, creditors and others. But where those interests are not aligned or may conflict, it is for the directors, acting lawfully and through the exercise of business judgment, to decide what is in the overall best interests of the corporation. Thus, the board of Indalex, as an employer-administrator, could not always act exclusively in the interests of the plan beneficiaries; it also owed duties to Indalex as a corporation.

(c) Breaches of Fiduciary Duty

195 Against the background of these legal principles, I turn to consider the Court of Appeal's findings in relation to Indalex's breach of its fiduciary duties as administrator of the plans. As noted, they fall into three categories: being in a conflict of interest position; taking steps to reduce pension obligations in the *CCAA* proceedings; and seeking bankruptcy status.

(i) Conflict of Interest

196 The questions here are first what constitutes a conflict of interest or duty between Indalex as business decision-maker and Indalex as plan administrator and what must be done when a conflict arises?

197 The Court of Appeal in effect concluded that a conflict of interest arises whenever Indalex makes business decisions that have "the potential to affect the Plans beneficiaries' rights" (para. 132) and that whenever such a conflict of interest arose, the employer-administrator was immediately in breach of its fiduciary duties to the plan members. Respectfully, this position puts the matter far too broadly. It cannot be the case that a conflict arises simply because the employer, exercising its management powers in the best interests of the corporation, does something that has the potential to affect the plan beneficiaries.

198 This conclusion flows inevitably from the statutory context. The existence of apparent conflicts that are inherent in the two roles being performed by the same party cannot be a breach of fiduciary duty because those conflicts are specifically authorized by the statute which permits one party to play both roles. As noted earlier, the PBA specifically permits employers to act as plan administrators (s. 8(1)(a)). Moreover, the broader business interests of the employer corporation and the interests of pension beneficiaries in getting the promised benefits are almost always at least potentially in conflict. Every important business decision has the potential to put at risk the solvency of the corporation and therefore its ability to live up to its pension obligations. The employer, within the limits set out in the plan documents and the legislation generally, has the authority to amend the plan unilaterally and even to terminate it. These steps may well not serve the best interests of plan beneficiaries.

199 Similarly, the simple existence of the sort of conflicts of interest identified by the Court of Appeal — those inherent in the employer's exercise of business judgment — cannot of themselves be a breach of the administrator's fiduciary duty. Once again, that conclusion is inconsistent with the statutory scheme that expressly permits an employer to act as plan administrator.

200 How, then, should we identify conflicts of interest in this context?

201 In *R. v. Neil*, 2002 SCC 70, [2002] 3 S.C.R. 631 (S.C.C.), Binnie J. referred to the *Restatement Third, The Law Governing Lawyers* (2000), at § 121, to explain when a conflict of interest occurs in the context of the lawyer-client relationship: para. 31. In my view, the same general principle, adapted to the circumstances, applies with respect to employer-administrators. Thus, a situation of conflict of interest occurs when there is a substantial risk that the employer-administrator's representation of the plan beneficiaries would be materially and adversely affected by the employer-administrator's duties to the corporation. I would recall here, however, that the employer-administrator's obligation to represent the plan beneficiaries extends only to those tasks and duties that I have described above.

202 In light of the foregoing, I am of the view that the Court of Appeal erred when it found, in effect that a conflict of interest arose whenever Indalex was making decisions that "had the potential to affect the Plans beneficiaries' rights": para. 132. The Court of Appeal expressed both the potential for conflict of interest or duty and the fiduciary duty of the plan administrator much too broadly.

(ii) Steps in the CCAA Proceedings to Reduce Pension Obligations and Notice of Them

203 The Court of Appeal found that Indalex breached its fiduciary duty simply by commencing CCAA proceedings knowing that the plans were underfunded and by failing to give the plan beneficiaries notice of the proceedings: para. 139. As I understand the court's reasons, the decision to commence CCAA proceedings was solely the responsibility of the corporation and not part of the administration of the pension plan: para. 131. The difficulty which the Court of Appeal saw arose from the potential of the CCAA proceedings to result in a reduction of the corporation's pension obligations to the prejudice of the beneficiaries: paras. 131-32.

204 I respectfully disagree. Like Justice Deschamps, I find that seeking an initial order protecting the corporation from actions by its creditors did not, on its own, give rise to any conflict of interest or duty on the part of Indalex (reasons of Justice Deschamps, at para. 72).

205 First, it is important to remember that the purpose of CCAA proceedings is not to disadvantage creditors but rather to try to provide a constructive solution for all stakeholders when a company has become insolvent. As my colleague, Deschamps J. observed in *Century Services*, at para. 15:

> ... the purpose of the CCAA ... is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets.

In the same decision, at para. 59, Deschamps J. also quoted with approval the following passage from the reasons of Doherty J.A. in *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57 (dissenting):

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.

For this reason, I would be very reluctant to find that, simply by virtue of embarking on *CCAA* proceedings, an employer-administrator breaches its duties to plan members.

206 Second, the facts of this case do not support the contention that the interests of the plan beneficiaries and the employer were in conflict with respect to the decision to seek *CCAA* protection. It cannot seriously be suggested that some other course would have protected more fully the rights of the plan beneficiaries. The Court of Appeal did not suggest an alternative to seeking *CCAA* protection from creditors, nor did any of the parties. Indalex was in serious financial difficulty and its options were limited: either make a proposal to its creditors (under the *CCAA* or under the *BIA*), or go bankrupt. Moreover, the plan administrator's duty and authority do not extend to ensuring the solvency of the corporation and an independent administrator could not reasonably expect to be consulted about the plan sponsor's decision to seek *CCAA* protection. Finally, the application for *CCAA* proceedings did not reduce pension obligations other than to temporarily relieve the corporation of making special payments and it was the only step with any prospect of the pension funds obtaining from the insolvent corporation the money that would become due. There was thus no conflict of duty or interest between the administrator and the employer when protective action was taken for the purpose of preserving the *status quo* for the benefit of all stakeholders.

207 The Court of Appeal also found that it was a breach of fiduciary duty not to give the plan beneficiaries notice of the initial application for *CCAA* protection. Again, here, I must join Deschamps J. in disagreeing with the Court of Appeal's conclusion. Section 11(1) of the *CCAA* as it stood at the time of the proceedings, provided that parties could commence *CCAA* proceedings without giving notice to interested persons:

> **11.** (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

208 This provision was renumbered but not substantially changed when the Act was amended in September of 2009 (S.C. 2005, c. 47, s. 128, in force Sept. 18, 2009, SI/2009-68). Although it is not appropriate in every case, *CCAA* courts have discretion to make initial orders on an *ex parte* basis. This may be an appropriate — even necessary — step in order to prevent "creditors from moving to realize on their claims, essentially a 'stampede to the assets' once creditors learn of the debtor's financial distress": J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at p. 55 ("*Rescue!*"); see also *Algoma Steel Inc., Re* (2001), 25 C.B.R. (4th) 194 (Ont. C.A.), at para. 7. The respondents did not challenge Morawetz J.'s decision to exercise his discretion to make an *ex parte* order in this case.

209 This is not to say, however, that *ex parte* initial orders will always be required or acceptable. Without attempting to be exhaustive or to express any final view on these issues, I simply note that there have been at least three ways in which courts have mitigated the possible negative effect on creditors of making orders without notice to potentially affected parties. First, courts have been reluctant to grant *ex parte* orders where the situation of the debtor company is not urgent. In *Rescue!*, Janis Sarra explains that courts are increasingly expecting applicants to have given notice before applying for a stay under the *CCAA*: p. 55. An example is *Marine Drive Properties Ltd., Re*, 2009 BCSC 145, 52 C.B.R. (5th) 47 (B.C. S.C.), a case in which Butler J. held that "[i]nitial applications in *CCAA* proceedings should not be brought without notice merely because it is an application under that Act. The material before the court must be sufficient to indicate an emergent situation": para. 27. Second, courts have included "come-back" clauses in their initial orders so that parties could return to court at a later date to seek to set aside some or all of the order: *Rescue!*, at p. 55. Note that such a clause was included in the initial order by Morawetz J.: para. 46. Finally, courts have limited their initial orders to the issues that need to be resolved immediately and have left other issues to be resolved after all interested parties have been given notice. Thus, in *Timminco Ltd., Re*, 2012 ONSC 506, 85 C.B.R. (5th) 169 (Ont. S.C.J. [Commercial List]), Morawetz J. limited the initial *CCAA* order so that priorities were only granted over the party that had been given notice. The discussion of suspending special payments or granting creditors priority over pension

beneficiaries was left to a later date, after the parties that would be affected had been given notice. A similar approach was taken in the case of *AbitibiBowater Inc., Re*, 2009 QCCS 6459 (C.S. Que.). In his initial CCAA order, Gascon J. put off the decision regarding the suspension of past service contributions or special payments to the pension plans in question until the parties likely to be affected could be advised of the applicant's request: para. 7.

210 Failure to give notice of the initial CCAA proceedings was not a breach of fiduciary duty in this case. Indalex's decision to act as an employer-administrator cannot give the plan beneficiaries any greater benefit than they would have if their plan was managed by a third party administrator. Had there been a third party administrator in this case, Indalex would not have been under an obligation to tell the administrator that it was planning to enter CCAA proceedings. The respondents are asking this Court to give the advantage of Indalex's knowledge as employer to Indalex as the plan administrator in circumstances where the employer would have been unlikely to disclose the information itself. I am not prepared to blur the line between employers and administrators in this way.

211 I conclude that Indalex did not breach its fiduciary duty by commencing CCAA proceedings or by not giving notice to the plan beneficiaries of its intention to seek the initial CCAA order.

212 I turn next to the Court of Appeal's conclusion that seeking and obtaining the DIP orders without notice to the plan beneficiaries and seeking and obtaining the sale approval order constituted breaches of fiduciary duty.

213 To begin, I agree with the Court of Appeal that "just because the initial decision to commence CCAA proceedings is solely a corporate one ... does not mean that all subsequent decisions made during the proceedings are also solely corporate ones": para. 132. It was at this point that Indalex's interests as a corporation came into conflict with its duties as a pension plan administrator.

214 The DIP orders could easily have the effect of making it impossible for Indalex to satisfy its funding obligations to the plan beneficiaries. When Indalex, through the exercise of business judgment, sought CCAA orders that would or might have this effect, it was in conflict with its duty as plan administrator to ensure that all contributions were paid when due.

215 I do not think, however, that the simple existence of this conflict of interest and duty, on its own, was a breach of fiduciary duty in these circumstances. As discussed earlier, the PBA expressly permits an employer to be a pension administrator and the statutory provisions about conflict of interest must be understood and applied in light of that fact. Moreover, an independent plan administrator would have no decision-making role with respect to the conduct of CCAA proceedings. So in my view, the difficulty that arose here was not the existence of the conflict itself, but Indalex's failure to take steps so that the plan beneficiaries would have the opportunity to have their interests protected in the CCAA proceedings as if the plans were administered by an independent administrator. In short, the difficulty was not the existence of the conflict, but the failure to address it.

