File No. CI 24-01-45056

THE KING'S BENCH
Winnipeg Centre

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 SEA AIR INTERNAIONAL FORWARDERS LIMITED

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II. STATEMENT OF FACTS

1. Sea Air international Forwarders Limited ("Sea Air") is an Ontario Corporation having its registered office in Mississauga, Ontario, and carries on business throughout Canada and beyond as an international freight forwarder.

2. Genesus Inc. ("Genesus") is a company incorporated pursuant to the laws of Manitoba carrying on the business of breeding and selling swine. At the material times, it had approximately 18,000 hogs under its care and control.

3. Bank of Montreal ("BMO") began financing Genesus in 2011, and while the financing agreements provided for security and were amended in 2019, 2020, 2021 and 2022, BMO did not have a real property mortgage until the fall of 2023.

4. In March of 2023, BMO retained BDO to provide assistance with respect to Genesus' financial position and review BMO's security over its assets.

5. As set out at Exhibit "II" of the Affidavit of Ed Barrington sworn February 9, 2024, BMO sent a demand letter attaching a notice of Intention to Enforce Security addressed to "Genesus Inc., an insolvent person" issued pursuant to s. 244 of the *Bankruptcy and Insolvency Act, RSC 1985, c B-3* (the "BIA") on June 16, 2023.

6. Sea Air provided services and invoiced Genesus for same on May 23, May 30, June 6 and June 26 of 2023.

7. As those invoices were not paid, Sea Air obtained default judgment against Genesus on October 3, 2023, in the amount of $319,796.33 plus costs.

8. The judgment was registered against title to three parcels of land owned by Genesus (the "Properties") on December 15, 2023.

9. Between the time Sea Air's action was commenced and the date on which its judgment was registered against title to the Properties, BMO registered a mortgage with a face value of $8 million against each of the Properties.

10. The stated consideration for the BMO mortgage was a 3.5 month forbearance set out in a Forbearance Agreement attached to Mr. Barrington's Affidavit as Exhibit "KK". There is no indication that any further funds were advanced for any other consideration aside from the forbearance period. Indeed, the Forbearance Agreement (as is typically the case) heavily favours the Bank, with little or nothing of real value provided to Genesis in return.

11. BMO initiated the within proceedings pursuant s. 243 of the *BIA*, and on June 11, 2024, BDO was appointed as Receiver of all of Genesus' assets, property, and undertaking.

12. Sea Air brings this motion to seek a declaration that Mortgage No. 5583625/1 granted by Genesus to BMO is void and/or otherwise unenforceable and, or in the alternative, a declaration that the mortgage is subordinate to the Certificate of Judgment registered by Sea Air as No. 5602937/1.

III. THE LAW

13. Section 4.2 and s. 183(1) of the BIA and s. 2 of *The Fraudulent Conveyances Act*, CCSM c F160 (the "FCA") are the relevant statutory authorities.

14. Section. 4.2(1) of the *BIA* specifies that any interested person in any proceeding under the *BIA* must act in good faith with respect to the proceedings and s. 4.2(2) sets out the powers of the court – if the court is satisfied that a party has failed to act in good faith, on application by any interested person the court may make any order that it considers appropriate in the circumstances.

Tab 1 – BIA at s. 4.2

15. Section 183 of the *BIA* vests the court with jurisdiction in law and in equity to exercise original auxiliary and ancillary jurisdiction in bankruptcy and other proceedings authorized by the BIA, and grounds the authority of this court to utilize the doctrine of equitable subordination.

Tab 1 – BIA at s. 183(1)
Tab 15 – *Lloyd's Non-Marine Underwriters v. JJ Lacey Insurance Ltd*., 2009 NLTD 148
Tab 13 – *US Steel Canada Inc*., Re, 2016 ONCA 662 at para 104

16. The *FCA* serves as a comprehensive scheme to catch many transactions made with the intent to defeat creditors. The relevant sections read as follows:

Definitions

iii 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;

"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;

> **"real property"** includes lands, tenements, hereditaments, and any estate or interest therein.
>
> **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.

Tab 2 – FCA at s. 2

<u>**Fraudulent Conveyance**</u>

17. Intent to defeat, hinder, delay or defraud creditors can be (and almost always is) inferred from the circumstances. In the case of a voluntary transaction, as with the conveyance of security in the form of a mortgage to BMO, it is only necessary to show such an intention of the transferor at the time of the transaction.

Tab 3 – *Bank of Nova Scotia v. Bass* (1983), 22 Man. R. (2d) 153 (Q.B.)

18. Justice Clearwater elaborated on this analysis in *Royal Bank v. O'Brien,* outlining certain 'badges' which have been identified by courts as indicative of fraud:

> 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 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).

Tab 4 – *Royal Bank v. O'Brien* (1997), 1997 Carswell Man 420

19. In *Garlicki (Trustee of) v. Garlicki*, Justice Bond said the following:

77 In the absence of direct evidence, fraudulent intent may be inferred from suspicious circumstances: Royal Bank v. O'Brien, [1997] 9 W.W.R. 439 (Man. Q.B.); Shoukralla v. Shoukralla, 2014 ONSC 4205, [2014] O.J. No. 3329 (Ont. S.C.J.) (QL). Both Justice Clearwater of the Manitoba Court of Queen's Bench in Royal Bank and Justice Croll of the Ontario Superior Court of Justice in Shoukralla provide lists of fact situations that have been identified as "badges of fraud". As Justice Clearwater states, at para. 16, "These situations, taken separately, or combined, may (but not necessarily will) result in a finding of fraud, if proven."

78 In this case, the following circumstances mirror those referred to in Royal Bank and Shoukralla and support an inference of fraudulent intent:

…

(3) The amount of the consideration for the assignment is unclear and appears to be inadequate. In July 2003, when it is claimed by the defendants that the assignment was contemplated and the letter prepared, Lucy owed Krystyna approximately $20,000 according to the summary of debts filed. The potential MPA settlement was acknowledged to be at minimum $168,000 and potentially much more. It was ultimately settled for $180,000. The evidence provided by the defendants regarding the total amount ultimately loaned to Lucy by Krystyna is at best inflated, and at worst false. Many of the purported payments are without any documentary corroboration and despite requests made of her during examinations conducted prior to trial, Lucy has produced no bank statements, credit card statements, or receipts to support her assertions.

Tab 5 – *Garlicki (Trustee of) v. Garlicki*, 2015 MBQB 125

20. The badges of fraud, when found, form a *prima facie* case, which shifts the evidentiary burden to the Defendants.

Tab 6 – *Conte Estate v. Allessandro*, 2002 CarswellOnt 4507, aff'd 2004 CarswellOnt 3218

21. Finally, the case of *Botham Holdings Ltd. (Trustee of) v. Braydon Investments Ltd.* offers further clarification on the issue of the requisite intent under the analogous statute in British Columbia, and reflects a development in the law. The Court in Botham held that it is not necessary to show dishonest or fraudulent intent in order for the Act to apply: all that needs to be shown is that a conveyance is made with the intention, and has the effect, of hindering or impairing the right of a creditor or other person to satisfy a claim against the transferor.

Tab 7 – *Botham Holdings Ltd. (Trustee of) v. Braydon Investments Ltd.*, 2009 BCCA 521, leave to appeal refused 300 B.C.A.C. 318 (note) (SCC)

<u>Good Faith</u>

22. In *CWB Maxium Financial Inc v. 2026998 Alberta Ltd*, 2021 ABQB 137, Justice Mah considered the meaning of "good faith" in the context of the *BIA* and applied the principles of good faith derived from *Bhasin v. Hrynew* and *C.M. Callow Inc. v. Zollinger* to give content to s. 4.2, emphasizing the importance of the policy objectives of the *BIA*. Considering the requirements of section 4.2 in the context of the actions of a secured lender, Justice Mah held, *inter alia*, that:

- 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;

- 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.

- 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;

- 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.

- 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.

Tab 8 – *CWB Maxium Financial Inc v. 2026998 Alberta Ltd*, 2021 ABQB 137 at para 59

23. Justice Mah also acknowledged that it is not just secured creditors who are required to act in good faith. Debtors are 'interested persons' subject to the good faith requirement as well.

Tab 8 – *CWB Maxium Financial Inc v. 2026998 Alberta Ltd*, *supra,* at para 40

24. In *Taber Water Disposal Inc. (Re),* 2024 ABKB 680 Feasby, J. outlined some of the principles and best practices which ought to be considered in conjunction with the good faith obligations imposed by section 4.2:

> 33 Prior to the amendment of the BIA adding s 4.2, Professor Janis Sarra wrote an article advocating for a statutorily codified obligation to act in good faith: Janis Sarra, "La bonne foi est une consideration de base – Requiring Nothing Less than Good Faith in Insolvency Law Proceedings" in Janis P. Sarra, ed, Annual Review of Insolvency Law 2014, (Toronto: Carswell, 2009) 145. Professor Sarra outlined "principles and best practices" that "court[s] should make clear" which could provide content for a codified obligation of good faith. The principles and best practices identified by Professor Sarra at 182-83 relevant to the present case include:

- The requirement to act in good faith in insolvency proceedings is an obligation of all parties and their professionals, and is an obligation that cannot be contracted out of. The good faith standard also applies to government regulators, interim financiers, plan sponsors, and all other stakeholders involved in the proceeding.

- In determining good faith, the court will determine if the debtor, creditors, other stakeholders and their professionals have acted candidly, honestly, forthrightly and reasonably in their dealings with one another and the court. Dealings in this respect would include dealings from the commencement of the proceedings to final resolution, including negotiation for, and implementation of, a proposal or plan under the BIA or CCAA.

- All stakeholders in insolvency proceedings should have appropriate regard for the legitimate interests of the other creditors and stakeholders, "appropriate regard" requiring that the parties not seek to undermine the interests of others in bad faith.

- The good faith obligation includes a duty of creditors and other stakeholders to disclose all of their real economic interests in the insolvency proceedings.

. . . [Emphasis added]

Tab 9 – *Taber Water Disposal Inc. (Re),* 2024 ABKB 680 at para 33

25. In the same article relied on by the court in *Taber*, Dr Janis Sarra convincingly argued that the reasoning of the Supreme Court in Canada in *Bhasin v Hyrnew* has a direct application to insolvency proceedings, and that "creditors' conduct should be explicitly required to be in good faith if they expect the full benefit of remedies under insolvency law and contract law to which they may be entitled." [Emphasis added]

Tab 10 – What Does ''Good Faith" Mean in Insolvency Proceedings?, Linc A. Rogers, David Sieradzki and Matthew Kanter at p 57

26. In *Taber*, Justice Feasby recognized that s. 4.2 "provides the Court with broad remedial discretion" and determined that Arrow Point, who waited until a Vesting Order had been made before coming forward with its claim on the title of the debtor, had

breached its duty of good faith. In exercising his broad remedial discretion, Justice Feasby drew an adverse inference that the that Arrow Point did not own the disputed interest.

Tab 9 – *Taber Water Disposal Inc. (Re),* 2024 *supra,* at paras 34 and 5

27. In *CWB*, Justice Mah held 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" (para 44). As such, the conduct of BMO and Genesus, in assessing whether they have breached their good faith obligations, should be be assessed in light of the intent and policy objectives of the BIA.

28. Fairness is one of the foundational principles of the BIA, and it is respectfully submitted that it should be a central consideration for this Court in determining whether to grant an order pursuant to s.4.2(2), which allows for broad remedial discretion.

29. For example, in *Re Residential Warranty Company of Canada*, 2006 ABQB 236, at para 25, Topolniski, J noted that the "fundamental tenet of BIA proceedings is that fairness should govern". Further, at paragraph 26 she expanded on the importance of fairness in the context of exercising inherent jurisdiction:

> Inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfillment of the substantive objectives of the BIA, including the proper administration and protection of the bankrupt's estate. [Emphasis added]

Tab 11 – *Re Residential Warranty Company of Canada*, 2006 ABQB 236, aff'd 2006 ABCA 293 at para 26

30. In *Pope & Talbot*, 2009 BCSC 1552 Walker, J. affirmed the proposition that the *BIA* confers jurisdiction on the superior courts to disrupt private contractual rights (at para. 118). Walker J. interpreted s. 183 of the *BIA* as empowering the court to exercise

its "inherent jurisdiction to control its own processes in order to promote the objectives of the *BIA*" (at para. 126). He explained that the underlying rationale is to achieve fairness in the bankruptcy process and achieve the underlying objectives of the *BIA*, citing the decision of Topolinski J. in *Residential Warranty Co. of Canada Inc*., Re, 2006 ABQB 236 (Alta QB):

> [119] The rationale underlying that point is well set out in the decision of Topolniski J., whose reasoning was affirmed by the Alberta Court of Appeal in *Residential Warranty Co. of Canada Inc. (Re)*, 2006 ABQB 236, 62 Alta. L.R. (4th) 168, aff'd 2006 ABCA 293, 65 Alta. L.R. (4th) 32:
>
>> [25] A significant objective of the *BIA* is to ensure that all of the property owned by the bankrupt or in which the bankrupt has a beneficial interest at the date of the bankruptcy will, with limited exceptions, vest in the trustee for realization and ratable distribution to creditors. To further this objective, the *BIA* provides for practical, efficient and relatively inexpensive mechanisms for asset recovery, determination of the validity of creditor claims, and distribution of the estate. A fundamental tenet of *BIA* proceedings is that fairness should govern. [Emphasis added]

Tab 12 – *Pope & Talbot*, 2009 BCSC 1552

Equitable Subordination

31. A common remedy in US bankruptcy law, the doctrine of equitable subordination refers to "a form of equitable relief to subordinate the claim of a creditor who has engaged in inequitable conduct." In effect, equitable subordination permits a court to alter the statutory distribution scheme by moving a creditor down in the priority chain.

Tab 13 – *U.S. Steel Canada Inc., Re* 2016 ONCA 662 at para 91

32. In Canada, the following definition of equitable subordination has been adopted by the courts, 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."

Tab 14 – "Transplanting Equitable Subordination: The New Free-Wheeling Equitable Discretion in Canadian Insolvency Law?" (2002) 36 Can. Bus. L.J., 36 at p. 36

Tab 15 – *Lloyd's Non-Marine Underwriters v. JJ Lacey Insurance Ltd*., *supra,* at para 32

33. The Newfoundland and Labrador Supreme Court recently recognized the doctrine of equitable subordination and applied the American three-part *Mobil Steel* test to subordinate the claim of another creditor in the face of inequitable conduct. The court began its analysis by asking:

> 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.

Tab 15- *Lloyd's Non-Marine Underwriters v. JJ Lacey Insurance Ltd*., *supra,* at para 32

34. The court in *Lloyd's* answered that question in the affirmative. The court was "satisfied that the three part test for equitable subordination…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."

Tab 15 – *Lloyd's Non-Marine Underwriters v. JJ Lacey Insurance Ltd*., *supra*, at para 54

35. More recently, in *Re US Steel Canada Inc*., 2016 ONCA 662, the Ontario Court of Appeal reasoned in *obiter* that equitable subordination should apply to the BIA. Strathy, C.J.O, relying upon section 183 of the BIA, concluded:

> [I]f 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.

Tab 13 – *US Steel Canada Inc.*, Re, *supra*, at para 104

36. As regards the three-part *Mobil Steel* test described in *Lloyd's*, before exercising the power of equitable subordination, a court must be satisfied that:

> (iii) The claimant must have engaged in some type of inequitable misconduct;
>
> (ii) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant;
>
> (iii) Equitable subordination of the claim must not be inconsistent with the provisions of the *Bankruptcy Act*.

Tab 15 – *Lloyd's Non-Marine Underwriters v. JJ Lacey Insurance Ltd.*, *supra*, at para 35

IV. THE ISSUE

37. Is Mortgage No. 5583625/1 granted by Genesus Inc. to Bank of Montreal void and/or otherwise unenforceable, and/or is it subordinate to the Certificate of Judgment registered by Sea Air?

V. ARGUMENT

Fraudulent Conveyance

38. Sea Air submits that s. 2 of the *FCA* is clearly applicable in the present circumstances. That provision has two components: first, there must be a conveyance of real or personal property and second, the conveyor must have intended to "*defeat, hinder, delay or defraud creditors".* 'Conveyance' includes a charge on or encumbrance of real property, and 'real property' includes lands.

39. In the present circumstances, the 'conveyance' of 'real property' is clear: the registration of the mortgage against the Properties in favour of BMO.

40. As noted earlier, an intent to defeat, hinder, delay, or defraud creditors may be (and typically is) inferred from the circumstances. The Court in *Botham Holdings* held that fraudulent intent on the part of the transferor does not need to be established under the FCA. Rather, all that needs to be proved is that in making the transfer, the transferor did so with intent to delay, hinder or defraud creditors or others.

Tab 7 – *Botham Holdings Ltd. (Trustee of) v. Braydon Investments Ltd.*, *supra*

41. As articulated by the Court in *Royal Bank v. O'Brien,* citing *Bank of Nova Scotia v Bass*, there are particular fact situations which are often described as badges of fraud. These badges may (but will not necessarily), collectively or individually, result in a finding of fraud, and include, *inter alia:*

- the consideration is grossly inadequate;
- there is unusual haste to make the transfer;

Tab 4 – *Royal Bank v. O'Brien* (1997), *supra*

42. Sea Air submits that at least the two badges above noted apply in the case at bar.

43. First, the value of the mortgage was far in excess of the value, if any, provided by BMO to Genesus. In that regard the question that must be asked is what would BMO have done had Genesus not agreed to provide additional security.

44. It is submitted that practically speaking, BMO would not have done anything different as there were animals that needed to be fed and cared for and brought to market weight. Further, BMO no doubt wanted (and needed time to arrange for) the protection afforded to a court appointed receiver (as opposed to a secured creditor in possession) in respect of environmental issues, an obvious concern given the nature of Genesus' operation, and because a formal process of some sort was clearly necessary in order to facilitate a sale or liquidation.

45. Indeed, the forbearance period is nearly identical to the look back period under the BIA. In other words, if BMO did not agree to forbear for more than three months and Genesus went bankrupt, the conveyance would likely have constituted a preference and/or a transfer under value pursuant to s. 95 and s. 96 of the BIA.

46. In any event, the amount of time provided is grossly inadequate consideration in exchange for a mortgage in the amount of $8,000.000.00. Given that there was no fresh advance of funds (indeed, Genesus was charged a forbearance fee), moreover, the mortgage secured a pre-existing debt that in and of itself was not proper (or really any) consideration.

47. Sea Air further submits that the second applicable badge of fraud which involves unusual haste to make the transfer is clearly present. The lending relationship between BMO and Genesus began in 2011. For nearly twelve years, until September of 2023, and despite amending agreements in each of the preceding four years, BMO did not see fit to seek mortgage security from Genesus despite the challenges presented by the pandemic and the industry's obvious ups and downs.

Question and Answer no. 8 of the Cross-Examination of Ed Barrington

48. It is respectfully submitted that the haste with which BMO and Genesus moved to improve BMO's security position over the Properties in the face of Genesus' known financial difficulties constitutes an unusual circumstance and evidences an intention to defeat Genesus' other creditors.

49. Given that at least two badges of fraud are present on the preponderance of probabilities, it is submitted that Sea Air has made out its case on at least a *prima facia* basis.

50. Even if only one badge of fraud has been made out, it is submitted (again relying on *Conte Estate v. Alessandro*) that this Court can reasonably find that Sea Air has made out a *prima facie* case. In the result, the evidentiary burden now falls on Genesus.

51. With respect, Sea Air submits that Genesus (and BMO) have failed to produce evidence discharging this evidentiary burden. In particular, they have failed to produce any evidence demonstrating that anything close to adequate consideration passed between the parties in exchange for the mortgage. In fact, the evidence produced by

BMO demonstrates that BMO requested and received from Genesus a forbearance fee "in consideration of the forbearance"

Affidavit of Ed Barrington affirmed January 15 2025 (Exhibit H, page 56)

52. Sea Air submits that the requirements of s. 2 of the *FCA* have been met, and thus BMO's mortgage over the Properties ought to be declared void.

Good Faith

53. Further, or in the alternative, Sea Air submits that s. 4.2 of the *BIA* is applicable in the circumstances and the Court is afforded broad discretionary powers to fashion a remedy in the face of Genesus and BMO's inequitable conduct.

54. As a preliminary matter, Sea Air submits that the obligation to act in good faith with respect to insolvency proceedings under s. 4.2 applies to both BMO as creditor and Genesus as debtor.

Tab 8 – *CWB Maxium Financial Inc v. 2026998 Alberta Ltd*, *supra*, at para 40

55. Further, BMO's and Genesus' conduct in the events preceding the receivership application, including the circumstances under which the parties entered into the Forbearance Agreement and registered the mortgage, falls within the good faith requirement as such conduct is "factually and temporally connected to the proceedings".

Tab 8 – *CWB Maxium Financial Inc v. 2026998 Alberta Ltd*, *supra*, at para 59

56. Accordingly, both BMO and Genesus were required to avoid conducting themselves in the negotiation and entering of the forbearance agreement in such a way which imputes an oblique motive or improper purpose.

Tab 8 – *CWB Maxium Financial Inc v. 2026998 Alberta Ltd*, *supra*, at para 59

57. It is submitted that the conduct of both BMO and Genesus is contrary to the relevant foundational principles of bankruptcy law, which seeks to ratably distribute the assets of the debtor to creditors in a manner that is governed, above all, by fairness.

Tab 12 – *Pope & Talbot*, *supra*

58. Sea Air respectfully submits that neither BMO nor Genesus had appropriate regard for the legitimate interests of other creditors and stakeholders, including Sea Air, who have been significantly prejudiced by the actions of the parties.

59. BMO was certainly aware that Geneus was insolvent when the parties entered into the Forbearance Agreement (and of course when BMO registered its mortgage against the Properties). In fact, it is submitted that Genesus' financial difficulties were BMO's only motivation in obtaining the mortgage at all, a conclusion which is readily apparent based on the timing of its registration and the fact that no mortgage security on the Properties was sought or obtained in the twelve years prior.

60. Genesus was aware that a claim had been filed against it by Sea Air, having been served with the claim on September 11, 2023, and was obviously aware that default judgment would issue against it if it did not defend the claim. It is likewise submitted that BMO would have also been aware that the Properties were exposed to judgements (in favour of Sea Air and others) being registered against them.

61. As such, Genesus and BMO both must have known that the mortgage would delay, disadvantage, or defeat the interests of Sea Air. This unfairly disregards Sea Air's interests and is contrary to the principle of fairness underpinning bankruptcy law itself.

62. Further, and in any event, by the fall of 2023 Genesus was being pressed for payment by a number of creditors and was on a COD basis with some of its suppliers. The fact that Genesus allowed another creditor to step in and take security in the circumstances for no, or grossly inadequate consideration, is antithetical to the notion of fairness and good faith which ought to govern the parties' conduct.

Question and Answer nos. 52 and 53 of the Examination of James Long

63. According to its CEO, James Long, Genesus began experiencing financial difficulty as a result of the COVID-19 pandemic. Despite experiencing such financial difficulties, Genesus entered into a contract with Sea Air for services which it could not, or refused, to pay for.

Question and Answer nos. 24 and 25 of the Cross-Examination of James Long

64. As set out in the Statement of Claim attached as Exhibit A to the Affidavit of Allan Herman, rather than pay anything to Sea Air, Genesus engaged another forwarder for its next shipment, but still attempted to use Sea Air's facilities to water and rest its animals for the shipment it arranged through the other forwarder. All of this was done just prior to Genesus engaging insolvency counsel on July 7, 2023.

Affidavit of Allan Heman affirmed May 29, 2024

65. Genesus, with multiple indices of insolvency looming, conducted its business in such a way so as to deprive Sea Air of $315,686.35 for services rendered, and when judgment was rendered in that amount, subverted Sea Air's claim by preferring BMO.

66. It is submitted that BMO also acted improperly, and took advantage of Genesus' vulnerable financial position when, after being approached by Genesus' counsel seeking

forbearance, it used its superior negotiating position to leverage further security from Genesus, while providing no (or grossly inadequate) value in return.

67. Both BMO and Genesus have thus acted for an improper purpose by attempting to undermine the established distribution scheme on the eve of Genesus' formal insolvency and in fact in direct contemplation of it.

68. It is submitted that the fact that the mortgage was registered more than three months before an initial bankruptcy event does not allow Genesus and BMO to undermine the foundational principles of the BIA by preferring another creditor in bad faith, and with disregard for all other stakeholders. In fact, s. 4.2 was codified precisely for this purpose; to grant a discretionary remedy when the conduct of the parties, although not strictly contrary to creditor preference rules or other rules of technical formality, flies directly in the face of the policy objectives of the Act. As stated by Dr .Sarra, "creditors' conduct should be explicitly required to be in good faith if they expect the full benefit of remedies under insolvency law and contract law to which they may be entitled." It is submitted that BMO should not expect the full benefit of its security over the legitimate interests of other creditors when such security was not obtained in good faith.

69. If the mortgage is recognized as a legitimate charge over the Properties there will be nothing left to distribute to Sea Air or any unsecured creditor after they are sold as the amount owed to BMO will no doubt exceed the available net proceeds. However, if BMO's mortgage is voided, BMO and all of Genesus' unsecured creditors would no doubt receive a *pro rata* distribution given the much smaller amount owed to Sea Air. As such, the relative prejudices to each party were this Court to grant the remedy sought by Sea

Air are far less than they would be were the Court to allow the bad faith conduct of BMO and Genesus to subvert the entirety of Sea Air's claim.

70. Indeed, it is submitted that the purpose of secured credit is to reduce risk to creditors and allow for lending which may otherwise not occur. Bankruptcy law recognizes this fact and affords priority to secured creditors in order to promote a stable lending environment and increase market efficiency. In this case, BMO advanced 100% of the debt owed by Genesus on the strength of other security it obtained several years ago — apparently on all of Genesus' assets other than real property (Exhibit "D" of the Affidavit of Allan Herman). To recognize BMO's mortgage security in the circumstances is entirely contrarian to the purpose of secured credit, as recognized in the provisions of the BIA. Rather than promote a stable lending environment and encourage secured lending, recognizing the mortgage as a valid charge would signal to stakeholders that all that is required to jump ahead of the legitimate interests of other creditors is agreement between debtor and creditor to grant security, whether valid consideration passes between them or not. As long as this is done more than 3 months before an initial bankruptcy event the secured creditor will have successfully undermined other creditors' interests. This would greatly undermine the predictability of this and future proceedings, another fundamental tenet of the insolvency system. Respectfully, this cannot be the finding of this Court as it relates to the conduct of BMO and Genesus, given the explicit good faith obligations mandated by s. 4.2 and the associated policy considerations which must flow from it.

71. Sea Air respectfully submits that the aim of any use of the good faith doctrine should be to preserve the distribution scheme of the *BIA* from attempts to subvert it at the

expense of other creditors and it therefore asks this Court to subordinate BMO's secured charge for this purpose.

Equitable Subordination

72. Further, or in the alternative, Sea Air submits that the doctrine of equitable subordination applies in the circumstances and BMO's mortgage should be subordinated to Sea Air's claim.

73. It is respectfully submitted that this Court should peer behind the veil of formal arrangements by BMO and Genesus to discern 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."

Tab 15 – *Lloyd's Non-Marine Underwriters v. JJ Lacey Insurance Ltd*., *supra,* at para 32

74. Applying the three part test from US case *Mobile Steel*, affirmed in Canada in *Lloyd's*, a court must be satisfied that:

(i) The claimant must have engaged in some type of inequitable misconduct;

(ii) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and

(iii) Equitable subordination of the claim must not be inconsistent with the provisions of the *Bankruptcy Act*.

75. It is submitted that all three elements are present in this matter.

76. First, BMO has engaged in inequitable misconduct in obtaining the mortgage. While it is appreciated that BMO is permitted to engage in conduct which seeks to protect its own business interests, the codification of good faith requirements at s. 4.2 and recent case law interpreting this provision have demonstrated that a claimant's self-interest must

have appropriate regard for the legitimate interests of other creditors and stakeholders. The policy objectives of the BIA itself demand this.

Tab 9 – *Taber Water Disposal Inc. (Re),* 2024 *supra*, at para 33

77. Second, there is little doubt that the conduct of BMO in obtaining the mortgage has resulted in both a significant advantage to itself and a significant disadvantage to Sea Air as Sea Air will receive nothing from Genesus' insolvent estate while BMO will be made whole or nearly whole.

78. Finally, it is submitted that equitable subordination is consistent with the *BIA*. Besides the inherent jurisdiction of this Court conferred by s. 183, s. 4.2 confers broad discretionary powers to this Court to fashion a remedy that is appropriate in the circumstances.

79. Sea Air therefore submits that the three part test is met, and as such it is entirely appropriate in the circumstances to subordinate BMO's mortgage to Sea Air's judgment.

VI CONCLUSION

80. Sea Air submits that on a balance of probabilities it has clearly been made out, *inter alia,* that Genesus granted a security interest in the Properties to BMO with an intent to (objectively speaking) defeat, hinder, delay and/or defraud its other creditors and in particular Sea Air.

81. Furthermore, Sea Air submits that manner in which BMO and Genesus entered into the Forbearance Agreement and registered the mortgage constitutes a breach of their obligations to act in good faith, and that their inequitable misconduct resulted in significant prejudice to Sea Air.

82. Given all of the foregoing, Sea Air respectfully submits that Mortgage No. 5583625/1 granted by Genesus Inc. to Bank of Montreal is void and/or otherwise unenforceable, or subordinate to the Certificate of Judgment registered by Sea Air ,and seeks costs on a solicitor-client basis accordingly.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 21st DAY OF MARCH, 2025

TAPPER CUDDY LLP

Per: ______________________
Richard W. Schwartz /
Connor A. Jonsson
Counsel for Sea Air

Tab 1

CANADA

CONSOLIDATION

CODIFICATION

Bankruptcy and Insolvency Act

Loi sur la faillite et l’insolvabilité

R.S.C., 1985, c. B-3

L.R.C. (1985), ch. B-3

Current to February 17, 2025

Last amended on December 12, 2024

À jour au 17 février 2025

Dernière modification le 12 décembre 2024

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persons are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.

R.S., 1985, c. B-3, s. 4; 2000, c. 12, s. 9; 2004, c. 25, s. 9(F); 2005, c. 47, s. 5; 2007, c. 36, s. 2.

Her Majesty

Binding on Her Majesty

4.1 This Act is binding on Her Majesty in right of Canada or a province.

1992, c. 27, s. 4.

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.

2019, c. 29, s. 133.

PART I

Administrative Officials

Superintendent

Appointment

5 (1) The Governor in Council shall appoint a Superintendent of Bankruptcy to hold office during good behaviour for a term of not more than five years, but the Superintendent may be removed from office by the Governor in Council for cause. The Superintendent's term may be renewed for one or more further terms.

Salary

(1.1) The Superintendent shall be paid the salary that the Governor in Council may fix.

Extent of supervision

(2) The Superintendent shall supervise the administration of all estates and matters to which this Act applies.

Duties

(3) The Superintendent shall, without limiting the authority conferred by subsection (2),

de même, sauf preuve contraire, pour l'application des alinéas 95(1)b) ou 96(1)b).

L.R. (1985), ch. B-3, art. 4; 2000, ch. 12, art. 9; 2004, ch. 25, art. 9(F); 2005, ch. 47, art. 5; 2007, ch. 36, art. 2.

Sa Majesté

Obligation de Sa Majesté

4.1 La présente loi lie Sa Majesté du chef du Canada ou d'une province.

1992, ch. 27, art. 4.

Obligation d'agir de bonne foi

Bonne foi

4.2 (1) Tout intéressé est tenu d'agir de bonne foi dans le cadre d'une procédure intentée au titre de la présente loi.

Bonne foi — pouvoirs du tribunal

(2) S'il est convaincu que l'intéressé n'agit pas de bonne foi, le tribunal peut, à la demande de tout intéressé, rendre toute ordonnance qu'il estime indiquée.

2019, ch. 29, art. 133.

PARTIE I

Fonctionnaires administratifs

Surintendant

Nomination

5 (1) Le gouverneur en conseil nomme à titre inamovible un surintendant des faillites pour un mandat renouvelable d'au plus cinq ans, sous réserve de révocation motivée de la part du gouverneur en conseil.

Traitement

(1.1) Le surintendant des faillites reçoit le traitement que fixe le gouverneur en conseil.

Surveillance

(2) Le surintendant contrôle l'administration des actifs et des affaires régis par la présente loi.

Fonctions

(3) Le surintendant, sans que soit limitée l'autorité que lui confère le paragraphe (2) :

Effect of annulment of bankruptcy

(2) If an order is made under subsection (1), all sales, dispositions of property, payments duly made and acts done before the making of the order by the trustee or other person acting under the trustee's authority, or by the court, are valid, but the property of the bankrupt shall vest in any person that the court may appoint, or, in default of any appointment, revert to the bankrupt for all the estate, or interest or right of the trustee in the estate, on any terms and subject to any conditions, if any, that the court may order.

Final statement of receipts and disbursements

(3) If an order is made under subsection (1), the trustee shall, without delay, prepare the final statements of receipts and disbursements referred to in section 151.

R.S., 1985, c. B-3, s. 181; 2004, c. 25, s. 86; 2005, c. 47, s. 109.

Stay on issue of order

182 (1) An order of discharge or annulment shall be dated on the day on which it is made, but it shall not be issued or delivered until the expiration of the time allowed for an appeal, and, if an appeal is entered, not until the appeal has been finally disposed of.

(2) [Repealed, 1992, c. 27, s. 65]

R.S., 1985, c. B-3, s. 182; 1992, c. 27, s. 65.

PART VII

Courts and Procedure

Jurisdiction of Courts

Courts vested with jurisdiction

183 (1) The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during their respective terms, as they are now, or may be hereafter, held, and in vacation and in chambers:

(a) in the Province of Ontario, the Superior Court of Justice;

(b) [Repealed, 2001, c. 4, s. 33]

(c) in the Provinces of Nova Scotia and British Columbia, the Supreme Court;

(d) in the Provinces of New Brunswick and Alberta, the Court of Queen's Bench;

Effet d'annulation de la faillite

(2) Lorsqu'une ordonnance est rendue en vertu du paragraphe (1), toutes les ventes et dispositions de biens, tous les paiements dûment effectués et tous les actes faits antérieurement par le syndic, par une autre personne agissant sous son autorité ou par le tribunal sont valides; mais les biens du failli sont dévolus à la personne que le tribunal peut nommer, ou, à défaut de cette nomination, retournent au failli pour tout droit, domaine ou intérêt du syndic, aux conditions, s'il en est, que le tribunal peut ordonner.

État définitif des recettes et des débours

(3) Malgré l'annulation de la faillite, le syndic prépare sans délai l'état définitif des recettes et des débours visé à l'article 151.

L.R. (1985), ch. B-3, art. 181; 2004, ch. 25, art. 86; 2005, ch. 47, art. 109.

Suspension de l'émission de l'ordonnance

182 (1) L'ordonnance de libération ou d'annulation porte la date à laquelle elle est rendue, mais ne peut être émise ou délivrée avant l'expiration du délai accordé pour un appel ni, si appel est interjeté, avant que l'appel ait été finalement jugé.

(2) [Abrogé, 1992, ch. 27, art. 65]

L.R. (1985), ch. B-3, art. 182; 1992, ch. 27, art. 65.