216 Despite Indalex's failure to address its conflict of interest, the plan beneficiaries, through their own efforts, were represented at subsequent steps in the CCAA proceedings. The effect of Indalex's breach was therefore mitigated, a point which I will discuss in greater detail when I turn to the issue of the constructive trust.

217 Nevertheless, for the purposes of providing some guidance for future CCAA proceedings, I take this opportunity to briefly address what an employer-administrator can do to respond to these sorts of conflicts. First and foremost, an employer-administrator who finds itself in a conflict must bring the conflict to the attention of the CCAA judge. It is not enough to include the beneficiaries in the list of creditors; the judge must be made aware that the debtor, as an administrator of the plan is, or may be, in a conflict of interest.

218 Given their expertise and their knowledge of particular cases, CCAA judges are well placed to decide how best to ensure that the interests of the plan beneficiaries are fully represented in the context of "real-time" litigation under the CCAA. Knowing of the conflict, a CCAA judge might consider it appropriate to appoint an independent administrator or independent counsel as *amicus curiae* on terms appropriate to the particular case. Indeed, there have been cases in which representative counsel have been appointed to represent tort claimants, clients, pensioners and non-unionized employees in CCAA proceedings on terms determined by the judge: *Rescue!*, at p. 278; see, e.g., *First Leaside Wealth Management Inc., Re*, 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]); *Nortel Networks Corp., Re* (2009), 75 C.C.P.B. 206 (Ont. S.C.J. [Commercial List]). In other

circumstances, a CCAA judge might find that it is feasible to give notice directly to the pension beneficiaries. In my view, notice, though desirable, may not always be feasible and decisions on such matters should be left to the judicial discretion of the CCAA judge. Alternatively, the judge might consider limiting draws on the DIP facility until notice can be given to the beneficiaries: *Royal Oak Mines Inc., Re* (1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]), at para. 24. Ultimately, the appropriate response or combination of responses should be left to the discretion of the CCAA judge in a particular case. The point, as well expressed by the Court of Appeal, is that the insolvent corporation which is also a pension plan administrator cannot "simply ignore its obligations as the Plans' administrator once it decided to seek CCAA protection": para. 132.

219 I conclude that the Court of Appeal erred in finding that Indalex breached its fiduciary duties as plan administrator by taking the various steps it did in the CCAA proceedings. However, I agree with the Court of Appeal that it breached its fiduciary duty by failing to take steps to ensure that the plan beneficiaries had the opportunity to be as fully represented in those proceedings as if there had been an independent plan administrator.

(iii) The Bankruptcy Motion

220 At the same time Indalex applied for the sale approval order, it also applied to lift the CCAA stay so that it could file an assignment into bankruptcy. As Campbell J. put it, this was done "to ensure the priority regime [it] urged as the basis for resisting the deemed trust": para. 52. The Court of Appeal concluded that this was a breach of Indalex's fiduciary duties because the motion was brought "with the intention of defeating the deemed trust claims and ensuring that the Reserve Fund was transferred to [the U.S. debtors]": para. 139. I respectfully disagree.

221 It was certainly open to Indalex as an employer to bring a motion to voluntarily enter into bankruptcy. A pension plan administrator has no responsibility or authority in relation to that step. The problem here is not that the motion was brought, but that Indalex failed to meaningfully address the conflict between its corporate interests and its duties as plan administrator.

222 To sum up, I conclude that Indalex did not breach any fiduciary duty by undertaking CCAA proceedings or seeking the relief that it did. The breach arose from Indalex's failure to ensure that its pension plan beneficiaries had the opportunity to have their interests effectively represented in the insolvency proceedings, particularly when Indalex sought the DIP financing approval, the sale approval and the motion for bankruptcy.

(3) Was Imposing a Constructive Trust Appropriate in This Case?

223 The next issue is whether a remedial constructive trust is, as the Court of Appeal concluded, an appropriate remedy in response to the breach of fiduciary duty.

224 The Court of Appeal exercised its discretion to impose a constructive trust and its exercise of this discretion is entitled to deference. Only if the discretion has been exercised on the basis of an erroneous principle should the order be overturned on appeal: *Donkin v. Bugoy*, [1985] 2 S.C.R. 85 (S.C.C.), cited in *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.), at para. 54, by Sopinka J. (dissenting, but not on this point). In my respectful view, the Court of Appeal's erroneous conclusions about the scope of a plan administrator's fiduciary duties require us to examine the constructive trust issue anew. Moreover, the Court of Appeal, in my respectful opinion, erred in principle in finding that the asset in this case resulted from the breach of fiduciary duty such that it would be unjust for the party in breach to retain it.

225 As noted earlier, the Court of Appeal imposed a constructive trust in favour of the plan beneficiaries with respect to funds retained in the reserve fund equal to the total amount of the wind-up deficiency for both plans. In other words, upon insolvency of Indalex, the plan beneficiaries received 100 cents on the dollar as a result of a judicially imposed trust taking priority over secured creditors, and indeed over other unsecured creditors, assuming there was no deemed trust for the executive plan.

226 I have explained earlier why I take a different view than did the Court of Appeal of Indalex's breach of fiduciary duty. In light of what I conclude was the breach which could give rise to a remedy, my view is that the constructive trust cannot properly be imposed in this case and the Court of Appeal erred in principle in exercising its discretion to impose this remedy.

227 I part company with the Court of Appeal with respect to several aspects of its constructive trust analysis; it is far from clear to me that any of the conditions for imposing a constructive trust were present here. However, I will only address one of them in detail. As I will explain, a remedial constructive trust for a breach of fiduciary duty is only appropriate if the wrongdoer's acts give rise to an identifiable asset which it would be unjust for the wrongdoer (or sometimes a third party) to retain. In my view, Indalex's failure to meaningfully address conflicts of interest that arose during the CCAA proceedings did not result in any such asset.

228 As the Court of Appeal recognized, the governing authority concerning the remedial constructive trust outside the domain of unjust enrichment is Soulos. In Soulos, McLachlin J. (as she then was) wrote that a constructive trust may be an appropriate remedy for breach of fiduciary duty: paras. 19-45. She laid out four requirements that should generally be satisfied before a constructive trust will be imposed: para. 45. Although, in Soulos, McLachlin J. was careful to indicate that these are conditions that "generally" must be present, all parties in this case accept that these four conditions must be present before a remedial constructive trust may be ordered for breach of fiduciary duty. The four conditions are these:

> (1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;
>
> (2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;
>
> (3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties and;
>
> (4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected. [para. 45]

229 My concern is with respect to the second requirement, that is, whether the breach resulted in an asset in the hands of Indalex. A constructive trust arises when the law imposes upon a party an obligation to hold specific property for another: D. W. M. Waters, M. R. Gillen and L. D. Smith, *Waters' Law of Trusts in Canada* (3rd ed. 2005), at p. 454 ("*Waters'*"). The purpose of imposing a constructive trust as a remedy for a breach of duty or unjust enrichment is to prevent parties "from retaining property which in 'good conscience' they should not be permitted to retain": Soulos, *at* para. 17. It follows, therefore, that while the remedial constructive trust may be appropriate in a variety of situations, the wrongdoer's conduct toward the plaintiff must generally have given rise to assets in the hands of the wrongdoer (or of a third party in some situations) which cannot in justice and good conscience be retained. That cannot be said here.

230 The Court of Appeal held that this second condition was present because "[t]he assets [i.e. the reserve fund monies] are directly connected to the process in which Indalex committed its breaches of fiduciary obligation": para. 204. Respectfully, this conclusion is based on incorrect legal principles. To satisfy this second condition, it must be shown that the breach *resulted in* the assets being in Indalex's hands, not simply, as the Court of Appeal thought, that there was a "connection" between the assets and "the process" in which Indalex breached its fiduciary duty. Recall that in Soulos itself, *the defendant's acquisition of the disputed property was a direct result of his breach of his duty of loyalty* to the plaintiff: para. 48. This is not our case. As the Court observed, in the context of an unjust enrichment claim in *Peter v. Beblow*, [1993] 1 S.C.R. 980 (S.C.C.), at p. 995:

> ... for a constructive trust to arise, the plaintiff must establish a direct link to the property which is the subject of the trust by reason of the plaintiff's contribution.

231 While cases of breach of fiduciary duty are different in important ways from cases of unjust enrichment, La Forest J. (with Lamer J. concurring on this point) applied a similar standard for proprietary relief in *Lac Minerals*, a case in which wrongdoing was the basis for the constructive trust: p. 678, quoted in *Waters'*, at p. 471. His comments demonstrate the high standard to be met in order for a constructive trust to be awarded:

> The constructive trust awards a right in property, but that right can only arise once a right to relief has been established. In the vast majority of cases a constructive trust will not be the appropriate remedy.... [A] constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property. [p. 678]

232 The relevant breach in this case was the failure of Indalex to meaningfully address the conflicts of interest that arose in the course of the CCAA proceedings. (The breach that arose with respect to the bankruptcy motion is irrelevant because that motion was not addressed and therefore could not have given rise to the assets.) The "assets" in issue here are the funds in the reserve fund which were retained from the proceeds of the sale of Indalex as a going concern. Indalex's breach in this case did not give rise to the funds which were retained by the Monitor in the reserve fund.

233 Where does the respondents' claim of a procedural breach take them? Taking their position at its highest, it would be that the DIP approval proceedings and the sale would not have been approved. This position, however, is fatally flawed. Turning first to the DIP approval, there is no evidence to support the view that, had Indalex addressed its conflict in the DIP approval process, the DIP financing would have been rejected or granted on different terms. The CCAA judge, being fully aware of the pension situation, ruled that the DIP financing was "required", that there was "no other alternative available to the Applicants for a going concern solution", and that "the benefit to stakeholders and creditors of the DIP Financing outweighs any potential prejudice to unsecured creditors that may arise as a result of the granting of super-priority secured financing": endorsement of Morawetz J., April 8, 2009, at paras. 6 and 9. In effect, the respondents are claiming funds which arose only because of the process to which they now object. Taking into account that there was an absence of any evidence that more favourable financing terms were available, that the judge's decision was made with full knowledge of the plan beneficiaries' claims, and that he found that the DIP financing was necessary, the respondents' contention is not only speculative, it also directly contradicts the conclusions of the CCAA judge.

234 Turning next to the sale approval and the approval of the distribution of the assets, it is clear that the plan beneficiaries had independent representation but that this did not change the result. Although, perhaps with little thanks to Indalex, the interests of both plans were fully and ably represented before Campbell J. at the sale approval and interim distribution motions in July of 2009.

235 The executive plan retirees, through able counsel, objected to the sale on the basis that the liquidation values set out in the Monitor's seventh report would provide greater return for unsecured creditors. The motions judge dismissed this objection "on the basis *that there was no clear evidence to support the proposition and in any event the transaction as approved did preserve value for suppliers, customers and preserve approximately 950 jobs"*: trial reasons of Campbell J., at para. 13 (emphasis added). Both the executive plan retirees and the USW, which represented some members of the salaried plan, objected to the proposed distribution of the sale proceeds. In response to this objection, it was agreed that those objections would be heard promptly and that the Monitor would retain sufficient funds to satisfy the pensioners' claims if they were upheld: trial reasons of Campbell J., at paras. 14-16.

236 There is no evidence to support the contention that Indalex's breach of its fiduciary duty as pension administrator resulted in the assets retained in the reserve fund. I therefore conclude that the Court of Appeal erred in law in finding that the second condition for imposing a constructive trust — i.e. that the assets in the defendant's hands must be shown to have resulted from the defendant's breaches of duty to the plaintiff — had been established.

237 I would add only two further comments with respect to the constructive trust. A major concern of the Court of Appeal was that unless a constructive trust were imposed, the reserve funds would end up in the hands of other Indalex entities which were not operating at arm's length from Indalex. The U.S. debtors claimed the reserve fund because it had paid on its guarantee of the DIP loans and thereby stepped into the shoes of the DIP lender with respect to priority. Sun Indalex claims in the U.S. bankruptcy proceedings as a secured creditor of the U.S. debtors. The Court of Appeal put its concern this way: "To permit Sun Indalex to recover on behalf of [the U.S. debtors] would be to effectively permit the party who breached its fiduciary obligations to take the benefit of those breaches, to the detriment of those to whom the fiduciary obligations were owed": para. 199.

238 There are two difficulties with this approach, in my respectful view. The U.S. debtors paid real money to honour their guarantees. Moreover, unless there is a legal basis for ignoring the separate corporate personality of separate corporate entities, those separate corporate existences must be respected. Neither the parties nor the Court of Appeal advanced such a reason.

239 Finally, I would note that imposing a constructive trust was wholly disproportionate to Indalex's breach of fiduciary duty. Its breach — the failure to meaningfully address the conflicts of interest that arose during the CCAA process — had no adverse impact on the plan beneficiaries in the sale approval process which gave rise to the "asset" in issue. Their interests were fully represented and carefully considered before the sale was approved and the funds distributed. The sale was nonetheless judged to be in the best interests of the corporation, all things considered. In my respectful view, imposing a $6.75 million penalty on the other creditors as a remedial response to this breach is so grossly disproportionate to the breach as to be unreasonable.

240 A judicially ordered constructive trust, imposed long after the fact, is a remedy that tends to destabilize the certainty which is essential for commercial affairs and which is particularly important in financing a workout for an insolvent corporation. To impose a constructive trust in response to a breach of fiduciary duty to ensure for the plan beneficiaries some procedural protections that they in fact took advantage of in any case is an unjust response in all of the circumstances.

241 I conclude that a constructive trust is not an appropriate remedy in this case and that the Court of Appeal erred in principle by imposing it.

C. Third Issue: Did the Court of Appeal Err in Concluding That the Super Priority Granted in the CCAA Proceedings Did Not Have Priority by Virtue of the Doctrine of Federal Paramountcy?

242 Although I disagree with my colleague Justice Deschamps with respect to the scope of the s. 57(4) deemed trust, I agree that if there was a deemed trust in this case, it would be superseded by the DIP loan because of the operation of the doctrine of federal paramountcy: paras. 48-60.

D. Fourth Issue: Did the Court of Appeal Err in its Cost Endorsement Respecting the USW?

(1) Introduction

243 The disposition of costs in the Court of Appeal was somewhat complex. Although the costs appeal relates only to the costs of the USW, it is necessary in order to understand their position to set out the costs order below in full.

244 With respect to the costs of the appeal to the Court of Appeal, no order was made for or against the Monitor due to its prior agreement with the former executives and the USW. However, the court ordered that the former executives and the USW, as successful parties, were each entitled to costs on a partial indemnity basis fixed at $40,000 inclusive of taxes and disbursements from Sun Indalex and the U.S. Trustee, payable jointly and severally: costs endorsement, 2011 ONCA 578, 81 C.B.R. (5th) 165 (Ont. C.A.), at para. 7.

245 Morneau Shepell Ltd., the Superintendent, and the former executives reached an agreement with respect to legal fees and disbursements and the Court of Appeal approved that agreement. The former executives received full indemnity legal fees and disbursements in the amount of $269,913.78 to be paid from the executive plan attributable to each of the 14 former executives' accrued pension benefits, allocated among the 14 former executives in relation to their pension entitlement from the executive plan. In other words, the costs would not be borne by the other three members of the executive plan who did not participate in the proceedings: C.A. costs endorsement, at para. 2. The costs of the appeal payable by Sun Indalex and the U.S. Trustee were to be paid into the fund of the executive plan and allocated among the 14 former executives in relation to their pension entitlement from the executive plan.

246 USW sought an order for payment of its costs from the fund of the salaried plan. However, the Court of Appeal declined to make such an order because the USW was in a "materially different position" than that of the former executives: costs endorsement, at para. 3. The latter were beneficiaries to the pension fund (14 of the 17 members of the plan), and they consented to the payment of costs from their individual benefit entitlements. Those who had not consented would not be affected by the

payment. In contrast, the USW was the bargaining agent (not the beneficiary) for only 7 of the 169 beneficiaries of the salaried plan, none of whom was given notice of, or consented to, the payment of legal costs from the salaried plan. Moreover, the USW sought and seeks an order that its costs be paid out of the fund. This request is significantly different than the order made in favour of the former executives. The former executives explicitly ensured that their choice to pursue the litigation would not put at risk the pension benefits of those members who did not retain counsel even though of course those members would benefit in the event the litigation was successful. The USW is not proposing to insulate the 162 members whom it does not represent from the risk of litigation; it seeks an order requiring all members to share the risk of the litigation even though it represents only 7 of the 169. The proposition advanced by the USW was thus materially different from that advanced on behalf of the executive plan and approved by the court.

(2) Standard of Review

247 In *Kerry (Canada) Inc. v. Ontario (Superintendent of Financial Services)*, 2009 SCC 39, [2009] 2 S.C.R. 678 (S.C.C.), Rothstein J. held that "costs awards are quintessentially discretionary": para. 126. Discretionary costs decisions should only be set aside on appeal if the court below "has made an error in principle or if the costs award is plainly wrong": *Hamilton v. Open Window Bakery Ltd.* (2003), 2004 SCC 9, [2004] 1 S.C.R. 303 (S.C.C.), at para. 27.

(3) Analysis

248 I do not see any basis to interfere with the Court of Appeal's costs endorsement in this case. In my view, the USW's submissions are largely based on an inaccurate reading of the Court of Appeal's costs endorsement. Contrary to what the USW submits, the Court of Appeal did *not* require the consent of plan beneficiaries as a prerequisite to ordering payment of costs from the fund. Nor is it correct to suggest that the costs endorsement would "restrict recovery of beneficiary costs to instances when there is a surplus in the pension trust fund" or "preclude financing of beneficiary action when a fund is in deficit": USW factum, at paras. 71 and 76. Nor would I read the Court of Appeal's brief costs endorsement as laying down a rule that a union representing pension beneficiaries cannot recover costs from the fund because the union itself is not a beneficiary.

249 The premise of the USW's appeal appears to be that it was entitled to costs because it met what it refers to in its submissions as the Costs Payment Test and that if the executive plan members got their costs out of their pension fund, the union should get its costs out of the salaried employees' pension fund. Respectfully, I do not accept the validity of either premise.

250 The decision whether to award costs from the pension fund remains a discretionary matter. In *Nolan*, Rothstein J. surveyed the various factors that courts have taken into account when deciding whether to award a litigant its costs out of a pension trust. The first broad inquiry considered in *Nolan* was into whether the litigation concerned the due administration of the trust. In connection with this inquiry, courts have considered the following factors: (1) whether the litigation was primarily about the construction of the plan documents; (2) whether it clarified a problematic area of the law; (3) whether it was the only means of clarifying the parties' rights; (4) whether the claim alleged maladministration; and (5) whether the litigation had no effect on other beneficiaries of the trust fund: *Nolan*, at para. 126.

251 The second broad inquiry discussed in *Nolan* was whether the litigation was ultimately adversarial: para. 127. The following factors have been considered: (1) whether the litigation included allegations by an unsuccessful party of a breach of fiduciary duty; (2) whether the litigation only benefited a class of members and would impose costs on other members if successful; and (3) whether the litigation had any merit.

252 I do not think that it is correct to elevate these two inquiries (which constitute the Costs Payment Test articulated by the USW) to a test for entitlement to costs in the pension context. The factors set out in *Nolan* and other cases cited therein are best understood as highly relevant considerations guiding the exercise of judicial discretion with respect to costs.

253 The litigation undertaken here raised novel points of law with all of the uncertainty and risk inherent in such an undertaking. The Court of Appeal in essence decided that the USW, representing only 7 of 169 members of the plan, should not without consultation be able to in effect impose the risks of that litigation on all of the plan members, the vast majority of whom were not union members. Whatever arguments might be raised against the Court of Appeal's decision in light of the success of

the litigation and the sharing by all plan members of the benefits, the failure of the litigation seems to me to leave no basis to impose the cost consequences of taking that risk on all of the plan members of an already underfunded plan.

254 The second premise of the USW appeal appears to be that if the executive plan members have their costs paid out of the fund, so too should the salaried plan members. Respectfully, however, this is not an accurate statement of the order made with respect to the executive plan.

255 The Court of Appeal's order with respect to the executive plan meant that only the pension fund attributable to those members of the plan who actually supported the litigation — the vast majority I would add — would contribute to the costs of the litigation even though all members of the plan would benefit in the case of success. As the Court of Appeal noted:

> The individual represented Retirees, who comprise 14 of 17 members of the Executive Plan, have consented to the payment of costs from their individual benefit entitlements. Those who have not consented will not be affected by the payment. [Costs endorsement, at para. 3]

256 The Court of Appeal therefore approved an agreement as to costs which did not put at further risk the pension funds available to satisfy the pension entitlements of those who did not support the litigation. Thus, the Court of Appeal did not apply what the USW refers to as the Costs Payment Test to the executive plan because the costs order was the product of agreement and did not order payment of costs out of the fund as a whole.

257 In the case of the USW request, there was no such agreement and no such limitation of risk to the supporters of the litigation.

258 I see no error in principle in the Court of Appeal's refusal to order the USW costs to be paid out of the pension fund, particularly in light of the disposition of the appeal to this Court. I would dismiss the USW costs appeal but without costs.

IV. Disposition

259 I would allow the Sun Indalex, FTI Consulting and George L. Miller appeals and, except as noted below, I would set aside the orders of the Ontario Court of Appeal and restore the February 18, 2010 orders of Campbell J.

260 With respect to costs, I would set aside the Court of Appeal's orders with respect to the costs of the appeals before that court and order that all parties bear their own costs in the Court of Appeal and in this Court.