PARTIE VII

Tribunaux et procédure

Compétence des tribunaux

Tribunaux compétents

183 (1) Les tribunaux suivants possèdent la compétence en droit et en equity qui doit leur permettre d'exercer la juridiction de première instance, auxiliaire et subordonnée en matière de faillite et en d'autres procédures autorisées par la présente loi durant leurs termes respectifs, tels que ces termes sont maintenant ou peuvent par la suite être tenus, pendant une vacance judiciaire et en chambre :

a) dans la province d'Ontario, la Cour supérieure de justice;

b) [Abrogé, 2001, ch. 4, art. 33]

c) dans les provinces de la Nouvelle-Écosse et de la Colombie-Britannique, la Cour suprême;

(e) in the Province of Prince Edward Island, the Supreme Court of the Province;

(f) in the Provinces of Manitoba and Saskatchewan, the Court of Queen's Bench;

(g) in the Province of Newfoundland and Labrador, the Trial Division of the Supreme Court; and

(h) in Yukon, the Supreme Court of Yukon, in the Northwest Territories, the Supreme Court of the Northwest Territories, and in Nunavut, the Nunavut Court of Justice.

Superior Court jurisdiction in the Province of Quebec

(1.1) In the Province of Quebec, the Superior Court is invested with the jurisdiction that will enable it to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during its term, as it is now, or may be hereafter, held, and in vacation and in chambers.

Courts of appeal — common law provinces

(2) Subject to subsection (2.1), the courts of appeal throughout Canada, within their respective jurisdictions, are invested with power and jurisdiction at law and in equity, according to their ordinary procedures, except as varied by this Act or the General Rules, to hear and determine appeals from the courts vested with original jurisdiction under this Act.

Court of Appeal of the Province of Quebec

(2.1) In the Province of Quebec, the Court of Appeal, within its jurisdiction, is invested with power and jurisdiction, according to its ordinary procedures, except as varied by this Act or the General Rules, to hear and determine appeals from the Superior Court.

Supreme Court of Canada

(3) The Supreme Court of Canada has jurisdiction to hear and to decide according to its ordinary procedure any appeal so permitted and to award costs.

R.S., 1985, c. B-3, s. 183; R.S., 1985, c. 27 (2nd Supp.), s. 10; 1990, c. 17, s. 3; 1998, c. 30, s. 14; 1999, c. 3, s. 15; 2001, c. 4, s. 33; 2002, c. 7, s. 83; 2015, c. 3, s. 9.

d) dans les provinces du Nouveau-Brunswick et d'Alberta, la Cour du Banc de la Reine;

e) dans la province de l'Île-du-Prince-Édouard, la Cour suprême;

f) dans les provinces du Manitoba et de la Saskatchewan, la Cour du Banc de la Reine;

g) dans la province de Terre-Neuve-et-Labrador, la Division de première instance de la Cour suprême;

h) au Yukon, la Cour suprême du Yukon, dans les Territoires du Nord-Ouest, la Cour suprême des Territoires du Nord-Ouest et, au Nunavut, la Cour de justice du Nunavut.

Compétence de la Cour supérieure de la province de Québec

(1.1) Dans la province de Québec, la Cour supérieure possède la compétence pour exercer la juridiction de première instance, auxiliaire et subordonnée en matière de faillite et en d'autres procédures autorisées par la présente loi durant son terme, tel que celui-ci est maintenant ou peut par la suite être tenu, pendant une vacance judiciaire et en chambre.

Cours d'appel — provinces de common law

(2) Sous réserve du paragraphe (2.1), les cours d'appel du Canada, dans les limites de leur compétence respective, sont, en droit et en equity, conformément à leur procédure ordinaire, sauf divergences prévues par la présente loi ou par les Règles générales, investies de la compétence d'entendre et de juger les appels interjetés des tribunaux exerçant juridiction de première instance en vertu de la présente loi.

Cour d'appel de la province de Québec

(2.1) Dans la province de Québec, la Cour d'appel, dans les limites de sa compétence, est, conformément à sa procédure ordinaire, sauf divergences prévues par la présente loi ou par les Règles générales, investie de la compétence d'entendre et de juger les appels interjetés de la Cour supérieure.

Cour suprême du Canada

(3) La Cour suprême du Canada a compétence pour entendre et décider, suivant sa procédure ordinaire, tout appel ainsi autorisé et pour adjuger les frais.

L.R. (1985), ch. B-3, art. 183; L.R. (1985), ch. 27 (2e suppl.), art. 10; 1990, ch. 17, art. 3; 1998, ch. 30, art. 14; 1999, ch. 3, art. 15; 2001, ch. 4, art. 33; 2002, ch. 7, art. 83; 2015, ch. 3, art. 9.

Tab 2

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 18 May 2023, 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 18 mai 2023. 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 fèvr. 1988 (Gaz. du Man. : 6 fèvr. 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 3

1983 CarswellMan 28
Manitoba Court of Queen's Bench

Bank of Nova Scotia v. Bass

1983 CarswellMan 28, [1983] M.J. No. 52, 22 Man. R. (2d) 153, 47 C.B.R. (N.S.) 203

BANK OF NOVA SCOTIA v. BASS et al.

Kroft J.

Judgment: April 8, 1983
Docket: Suit No. 0898/82

Counsel: *L.B. Cherrett*, for plaintiff.
A.D. Hoffer, for defendants.

Subject: Corporate and Commercial; Insolvency; Contracts; Torts

Related Abridgment Classifications

Debtors and creditors

XII Fraudulent conveyances

XII.10 Fraudulent intent

XII.10.f Evidence of intention

Headnote

Fraud and Misrepresentation --- Fraudulent conveyances — Fraudulent intent — Evidence of intention

Fraudulent conveyances — Conveyances fraudulent as against creditors — Voluntary conveyances — Father guaranteeing son's debt — Father agreeing to transfer his interest in matrimonial home to wife due to marital problems — Creditor notifying father of son's default — Father formally transferring interest in house to wife — Plaintiff not proving conveyance made with intent to defraud creditors.

The plaintiff brought an action to set aside as a fraudulent conveyance the transfer by the defendant husband of his one-half interest in their matrimonial home to his wife. The husband had guaranteed his son's indebtedness to the plaintiff. The husband and wife had separated on several occasions. Prior to any concern over the financial stability of the son, the husband agreed to transfer his interest in the home to his wife, but no enforceable agreement or formal transfer was signed, partly because of the dereliction of their son who as a lawyer had been asked to look after the matter. After the plaintiff had notified the husband that the son had defaulted in recent payment promises a formal transfer to the wife of the one-half interest in the home was registered.

Held:

Action dismissed.

The original intent of the grantor to transfer his one-half interest in the home to his wife had never been abandoned or changed. There was no intent on the part of the grantor to defraud the creditors in general or the plaintiff in particular. The plaintiff had therefore failed to establish that there was a conveyance made with the intent of defrauding creditors.

Table of Authorities

Cases considered:

Commerce Capital Mtge. Corp. v. Jemmett (1981), 37 C.B.R. (N.S.) 59 (Ont. S.C.) — *applied*

Mandryk v. Merko, 15 C.B.R. (N.S.) 246, [1971] 2 W.W.R. 542, 19 D.L.R. (3d) 238 (Man. C.A.) — *applied*

Tempo Bldg. Supplies Ltd. v. Pitura (1979), 33 C.B.R. (N.S.) 23 (B.C.S.C.) — *applied*

Union Bank v. Murdock, 28 Man. R. 229, [1917] 3 W.W.R. 820, 37 D.L.R. 150 (C.A.) — *applied*

Statutes considered:

Fraudulent Conveyances Act, C.C.S.M., c. F160, s. 3.

Application to set aside as fraudulent the conveyance by husband of his one-half interest in matrimonial home to wife.

***Kroft J.*:**

1 At the outset of the trial, with the consent of counsel and the approval of the court, the plaintiff discontinued its action against Jack Bass and abandoned its damage claims against the remaining defendants. The defendants, for their part, abandoned the counterclaim.

2 There remains in issue only the plaintiff's claim that a certain transfer of residential property, from Joseph Bass and Lorraine Bass as joint tenants to Lorraine Bass alone, was a fraudulent conveyance within the meaning of the Fraudulent Conveyances Act, C.C.S.M., c. F160.

3 Joseph and Lorraine Bass have been married for more than 40 years. The marriage has been marked by hard work, meagre financial success and periods of discord. The only known asset presently belonging to either of them is the marital home which was purchased in 1949, in their joint names, but now stands in the name of Lorraine Bass alone. It has an acknowledged market value of approximately $40,000 and is free of any mortgage. For reasons which will become clear, Joseph Bass is substantially indebted to various financial institutions in an amount which it is unlikely he will ever be able to discharge.

4 The particular liability with which we are here concerned arises out of an unlimited guarantee executed on 9th July 1976 by Joseph Bass in favour of his son, Jack Alexander Bass, and upon which he was ultimately called. Pursuant to that guarantee, an action was commenced on 12th January 1981 against Jack as debtor and against Joseph Bass and one of Jack's corporations as guarantors. A default judgment for $31,013.70 was obtained on 28th May 1981. Subsequent to obtaining that judgment the plaintiff discovered that the jointly owned residence had, by way of transfer of land registered in the Winnipeg Land Titles Office on 12th February 1980, been conveyed to Lorraine Bass. It is that conveyance which the plaintiff seeks to set aside in order to pursue the judgment against Joseph Bass.

5 The particular statutory provision on which the plaintiff bases its case is s. 3 of the Fraudulent Conveyances Act. It provides:

> 3 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.

That section and similar provisions in other jurisdictions have received frequent judicial attention. Of particular assistance to me in the circumstances of this case were *Union Bank v. Murdock*, 28 Man. R. 229, [1917] 3 W.W.R. 820, 37 D.L.R. 150 (C.A.); *Mandryk v. Merko*, 15 C.B.R. (N.S.) 246, [1971] 2 W.W.R. 542, 19 D.L.R. (3d) 238 (Man. C.A.); *Commerce Capital Mtge. Corp. v. Jemmett* (1981), 37 C.B.R. (N.S.) 59 (Ont. S.C.); and *Tempo Bldg. Supplies Ltd. v. Pitura* (1979), 33 C.B.R. (N.S.) 23 (B.C.S.C.).

6 So that my more detailed review and assessment of the evidence can be placed in context, I will now deal briefly with several general principles which I am satisfied can be safely drawn from the Fraudulent Conveyances Act and from the authorities.

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.

8 If the conveyance is voluntary and particularly if, as here, it is between relatives, the transaction will be regarded with suspicion and there will be a substantial evidentiary burden upon the grantor to explain why the transaction should not be regarded as fraudulent. Considerable judicial attention has been given to the question of whether, when the transaction is voluntary and within a family, the trial judge must presume the transaction to have been fraudulent or whether the presumption is rebuttable. I am satisfied, based on the reasons expressed by Freedman J.A. (as he then was) in the *Mandryk* case and Lerner J. in the *Commerce Capital Mortgage* case (both supra), that while a judge may treat the evidence as to the nature of the transaction as sufficient to establish a prima facie case, he is not, in law, bound to do so. In the final analysis, even in circumstances which

fall in the category of being "suspicious", if the plaintiff is to succeed, it is necessary to show that there was in fact a fraudulent intent on the part of the grantor to defeat the plaintiff creditor.

9 The final question to be considered in cases of this sort is, assuming that the evidentiary burden has shifted to the defendant, what sort of evidence is necessary to rebut the initial assumption of a fraudulent intent? Is the credible statement of bona fides by the grantor sufficient or do the "suspicious" circumstances make it incumbent upon the defendant to adduce supportive or corroborative evidence?

10 As the cases reviewed in the *Union Bank* case, supra, indicate, there is some authority for saying that it is competent for the trial judge, if he is impressed with the veracity of the grantor, to accept and act upon his unsupported testimony. I have concluded, however, from the reading of authorities, that the more prudent approach is to require independent supporting testimony.

11 I turn now to a consideration of the evidence.

12 In 1976 when Joseph Bass gave a statement of affairs to the plaintiff and signed a guarantee in its favour, he and his wife were living together in their jointly owned residence and were together operating a seven day a week "mom and pop" type grocery store. Mrs. Bass drew a salary and Mr. Bass kept whatever profits were earned. At that time they were not well off but were solvent. They had some modest investments; some in her name, some in his. It is quite clear to me, however, that they made no real distinction as to who owned what. Although it is of no relevance, it seems that everything they owned was either joint property or property that would have been equally divisible under marital property legislation.

13 As already indicated, the guarantee was in support of an investment loan made by their son, Jack, who was then a practising lawyer. This commitment of Joseph Bass was one of a number of involvements that Jack induced his father to make to support his business dealings. It, like the others, was a mistake. Jack's dealings clearly brought financial ruin upon himself and his parents, and it would appear were a contributing cause to his own trouble with the law society.

14 Sometime in the summer of 1977 Joseph and Lorraine Bass separated, with Joseph leaving the home. I need not explore the reasons. On 29th July 1977 Mrs. Bass consulted Mr. Perry Schulman, Q.C., concerning her marital situation. Mr. Schulman testified (with the consent of Mrs. Bass) that he was advised that the Basses were already living separate and apart and that they wanted a separation agreement prepared. He was told that Mr. Bass had agreed to "sign over the house", and that Mrs. Bass would remain employed in the store at a stipulated salary. Mr. Schulman wrote to Mr. Bass advising of his instructions, and received a letter dated 12th August 1977 from a Mr. Earl Essers, another Winnipeg solicitor, advising that he was acting. Discussions took place between Essers and Schulman. Mr. Essers (who testified with the consent of Mr. Bass) was concerned that the only point that was ever in issue was the amount of salary that Mrs. Bass would get from the store. Mr. Schulman drafted a short separation agreement, which bears the date 30th August 1977, and which both lawyers confirm accurately expresses the instructions of their clients. It included the agreement by Mr. Bass to transfer his interest in the house. The document was, though, never executed.

15 Later in the fall Mr. and Mrs. Bass resumed cohabitation in the marital home.

16 I jump ahead here somewhat in the chronology of events to 1978 when Mr. and Mrs. Bass again separated for a few months. Mrs. Bass visited Mr. Schulman on 15th August 1978 at which time, upon her instruction, he prepared a two-paragraph form of agreement simply confirming that the parties had again been living separate and apart since 15th February 1978 and intended to continue doing so, and that the husband was not to enter the premises where the wife was living. Mr. Schulman received no instructions that suggested that the earlier intentions with respect to the transfer of the home, and employment, had been changed.

17 That form of agreement was sent to Mr. Essers. However, when he called his client he was told simply that he would let him know later what was to be done. Neither Mr. Schulman nor Mr. Essers received further instructions and the second form of agreement was never signed. In fact, shortly thereafter Mr. and Mrs. Bass resumed cohabitation.

18 I return now to the summer of 1977. On 22nd August of that year, at the instance of the plaintiff, Mr. Bass completed his second and last statement of affairs. It showed the house as being jointly owned, which of course was the fact, although the Basses had already agreed that it was to be conveyed into Mrs. Bass's name alone. There is no suggestion that this matter was in any way discussed with the bank and Mr. Bass says that he simply updated the earlier statement by reference to his own rather unsophisticated financial statements.

19 There is nothing in the evidence that causes me to think that either the bank or Mr. Bass had concern for his financial stability at that time.

20 In August or September 1977, according to Mr. Bass and Jack, instructions were given to Jack to transfer the home pursuant to the agreement. Jack did, in fact, open a file in his office about that time. The precise date is not known because Jack's records are still in the possession of the law society; however, there was a 1977 file folder entered in evidence with some miscellaneous papers relating to the transaction on the file. It is Jack's evidence that a form of transfer was prepared soon after the file was opened. There is, amongst the miscellaneous papers still on that file, a carbon copy of a transfer signed by Lorraine Bass and Jack Bass. The front page of that copy bears no date, although the affidavits of value and of execution are dated 4th February 1980 which is just prior to the date of actual registration.

21 Jack testified that sometime in the fall of 1977 he obtained the signatures of his parents on the transfer. He is unable to give any precise date of the signing and it is, of course, the position of the plaintiff that the document was not signed until February 1980.

22 One of the other papers on the file is an undated handwritten memo by Jack to his then law student, Mary Beehler, requesting that she take the transfer to his parents to be signed. Mary Beehler gave evidence confirming that she was Jack's student at that time and that she remained in his employ after her call to the bar until the fall of 1978.

23 She recollects discussing the file with Jack at a time which she places as being in July or August 1977. She says, however, that she requested Jack to look after the matter himself because she would be uncomfortable dealing with his parents on their marital matters. Ms. Beehler is unable to say when the transfer was actually signed.

24 Jack says that there was no reason why the completion of the transaction was not attended to promptly, other than his own oversight. Jack pointed out that in the law society proceedings against him he was found to be derelict in his attention to his files, and suggested that this transaction is one of those meeting that description.

25 I refer here to the testimony of yet another lawyer, Mr. Harry Gordon, Q.C. In 1979 and 1980 he was giving Jack Bass professional advice relating to his various difficulties. He acknowledges that in late 1979 (he at first said late 1980 but that was obviously an error), Jack came to him to seek advice as to whether the transfer, which Jack said had been executed some time previously, could be back-dated to the date of execution or whether it should be executed more contemporaneously with the date of registration. He advised that regardless of when it had been signed it should be dated and the affidavits completed with current dates. He did not actually see the document, so that he is unable to confirm if or when it was signed. His testimony is, however, consistent with evidence relating to an earlier signing.

26 I return now to 24th January 1978. It was on that date that Mr. Turner of the Bank of Nova Scotia hand delivered to Mr. Bass a demand for the payment of $24,278.46, together with interest of $845.44, all pursuant to the guarantee. Mrs. Bass was present. Thereafter, Mr. Bass had further communications with the bank, at meetings and by correspondence, concerning Jack's payment progress or lack of it. There is no evidence however that there was any particular pressure on Mr. Bass for payment. In fact, in a letter of 7th February 1980 from the bank to Joseph Bass, he was advised that Jack had been defaulting on recent payment promises and was requested to attend at the bank on 15th February 1980 so that the bank could "again review the loan and be brought up to date on Jack's personal circumstances". It was not until 6th March 1980 that the second formal demand for payment was made upon Joseph Bass. It was several weeks prior to this that the actual registration of the questioned transfer of title took place.

27 The findings of fact set forth to this point are supported by the admissions of counsel, the documents tendered, and the credible evidence of witnesses other than the parties. I have referred little to the testimony of Mr. Turner, the bank's sole witness, or to the testimony of Joseph and Lorraine Bass.

28 Mr. Turner's evidence was not open to any criticism but understandably bore only on the bank's direct involvement. Nothing to which he testified bore directly on the essential issues in the case and none of what he said is the subject of any real controversy.

29 I found both Joseph Bass and Lorraine Bass to be credible, although obviously not disinterested. For the reasons relating to evidentiary onus, I think it wise not to rely on their testimony more than need be. It is, however, necessary to observe that both of them testified that the intent to transfer Mr. Bass's interest in the residence had been formed in 1977 and had never been abandoned or changed. From the time they requested Jack to look after the matter in the fall of 1977 they seemed to have put it out of their minds and assumed that it had been done. It would have served both their purposes to have testified that they signed the transfer, as I find they probably did, in 1977, but neither of them pretended that they could remember. In my opinion that serves to enhance their credibility. Mrs. Bass claims that it was the 1979 real property tax statement received from the city of Winnipeg, which showed her and her husband still to be the joint owners, that caused her to press Jack to complete the transfer. I believe her, although I cannot ignore the possibility that it was the general state of their, and Jack's, financial circumstances at that time which made them realize the vulnerability of their positions.

30 In any event, the transfer of the home took place at a time when Joseph Bass either was, or knew he was in real danger of becoming, insolvent, and that is the context in which I must consider the matter.

31 Some time was spent in argument by Mr. Hoffer to convince me that in light of the circumstances in which the initial undertaking to transfer the land was made in 1977 and in light of the reference to the $1 consideration, I should treat this conveyance as one made for good and valuable consideration. I do not dismiss the argument as being without merit. Certainly the adequacy of consideration is an element to be considered in determining, in cases like this, whether there was fraud. In my opinion, however, that portion of the submission is weak and should be dismissed.

32 There was then a conveyance which was completed, between a husband and wife, on a voluntary basis, at a time when the husband as transferor knew that he was, or was about to become, insolvent. The plaintiff has unquestionably been hindered in the collection of its just debt. In accordance with the concepts earlier enunciated, this is a "suspicious" circumstance in which Joseph Bass has a significant evidentiary onus if the plaintiff's request for a declaration that the transaction is void is to be defeated. Nonetheless, the plaintiff can only succeed if this court is satisfied that there was, in fact, an intent to defraud.

33 If the parties had entered into and executed a binding agreement with respect to the transfer of land in August 1977, or if there were any certainty that a transfer of land had been completed at that time, then I think that the ultimate registration of the transfer could not, in itself, result in a finding of fraud. There was not, however, an enforceable agreement entered into in 1977 and there is uncertainty as to when the transfer was signed. Nonetheless, it is the bona fides of the intent, and not the date of the registration of the transfer, that to me is the most significant.

34 On the testimony of Mr. and Mrs. Bass, which I have found to be honestly given and not seriously impugned, and on the basis of a good deal of supportive evidence, both documentary and viva voce, I am satisfied that in August 1977 Mr. and Mrs. Bass, at a time when Mr. Bass was facing no apparent threat of insolvency, mutually formed the intent to convey their residence from their joint names into the name of Mrs. Bass alone. In a general sense they were, in all likelihood, thinking of Mrs. Bass's security and protection. There is no reason, however, to think that their motive was to defeat creditors in general or the plaintiff in particular.

35 I am satisfied from the evidence that their intent continued from at least August 1977 uninterrupted, notwithstanding their reconciliation, up until the actual date of conveyance. By that time, Mr. Bass's vulnerability and a concern to protect Mrs. Bass may have been a factor. That however, in my mind, does not detract from my conclusion that the registration of the transfer

was the culmination of a longstanding, continuing, bona fide intent that would have been brought to fruition much sooner if not for their son's dereliction.

36 In light of this finding it cannot be said that the plaintiff has established that there was a conveyance made with the intent of defrauding creditors, and its action is dismissed.

37 The defendants Joseph and Lorraine Bass will have their costs in an amount that can be spoken to if not agreed.

Application dismissed.

Tab 4

1997 CarswellMan 420
Manitoba Court of Queen's Bench

Royal Bank v. O'Brien

1997 CarswellMan 420, [1997] 9 W.W.R. 439, [1997] M.J. No. 429, 122 Man. R. (2d) 1, 34 B.L.R. (2d) 1, 49 C.B.R. (3d) 5, 73 A.C.W.S. (3d) 952

Royal Bank of Canada, on behalf of itself and all other creditors of Barry Thomas O'Brien also known as Stewart O'Brien, Plaintiff and Barry Thomas O'Brien, also known as Stewart O'Brien, and Frances O'Brien, Defendants

Clearwater J.

Judgment: September 12, 1997
Docket: CI 94-01-84400

Proceedings: affirmed (April 3, 1998), Doc. AI 97-30-03513 (Man. C.A.)

Counsel: *David M. Skwark* and *Kristin Erickson*, for the Plaintiff.
John L. Sinclair, for the Defendants.

Subject: Insolvency; Property; Contracts; Corporate and Commercial; Torts
Related Abridgment Classifications
Civil practice and procedure
XXIII Practice on appeal
XXIII.13 Powers and duties of appellate court
XXIII.13.g Reversing findings of fact
XXIII.13.g.ii Finding by judge alone
XXIII.13.g.ii.C Evidence misunderstood or overlooked
Debtors and creditors
XII Fraudulent conveyances
XII.10 Fraudulent intent
XII.10.g No bona fide conveyance
Debtors and creditors
XII Fraudulent conveyances
XII.11 Practice and procedure
XII.11.i Appeals
Headnote
Fraud and misrepresentation --- Fraudulent conveyances — Fraudulent intent — No bona fide conveyance
Bank made loans to defendant on basis of representations that he owned equity in property transferred to his mother — Defendant defaulted on loans and bank brought action for declaration that conveyance to mother was void — Action was allowed — Evidence suggested that mother knew property was being transferred to protect it from defendant's creditors — Conveyance to mother was not made for good consideration and bona fide — Conveyance was made with intent to defeat, hinder, delay or defraud defendant's creditors, and was void — Fraudulent Conveyances Act, R.S.M. 1987, c. F160, C.C.S.M., c. F160, ss. 2, 4.
The defendant purchased a home in 1988 with an advance of approximately $25,000 from his mother and $49,000 borrowed from a credit union and secured by a first mortgage on the property. The mother transferred the property to the defendant for one dollar and "other good and valuable consideration." The defendant paid off the mortgage in 1991. The following year, he financed the construction of an addition to the home with a loan of $50,000 from the plaintiff bank, secured by a first mortgage. In the course of his relationship with the bank, the defendant made numerous other applications for credit.

In 1993, the defendant transferred title to the property back to his mother for consideration of one dollar. The mortgage was discharged in 1994. The defendant never advised the bank or his insurer that he was no longer the owner of the property. In 1994, he defaulted on his loan payments, and the bank commenced action on behalf of itself and all other creditors for a declaration pursuant to *The Fraudulent Conveyances Act* that the 1993 conveyance to the mother was void for having been made "with intent to defeat, hinder, delay or defraud creditors," contrary to s. 2 of the Act. In 1995, the defendant made an assignment in bankruptcy.

The defendant and his mother alleged that the 1993 conveyance was made pursuant to an agreement made between them in 1989. The mother did not testify at trial, but the transcript of her examination for discovery was read in, and was inconsistent with the defendant's evidence on several material facts.

Held: The action was allowed; the conveyance of title to the defendant's mother was void.

The differences in evidence between the defendant and his mother had a bearing on the defendant's credibility and the intention surrounding the impugned conveyance. The defendant's claim that the 1993 conveyance was made pursuant to a previous agreement should be rejected. The mother stated that the advance of $25,000 was a gift, and although the property was transferred to her for consideration of one dollar, no money exchanged hands. Further, the mother considered the house to be that of the defendant. The defendant's attempts to explain the differences between his evidence and that of his mother were inadequate. The best interpretation that could be put on the evidence as to the intention of both parties at the time was that the mother knew the property was being transferred into her name to protect it from the defendant's creditors.

It could be concluded, on a balance of probabilities, that any and all monies that the mother advanced to the defendant for the purchase of the property were unequivocal gifts. Title was originally placed in the mother's name, and transferred into the defendant's name when he had established his credit rating. From the time it was transferred to him by his mother, he owned the property and any equity in it. The conveyance of title back to his mother in 1993 was not made for good consideration and bona fide to a person not having knowledge of the defendant's intent, and therefore was not saved by s. 4 of the Act.

The defendant knew that the bank continued to lend him money on the basis, at least in part, of the strength of his representation that he owned the equity in the property. The bank's representative did not know the defendant had transferred title to the land to his mother when approving his ongoing business loans. Rather, she relied on his representations that he continued to have equity in the property of $140,000.

The conveyance in 1993 was made by the defendant with the intent to defeat, hinder, delay or defraud creditors regarding his equity in the property, and was therefore in breach of s. 2 of the Act. Accordingly, the conveyance of title to the mother was void. The registrar was to be directed to cancel the existing certificate of title and to issue a new certificate in the defendant's name, subject to any encumbrances registered against title.

Table of Authorities

Cases considered by *Clearwater J.*:

Bank of Montreal v. Cyr (1985), 61 N.B.R. (2d) 283, 158 A.P.R. 283 (N.B. C.A.) — referred to

Bank of Montreal v. Kelliher (1980), 36 C.B.R. (N.S.) 205 (B.C. S.C.) — referred to

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

Bell v. Williamson, [1945] O.R. 484, [1945] 4 D.L.R. 253 (Ont. H.C.) — referred to

Bell v. Williamson, [1945] O.R. 844, [1946] 1 D.L.R. 372 (Ont. C.A.) — referred to

Havel v. Galemar Holdings Ltd. (1981), 36 O.R. (2d) 348, 42 C.B.R. (N.S.) 295 (Ont. H.C.) — considered

Katzschke v. Walter (1995), 32 C.B.R. (3d) 153 (B.C. S.C.) — considered

Mandryk v. Merko, [1971] 2 W.W.R. 542, 15 C.B.R. (N.S.) 246, 19 D.L.R. (3d) 238 (Man. C.A.) — considered

Mining & Allied Supplies (Canada) Ltd. v. 2390869 Manitoba Ltd. (1994), (sub nom. *Mining & Allied Supplies (Overseas) Ltd. v. Parks)* 96 Man. R. (2d) 91 (Man. Q.B.) — referred to

Ramgotra (Trustee of) v. North American Life Assurance Co., [1996] 3 W.W.R. 457, 37 C.B.R. (3d) 141, 10 C.C.P.B. 113, 13 E.T.R. (2d) 1, [1996] 1 C.T.C. 356, (sub nom. *Ramgotra (Bankrupt), Re)* 193 N.R. 186, (sub nom. *Ramgotra (Bankrupt), Re)* 141 Sask. R. 81, (sub nom. *Ramgotra (Bankrupt), Re)* 114 W.A.C. 81, (sub nom. *Royal Bank v. North American Life Assurance Co.)* 132 D.L.R. (4th) 193, (sub nom. *Royal Bank v. North American Life Assurance Co.)* [1996] 1 S.C.R. 325, (sub nom. *Royal Bank v. North American Life Assurance Co.)* 96 D.T.C. 6157 (S.C.C.) — considered

Rosenfeldt v. Olson (1984), 59 B.C.L.R. 193, 20 E.T.R. 133, [1985] 2 W.W.R. 502, 16 D.L.R. (4th) 103 (B.C. S.C.) — referred to

Rosenfeldt v. Olson, 1 B.C.L.R. (2d) 108, 22 E.T.R. 83, [1986] 3 W.W.R. 403, 25 D.L.R. (4th) 472 (B.C. C.A.) — referred to
Sun Life Assurance Co. v. Elliott (1900), 31 S.C.R. 91 (S.C.C.) — referred to

Statutes considered:

Fraudulent Conveyances Act, R.S.M. 1987, c. F160; C.C.S.M., c. F160
Generally — referred to

s. 2 — considered

s. 4 — referred to

Real Property Act, R.S.M. 1988, c. R30; C.C.S.M., c. R30
s. 176(3) — referred to

Tariffs considered:

Manitoba, Queen's Bench Rules, Man. Reg. 553/88*Tariff of Costs*
Class III — referred to

Class IV — referred to

ACTION by bank for declaration that conveyance of land was void.

***Clearwater J.*:**

The Action

1 By statement of claim filed October 18, 1994, the plaintiff ("the Bank") commenced this action on behalf of itself and all other creditors of the defendant Barry Thomas O'Brien ("O'Brien"), seeking a declaration pursuant to *The Fraudulent Conveyances Act*, R.S.M. 1987, c. F160 ("the *Act*"). Specifically, the Bank seeks a declaration that a May 1993 conveyance (transfer of land) of the lands and premises commonly known as 586 Renfrew Street, Winnipeg, Manitoba ("the land"), by O'Brien to his mother (the co-defendant, Frances O'Brien) ("O'Brien's mother"), is void. The Bank alleges that this conveyance was made, contrary to s. 2 of the *Act*, "with intent to defeat, hinder, delay or defraud creditors" of O'Brien. The Bank also seeks an order directing the District Registrar of the Winnipeg Land Titles Office to cancel the existing certificate of title in the name of O'Brien's mother and to issue a new certificate of title in the name of O'Brien, together with an order for costs on a solicitor and own client basis.

Background

2 O'Brien's mother, who is now approximately 80 years of age, has resided most of her life in London, Ontario. O'Brien, who is presently 55 years of age, has resided in Winnipeg for many years and currently resides at 586 Renfrew Street (the "land" in issue in this action). At all material times O'Brien was an employee of the City of Winnipeg and was also engaged in the business of buying and selling used motor vehicles under the firm name and style of "O'Brien's Auto Brokers". He had been carrying on this latter business from his home on Renfrew Street since at least 1988 and he had been employed with the City of Winnipeg from approximately May 1982 until he ceased active employment with the City of Winnipeg in the spring of 1991 and commenced receipt of a permanent disability pension. He had worked with the Parks and Recreation Branch and his usual practise during those years was to work approximately 7 $^{1}/_{2}$ to 8 months per year (seasonal work with the City of Winnipeg) and to collect unemployment insurance benefits for that portion of the year (usually the winter season) when he was unemployed.

3 O'Brien, by his own admission, had experienced marital and financial problems, health problems related to disease or injury sustained by him at work resulting in his disability pension, and health problems related to his excessive consumption of alcohol from time to time. In 1987 or 1988 his marriage broke down and he retained care and control of his three sons. His problems led to an initial bankruptcy in or about March 1987 and, subsequent to the events in issue in this action, he made an assignment in bankruptcy on March 31, 1995. He is presently an undischarged bankrupt.

4 Following the breakup of his marriage in 1987 and 1988 and needing a home for himself and his three young sons, he convinced his mother (the co-defendant), apparently with input from a sister in Ontario, to assist him with the purchase of the

home at 586 Renfrew Street in the spring of 1988. O'Brien located the home in question and negotiated the purchase agreement with the vendors. The purchase price of $74,000 (±) was obtained and paid as follows:

(a) O'Brien's mother advanced him approximately $25,000 from her savings; and

(b) the balance of $49,000 (±) was borrowed from the Civic Employees Credit Union Limited ("the Credit Union") where O'Brien conducted his banking affairs at the time, with a loan secured by a first mortgage on the lands in favour of the Credit Union.

5 By June or July 1988 title to the property had issued in the name of O'Brien's mother, subject to the first mortgage to the Credit Union. The mortgage was granted (and executed) by O'Brien's mother as mortgagor and O'Brien executed this mortgage as a "covenantor". Although there is a difference in the evidence of O'Brien from that of his mother as to her involvement in making (or assisting O'Brien with) the mortgage payments, the evidence clearly establishes that O'Brien was to be responsible for the monthly mortgage payments to the Credit Union. The evidence also establishes that O'Brien made most, if not all, of those payments and that O'Brien's mother, although she may have given him some monies from time to time over the years after the purchase, did not (according to her) make the monthly mortgage payments to the Credit Union (or to the Bank when O'Brien later arranged a new mortgage). It should be noted that the mortgage document (Ex. 1, Tab 18) contains an unexplained declaration by O'Brien and his mother (under oath) to the effect that they are each "entitled to be the owner" of the land "in trust".