261 I would not disturb paras. 9 and 10 of the order of the Court of Appeal in the former executives' appeal so that the full indemnity legal fees and disbursements of the former executives in the amount of $269,913.78 shall be paid from the fund of the executive plan attributable to each of the 14 former executives' accrued pension benefits, and specifically such amounts shall be allocated among the 14 former executives in relation to their pension entitlement from the executive plan and will not be borne by the other three members of the executive plan.

262 I would dismiss the USW costs appeal, but without costs.

***LeBel J.* (dissenting):**

I. Introduction

263 The members of two pension plans set up by Indalex Limited ("Indalex") stand to lose half or more of their pension benefits as a consequence of the insolvency of their employer and of the arrangement approved by the Ontario Superior Court of Justice under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). The Court of Appeal for Ontario found that the members were entitled to a remedy. For different and partly conflicting reasons, my colleagues Justices Deschamps and Cromwell would hold that no remedy is available to them. With all due respect for their opinions, I would conclude, like the Court of Appeal, that the remedy of a constructive trust is open to them and should be imposed in the circumstances of this case, for the following reasons.

264 I do not intend to summarize the facts of this case, which were outlined by my colleagues. I will address these facts as needed in the course of my reasons. Before moving to my areas of disagreement with my colleagues, I will briefly indicate where and to what extent I agree with them on the relevant legal issues.

265 Like my colleagues, I conclude that no deemed trust could arise under s. 57(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), in the case of the Executive Plan because this plan had not been wound up when the *CCAA* proceedings were initiated. In the case of the Salaried Employees Plan, I agree with Deschamps J. that a deemed trust arises in respect of the wind-up deficiency. But, like her, I accept that the debtor-in-possession ("DIP") super priority prevails by reason of the application of the federal paramountcy doctrine. I also agree that the costs appeal of the United Steelworkers should be dismissed.

266 But, with respect for the opinions of my colleagues, I take a different view of the nature and extent of the fiduciary duties of an employer who elects to act as administrator of a pension plan governed by the *PBA*. This dual status does not entitle the employer to greater leniency in the determination and exercise of its fiduciary duties or excuse wrongful actions. On the contrary, as we shall see below, I conclude that Indalex not only neglected its obligations towards the beneficiaries, but actually took a course of action that was actively inimical to their interests. The seriousness of these breaches amply justified the decision of the Court of Appeal to impose a constructive trust. To that extent, I propose to uphold the opinion of Gillese J.A. and the judgment of the Court of Appeal (2011 ONCA 265, 104 O.R. (3d) 641).

II. The Employer as Administrator of a Pension Plan: Its Fiduciary Duties

267 Before entering into an analysis of the obligations of an employer as administrator of a pension plan under the *PBA*, it is necessary to consider the position of the beneficiaries. Who are they? At what stage are they in their lives? What are their vulnerabilities? A fiduciary relationship is a relationship, grounded in fact and law, between a vulnerable beneficiary and a fiduciary who holds and may exercise power over the beneficiary in situations recognized by law. Any analysis of such a relationship requires careful consideration of the characteristics of the beneficiary. It ought not stop at the level of a theoretical and detached approach that fails to address how, very concretely, this relationship works or can be twisted, perverted or abused, as was the situation in this case.

268 The beneficiaries were in a very vulnerable position relative to Indalex. They did not enjoy the protection that the existence of an independent administrator might have given them. They had no say and no input in the management of the plans. The information about the plans and their situation came from Indalex in its dual role as employer and manager of the plans. Their particular vulnerability arose from their relationship with Indalex, acting both as their employer and as the administrator of their retirement plans. Their vulnerability was substantially a consequence of that specific relationship (*Perez v. Galambos*, 2009 SCC 48, [2009] 3 S.C.R. 247 (S.C.C.), at para. 68, *per* Cromwell J.). The nature of this relationship had very practical consequences on their interests. For example, as Gillese J.A. noted in her reasons (at para. 40) the consequences of the decisions made in the course of management of the plan and during the *CCAA* proceedings signify that the members of the Executive Plan stand to lose one-half to two-thirds of their retirement benefits, unless additional money is somehow paid into the plan. These losses of benefits are, in all probability, permanent in the case of the beneficiaries who have already retired or who are close to retirement. They deeply affect their lives and expectations. For most of them, what is lost is lost for good. No arrangement will allow them to get a start on a new life. We should not view the situation of the beneficiaries as regrettable but unavoidable collateral damage arising out of the ebbs and tides of the economy. In my view, the law should give the members some protection, as the Court of Appeal intended when it imposed a constructive trust.

269 Indalex was in a conflict of interest from the moment it started to contemplate putting itself under the protection of the *CCAA* and proposing an arrangement to its creditors. From the corporate perspective, one could hardly find fault with such a decision. It was a business decision. But the trouble is that at the same time, Indalex was a fiduciary in relation to the members and retirees of its pension plans. The "two hats" analogy offers no defence to Indalex. It could not switch off the fiduciary relationship at will when it conflicted with its business obligations or decisions. Throughout the arrangement process and until it was replaced by an independent administrator (Morneau Shepell Ltd.) it remained a fiduciary.

270 It is true that the PBA allows an employer to act as an administrator of a pension plan in Ontario. In such cases, the legislature accepts that conflicts of interest may arise. But, in my opinion, nothing in the PBA allows that the employer *qua* administrator will be held to a lower standard or will be subject to duties and obligations that are less stringent than those of an independent administrator. The employer remains a fiduciary under the statute and at common law (PBA, s. 22(4)). The employer is under no obligation to assume the burdens of administering the pension plans that it has agreed to set up or that are the legacy of previous decisions. However, if it decides to do so, a fiduciary relationship is created with the expectation that the employer will be able to avoid or resolve the conflicts of interest that might arise. If this proves to be impossible, the employer is still "seized" with fiduciary duties, and cannot ignore them out of hand.

271 Once Indalex had considered the CCAA process and decided to proceed in that manner, it should have been obvious that such a move would trigger conflicts of interest with the beneficiaries of the pension plans and that these conflicts would become untenable, as per the terms of s. 22(4) of the PBA. Given the nature of its obligations as administrator and fiduciary, it was impossible to wear the "two hats". Indalex had to discharge its corporate duties, but at the same time it had to address its fiduciary obligations to the members and beneficiaries of the plans. I do not fault it for applying under the CCAA, but rather for not relinquishing its position as administrator of the plans at the time of the application. It even retained this position once it engaged in the arrangement process. Other conflicts and breaches of fiduciary duties and of fundamental rules of procedural equity in the Superior Court flowed from this first decision. Moreover, Indalex maintained a strongly adversarial attitude towards the interest of the beneficiaries throughout the arrangement process, while it was still, at least in form, the administrator of the plans.

272 The option given to employers to act as administrators of pension plans under the PBA does not constitute a licence to breach the fiduciary duties that flow from this function. It should not be viewed as an invitation for the courts to whitewash the consequences of such breaches. The option is predicated on the ability of the employer-administrator to avoid the conflicts of interests that cause these breaches. An employer deciding to assume the position of administrator cannot claim to be in the same situation as the Crown when it discharges fiduciary obligations towards certain groups in society under the Constitution or the law. For those cases, the Crown assumes those duties because it is obligated to do so by virtue of its role, not because it chooses to do so. In such circumstances, the Crown must often balance conflicting interests and obligations to the broader society in the discharge of those fiduciary duties (*Elder Advocates of Alberta Society v. Alberta*, 2011 SCC 24, [2011] 2 S.C.R. 261 (S.C.C.), at paras. 37-38). If Indalex found itself in a situation where it had to balance conflicting interests and obligations, as it essentially argues, it could not retain the position of administrator that it had willingly assumed. The solution was not to place its function as administrator and its associated fiduciary duties in abeyance. Rather, it had to abandon this role and diligently transfer its function as manager to an independent administrator.

273 Indalex could apply for protection under the CCAA. But, in so doing, it needed to make arrangements to avoid conflicts of interests. As nothing was done, the members of the plans were left to play catch up as best they could when the process that put in place the DIP financing and its super priority was initiated. The process had been launched in such a way that it took significant time before the beneficiaries could effectively participate in the process. In practice, the United Steelworkers union, which represented only a small group of the members of the Salaried Employees Plan, acted for them after the start of the procedures. The members of the Executive Plan hired counsel who appeared for them. But, throughout, there were problems with notices, delays and the ability to participate in the process. Indeed, during the CCAA proceedings, the Monitor and Indalex seemed to have been more concerned about keeping the members of the plans out of the process rather than ensuring that their voices could be heard. Two paragraphs of the submissions to this Court by Morneau Shepell Ltd., the subsequently appointed administrator of the plan, aptly sums up the behaviour of Indalex and the Monitor towards the beneficiaries, whose representations were always deemed to be either premature or late:

> When counsel for the Retirees again appeared at a motion to approve the bidding procedure, his objections were considered premature:
>
> > In my view, the issues raised by the retirees do not have any impact on the Bidding Procedures. The issues can be raised by the retirees on any application to approve a transaction — but that is for another day. [(2009), 79 C.C.P.B. 101 (Ont. S.C.J.), at para. 10, *per* Morawetz J.]

> Only when counsel appeared at the sale approval motion, as directed by the motions judge, were the concerns of the pension plan beneficiaries heard. At that time, the Appellants complain, the beneficiaries were too late and their motion constituted a collateral attack on the original DIP Order. However, it cannot be the case that stakeholder groups are too early, until they are too late. [Factum, at paras. 54-55]

274 I must also mention the failed attempt to assign Indalex in bankruptcy once the sale of its business had been approved. One of the purposes of this action was essentially to harm the interests of the members of the plans. At the time, Indalex was still wearing its two hats, at least from a legal perspective. But its duties as a fiduciary were clearly not at the forefront of its concerns. There were constant conflicts of interest throughout the process. Indalex did not attempt to resolve them; it brushed them aside. In so acting, it breached its duties as a fiduciary and its statutory obligations under s. 22(4) *PBA*.

III. Procedural Fairness in CCAA Proceedings

275 The manner in which this matter was conducted in the Superior Court was, at least partially, the result of Indalex disregarding its fiduciary duties. The procedural issues that arose in that court did not assist in mitigating the consequences of these breaches. It is true that, in the end, the beneficiaries obtained, or were given, some information pertaining to the proceedings and that counsel appeared on their behalf at various stages of the proceedings. However, the basic problem is that the proceedings were not conducted according to the spirit and principles of the Canadian system of civil justice.

276 I accept that those procedures are often urgent. The situation of a debtor requires quick and efficient action. The turtle-like pace of some civil litigation would not meet the needs of the application of the *CCAA*. However, the conduct of proceedings under this statute is not solely an administrative process. It is also a judicial process conducted according to the tenets of the adversarial system. The fundamentals of such a system must not be ignored. All interested parties are entitled to a fair procedure that allows their voices to be raised and heard. It is not an answer to these concerns to say that nothing else could be done, that no other solution would have been better, that, in substance, hearing the members would have been a waste of time. In all branches of procedure whether in administrative law, criminal law or civil action, the rights to be informed and to be heard in some way remain fundamental principles of justice. Those principles retain their place in the *CCAA*, as some authors and judges have emphasized (J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 55-56; *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]), at para. 5, *per* Farley J.). This was not done in this case, as my colleagues admit, while they downplay the consequences of these procedural flaws and breaches.

IV. Imposing a Constructive Trust

277 In this context, I see no error in the decision of the Court of Appeal to impose a constructive trust (paras. 200-207). It was a fair decision that met the requirements of justice, under the principles set out by our Court in *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534 (S.C.C.), and in *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.). The remedy of a constructive trust was justified in order to correct the wrong caused by Indalex (*Soulos*, at para. 36, *per* McLachlin J. (as she then was)). The facts of the situation met the four conditions that generally justify the imposition of a constructive trust (*Soulos*, at para. 45), as determined by Justice Gillese in her reasons, at paras. 203 and 204: (1) the defendant was under an equitable obligation in relation to the activities giving rise to the assets in his or her hands; (2) the assets in the hands of the defendant were shown to have resulted from deemed or actual agency activities of the defendant in breach of his or her equitable obligation to the plaintiff; (3) the plaintiff has shown a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendants remain faithful to their duties; and (4) there are no factors which would render imposition of a constructive trust unjust in all the circumstances of the case, such as the protection of the interests of intervening creditors.

278 In crafting such a remedy, the Court of Appeal was relying on the inherent powers of the courts to craft equitable remedies, not only in respect of procedural issues, but also of substantive questions. Section 9 of the *CCAA* is broadly drafted and does not deprive courts of their power to fill in gaps in the law when this is necessary in order to grant justice to the parties (G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation,

Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law, 2007* (2008), 41, at pp. 78-79).

279 The imposition of the trust did not disregard the different corporate personalities of Indalex and Indalex U.S. It properly acknowledged the close relationship between the two companies, the second in effect controlling the first. This relationship could and needed to be taken into consideration in order to determine whether a constructive trust was a proper remedy.

280 For these reasons, I would uphold the imposition of a constructive trust and I would dismiss the appeal with costs to the respondents.

Order accordingly.

Ordonnance en conséquence.

Appendix

The Pension Benefits Amendment Act, 1973, S.O. 1973, c. 113

6. The said Act is amended by adding thereto the following sections:

23*a*. — (1) Any sum received by an employer from an employee pursuant to an arrangement for the payment of such sum by the employer into a pension plan as the employee's contribution thereto shall be deemed to be held by the employer in trust for payment of the same after his receipt thereof into the pension plan as the employee's contribution thereto and the employer shall not appropriate or convert any part thereof to his own use or to any use not authorized by the trust.

(2) For the purposes of subsection 1, any sum withheld by an employer, whether by payroll deduction or otherwise, from moneys payable to an employee shall be deemed to be a sum received by the employer from the employee.

(3) Any sum required to be paid into a pension plan by an employer as the employer's contribution to the plan shall, when due under the plan, be deemed to be held by the employer in trust for payment of the same into the plan in accordance with the plan and this Act and the regulations as the employer's contribution and the employer shall not appropriate or convert any part of the amount required to be paid to the fund to his own use or to any use not authorized by the terms of the pension plan.

Pension Benefits Act, R.S.O. 1980, c. 373

21. . . .

(2) Upon the termination or winding up of a pension plan filed for registration as required by section 17, the employer is liable to pay all amounts that would otherwise have been required to be paid to meet the tests for solvency prescribed by the regulations, up to the date of such termination or winding up, to the insurer, administrator or trustee of the pension plan.

. . . . .

23. — (1) Where a sum is received by an employer from an employee under an arrangement for the payment of the sum by the employer into a pension plan as the employee's contribution thereto, the employer shall be deemed to hold the sum in trust for the employee until the sum is paid into the pension plan whether or not the sum has in fact been kept separate and apart by the employer and the employee has a lien upon the assets of the employer for such amount that in the ordinary course of business would be entered in books of account whether so entered or not.

. . . . .

(3) Where an employer is required to make contributions to a pension plan, he shall be deemed to hold in trust for the members of the plan an amount calculated in accordance with subsection (4), whether or not,

(a) the employer contributions are payable into the plan under the terms of the plan or this Act; or

(b) the amount has been kept separate and apart by the employer,

and the members have a lien upon the assets of the employer in such amount that in the ordinary course of business would be entered into the books of account whether so entered or not.

(4) For the purpose of determining the amount deemed to be held in trust under subsection (3) on a specific date, the calculation shall be made as if the plan had been wound up on that date.

. . . . .

32. In addition to any amounts the employer is liable to pay under subsection 21 (2), where a defined benefit pension plan is terminated or wound up or the plan is amended so that it is no longer a defined benefit pension plan, the employer is liable to the plan for the difference between,

(a) the value of the assets of the plan; and

(b) the value of pension benefits guaranteed under subsection 31 (1) and any other pension benefit vested under the terms of the plan,

and the employer shall make payments to the insurer, trustee or administrator of the pension plan to fund the amount owing in such manner as is prescribed by regulation.

Pension Benefits Amendment Act, 1983, S.O. 1983, c. 2

2. Subsection 21 (2) of the said Act is repealed and the following substituted therefor:

(2) Upon the termination or winding up of a registered pension plan, the employer of employees covered by the pension plan shall pay to the administrator, insurer or trustee of the pension plan,

(a) an amount equal to,

(i) the current service cost, and

(ii) the special payments prescribed by the regulations,

that have accrued to and including the date of the termination or winding up but, under the terms of the pension plan or the regulations, are not due on that date; and

(b) all other payments that, by the terms of the pension plan or the regulations, are due from the employer to the pension plan but have not been paid at the date of the termination or winding up.

(2a) For the purposes of clause (2) (a), the current service cost and special payments shall be deemed to accrue on a daily basis.

3. Section 23 of the said Act is repealed and the following substituted therefor:

23. — (1) Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension plan as the employee's contribution to the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension plan.

(2) For the purposes of subsection (1), money withheld by an employer, whether by payroll deduction or otherwise, from moneys payable to an employee shall be deemed to be money received by the employer from the employee.

(3) The administrator or trustee of the pension plan has a lien and charge upon the assets of the employer in an amount equal to the amount that is deemed to be held in trust under subsection (1).

(4) An employer who is required by a pension plan to contribute to the pension plan shall be deemed to hold in trust for the members of the pension plan an amount of money equal to the total of.

(a) all moneys that the employer is required to pay into the pension plan to meet,

(i) the current service cost, and

(ii) the special payments prescribed by the regulations,

that are due under the pension plan or the regulations and have not been paid into the pension plan; and

(b) where the pension plan is terminated or wound up, any other money that the employer is liable to pay under clause 21 (2) (a).

(5) The administrator or trustee of the pension plan has a lien and charge upon the assets of the employer in an amount equal to the amount that is deemed to be held in trust under subsection (4).

(6) Subsections (1) and (4) apply whether or not the moneys mentioned in those subsections are kept separate and apart from other money.

. . . . .

8. Sections 32 and 33 of the said Act are repealed and the following substituted therefor:

32. — (1) The employer of employees who are members of a defined benefit pension plan that the employer is bound by or to which the employer is a party and that is partly or wholly wound up shall pay to the administrator, insurer or trustee of the plan an amount of money equal to the amount by which the value of the pension benefits guaranteed by section 31 plus the value of the pension benefits vested under the defined benefit pension plan exceeds the value of the assets of the plan allocated in accordance with the regulations for payment of pension benefits accrued with respect to service in Ontario.

(2) The amount that the employer is required to pay under subsection (1) is in addition to the amounts that the employer is liable to pay under subsection 21 (2).

(3) The employer shall pay the amount required under subsection (1) to the administrator, insurer or trustee of the defined benefit pension plan in the manner prescribed by the regulations.

Pension Benefits Act, 1987, S.O. 1987, c. 35

58. — (1) Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension fund as the employee's contribution under the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension fund.

. . . . .

(3) An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.

(4) Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

. . . . .

59. — (1) Money that an employer is required to pay into a pension fund accrues on a daily basis.

(2) Interest on contributions shall be calculated and credited at a rate not less than the prescribed rates and in accordance with prescribed requirements.

. . . . .

75. — (1) A member in Ontario of a pension plan whose combination of age plus years of continuous employment or membership in the pension plan equals at least fifty-five, at the effective date of the wind up of the pension plan in whole or in part, has the right to receive,

(a) a pension in accordance with the terms of the pension plan, if, under the pension plan, the member is eligible for immediate payment of the pension benefit;

(b) a pension in accordance with the terms of the pension plan, beginning at the earlier of,

(i) the normal retirement date under the pension plan, or

(ii) the date on which the member would be entitled to an unreduced pension under the pension plan if the pension plan were not wound up and if the member's membership continued to that date; or

(c) a reduced pension in the amount payable under the terms of the pension plan beginning on the date on which the member would be entitled to the reduced pension under the pension plan if the pension plan were not wound up and if the member's membership continued to that date.

. . . . .

76. — (1) Where a pension plan is wound up in whole or in part, the employer shall pay into the pension fund,

(a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and

(b) an amount equal to the amount by which,

(i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Commission declares that the Guarantee Fund applies to the pension plan,

(ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and

(iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 40 (3) (50 per cent rule) and section 75,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

Pension Benefits Act, R.S.O. 1990, c. P.8

57. (1) [Trust property] Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension fund as the employee's contribution under the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension fund.

(2) [Money withheld] For the purposes of subsection (1), money withheld by an employer, whether by payroll deduction or otherwise, from money payable to an employee shall be deemed to be money received by the employer from the employee.

(3) [Accrued contributions] An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.

(4) [Wind up] Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

. . . . .

58. (1) [Accrual] Money that an employer is required to pay into a pension fund accrues on a daily basis.

(2) [Interest] Interest on contributions shall be calculated and credited at a rate not less than the prescribed rates and in accordance with prescribed requirements.

. . . . .

74. (1) [Activating events] This section applies if a person ceases to be a member of a pension plan on the effective date of one of the following activating events:

1. The wind up of a pension plan, if the effective date of the wind up is on or after April 1, 1987.

2. The employer's termination of the member's employment, if the effective date of the termination is on or after July 1, 2012. However, this paragraph does not apply if the termination occurs in any of the circumstances described in subsection (1.1).

3. The occurrence of such other events as may be prescribed in such circumstances as may be specified by regulation.

(1.1) [Same, termination of employment] Termination of employment is not an activating event if the termination is a result of wilful misconduct, disobedience or wilful neglect of duty by the member that is not trivial and has not been condoned by the employer or if the termination occurs in such other circumstances as may be prescribed.

(1.2) [Exceptions, election by certain pension plans] This section does not apply with respect to a jointly sponsored pension plan or a multi-employer pension plan while an election made under section 74.1 for the plan and its members is in effect.