6 The documents, many of which were filed by agreement, establish the following relevant chronology of events:

1) on June 20, 1989, O'Brien's mother executed a transfer of land prepared in Winnipeg by O'Brien's solicitor and sent to her for execution in London, Ontario, wherein she transferred the property to O'Brien for consideration stated to be "One Dollar and other good and valuable consideration" (Ex. 1, Tab 21);

2) O'Brien certified in this document (as if it were under oath pursuant to s. 176(3) of *The Real Property Act*, R.S.M. 1988, c. R30) that the fair market value of the land was $48,000 (notwithstanding that he had paid approximately $75,000 for the land about one year earlier and notwithstanding that by October 18, 1990 he was certifying to the Bank in a credit application that the fair market value of the land was then "$82,000");

3) this transfer of land was registered on July 5, 1989 and title issued in O'Brien's name, subject to the mortgage in favour of the Credit Union. O'Brien paid off the Credit Union mortgage by December 1991 and this mortgage was discharged in or about December 1991 (Ex. 1, Tab 24);

4) O'Brien established a banker-customer relationship at the Bank's Corydon and Renfrew branch. As of December 1991 this relationship was considered by both O'Brien and the Bank to be a "good" banking relationship, whereby O'Brien made various loans from time to time to finance his business ("O'Brien's Auto Brokers"). O'Brien made his loan payments as and when required pursuant to his agreements with the Bank;

5) in early 1992 O'Brien decided to build an addition to the home on Renfrew Street and he financed the construction of this addition with a loan from the Bank for $50,000. This loan was secured by a first mortgage given and executed by him and registered against the title on April 1, 1992 (Ex. 1, Tab 25);

6) in that new mortgage to the Bank, O'Brien declared, under oath, that he was the owner of the land;

7) in the course of this banking relationship both before and after O'Brien borrowed the $50,000, gave a first mortgage to the Bank to secure this amount, and completed renovations and additions to the premises on the land, he borrowed money from time to time for his business and completed credit applications in support of various loans. In these credit applications he made the following representations to the Bank as to the fair market value of the lands and premises:

(a) March 5, 1992 — "current value ... $85,000" and "equity ... $40,000" (Ex. 1, Tab 5);

(b) February 24, 1993 — "current value ... $140,000" and "equity ... $110,000" (Ex. 1, Tab 6);

(c) April 24, 1993 — "current value ... $140,000" and "equity ... $110,000" (Ex. 1, Tab 7);

(d) March 12, 1994 — "current value ... $140,000" and "*equity ... $139,000*" (Ex. 1, Tab 8) (emphasis supplied);

(e) May 10, 1994 — "current value ... $140,000" and "equity ... $140,000" (Ex. 1, Tab 9);

8) by a transfer of land executed on May 17, 1993 and registered in the Winnipeg Land Titles Office on May 19, 1993, O'Brien transferred title to the land back into the name of his mother for a consideration stated to be "One Dollar". In that transfer he declared (again as if under oath) that the fair market value of the property was then $75,000 and that he was the owner of the land. This transfer of land and this current title standing in the name of O'Brien's mother, are the documents impugned by the Bank in this action;

9) after borrowing the $50,000 from the Bank for the renovations and additions to the land (and giving the mortgage) in April 1992, O'Brien made all of the regular monthly payments to the Bank as required by the terms of the mortgage. He also made several significant principal pre-payments on this mortgage, such that by April 1994 he had paid the full amount secured by this mortgage. Following payment in full he received and registered a discharge of the Bank's mortgage in or about April 1994. Title to the land in question was by then (and had been since May 19, 1993) registered in the name of O'Brien's mother;

10) although title to the property has been registered in name of O'Brien's mother in the Winnipeg Land Titles Office since May 19, 1993 (with the property having been continuously occupied by O'Brien), O'Brien continued to insure the property with his insurer (Cumis General Insurance Company), at least for the period "from June 16/93 to June 16/94" (Ex. 1, Tab. 32). O'Brien did not advise his insurer that he was not the owner of the property (after May 19, 1993). He led no evidence to suggest that the insurer was ever notified that O'Brien's mother had any insurable interest in the land;

11) as part of his business relationship with the Bank, O'Brien executed the Bank's form of "client agreements" dated February 24, 1993, April 26, 1993 and March 29, 1994 (Ex. 1, Tab 11), wherein he acknowledged and certified to the Bank, in support of the numerous applications for credit that he made over these years as follows:

> I certify that all information I supply to you (Royal Bank of Canada) today or in the future in connection with my present and any future credit applications *is true and complete as at the time it is supplied*. I acknowledge that you will use this information to determine my creditworthiness. (emphasis supplied)

12) my review of the credit applications filed as Ex. 1, Tabs 7, 8 and 9 establishes that the Bank's records contained the following information as to O'Brien's financial status:

(a) Ex. 1, Tab 7 (April 24, 1993) shows his total indebtedness is approximately $54,332 consisting of the balance owing at that date on his mortgage to the Bank of $28,778, other bank loans totalling $25,441, and some miscellaneous "other loans" totalling $113. This document also shows his annual salary with the City of Winnipeg as being $24,500 and his income from O'Brien's Auto Brokers as being $30,000;

(b) Ex. 1, Tab 8 (prepared shortly after April 24, 1993) shows his monthly income to be $4,541 and his monthly expenses to be $1,482. His debts consisted of four bank loans totalling $16,000 plus the Bank's mortgage loan which, according to Ex. 1, Tab 12, had a balance of approximately $28,950 at May 3, 1993;

(c) Ex. 1, Tab 9 (May 10, 1994) shows his annual income as $24,500 from the City of Winnipeg and $30,000 from O'Brien's Auto Brokers with the land now being shown as "clear title" and equity of $140,000. There was $29,441 owing on a line of credit and he was borrowing or applying to borrow a further $27,000 to purchase a trailer at that time;

13) O'Brien defaulted on his payments to the Bank in May or June 1994 and the Bank made a formal demand for payment of all loans from him on July 8, 1994 (Ex. 9);

14) the Bank commenced this action on October 18, 1994 and on March 31, 1995 O'Brien made an assignment in bankruptcy wherein he declared, under oath, that his assets consisted of $2,500 worth of furniture and his unsecured debts totalled $72,285 (Ex. 1, Tab 33). The trustee's amended report dated December 21, 1995 on O'Brien's application for a discharge evidences assets (furniture) worth $2,500 and "proven" unsecured debts of $157,487.45; over double the debt that O'Brien declared to the trustee 9 $^{1}/_{2}$ months earlier.

The Positions of The Parties

7 The Bank's position, reflected in its statement of claim, in the evidence it led at trial, and in its counsels' submissions at trial, has remained consistent throughout. Simply put, the Bank submits that it has satisfied the onus of proof (proof on a balance of probabilities) which lies on it in an action such as this to establish that the impugned transaction (the May 1993 transfer of title by O'Brien to his mother) was made "with intent to defeat, hinder, delay *or* defraud creditors" as those terms are used in s. 2 of the *Act* and in the case law developed in this area. It should be noted that the filing of an assignment in bankruptcy by O'Brien on March 31, 1995 (Court of Queen's Bench, Winnipeg Centre, Bankruptcy File No. 95-01-44129) had the effect of staying these proceedings. This stay was, on motion of the Bank, lifted by an order of the Registrar on August 1, 1995 which granted leave to the Bank to continue this action on the terms and conditions contained in that order.

8 Although it is not conclusively fatal to the defence of this claim by the defendants in the fact circumstances proven, the same consistency is lacking in the positions taken by the defendants. O'Brien and his mother filed a joint statement of defence on December 28, 1994. They have been represented by the same solicitors throughout this action. In their statement of defence they took the position (as pleaded in paragraphs 3 and 4) that the conveyance of the land from O'Brien to his mother on May 19, 1993 was made pursuant to an agreement (and not for the impugned purpose alleged by the plaintiff) made between them in 1989 (subsequent to the purchase of the property by her in 1988). The defendants pleaded the following specific agreement in paragraph 4 of their statement of defence:

"... that, provided he" (O'Brien) "made all the payments relating to the property, she transferred the property to him." (O'Brien) "He did not make the aforesaid payments in accordance with the agreement and consequently the property was transferred back to the Defendant, Frances O'Brien, in 1993 *in compliance with the Agreement*." (emphasis supplied)

9 O'Brien's mother did not appear or testify at trial. To the extent that I have any evidence from her with respect to the facts or matters alleged in the pleadings, it is by way of admissions made by her to the Bank's counsel on his examination for discovery of her in London, Ontario on March 21, 1996. The Bank read in and adopted certain portions of her discovery as part of its case. I will refer specifically to that evidence later. At this point it is sufficient to say that O'Brien's mother's evidence is inconsistent with (some might say contradictory to) O'Brien's evidence on several material facts. O'Brien had been examined for discovery by counsel for the Bank on January 17, 1995 (Ex. 4) and this examination for discovery was continued on May 10, 1996, after the examination of his mother. After acknowledging (Ex. 6, Q & A 550 and 551) that he was aware that his mother had been examined in London, Ontario on March 21, 1996, the following exchange took place between he and the Bank's counsel (Ex. 6, Q & A 566):

566Q Are you disputing your mother's position in this action?

A No, I am not disputing my mother's position in this action. Maybe my mother didn't understand the question.

10 As O'Brien's mother was not called at trial to explain any differences in her evidence from that of O'Brien's evidence, and where the evidence does differ, I am left with speculation or conjecture from O'Brien and the clear, unequivocal answers given by O'Brien's mother at her examination for discovery and read in by counsel for the Bank. I make reference to these differences in evidence between the defendants for at least two reasons:

(a) firstly, the differences have a bearing on my assessment of O'Brien's credibility when his evidence at trial is inconsistent with his mother's evidence or any other evidence; and

(b) the differences in evidence are relevant to a determination of the intentions of O'Brien and his mother surrounding the conveyance in 1993 (a central issue in this case).

11 O'Brien's position at trial, as found in his evidence and the submissions of his counsel, is not entirely consistent with the position expressed in his statement of defence. At trial, notwithstanding his mother's evidence to the contrary, O'Brien maintained the position advanced in the pleadings to the effect that there was an agreement with his mother whereby the property would be transferred back to her (and presumably be her property and not O'Brien's) if he did not make the mortgage payments and (or) if she was called upon to make them. At the same time, O'Brien and his counsel submit that he never at any time had the intent necessary to bring himself within s. 2 of the *Act*; that is, he was simply making himself "judgment proof" at a point in time when he was entitled to do so, by transferring his only significant asset (his equity in the land) to his mother. In support of this latter position, defendants' counsel refers to and relies on the following authorities (and principles as summarized from these authorities):

(a) *Katzschke v. Walter* (1995), 32 C.B.R. (3d) 153 (B.C. S.C.), a decision of Macdonald, J. of the British Columbia Supreme Court, where after considering the evidence led on the issue of the debtor's intent to defraud his creditors and having found that the debtor's "business ethics leave much to be desired" (supra, p. 160), the trial judge concluded that the evidence fell short of establishing the necessary intent and therefore the debtor had succeeded in making himself judgment proof;

(b) *Havel v. Galemar Holdings Ltd.* (1981), 36 O.R. (2d) 348 (Ont. H.C.), a decision of Anderson, J. of the Ontario High Court of Justice; a situation where the trial judge found that the plaintiff had not established the necessary intent. The judge appears to have given some considerable weight to the absence of evidence of pressing financial need or prospective insolvency on the part of the debtor at the time of the conveyance;

(c) *Mandryk v. Merko* (1971), 19 D.L.R. (3d) 238 (Man. C.A.), a decision of the Manitoba Court of Appeal where the late Freedman, J.A. (as he then was), writing for a unanimous court, concluded that although there is a strong presumption that a conveyance which necessarily has the effect of delaying and defeating creditors is fraudulent, it is only a presumption and this presumption must yield in favour of evidence establishing an honest purpose. This case involved a transfer of property by a defendant at a point in time when the plaintiff was not yet a creditor with an existing debt but, rather, was at most a person with a potential debt arising from a claim for damages. O'Brien's counsel also points to the dicta of Freedman, J.A. at p. 241 where he states:

> ... There is authority indicating that, if a grantor with debts makes a transfer the effect of which is to render him unable to meet his then existing liabilities, that circumstance furnishes very strong evidence of an intent to defraud his creditors, *but such evidence is not conclusive*. ...

The Law

12 The following sections of the *Act* are particularly applicable to this action:

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.

. . . . .

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. (emphasis supplied)

13 In his introduction to the chapter entitled "Fraudulent Conveyances and Preferences" in his text, *Creditor-Debtor Law in Canada* (1995, 2nd ed.), Professor C.R.B. Dunlop reviews the history of fraudulent conveyance legislation generally and at p. 592 sets the background against which law in this area has been developed by the courts:

> ... It is clearly desirable that an insolvent person should not be able to shelter assets from the legitimate claims of creditors by assigning them to a convenient friend. On the other hand, the law is prepared to permit a person embarking on a risky business to protect personal wealth from subsequent claims by incorporating the enterprise as a separate legal entity. To what extent should a debtor have to retain assets so that subsequent creditors will have something to seize? Can and should a distinction be drawn-between fraudulent and innocent transfers and, if so, whose intention is significant? The law cannot go to any lengths to protect creditors; the *bona fide* purchaser of assets from a debtor has some claim to be saved harmless from unforeseeable risks. Where should the law draw the line between freedom of commerce and the security of the purchaser's title on the one hand and the legitimate claims of creditors on the other?
>
> When we turn from the fraudulent conveyance designed to defeat creditors generally to the transfer intended to prefer some creditors over others, the policy conflict becomes more acute. At common law, creditors had no responsibility to share the fruits of execution equally with other creditors, and we would expect that the debtor's voluntary payment of some but not others should be equally acceptable. However the first come first served policy of the common law has been rejected in favour of *pari passu* sharing in bankruptcy statutes and, in this country, in creditors' relief legislation. As a corollary, Canadian legislatures have passed Fraudulent Preference Acts, the purpose of which is to prohibit at least some preferential transfers, no matter how valid or meritorious the claim of the preferred creditor. The courts have however been more hesitant to strike down the preference of a legitimate creditor than they have a conveyance designed to defeat all creditors alike.

14 The following general principle stated by Professor Dunlop in his text (supra) at p. 598, has recently been approved by the Supreme Court of Canada in *Ramgotra (Trustee of) v. North American Life Assurance Co.*, [1996] 1 S.C.R. 325 (S.C.C.):

> The purpose of the Statute of Elizabeth and of the Canadian Acts based on it, as interpreted by the courts, is to strike down all conveyances of property made with the intention of delaying, hindering or defrauding creditors and others, except for conveyances made for good consideration and *bona fide* to persons not having notice of such fraud. The legislation is couched in very general terms and should be interpreted liberally. ...

Prof. Dunlop goes on in his text (supra) at p.600 to state:

> Where the debtor has given property to a donee for nothing or for nominal consideration, the courts have held that, in considering whether the transaction is voidable under the Statute of Elizabeth, it is necessary to consider *only* the intent of the debtor. (emphasis supplied)

At p. 601 he states:

> The crucial problem in any fraudulent conveyance action is to establish the fraudulent intention of the debtor, a task which creates serious problems for counsel and judge alike. ...

15 In a comprehensive analysis of the *Act* and case law, Kroft, J. (as he then was) in *Bank of Nova Scotia v. Bass* (1983), 47 C.B.R. (N.S.) 203 (Man. Q.B.), set out the context in which a trial judge should review and assess evidence in cases such as this (pp. 205-206):

> 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.
>
> If the conveyance is voluntary and particularly if, as here, it is between relatives, the transaction will be regarded with suspicion and there will be a substantial evidentiary burden upon the grantor to explain why the transaction should not be regarded as fraudulent. Considerable judicial attention has been given to the question of whether, when the transaction is voluntary and within a family, the trial judge must presume the transaction to have been fraudulent or whether the presumption is rebuttable. I am satisfied, based on the reasons expressed by Freeman J.A. (as he then was) in the *Mandryk*

case and Lerner J. in the *Commerce Capital Mortgage* case (both supra), that while a judge may treat the evidence as to the nature of the transaction as sufficient to establish a prima facie case, he is not, in law, bound to do so. In the final analysis, even in circumstances which fall in the category of being 'suspicious', if the plaintiff is to succeed, it is necessary to show that there was in fact a fraudulent intent on the part of the grantor to defeat the plaintiff creditor.

The final question to be considered in cases of this sort is, assuming that the evidentiary burden has shifted to the defendant, what sort of evidence is necessary to rebut the initial assumption of a fraudulent intent? Is the credible statement of bona fides by the grantor sufficient or do the 'suspicious' circumstances make it incumbent upon the defendant to adduce supportive or corroborative evidence?

As the cases reviewed in the *Union Bank* case, supra, indicate, there is some authority for saying that it is competent for the trial judge, if he is impressed with the veracity of the grantor, to accept and act upon his unsupported testimony. I have concluded, however, from the reading of authorities, that the more prudent approach is to require independent supporting testimony.

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).

Decision

17 I have no hesitation in finding that the initial position (defence) as pleaded in paragraph 4 of the statement of defence and referred to at p. 10 (supra) of these reasons, fails. O'Brien's mother, in 1988, by her own admission gave O'Brien the $25,000 which was used as a down payment to finance the purchase of the land. O'Brien, by his own admission, was at that time either an undischarged bankrupt or a recently discharged bankrupt; either way, his credit rating was poor. The initial mortgage loan was arranged by him at the Credit Union and he executed the mortgage as a guarantor or covenantor. Contrary to the pleading in paragraph 4 of the statement of defence and contrary to O'Brien's evidence at trial, I am satisfied that there was no agreement (in 1988 when the property was purchased, in 1989 when the property was transferred by O'Brien's mother to O'Brien, or at any time) pursuant to which O'Brien transferred the property back to his mother in May 1993. O'Brien's attempt to establish such an agreement (in effect, his attempt to prove that the May 1993 conveyance was a bona fide transfer for valuable consideration) fails. The admissions of O'Brien's mother made at her examination for discovery and read in and adopted by the Bank belie the

suggestion of any such agreement. For example, when asked about the $25,000 cash which she advanced to O'Brien to make the down payment in 1988, she admitted that this was "more or less" a gift. Although O'Brien may have promised to pay her back at some point in time, she told him on different occasions to "forget it" (Ex. 3, p. 13, Q & A 88-85). Even if O'Brien's mother gave him money to make some of the mortgage payments (O'Brien testified that this was part of this "bona fide" agreement with his mother), O'Brien's mother was very clear on her examination for discovery; the $25,000 down payment and any monies that she may have advanced to help him from time to time thereafter were clearly and unequivocally gifts to him, from a "loving mother" to a son (Ex. 3, p. 17, Q & A 110-111). As regards the next mortgage loan that O'Brien obtained from the Bank, O'Brien's mother testified that she did not help him make any of the mortgage payments to the Bank (Ex. 3, pp. 29-30, Q & A 183-186).

18 As regards the transfer of title in May 1993, O'Brien's mother confirmed that the property was transferred to her and that although "One Dollar" was shown as consideration in the transfer of land, no money exchanged hands.

19 With respect to the May 1993 transfer of land, this was done by way of a transfer of land prepared by O'Brien's Winnipeg solicitor, in Winnipeg, and registered in the Winnipeg Land Titles Office. There is no evidence that O'Brien's mother ever saw this transfer of land before or after it was executed (at least before the action started) or that she even knew about it before it was done. Even if I am to assume that she at least knew title was being transferred back to her in May 1993, the best interpretation that I can place on the evidence as to the intention of both parties at that time is that she knew it was being transferred into her name to protect it from creditors. She testified on her examination for discovery (Ex. 3) as follows:

> 232 Q. Did you have any intention of selling the house when it was transferred back to you in 1993?
>
> A. NO, no, no. Everything was to have a home for the kids as long as they were at the age where they were there and then later on, I mean, whatever he wanted to do with the house which he always said that he had it in his will that the house was to go to the three children. I made my will. I left his children in my will so —

20 Perhaps the most damaging admission as regards the suggestion of any "bona fide" transfer pursuant to any alleged agreement between O'Brien and his mother is found in the following exchange from her examination for discovery (Ex. 3):

> 241 Q. This is really Barry's house, right?
>
> A. *Yes, that's right* and he is very high strung and I think that it is one of those things. I mean, I worry about it because I mean, I keep thinking well, if he loses it what will happen? They worked hard. They've done things and kept the place up nice which I was quite proud not being a gardener. He had lovely flowers. (emphasis supplied)

21 O'Brien's attempt to explain the differences between his evidence and his mother's evidence on the issues raised in paragraph 4 of the statement of defence are inadequate. He testified at trial to the effect that his mother either may not have understood the questions that she was answering at her examination for discovery (or that she must not have understood them). He persisted with his position as to the agreement pleaded in paragraph 4 of the statement of defence. He suggests she is elderly (which she is) and that, accordingly, her memory or abilities may not be as good as they should be. No medical evidence was led to substantiate such a suggestion and O'Brien's mother was not presented at trial.

22 I am satisfied, on balance, that any and all monies which O'Brien's mother advanced to O'Brien and which were put toward the purchase of the land (either by way of down payment or contributions made to assist with mortgage payments or other expenses from time to time) were unequivocal gifts to O'Brien. Title was originally placed in O'Brien's mother's name and then transferred into his name when he had established his credit rating and got back on his feet financially. From the time that it was transferred to him by his mother in 1989 (if not from the time of purchase), he was the owner (both legally and beneficially) of the land and any equity in it. The conveyance of title back to O'Brien's mother on May 19, 1993 was not made for good consideration and, as stated by Kroft, J. in *Bank of Nova Scotia v. Bass* (supra), the plaintiff is only required to prove the breach of s. 2 of the *Act* on the part of O'Brien himself. If I have erred in that conclusion, having regard to the admissions of O'Brien's mother on her examination for discovery I have no hesitation in finding that the plaintiff has proven the necessary intent on her part; she acknowledged under oath that the transfer was for the purpose of protecting the property for O'Brien and his children.

23 The somewhat more problematical issue arises from the submissions of O'Brien's counsel to the effect that the May 19, 1993 conveyance was a legitimate or "bona fide" step taken by O'Brien to protect his assets from creditors and (or) to keep himself judgment-proof [see *Katzschke v. Walter* and *Havel v. Galemar Holdings Ltd.* (supra)]. Simply put, defence counsel argues, the Bank has failed to prove that in May 1993 O'Brien was insolvent or otherwise not meeting his obligations as they came due at that point in time, and, accordingly, he was entitled to organize his affairs so as to protect the equity that he had accumulated in the land from creditors (either existing creditors such as the Bank or potential creditors). Dealing with the evidence of O'Brien's financial position in May 1993, I have no hesitation in making the following findings:

(a) if he was not the owner of the equity in the lands from and after May 19, 1993 (as he alleges), his indebtedness at the Bank (irrespective of whatever other indebtedness he may have had) was significantly more than the value of any other assets that he owned;

(b) that he was then (and is now) sophisticated enough to know, and did in fact know and recognize at all material times, that the Bank continued to lend him money based at least in part on the strength of his representation that he owned the equity in the land. As to the difference in evidence between O'Brien and the Bank's central witness (Irene Halipchuk) surrounding what the Bank was told by O'Brien as to his ownership of or interest in the land both before and after the Bank's mortgage was discharged, I do not believe O'Brien's testimony to the effect that he told he Ms. Halipchuk, when she repeatedly asked him for security against the land to support his ongoing loans, that he was not the owner of the land or that the land belonged to his mother. Rather, I accept Ms. Halipchuk's version of these conversations to the effect that, when she repeatedly asked for security against the land, O'Brien simply represented to her that clear title to the land was his "goal" and that getting and maintaining clear title to the land was an achievement for himself and his family that he was not going to give up;

(c) although Ms. Halipchuk knew (as she admits) that O'Brien consistently refused to give the Bank security against the land for his ongoing business loans, I am satisfied that she did not know O'Brien had transferred title to the land to his mother (or anyone else) when she continued to approve the loan. I am satisfied that she (the Bank) relied on O'Brien's representations (and he knew that she and the Bank were relying on them) to the effect that he continued to have equity in the land valued by him in the area of $140,000 (after the Royal Bank mortgage was discharged). These representations are reflected in the Bank's Credit Application Inquiries (Ex. 1, Tabs 6, 7, 8 and 9).

24 I am mindful of the defence counsel's submission to the effect that O'Brien's business ethics (which are clearly lacking) are not on trial. However, when I analyze O'Brien's evidence, with regard to the "badges" or "inferences" of fraud referred to at pp. 18 and 19 (supra), I have no hesitation in finding that this conveyance was made by O'Brien in breach of s. 2 of the *Act*; that is, he had the necessary intent to defeat, hinder, delay *or* defraud creditors (including the Bank) as regards his equity in the lands. If O'Brien honestly transferred this land with no intention to defeat, hinder, delay or defraud the Bank, it was particularly incumbent on him, the next time that he borrowed any money from the Bank after May 1993, or the next time that the Bank required an update of his financial position, to clearly and unequivocally advise the Bank that he no longer owned the land in question and had absolutely no interest in the equity (i.e. the equity was no longer part of his net worth). He deliberately did not do so.

25 Accordingly, I find and declare that the conveyance of title to the land from O'Brien to his mother in May 1993 is void and I order and direct the District Registrar of the Winnipeg Land Titles Office to cancel the existing certificate of title for the land (which is presently in the name of O'Brien's mother) and to issue a new certificate of title in O'Brien's name, subject to whatever encumbrances are registered against the title. If a pending litigation order is required at this stage, as requested in the statement of claim, it is granted.

26 I have considered the Bank's submissions requesting costs on a solicitor and own client basis. I am mindful of my findings and conclusions as to O'Brien's conduct generally and specifically as regards his failure to clearly advise the Bank of the conveyance when he was required to do so. He admittedly wanted to protect the land from creditors; this intention, in itself, may not be sufficient to found liability in some circumstances. Ms. Halipchuk, as an experienced bank employee, was not as

careful as she might have been in protecting the Bank's interests when she continued to authorize loans to O'Brien knowing of his involvement in a fairly high risk business (the buying and selling of used cars out of his home) and, more importantly, having repeated refusals from O'Brien to pledge the title to the land as security for these loans (or otherwise give security against the land). That refusal of security to a bank lending officer would normally trigger a warning that something might be amiss in the financial affairs of a borrower. Solicitor and own client costs are granted only in rare and exceptional circumstances. The amount owing to the Bank, including interest to the date of judgment, brings this action within Class III of the tariff. There was no suggestion (or evidence) that the defendants conducted the litigation in such a way as to either unnecessarily prolong the action or increase costs.

27 I am satisfied that this is not a case for solicitor and own client costs, but the plaintiff should have costs on an increased scale. Accordingly, the plaintiff will have its costs as if this were a Class IV action, with the Class IV amounts to be increased by one-third. If the parties cannot agree upon costs, they may be spoken to.

APPENDIX — Schedule of Statutes, Texts and Authorities

Statutes:

• *The Fraudulent Conveyances Act*, R.S.M. 1987, c, F160 (s. 2 and s. 4)

• Queen's Bench Rule 57

Texts:

• Professor C. R. B. Dunlop, *Creditor-Debtor Law in Canada* (1995, 2nd ed.), chapter on "Fraudulent Conveyances and Preferences"

• Springman, Stewart and MacNaughton, *Fraudulent Conveyances and Preferences* (1994 ed.)

Cases:

• *Sun Life Assurance Co. v. Elliott* (1900), 31 S.C.R. 91 (S.C.C.)

• *Bell v. Williamson*, [1945] 4 D.L.R. 253 (Ont. H.C.)

• *Bell v. Williamson* (1945), [1946] 1 D.L.R. 372 (Ont. C.A.)

• *Mandryk v. Merko* (1971), 19 D.L.R. (3d) 238 (Man. C.A.)

• *Bank of Montreal v. Kelliher* (1980), 36 C.B.R. (N.S.) 205 (B.C. S.C.)

• *Havel v. Galemar Holdings Ltd.* (1981), 36 O.R. (2d) 348 (Ont. H.C.)

• *Bank of Nova Scotia v. Bass* (1983), 47 C.B.R. (N.S.) 203 (Man. Q.B.)

• *Rosenfeldt v. Olson* (1984), 16 D.L.R. (4th) 103 (B.C. S.C.)

• *Bank of Montreal v. Cyr* (1985), 61 N.B.R. (2d) 283 (N.B. C.A.)

• *Rosenfeldt v. Olson* (1986), 25 D.L.R. (4th) 472 (B.C. C.A.)

• *Mining & Allied Supplies (Canada) Ltd. v. 2390869 Manitoba Ltd.* (1994), 96 Man. R. (2d) 91 (Man. Q.B.)

• *Katzschke v. Walter* (1995), 32 C.B.R. (3d) 153 (B.C. S.C.)

• *Ramgotra (Trustee of) v. North American Life Assurance Co.*, [1996] 1 S.C.R. 325 (S.C.C.)

Action allowed.

Tab 5

2015 MBQB 125
Manitoba Court of Queen's Bench

Garlicki (Trustee of) v. Garlicki

2015 CarswellMan 392, 2015 MBQB 125, [2015] W.D.F.L. 5926, 257 A.C.W.S. (3d) 268, 320 Man. R. (2d) 33

Pricewaterhousecoopers Inc., as Trustee of the Estate of Lucy Maria Garlicki, a Bankrupt, Plaintiff and Krystyna Garlicki and Lucy Maria Garlicki, Defendants

Meyers Norris Penny Limited, as Trustee of the Estate of Lucy Maria Garlicki, a Bankrupt, Plaintiff and Krystyna Garlicki and Lucy Maria Garlicki, Defendants

Bond J.

Judgment: July 16, 2015
Docket: Winnipeg Centre CI 09-01-64122

Counsel: Richard W. Schwartz, for Plaintiff
Gene G. Zazelenchuk, for Defendants

Subject: Contracts; Corporate and Commercial; Estates and Trusts; Family; Insolvency; Property; Torts
Related Abridgment Classifications
Bankruptcy and insolvency
VIII Property of bankrupt
VIII.6 Family law issues
Bankruptcy and insolvency
XI Avoidance of transactions prior to bankruptcy
XI.3 Fraudulent and illegal transactions
Headnote
Bankruptcy and insolvency --- Property of bankrupt — Family law issues — Matrimonial property legislation
Bankrupt had two judgments against her, and assigned herself into bankruptcyr — Trustee in bankruptcy became aware that bankrupt's former husband had recently paid large sum of money to bankrupt's mother — Bankrupt had purportedly assigned matrimonial claim to mother four years prior to bankruptcy, and payment had been made to resolve claim — Trustee brought action for, inter alia, declaration that assignment was settlement under s. 91(2) of Bankruptcy and Insolvency Act (Can.) — Action allowed on other grounds — Assignment was not settlement under s. 91(2) of Act — Evidence relating to assignment was problematic and lacking in credibility — Bankrupt and mother had prepared list of debts together before mother was subjected to questioning by trustee in bankruptcy — Nonetheless, assignment could not be said to be gratuitous or made for merely nominal consideration — Evidence suggested mother had indeed provided some loans to bankrupt.
Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent and illegal transactions — Reviewable transactions under Act
Bankrupt had two judgments awarded against her prior to assigning herself into bankruptcy — Trustee in bankruptcy became aware that bankrupt's former husband had recently paid large sum to bankrupt's mother — Bankrupt had purportedly assigned matrimonial claim to mother prior to assigning herself into bankruptcy, and payment had been made to resolve claim — Trustee brought action for declaration that assignment was void under s. 2 of Fraudulent Conveyances Act (Man.) (FCA) and for damages for conspiracy — Action allowed — Trustee was awarded $180,000 — Assignment had been made to defeat, hinder, delay, or defraud bankrupt's creditors of their just and lawful actions and damages within meaning of s. 2 of FCA pursuant to conspiracy between bankrupt and mother — Evidence relating to assignment was problematic and lacking in credibility — Bankrupt had used her maiden name in assignment letter even though she used her married name for other purposes up to 2006 — Bankrupt claimed she wanted assignment to have legal effect, but bankrupt's maiden name was not her legal name

at time assignment was purportedly prepared — Mother's evidence about preparation of assignment letter was inconsistent — Assignment was not formally registered under Personal Property Security Act (Man.) until April 2006 — Mother lied about not having experience with legal matters — Mother was actually realtor and fairly sophisticated business person — Bankrupt and mother had prepared list of debts together in 2008 before mother was subjected to questioning by trustee in bankruptcy — Bankrupt and mother had not provided adequate document production — Mother made deliberate attempt to tailor her evidence to justify assignment.

Table of Authorities

Cases considered by *Bond J.*:

Hall-Chem Inc. v. Vulcan Packaging Inc. (1994), 12 B.L.R. (2d) 274, 1994 CarswellOnt 230 (Ont. Gen. Div.) — 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

Shoukralla v. Shoukralla (2014), 2014 ONSC 4205, 2014 CarswellOnt 9518, 16 C.B.R. (6th) 95 (Ont. S.C.J.) — considered

Statutes considered:

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

Generally — referred to

s. 2 "property" — considered

s. 2 "settlement" — considered

s. 91 — considered

s. 91(2) — considered

s. 163 — considered

Family Property Act, R.S.M. 1987, c. M45

Generally — referred to

Fraudulent Conveyances Act, R.S.M. 1987, c. F160

Generally — referred to

s. 1 "conveyance" — considered

s. 1 "personal property" — considered

s. 2 — considered

Personal Property Security Act, S.M. 1993, c. 14

Generally — referred to

ACTION by trustee in bankruptcy seeking declaration that assignment of marital property claim from bankrupt to her mother was settlement under Bankruptcy and Insolvency Act, and/or was void under The Fraudulent Conveyances Act.

***Bond J.*:**

I. Introduction

1 On May 9, 2007, Lucy Maria Garlicki ("Lucy") assigned herself into bankruptcy. PricewaterhouseCoopers Inc. ("PwC") was appointed as trustee.

2 Later in 2007, PwC became aware that Lucy's former husband Keith Ferguson ("Keith") had recently paid the sum of $180,000 to Lucy's mother Krystyna Garlicki ("Krystyna"). At that time Lucy and Keith were divorced, the divorce judgment having been granted January 12, 2005. The payment was more or less contemporaneous with the dismissal on consent of Lucy's claim under *The Family Property Act*, C.C.S.M. c. F25, formerly *The Marital Property Act*, C.C.S.M. c. M45 ("*MPA*"). It was purportedly made pursuant to an assignment of Lucy's *MPA* claim to Krystyna.

3 In December 2009, PwC commenced an action seeking a declaration that the assignment of the *MPA* claim was a settlement under section 91(2) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") as it read in May 2007 and/or was void under section 2 of *The Fraudulent Conveyances Act*, C.C.S.M. c. F160 ("*FCA*"). The claim also alleged that Lucy and Krystyna are liable for damages having committed the tort of conspiracy. In June 2010, Meyers Norris Penny Limited took over PwC's consumer insolvency practice and was formally substituted as trustee. It now continues the claim originally filed by PwC.

II. Positions of the Parties

4 The plaintiff argues that the case turns on credibility. It says that the evidence of Lucy and Krystyna regarding the payment from Keith to Krystyna and the assignment of Lucy's *MPA* claim to Krystyna is not to be believed. It argues that the evidence is inconsistent, unsupported by documentation, and nonsensical. The plaintiff urges the court to find that Lucy and Krystyna fabricated evidence to support their position.

5 The plaintiff argues that the requirements of section 91(2) of the *BIA* as it read in 2007 are met. It says that the court ought to find that the assignment was made gratuitously and without consideration, and that it was made at a time when Lucy was insolvent.

6 The plaintiff also argues that the assignment meets the requirements of section 2 of the *FCA*, being a transfer of property with the intent to defeat, hinder, delay or defraud creditors of their just and lawful actions, suits, debts, accounts, damages, penalties, or forfeitures. It says that Lucy essentially had her *MPA* settlement paid to Krystyna with the intent of keeping it from her creditors. This intent, it says, may be inferred from the evidence, which demonstrates circumstances that are "badges of fraud".

7 Finally, the plaintiff argues that the conduct of Lucy and Krystyna constitutes the tort of conspiracy. It says that Lucy and Krystyna acted together with the intent of causing injury or harm to Lucy's creditors, by hiding the *MPA* settlement and preventing them from garnishing the proceeds.

8 The defendants take the position that they did nothing wrong. They say that Lucy assigned her *MPA* claim to Krystyna in early July 2003 as "security" for Krystyna when it became clear to them that Lucy would be borrowing significant amounts of money from Krystyna. They say that there was no suggestion at that time that Lucy would be facing bankruptcy. They argue that the assignment was nothing more than Lucy's exercise of her legitimate right to prefer one creditor over another. They say that there is evidence to support their position that Krystyna loaned significant amounts of money to Lucy, and the fact that the payment she ultimately received from Keith was more than the total of the loans is not relevant. Krystyna received the assignment and ultimately made a profit when she settled the claim. This, they say, is lawful and legitimate.

9 I will begin with the evidence and findings of credibility and then address each of the plaintiff's claims in turn.

III. Facts

10 Lucy was married to Keith from 1985 until they separated in 2003. During the marriage Lucy's name was Lucy Ferguson. At some point after she and Keith divorced, she reverted to Lucy Garlicki. In 2009, she married Greg Chartier and now goes by the name Lucy Chartier. In these reasons, for ease of reference, I will refer to her as Lucy and to her mother as Krystyna.

11 In 1994, Lucy began operating a tile supply business called Expressions in Tile. In the beginning it was a successful business. In 1999, the business had $1.5 million in sales. However, over the years the success of the business declined and Lucy ran into financial difficulties. In 2005, Lucy closed the business and in 2007 she filed for bankruptcy. During the life of her business, Lucy became involved in two lawsuits. Lucy testified that these lawsuits were very expensive and difficult for her. By 2005, one of the lawsuits had resulted in a judgment against Lucy for $109,000. The other had resulted in a finding of liability against Lucy, with quantum to be determined and a costs award against Lucy of $9,000.

12 On May 7, 2006, Keith paid Krystyna $90,000. The payment was made out of funds Keith was to receive after the dissolution of a company in which Keith and Krystyna had been involved together. In January 2007, Keith paid Krystyna

$90,000. The payment was made pursuant to a mortgage in the amount of $90,000 that Keith had granted Krystyna on April 28, 2006, on his property at 124 Harrow Street, in Winnipeg.

13 In this action, Lucy and Krystyna claimed that Lucy relied on Krystyna for financial support and that Lucy assigned her *MPA* claim to Krystyna in return.

A. The Assignment Letter

14 The purported assignment of Lucy's *MPA* claim to Krystyna is the central event in the narrative of this case. The letter that the defendants say constitutes the assignment is dated July 1, 2003. The plaintiff says that the evidence shows that the assignment letter was not prepared on July 1, 2003, and it was in fact prepared sometime in 2006, or thereabouts, when Lucy was contemplating bankruptcy.

15 The only direct evidence regarding the preparation of the assignment letter came from Lucy and Krystyna. The evidence given is problematic and lacks credibility.

16 In 2003, Keith moved out of the home located at 124 Harrow Street, in Winnipeg, and Lucy filed for divorce. Lucy testified that the house at 124 Harrow Street was large (6,000 square feet) and old (built in 1920). It was expensive to heat and required ongoing maintenance. The property included a bachelor apartment. In 2003, after Keith left, Lucy moved into the apartment, and rented out the house.

17 Regarding the assignment letter, Lucy testified that after Keith left, she needed money from Krystyna to maintain the house, including replacing the boiler and repairing the roof. She needed small amounts at first, but later needed to borrow a larger amount. She said that she was going on a trip, and wanted Krystyna to have some assurance that she would receive payment of her money back should something happen to her while she was away. She denied that the document was prepared to cheat anyone, or to deny anyone what they were legally entitled to, or to conspire with Krystyna to commit a fraud. She testified that she prepared the document because she wanted protection for Krystyna. When asked in cross-examination what protection she believed the letter would give Krystyna, Lucy said that she did not know.

18 The letter specifies that the proceeds of Lucy's divorce settlement are assigned to Krystyna "as repayment for any and all monies I have or may in the future be required to borrow including but not limited to living expenses, legal fees, home repairs, etc." It also states, "Such debt to supersede any other debts I may have either previously incurred or may be required to incur whether personally or corporately." It is signed by Lucy. The document is not witnessed.

19 As for the preparation of the letter itself, Lucy testified that she and Krystyna discussed it and "did the framework on it together" but she could not recall who actually prepared the document. In her examination pursuant to section 163 of the *BIA* conducted on November 12, 2008, Lucy testified that Krystyna had prepared the document and had simply brought it to her to sign.

20 The document identifies Lucy as Lucy Garlicki or Lucy Garlicki (Ferguson). As noted above, in July 2003, Lucy was recently separated from Keith and her legal name was Ferguson. Lucy claimed in her evidence that in 2003 she began using the name Garlicki, because she had discovered that Keith had been dishonest and unfaithful and was "a despicable guy", and she "didn't want anything to do with that name". However, a review of the many documents filed in this matter indicates that Lucy was referred to as Lucy Ferguson up to and including 2006. There is no indication that she had reverted to Garlicki prior to that date. Moreover, Lucy is a reasonably sophisticated business person and she claimed that she intended the assignment letter to be legally binding to protect Krystyna. It seems unlikely that she would have used a name that was not her legal name in such a document. In addition, it seems unlikely that Lucy would be using the name Garlicki at all in 2003, having been married to Keith and having used Ferguson for 15 years prior to that.

21 Regarding the assignment letter, Krystyna claimed that she loaned Lucy small amounts of money from time to time, and that in July 2003, Lucy asked her for $11,000, a much larger sum than she had previously loaned. Krystyna said that she wanted to "be protected" in the event "anything happened", and therefore on the eve of a trip that Lucy was taking, a letter was

prepared, dated July 1, 2003, and signed by Lucy, that would in Krystyna's mind be her "security". It purported to assign the proceeds of Lucy's divorce settlement to Krystyna. In response to a question about Lucy's intention regarding the assignment of the *MPA* claim, she said, "She felt that I should get paid first because I took care of her. I took care of her bills."

22 Krystyna was inconsistent in her evidence about how the assignment letter came to be prepared. In direct examination, she said at one point that she and Lucy drew up the letter together. At another point, she testified that Lucy said that Krystyna should prepare the letter. At another point, Krystyna testified that Lucy gave the letter to her. In cross-examination, Krystyna said that the document was prepared at her Coldwell Banker office and typed by her secretary. In her examination pursuant to section 163 of the *BIA* conducted on November 12, 2008, she had said that she could not remember who prepared the letter, but that it had been given to her. When cross-examined on this, she said that she had since remembered that her secretary had typed it at her direction. She then explained that the only people who could have prepared the document would have been her secretary or Lucy, and because Lucy was very busy at the time, it must have been her secretary. In answering questions about the preparation of the letter in cross-examination, she was evasive and sometimes argumentative.

23 When asked about Lucy's legal name in July 2003, Krystyna was again evasive and argumentative. She claimed that she did not know Lucy's legal name at the time. She claimed not to know when Lucy reverted to the name Garlicki. I note that in a document prepared by Krystyna in November 2008 for the purpose of summarizing the debts owed to Krystyna by Lucy, Lucy is referred to as Lucy Ferguson. When asked about this, Krystyna was again argumentative and attempted to distance herself from the preparation of the document, repeating "I'm not a typist." She said that either Lucy or her lawyer had prepared it from her handwritten notes.

24 Regarding the date of the assignment letter, she testified that she could not recall the exact date, but it must have been created before July 1, 2003, and Lucy may have signed it before July 1, 2003. She denied the suggestion that the letter was created after seeing her lawyer in 2006. The assignment was registered under Manitoba's *Personal Property Security Act* on April 28, 2006, after Krystyna sought legal advice.

25 In her evidence, Krystyna appeared to be trying to present herself as unsophisticated in matters of law and business. During cross-examination, she suggested that she was unfamiliar with the legal process as this was her first time in court. But in fact, when presented with the record of other lawsuits showing in the Queen's Bench Court Registry System, Krystyna admitted that she had been both a plaintiff and a defendant in several lawsuits. She also confirmed that she had dealings with lawyers on numerous occasions and had lawyers act for her in various legal matters. She testified that she did not have a lawyer assist with the preparation of the assignment letter because it was only between her and her daughter and she trusted her daughter. This seems to be contradictory to the assertion that the letter was for her protection in the event of something happening to Lucy. For the assignment to act as protection for Krystyna, it had to be binding on persons other than Lucy, and her trust of Lucy would not assist.

26 At the time of testifying, Krystyna was 71 years old. She had been self-employed as a realtor for 34 years. She was still working with RE/MAX at the time of the trial, and had previously worked with Coldwell Banker. She had also been involved in a business that held commercial properties. She acknowledged the importance of keeping business records for tax purposes. Her background, and her manner of giving evidence, showed her to be a fairly sophisticated business person.

27 Overall, the evidence from both Lucy and Krystyna regarding the assignment letter was vague, contradictory and unsatisfactory.

B. The Consideration

28 The assignment of the *MPA* claim purports to be for the purpose of repayment of debts Lucy owed or would come to owe to Krystyna. The evidence regarding those debts is similarly problematic.

29 To support their claim that the assignment was made to Krystyna to repay her for debts owed by Lucy, the defendants relied on a document entitled "Money owing to Krystyna Garlicki", which I will refer to as the "summary of debts". Krystyna testified that the document was created with information from her bank statements, credit card statements, and line of credit

statements. Initially she said that it was created "at the time when I felt that Lucy would have the money coming". She later admitted that it was created immediately prior to her section 163 *BIA* examination conducted in November 2008. Lucy testified that she had helped Krystyna type the summary of debts. It was clear from the evidence that Lucy and Krystyna prepared the document together and that it was prepared for the purpose of attempting to substantiate the claim that Lucy owed Krystyna money and that, therefore, the assignment of Lucy's *MPA* claim was legitimate.

30 Some of the payments listed were backed up by line items in Krystyna's bank statements. Some others were backed up by cancelled cheques. However, the majority of the entries involved cash payments. Many of them were for relatively small amounts ($100 or $200), but a few were of $1,000 or more. One cash transfer was for $4,000 and Krystyna was unable to say what it was for beyond maintenance for 124 Harrow Street. Krystyna could not answer why she gave Lucy cash rather than a cheque. She suggested that maybe she had run out of cheques. However, entries in the summary of debts suggested that Krystyna had cheques, because she had written some to third parties purportedly on behalf of Lucy at the time of the cash transfer and they were sequentially numbered. There was no answer as to why she had given Lucy such a large amount of cash.

31 Some entries were not backed up by any documents. When challenged under cross-examination in relation to the claim that Krystyna had written cheques to Lucy of $11,000 and $5,100 on July 1, 2003 and July 3, 2003 respectively, Krystyna acknowledged that she had not produced the cancelled cheques. Later that day, after a lunch recess, Krystyna came to court with a statement from her line of credit showing these cheques as having been negotiated on July 11, 2003. This statement provided no record of whom the cheque was made out to, and the cancelled cheques were not produced. The failure to produce the statement earlier in the litigation despite a clear obligation to do so, and then to produce it over a lunch break while she is testifying, shows at best a woeful neglect of her obligation to produce relevant documents, and at worst a willful attempt to obstruct the court process.

32 Regarding the entry on July 3, 2003, for $5,100, Lucy testified that it was for a repair to the roof at 124 Harrow Street. The $11,000 payment on July 1, 2003, was to CIBC Visa, which was a payment on the credit card Lucy used for personal and business expenses.

33 Under cross-examination, Lucy acknowledged that on June 1, 2006, when she was the subject of an examination in aid of execution of a judgment against her, she produced no documents to substantiate any loans she said that Krystyna had made to her. Further, when she was examined in November 2008 pursuant to section 163 of the *BIA*, she did not produce any documents. She said that since that examination, she had not reviewed her files to provide any other documentation. She claimed that many of her records were not available to her because they had been destroyed in a flood or seized by the landlord of her business premises when the property was seized and she was locked out of the offices. She admitted that despite being aware of her duty to produce relevant documents, she had not made an extensive search for documents, and had not made any effort to obtain documents from her bank.

34 Despite having been examined on this issue in 2008, and despite her acknowledged obligation to produce documents in the course of the current litigation, Lucy suggested before me that she thought the cancelled cheques from Krystyna would be enough, but that she could have another look for receipts. She testified, "I am sure I have the receipts in a file." As is the case with Krystyna, the failure to produce relevant documents despite a clear obligation to do so, and then to claim that she would have those documents available, shows at best a woeful neglect of Lucy's obligation to produce relevant documents, and at worst a willful attempt to obstruct the court process.

35 Included in the summary of debts were amounts purportedly owed for "rent loss" ($24,000, plus $4,000 for utilities and $5,000 for taxes) and "use of car" ($18,000, plus $4,000 for car insurance). Lucy's father owned a rental property, the address being 1133 McMillan Avenue, and Lucy lived there from August 2005 to April 2007. Lucy testified that she used one of her parents' vehicles for work travel, using sometimes her father's Ford Ranger and sometimes Krystyna's "nice vehicle". These amounts for "rent loss" and "use of car" were not substantiated by any documentary or independent evidence.

36 Under cross-examination, Krystyna agreed that the rent claimed in the summary of debts was rent for a house owned by her husband, although she said that anything that was her husband's was also hers. She also acknowledged that the utilities

would be paid by the tenant to her husband, not to her, and that the tenant does not pay the property taxes. I find that the amount referred to as "rent loss" is inflated by amounts actually owed to Krystyna's husband, not Krystyna, and amounts that would not be paid by a tenant.

37 Regarding the claim for "use of car", Krystyna agreed that Lucy used sometimes her husband's truck and sometimes her car. Regarding the amount of $600 per month plus insurance of $4,000, she said, "When we prepared the letter [summary of debts] we figured out that would be the proper amount." Again, there is no documentation to support the amounts owed, and apparently no previous agreement that Lucy would compensate Krystyna for the use of the vehicle.

38 I find that Krystyna made a deliberate attempt to tailor her evidence to justify the assignment of Lucy's *MPA* claim by exaggerating the amount of the debt owed to her by Lucy.

39 It is notable as well that during her two examinations in aid of execution conducted in June 2006, Lucy testified that she moved into 1133 McMillan Avenue in August 2005 and that her then boyfriend Greg Chartier paid rent to her father of $800 per month and that Mr. Chartier also paid the utilities. When asked in cross-examination about this inconsistency, she had no explanation.

40 Throughout her evidence regarding the debt owed to Krystyna, Lucy was evasive and argumentative. At times it seemed that she was pulling answers out of thin air. For example, under cross-examination, Lucy testified that some of the small amounts of cash given to her by Krystyna were for vehicle repairs. When it was put to her that she did not own a car, she claimed she had to pay for the repairs to her parents' vehicles despite accumulating a debt of $600 per month for the use of the vehicle.

41 Lucy swore an affidavit on August 18, 2004, regarding her financial situation for the purposes of the divorce proceedings. There is no reference in that affidavit to any debts to Krystyna. There is reference, however, to Lucy's employment contract with a tile supply company called Midgley & West Ltd. In that affidavit, she swore that the contract provided for reasonable travel expenses and automobile expenses. When she was cross-examined on this point at trial, she testified that this statement was in error and that she was not reimbursed for travel or automobile expenses. She then stated that she could not recall whether she was reimbursed or not.

42 I find that the evidence regarding the consideration for the assignment lacked credibility, included amounts not supported by any documentary or independent evidence, and contained obvious exaggeration.

C. Lucy's Financial Situation

43 Lucy acknowledged that she had some income in 2003, 2004 and 2005 until her business closed in 2005. This income was evidenced by T4 slips from Midgley & West Ltd. amounting to approximately $66,125 in 2003, $69,300 in 2004, and $39,260 in 2005. Lucy testified that at the time of her separation from Keith in May 2003, she did not consider herself insolvent, her assets were worth more than her liabilities, and she was able to meet her obligations as they became due. When asked why then she was borrowing money from Krystyna starting in 2003, she said that she was unable to pay large repair bills for the house and that Krystyna loaned her $11,000 to pay a credit card bill. When pressed on why she was borrowing money from Krystyna at a time when she was making some money and she says she was able to meet her obligations, Lucy was unable to provide a satisfactory answer. Her responses simply did not make sense. I would note as well that according to the summary of debts, Krystyna gave small amounts of cash to Lucy and paid a Hydro bill for 124 Harrow Street. If the summary of debts is to be believed, then Lucy needed to borrow small amounts of money from Krystyna for everyday living costs and not just large expenses in 2003.

44 In an affidavit affirmed February 2, 2006, attaching a summary of assets and liabilities as they stood at the date of separation from Keith in May 2003, Lucy claimed to hold $56,959 in assets (being some savings and her interest in Expressions in Tile) and to owe $288,204 in debts. However, a large portion of the liabilities ($259,000) was attributable to judgments rendered or anticipated in relation to the two lawsuits in which Lucy was engaged that had not yet been resolved or determined by 2003. This statement would suggest that absent the potential but not yet actual liability that could result from the lawsuits, her assets would have exceeded her debts in May 2003.

45 The evidence presented at trial shows a steady decline in Lucy's financial situation between 2003 and 2006. At what point during that time Lucy became insolvent is difficult to determine on the evidence, particularly given the inconsistencies in Lucy's evidence. However, it seems reasonable to conclude that once judgment was rendered in favour of Guiseppe Bruni (at least on the issue of liability) in 2005 and in favour of Julian Ceramic Tile Inc. in the amount of $109,000 in 2005, Lucy's debts outweighed her assets. Indeed, in her statement of net worth sworn in October 2005, Lucy stated that her debts exceeded her assets by a significant amount, being anywhere from $163,000 to $522,000.

46 In June 2006, in two examinations in aid of execution, Lucy testified that she had no assets and no income. She said that her expenses were all being paid by her boyfriend Greg Chartier, or Krystyna, or her father.

47 I conclude that during the relevant time, from 2003 to 2006, the only asset of significance held by Lucy was her *MPA* claim.

D. The MPA Settlement

48 Lucy's divorce judgment was granted on January 12, 2005, but the *MPA* claim remained outstanding until it was dismissed on consent on May 15, 2006.

49 Lucy testified that in the spring of 2006, she was depressed and under stress. She decided at that time that she would be unable to win the legal battles she was engaged in. She decided to give up on fighting about what money was left over, and to let those who were seeking it to fight over it. The only thing she cared about at this point was Krystyna who had supported her throughout. Lucy testified that at that time she told Krystyna to go see her lawyer and attempt to settle the *MPA* claim.

50 Lucy acknowledged, however, that in March 2006 Keith had offered her $168,000 to settle the *MPA* claim and she had refused it. In her examination in aid of execution on June 16, 2006, Lucy acknowledged that she refused the settlement because she knew any money she received would go to her creditors. When cross-examined on this point at trial, all she could say was that at the time she was angry and her "mind was a mess".

51 Krystyna testified that in the spring of 2006, her money was running out and she could no longer support Lucy. She said that she talked to Lucy about this, and that Lucy told her to go see a lawyer and to get what she could from the *MPA* claim. Krystyna went to see her lawyer and following that meeting, on April 28, 2006, she registered the assignment pursuant to *The Personal Property Security Act*. Ultimately, a settlement was negotiated with Keith paying Krystyna $180,000.

52 Krystyna agreed she was not owed $180,000 by Lucy at the time that she went to see her lawyer in 2006.

53 Krystyna said that there was no talk of bankruptcy at the time that she went to see her lawyer. When asked whether she intended to pay Lucy's creditors after receiving money from the *MPA* settlement, Krystyna was very evasive. She did not answer the question, but eventually admitted that she knew whatever she got out of the settlement was for her alone. Krystyna said that Lucy had told her that the money would be for her alone.

54 Lucy acknowledged that the payment to Krystyna constituted a settlement of her *MPA* claim.

E. Inconsistencies in Disclosure of MPA Settlement

55 The plaintiff called David Johnson ("Johnson") as a witness. He was the trustee in bankruptcy who handled Lucy's file in 2005 and 2007, employed in that capacity with PwC at that time. In 2005, Johnson had met with Lucy and, on her instructions, made an informal proposal to her creditors, which was refused. Johnson confirmed that in August 2005, Krystyna offered to loan Lucy $20,000 to settle Lucy's debts with two of her creditors (Julian Ceramic Tile Inc. and Guiseppe Bruni). In a statement of net worth sworn on October 11, 2005, Lucy stated that she owed Krystyna $75,000. She also listed as one of her assets a possible *MPA* settlement, indicating that the amount was unknown, and that she did not have the funds available to pay the legal fees necessary to pursue the claim. There is no indication in that document that Lucy had assigned the *MPA* claim to Krystyna.

56 Johnson met with Lucy again in 2007 and ultimately Lucy made her assignment in bankruptcy.

57 Johnson testified that later in 2007, following the assignment in bankruptcy, it came to his attention that Lucy's *MPA* claim had been settled. He had not known of it before the assignment in bankruptcy. He testified that he spoke to Lucy about it, and she told him that there had been some business dealings between Krystyna and Keith, that Krystyna may have received a small amount of money, and that she would follow up with him with documents. He did not receive any documents from Lucy. He decided to proceed to an examination of Lucy and Krystyna under section 163 of the *BIA*. These examinations occurred in November 2008.

58 Lucy was examined in aid of execution twice in June 2006. Both times she failed to disclose the assignment of her *MPA* claim or its settlement in May 2006:

(a) She was examined on June 1, 2006, in relation to the judgment obtained by Guiseppe Bruni. She was asked numerous questions specifically about her divorce and *MPA* claim, and she testified that the divorce was final and the *MPA* claim was dismissed on consent. When asked why she consented to the dismissal of the claim, she said that she could no longer continue to pursue the claim because her financial resources were drained. She did not mention that the claim had been assigned to Krystyna, who had in fact negotiated a settlement of the claim.

(b) In her examination in aid of execution conducted on June 16, 2006, in relation to the judgment obtained by Julian Ceramic Tile Inc., Lucy testified that she owed Krystyna money, and that she intended to repay it "as a daughter would to a mother", but could not say at that time how much she owed. When asked whether there was a formal written agreement entered into between her and Krystyna "to govern any money she's lent you", Lucy answered, "Not that I can recall." This answer is simply not credible. When asked whether she had assigned or transferred any property to anybody within the last five years, her answer was "No." Clearly this is not true. She did not mention that the claim had been assigned to Krystyna.

IV. Conclusions Regarding the Evidence

59 I do not find Lucy to be a credible witness. Her explanation for clear inconsistencies between her evidence before me and evidence she gave under oath on previous occasions was that she was under stress and close to breakdown at the time of the examinations. I do not accept this explanation. I find that Lucy attempted to tailor her evidence at the examinations and before me in an effort to support whichever position she thought most favourable to her at the time.

60 In addition, I do not find Krystyna to be a credible witness. She feigned a lack of sophistication when she thought it was in her interests to do so. She clearly loves her daughter and wants to help her as much as she can. It appears that she was prepared to tailor her evidence in an effort to assist Lucy as well as herself.

61 Specifically, I do not accept the evidence of Lucy and Krystyna regarding the assignment of the *MPA* claim. Their evidence on the preparation of the assignment letter was vague and inconsistent. I have no confidence in their evidence of when and how it was prepared. The plaintiff urges me to find that the assignment letter was prepared in the spring of 2006 in contemplation of a settlement of the *MPA* claim being reached. While I am suspicious that that is the case, I am not prepared to make that finding in the absence of some evidence to support it. To do so would, in my view, go beyond drawing inferences to speculation. I am left then with finding that the letter was prepared sometime between 2003 and 2006.

62 Regardless of the date of the letter, I do not believe the assignment was a legitimate attempt to provide security for loans made to Lucy by Krystyna. Lucy and Krystyna claimed to be concerned about protecting Krystyna should something happen to Lucy. However, based on all of the evidence before me, I find that their intention was to make sure that Julian Ceramic Tile Inc. and Guiseppe Bruni did not get any of Lucy's money.

63 Overall, my impression is that both defendants believed that what they did was justified. Together they viewed Lucy as being under attack by Julian Ceramic Tile Inc. and Guiseppe Bruni. They did not accept the claims of those two parties as being legitimate. They wanted to make sure that those creditors did not receive any money from Lucy's *MPA* settlement. To that end, Lucy and Krystyna took steps to ensure that one or both of them would receive the benefit of the *MPA* settlement rather than Lucy's creditors.

V. Analysis

64 The plaintiff seeks judgment in the amount of $180,000 on the basis of the following claims:

(1) The assignment of the *MPA* claim, resulting in the payment of $180,000 to Krystyna, constitutes a settlement within the meaning of sections 2 and 91 of the *BIA*.

(2) The assignment of the *MPA* claim, resulting in the payment of $180,000 to Krystyna, was made with the intent to defeat, hinder, delay or defraud Lucy's creditors of their just and lawful actions, suits, debts, accounts, damages, penalties, or forfeitures within the meaning of section 2 of the *FCA*.

(3) In assigning the *MPA* claim and having Krystyna receive payment of $180,000 from Keith, the defendants conspired together to defraud Lucy's creditors.

65 I will consider each in turn.

A. The BIA

66 Lucy filed her assignment in bankruptcy on May 9, 2007. At that time, section 91(2) of the BIA provided as follows:

If bankrupt within five years

(2) Any settlement of property made within the period beginning on the day that is five years before the date of the initial bankruptcy event in respect of the settlor and ending on the date that the settlor became bankrupt, both dates included, is void as against, or in the Province of Quebec, may not be set up against, the trustee if the trustee can prove that the settlor was, at the time of making the settlement, unable to pay all the settlor's debts without the aid of the property that was the subject of the settlement or that the interest of the settlor in the property did not pass on the execution of the settlement.

67 In section 2 of the *BIA*, "property" was defined broadly as follows:

... any type of property, whether situated in Canada or elsewhere, and includes money, goods, things in action, land and every description of property, whether real or personal, legal or equitable, as well as obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, in, arising out of or incident to property;

68 There is no question that the assignment of Lucy's *MPA* claim would fall within this definition.

69 For the purposes of this case, the "date of the initial bankruptcy event" is the date of Lucy's assignment in bankruptcy, that being May 9, 2007. (See section 2 of the *BIA*.) This means that the assignment of Lucy's *MPA* claim to Krystyna would fall within the five-year window if it was effected on or after May 10, 2002.

70 In section 2 of the *BIA*, "settlement" was defined as including:

... a contract, covenant, transfer, gift and designation of beneficiary in an insurance contract, to the extent that the contract, covenant, transfer, gift or designation is gratuitous or made for merely nominal consideration;

71 In this case, there is little doubt that there was a transfer. Not only is there the purported assignment, there is also the fact that in 2006/2007, Krystyna was the recipient of $180,000 paid to her by Keith in settlement of Lucy's *MPA* claim.

72 The question is whether the transfer was "gratuitous or made for merely nominal consideration". Despite the weaknesses in the evidence of the defendants regarding the debts Lucy owed to Krystyna, I cannot find that the assignment was "gratuitous or made for merely nominal consideration". Some of the payments Krystyna made to Lucy or on her behalf are corroborated by cancelled cheques or other documents. Although the total amount is difficult to ascertain, it is beyond "nominal".

73 In the absence of a finding that the assignment was made gratuitously or for nominal consideration, I cannot find that the transfer was a settlement within the meaning of the *BIA* as it was in force in 2007. The plaintiff's claim in this regard must fail.

B. The FCA

74 Manitoba's *FCA* is applicable to this case. Section 2 of the *FCA* reads:

> **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.

75 There is no question that the assignment of Lucy's *MPA* claim to Krystyna was a "conveyance" of "personal property" as defined in section 1 of the *FCA*. The definition of "conveyance" specifically includes "assignment". The definition of "personal property" is broad and includes any interest in "goods, chattels, effects, bills, bonds, notes and securities". The *MPA* claim would be included under this definition as a "bill".

76 The question is whether the conveyance was made with the intent to "defeat, hinder, delay or defraud creditors".

77 In the absence of direct evidence, fraudulent intent may be inferred from suspicious circumstances: *Royal Bank v. O'Brien*, [1997] 9 W.W.R. 439 (Man. Q.B.); *Shoukralla v. Shoukralla*, 2014 ONSC 4205, [2014] O.J. No. 3329 (Ont. S.C.J.) (QL). Both Justice Clearwater of the Manitoba Court of Queen's Bench in *Royal Bank* and Justice Croll of the Ontario Superior Court of Justice in *Shoukralla* provide lists of fact situations that have been identified as "badges of fraud". As Justice Clearwater states, at para. 16, "These situations, taken separately, or combined, may (but not necessarily will) result in a finding of fraud, if proven."

78 In this case, the following circumstances mirror those referred to in *Royal Bank* and *Shoukralla* and support an inference of fraudulent intent:

> (1) The assignment is within a close family relationship.
>
> (2) The *MPA* claim was the only asset of any significant value held by Lucy between 2003 and her assignment in bankruptcy in 2007.
>
> (3) The amount of the consideration for the assignment is unclear and appears to be inadequate. In July 2003, when it is claimed by the defendants that the assignment was contemplated and the letter prepared, Lucy owed Krystyna approximately $20,000 according to the summary of debts filed. The potential *MPA* settlement was acknowledged to be at minimum $168,000 and potentially much more. It was ultimately settled for $180,000. The evidence provided by the defendants regarding the total amount ultimately loaned to Lucy by Krystyna is at best inflated, and at worst false. Many of the purported payments are without any documentary corroboration and despite requests made of her during examinations conducted prior to trial, Lucy has produced no bank statements, credit card statements, or receipts to support her assertions.
>
> (4) The assignment letter was purported to have been signed on or about July 1, 2003, but the assignment was not registered under *The Personal Property Security Act* until April 28, 2006.
>
> (5) Lucy failed to disclose the assignment to her trustee in bankruptcy and during two separate examinations in aid of execution conducted in June 2006.

79 To these enumerated circumstances, I would add that I found Lucy and Krystyna to generally lack credibility and to be willing to tailor their evidence to what they perceived to be to their advantage.

80 Contrary to the argument of counsel for the defendants, the assignment was not a legitimate preference of one creditor over another. Lucy was clearly intending to defeat the claims of her creditors. Indeed, she as much as said so in her examination in aid of execution in relation to Julian Ceramic Tile Inc. in 2006 when in answer to a question about the proceeds of her divorce settlement she said, "Any monies that I would have received from Keith would have just gone to the creditors anyway." When asked why she refused an offer made in March 2006 to settle the *MPA* claim for a payment of $168,000, she answered, "I owe you 110. I owe Bruni 150. I walk away with nothing. And I refuse to continue on to fight this battle. I would rather he keep it than you guys get it, let me put it to you that way." Lucy gave this evidence in June 2006. The settlement was concluded in May 2006. Lucy filed her assignment in bankruptcy on May 9, 2007. Lucy acknowledged that she deliberately delayed filing for bankruptcy until that date.

81 I conclude that the assignment of Lucy's *MPA* claim, resulting in the payment of the proceeds of its settlement to Krystyna, was effected with the intent to defeat, hinder, delay or defraud Lucy's creditors of their just and lawful actions and damages. It is, therefore, void.

C. Tort of Conspiracy

82 The tort of conspiracy was explained as follows in *Hall-Chem Inc. v. Vulcan Packaging Inc.* (1994), 12 B.L.R. (2d) 274 (Ont. Gen. Div.)):

> [72] In *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.* (1983), 145 D.L.R. (3d) 385 (S.C.C.), Estey J. made the following statement about the law of torts in respect of conspiracy [at p. 398]:
>
> > Although the law concerning the scope of the tort of conspiracy is far from clear, I am of the opinion that whereas the law of tort does not permit an action against an individual defendant who has caused injury to the plaintiff, the law of torts does recognize a claim against them in combination as the tort of conspiracy if:
> >
> > > (1) whether the means used by the defendants are lawful or unlawful, the predominant purpose of the defendants' conduct is to cause injury to the plaintiff; or,
> > >
> > > (2) where the conduct of the defendants is unlawful, the conduct is directed towards the plaintiff (alone or together with others), and the defendants should know in the circumstances that injury to the plaintiff is likely to and does result.
> >
> > In situation (2) it is not necessary that the predominant purpose of the defendants' conduct be to cause injury to the plaintiff but, in the prevailing circumstances, it must be a constructive intent derived from the fact that the defendants should have known that injury to the plaintiff would ensue. In both situations, however, there must be actual damage suffered by the plaintiff.

83 I have found that the defendants in this case acted together to frustrate Lucy's creditors' attempts to obtain satisfaction of the judgments made against her in their favour. Based on the evidence, I find that not only did Lucy act with that intent but Krystyna shared that intent.

84 It is not necessary that injury to another party be the only intent of the defendants in a claim of conspiracy. What is required is that it be the predominant intent. It is common that there will be no direct evidence of a person's intent and intent must be inferred from the circumstances. In this case, I infer from the evidence outlined above that Lucy and Krystyna intended to stop Lucy's creditors — Julian Ceramic Tile Inc. and Guiseppe Bruni — from garnishing the proceeds of her *MPA* settlement. That the defendants' purpose or motivation was to protect their own financial interests or to allow Lucy to "get on with her life" does not undermine the claim. The intent of the assignment and ultimate payment of the *MPA* claim to Krystyna was to keep the money away from the creditors' legitimate claims.

VI. Conclusion

85 For the reasons given above, I conclude the following:

(1) The assignment of Lucy's *MPA* claim to Krystyna, resulting in the payment of $180,000 from Keith to Krystyna, was made to defeat, hinder, delay or defraud Lucy's creditors of their just and lawful actions and damages within the meaning of section 2 of the *FCA*.

(2) The defendants Lucy and Krystyna committed the tort of conspiracy by intentionally defeating the legitimate claims of Lucy's creditors.

(3) The plaintiff is entitled to judgment in the amount of $180,000, plus pre- and post-judgment interest.

86 If counsel cannot agree, they may speak to costs.

Action allowed.

Tab 6

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.

End of Document

Tab 7

Botham Holdings Ltd. (Trustee of) v. Braydon Investments Ltd.

British Columbia Judgments

British Columbia Court of Appeal

Vancouver, British Columbia

L.S.G. Finch C.J.B.C., P.D. Lowry and H. Groberman JJ.A.

Heard: September 24, 2009.

Judgment: November 24, 2009.

Docket: CA036607

[2009] B.C.J. No. 2315 | 2009 BCCA 521 | 283 B.C.A.C. 12 | 59 C.B.R. (5th) 1 | 314 D.L.R. (4th) 360 | 2009 CarswellBC 3135 | 183 A.C.W.S. (3d) 445

Between Abakhan & Associates Inc., the trustee of the estate of Botham Holdings Ltd., a bankrupt, Respondent (Plaintiff), and Braydon Investments Ltd., Appellant (Defendant)

(91 paras.)

Case Summary

Creditors and debtors law — Fraudulent conveyances — Conveyances that are void — Intent to defeat, hinder, delay or defraud creditors — Appeal by transferee of bankrupt's assets from order declaring transfer void dismissed — Although transfer may have been effected to obtain legal tax advantages, effect of transfer was to place assets of bankrupt beyond reach of creditors — Fraudulent state of mind need not be shown — Fraudulent Conveyances Act, ss. 1, 2.

Appeal by Braydon Investments from an order declaring void as against Botham Holding's bankruptcy trustee a transfer of assets from Botham to Braydon. The companies shared the same directing mind. The transaction, under which virtually all Botham's assets were transferred to Braydon, enabled Botham to claim capital cost allowances to offset capital gains tax it owed. Botham had significant debts at the time of the transfer. It was assigned into bankruptcy within about one year. The court found that while the directing mind had not engaged in the transaction with the intention of defeating Botham's creditors, the transaction was nonetheless a fraudulent conveyance and set it aside.
HELD: Appeal dismissed.

No subjective or fraudulent state of mind on the part of the directing mind needed to be shown to render the transaction void. The effect of defeating, hindering, or delaying the creditors of Botham was enough. The collateral motive of obtaining a tax advantage for Botham did not change the fact the transaction placed its assets beyond the reach of its creditors.

Statutes, Regulations and Rules Cited:

Fraudulent Conveyance Act, RSBC 1996, CHAPTER 163, s. 1, s. 2

Fraudulent Conveyance Act, R.S.B.C. 1987, c. 43, s. 1

Fraudulent Conveyance Act, R.S.B.C. 1979, c. 142, s. 2, s. 3, s. 4

Fraudulent Conveyance Act, R.S.B.C. 1897, c. 86, s. 3

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 85

Miscellaneous Statute Amendment Act, R.S.B.C. 1987, c. 42,

Statute of Elizabeth, 1571 (13 Eliz. 1), c. 5,

Appeal From:

On appeal from: Supreme Court of British Columbia, November 14, 2008 (*Abakhan & Associates Inc. v. Braydon Investments Ltd.*, S077051)

Counsel

Counsel for the Appellant: G.K. Macintosh, Q.C., S. Hern.