(1.3) [Benefit] A member in Ontario of a pension plan whose combination of age plus years of continuous employment or membership in the pension plan equals at least 55 on the effective date of the activating event has the right to receive,

(a) a pension in accordance with the terms of the pension plan, if, under the pension plan, the member is eligible for immediate payment of the pension benefit;

(b) a pension in accordance with the terms of the pension plan, beginning at the earlier of,

(i) the normal retirement date under the pension plan, or

(ii) the date on which the member would be entitled to an unreduced pension under the pension plan if the activating event had not occurred and if the member's membership continued to that date; or

(c) a reduced pension in the amount payable under the terms of the pension plan beginning on the date on which the member would be entitled to the reduced pension under the pension plan if the activating event had not occurred and if the member's membership continued to that date.

(2) [Part year] In determining the combination of age plus employment or membership, one-twelfth credit shall be given for each month of age and for each month of continuous employment or membership on the effective date of the activating event.

(3) [Member for 10 years] Bridging benefits offered under the pension plan to which a member would be entitled if the activating event had not occurred and if his or her membership were continued shall be included in calculating the pension benefit under subsection (1.3) of a person who has at least 10 years of continuous employment with the employer or has been a member of the pension plan for at least 10 years.

(4) [Prorated bridging benefit] For the purposes of subsection (3), if the bridging benefit offered under the pension plan is not related to periods of employment or membership in the pension plan, the bridging benefit shall be prorated by the ratio that the member's actual period of employment bears to the period of employment that the member would have to

the earliest date on which the member would be entitled to payment of pension benefits and a full bridging benefit under the pension plan if the activating event had not occurred.

(5) [Notice of termination of employment] Membership in a pension plan that is wound up includes the period of notice of termination of employment required under Part XV of the *Employment Standards Act, 2000*.

(6) [Application of subs. (5)] Subsection (5) does not apply for the purpose of calculating the amount of a pension benefit of a member who is required to make contributions to the pension fund unless the member makes the contributions in respect of the period of notice of termination of employment.

(7) [Consent of employer] For the purposes of this section, where the consent of an employer is an eligibility requirement for entitlement to receive an ancillary benefit, the employer shall be deemed to have given the consent.

(7.1) [Consent of administrator, jointly sponsored pension plans] For the purposes of this section, where the consent of the administrator of a jointly sponsored pension plan is an eligibility requirement for entitlement to receive an ancillary benefit, the administrator shall be deemed to have given the consent.

(8) [Use in calculating pension benefit] A benefit described in clause (1.3) (a), (b) or (c) for which a member has met all eligibility requirements under this section shall be included in calculating the member's pension benefit or the commuted value of the pension benefit.

. . . . .

75. (1) [Liability of employer on wind up] Where a pension plan is wound up, the employer shall pay into the pension fund,

(a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and

(b) an amount equal to the amount by which,

(i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,

(ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and

(iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

End of Document

TAB 19

KeyCite treatment
Most Negative Treatment: Distinguished
Most Recent Distinguished: Bison Properties Ltd., Re | 2016 BCSC 793, 2016 CarswellBC 1199, [2016] B.C.W.L.D. 3744, [2016] B.C.W.L.D. 3745, [2016] B.C.W.L.D. 3746, 266 A.C.W.S. (3d) 549, 36 C.B.R. (6th) 66 | (B.C. S.C., May 3, 2016)

2013 MBQB 171

Manitoba Court of Queen's Bench

Puratone Corp., Re

2013 CarswellMan 360, 2013 MBQB 171, [2013] M.J. No. 247, 229 A.C.W.S. (3d) 632, 295 Man. R. (2d) 55

In the Matter of: The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

In the Matter of: A Plan of Compromise or Arrangement of The Puratone Corporation, Pembina Valley Pigs Ltd. and Niverville Swine Breeders Ltd. (the "Applicants")

Dewar J.

Judgment: July 8, 2013
Docket: Winnipeg Centre CI 12-01-79231

Counsel: David Jackson, for Puratone Corporation
J.J. Burnell, for Bank of Montreal
Jeffrey Lee, Sandra Zinchuk, for Farm Credit Canada
Richard Schwartz, Jason Harvey, for ITB Claimants
Ross McFadyen, for Deloitte Touche Inc.
David Kroft, Aaron Challis, for Directors and Officers

Subject: Insolvency; Civil Practice and Procedure; Contracts; Corporate and Commercial; Estates and Trusts; Restitution; Torts

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.c Lifting of stay

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Lifting of stay

In September 2012, group of three companies involved in commercial hog production filed application and granted initial order under Companies' Creditors Arrangement Act (CCAA) — Order included usual provision staying commencement or continuation of any proceeding against companies, officers and directors — In November 2012, court approved sale of virtually all of companies' assets to third party — In March 2013, court authorized distribution of majority of proceeds of sale to major secured creditors, each of whom sustained significant shortfall — Monitor retained $6.75 million, including $5 million as general holdback, pending completion of CCAA proceeding — Claimants, group of farmers who had supplied grain to companies in two weeks prior to CCAA filing, and who remained unpaid, requested holdback of $903,250 and sought leave to commence action against companies as well as officers and directors for, among other things, damages for fraudulent misrepresentation and declaration of constructive trust on basis of unjust enrichment — Claimants alleged companies, officers and directors must have known that CCAA application, made for purpose of liquidation rather than true restructuring, intended at time grain supplied — Major secured creditors objected on basis proposed action had insufficient merit to justify delay in distribution of holdback moneys — Claimants brought motion for order authorizing commencement of action — Motion granted — Section 11.02(3) of CCAA authorized court to lift stay of proceedings where appropriate and applicant acting in good faith and with due diligence — Judicial authority required "sound reasons", considering balance of convenience, prejudice and merits of proposed action — Scrutiny of proposed action and circumstances suggested dismissal of action not foregone conclusion — Proposed action essentially priority dispute between creditors — Since CCAA proceeding almost over, lifting stay would not put any restructuring plan at risk — Balance of convenience favoured claimants — Holdback of $903,250 would not prejudice secured creditors to significant degree if claimants filed undertaking as to damages.

Table of Authorities

Cases considered by *Dewar J.*:

ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd. (2007), 2007 SKCA 72, 2007 CarswellSask 324, [2007] 9 W.W.R. 79, (sub nom. *Bricore Land Group Ltd., Re)* 299 Sask. R. 194, (sub nom. *Bricore Land Group Ltd., Re)* 408 W.A.C. 194, 33 C.B.R. (5th) 50 (Sask. C.A.) — followed

International Corona Resources Ltd. v. LAC Minerals Ltd. (1989), 44 B.L.R. 1, 35 E.T.R. 1, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* 69 O.R. (2d) 287, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* 61 D.L.R. (4th) 14, 101 N.R. 239, 36 O.A.C. 57, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* [1989] 2 S.C.R. 574, 6 R.P.R. (2d) 1, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* 26 C.P.R. (3d) 97, 1989 CarswellOnt 126, 1989 CarswellOnt 965 (S.C.C.) — considered

People's Department Stores Ltd. (1992) Inc., Re (2004), (sub nom. *Peoples Department Stores Inc. (Bankrupt) v. Wise)* 326 N.R. 267 (Eng.), (sub nom. *Peoples Department Stores Inc. (Bankrupt) v. Wise)* 326 N.R. 267 (Fr.), 4 C.B.R. (5th) 215, [2004] 3 S.C.R. 461, 2004 SCC 68, 2004 CarswellQue 2862, 2004 CarswellQue 2863, (sub nom. *Peoples Department Stores Inc. (Trustee of) v. Wise)* 244 D.L.R. (4th) 564, 49 B.L.R. (3d) 165 (S.C.C.) — considered

Statutes considered:

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

Generally — referred to

s. 11(6) — considered

s. 11.02(3) [en. 2005, c. 47, s. 128] — considered

Corporations Act, R.S.M. 1987, c. C225

s. 234 — referred to

Rules considered:

Queen's Bench Rules, Man. Reg. 553/88

Generally — referred to

R. 46.14(1) — considered

R. 46.14(3) — considered

MOTION by claimants to authorize commencement of action.

***Dewar J.*:**

1 On September 12, 2012, an Initial Order was pronounced by me in a proceeding under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 (the "CCAA") filed on that date by three of the companies within the Puratone umbrella, namely The Puratone Corporation, Pembina Valley Pigs Ltd., and Niverville Swine Breeders Ltd. (hereinafter "Puratone").

2 The Puratone Group of companies ran a commercial hog production business. Their business included the breeding, farrowing, finishing and marketing of hogs. In order to carry on this business, Puratone needed grain to be used in feed for its hogs.

3 This motion involves 17 farming operators who claim priority to some of the proceeds of sale of the assets of the companies covered by the within CCAA proceedings. The lead farming operator, Interlake Turkey Breeders Ltd. claims to be a part of the steering committee for a group of farmers who supplied grain to the Puratone Group of Companies within two weeks of the filing of this CCAA proceeding. I will hereinafter refer to the group of farmers as "the ITB Claimants".

4 The Initial Order contained many of the usual provisions, including stay provisions as follows:

NO PROCEEDINGS AGAINST THE APPLICANTS OR THE PROPERTY

18. THIS COURT ORDERS that until and including October 12, 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 Applicants or the Monitor, or affecting the Business or the Property, except with the written consent of the Applicants and the Monitor, or with leave of this Court, and any and all Proceedings currently under way against or in respect of the Applicants 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 Applicants or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of the Applicants and the Monitor, or leave of this Court, provided that nothing in this Order shall (i) empower the Applicants to carry on any business which the Applicants are not lawfully entitled to carry on, (ii) affect such investigations, actions, suits or proceedings by a regulatory body as are permitted by Section 11.1 of the CCAA, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

PROCEEDINGS AGAINST DIRECTORS AND OFFICERS

26. 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 Applicants with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of the Applicants 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 Applicants, if one is filed, is sanctioned by this Court or is refused by the creditors of the Applicants or this Court.

5 Although the Initial Order included the stay provisions for only 30 days ending October 12, 2012, the stays have been extended as a result of a series of motions whilst Puratone has been undergoing its "restructuring". The restructuring referred to has essentially involved the sale of substantially all of its assets to Maple Leaf Foods Inc. on a going concern basis. That sale was approved by the court on November 8, 2012 and closed on December 17, 2012. As part of the order approving the sale, I ordered that the proceeds of sale should be paid to the Monitor to be held pending receipt of a Distribution Order. On March 12, 2013, I granted an order authorizing the distribution of most of the net proceeds from the sale of the assets. The creditors who received funds from the Distribution Order were as follows:

a) Bank of Montréal	\$17,726,173;
b) Farm Credit Corporation	\$15,817,303
c) Manitoba Agricultural Services Corporation (MASC)	\$1,041,524

6 The sworn pre-CCAA claim of Bank of Montréal before receiving this distribution was \$43,322,558. The sworn pre-CCAA claim of the Farm Credit Corporation (FCC) before receiving this distribution was \$41,025,891.76. The sworn pre-CCAA claim of MASC before receiving the distribution was \$5,263,767.