Counsel for the Respondent: R.A. Millar, L. Sulek.

[Editor's note: A correction was sent by the Court February 3, 2010; the change has been made to the text and the correction has been appended to this document.]

Reasons for Judgment

The judgment of the Court was delivered by

L.S.G. FINCH C.J.B.C.

I. Introduction

1 Braydon Investments Ltd. ("Braydon") appeals from the order of the Supreme Court of British Columbia pronounced 14 November 2008, holding the transfer of assets from Botham Holdings Ltd. ("BHL") to Braydon, pursuant to an agreement made 31 October 2005, to be void and of no effect as against the plaintiff Abakhan, the trustee in bankruptcy of BHL.

2 Following a trial on affidavit evidence under Rule 18A, the learned summary trial judge held that one purpose of the asset transfer was to put BHL's assets out of reach of its creditors, and the transfer was therefore a fraudulent conveyance within the meaning of the *Fraudulent Conveyance Act*, 1996, R.S.B.C., c. 163. The trial judge held this to be so, despite the fact that BHL's and Braydon's principal, William Botham, had no dishonest intent, or *mala fides*, and acted on professional advice to effect legitimate business purposes.

3 I respectfully agree with the conclusion of the learned summary trial judge, and would dismiss the defendant's appeal.

II. Facts

4 The background leading to the asset transfer of 31 October 2005 was described by the learned trial judge this way:

> [3] Mr. William Botham was the directing mind of BHL. That company had been incorporated many years earlier and had accumulated substantial worth such that its equity in real property was worth approximately $20 million at the time of the Transaction. The shareholders in BHL were Mr. Botham and the Botham Grandchildren's Trust (the "Family Trust"), although that changed after the Transaction to include Braydon.
>
> [4] Mr. Botham was also the directing mind of Braydon. Braydon was incorporated on October 25, 2005. The shareholders of Braydon were Mr. Botham and the Family Trust.
>
> [5] In 2004, BHL sold a substantial real estate asset at a profit. BHL therefore paid a large amount of capital gains tax.
>
> [6] In 2005, Mr. Botham was looking for an opportunity to invest the funds realized by BHL's sale of its real estate asset. He had discussions with a friend, Jordan Welsh, who had had many years' experience in the car leasing business. He encouraged Mr. Botham to invest in a new business, involving the selling and leasing of motor vehicles.
>
> [7] Mr. Welsh proposed that they form a new business called "JW Auto Group" and acquire a portfolio of leased vehicles from a failed business, Totem Ford.
>
> [8] The proposed investment would have the tax benefit of generating capital cost allowance claims. This would enable BHL to obtain refunds of capital gains tax which it had previously paid.
>
> [9] However, BHL could only claim this tax benefit if it became a general partner in the new business, and only if the new business were its major source of revenue.
>
> [10] As a general partner of JW Auto Group, however, BHL would be responsible for any debts incurred by the partnership. But BHL had substantial assets which far exceeded what Mr. Botham wished to invest in the new venture.

5 William Botham was advised that he could both protect BHL's assets from creditors' claims, and qualify for the tax benefits of capital cost allowance claims by transferring BHL's assets to a new corporation, Braydon, and using BHL to invest as a general partner in JW Auto.

6 The mechanisms for achieving these ends were complicated, and are reviewed in the trial judge's reasons at paras. 17-27. An intermediary company, Silverspoon Developments Limited (SSDL) was used in the transaction. The trial judge said the transaction was summarized by BHL and William Botham's solicitor as follows:

1. Bill Botham and a family trust sold to Braydon preferred shares of Botham Holdings Ltd., having a redemption value, in total, of $18,700,000. The redemption values track the fair market value of the real estate owned by BHL. Thus, at this step in the reorganization, Braydon owned preferred shares of BHL, having a redemption value of approximately $18,700,000.
2. BHL sold its real estate to Braydon for consideration which included assumption of debt owing to third parties of approximately $4,300,000, and a promissory note of approximately $12,100,000, plus preferred shares having a redemption value of approximately $6,900,000; at this point, BHL had virtually no debt, had a promissory note

in the amount of $12,160,000 from Braydon and preferred shares having an aggregate redemption value of $6,900,000.

3. The preferred shares of Braydon owned by BHL were redeemed for a promissory note of approximately $6,900,000.
4. The preferred shares of BHL owned by Braydon were then redeemed and a promissory note for approximately $18,000,000 was issued by BHL in favour of Braydon, representing the redemption proceeds.
5. The promissory notes were then cancelled off against each other.
6. In the end result, Braydon owed approximately $350,000 to BHL as the promissory notes differed by that amount; Braydon and Silverspoon used their rights of offset to cancel that note against the amounts to Silverspoon owing by BHL as a partner of JW Auto Group.

7 The effect of the transaction was described as follows:

> On October 31, 2005, two months after the Partnership [JW Auto] had been formed and commenced operations, BHL and Braydon completed the BHL-Braydon Transaction. While the BHL-Braydon Transaction is complicated in its structure, and required a substantial number of transitional documents, its effect was to transfer all of BHL's assets to Braydon, without triggering capital gains tax on the disposition, and leaving BHL with effectively no assets except for BHL's interest in the Partnership, which ... had a nominal or negative value.

8 The trial judge recorded:

> [30] At the time of the transaction, October 31, 2005, BHL did have several creditors. Its indebtedness to AIG exceeded $4 million. It owed SSDL $5.2 million. It was the guarantor of indebtedness to the Bank of Montreal of $2.1 million.
>
> [31] Ultimately, BHL's investment in JW Auto Group was a failure. Within seven months, as of May 31, 2006, the partnership had operating losses of more than $5 million. By May 2007, both the partnership and BHL were assigned into bankruptcy. Creditors' claims currently exceed $20 million.

9 William Botham admitted on his examination for discovery at Q. 333 that:

> Q. ... The purpose and intent and effect of the transaction was to make sure that the assets of BHL were removed from BHL so that creditors of JW Auto couldn't have access to them to satisfy their claim?
>
> R. That's what I understood.

10 However, the plaintiff conceded that William Botham had no "dishonest intent" or any intent to "defraud" creditors. And in addition to his wish to protect his and his family's assets, William Botham also testified that the asset transfer was done in order to take advantage of the tax free rollover available under s. 85 of the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1.

11 The trial judge concluded that the asset transfer was a fraudulent conveyance. He said:

> [77] Based on the foregoing, I find that BHL did engage in a fraudulent conveyance, despite Mr. Botham's lack of dishonest intent. A transaction which is the result of an honest intent to defeat one's creditors is precisely one of the situations caught by the *Fraudulent Conveyance Act*.
>
> [78] I have also considered the defendant's argument that the plaintiff's position, if accepted, would place judge-made restrictions on a taxpayer's right to avail him or herself of s. 85 tax-free

> rollovers under the *Income Tax Act* and on the right of a corporation to redeem shares under ss. 77 and 79 of the *Business Corporations Act*.
>
> [79] I disagree. These statutory provisions do not provide a license to engage in transactions which are counter to the *Fraudulent Conveyance Act*. ...

12 The judge held that the defendant had no defence under s. 2 of the *Act*:

> [80] There are three parts to this defence. It requires that the disposition be made (1) for good consideration, (2) in good faith, and (3) to a person who had no notice or knowledge of the fraud. The defence does not apply in the case at bar. I find that there was no good consideration which passed from Braydon to BHL for the assets. At the end of the Transaction, BHL was left with virtually no assets while Braydon had obtained $19 million in assets. The Transaction was clearly not in good faith based on the direct evidence of Mr. Botham's intent with regards to BHL's assets. Finally, given that Mr. Botham was the directing mind of both Braydon and BHL, it cannot be said that the transferee had no notice or knowledge of the fraud.

13 He accordingly concluded that the transaction was void and of no effect.

III.

14 The issue on this appeal is whether the learned summary trial judge erred in setting aside the 31 October 2005 transaction as a fraudulent conveyance. More precisely, the question may be framed as whether a transfer of property made with a view to protecting assets from creditors, present or future, if made honestly, without moral blameworthiness, and for other legitimate business purposes, is prohibited by the *Fraudulent Conveyance Act*.

IV. The Parties' Positions

A. The Appellant Braydon

15 Braydon says the learned trial judge erred both in fact and law in holding the transfer of assets from BHL to Braydon to be a fraudulent conveyance.

16 The appellant says the legal error was in interpreting s. 1 of the *Fraudulent Conveyance Act* as requiring only an intent in the transferor to put assets out of the reach of creditors. The appellant says that a fraudulent or dishonest intent must be proven. The appellant points to the language of s. 1 in the *Act* which renders void a disposition made to "delay, hinder or defraud" creditors "by collusion, guile, malice or fraud".

17 The appellant says the section has been interpreted, correctly, to mean that there must be "*mala fides*" in the intent of the transaction: See *Westinghouse Canada Limited v. Caldwell* (1979), 31 C.B.R. (N.S.) 276 (B.C.S.C.) at p. 282; *First Royal Enterprises Ltd. v. Armadillo's Restaurant Ltd.* (1995), 15 B.C.L.R. (3d) 254 (C.A.) at paras. 23, 35 and 36; and *Mandryk v. Merko* (1971), 19 D.L.R. (3d) 238 (Man. C.A.) at pp. 241-242. Here the appellant says the trial judge erred in holding that an "honest intent to defeat ones creditors" was, as a matter of law, an intent sufficient to meet the requirements of s. 1.

18 The appellant also says the trial judge erred in fact in finding that the plaintiff had proven the intent proscribed by s. 1. The appellant says that on the whole of the evidence William Botham's intent was an honest and prudent one, to take advantage of the tax benefits provided by the "rollover" plan devised by his professional advisors. The appellant says that by focusing on William Botham's answers on his examinations for discovery to questions 395 and 396 where he agreed that the "whole motivation" behind the transfer was to "ensure that creditors wouldn't get the assets of the estate", the trial judge ignored or failed to give effect to the whole of the evidence which showed Mr. Botham's "innocent and reasonable intentions in engaging in the rollover".

19 As expressed in the appellant's factum: "... the plan was to empty an old company of its assets unrelated to auto leasing, and use the old company for the partnership rather than incorporate a new one, because using the old company allowed for a tax benefit".

20 The appellant says that if a new company controlled by Mr. Botham had been incorporated and used as the general partner there would be no question of a fraudulent conveyance. They say that is so because, first, there would have been no conveyance and, secondly, there could be nothing fraudulent in engaging in a partnership by way of a private, limited liability company. By extension, this argument appears to be that effecting the same intention by way of a conveyance cannot, therefore, be considered fraudulent. The appellant contends that what was done in this case is no different and no more "fraudulent" than what has routinely been done by persons seeking to limit personal liability by incorporation. (citing C.R.B. Dunlop, *Creditor-Debtor Law in Canada,* looseleaf, Toronto (Carswell, 1995, 2nd ed.) at 592.

21 The appellant distinguishes the facts of this case from others where a fraudulent intent has been found because at the time of the asset transfer no creditor had an outstanding demand against BHL that it could not satisfy. Neither BHL nor JW Auto were under any financial pressure from which a fraudulent intent could be inferred. The appellant says the transfer of assets in the rollover was not "voluntary" but was rather for "valuable" consideration, and that while the "nature" of BHL's assets changed as a result of the transfer, its net financial position did not.

22 The appellant submits that no creditors of JW Auto relied on the asset holdings of BHL in deciding to advance credit to JW Auto and that no creditors of BHL were prejudiced by the asset transfer. The appellant further contends that its asset transfer to Braydon following redemption of Braydon's preferred shares was a *bona fide* payment to a creditor.

23 The appellant therefore contends that, in any event, its conduct falls within the defence to an allegation of a fraudulent conveyance afforded by s. 2 of the *Act*, in that the transfer was for good consideration, made in good faith, and made to a person (William Botham was the directing mind of Braydon as well as BHL) who had no notice or knowledge of any collusion or fraud.

B. The Respondent's Position

24 On the question of how to construe s. 1 of the *Fraudulent Conveyance Act*, counsel for the respondent says the words "collusion, guile, malice or fraud" add little or nothing to the meaning of the section. The respondent says the only intent necessary to contravene the section is the intent to put assets out of the reach of one's creditors. If there is an intent to delay or hinder a creditor's rights, the transfer is void as against the creditor. The respondent says that even if the transferor has other legitimate intentions, so long as one intent is to put assets out of a creditor's reach, that is sufficient to void the disposition. So the respondent says despite the fact that BHL (through William Botham) intended to obtain a tax advantage from the deal, the transfer is nonetheless a contravention of s. 1 if its intent and effect is to defeat creditors' claims.

25 The respondent says the meaning attributed by the trial judge to the words of s. 1 is consistent with a long line of cases, both in British Columbia and elsewhere. Counsel says there was no legal error in the judge's interpretation of s. 1.

26 As to whether the appellant had an intention prohibited by s. 1, the respondent says that is a question of fact on which this Court should defer to the judge's findings unless the appellant establishes a palpable and overriding error. Here the respondent says there was ample evidence, including the admissions of William Botham himself, on which the proscribed intent could be found.

27 The effect of the transfer was to place all of BHL's real estate assets in the hands of Braydon. BHL was left with the preferred shares it acquired as consideration for the real estate transfer. And in addition, BHL was left with the debts it owed previously to CFI, Shamrock and the Bank of Montreal, as well as its indebtedness to SSDL as a result of the transaction. BHL also became liable, as a general partner, to all of JW Auto's creditors.

28 The respondent says it is no answer for the appellant to say that no creditor was pressing for payment at the time of the transfer, and that it is wrong to say that no creditor was prejudiced by the transfer. The fact is that the real assets were put out of reach of BHL's creditors, and that they were prejudiced because it was far more difficult to execute against the preferred shares than it would have been to execute against the real estate.

29 The respondent concedes that it would have been perfectly lawful for BHL to limit its liability by incorporating a new company to invest in JW Auto. But, the respondent points out, that is what BHL explicitly decided not to do because of its desire to obtain both limited liability and tax advantages.

30 The respondent says that the defence available to transferors under s. 2 of the *Fraudulent Conveyance Act* is not available to the appellant on the facts of this case. To say, as the appellant suggests, that the transfer to Braydon was payment to an existing creditor, has no air of reality. Braydon was created for the sole purpose of receiving BHL's assets. The consideration for the transfer, even if "good consideration", was by no means of the same nature or quality as the assets Braydon received. In the result, Braydon ultimately paid nothing and BHL was left with nothing of value.

31 In any event, the respondent says the transfer could not be said to be in good faith because the controlling mind of both BHL and Braydon was William Botham, and his intent to defeat BHL's creditors must also be attributed to Braydon. And for the same reason, Braydon is fixed with notice of BHL's improper intent (see *Chan v. Stanwood*).

32 The respondent says that neither legitimate business goals, nor tax or estate planning advantages can excuse a fraudulent conveyance. That is especially so here where the only "estate planning" achieved by the transaction was to protect BHL's assets from its creditors.

V. The Provisions of the Statute

33 The *Fraudulent Conveyance Act*, R.S.B.C. 1996, c. 163, provides, in full:

Fraudulent conveyance to avoid debt or duty of others

1 If made to delay, hinder or defraud creditors and others of their just and lawful remedies

(a) a disposition of property, by writing or otherwise,

(b) a bond,

(c) a proceeding, or

(d) an order

is void and of no effect against a person or the person's assignee or personal representative whose rights and obligations by collusion, guile, malice or fraud are or might be disturbed, hindered, delayed or defrauded, despite a pretence or other matter to the contrary.

Application of Act

2 This Act does not apply to a disposition of property for good consideration and in good faith lawfully transferred to a person who, at the time of the transfer, has no notice or knowledge of collusion or fraud.

[Emphasis added.]

VI. Analysis

34 The defendant points to the words in s. 1, "... by collusion, guile, malice or fraud ..." as showing a clear legislative requirement for a morally blameworthy intent, or *mala fides*, on the part of the transferor in order to constitute the conduct proscribed by the *Act*.

35 Here, the plaintiff conceded and the trial judge found that William Botham had no "dishonest intent". The question, then, is whether the mere intent to delay or hinder creditors is sufficient or whether *mala fides* must be established under s. 1 of the *Act*.

A. Legislative History

36 It is generally acknowledged that the fraudulent conveyance statutes enacted in British Columbia have their roots in the *Statute of Elizabeth*, 1571 (13 Eliz. 1), c. 5. In a feasibility study written for the Uniform Law Conference of Canada, Civil Law Section (August, 2004), Professor C.R.B. Dunlop wrote:

> [6] English law on fraudulent conveyances dates back to the Middle Ages, but the first comprehensive attempt at prohibition may be the *Fraudulent Conveyance Act, 1571,* usually referred to as the Statute of Elizabeth. The Statute sought to avoid "feigned, covinous and fraudulent" transfers of land and personalty entered into with the intent to "delay, hinder or defraud creditors and others" of their just and lawful claims. S. 2 provided that such conveyances should be "clearly and utterly void, frustrate and of no effect" as against "creditors and others" whose claims might be delayed by such conveyances. S. 6 contained the important proviso that the Act did not extend to a conveyance for "good consideration" entered into bona fide and without notice of the fraud. The Statute of Elizabeth on its face created a criminal offence, but the courts quickly saw its potential as the foundation for a civil action to avoid fraudulent conveyances of exigible property by debtors. Since 1571, the courts have been active in creating a large and complex body of law which purports to interpret the Statute but which in reality constructs a new right in "creditors and others" to challenge and avoid fraudulent conveyances.

37 The *Statute of Elizabeth* was, in Dunlop's view, "... intended primarily to create a crime, not a civil cause of action" (at para. 36).

38 The first *Fraudulent Conveyance Act* in British Columbia was enacted in 1897 (R.S.B.C. 1897, c. 86). It adopted the language of the *Statute of Elizabeth,* including the words "contrived of malice, fraud, covin, collusion or guile". The original B.C. statute also included, in s. 3, the penal provision of the *Statute of Elizabeth*, imposing penalties and forfeitures for the fraud, including imprisonment.

39 The penal provision remained in the British Columbia statute through successive amendments and re-enactments until it was formally repealed by the Legislature in 1987 (*Miscellaneous Statute Amendment (No. 2) Act,* S.B.C. 1987, c. 43).

40 The penal provision of the 1960 *Act* was contained in s. 3, which concluded with the words:

> ... and also, being thereof lawfully convicted, shall suffer imprisonment for one half year without bail or mainprize.

41 In 1965, the constitutionality of this legislation was challenged. In *Allison & Burnham Concrete Ltd. v. Mountain View Construction Ltd. et al*, 54 D.L.R. (2d) 67 (B.C.S.C.); [1965] B.C.J. No. 157, Mr. Justice Ruttan said:

> 14 Section 3 then imposes penalties and forfeitures for the fraud and concludes with these words: "... and also, being thereof lawfully convicted, shall suffer imprisonment for one-half year without bail or mainprize."
>
> 15 There is no doubt that the portion just quoted from s. 3 of the Act is beyond the jurisdiction of a Provincial Legislature. It refers to a criminal process resulting in a term of imprisonment and as such is entirely within the jurisdiction of the Federal Government in criminal law. In *R. v. Smith* (1852), 6 Cox C.C. 31 at p. 37, Maule, J., had this to say about the identical words as they appear in the English statute:
>
>> It surely could never be contended that the meaning of the statute is, that when such a court has given judgment for the damages, it should proceed to award to the defendant the punishment of imprisonment for half a year. The humanity of our law has established a clear distinction between civil and criminal proceedings, and this act of Parliament cannot be supposed to sanction so anomalous a course as that. It is obvious that by some means or another, imprisonment is to be awarded after a proper conviction before a recognised tribunal. How then can that be done, otherwise than by indictment?
>
> 16 This section, of course, would never be invoked in criminal prosecutions for the same subject-matter is covered in the *Criminal Code* of Canada. But I do not agree with counsel for the defendant that because the statute has ventured to legislate in part in the field of criminal law the whole statute is therefore "in pith and substance" to be deemed a criminal one and therefore *ultra vires in toto*. Mr. Vogel cites the Alberta decision of *Connors v. Egli*, [1924] 2 D.L.R. 59, 20 A.L.R. 205, [1924] 1 W.W.R. 1050, where it was held by the Alberta Court of Appeal that s. 3 of the statute is criminal law and the ground having been occupied by the *Criminal Code* of Canada, is not now in force in the Province of Alberta.

42 Ruttan J. concluded that while the imprisonment portion of s. 3 was "clearly within the scope of criminal law and invalid in a provincial statute, the remainder of s. 3 is clearly a matter of civil suit and therefore *intra vires* the Provincial Legislature." (at para. 18, citations omitted).

43 Despite this declaration of invalidity, the British Columbia statute retained a penal provision in the 1979 revision. Section 3 of the *Fraudulent Conveyance Act*, R.S.B.C. 1979, c. 142 provided:

> A fraudulent disposition under this Act is an offence punishable on conviction by 6 months imprisonment.

44 Finally, in 1987 the Provincial Legislature repealed ss. 2 and 3 of the *Fraudulent Conveyance Act*, R.S.B.C. 1987, c. 43.

45 The repeal of ss. 2 and 3 of the *Act* left remaining s. 1 and what had been s. 4. They now appear as ss. 1 and 2 of the *Fraudulent Conveyance Act*, R.S.B.C. 1996, c. 163, quoted in full above at para. 34.

46 As is evident, the words in s. 1 "... by collusion, guile, malice or fraud ..." remain in the *Act* to the present time.

B. Case Law

47 The appellant relies heavily on two British Columbia decisions as support for its submission that a dishonest or quasi-criminal intent in the transferor is required before a conveyance may be set aside under s. 1.

48 In *Westinghouse Canada Limited v. Caldwell*, *Hickman* (1979), 31 C.B.R. (N.S.) 276 (B.C.S.C.); [1979] B.C.J. No. 604, Taylor J., applying the provisions of the 1960 version of the *Act* said at p. 282:

> ... A careful reading of the legislation as a whole discloses an intention to visit with criminal as well as civil consequences transfers of property which have been contrived so as to "delay, hinder or defraud" creditors and "other persons". It not only declares such conveyances void as against persons thereby "disturbed, hindered, delayed or defrauded" but condemns the parties responsible for such transactions to six months imprisonment and also to substantial monetary penalties. Thus the conduct at which the statute is aimed is conduct deserving of criminal sanction. It deals, albeit somewhat more broadly, with the offence now described in s. 350 of the Criminal Code, R.S.C. 1970, c. C-34, which carries a maximum sentence of two years' imprisonment.
>
> <u>Insofar as it forms a valid part of the law of British Columbia, the Fraudulent Conveyances Act may be regarded as providing a civil remedy to those persons who have been the victims of conduct of a criminal, or at least quasi-criminal, character designed to defeat creditors. There must, it seems, be mala fides in the intent of the transaction.</u> [Emphasis added.]

49 The underlined paragraph was quoted, with apparent approval, by this Court in *First Royal Enterprises Ltd. v. Armadillo's Restaurant Ltd.* (1995), 15 B.C.L.R. (3d) 254 (C.A.) at para. 23.

50 I would make the following observations about these two judgments. In *Westinghouse*, the learned judge concluded that the *Act* was aimed at providing a remedy for victims of conduct that was criminal or quasi-criminal in nature and that "*mala fides* in the intent" was, therefore, a necessary element. This conclusion is clearly based on the presence of the penal provision which formed part of the 1960 statute that he was applying.

51 It does not appear that the decision of Mr. Justice Ruttan in *Allison & Burnham Concrete Ltd.* was drawn to the attention of the Court in *Westinghouse*. If the learned judge there had had his mind directed to the earlier judgment, and to Ruttan J.'s declaration that the imprisonment portion of s. 3 was *ultra vires* the province, he could not have relied on it to support his reasoning.

52 Similarly, in *First Royal Enterprises*, the Court was apparently not made aware of the judgment in *Allison & Burnham Concrete Ltd.* The Court there was applying the 1979 version of the *Fraudulent Conveyance Act* which retained the imprisonment provision in s. 3. There is no indication in the judgment that the imprisonment portion of s. 3 had been declared *ultra vires* in 1965.

53 I am therefore of the view that neither *Westinghouse* nor *First Royal Enterprises* can be considered as sound authority for the proposition that a dishonest intent, or *mala fides*, is necessary to the application of s. 1 of the *Act*. In any event, with the repeal of s. 3 in 1987, such authority would no longer be applicable to the modern *Act.*

54 Counsel for the appellant referred to *Havel v. Galemar Holdings Ltd. and Fabbro* (1981), 36 O.R. (2d) 348 (H.C.J.), but I do not read that case as authority for the proposition that anything more than an intent to defeat creditors is required in order to render a transfer void under the equivalent Ontario statute.

55 Counsel for the appellant also relied extensively on *Mandryk v. Merko* (1971), 19 D.L.R. (3d) 238 (Man. C.A.). As I understand the judgment in *Mandryk*, the Court held that the intent required to render a transfer void was the intent to defeat creditors; that such an intent could be inferred from evidence of the transaction and other circumstances; that the direct evidence of the transferor must be considered; and that any inference or "presumption" to be drawn from the effect of the transfer was not conclusive.

56 I do not read *Mandryk* as holding that a subjectively dishonest or fraudulent state of mind in the transferor is required to render the transfer void. In simple terms, the action in *Mandryk* failed because the plaintiff failed to prove, as a matter of fact, the transferor's intent to delay, defeat or hinder his creditors.

57 In considering what meaning, if any, is to be given to the words "by collusion, guile, malice or fraud" in s. 1, it is instructive to consider the substantial body of authority holding it unnecessary to establish *mala fides* on the part of the transferor to commit fraud. The focus in the case law has been on the provision of a civil remedy for creditors disadvantaged by the conduct of their debtors.

58 In *Freeman v. Pope* (1870), L.R. 5 Ch App 538, Lord Hatherley stated at pg. 540 that the principle on which the *Fraudulent Conveyance Act* is based is "that persons must be just before they are generous, and that debts must be paid before gifts can be made". As a result, if the necessary effect of a conveyance was to defeat, hinder or delay the creditors, that necessary effect was to be considered as showing an intention to do so. Such intention was sufficient to establish a fraudulent conveyance.

59 *Freeman* was applied in *Mackay v. Douglas* (1872) L.R. 14 E.Q. 106, where Vice-Chancellor Malins said at p. 120:

> ... It is not at all necessary to shew that a man had any fraudulent intent in making a settlement as the law is now settled. ... The statute speaks of cases where the creditors "are, shall, or might be in any wise disturbed, hindered, delayed, or defrauded," and it is not necessary to shew an intention to do that, because if the settlement must have that effect the Court presumes the intention and will attribute it to the settlor. ... So I dare say that Mr. *Douglas* had no fraudulent intention, according to his view, in making the settlement, and that he thought it a prudent thing to protect his wife and children. But in doing that he has, within the meaning of this statute, committed a fraudulent act, because, going into trade, he was taking away the only property which would be available for his creditors.

60 In this Province, there are several cases articulating the intent required by s. 1 to render a disposition void. In *Ocean Construction Supplies Ltd. v. Creative Prosperity Capital Corp.* (1995), 34 C.B.R. (3d) 241, 1995 CanLII 740 (B.C.S.C.), Madam Justice Baker said:

> 25 In essence, a fraudulent conveyance is a transfer of an interest in property which is made with the intention, and which has the effect, of hindering or impairing the right of a creditor or other person to satisfy a claim against the transferor. It is not necessary for the person seeking relief to show that the transferor was insolvent at the time the transfer was made, and the applicant need

not establish that he or she was a creditor, or an unsecured creditor, at the time the transfer was made: *Re Skinner* (1960), 27 D.L.R. (2d) 74 (B.C.S.C.).

26 All that the applicant must show is that the transferor, in making the gift or transfer, did so with intent to delay, hinder or defraud creditors or others: *Canadian Imperial Bank of Commerce v. Ash* (1964), 47 D.L.R. (2d) 620 (B.C.S.C.); *Canadian Imperial Bank of Commerce v. Boukalis* (1987), 11 B.C.L.R. (2d) 190 (C.A.).

61 In *Jaston & Co. v. McCarthy* (1996), 41 C.B.R. (3d) 212, 1996 CanLII 2982 (B.C.S.C.), Mr. Justice K. Smith said much the same thing:

85 The plaintiffs' case on this claim is made out on the testimony of Mr. and Mrs. McCarthy. Each testified that their intention was to distance the shares in McCarthy Realty (72) Ltd. and Dev-Gro Holdings Ltd. from potential claims by clients of Mr. McCarthy's notary practice. That intention resulted, they say, from advice they received at a notaries' convention to shelter their assets from such claims because of a reduction in the limit of third party liability insurance available to notaries. Thus, the transfer of these shares was not *bona fide* but was made for the purpose of avoiding future claims of creditors.

86 <u>It is sufficient to fix the defendants with liability if they foresaw potential creditors who might be defeated by the conveyance</u>: *Newlands Sawmills Ltd. v. Bateman*, 31 B.C.R. 351, [1922] 3 W.W.R. 649, 70 D.L.R. 165 (C.A.), appl'd *Canadian Imperial Bank of Commerce v. Boukalis* (1987), 11 B.C.L.R. (2d) 190 (C.A.), at p. 196; *Bank of Montreal v. Kelliher* (1980), 36 C.B.R.) (N.S.) 205 (B.C.S.C.) at p. 210. On their own evidence they foresaw such creditors here. [Emphasis added.]

62 In *Sykes (Re)* (1998), 156 D.L.R. (4th) 105, 48 B.C.L.R. (3d) 169 (C.A.), McEachern C.J.B.C. cited the remarks of Mr. Justice Gonthier in *Royal Bank of Canada v. North American Life Assurance Co.*, [1996] 1 S.C.R. 325 at 365, as follows:

However, the other provincial statutes all refer to some sort of "conveyance" or "disposition "of "property" with the "intent to defeat" creditors' claims. All the provincial fraud provisions are clearly remedial in nature, and *their purpose is to ensure that creditors may set aside a broad range of transactions involving a broad range of property interests, where such transactions were effected for the purpose of defeating the legitimate claims of creditors*. Therefore, the statutes should be given the fair, large and liberal construction and interpretation that best ensures the attainment of their objects as required by provincial statutory interpretation legislation ... I agree with the following observation by Professor Dunlop in Creditor-Debtor Law in Canada (2nd ed. 1995), at p. 598, that the purpose of fraudulent conveyance legislation:

> ... is to strike down all conveyances of property made with the intention of delaying, hindering or defrauding creditors and others except for conveyances made for good consideration and bona fide to persons not having notice of such fraud. <u>The legislation is couched in very general terms and should be interpreted liberally.</u> [Emphasis added by Gonthier J.]

[Italic emphasis added by this Court.]

63 In *Chan v. Stanwood*, 2002 BCCA 474, 6 B.C.L.R. (4th) 273, Madam Justice Newbury, giving the judgment of this Court, noted the differences in the intent required between cases where consideration for a transfer was inadequate or nominal, and those where "valuable" consideration had passed. She said:

20 The Commission's report also stated, however, that the significance of consideration lies both in its relation to the *intention* behind the transaction and in relation to its effect. Where the

consideration is inadequate or nominal, a creditor need only show that the *Transferor* intended to delay, hinder or defraud the creditor of his remedies. Where on the other hand valuable consideration has passed, the creditor must also show that the *transferee* actively participated in the fraud. As stated by this court in *Meeker Cedar Products Ltd. v. Edge* (1968), 68 D.L.R. (2d) 294 (B.C.C.A.) (aff'd at (1968), 1 D.L.R. (3d) 240 (S.C.C.)):

> ... it is clear as a matter of interpretation of the statute as a whole and upon authority that where a sale is made for good and valuable consideration the transaction will not be void by reason of the purchaser's having notice of knowledge of the vendor's intent to delay, hinder or defraud creditors and others unless it be proved that the purchase was actually privy to the fraud, *i.e.*, a party to carrying out the fraudulent intention and purpose. [at 299; emphasis added.]

21 Where valuable consideration has passed, then, the focus is not on the sufficiency of that consideration but on the intentions of both parties to the transaction. The trial judge rightly stated at para. 36 of her Reasons that in this case, the intention of the holding companies must be taken to have been the intention of the Stanwoods. Further, she found it was clear on the evidence that the Stanwoods had intended to delay and defeat their creditors by exchanging their exigible assets for shares which were "not effectively exigible".

22 I agree with these conclusions. ... Although exigible in theory, the various restrictions and obstacles placed in the way of any 'unfriendly' holder meant that in fact they were not worth executing against. The exchange of exigible assets for the Preferred shares delayed, hindered or defrauded the Chans - and did so by design. This "design" or "purpose" constitutes the "fraudulent intent" required by the *Act ...*

64 Most recently, in *Royal Bank of Canada v. Clarke*, 2009 BCSC 481, Madam Justice Griffin said:

> [21] I am bound by the authorities that have clearly held that it is unnecessary to show any dishonest intention, other than the intention to move the property out of reach of potential creditors, for the *Act* to apply: *Jaston & Co. v. McCarthy* (1996), 41 C.B.R. (3d) 212 (B.C.S.C.) as cited in *Abakhan* at para. 75.

65 In my respectful opinion, a review of the case law amply demonstrates that a dishonest intent, or *mala fides*, is not necessary to avoid a transaction under s. 1 of the *Act*.

C. Principles of Statutory Interpretation

66 The guiding principle of statutory interpretation 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: *Bell Express Vu Limited Partnership v. Rex*, 2002 SCC 42 at para. 26.

67 Mr. Justice Gonthier in *Royal Bank of Canada v. North American Life Assurance Co.* (*supra*) said that the fraud provisions in provincial statutes "are clearly remedial in nature". The cases reviewed above support the remedial purpose of the legislation. They have essentially ignored the words "by collusion, guile, malice or fraud".

68 In Springman, M.A. et al, *Fraudulent Conveyances And Preferences,* looseleaf, Toronto (Carswell, 2009), the learned author comments on the inclusion of the words "by collusion, guile, malice or fraud" in s. 1 of the B.C. Statute. The learned author says:

> Furthermore, the addition of the concepts of "collusion, guile, malice or fraud," arguably as a way of adding some flesh to the earlier description of the transferor's intent, is also interesting. But would the addition of these concepts mean that a disposition, etc. with the intent "to delay, hinder or defraud," but somehow not animated by "collusion, guile, malice or fraud", would be immune from impeachment under the Act? And if the response is that, in the very nature of things, the transferor could never have the intent "to delay, hinder or defraud" without "collusion, guile, malice or fraud" being involved, then what is the value of the latter words? Perhaps there are simply too many words used to describe the legislators' more simple purpose here. At the very least, s. 1 would seem to leave itself open to a host of possible arid arguments. [Footnote 23 at 1-13 to 1-14]

69 In the period when dispositions under the *Act* attracted penal consequences, it was at least arguable that a dishonest intention in the transferor was a necessary element of the prohibited transaction.

70 However, for many years, and certainly since the repeal of the penal provisions in 1987, the purpose and scheme of the B.C. *Fraudulent Conveyance Act* has been to provide a civil remedy to creditors. Its purpose is to protect creditors where property dispositions by debtors "... were effected for the purpose of defeating the legitimate claims of creditors" per *Sykes* (*supra*). As a result, the words "by collusion, guile, malice or fraud" no longer perform a meaningful function in the text.

71 Thus, as stated in *Sullivan on the Construction of* Statutes, 5th ed. (Markham: LexisNexis, 2008) at pp. 178-179, in circumstances where:

> ... courts encounter words in a legislative text for which no satisfactory interpretation can be offered ... courts may strike out the offending language if the text makes sense without it. ... In effect, the court must conclude that the words to be struck perform no meaningful function in the text, contrary to the presumption against tautology; their presence is simply a mistake.

72 The *Act* not only makes sense after removal of these words, but accords with the modern purpose and scheme of the *Act*. Therefore, the words "by collusion, guile, malice or fraud" should be struck.

73 The only intent now necessary to avoid a transaction under the modern version of the *Act* is the intent to "put one's assets out of the reach of one's creditors" (per *RBC v. Clarke*). No further dishonest or morally blameworthy intent is required.

D. Proof of Intent

74 Intent is a state of mind and a question of fact.

75 For example, in *Mackay v. Douglas* (*supra*), Malins, V.C. said (at p. 120) that where a disposition had the effect of hindering or delaying or defeating creditors, "the Court presumes the intention and will attribute it to the settlor". That was held to be sufficient proof of the intent even though Mr. Douglas apparently gave evidence and "had no fraudulent intention". Mr. Douglas thought he had made a settlement of property as "a prudent thing to protect his wife and children" (p. 120). Despite this, it was held to be a fraudulent conveyance.

76 In *Ocean Construction* (*supra*), Baker J. said this about proof of fraudulent intent:

> 27 Fraudulent intent is essentially a matter of fact to be proved in the circumstances of each particular case. Proof that the transferor intended to defeat or delay its creditors usually involves drawing inferences from the circumstances surrounding the transaction. Where some

> consideration has flowed from the transferee to the transferor, the court may consider the adequacy of the consideration in relation to the issue of intent, since a transfer at an undervalue raises suspicions about motive. Inadequate consideration may be considered to be a badge of fraud.

77 In that case, the controlling mind of the defendant company, Mr. Lee, gave evidence as to the debtor's solvency, which the court did not accept (para. 37). The transfer was held to be void based on the inference drawn from the transfer itself and other circumstances (para. 39) despite Mr. Lee's evidence to the contrary.

78 In *Jaston v. MCarthy* (*supra*) the defendants testified that their intention to protect assets was based on advice concerning potential risks arising from reduced insurance coverage (para. 85). The Supreme Court of British Columbia held that the defendants contravened the prohibition in s. 1 because they foresaw that potential creditors might be defeated by the impugned conveyance.

79 In *Chan v. Stanwood* (*supra*) the intent to delay or defeat creditors was inferred at trial from evidence that "exigible assets" were exchanged "for shares" which were "not effectively exigible". The defendants' intent to put assets beyond the reach of their creditors was inferred from the effect of the transaction, and despite the fact that the defendants acted on professional advice.

80 In many of the cases cited there is no direct evidence of the grantor's intent. Intent could only be proven by drawing an inference from the grantor's conduct, the effect of the transfer or other circumstances. However, in some cases where the grantor has given evidence, there may be direct evidence of his intent and the question of proof then turns on the weight or credit given to the direct evidence, viewed in light of the other circumstances and the inferences to be drawn.

VII. Application of the Law to the Facts of This Case

81 Having established that the intent to delay or hinder creditors is sufficient under s. 1 of the *Act,* it is now necessary to assess the trial judge's finding that the disposition in this case was a fraudulent conveyance.

82 The trial judge found that on the whole of the evidence, Mr. Botham had the requisite intent to delay and hinder creditors. He stated:

> [65] Proof of intent to defeat or delay creditors typically requires drawing inferences from the circumstances surrounding the transaction. However, it is not necessary in this case to draw an inference at all. Here, there is direct evidence of the intent of Mr. Botham and his solicitors. Mr. Botham's answers on examination for discovery and in his affidavit make his intent patently clear:

395. Q. Okay. Well here's my suggestion. This BHL - Braydon transaction had nothing to do with estate planning unless you would say that the protection of your assets from claims of creditors is part of estate planning?

A. That I could agree with.

396. Q. All right. And the whole motivation behind the BHL - Braydon transaction again was to ensure that creditors wouldn't get assets of the estate?

A. Yes.

[66] The letter from Owen Bird dated October 31, 2005 describes the objectives and purpose of the Transaction as follows:

1. Move the real property of BHL to a new company ("Newco") to ensure that BHL's real property and other assets are not exposed to its new leasing venture; and
2. Limit the activities and gross revenue of BHL to its interest in the JW Auto Group partnership.

[emphasis added]

[67] In his affidavit sworn October 3, 2007 in Action No. S076370, Mr. Botham stated:

... I did not want to cause BHL to go into the partnership with the nine properties at risk of execution by creditors of the partnership.

[68] In the same affidavit Mr. Botham deposed that it was not his "objective ... to deprive creditors of any remedies against BHL. ..." However, this statement is inconsistent with all of the evidence in this case and cannot be accepted.

[69] For these reasons, it is not necessary to attempt to draw an inference. Mr. Botham's evidence, taken as a whole, is conclusive as to his intent to defeat BHL's creditors and must result in the finding that the Transaction was a fraudulent conveyance.

83 As a result, the trial judge concluded:

[77] Based on the foregoing, I find that BHL did engage in a fraudulent conveyance, despite Mr. Botham's lack of dishonest intent. A transaction which is the result of an honest intent to defeat one's creditors is precisely one of the situations caught by the *Fraudulent Conveyance Act*.

84 Counsel for the appellant argues that the judge made a palpable and overriding error in relying on Mr. Botham's evidence on examination for discovery. He argues that those answers suggest that Mr. Botham and BHL had only one intention, namely to protect the assets from creditors' claims. He argues that there was other evidence of Mr. Botham's legitimate business purposes, namely to gain the benefit of the s. 85 tax rollover. Counsel for the appellant placed much emphasis on the facts that the appellant was pursuing a prudent and legitimate business strategy in attempting to take advantage of the capital cost allowance claims available under s. 85 of the *Income Tax Act,* and in attempting to limit his liability when investing in the new venture, JW Auto.

85 Such arguments do not establish a palpable and overriding error. As this Court put it in *Chan v. Stanwood,* "the question in every case is whether it was carried out 'to delay, hinder or defraud creditors and others of their just and lawful remedies'." While Botham may have been pursuing other business objectives, such as trying to obtain tax advantages, it is nevertheless clear that he had the intent to put BHL's assets beyond the reach of JW Auto's creditors. This is what the trial judge found, stating:

> BHL entered into the partnership with Mr. Welsh at a time when BHL had substantial assets. As a partner, BHL was responsible for all debts incurred by the partnership. BHL then acted to shelter its assets from the claims of present and future creditors of the partnership. BHL did this by transferring its assets to Braydon, a related company, for little to no consideration. (para. 81).

86 This is a clear finding of fact that is supported by the evidence. The trial judge's findings cannot be characterized as palpable and overriding errors.

87 There is also no dispute that the *effect* of the transfer was to delay and hinder the creditors of BHL, both present and future. Section 1 captures transfers intended to defeat the rights of creditors and "others," which includes future creditors: *Canadian Imperial Bank of Commerce v. Bukalis* (1987), 34 D.L.R. (4th) 481, 11 B.C.L.R. (2d) 190 (C.A.) at 484. As a general partner of JW Auto, BHL was, as the trial judge found, "responsible for all debts incurred by the partnership." Therefore, by transferring its assets to Braydon, BHL was not only hindering its creditors, but was hindering the present and future creditors of JW Auto. As the trial judge found, at para. 81, creditors' claims currently exceed $20 million.

88 The appellant also argues that it is legitimate to limit the assets which one puts at risk in a business venture, otherwise corporations would be illegal. However, the trial judge correctly found, at para. 81 of his reasons, that while BHL could have limited its liability by incorporating a new corporation, it made the explicit choice not to do so. It would have been legitimate for BHL to limit its liability in the new venture by incorporating a new corporation to act as the general partner in JW Auto. However, Botham and BHL wanted to achieve two objectives, one being to limit liability and the other being to obtain the tax advantages under s. 85 of the *ITA*. By incorporating a new corporation, it was possible to limit liability, but it would not have been possible to obtain the tax advantages. Therefore, Botham and BHL made the choice to try to achieve both the limited liability and tax advantages by transferring the assets of BHL out of the company and into Braydon. As the appellant states in its factum, "... the plan was to empty an old company of its assets unrelated to auto leasing, and use the old company for the partnership rather than incorporate a new one, because using the old company allowed for a tax benefit." However, in doing this and in choosing not to incorporate a new company, BHL engaged in a fraudulent conveyance.

89 Finally, the trial judge cannot be said to have made a palpable and overriding error in his factual findings relating to the defence in s. 2. The trial judge stated:

> [80] There are three parts to this defence. It requires that the disposition be made (1) for good consideration, (2) in good faith, and (3) to a person who had no notice or knowledge of the fraud. The defence does not apply in the case at bar. I find that there was no good consideration which passed from Braydon to BHL for the assets. At the end of the Transaction, BHL was left with virtually no assets while Braydon had obtained $19 million in assets. The Transaction was clearly not in good faith based on the direct evidence of Mr. Botham's intent with regards to BHL's assets. Finally, given that Mr. Botham was the directing mind of both Braydon and BHL, it cannot be said that the transferee had no notice or knowledge of the fraud.

90 In my view, there was evidence on which the judge could properly find that none of the elements in s. 2 had been established. While the parties disagree on appeal as to whether or not there was good consideration, it does not affect the disposition because Braydon cannot establish the other two elements under s. 2. As the trial judge stated, because Botham controlled both BHL and Braydon, his knowledge and intent to delay and hinder BHL's creditors must be imputed to both corporations.

91 I would dismiss the appeal.

L.S.G. FINCH C.J.B.C.
P.D. LOWRY J.A.:— I agree.
H. GROBERMAN J.A.:— I agree.

* * * * *

CORRECTION

Released: February 2, 2010

The citation found at page 11, para. 39 of the reasons for judgment released November 24, 2009, is amended to read:

(Miscellaneous Statute Amendment (No. 2) Act, S.B.C. 1987, c. 43).

End of Document

Tab 8

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 | (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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Uniforêt Inc., Re (2002), 2002 CarswellQue 2546, 40 C.B.R. (4th) 281 (C.A. Que.) — 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 Assurance*Co, 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 9

2024 ABKB 680
Alberta Court of King's Bench

Taber Water Disposal Inc. (Re)

2024 CarswellAlta 2941, 2024 ABKB 680, [2025] A.W.L.D. 7, 16 C.B.R. (7th) 75, 2024 A.C.W.S. 6042

In the Matter of the Bankruptcy and Insolvency Act, RSC 1985, C B-3, as amended

In the Matter of the Notice of Intention to make a Proposal of Taber Water Disposal Inc. and Enerstar Petroleum Corp.

Colin C.J. Feasby J.

Heard: November 14, 2024
Judgment: November 19, 2024
Docket: Calgary B301-060090, 25-3060090

Counsel: Jack R. Maslen, Erick Juergens, for Applicant, 2635672 Alberta Ltd.
Christian J. Popowich, Dextin Zucchi, for Respondents, Whitehaven Beach Capital Corp and Title Shot Oil Inc

Subject: Insolvency; Property
Related Abridgment Classifications
Bankruptcy and insolvency
VIII Property of bankrupt
VIII.8 Miscellaneous
Headnote
Bankruptcy and insolvency --- Property of bankrupt — Miscellaneous
Applicant purchased 45 percent working interest in oilfield in southern Alberta from debtors T Inc. and E Corp. pursuant to Bankruptcy and Insolvency Act proposal process supervised by Court — After completion of sales and investment solicitation process, Court granted Approval and Vesting Order (AVO) vesting debtors' title in oilfield free and clear of encumbrances in applicant — W Corp., which was owner of remaining 55 percent of oilfield, refused to recognize applicant because it believed third party A Ltd. was true owner of 45 percent working interest in oilfield claimed by applicant — Applicant brought application for declaration of ownership of 45 percent of oilfield — Application granted — Interest in oilfield in dispute was originally wholly owned by A Ltd. — At some point, A Ltd. conveyed 55 percent interest to W Corp. — A Ltd. assigned 45 percent working interest in oilfield to affiliate G Ltd. — E Corp. acquired 45 percent working interest in oilfield from G Ltd. by way of purchase agreement in 2018 — In 2019, E Corp. transferred five percent working interest in oilfield to affiliate T Inc. — Evidence overwhelmingly supported finding that debtors owned 45 percent working interest in oilfield and that debtors' interest was conveyed by AVO to applicant.
Table of Authorities
Cases considered by *Colin C.J. Feasby J.*:

Armstrong v. Gula (2024), 2024 ABKB 358, 2024 CarswellAlta 1638, 74 Alta. L.R. (7th) 295 (Alta. K.B.) — referred to

Bhasin v. Hrynew (2014), 2014 SCC 71, 2014 CSC 71, 2014 CarswellAlta 2046, 2014 CarswellAlta 2047, [2014] 11 W.W.R. 641, 27 B.L.R. (5th) 1, 464 N.R. 254, 379 D.L.R. (4th) 385, 20 C.C.E.L. (4th) 1, [2014] 3 S.C.R. 494, 584 A.R. 6, 623 W.A.C. 6, 4 Alta. L.R. (6th) 219 (S.C.C.) — referred to

Giffen, Re (1998), 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, 45 B.C.L.R. (3d) 1, 1 C.B.R. (4th) 115, [1998] 7 W.W.R. 1, 13 P.P.S.A.C. (2d) 255 (S.C.C.) — referred to

Golden Band Resources Inc., Re (2018), 2018 SKQB 284, 2018 CarswellSask 506 (Sask. Q.B.) — followed

Goodswimmer v. Canada (Attorney General) (2017), 2017 ABCA 365, 2017 CarswellAlta 2299, 60 Alta. L.R. (6th) 226, 418 D.L.R. (4th) 157 (Alta. C.A.) — referred to

Guarantee Co. of North America v. Gordon Capital Corp. (1999), 1999 CarswellOnt 3171, 1999 CarswellOnt 3172, 178 D.L.R. (4th) 1, 247 N.R. 97, [2000] I.L.R. I-3741, 126 O.A.C. 1, 49 B.L.R. (2d) 68, 15 C.C.L.I. (3d) 1, [1999] 3 S.C.R. 423, 39 C.P.C. (4th) 100 (S.C.C.) — considered

Hosseini v. Red Deer College (2022), 2022 ABQB 850, 2022 CarswellAlta 3642 (Alta. K.B.) — referred to

Manitok Energy Inc (Re) (2022), 2022 ABCA 260, 2022 CarswellAlta 1929, 1 C.B.R. (7th) 11, [2022] 10 W.W.R. 561, 47 Alta. L.R. (7th) 227 (Alta. C.A.) — referred to

Prairiesky Royalty Ltd v. Yangarra Resources Ltd (2023), 2023 ABKB 11, 2023 CarswellAlta 30, 16 P.P.S.A.C. (4th) 17, 59 Alta. L.R. (7th) 386, [2023] 11 W.W.R. 672 (Alta. K.B.) — referred to

Quicksilver Resources Canada Inc., Re (2018), 2018 ABQB 653, 2018 CarswellAlta 1894 (Alta. Q.B.) — followed

Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc. (2019), 2019 ONCA 508, 2019 CarswellOnt 9683, 70 C.B.R. (6th) 181, 3 R.P.R. (6th) 175, 435 D.L.R. (4th) 416, 11 P.P.S.A.C. (4th) 11 (Ont. C.A.) — followed

Weir-Jones Technical Services Incorporated v. Purolator Courier Ltd. (2019), 2019 ABCA 49, 2019 CarswellAlta 204, 32 C.P.C. (8th) 247, [2019] 6 W.W.R. 567, 86 Alta. L.R. (6th) 240, 442 D.L.R. (4th) 9 (Alta. C.A.) — referred to

Statutes considered:

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

Generally — referred to

s. 4.2 [en. 2019, c. 29, s. 133] — pursuant to

s. 4.2(2) [en. 2019, c. 29, s. 133] — referred to

s. 51(9) — pursuant to

s. 81 — pursuant to

s. 81(4) — referred to

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

Generally — referred to

Oil and Gas Conservation Act, R.S.A. 2000, c. O-6

Generally — referred to

Pipeline Act, R.S.A. 2000, c. P-15

Generally — referred to

APPLICATION for declaration of ownership interest in oilfield.

***Colin C.J. Feasby J.*:**

I. Introduction

1 Vesting orders are commonplace in contemporary insolvency and restructuring practice. Indeed, there is a template Approval and Vesting Order on the Court's website. Vesting orders provide purchasers with certainty of title which de-risks assets and encourages purchasers to pay increased prices. In this way, vesting orders are essential to maximizing return for creditors of an insolvent entity. Competing claims to ownership of assets in the possession of the debtor should be identified and resolved prior to their sale in an insolvency proceeding so that the assets may be sold without a cloud over title. But what happens when a third party asserts an ownership interest in property conveyed pursuant to a vesting order in an insolvency proceeding *after* the vesting order has been granted?

2 The applicant, 2635672 Alberta Ltd (the "Purchaser"), purchased a 45% working interest in an Oilfield in southern Alberta from Taber Water Disposal Inc ("Taber Water") and Enerstar Petroleum Corp ("Enerstar") (together, the "Debtors") pursuant to a *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("*BIA*") proposal process supervised by the Court. After the completion of the sales and investment solicitation process the Court granted an Approval and Vesting Order ("AVO") vesting the Debtors' title

in the Oilfield free and clear of encumbrances in the Purchaser. After the AVO was granted, the Purchaser went to Whitehaven Beach Capital Corp ("Whitehaven"), the operator and together with its affiliate Title Shot Oil Inc ("Title Shot") 55% owner of the Oilfield, seeking to be recognized as a joint owner of the Oilfield. Whitehaven refused to recognize the Purchaser because it believed a third party, Arrow Point Oil & Gas Limited ("Arrow Point") was the true owner of the 45% working interest in the Oilfield claimed by the Purchaser. After the present application for a declaration of ownership was made by the Purchaser, Whitehaven acquired Arrow Point's purported interest in the Oilfield in exchange for a gross overriding royalty interest.

3 The issues to be determined on this application are:

(a) did the AVO extinguish Arrow Point's claim to the Debtors' (and now the Purchaser's) 45% interest in the Oilfield?

(b) if not, did Arrow Point have a good faith obligation to participate in the Debtors' insolvency process?

(c) if yes, did Arrow Point breach its duty of good faith?

(d) if yes, what is the consequence of Arrow Point's breach of its duty of good faith?

(e) who is the owner of the 45% interest in the Oilfield?

II. Insolvency Proceedings and Approval and Vesting Order

4 The Debtors owned commercial wastewater injection assets and the disputed 45% working interest in the Oilfield. On April 16, 2024, the Debtors filed an application returnable April 22, 2024 for various relief, including approval of a sale and investment solicitation process for the Debtors' interest in the Oilfield and "a declaration that they have, in sum total, a valid and enforceable 45% working interest in the Oilfield, more particularly, 40% as to Enerstar and 5% as to Taber Water." They explained that "[t]his declaration is necessary in order for the Companies to market and sell their oil and gas property and assets pursuant to the SISP."

5 Counsel for Whitehaven wrote to Justice Yamauchi to outline its position in respect of the Debtors' application for approval of the sale process and a declaration of ownership. Whitehaven submitted, "[t]he proposed sale and solicitation process should be denied, as the Insolvent Companies do not have an ownership interest in the oilfield . . . " Whitehaven objected to the declaration sought by the Debtors on the grounds that the Debtors "seek to sell an interest in an oilfield they do not have . . . ."

6 In oral submissions before Yamauchi J, Whitehaven proposed a solution to the impasse. Whitehaven proposed that the Debtors relinquish operatorship of the Oilfield in favour of Whitehaven. This would, in the words of counsel for Whitehaven, allow "the sales process . . . to proceed with respect to the contested 45% ownership." Justice Yamauchi said to counsel for Whitehaven, "from your client's perspective, you don't really care who owns it. You're operating it . . . " Counsel for Whitehaven agreed and went on to say, "I leave to you and the insolvent companies how they want to deal with that other [party's] claim [of ownership of the 45%]." But, as the facts set out later in these Reasons show, Whitehaven really did care who owned the other 45% of the Oilfield and was not content to let the question of ownership play out between the insolvent companies and the putative third party owner.

7 Counsel for the Debtors acceded to Whitehaven's proposal. He explained that his understanding was that following the sale process "we'd be coming back to the Court for approval of the transaction, and that would be to get a vesting order free and clear to whoever's purchasing it, and then at closing then there'll be proceeds paid, right? And then parties can make a claim to say we're entitled to those proceeds." Neither Yamauchi J nor counsel for the Respondents responded to this point.

8 Yamauchi J later said that he was not comfortable with granting declaratory relief with respect to ownership of the Oilfield because of the quality of the evidence before him at that time. He adjourned the issue of declaratory relief *sine die*. The issue of ownership of the Oilfield remained in abeyance throughout the sale process.

9 The Purchaser was the successful bidder in the sale process. Following the completion of the sale process, the Debtors brought an application for an approval and vesting order. No submissions concerning the disputed ownership of the Oilfield were made prior to Associate Chief Justice Nixon granting the AVO on August 8, 2024. The AVO provided as follows at para 3:

> . . . all of the Companies' right, title, and interest in and to the Purchased Assets listed in **Schedule "B"** hereto shall vest absolutely in the name of the Purchaser (or its nominee), free and clear of and from any and all caveats, security interests, hypothecs, pledges, mortgages, encumbrances, liens, trusts or deemed trusts, reservations of ownership, royalties, options, rights of pre-emption, privileges, interests, assignments, actions, judgments, executions, levies, taxes, writs of enforcement, charges, or other claims, whether contractual, statutory, financial, monetary, or otherwise whatsoever, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise (collectively, the "**Claims**") . . . .

10 On August 22, 2024, the Purchaser sent Whitehaven a notice of assignment. On August 30, 2024, Whitehaven responded saying that it "does not recognize the validity of the NOA" and that "the NOA is of no force or effect." Whitehaven further advised that it "does not consider itself bound" to accept the Purchaser as a working interest owner in the Oilfield.

11 This matter came before me on the Commercial List on October 10, 2024. At that time, Arrow Point, the purported owner of the Working Interest according to Whitehaven was not present in Court though it had notice of the application. In my view it was not appropriate for an application concerning the ownership in the Oilfield to proceed without the third party who Whitehaven said owned the disputed 45% interest. I adjourned the application, directed that the purported Working Interest owner be served, and that the parties set a litigation plan to be memorialized in a procedural order that would have the matter ready to be heard the next time that I was the justice presiding over the Commercial List.

12 On October 28, 2024, the same date that Arrow Point's principal Mr. von Gramatzki swore his affidavit, Title Shot purchased Arrow Point's purported interest in the Oilfield in exchange for a gross overriding royalty on production to be sold from the Oilfield. The position of Whitehaven and Title Shot is that after the transaction with Arrow Point, Title Shot owned 80% of the Oilfield and Whitehaven owned 20% of the oilfield.

III. Vesting Orders and Third Party Ownership Claims

13 Whitehaven relies on the principle of *nemo dat quod non habet* which in English means no one can give what they do not have: ***PrairieSky Royalty Ltd v Yangarra Resources Ltd*, 2023 ABKB 11** at para 145 citing Bruce Ziff, *Principles of Property Law*, 5th ed, (Toronto: Carswell, 2000) at 460. Whitehaven submits that a vesting order may convey no better title to the assets than the seller has and that it is an abuse of process to interpret vesting orders as barring the claims of a true owner: ***Quicksilver Resources Canada Inc (Re)*, 2018 ABQB 653** at para 55.

14 The Purchaser submits that Arrow Point and its affiliate Global One GP Limited ("Global") were served with materials for all court applications in the insolvency proceedings and, as such, were aware that the Court was going to grant the AVO in respect of the disputed interest in the Oilfield. The Purchaser submits that the Court had the power to determine ownership of the disputed assets and did so when it issued the AVO. The Purchaser asserts that insolvency and restructuring practice demands forthright participation of interested parties and it is not open for third parties with ownership claims to lie in the weeds. The Purchaser relies on two cases decided after ***Quicksilver***, ***Third Eye Capital Corporation v Ressources Dianor Inc/Dianor Resources Inc*, 2019 ONCA 508 ("***Dianor II*") and ***Re Golden Band Resources Inc*, 2018 SKQB 284** ("*Golden Band*").

15 The issue before the Court in ***Dianor II*** was whether a vesting order could extinguish a gross overriding royalty that had been found to be an interest in land. Justice Pepall began her analysis by explaining at para 25 that a "[vesting] order acts as a conveyance of title and also serves to extinguish encumbrances on title." She accepted the view expressed in David Bish & Lee Cassey, "Vesting Orders Part 1: The Origins and Development" (2015) 32 National Insolvency Review 41 at 41-42 that vesting orders are the "cornerstone" of contemporary restructuring practice. Pepall JA's discussion of vesting orders was cited with approval in ***Manitok Energy Inc (Re)*, 2022 ABCA 260** at paras 38-39.

16 After concluding that the Court has the power to grant a vesting order in a *BIA* receivership despite the absence of express statutory language, Pepall JA reviewed how a Court should approach a vesting order that proposes to extinguish a third party interest in land. She explained that the first thing that must be evaluated is "the nature and strength of the interest that is proposed to be extinguished": ***Dianor II*** at para 103. The Court shall determine whether

> the interest in land is more akin to a fixed monetary interest that is attached to real or personal property subject to the sale (such as a mortgage or lien for municipal taxes), or whether the interest is more akin to a fee simple that is in substance an ownership interest in some ascertainable feature of the property itself: ***Dianor II*** at para 105.

17 The second thing to consider is "whether the interest holder has consented to the vesting out of their interest either in the insolvency process itself or in agreements reached prior to the insolvency": ***Dianor II*** at para 109. Pepall JA further held at para 110 that if the first two steps of the analysis do not point to a conclusion, a court "may engage in a consideration of the equities to determine if a vesting order is appropriate in the particular circumstances of the case."

18 ***Dianor II*** is of limited assistance in resolving the issue in the present case because ***Dianor II*** contemplated the analysis of the appropriateness of extinguishing third party claims occurring *before* the granting of the vesting order. Best practice is, without doubt, for third party ownership claims to be decided prior to a vesting order being issued or, if that is not possible, for the disputed property to be excluded from the vesting order and a direction made for the process for the determination of the disputed claim.

19 There are diverging approaches where a third party ownership claim is made *after* the granting of a vesting order. Justice Jones in ***Quicksilver*** invoked the maxim *caveat emptor* and disavowed any suggestion that the interests of stakeholders in the insolvency process could justify extinguishing a third party ownership interest. For Jones J, the purchaser in an insolvency process bears the risk of defects in title and must conduct itself accordingly. Justice Meschishnick took the opposite view in ***Golden Band***. He concluded that a third party with notice of a vesting order application in respect of disputed assets must come forward and participate in the insolvency proceedings. Meschishnick J concluded that the interest of stakeholders in the orderly conduct of the insolvency proceedings was paramount and it was not open to a third party with an ownership claim to remain silent.

20 Justice Jones in ***Quicksilver*** was faced with the question of whether an Approval and Vesting Order conveyed title to a gas metering station and associated facilities. Jones J started his analysis by asking the question whether the disputed assets were conveyed pursuant to the Asset Purchase Agreement. To answer this question, he had regard to assets previously conveyed to a different party pursuant to a Contribution Agreement which was defined as an "Excluded Contract" in the Asset Purchase Agreement. The assets conveyed pursuant to the Contribution Agreement were accordingly defined in the Asset Purchase Agreement as "Excluded Assets." He concluded at para 51 that the disputed assets were transferred pursuant to the Contribution Agreement and therefore not conveyed pursuant to the Asset Purchase Agreement.

21 Justice Jones rejected the submission that nullifying a third party's disputed ownership interest in property was necessary for the proper functioning of CCAA proceedings and "to provide purchasers with certainty and security": ***Quicksilver*** at para 55. He rejected the idea that the Court could be engaged in "confirming title to assets purported to be sold": ***Quicksilver*** at para 57. He went on to say that "it would be an abuse of CCAA orders to interpret them as the Court's confirmation that title the seller does not possess may be vested in the buyer free of claims to ownership by the true owner. The better interpretation is that a CCAA order may vest off certain claims against title, but does not create title": ***Quicksilver*** at para 57.

22 ***Golden Band***, like ***Quicksilver***, concerned a third party ownership claim advanced after the granting of a vesting order. Golden Band Resources Inc ("GBRI") owned an interest in the Greywacke Deposit and was party to a joint venture agreement with Masuparia Gold Corporation ("Masuparia"). GBRI made a bankruptcy proposal. Procon Resources Inc ("Procon") was the successful bidder in the court-approved sales and investment solicitation process. Procon acquired the shares of GBRI. After the approval of the transaction, Masuparia asserted that GBRI's interest in the Greywacke Deposit had been transferred to Masuparia prior to the insolvency proceedings.

23 Masuparia was served with notice of the various applications in the insolvency proceedings and was aware of the relevant facts concerning the process through receipt of the reports of the Proposal Trustee. Masuparia was served with the Notice of Application for the Sanction Order and associated materials. These documents explained, amongst other things, that Procon would be acquiring GBRI and that all claims against GBRI would be "forever barred and extinguished." Masuparia did not appear at the Sanction Order application. Later, Masuparia asserted that GBRI had conveyed its interest in the Greywacke Deposit prior to the insolvency proceedings.

24 The Court held that Masuparaia's "claim to the Greywacke Deposit was extinguished by the Claims Bar Clause": ***Golden Band***, para 22. The fact that Masuparaia was aware of the bankruptcy proposal proceedings and chose not to participate weighed heavily in the Court's analysis. Justice Meschishnick observed at para 24:

> Indeed, the Proposal as presented to the stakeholders and this court for approval proceeded on the understanding that Golden Band held an interest in the Greywacke Deposit. By not raising its assertion at any time and in particular when the court was asked to make the Sanction Order which included the Claims Bar Clause, Masuparia allowed the stakeholders and this court to be misled.

25 Justice Meschishnick in ***Golden Band*** took a different view of the policy issues at play in insolvency proceedings than Justice Jones in ***Quicksilver***. For him, the question of certainty with respect to title to an insolvent entity's assets is a matter of fairness to all stakeholders including creditors and the purchaser. Meschishnick J explained at para 25 that the Court is concerned "that there is no misunderstanding as to what the restructured company will own if a proposal is approved." He concluded at para 26 that knowing the assets of the insolvent entity is essential for the Proposal Trustee to discharge its statutory duty pursuant to *BIA* s 51(9) to make "a detailed inquiry into the debtor's assets and their value and then opine on whether the Proposal is an advantageous one for the creditors."

26 Justice Meschinshnick also found in ***Golden Band*** that the third party should have advanced its ownership claim pursuant to *BIA* s 81. *BIA* s 81 permits a trustee to give notice to anyone with a potential claim against property in the possession of the bankrupt. A person who receives such a notice and has a claim to ownership of property in the possession of a bankrupt is obliged to file a proof of claim. If the third party files a proof of claim, the trustee may accept or dispute the claim. If the third party fails to come forward with a proof of claim, *BIA* s 81(4) permits the trustee to, "with the leave of the court, sell or dispose of the property free of any right, title or interest of that person." *BIA* s 81 is a statutory exception to the *nemo dat* principle that permits a trustee to convey good title to a purchaser: ***Giffen (Re)*, [1998] 1 SCR 91** at para 59. There was no evidence before me that the *BIA* s 81 process was followed in the present case, nor was the applicability of *BIA* s 81 argued by the parties.

27 The law concerning third party ownership claims and vesting orders is not clear. The principles that I take from ***Dianor II***, ***Quicksilver***, and ***Golden Band*** are as follows:

> (a) The *nemo dat* principle is not sacrosanct. *BIA* s 81 is a statutory exception to *nemo dat* and ***Dianor II*** held that interests in land may be vested off in insolvency proceedings.
>
> (b) Third party ownership claims are different than other interests in land that derive from the debtor's title, such as mortgages and liens, and should only be vested off in exceptional circumstances applying the analytical framework in ***Dianor II***.
>
> (c) Third party ownership claims should be determined prior to a vesting order being made or disputed assets should be excluded from the vesting order and a process for determination of the claim should be ordered.
>
> (d) Where third party ownership claims are not determined prior to a vesting order being made, if the third party had an obligation to advance its claim in the insolvency process (as, for example, pursuant to *BIA* s 81) such claims may be extinguished by an appropriately worded vesting order.

28 In the next section of these Reasons, I find that Arrow Point had a duty of good faith to bring its claim forward in the Debtors' insolvency process. Here, I will limit my comments to the interpretation of the AVO. The wording of the AVO does not extinguish Arrow Point's purported ownership interest in the Oilfield. AVO para 3, quoted above in para 9, conveys "all of the Companies' right, title, and interest in and to the Purchased Assets . . . " [emphasis added]. Consistent with the *nemo dat* principle, the AVO purports only to convey the title that the Debtor had. The balance of AVO para 3 is concerned with cleaning up that title by extinguishing claims and removing encumbrances. The nature of the listed claims extinguished by AVO para 3 are claims that are derive from the Debtor's title, not rival claims of ownership. I do not consider it appropriate to interpret a capacious phrase like "or otherwise whatsoever" to include a claim to ownership. The *esjudem generis* principle holds that where general words follow a list of two or more things, they apply only to things of the same kind specifically mentioned: see, for example, ***Hosseini v Red Deer College*, 2022 ABQB 850** at para 22. Accordingly, if an AVO is to extinguish a third party ownership interest, it must do so in clear terms. An example of such clear language is found in ***Golden Band*** at para 28 where the Proposal definition of claims to be extinguished is reproduced. Claims included "any right or claim ... by reason of any right of ownership or title to property or assets...." This language was absent from the AVO and is not found in the Alberta template AVO.

IV. Good Faith and Third Party Participation in Insolvency Proceedings

29 The Purchaser asserts that Arrow Point, having been served with all the materials for all the applications in the insolvency process and believing that it had a claim to the disputed interest in the Oilfield, had a duty of good faith to come forward to seek direction from the Court with respect to a process for the determination of its claim. Whitehaven's position is that Arrow Point had no such obligation to participate in the insolvency process. Arrow Point was free to sit back and let the insolvency process unfold. The divergent views offered by Whitehaven and the Purchaser mirror the contrasting views of the obligations of parties with an interest in insolvency proceedings and the role of the Court evident in ***Quicksilver*** and ***Golden Band***.

30 ***Quicksilver*** and ***Golden Band*** were decided prior to the amendment of the *BIA* in 2019 to impose an express obligation of good faith on persons with an interest in insolvency proceedings. *BIA* s 4.2 provides:

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

31 I am satisfied that, for the purposes of *BIA* s 4.2, an "interested person" includes a third party with a claim of ownership of assets in the possession of the debtor who has notice of the debtor's insolvency proceedings. Of course, a third party with an ownership claim in respect of a debtor's assets that does not have notice of the debtor's insolvency proceedings would stand on different footing.

32 Arrow Point and Global were identified as "interested parties" on the service list and were served with materials throughout the proceedings. They were served with the materials for the April 22, 2024 application for declaratory relief concerning ownership of the Oilfield before Yamauchi J. For whatever, reason, they did not respond to the application. Arrow Point and Global were also served with the materials for the AVO application and knew or ought to have known that the Debtor's interest in the Oilfield was to be sold to the Purchaser. Arrow Point and Global were interested persons pursuant to *BIA* s 4.2 and accordingly were subject to a duty of good faith.

33 Prior to the amendment of the *BIA* adding s 4.2, Professor Janis Sarra wrote an article advocating for a statutorily codified obligation to act in good faith: Janis Sarra, "La bonne foi est une consideration de base - Requiring Nothing Less than Good Faith in Insolvency Law Proceedings" in Janis P. Sarra, ed, *Annual Review of Insolvency Law 2014*, (Toronto: Carswell, 2009) 145. Professor Sarra outlined "principles and best practices" that "court[s] should make clear" which could provide content for a codified obligation of good faith. The principles and best practices identified by Professor Sarra at 182-83 relevant to the present case include:

• The requirement to act in good faith in insolvency proceedings is an obligation of all parties and their professionals, and is an obligation that cannot be contracted out of. The good faith standard also applies to government regulators, interim financiers, plan sponsors, and all other stakeholders involved in the proceeding.