7 There are therefore significant shortfalls being sustained by each of the major secured creditors.

8 The Monitor has retained a sum in an amount of \$6,753,765 from the net proceeds. Of this amount, \$1,573,765 has been withheld to deal with an issue that has arisen with the purchaser out of the sale and to that extent, as against Puratone and its

creditors, the purchaser has the first claim against those funds. A further $5,000,000 was also recommended to be held back. These monies, in addition to whatever might be obtained from the relatively small number of assets yet to be liquidated, are intended to serve as a general holdback pending completion of the CCAA proceedings including the continued realization of remaining assets, resolution of the dispute with the purchaser and potential legal actions.

9 One of the potential legal actions is a claim by the ITB Claimants ("the ITB Claim"). At the time of the application of the Monitor for a Distribution Order, a motion was brought by the ITB Claimants requesting that $903,250.50 be withheld from any distribution to the major secured creditors, and requesting leave to commence an action against Puratone and its directors and/or officers in order to make the said claim. On its initial return date, I adjourned the motion of the ITB Claimants while authorizing the distribution set out above, which contemplated the holdback that had been recommended by the Monitor. I set time frames for the parties to provide briefs and any further affidavit material. On April 10, 2013 the ITB Claimants filed a further notice of motion which amplified their requests. The matter came on for hearing on April 11, 2013 at which time, after hearing submissions, I reserved judgment.

10 The claim of the ITB claimants is that they supplied grain to Puratone on an individual contract basis on various dates between August 29 and September 11, 2012, a period within two weeks of the filing of the CCAA proceeding. It is alleged that the grain was used by Puratone to feed the hogs that were ultimately sold to Maple Leaf Foods Inc. as part of the going concern sale ultimately approved by the court. The ITB Claimants argue that at the time of the supply transactions, Puratone was gearing up for its CCAA application and must have then known that it would have been unable to pay for the grain once an Initial Order was pronounced. In essence, the claim of the ITB Claimants boils down to allegations that Puratone acquired the grain when it had no intention of paying for it. As a result, the ITB claimants argue that they have causes of action against Puratone entitling them to:

a) damages for fraudulent misrepresentation on the part of Puratone;

b) a claim [an order] under s. 234 of *The Corporations Act*, C.C.S.M. c. C225, that Puratone's conduct was oppressive as regards the plaintiffs;

c) a declaration that an implied or constructive trust exists in favour of the plaintiffs, and that Puratone and its secured creditors were unjustly enriched by the feed supplied by the plaintiffs;

d) a declaration that the secured creditors claims are subordinate to those of the plaintiffs, and/or that in equity they subordinated their security to the ITB Claimants;

e) a declaration that Puratone and its directors and officers wrongfully and/or fraudulently caused Puratone to obtain feed from the plaintiffs which they knew would not be paid for;

f) a declaration that the secured creditors colluded with Puratone and/or its directors and officers to, in effect, wrongfully obtain feed which they knew would not be paid for; and

g) a declaration that the secured creditors indemnified, in fact or at law, Puratone and/or its directors and officers by supporting and participating in a process that was designed to ensure that the secured creditors received the benefit of the feed without having to pay for it.

Analysis

11 A stay of proceedings is normally included in an Initial Order in order to permit an applicant to proceed with its restructuring (including, in some cases, its liquidation) without continually being harassed by creditors who are dissatisfied with the state of their outstanding accounts. The theory behind the stay order is that it will allow the applicant to devote its full time, efforts and resources to presenting and executing a restructuring plan which is in the best interests of the creditors generally, rather than fighting rearguard actions against individual creditors who are trying to collect their individual accounts.

12 A stay of proceedings however can be lifted in the appropriate case, but those cases will be the subject of judicial consideration which normally involves a balancing of stakeholder interests.

13 The CCAA does not set out a specific test identifying the circumstances in which the stay of proceedings should be lifted. Rather, it is in the discretion of the supervising CCAA judge whether a proposed action should be allowed to proceed. Apart from giving the judge the authority to grant the stay, the only guidelines expressed in the CCAA respecting such a stay order are found in section 11.02(3) which says:

> (3) The court shall not make the order unless
>
> (a) the applicant satisfies the court that circumstances exist that make the order appropriate; and
>
> (b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

14 In *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.*, 2007 SKCA 72, [2007] 9 W.W.R. 79 (Sask. C.A.), the Saskatchewan Court of the Appeal indicated that there must be "sound reasons", consistent with the scheme of the CCAA, to relieve against the stay. In the search for "sound reasons", the court suggested the following considerations:

> a) the balance of convenience;
>
> b) the relative prejudice to the parties; and
>
> c) the merits of the proposed action.

It also indicated that, "The supervising CCAA judge should also consider the good faith and due diligence of the debtor company as referenced in s. 11(6)".

15 In my respectful view, these considerations are all to be viewed together and in the context of the nature and timing of the CCAA process before the court. The same request may very well receive a different reception in the case of an application for the lifting of a stay early in a CCAA proceeding that contemplates a true restructuring than in the case of an application brought late in a CCAA proceeding that involves only the sale of assets. In the former situation, the existence of a contemporaneous action might jeopardize the ability of the company to restructure as intended. In the latter case, the restructuring, such as it is, has been accomplished and the only issue being left to sort through is who is entitled to the money. In my view, a court would be more receptive to lifting the stay in the latter case than in the former.

The stay respecting claims against Puratone

16 The motion of the ITB Claimants was opposed by Bank of Montréal and FCC. They essentially argued that the ITB Claimants had not demonstrated the existence of a cause of action with enough of a reasonable prospect of success to justify a delay in the distribution of the holdback monies to the secured creditors. In short they focused on the third of the considerations described in *ICR Commercial Real Estate (Regina) Ltd.*. They argued that the proposed claim of the ITB Claimants for a constructive trust respecting some of the assets of Puratone would fail for a number of reasons, namely:

> a) The sale of grain by the ITB Claimants involved transactions that do not qualify for the application of the doctrines of unjust enrichment, or equitable subordination. These transactions were essentially commercial transactions as between buyer and seller. It was argued that an unpaid seller is simply a debtor of Puratone. Although Puratone has received a benefit, the normal buyer-seller relationship provides a juristic reason for the benefit, and therefore the doctrine of unjust enrichment does not apply. Furthermore the banks argued that the doctrine of equitable subordination has never been recognized in Canada.

b) The secured creditors are to be viewed as *bona fide* third parties with a commercial interest in the assets of Puratone and the ITB Claimants should not be entitled to jump the queue from the status of unsecured creditors and receive a priority ahead of secured creditors who hold valid and properly registered securities.

c) It is impossible to trace the grain into the hogs that were ultimately sold during the CCAA proceedings. Therefore, the ITB Claimants have no claim to the proceeds of sale of the hogs.

17 Counsel for the ITB Claimants has argued that this situation is a relatively new phenomenon. Historically, CCAA proceedings involved the restructuring of a company to permit it to carry on its business. CCAA proceedings in days gone by were not intended to be used where there were no future plans for the company. Counsel for the ITB Claimants argued that in this case, the plan was always to liquidate the assets in a controlled way in order to maximize the return to the secured creditors, but with the expectation that a shortfall would invariably occur to the secured creditors. He submitted that it must have been well known to Puratone as well as its secured creditors and directors and officers that at the time that the grain was supplied by the ITB claimants, Puratone was deeply underwater to its secured creditors. He argued that the evidence of knowledge of such insolvent condition can be inferred by the large shortfall suffered by Bank of Montréal and FCC notwithstanding a going concern sale which was negotiated during the CCAA proceedings only two months after the feed was supplied by the ITB Claimants. Counsel submits that CCAA applications of the scale of this proceeding are not prepared overnight, and that at the time of the supply of grain, Puratone would have been preparing its CCAA materials and would have known that the CCAA proceedings would only yield a sale which resulted in large secured creditor deficiencies. He argued that at the time of these contracts of supply, there was no likelihood that the ITB claimants would receive any of their money. He argued that by ordering the grain under these circumstances, essentially Puratone was perpetrating a fraud on the ITB claimants.

18 It was urged upon me by counsel for the two banks that the case authorities require a judge to scrutinize the claim which a creditor intends to advance before lifting the stay in a CCAA proceeding. It was argued that the authorities suggest that the test to be employed in lifting a CCAA stay is more than the test used in striking out a statement of claim as disclosing no cause of action or being frivolous and vexatious, but does not require prospective plaintiffs to demonstrate a *prima facie* case. The terms "reasonable cause of action" or "tenable case" have sometimes been used.

19 In the *ICR* case, at paragraph 64 and 65, Jackson, JA wrote:

[64] Koch J. used *prima facie* case, which he equated with tenable cause of action. "Tenable cause of action" is taken from Ground J.'s decision in Ivaco, but Ground J. used "reasonable cause of action" or "tenable case," as comparable terms and as only one of four criteria to be considered. The use of "*prima facie* case" defined as "tenable cause of action" is not particularly helpful as the words have been used in different contexts with different purposes in mind. Even in the context of bankruptcy where specific guidelines are given, and the courts have had long experience with the application of the tests, the debate continues as to what is meant by *prima facie* case and whether it is too high of a standard to apply in determining whether an action may be commenced.

[65] Koch J. was clearly correct to hold that the threshold established by s. 173 of *The Queen's Bench Rules* is too low. On the other hand, it is also important not to decide the case. The purpose for passing on the claim is not to determine whether it will or will not succeed, but to determine whether the plan of arrangement should be delayed or further compromised to accommodate a future claim, or some other step need be taken to maintain the integrity of the CCAA proceeding.

(Emphasis added)

20 When I scrutinize the proposed claim of the ITB Claimants against Puratone, I conclude that its dismissal is not a foregone conclusion. The ITB Claimants raise a point which so far as I am aware has not been addressed by this court. Here, the court is faced with a CCAA proceeding which has had from the outset all of the earmarks of a liquidation proceeding. The affidavit of Raymond Hildebrand, sworn September 12, 2012 underlying the request for the Initial Order as well as the Pre-Filing Monitor's Report outlined the financial difficulties being experienced by Puratone, the reasons for those difficulties, as well as the efforts that had been made by Puratone and its restructuring professionals to deal with them. Some of the efforts had included a Sales

and Solicitation Process ("SISP"), a process designed to find people who were willing to inject money into Puratone either through a going concern sale of assets or in equity injection. Those efforts failed.

21 In the Pre-Filing Report of Deloitte & Touche Inc., the then Proposed Monitor wrote:

> 46 The Proposed Monitor has been advised that the SISP, as originally proposed, failed to result in a successful investment or sale transaction. Accordingly, the SISP has been terminated and replaced with a short-term, expedited strategy to complete a sale of the business, or parts thereof, which will be undertaken by the Applicants with the assistance of the Proposed Monitor (the "Sales Process").

22 The Initial Order was granted based on information, *inter alia*, that the major secured creditors were Bank of Montréal and FCC. As indicated earlier, less than three months later, the parties were recommending a sale which would result in large secured creditor shortfalls. The ITB Claimants argue that this result must have been contemplated by Puratone at the time that the ITB Claimants supplied their grain to Puratone. This raises the interesting question as to whether that expectation was in the mind of Puratone at the time that the grain was supplied, and if so, whether the ITB Claimants are entitled to any relief from Puratone other than a meaningless monetary judgment. It raises the issue whether a company with exposed secured creditors should be incurring credit at a time when it is preparing to make a CCAA application.