. . .

• In determining good faith, the court will determine if the debtor, creditors, other stakeholders and their professionals have acted candidly, honestly, forthrightly and reasonably in their dealings with one another and the court. Dealings in this respect would include dealings from the commencement of the proceedings to final resolution, including negotiation for, and implementation of, a proposal or plan under the *BIA* or *CCAA*.

• All stakeholders in insolvency proceedings should have appropriate regard for the legitimate interests of the other creditors and stakeholders, "appropriate regard" requiring that the parties not seek to undermine the interests of others in bad faith.

• The good faith obligation includes a duty of creditors and other stakeholders to disclose all of their real economic interests in the insolvency proceedings.

. . . [emphasis added]

34 The *BIA* s 4.2 duty of good faith in the present case required Arrow Point to come forward with its claim to the disputed interest in the Oilfield at the AVO application or before. Arrow Point's silence was contrary to the interests of the Debtor, creditors, and the Purchaser. Moreover, Arrow Point's conduct is anathema to the efficient administration of the insolvency process.

35 How should Arrow Point's breach of its duty of good faith be addressed by the Court? What is the appropriate remedy now that Arrow Point has sold its disputed interest in the Oilfield to Whitehaven? *BIA* s 4.2(2) provides the Court with broad remedial discretion. The appropriate remedy, in my view, is an adverse inference that Arrow Point did not own the disputed interest in the Oilfield. Arrow Point's non-participation in the insolvency proceedings is consistent with it not having a *bona fide* interest in the Oilfield. And, as will be explained in the following section of these Reasons, even absent the adverse inference, the evidence weighs in favour of finding that Arrow Point did not have a legitimate claim to the Debtor's interest (and now the Purchaser's interest) in the Oilfield.

V. Ownership of the Oilfield

36 The interest in the Oilfield that is now in dispute was originally wholly owned by Arrow Point. At some point, Arrow Point or Global conveyed a 55% interest in the Oilfield to Whitehaven and Title Shot.

37 Arrow Point assigned a 45% working interest in the Oilfield to Global. Arrow Point and Global were affiliates, both under the control of Mr. von Gramatzki. Mr. von Gramatzki deposed that he had "no recollection of Whitehaven ever consenting to a transfer of a 45% working interest from Arrow Point to Global One under the joint operating agreement for the oilfield - which as I understand would mean the 45% working interest remains with Arrow Point (being the original purchaser of the oilfield)." Mr. von Gramatzki assumed that Whitehaven was required to consent to such a transfer and offered an opinion with respect to the legal effect of the lack of consent. This is not proper evidence so I do not accept Mr. von Gramatzki's opinion on these points.

38 The 1990 CAPL Operating Procedure and 1993 CAPL Assignment Procedure that govern the Oilfield and are in evidence before the Court do not require consent when the transfer is between affiliates. Accordingly, Whitehaven was not required to consent to the transfer of the working interest from Arrow Point to Global. Further, Arrow Point and Global entered into an Assignment Agreement dated May 23, 2017 with PrairieSky Royalty Ltd ("PSRL") whereby PSRL as lessor consented to the assignment of a 45% interest in its lease from Arrow Point to Global. The Assignment Agreement with PSRL, an arm's length third party, is strong evidence that the assignment of the 45% interest in the Oilfield from Arrow Point to Global occurred. The subsequent dealings between Global and Enerstar all indicate that Mr. von Gramatzki believed that Global possessed the 45% interest in the Oilfield.

39 The only evidence before the Court is consistent with the 45% interest in the Oilfield passing from Arrow Point to Global. This is fatal to Whitehaven's position because it asserts that Arrow Point, not Global, was the true owner of the 45% interest in the Oilfield until Whitehaven's recent purported purchase of the interest.

40 Enerstar acquired the 45% working interest in the Oilfield from Global by way of a Purchase Agreement dated November 8, 2018 that was amended November 19, 2018. Mr. von Gramatzki acknowledged signing both the Purchase Agreement and the Purchase Agreement Amendment in his capacity as President of Global.

41 According to the closing agenda, the transaction between Enerstar and Global was to close on November 19, 2018. Mr. von Gramatzki signed a document dated November 19, 2018 indicating Global's receipt of $404,000 as payment pursuant to the Purchase Agreement.

42 Mr. von Gramatzki signed a notice of assignment of Global's interest in the Oilfield to Enerstar dated November 19, 2018. The notice of assignment was provided to Whitehaven and Arrow Point, the other registered working interest participants in the Oilfield at the time. Also on November 19, 2018, Mr. von Gramatzki wrote to PSRL to advise that "Global One GP Limited assigned its entire interest in certain leases to Enstar [*sic*] Petroleum Corp." Pursuant to the notice of assignment, Whitehaven had until January 1, 2019 to object to the assignment.

43 A week later, Mr. Coney, the President of Enerstar, emailed the President of Whitehaven, Mr. Hosie, seeking his support for replacing Arrow Point as operator of the Oilfield. Mr. Hosie agreed that Arrow Point must be replaced as operator because it was insolvent. The following day, on behalf of Whitehaven, Mr. Hosie signed a notice addressed to Arrow Point removing it as operator of the Oilfield and appointing Enerstar in its place. The joint notice stated, "Whitehaven Beach Capital Corp, as a signatory to this notice, acknowledges and consents to the appointment of Enerstar Petroleum Corp."

44 On December 27, 2018, Mr. Hosie sent an email to Mr. Coney that, among other things, stated, "[s]ince your 45% working interest started mid November . . . " Despite this seeming acknowledgement of Enerstar's interest in the Oilfield, four days later Mr. Hosie wrote to Global and Arrow Point objecting to the assignment of Global's working interest to Enerstar ("Notice of Objection"). There is no evidence that Whitehaven's Notice of Objection was contemporaneously provided to Enerstar. Whitehaven's objections were:

> 1) The purported transaction between Global One GP Limited and Enstar [*sic*] Petroleum Corp. is void and inoperative given that Enstar [*sic*] Petroleum Corp. does not exist and that Global One GP Limited is not an Assignor under the Master Agreement or a party to any relevant documentation.
>
> 2) The Notices of Assignment dated November 19, 2018 attached to this letter are fraudulent, void and inoperative.
>
> 3) The purported transaction is not exempt under the 1990 CAPL Operating Procedure.

45 Whitehaven's first objection appears to be based on a spelling mistake - believing the assignee to be Enstar, not En<u>e</u>rstar - and the mistaken belief that Arrow Point remained the owner of the 45% interest in the Oilfield. The second objection is a bald allegation devoid of particulars. And the third objection, though accurate, neglects to address the fact that under cl 2401, Alternate B, where the objecting party does not elect to purchase the property, pursuant to (e) "consent shall not be unreasonably withheld." The Whitehaven notice of objection to the transfer to Enerstar does not provide a genuine reason for objecting to the transfer.

46 The Whitehaven Notice of Objection to the assignment to Enerstar is void because it was issued in breach of its duty of good faith contractual performance. The duty of good faith contractual performance requires "that parties not lie or otherwise mislead each other about matters directly linked to the performance of the contract": ***Bhasin v Hrynew*, 2014 SCC 71** at para 73. Alternatively, by consenting to the appointment of Enerstar as operator of the Oilfield, Whitehaven waived its right to object to the assignment or was estopped from doing so: ***Armstrong v Gula*, 2024 ABKB 358** at para 63.

47 Whitehaven consented to the appointment of Enerstar as operator of the Oilfield on November 26, 2018. The clear intention of Whitehaven's consent was to cause Enerstar to take on the role and responsibilities of operator of the Oilfield. Enerstar acted as operator of the Oilfield from that date and was bound by the terms of the JOA. After consenting to Enerstar's appointment as operator of the Oilfield, it was not open to Whitehaven to then object to the assignment of Global's interest in the Oilfield to Enerstar. Put simply, having treated Enerstar as a party to the JOA by consenting to it assuming the role of operator and Enerstar having acted in reliance on Whitehaven's representation and conduct, it was inequitable for Whitehaven to object to Global's assignment of its interest in the Oilfield to Enerstar.

48 From November 19, 2018 until very recently, Mr. von Gramatzki and Arrow Point conducted themselves as if the 45% interest in the Oilfield claimed by Enerstar was, in fact, conveyed to Enerstar. Enerstar and later Taber Water operated the Oilfield. Arrow Point was struck from the corporate registry. Arrow Point has held no licences for wells or facilities in the Oilfield since at least 2020. The fact that Arrow Point has not acted like an owner of the Oilfield for an extended period is evidence that it is not an owner of the Oilfield.

49 Mr. von Gramatzki now says that the transaction between Global and Enerstar did not close and that Global returned the purchase funds to Enerstar. On cross-examination, Mr. von Gramatzki could not recall when the funds were returned, what amount was returned, nor did he have any documentation to support his naked assertion. As the principal of Global, Mr. von Gramatzki should have had access to Global's bank records. I do not accept Mr. von Gramatzki's claim that Enerstar returned the purchase funds to Global. This is not a matter of credibility; it is a matter of a lack of evidence. Mr. von Gramatzki's belated claim to Arrow Point or Global's ownership in the Oilfield stands in stark contrast to his conduct and the conduct of those companies from November 2018 onward which is consistent with neither Arrow Point nor Global owning the 45% interest in the Oilfield.

50 On January 1, 2019, Enerstar transferred a 5% working interest in the Oilfield to its affiliate, Taber Water. On January 10, 2019, Enerstar and Taber Water provided notice of the transfer to Whitehaven, Arrow Point, and Global. None of the parties receiving notice objected to the transfer.

51 On September 19, 2019, the Alberta Energy Regulator amended the order granted pursuant to the *Oil and Gas Conservation Act*, RSA 2000, c O-6 and the *Pipeline Act*, RSA 2000, c P-15 to recognize Enerstar and Taber Water's collective 45% interest in the Oilfield. There is no evidence of Arrow Point or Global taking any steps to challenge the AER's recognition of Enerstar and Taber Water's interest in the Oilfield.

52 Whitehaven submits that the Court cannot, in the face of Mr. von Gramatzki's evidence that Enerstar returned the purchase funds to Global and that the Enerstar-Global transaction did not close, find that the Purchaser owns the disputed 45% interest in the Oilfield. The general rule is that credibility issues and a dispute on material facts cannot be decided in a matter heard summarily based on a paper record: ***Weir-Jones Technical Services Inc v Purolator Courier Ltd*, 2019 ABCA 49** at para 35. I raised this issue with counsel for both parties and asked if either party took the position that a *viva voce* hearing was required. Both parties insisted that they should prevail based on the material presented to the Court and that there was no need for a *viva voce* hearing.

53 Mr. von Gramatzki's evidence is, in my view, is superficial and self-serving. The Supreme Court of Canada held in ***Guarantee Co of North America v Gordon Capital Corp*, [1999] 3 SCR 423** at para 31 that "a self-serving affidavit is not sufficient in itself to create a triable issue in the absence of detailed facts and supporting evidence." See also, ***Goodswimmer v Canada (Attorney General)*, 2017 ABCA 365** at para 40. The claim that the Enerstar-Global transaction failed to close is not supported by documentary evidence or the actions of the various parties. The evidence before the Court overwhelmingly supports a finding that the Debtor owned the 45% working interest in the Oilfield and that its interest was conveyed by the AVO to the Purchaser.

VI. Conclusion

54 The Purchaser owns a 45% working interest in the Oilfield. Should Whitehaven and Title Shot fail to recognize the Purchaser's 45% working interest in the Oilfield, the Purchaser may apply to the Court for further directions. The Purchaser is

entitled to costs of this application. If the parties are unable to agree on the quantum of costs, they may make submissions to the Court of three pages or less supported by a bill of costs.

Application granted.

Tab 10

What Does "Good Faith" Mean in Insolvency Proceedings?

Linc A. Rogers, David Sieradzki and Matthew Kanter[*]

1. INTRODUCTION

Commercial insolvencies do not have to be, in every instance, a zero sum game — a situation where one party's gain is equal to another party's loss. The perception that they are, however, can lead creditors to seek to maximize their own economic gain by minimizing the financial recovery of other stakeholders. Paradoxically, if each creditor precipitously pursues its own economic self-interest, the inevitable result will be the destruction of the very value that creditors are seeking to capture. Well-crafted insolvency regimes anticipate that commercial desperation may lead to aggressive creditor behaviour and the disregarding of the interests of competing stakeholders. The comprehensive stay of proceedings has emerged as the most obvious and blunt judicial and statutory instrument to protect creditors from themselves and each other.

As a result of the stay, a system is imposed on creditors that impairs their legal entitlements. This impairment is not without benefit. The system provides creditors with greater transparency and stability and a forum to seek recourse should they believe the process is not treating them fairly. Informed commentators, however, are questioning whether the scales have been correctly balanced and whether the actions of self-serving creditors are being properly corralled by the existing judicial and statutory infrastructure. There is an ongoing debate as to whether creditors in an insolvency proceeding, made desperate by circumstance, should be subject to an express statutory duty of good faith.[1] A recent decision of the Supreme Court of Canada has fuelled this debate.

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1 See, e.g., Dr. Janis Sarra, "Examining the Insolvency Toolkit: Report of the Public Meetings of the Canadian Commercial Insolvency Law System" (July 2012), online: <http://www.insolvency.ca/en/iicresources/resources/Examining_the_Insolvency_-Toolkit_Dr._J_Sarra_2012.pdf> at 12; and "Report of the statutory review of the *Bankruptcy and Insolvency Act* and *Companies' Creditors Arrangement Act* by the

In November 2014, the Supreme Court of Canada (Supreme Court) released its seminal decision in *Bhasin v. Hyrnew*,[2] and found that there was a common law duty, which applies to all contracts, to act honestly in the performance of contractual obligations. The Supreme Court held that good faith contractual performance is a general organizing principle at common law and is the animating principle behind the sentiment that parties have a duty to act "honestly and reasonably and not capriciously or arbitrarily"[3] and that parties must have "appropriate regard to the legitimate contractual interests of the contracting partner."[4]

The Supreme Court anticipated the criticism that injecting a principle as malleable and inherently subjective as good faith into commercial dealings would lead to legal uncertainty and frustrate market efficiency. In that regard, the Supreme Court held that parties are free to act in their own economic self-interest, but cannot lie or deliberately mislead a contracting party in furtherance of that self-interest. Indeed, the Supreme Court was of the view that imposing this baseline duty reinforced the legitimate commercial expectations of contractual parties, rather than undermining them.

Accordingly, the findings in *Bhasin* should not be overstated. *Bhasin* calls for a highly contextual and case-specific understanding of what is required to give appropriate consideration to the legitimate interests of both contracting parties; good faith does not require acting to serve the other party's interests in all cases.[5] A counter-party to a contract is not, by its very nature, a fiduciary, and does not owe a duty of loyalty to another party to the contract. The doctrine articulated by the Supreme Court "merely requires that a party not seek to undermine [a co-contracting party's] interests in bad faith."[6] Despite the measured tones of the Supreme Court in evolving the common law in this area, it is clear that the decision will have a broader impact than the law of contract, including in the insolvency field.

In a recent article, Dr. Janis Sarra asserts that the Supreme Court's reasoning in *Bhasin* has a "direct application" to insolvency cases.[7] Dr. Sarra argues, with typical clarity and eloquence, that express statutory provisions

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legislative review task force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency Restructuring Professionals" (15 July 2014) online: <http://www.insolvency.ca/en/resources/DOCS-13606783-v1-JOINT_TASK_FORCE_REPORT_-_JULY_15__2014.PDF> at p. 11.

2 2014 SCC 71, 2014 CarswellAlta 2046, 2014 Carswell Alta 2047 [*Bhasin*].

3 *Ibid*. at para. 63.

4 *Ibid*. at para. 65.

5 *Ibid*.

6 *Ibid*. at para. 65.

7 Janis P. Sarra, "La bonne foi est un considération de base — Requiring Nothing Less than Good Faith in Insolvency Law Proceedings" in Janis P. Sarra & Justice Barbara

requiring good faith should be incorporated into our insolvency legislation. Further, such express statutory provisions would be consistent with already existing case law, including *Bhasin*.[8] Dr. Sarra submits that in addition to the requirements set forth in *Bhasin*, "[c]reditors' conduct should be explicitly required to be in good faith if they expect the full benefit of remedies under insolvency law and contract law to which they may be entitled."[9]

Notably, the *Companies' Creditors Arrangement Act* (CCAA) and the *Bankruptcy and Insolvency Act* (BIA) already contain statutorily codified obligations for the principal parties in insolvency proceedings to act in good faith. For example, debtor companies have an affirmative duty to act in good faith to obtain a comprehensive stay of proceedings in an initial order under the CCAA or any extension of the stay. Under the BIA, debtors who file a notice of intention (NOI) to file a proposal receive the benefit of an automatic stay of proceedings, but must act in good faith to extend the stay. In addition, receivers and court-appointed monitors have an affirmative duty to act in good faith, while receivers, monitors, and trustees may only be insulated from liability to the extent that they carry out their duties in good faith.[10]

Romaine, eds., *Annual Review of Insolvency Law 2014* (Toronto: Carswell, 2014) 145 at 157.

8 See *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60 at para. 70, (*sub nom. Ted Leroy Trucking Ltd., Re*) 2010 CarswellBC 3419 [*Century Services*]. Dr. Sarra also notes that the Quebec Civil Code already contains requirements to act in good faith and such requirements have already been considered in the insolvency context. See *Banque de Montréal c. TMI Education.com inc. (Faillite)*, 2014 QCCA 1431 (C.A.).

9 *Supra* note 7 at 149.

10 The CCAA and BIA also refer to good faith obligations in the following sections, although there is little relevant discussion of good faith in case law applying these provisions:
(a) section 33(3)(b) of the CCAA provides that a debtor may only obtain an order authorizing the debtor to serve a notice to bargain in respect of a collective bargaining agreement (CBA) if the debtor has made "good faith" efforts to renegotiate the provisions of the CBA;
(b) section 36(4)(a) of the CCAA provides that a debtor may sell assets to a related party outside the ordinary course of business only if all of the factors in section 36(3) are met *and* "good faith efforts" were made to sell or otherwise dispose of assets to unrelated parties;
(c) section 50(12)(a) of the BIA provides that a court may, on application by the trustee, an interim receiver or a creditor, declare that a proposal is deemed to have been refused by creditors if the debtor has not acted or is not acting in "good faith and with due diligence";
(d) section 65.12(2)(b) of the BIA provides that a debtor who has filed a NOI may only obtain an order authorizing the debtor to serve a notice to bargain in respect of

Tab 11

2006 ABQB 236
Alberta Court of Queen's Bench

Residential Warranty Co. of Canada Inc., Re

2006 CarswellAlta 383, 2006 ABQB 236, [2006] A.W.L.D. 1798, 21 C.B.R. (5th) 57, 393 A.R. 340, 62 Alta. L.R. (4th) 168

In the Matter of the Bankruptcy of Residential Warranty Company of Canada Inc.

In the matter of the Bankruptcy of Residential Warranty Insurance Services Ltd.

Topolniski J.

Judgment: March 24, 2006 *
Docket: Edmonton 24-112232, 24-112233

Proceedings: Affirmed, 2006 CarswellAlta 1354, (sub nom. Residential Warranty Co. of Canada Inc. (Bankrupt), Re) 417 A.R. 153, [2006] A.W.L.D. 3143, 275 D.L.R. (4th) 498, (sub nom. Kingsway General Insurance Co. v. Residential Warranty Co. of Canada Inc. (Trustee of)) [2006] I.L.R. I-4552, (sub nom. Residential Warranty Co. of Canada Inc. (Bankrupt), Re) 410 W.A.C. 153, [2006] 12 W.W.R. 213, 2006 ABCA 293, 65 Alta. L.R. (4th) 32, 25 C.B.R. (5th) 38 (Alta. C.A.)

Counsel: John I. McLean for Kingsway General Insurance Company
Kent Rowan for Deloitte & Touche Inc.

Subject: Insolvency; Estates and Trusts

Related Abridgment Classifications

Bankruptcy and insolvency

XIV Administration of estate

XIV.2 Trustees

XIV.2.d Remuneration of trustee

Headnote

Bankruptcy and insolvency --- Administration of estate — Trustees — Remuneration of trustee — General principles

Bankrupts were in process of winding up home warranty business — Trustee was appointed interim receiver in context of minority shareholder's oppression remedy — Creditor was insurance underwriter of home warranty policies brokered or administered by bankrupts — Creditor filed proofs of claim in estates for approximately $11 million pursuant to contractual, statutory and common law trusts and brought related concurrent action against bankrupts — Trustee gave notice that trust claim was disputed — Trustee maintained that all or substantially all insurance premiums collected by bankrupts for insurance policies were paid to creditor and that balance of estate of bankrupts was income derived from business operations — Creditor appealed trustee's decision — Creditor brought application for order that trustee was not entitled to utilize realizations of assets and property of bankrupts for purpose of fees and expenses — Application dismissed — Trustee was entitled to retrospective charge on assets under administration for fees and expenses in undertaking work on estate to date — Common sense dictated trustees in bankruptcy receive reasonable compensation when called upon to exercise duties and judgment — If compensation were commonly withdrawn in such instances, trustees would be inclined to shy away from problems and few would be willing to take on role — Creditor had not discharged onus of establishing valid trust on date of bankruptcy — Creditor's action had been stayed and creditor had not been vigilant in pursuing other grievances — No evidence was presented illustrating trustee's actions favoured any party to bankruptcy.

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APPLICATION by creditor for order that trustee was not entitled to utilize realizations of assets for fees and expenses.

***Topolniski J.*:**

I. Nature of the Application

1 This Decision concerns retrospective and prospective funding of a trustee in bankruptcy from assets under administration when all of the assets are subject to a disputed trust claim that is far from being resolved.

2 Residential Warranty Company of Canada Inc. (RWC) and Residential Warranty Insurance Services Ltd. (RWI) (collectively the Bankrupts) are Alberta companies that operated a home warranty business. They were in the process of winding up when, in late 2004, Deloitte & Touche LLP was appointed their interim receiver (IR) in the context of a minority shareholder's oppression action. On the companies' deemed bankruptcy in May 2005 (Bankruptcies), Deloitte & Touche LLP became their trustee in bankruptcy (Trustee).

3 The Applicant, Kingsway General Insurance Company (Kingsway), was an insurance underwriter of home warranty policies brokered or administered by the Bankrupts in Alberta and British Columbia. Kingsway filed proofs of claim in the estates pursuant to s. 81 of the *Bankruptcy and Insolvency Act* (*BIA*) [1] claiming approximately $11,200,000.00 pursuant to contractual, statutory and common law trusts. The Trustee gave notice under s. 81(2) that the trust claim was disputed. It maintains that all or substantially all of the insurance premiums collected by the Bankrupts for insurance policies on which Kingsway is liable have been paid to Kingsway and that the balance of the estate of the Bankrupts is income derived from the operation of their home warranty business. Kingsway has appealed the Trustee's decision (Appeal).

4 Kingsway's trust claim arises from a series of transactions that are detailed in a broadly drafted Amended Statement of Claim (BC Action) which it filed in the British Columbia Supreme Court in June 2004, prior to the Bankruptcies. The Amended Statement of Claim is comprised of 125 paragraphs over 42 pages and contains allegations of breach of contract, fraud, conversion, breach of trust, breach of fiduciary duty. The Bankrupts, along with certain of their directors, officers, and employees, are named as defendants in the lawsuit.

5 Kingsway now applies for an order:

1. declaring that the Trustee is not entitled to use the realizations of any assets and property of the Bankrupts for the purpose of paying its fees and expenses, both past and future, pending the hearing of the Appeal and the disposition of the BC Action;

2. directing that the Trustee return all fees paid after notice of its trust claim, subject to deduction for reasonable fees directly attributable to preservation of the alleged trust property;

3. appointing the Trustee as Interim Receiver of the Bankrupts' assets under s. 47.1 of the *BIA* (*BIA* IR) for preservation purposes pending determination of the Appeal and the BC Action; and

4. requiring the Trustee to post security for costs in respect of its defence of the Appeal and the BC Action;

6 The Trustee's position is that resolution of the Appeal to finally determine the validity of Kingsway's claim is central to administration of the Bankruptcies. The Trustee is concerned about prejudice to other creditors and competing trust claimants if it is unable to respond to the Appeal for lack of funding.

7 In response to Kingsway's application, the Trustee asks for a retrospective and prospective charge on all of the estate assets under its administration in order to pay its fees and disbursements, including legal fees and disbursements. The Canada Revenue Agency (CRA), an unsecured creditor, and a builder, Nucon Developments, support the Trustee's request.

8 The parties on this application focussed squarely on the issue of Trustee funding. Kingsway did not pursue its request for security for costs and, while mention was made of its request for the appointment of the Trustee as a *BIA* IR in Kingsway's written submissions, no evidence or argument was offered to support the relief requested. In supplemental written submissions, Kingsway argued that 'super-priority' funding for a *BIA* IR under s. 47.2 of the *BIA* is not applicable in a "straight bankruptcy" like this. I took this submission to mean that it had abandoned this arm of its application.

9 Kingsway has applied for an order transferring the Appeal to the British Columbia Supreme Court (In Bankruptcy) and for an order granting it leave to continue the BC Action "to be heard at the same time as the Appeal, subject to the direction of the Judge of the British Columbia Supreme Court hearing the BC Action". The applications and the Appeal were adjourned at the parties' suggestion. The applications are now set to be heard in mid May. Kingsway wants to await the outcome of its applications before scheduling the Appeal.

10 As Kingsway's application to have the Court in British Columbia deal with the Appeal has not been decided, my Ruling on the present application presumes that the Appeal will proceed in the ordinary course of events in this Court.

II. Background

A. The Bankrupts, the Builders and Kingsway

11 The Bankrupts brokered and administered residential warranty policies sold in Alberta and British Columbia to builders which were underwritten by Kingsway as the insurer of record. The builders paid for membership in the programs. Each of them also paid money by way of cash deposit or letters of credit as security for repairs covered by the warranty policies. The Bankrupts held the cash deposits in a segregated account. Provided a builder did not owe any money on expiry of the warranty period, the deposit would be repaid to the builder. Letters of credit were treated in a similar fashion.

12 Relations between Kingsway and the Bankrupts soured to the point where Kingsway terminated its contracts with them in August 2003, alleging that the Bankrupts had sold unauthorized products and had failed to remit certain premiums. The Bankrupts denied the allegations and the fight was on.

13 In the spring of 2004, Kingsway complained to the British Columbia Financial Institutions Commission (FICOM), British Columbia's insurance regulatory authority, about the Bankrupts' conduct. FICOM investigated the companies and RWI responded by surrendering its broker's license for three weeks. The Insurance Council of British Columbia subsequently allowed reinstatement of its license on conditions, one of which was that RWI hold approximately $3,100,000.00 in trust with its lawyers for premiums allegedly owed to Kingsway.

14 Kingsway commenced the BC Action in June 2004, claiming a minimum of $2,108,576.35 plus additional unascertained damages. It started a similar lawsuit in Alberta, but did not prosecute it. About three weeks after the BC Action was commenced, RWC paid $3,092,612.50 to Kingsway, unconditionally.

15 By the date of the Bankruptcies in May 2005, the defendants to the BC Action had defended and counter-claimed (alleging outstanding commissions, expenses, third party costs, lost income, lost opportunity, and loss of reputation) and Kingsway had demanded document production. Kingsway's forensic accountant apparently calculated the amount that remained owing to Kingsway from the Bankrupts as at June 7, 2005 to be $3,786,606.00. In late June 2005, after receiving certain financial

information from the Trustee, Kingsway's forensic accountant determined that $11,292,224.00 (over and above the monies already paid by RWC), plus additional amounts for unliquidated damages, was still owing from the Bankrupts.

16 Kingsway filed proofs of claim in the Bankruptcies on September 2, 2005 and put the Trustee on notice of its claim and of the position that it was taking with respect to the Trustee's fees and expenses on October 4, 2005.

17 In late 2005, the police charged the Bankrupts, one of their former directors, and a former employee with fraud, theft, uttering a forged document and drawing a document without authority. An Information was sworn and warrants were held until December 15, 2005. I was not provided with any additional information on this application as to the current status of the criminal proceedings.

B. The Interim Receiver, The Trustee and Stakeholders

18 The order appointing the IR granted the IR a 'super-priority' charge over the companies' assets, giving it priority over all security, charges and encumbrances affecting the assets.

19 The IR, which is also the Bankrupts' Trustee, complied with the Court's directions to investigate the Bankrupts' affairs, dispose of certain assets and report on numerous concerns, including the BC Action and the builders' deposits. It prepared three reports for the Court. Kingsway contends that the IR's mention of the BC Action in its first report, dated December 21, 2004, constitutes evidence of notice to Deloitte & Touche LLP of Kingsway's trust claim, and that funding for the Trustee from alleged trust assets, which comprise the entire estate of both Bankrupts, should not be allowed after that date. It asserts that funding should not extend beyond October 4, 2005 at the very latest, when its counsel particularized its trust claim and formally put the Trustee on notice of the position which it now advances.

20 The assets under the Trustee's administration include bank accounts and claims against various parties, but the vagaries of the Bankrupts' business and their relationships with others have somewhat complicated the Trustee's work. Apart from the typical issues arising in any bankruptcy (financial analysis, securing assets, reviewing proofs of claim, reporting to and meeting with creditors and inspectors, and acting as the point person coordinating court matters), the Trustee has instructed litigation and dealt with winding up business operations. It has also addressed enquiries from policyholders and builder claimants about warranties and the refund of deposits relating to 550 properties.

21 Kingsway has referred some policyholders to the Trustee on denying coverage under various policies and it has jointly instructed some litigation with the Trustee. The Trustee has provided it with financial analyses and other information, including information concerning the Trustee's findings on premium payments.

22 The Trustee predicts that its future work will entail continued realization of assets through litigation efforts, including intended litigation against Kingsway to recover $1,500,000.00 in allegedly overdue profit sharing, and resolution of creditor and proprietary claims. In due course, it will wind up the estates, return property rightfully belonging to others, and distribute residual property to the creditors.

23 There are 627 persons interested in the builders' deposit fund and letters of credit (Builder Claimants). The builders' deposit fund is worth approximately $1,000,000.00 while the letters of credit are valued at approximately $5,000,000.00. The Trustee concedes that some of the Builder Claimants have trust claims against the cash builders' deposits. The method by which builders' claims are to be proved in the bankruptcy and a claims bar date were set by Order in December 2005. Kingsway has agreed to that process.

24 Kingsway has participated in case management meetings and applications relating to the claims of the Builder Claimants. It has requested that it be given notice of claims that the Trustee disallows. It also wants to participate in the Trustee's application for directions as to whether the letters of credit are impressed with a trust and appeals of the disallowance by the Trustee of some builders' claims. Kingsway maintains that it is entitled to all of the value of the letters of credit, although it has not indicated how these can be considered traceable trust assets. It also claims approximately $300,000.00 of the builders' cash deposit fund as a result of alleged setoffs owed to it by builders for the cost of repairs. Kingsway takes the position that once the claims of

the Builder Claimants who are seeking access to the cash fund have been resolved in these bankruptcy proceedings, the Builder Claimants must "duke it out" with Kingsway in the ordinary courts to determine who is entitled to the funds.

III. Analysis

A. Fairness, Practicality and Neutrality

25 A significant objective of the *BIA* is to ensure that all of the property owned by the bankrupt or in which the bankrupt has a beneficial interest at the date of bankruptcy will, with limited exceptions, vest in the trustee for realization and ratable distribution to creditors. To further this objective, the *BIA* provides for practical, efficient and relatively inexpensive mechanisms for asset recovery, determination of the validity of creditor claims, and distribution of the estate. A fundamental tenet of *BIA* proceedings is that fairness should govern.

26 The *BIA* expressly preserves the Bankruptcy Court's equitable and ancillary powers. [2] Accordingly, inherent jurisdiction is maintained and available as an important but sparingly used tool. There are two preconditions to the Court exercising its inherent jurisdiction: (1) the *BIA* must be silent on a point or not have dealt with a matter exhaustively; and (2) after balancing competing interests, the benefit of granting the relief must outweigh the relative prejudice to those affected by it. Inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfilment of the substantive objectives of the *BIA*, including the proper administration and protection of the bankrupt's estate. [3]

27 Solutions to *BIA* concerns require consideration of the realities of commerce and business efficacy. A strictly legalistic approach is unhelpful in that regard. [4] What is called for is a pragmatic problem-solving approach which is flexible enough to deal with unanticipated problems, often on a case-by-case basis. As astutely noted by Mr. Justice Farley in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* [5] :

> While the *BIA* is generally a very fleshed-out piece of legislation when one compares it to the *CCAA*, it should be observed that s. 47(2)(c): "The court may direct an interim receiver ... to ... (c) take such other action as the court considers advisable" is not in itself a detailed code. It would appear to me that Parliament did not take away any inherent jurisdiction from the court but in fact provided, with these general words, that the court could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands". It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organised and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability.

28 Neutrality is the necessary mantra of trustees in bankruptcy. They are neither an agent of the creditors nor of the debtor, but rather are administrative officials and officers of the court charged with the responsibility of looking after all parties' interests. Trustees are obliged to comply with the procedures and rules of conduct set out in the *BIA*, the code of ethics in the *BIA General Rules* [6] and with professional codes of conduct, and cannot enter the fray between competing stakeholders. [7] They must present the facts in a dispassionate, non-adversarial manner in matters before the court. [8] Their job is to act as an independent voice of reason and to provide discipline in the oft-chaotic circumstances created on bankruptcy.

B. Trust Property

29 Unless otherwise provided by legislation, trustees in bankruptcy have no greater interest in the property they are responsible for administering than the bankrupt does.

30 The property held by a bankrupt in trust for another is not divisible among the creditors of the bankrupt. [9] However, this does not mean that the res of the trust is not subject to administration by the trustee in bankruptcy. On the contrary, property held by the bankrupt in trust for a third party becomes part of the bankrupt's estate in the possession of the trustee in bankruptcy, who is obliged to administer the property and to deal with it in accordance with the law. [10]

31 Section 81(2) of the *BIA* governs the actions of a trustee in bankruptcy when presented with a trust claim. Within 15 days of presentation, the trustee in bankruptcy is either to admit the claim or to give notice disputing it, together with the reasons for doing so. There is no intermediate position which may be taken.

32 Section 81(2) reads:

> 81(2) The trustee with whom a proof of claim is filed under subsection (1) shall within fifteen days thereafter or within fifteen days after the first meeting of creditors, whichever is the later, either admit the claim and deliver possession of the property to the claimant or give notice in writing to the claimant that the claim is disputed with his reasons therefor, and, unless the claimant appeals therefrom to the court within fifteen days after the mailing of the notice of dispute, he shall be deemed to have abandoned or relinquished all his right to or interest in the property to the trustee who thereupon may sell or dispose of the property free of any lien, right, title or interest of the claimant.

33 The Trustee in the present case has performed a quasi-judicial function in assessing and disallowing Kingsway's claim. There is no suggestion that it acted unfairly in doing so or that it has somehow entered into the fray between competing stakeholders. The Trustee has simply done its job.

34 The Trustee agrees that the Bankrupts had trust obligations to Kingsway for unremitted premiums, but disagrees with Kingsway's assessment that all of the money collected by the Bankrupts from their customers represented premiums. It also questions the merit of Kingsway's constructive trust claim arising from alleged "secret commissions" and breach of fiduciary duty. Tracing will be an issue concerning Kingsway's claim to entitlement to the letters of credit and possibly other aspects of its claim.