23 The ITB claimants request a constructive trust over the assets of Puratone that were sold during the CCAA proceeding which, if ordered, would erode the assets over which the banks claim security by the amount of the unpaid accounts of the ITB Claimants. A constructive trust has been recognized as a remedy against a debtor in the event that there has been a fraud. In Peter D. Maddaugh and John D. McCamus, The Law of Restitution, (looseleaf), Volume 1, at paragraph 5:200.30, the following is written:

> Chancery's willingness to impose a constructive trust in circumstances where a fraud has been perpetrated is by no means a modern development. No preexisting fiduciary relationship need be established for this category of constructive trust and, indeed, a breach of trust or other fiduciary obligation is, in itself, simply one form of equitable fraud. As Lord Westbury explained in *McCormick v. Grogan*: "it is a jurisdiction by which a Court of Equity, proceeding on the ground of fraud, converts the party who has committed it into a trustee for the party who is injured by that fraud." And, in *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.*, Lord Browne-Wilkinson recognized that "when property is obtained by fraud equity imposes a constructive trust on the fraudulent recipient: the property is recoverable and traceable in equity". For example, one who acquires property by theft or fraudulent misrepresentation may be held a constructive trustee of the misappropriated property.

24 The question arises whether there is any practical reason for permitting the ITB Claimants to make their claim against Puratone at this time. Courts will generally not impose a constructive trust where the remedy jeopardizes the priority of innocent parties for value. In this regard, see *International Corona Resources Ltd. v. LAC Minerals Ltd.*, [1989] 2 S.C.R. 574 (S.C.C.), where LaForest J says:

> 197 ...In the vast majority of cases a constructive trust will not be the appropriate remedy. Thus, in *Hunter Engineering Co. v. Syncrude Canada Ltd.*, *supra*, had the restitutionary claim been made out, there would have been no reason to award a constructive trust, as the plaintiff's claim could have been satisfied simply by a personal monetary award; a constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property. Among the most important of these will be that it is appropriate that the plaintiff receive the priority accorded to the holder of a right of property in a bankruptcy....

The banks argue that there is no evidence that they are anything but innocent parties in these circumstances. Counsel for the two banks argue that there is no affidavit evidence adduced by the ITB Claimants that indicates that the banks were knowledgeable about any fraudulent intent on the part of Puratone, even if such existed. They argue that the court should not lift the stay simply on the basis that the ITB Claimants make such an unsubstantiated allegation. Rather it is argued that the banks should, for the purpose of this motion, be assumed to have had no knowledge of any bad intent that is alleged to have been possessed on the part of Puratone, and that being the case, there is no prospect, let alone a reasonable prospect, that the ITB Claimants will be successful in obtaining a constructive trust at the end of the day.

25 The problem which I see with this submission is that evidence of the knowledge of the banks at the material times is a factual matter that is not readily apparent. Evidence such as that would normally only surface during the discovery process in civil litigation. The banks have chosen to file no affidavit material in this motion. It seems too high a threshold to require the ITB Claimants to demonstrate the knowledge of the banks at the material times on this motion. For current purposes, it is sufficient to conclude that given the size of the troubled loans, a reasonable inference is that the two banks who appeared to oppose the ITB Claimants motion would have been aware of the pending CCAA proceedings before they were filed, and at the time that the grain was being supplied, bank representatives would have had more than a cursory understanding of the business of Puratone and its financial difficulties. Whether the banks were aware that Puratone was purchasing grain on other than a COD basis after the decision had been made to apply for a CCAA order, and if so, whether the banks were in any position to do anything about it, is currently unknown. I do not say that the ITB Claimants will prevail in demonstrating the necessary knowledge in the fullness of time, but they have a claim which raises interesting issues, and they should be given the opportunity to pursue it sooner rather than later, especially when the existence of the claim will not jeopardize any restructuring.

26 What then of the other considerations enumerated by Jackson JA in the *ICR* case?

27 The merits of the claim against Puratone aside for the moment, the ITB Claim essentially translates into a priority claim between competing creditors. There is no restructuring plan which is being put at risk in this case. This proceeding is almost over. There are a few assets left to be liquidated, but that process will not be put at risk by the existence of the proposed claim by the ITB Claimants. Indeed, the Monitor confirms as such when in its latest report, it observed:

> 20. The Monitor understands that the general purpose of a stay of proceedings under the CCAA is to maintain the *status quo* for a period of time in order that a debtor company (and its directors and officers) can focus on restructuring efforts without undue interference.
>
> 21. Substantially all of the undertaking, property and assets of the Applicants have been sold and it is not anticipated that any formal restructuring will occur. In these circumstances, subject to the proviso which follows with respect to the role of the Monitor should litigation ensue, the Monitor is of the view that there would be no particular prejudice to the CCAA Proceedings if the stay of proceedings is lifted to enable ITB to initiate and proceed with an action against the Applicants and the directors and/or officers of the Applicants.

28 The proviso of the Monitor was simply that it not be required to retain any role in the litigation, if it was allowed to proceed.

29 Accordingly, the balance of convenience favors the ITB Claimants.

30 What then is the prejudice to be suffered if the claim were permitted to proceed at this time? The real prejudice in this case is that if the ITB Claimants are entitled to commence their action now against Puratone and the secured creditors, there could be a delay in the distribution of the holdback monies to the secured creditors. The banks would essentially be deprived of their use of the monies during the litigation and the return on the monies while sitting in the Monitor's trust account would not match what the banks might earn on those monies were they in hand.

31 On the other hand, if I do not permit the claim to be made at this time, the ITB Claimants would be forced to await the end of the CCAA proceeding before commencing their claim. By that time, there would be no money left in Puratone. It all will have been paid to the secured creditors, with at least the tacit acknowledgment by the court that those creditors were entitled to those monies ahead of anyone else. A result such as this is inconsistent with the notion that in a CCAA proceeding, creditors have resort to the supervising court to adjudicate on priority disputes.

32 Any prejudice created by the delay in distribution of funds can easily be alleviated by analogy to the Court Rules respecting prejudgment garnishment. In effect, that is the result which is being sought by the ITB Claimants. Although *Queen's Bench Rule* 46.14 (1) permits garnishment before judgment, Rule 46.14 (3) reads as follows:

46.14(3) An order under subrule (1) (Form 46D) may include,

(a) a requirement that the plaintiff post security in a form and amount to be determined by the court; and

(b) such other terms and conditions as may be just.

33 There is no doubt that the secured creditors are *prima facie* entitled to the proceeds of these proceedings. They have valid security agreements which have been properly registered. The ITB Claimants seek to challenge their priority not on the basis that the banks are not secured creditors, but on the basis of factual circumstances that would make it equitable to provide the ITB Claimants with a priority over the secured creditors. There are factual impediments to their claim for unjust enrichment and potentially legal impediments to their claim for equitable subordination and tracing. If I give them the right to make those claims, and those claims are not successful, the delays which those claims might cause to the timely receipt of monies by the secured creditors should not go unaddressed. This can be done by requiring the ITB Claimants to each file an undertaking whereby they would be liable to pay either or both of the banks damages arising from the delay in the payment of the holdback monies attributable to their claim. I am therefore ordering that out of the general holdback monies the amount of $903,250.50 be dedicated to the ITB Claim and not be paid out without further order of court, which presumably will occur either after the claim has been resolved or upon sufficient evidence being demonstrated that it has not been prosecuted in a timely way. Counsel may try and agree on the form of the undertaking as to damages, but may come back to me should agreement not be reached.

34 As regards Puratone, I therefore make the following orders:

a) Out of the general holdback monies, the sum of $903,250.50 and any interest accrued thereon since March 12, 2013 shall be segregated in an interest bearing account designated as the ITB Claim Monies.

b) Leave is given to the ITB Claimants to commence the action against Puratone described at Schedule A of their notice of motion dated April 10, 2013, provided:

(1) they issue it within 40 days after the date of signing of the Order that evidences this decision, and

(2) Prior to the issuance of the Statement of Claim, each named plaintiff will file an undertaking as to damages for its pro rata share of any damages sustained by Bank of Montréal and/or FCC arising from any delay after July 31, 2013 in the distribution of its portion of the ITB Claim monies to Bank of Montréal and/or FCC caused by the issuance of the ITB Claim.

35 If a claimant does not file the requested undertaking as to damages, I will consider that such claimant has abandoned its claim and the ITB Claim Monies may be reduced by the amount of that claimant's claim.

The Proposed Claim against the directors and/or officers

36 The claim of the ITB Claimants against the directors and/or officers similarly finds its roots in the allegations of fraud made against Puratone. Counsel for the directors and officers relies upon the case of *People's Department Stores Ltd. (1992) Inc., Re*, 2004 SCC 68, [2004] S.C.J. No. 64 (S.C.C.), drawing from it the principle that deference ought to be given to the decisions that directors make as they fulfill their functions. Notwithstanding that case, there is an argument to be made that where a company has committed a fraud, be it legal or equitable, knowledge on the part of directors of such conduct by officers or employees of the company may make the directors vicariously and/or personally liable.

37 Again, evidence of the actual knowledge of the directors and/or the officers is not readily apparent without the ability to inquire into the records of the company through the discovery process. For the same reasons that I expressed as regards the two banks, requiring the ITB Claimants to adduce evidence on this motion of the directors' and officers' knowledge is too high a threshold to impose. A reasonable inference is that at least some of the directors and officers would have known that a CCAA proceeding was being prepared within the two week period prior to the CCAA filing, and at least some of the directors and officers would have had intimate knowledge of the financial constraints of the company and the efforts which the company was

employing to solve them during the two week period prior to the filing of the CCAA proceeding. That reasonable inference in my view is sufficient to conclude that the proposed claim against the directors and/or officers is not necessarily doomed to fail. This case, as with many, will depend on facts not currently available to the court.

38 Additionally, the balance of convenience favors the ITB Claimants, and I see no prejudice to the directors and officers facing the ITB claim sooner rather than later.

39 In my view there are sound reasons to justify lifting the stay to permit the ITB Claimants to issue the proposed claim against the officers and are directors, providing it is issued within 40 days after the date of signing of the Order that evidences this decision. It will however be necessary for the claimants to name the particular individuals who they propose to sue, recognizing that they may expose themselves to costs, possibly on a solicitor and own client basis, for every person that they unsuccessfully sue.

Going Forward

40 I have contemplated that the claim should be commenced by one statement of claim, naming at least Puratone and the named officers and directors. The normal Rules of the Court should be followed with the additional requirement that the action will be case managed. A case management conference before me shall be set up within 30 days of the close of pleadings, or earlier upon written request of any party.

41 If necessary, the costs of this motion shall be determined by me upon the resolution of the ITB Claims.

Motion granted.