35 The Act is silent about the trustee's responsibilities on an appeal from its rejection of a claim. However, s. 41(4) of the *BIA* provides that an estate is deemed to have been fully administered only when "a trustee's accounts have been approved by the inspectors and taxed by the court and all objections, applications, oppositions, motions and appeals have been settled or disposed of and all dividends have been paid".

36 In my view, the Trustee is a necessary party to the Appeal, which it is to participate in as an officer of the court, presenting the relevant facts in a dispassionate, non-adversarial manner, leaving the court to decide the matter. The Trustee's responsibility is to ensure that only valid claims to the assets under administration are recognized.

37 Kingsway has asserted a significant trust claim that might prevail at the end of the day, but at present that claim is merely an assertion - a fact that weighs heavily on this application.

38 The onus of establishing a trust at the date of bankruptcy will rest with Kingsway and the ordinary law of trust applies in that regard.[11] Kingsway has not yet proved its claim of a valid trust. It has procured an accounting expert's opinion that it relies on, but that opinion is untested. The BC Action was in the early stages when stayed by the Bankruptcies. Other proceedings dealing with the same series of transactions are seemingly over or similarly not far advanced. FICOM's investigation resulted in a three-week licence suspension, but no further action was taken, and the criminal proceeding is in its early stages.

C. Trustee Funding

39 In a typical bankruptcy, the trustee is paid from estate assets. Like all insolvency professionals, trustees in bankruptcy are or should be alive to securing payment of their fees, particularly for work in the initial stages of a bankruptcy until the asset base from which they can be paid is assessed. Trustees often look to the petitioning creditor for an indemnity for their fees. Here, the Bankruptcies occurred when proposal deadlines were not met and there is no petitioning creditor. However, other interested parties include the CRA, an unsecured creditor and the Builder Claimants.

40 Section 39(1) of the *BIA* provides that: "The remuneration of the trustee shall be such as is voted to the trustee by ordinary resolution at any meeting of creditors." However, if remuneration has not been fixed under 39(1), the trustee is entitled under

s. 39(2) to insert in his final statement and retain as remuneration, subject to increase or decrease on application to the court, a sum not exceeding seven and one-half per cent of the amount remaining out of the realization of the property of the debtor after the claims of the secured creditors have been paid or satisfied.

41 Ordinarily, a trustee in bankruptcy will not be funded from trust assets unless it shows that its work was necessary to preserve or otherwise benefit the trust assets, [12] or the work was required for resolution of the trust claim or to sort out beneficiaries.

42 The first exception developed as a result of the court's exercise of inherent jurisdiction in ordinary trust cases, a topic reviewed in some depth by Sigurdson J. in *Gill, Re* and Tysoe J. in *Eron Mortgage Corp., Re*. [13] The court's inherent jurisdiction in this regard has been exercised sparingly and generally in circumstances where the beneficiary would have had to hire someone else to do the work performed by the trustee. [14] The second exception flows from the trustee in bankruptcy's duty under the *BIA* to approve or disallow of claims. [15]

43 There is also statutory authority in Alberta which allows for the funding of ordinary trustees. The *Trustee Act* [16] authorizes the court to order compensation for "the trustee's care, pains and trouble and the trustee's time expended in and about the trust estate". This compensation is available regardless of whether the trusteeship arises by construction, implication of law, or express trust. [17] Trustees in bankruptcy can avail themselves of this legislation to the extent that it is not in conflict with the *BIA*. [18]

44 The Alberta Court of Appeal in *Sproule v. Montreal Trust Co.* [19] considered the intent and scope of s. 44 funding (then s. 39). Mr. Justice Haddad commented that: [20]

> My concept of the term care and management is consistent with the expressions to which I have referred. It connotes to me not only the responsibility of reasonable supervision and vigilance over the preservation or disposition of assets but also the responsibility of judgment and decision making in the affairs of an estate to resolve problems from time to time arising over and above the usual and regular procedures attendant upon administration.

45 The Trustee in the present case was obliged to gather in trust property, which vested in the Trustee, but it cannot distribute the res of the trust to creditors. The Trustee therefore has two capacities, one as trustee in bankruptcy and the other as an ordinary trustee arising by implication of law. If Kingsway prevails at the end of the day, the Trustee is entitled to seek compensation for its work "in and about the trust". In my view, the broad scope of compensable work discussed by Mr. Justice Haddad in *Sproule* includes identifying which assets, if any, are subject to a trust and, if doubt exists, placing the necessary information before the court for determination of that issue.

46 There are several notable cases in which trustees in bankruptcy have been denied or given only limited funding from trust assets. *P.A.T., Local 1590 v. Broome*; *Shirt-Man Inc., Re* and *Genometrics Corp., Re* involved assets impressed with undisputed statutory trusts for employee withholdings. In *P.A.T., Local 1590 v. Broome*, as here, the trust claims were to the entirety of the funds gathering in by the trustee.

47 *P.A.T., Local 1590 v. Broome* concerned employee tax withholdings. Master Bowne described his ruling as: [21]

> ...A signal to trustees that where there are trust claims, before undertaking work with a view to realization of assets to benefit trust fund recipients, the trustee would be advised to make arrangements that remunerations would be paid by the administrator of the trust or otherwise.

48 Master Browne said in *obiter dicta* that even if the funds in the estate exceeded the amount of the trust claims, the expenses and fees which the trustee would be entitled to claim from the estate assets under s. 107 (now s. 136) of the *BIA* would not include indemnity for any work done which did not result in a benefit to the creditors. This aspect of the decision was qualified in *Pugsley, Re*, [22] an appeal of a registrar's taxing order which disallowed legal fees incurred by the trustee in obtaining an opinion on the validity of a trust claim asserted by Revenue Canada under s. 59 of the *Bankruptcy Act*, R.S.C. 1970, c. B-3

(now s. 81 of the *BIA*). Mr. Justice O'Driscoll in that case held that the comment of Master Browne in *P.A.T., Local 1590 v. Broome* should not be extended or expanded to include the assessed costs of legal counsel retained by the trustee to provide such legal services. He did not consider it logical that a trustee would be entitled to pay counsel for the opinion if in the end the proof of claim was adjudged invalid, but not if the claim was upheld, even though technically there was no benefit to the creditors in obtaining the opinion.

49 The debtor in *C.J. Wilkinson Ford Mercury Sales Ltd., Re* [23] sought a charge over statutory trust assets, again employee withholdings, to fund his legal counsel. The court denied the application, commenting that it would not allow money owned by one person to be paid over to another person so that he could pay it to yet another person.

50 *Grant v. Ste. Marie* [24] involved a summary trial in the ordinary courts, a bankrupt rogue, a finding of a valid express trust and competing claimants. The plaintiff was granted leave to proceed with his lawsuit against the bankrupt. The issue was whether the plaintiff, a victim of the bankrupt defendant's fraud, could trace funds that he had paid to the bankrupt into the hands of the trustee in bankruptcy.

51 Mr. Justice Slatter found that the bankrupt had used words of trust to reassure the plaintiff. He ruled that the trustee's investigative work was instrumental in precluding improper payouts to others and thereby benefited the plaintiff. Likening the trustee to a *bona fide* purchaser for value without notice, he allowed encroachment on the trust property to pay certain expenses to the extent they related to the trustee's dealings with the traced funds, but only to the date the trustee received notice of the trust claim.

52 Slatter J. noted that the trustee's fees and expenses relating to general administration of the estate were a legitimate expense of the estate. Where trust funds are used to discharge a debt owed to the recipient of the funds, there is a giving of value and no tracing to the recipient is permitted. [25] Therefore, he reasoned that the trustee's payment of legal expenses and even its own fees prior to receiving notice of the trust precluded the trust claimant from tracing those funds and defeated the beneficiary's interest to that extent. He commented [26] that:

> ... the Trustee is an officer of the Court, and a necessary part of the bankruptcy regime, and the discharge of the estate's obligation to pay the Trustee should also be considered as the giving of value. Before receiving notice of the Plaintiff's claim the Trustee was a bona fide purchaser for value without notice, and the Plaintiff cannot recover the portion of funds used to discharge the legitimate expenses of the estate.

53 *Westar Mining Ltd., Re* [27] addressed the issue from the opposite perspective. A group of trust claimants sought funding from estate assets to pay legal fees for their application to exclude certain assets from distribution to the creditors. The court held that the legal work did not benefit the bankrupt's estate nor was it necessary for the management and preservation of estate assets. The court was unmoved by the claimants' plea that it would be unfair to them to have to retain counsel when counsel for the trustee, who was paid for by the estate, represented the other creditors.

54 The court in *Ridout Real Estate Ltd., Re* [28] charged trust funds that ultimately were held to belong to realty vendors and purchasers, brokers and salespersons with payment of the fees of a trustee in bankruptcy. The only mention of the trustee's work in connection to the trust assets was that he received a deposit and brought an application for directions concerning distribution of the assets. Presumably, this was sufficient to warrant compensation. The case report refers only to trust funds in the trustee's hands. There is no mention made as to whether there were any residual assets in the bankrupt's estate.

55 In *NRS Rosewood Real Estate Ltd., Re*, [29] the court awarded the trustee in bankruptcy $25,000.00 in compensation from trust monies as it was satisfied that issues between the stakeholders had to be resolved by the court and it was the trustee's initiative which had caused that to happen. Apparently, there were some residual assets in that case.

56 Mr. Justice Urquhart in *Nakashidze, Re* [30] allowed the trustee compensation from securities that were not property of the bankrupt, noting that the trustee had undertaken a vast amount of work in sorting out and assembling the securities and

claims. However, he reached a contrary conclusion in *McLeod, Re*,[31] finding that the trustee in bankruptcy was not entitled to compensation from proprietary assets because the proprietary claimant rather than the trustee had "salvaged" the asset. Nevertheless, he did indicate that any work undertaken by the trustee could be taken into account when the estate was wound up in fixing his general compensation.

57 *Walter Davidson Ltd., Re*[32] involved a dispute between a secured creditor claiming under a general assignment of book debts, mechanics' lien claimants and unsecured creditors. The court ultimately ruled in favour of the statutory lien claimants, but held that it was the trustee in bankruptcy's efforts which had made the money available to the lien claimants and therefore charged the trust assets with payment of the trustee's fees.

58 Like Kingsway, the miners' lien claimants in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.*[33] protested funding of the insolvency professional. Funding in that case was pursuant to a 'super priority' charge granted under s. 47.2 of the *BIA*. In refusing the claimants' application, Mr. Justice Farley described the interim receiver's work as "providing discipline to the proceedings" and noted that the interim receiver had to be capable of exercising its own independent judgment. He commented as follows on the status of the applicants' claims in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.*:[34]

> ...Secondly, it would seem to me that one should not presume what one is hopeful of establishing (i.e. the MLA claimants have not yet proved the validity and priority of their liens). Thirdly, while it should be recognized that the IR may be funded, there is no assurance that it will "win"; it may "lose" in whole or in part. However, at least there will be the testing of the Royalty Claim for the benefit of all creditors who have a valid claim against *Curragh*...
>
> ... Simply put, it comes down to a question of cutting through the Gordian Knot: one does not know at this stage whether these opposing MLA claimants have a valid and prior claim. It seems to me that the amount of funding is reasonable in the circumstances and would be modest investment in the process.

59 The trustee is an integral part of the bankruptcy system. The claims review process is designed to ensure that only proper claimants are entitled to share in the bankrupt's property. The Trustee, at least in this case, is a necessary party to the Appeal. Kingsway should succeed only if it has a legitimate claim and not simply by default. To rule otherwise would be to open the door for possible abuse of the system by rogue claimants filing spurious proprietary claims.

60 If a charge is granted, Kingsway ultimately may be prejudiced if it proves its claim to the extent asserted, but that prospect remains an "if". The sheer magnitude of its claim is no reason to hold the Trustee and the bankruptcy system at bay pending determination of its validity. Mr. Justice Farley's words in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* resonate ... "one should not presume what one is hopeful of establishing".[35]

D. Charge on the Assets

61 Kingsway contends that an asserted trust claim valued at more than potential realizations, regardless of its facial merit, forces the trustee in bankruptcy to seek funding for an appeal of its disallowance of the claim from sources other than the assets under administration. It contends that responsibility to fund the Trustee falls on the shoulders of other creditors or claimants, whether by means of direct funding or an assignment under s. 38 of the *BIA*. Given the nature of the claims in these Bankruptcies, I disagree. The validity and priority of the trust claims must be determined. The Trustee is assisting the Court and all of the claimants in coordinating these matters and in providing the necessary information to resolve these issues.

62 The Trustee is not asking for a retrospective charge over undisputed statutory employee withholdings, as were the (unsuccessful applicant) trustees in bankruptcy in *P.A.T., Local 1590 v. Broome*; *Shirt-Man Inc., Re* and *Genometrics Corp., Re*. Nor is the Trustee seeking a prospective charge over undisputed statutory employee withholdings like the bankrupt in *C.J. Wilkinson Ford Mercury Sales Ltd., Re*.

63 Mr. Justice Slatter held in *Grant* that the trustee in that case could not use the trust funds after receiving notice of the proprietary plaintiff's claim. It is unclear what position the trustee in that case took concerning the trust claim (offering financial and documentary information to the court does not equate to disputing the claim), what work, if any, it undertook after notice of the trust claim, and whether there were residual assets from which it could be funded. This is not surprising given that the case was not about trustee compensation or the charging of trust assets.

64 The role of the Trustee here is more akin to that of the trustees described in *Ridout Real Estate Ltd., Re*; *NRS Rosewood Real Estate Ltd., Re*; *Nakashidze, Re*; *Walter Davidson Ltd., Re*, and *McLeod, Re*[36], each of whom was successful in obtaining a retroactive charge over established trust assets for their work in gathering and preserving trust assets or in sorting out the trust claims.

65 In *Pugsley, Re*, Mr. Justice O'Driscoll commented that a trustee should be able to pay counsel for their opinion and services in regard to a proof of claim whether the claim eventually is adjudged invalid or not. He reasoned that if the trustee cannot hire and remunerate counsel to process the claims, counsel to a trustee might refuse to do so because of the potential for non-remuneration. In his view, that would put the trustee in a "no win" situation with regard to legal advice and legal services regarding proofs of claim.

66 *Sproule* is also responsive to the "no win" situation identified by Mr. Justice O'Driscoll in *Pugsley*.

67 Common sense dictates that trustees in bankruptcy should receive reasonable compensation when they are called on to exercise their judgment and to be real problem solvers in a situation such as the present one. If it were otherwise, trustees would be inclined to shy away from problems and the list of persons willing to take on the role of trustee would dwindle, particularly in situations where there was no personal connection between the potential trustee and the beneficiary or the assets under administration.

1. Retrospective Charge

68 Kingsway's application is denied. The Trustee is entitled to a charge on the assets under administration for its fees and expenses in undertaking work on the estate to date. Presuming success for Kingsway in the end, a significant part of the Trustee's work will have benefited Kingsway, given that its claim is to all of the assets under administration. Furthermore, the Trustee is entitled to compensation for all of its work to date in sorting out Kingsway's claim. The Trustee has offered its assistance to Kingsway in related proceedings concerning proposals made by various directors and officers of the Bankrupts, it has formulated a plan that Kingsway has joined in for resolving claims by Builder Claimants, it has coordinated and attended case management meetings, and it has argued a preliminary arm of Kingsway's jurisdictional application.

69 I have taken Kingsway's choices regarding process into consideration in determining whether it is appropriate to grant the Trustee a retrospective charge on the contested assets for its fees and disbursements. Kingsway has chosen to make a preliminary application to move the Appeal to British Columbia. It wants to continue the BC Action. While it is entitled to bring these applications, it cannot ignore the logical consequences of doing so. These applications, and others which it has brought in parallel proceedings relating to the proposals made by various officers and directors of the Bankrupts, have and will continue to delay the ultimate decision about the validity of Kingsway's trust claim. Kingsway wants to take advantage of the bankruptcy proceedings to have this Court determine the validity of the claims of the Builder Claimants and whether the letters of credit are impressed by a trust, but to force builders with trust claims against which it alleges a right of setoff to "duke it out" in the ordinary courts. Finally, I observe that Kingsway did not seek an expedited hearing for this or its other applications.

70 Kingsway's application to stop the Trustee from using assets under its administration to pay its fees and expenses is denied and the Trustee is granted a retrospective charge over the assets under its administration for all of its reasonable fees and disbursements, including legal expenses, concerning the gathering in and preserving of assets in the estate and the general administration of the Bankruptcies, such as investigating Kingsway's trust claim. The charge is granted no matter what the outcome is of the Appeal.

71 If an appeal court decides that the retrospective charge should be restricted to fees and expenses relating to work undertaken before the Trustee had notice of Kingsway's claim, as in *Grant*, I offer my finding that reasonable notice did not occur until November 25, 2005. The reasons for my finding in this regard are:

1. The Trustee's work in its capacity as IR was at the Court's behest. Like the insolvency professional in *Ontario (Registrar of Mortgage Brokers) v. Matrix Financial Corp.*,[37] it is entitled to payment from trust assets for all work done prior to the Bankruptcies.

2. The Trustee, as IR, indicated in its reports to the Court between December 2004 and May 2005 that:

(i) the BC Action existed;

(ii) it had a concern about Kingsway's calculation of premiums owing;

(iii) it was premature to opine on the merits of the BC Action, but once that could be done, a decision would be taken to settle, vigorously defend or purse damages by counter-claim.

3. The allegation of breach of trust in the BC Action is just one of many claims in a broadly cast pleading. The filing of pleadings in a civil action does not mean that the plaintiff will pursue its claim in a bankruptcy.

4. It was not until October 4, 2005 that Kingsway's counsel particularized its trust claim and formally put the Trustee on notice of the position which it now asserts.

5. Kingsway's Notice of Motion was filed November 25, 2005. That is the date on which the clock should run.

2. Prospective Charge

72 *Gill* is the only reported bankruptcy case that specifically addresses prospective charges over trust assets. As might be expected, the decision there turned on the unique facts of the case. There were allegations that the bankrupt had been involved in a scheme to hide his interest in certain properties by having them registered in the names of others. The trustee filed 350 caveats to preserve the interests of creditors and potential proprietary claimants. Information about the extent of the trust property and the claimants was uncertain at the date of the application. The trustee sought a retrospective and prospective charge over the yet unascertained trust assets.

73 Mr. Justice Sigurdson found that the application for a prospective charge was premature, but granted leave to the trustee to reapply on evidence of creditor prejudice. He noted that the trustee's request would ripen when valid trust claims were established and sale proceeds were ready for distribution. He was concerned that affected parties should have notice of the application, an impossibility at the time of the application given that the trustee did not know who they were.

74 The facts in *Gill* are distinguishable from those in the present case. Unlike the situation in *Gill*, the Trustee's application here is not wholly premature. It is clear that Kingsway and the Builder Claimants advance trust claims. The value of Kingsway's claim is established. Values of the assets under administration are known, subject to some further collection efforts and potential litigation recoveries from actions against Kingsway. The trust claims have not been substantiated at present. That alone is not sufficient reason to defer the Trustee's application.

75 *Eron Mortgage Corp.* was followed in *Gill* and therefore merits brief discussion, although the facts in that case also are distinguishable. *Eron Mortgage Corp.* involved the judicial trusteeship of an insolvent company. A court sanctioned lenders' committee sought a charge over (what appear to be undisputed) trust assets to secure past and future payment of expenses and remuneration. Mr. Justice Tysoe concluded that he could exercise inherent jurisdiction to order the charge, but declined to do so, although he gave leave to the committee to reapply. His rationale for declining the charge was that the evidence was unclear about certain committee functions. He considered that it was premature to say what future efforts, if any, would benefit the trust assets.

76 In my view, it is clear in the present case that resolution of Kingsway's claim will benefit the trust claimant if it succeeds. Similarly, the creditors are entitled to have Kingsway's claim tested, presuming the Inspectors agree to the Trustee's involvement in the Appeal.

77 The Trustee's request, however, is not just for a charge over potential trust assets in relation to the Appeal, but for a charge in relation to furthering the general administration of the Bankruptcies, including the Appeal. I understand that the Trustee intends to seek a charge over the assets at issue in the Builder Claimants' matter. However, even excluding that work, the proposed charge encompasses more than the case law presently authorizes for sorting out claims and preserving trust assets. It is a request for a general "super priority" funding order like that available to *BIA* interim receivers under s. 47.2, to judicial receivers, and to debtors in *Companies' Creditors Arrangement Act*[38] proceedings for financing a restructuring (DIP or priming liens).

78 Except in the context of commercial restructuring cases under the *BIA*,[39] caution must be exercised when considering developments concerning inherent jurisdiction emanating from the *CCAA*. The *BIA* and *CCAA* are very different in degree of specificity and the policy considerations involved. For example, courts in *CCAA* proceedings routinely rationalize financing for commercial restructuring that compromises creditors' traditional interests in the name of the greater good. There is an overarching policy concern favouring the possibility of a going concern solution and the potential of a long-term upside value for a broad constituency of stakeholders.[40] Arguably, in some cases, super-priority financing and priming charges must be available if restructuring is to be a possibility.

79 Here, the policy consideration is not to facilitate a potential business survival, but rather to maintain the integrity of the bankruptcy system and to be fair, while recognizing established trusts law.

80 According to the court in *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.*,[41] "super priority" funding for judicial receivers ordinarily is limited to circumstances where either:

1. The receiver's appointment is at the request of or with the consent or approval of the holders of security.

2. The receiver's appointment is to preserve and realize assets for the benefit of all interested parties, including secured creditors.

3. The receiver has expended money for the necessary preservation or improvement of the property.

81 In my view, a prospective charge can be fashioned which will respect these limitations. Since the assets under administration are bank accounts and chose in action, the Trustee's work for general estate administration can be restricted to matters of some urgency. If the Appeal is dealt with in a timely fashion, significant hardship to the creditors can be avoided and Kingsway can be offered some assurance deductions from the assets over which it is claiming a trust will be minimized. I appreciate, however, that some litigation may be time sensitive. Therefore, the Trustee is granted leave to revisit this restriction on evidence of prejudice to the creditors by delaying litigation.

82 A prospective charge will be granted on the Trustee filing a report with the Court confirming that the Inspectors in these Bankruptcies have approved the actions which the Trustee proposes to take, including its involvement in the Appeal and all of the preliminary applications filed by Kingsway that may be heard prior to the Appeal. On the filing of that report, the prospective charge will cover the preliminary applications, the Appeal *per se*, and all steps to readying the Appeal for hearing, whether it is a "paper Appeal" or a directed trial of an issue. Conservative measures for asset maintenance and preservation also are covered by this prospective charge. However, the Trustee may not pursue new asset realization without leave of the Court or Kingsway's consent.

83 The Appeal will proceed on an expedited basis after the hearing of Kingsway's preliminary jurisdictional applications. Any application to have the Appeal dealt with by way of a trial of an issue is to be filed within 14 days of these Reasons and

made returnable on May 12, 2006. If there is no such application, a case management meeting will be held May 12, 2006 for the purpose of setting deadlines for the exchange of affidavits, cross-examinations on affidavit and the filing of written submissions.

84 If, as a result of the Appeal, Kingsway establishes a recoverable trust of the magnitude claimed, it will have suffered a loss by virtue of the charge. Nevertheless, that loss will have been incurred, broadly speaking, to benefit the trust in realizing assets and to determine entitlements. If it is held that all of the assets under administration are not impressed with the trust claimed by Kingsway, a hearing is to be held in order to determine out of which funds (i.e. any trust monies owing to Kingsway, any trust monies owing to the Builder Claimants or other parties with a proven trust claim, and the monies to be distributed to creditors), and in what proportion the Trustees' fees and expenses (once approved) are to be taken.

3. Builder Claimants

85 The retrospective and prospective charges which I have granted have the potential to affect the Builder Claimants if they are successful at the end of the day in establishing entitlement to some of the assets under administration. There is no evidence that the Builder Claimants have been given notice of this application. Accordingly, I direct that the Trustee serve the Builder Claimants with notice of my decision. The charges which I am granting will not take effect on any monies claimed by the Builder Claimants until 14 days after the Trustee has filed proof with the Court of service of these Reasons on all of the Builder Claimants. Prior to that time, the Builder Claimants may challenge the charges which I am granting the Trustee over that portion of the assets to which they claim an interest.

4. Costs

86 Costs of this application will be determined following the Appeal. If the Appeal does not proceed for some reason, the parties may return on notice to settle the issue of costs.

Application dismissed.

Footnotes

* Affirmed *Residential Warranty Co. of Canada Inc., Re* (2006), 2006 ABCA 293, 2006 CarswellAlta 1354 (Alta. C.A.).

1 R.S.C. 1985, c. B-3, as amended and renamed by S.C. 1992, c. 27

2 s. 183(1)

3 *Tlustie, Re* (1923), 3 C.B.R. 654, 23 O.W.N. 622 (Ont. S.C.); *Cheerio Toys & Games Ltd., Re*, [1971] 3 O.R. 721, 15 C.B.R. (N.S.) 77 (Ont. S.C.); varied [1972] 2 O.R. 845 (Ont. C.A.)

4 *A. Marquette & fils Inc. v. Mercure* (1975), [1977] 1 S.C.R. 547 (S.C.C.), at 556

5 (1994), 114 D.L.R. (4th) 176, 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List]), at 185 D.L.R.

6 Rules 34-53

7 *Rassell, Re* (1999), 177 D.L.R. (4th) 396, 237 A.R. 136, 12 C.B.R. (4th) 316 (Alta. C.A.); *Nagy, Re*, [1997] 10 W.W.R. 348, 199 A.R. 146, 45 C.B.R. (3d) 160 (Alta. Q.B.); reversed on other grounds [1999] 11 W.W.R. 48, 232 A.R. 399, 13 C.B.R. (4th) 1 (Alta. C.A.); *Engels v. Richard Killen & Associates Ltd.* (2002), 60 O.R. (3d) 572, 35 C.B.R. (4th) 77 (Ont. S.C.J.) at para. 150.

8 *Beetown Honey Products Inc., Re* (2003), 67 O.R. (3d) 511, 46 C.B.R. (4th) 195 (Ont. S.C.J.); affirmed (2004), 3 C.B.R. (5th) 204 (Ont. C.A.)

9 s. 67(1)(a)

10 *Ramgotra (Trustee of) v. North American Life Assurance Co.*, [1996] 1 S.C.R. 325, 37 C.B.R. (3d) 141 (S.C.C.) at para. 61

11 s. 81(3); *Kenny, Re* (1997), 149 D.L.R. (4th) 508, 37 C.B.R. (4th) 291, 1997 CarswellOnt 6031, 34 O.T.C. 321 (Ont. Gen. Div. [Commercial List])

12 *Gill, Re* (2002), 37 C.B.R. (4th) 257, 2002 BCSC 1401 (B.C. S.C.), at para. 23; *Grant v. Ste. Marie* (2005), 39 Alta. L.R. (4th) 71, 8 C.B.R. (5th) 81, 2005 ABQB 35 (Alta. Q.B.) at paras. 30 and 31; *Westar Mining Ltd., Re* (1999), 13 C.B.R. (4th) 289, 1999 CarswellBC 2149 (B.C. S.C.); *P.A.T., Local 1590 v. Broome* (1986), 61 C.B.R. (N.S.) 233 (Ont. S.C.); *C.J. Wilkinson Ford Mercury Sales Ltd., Re* (1986), 60 C.B.R. (N.S.) 289 (Ont. S.C.); *Shirt-Man Inc., Re* (1987), 65 C.B.R. (N.S.) 309, 19 C.C.E.L. 148 (Ont. S.C.); *Genometrics Corp., Re*, 2005 CarswellSask 790, 2005 SKQB 488 (Sask. Q.B.); *McLeod, Re*, 1949 CarswellOnt 88, 29 C.B.R. 163 (Ont. S.C.)

13 (1998), 53 B.C.L.R. (3d) 24, 2 C.B.R. (4th) 184 (B.C. S.C.)

14 *Eron Mortgage Corp., Re*, footnote 14; *Harris v. Conway* (1987), [1989] 1 Ch. D. 32, [1989] B.C.L.C. 28, [1988] 3 All E.R. 71 (Eng. Ch. Div.); *Ontario (Securities Commission) v. Consortium Construction Inc.* (1992), 9 O.R. (3d) 385, 14 C.B.R. (3d) 6 (Ont. C.A.); *Ontario (Registrar of Mortgage Brokers) v. Matrix Financial Corp.* (1993), 106 D.L.R. (4th) 132 (Ont. C.A.)

15 *Ridout Real Estate Ltd., Re* (1957), 36 C.B.R. 111 (Ont. S.C.); *NRS Rosewood Real Estate Ltd., Re* (1992), 9 C.B.R. (3d) 163 (Ont. Bktcy.); *Nakashidze, Re*, [1948] O.R. 254, 29 C.B.R. 35 (Ont. H.C.); *Walter Davidson Ltd., Re* (1957), 10 D.L.R. (2d) 77, 36 C.B.R. 65 (Ont. S.C.)

16 R.S.A. 2000, c. T-8, s. 44. The Act expressly permits charging of trust assets for the fees of judicial trustees, but otherwise is silent.

17 *Trustee Act*, footnote 16, s. 1(b)

18 *BIA*, footnote 1, s. 72(1); see also the discussion concerning operational conflict in *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161 (S.C.C.), at 190: "[T]here is no true repugnancy in the case of merely duplicative provisions since it does not matter which statute is applied; the legislative purpose of Parliament will be fulfilled regardless of which statute is invoked by a remedy-seeker; application of the provincial law does not displace the legislative purpose of Parliament." In my view, the overarching principle to be derived from *Multiple Access Ltd.* and later cases is that a provincial enactment must not frustrate the purpose of a federal enactment, whether by making it impossible to comply with the latter or by some other means. Impossibility of dual compliance is sufficient but not the only test for inconsistency.

19 (1979), 95 D.L.R. (3d) 458, 13 A.R. 420 (Alta. C.A.)

20 *Sproule v. Montreal Trust Co.*, footnote 20, para. 11

21 *P.A.T., Local 1590 v. Broome*, footnote 12, pp. 236 tp 237

22 (1988), 63 O.R. (2d) 635, 67 C.B.R. (N.S.) 98 (Ont. Bktcy.)

23 footnote 12

24 footnote 12

25 D.M. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors" (1989), 68 Can. Bar Rev. 315 at 321

26 footnote 12 at para. 31

27 footnote 12

28 footnote 15

29 footnote 15

30 footnote 15

31 footnote 12

32 footnote 15

33 [1994] O.J. No. 1917 (Ont. Gen. Div. [Commercial List])

34 1994 CarswellOnt 3853 (Ont. Gen. Div. [Commercial List]) at paras. 8 and 9

35 footnote 34 at para. 8

36 footnote 14

37 footnote 14

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

39 *Fiber Connections Inc. v. SVCM Capital Ltd.* (2005), 10 C.B.R. (5th) 192, 5 B.L.R. (4th) 271, 2005 CarswellOnt 1963 (Ont. S.C.J.), leave to appeal to Ont. C.A. granted (2005), 10 C.B.R. (5th) 201 (Ont. C.A. [In Chambers]).

40 *Royal Oak Mines Inc., Re* (1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]); David B. Light, "Involuntary Subordination of Security Interests to Charges for DIP Financing under the *Companies' Creditors Arrangement Act*," (2005) 30 C.B.R. (4th) 245.

41 (1975), 21 C.B.R. (N.S.) 201 (Ont. C.A.), at 205-206

End of Document

Tab 12

2009 BCSC 1552
British Columbia Supreme Court

Pope & Talbot Ltd., Re

2009 CarswellBC 3060, 2009 BCSC 1552, [2010] 6 W.W.R. 449, [2010] I.L.R. I-4922, [2010] B.C.W.L.D. 1, [2010] B.C.W.L.D. 34, [2010] B.C.W.L.D. 36, 182 A.C.W.S. (3d) 589, 2 B.C.L.R. (5th) 132, 61 C.B.R. (5th) 16, 66 B.L.R. (4th) 58

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

AND IN THE MATTER OF THE RECEIVERSHIP OF POPE & TALBOT LTD. and others

Paul Walker J.

Heard: October 14-15, 2009
Judgment: November 12, 2009
Docket: Vancouver S077839

Counsel: K.D. Kraft, H.D. Edinger for Federal Insurance Company
G.M. Nijman for National Union Fire Insurance Company of Pittsburgh, PA
D. Harris, Q.C., J.D. Hughes for XL Specialty Insurance Company
D.B. Kirkham, Q.C. for former Directors & Officers of Pope & Talbot
R.J.H. Berrow, K. Jackson for PricewaterhouseCoopers Inc.
P. Rubin for Ableco Finance LLC

Subject: Insolvency; International; Contracts; Civil Practice and Procedure; Corporate and Commercial; Public

Related Abridgment Classifications

Alternative dispute resolution
III Relation of arbitration to court proceedings
III.3 Stay of court proceedings
III.3.b Discretion of court to grant stay
Conflict of laws
VI Contracts
VI.1 Choice of law
VI.1.a Where contract specifying law
VI.1.a.ii Miscellaneous
Conflict of laws
VII Bankruptcy
VII.4 Miscellaneous

Headnote

Conflict of laws --- Bankruptcy — General principles

Pulp and paper business in British Columbia entered protection under Companies' Creditors Arrangement Act — Charge existed for amounts for wage claims against directors, and directors also had insurance from insurers NUFI Co., FI Co. and XLSI Co. — Insurers sought order that law of policies was state of Oregon in United States of America, and NUFI Co. sought stay of proceedings pending resolution of issue regarding arbitration clause — Law of policies was BC, no stay of proceedings issued — Parties anticipated depecage — Parties had chance to select one law and did not — Parties intended proper law to be determined by substance of claim made — BC had closest and most substantial connection with policies — Policies not made in Oregon, despite fact that broker was located there and FI Co. had office in Oregon — Section 5 of Insurance Act, which created presumption that location of contract was BC, was not rebutted — Forms of policy did not derive from any particular jurisdiction, and factor was neutral — Location of parties favoured BC — Insurer's head offices were in America although no insurer except FI Co. had office in BC — Business was incorporated in Delaware, where bankruptcy proceedings were initiated, and employees and operations located there — Subject matter was worldwide liability insurance, and favoured BC when nature of operations considered — Most claims would be expected to arise in Canada — Policies were not ambiguous regarding proper law.

Conflict of laws --- Contracts — Choice of law — Where contract specifying law

Pulp and paper business in British Columbia entered protection under Companies' Creditors Arrangement Act — Charge existed for amounts for wage claims against directors, and directors also had insurance from insurers NUFI Co., FI Co. and XLSI Co. — Insurers sought order that law of policies was state of Oregon in United States of America, and NUFI Co. sought stay of proceedings pending resolution of issue regarding arbitration clause — Law of policies was BC, no stay of proceedings issued — Parties anticipated depecage — Parties had chance to select one law and did not — Parties intended proper law to be determined by substance of claim made — FI Co. policy specified law of certain area as applicable in certain situations, yet choice of law overall not included in contracts — NUFI policy's only reference to law governing policy was in portion of agreement dealing with arbitration — XLSI Co. policy made specific reference to different governing law in different situations.

Alternative dispute resolution --- Relation of arbitration to court proceedings — Stay of court proceedings — Discretion of court to grant stay

Pulp and paper business in British Columbia entered protection under Companies' Creditors Arrangement Act — Charge existed for amounts for wage claims against directors, and directors also had insurance from insurers NUFI Co., FI Co. and XLSI Co. — Insurers sought order that law of policies was state of Oregon in United States of America, and NUFI Co. sought stay of proceedings pending resolution of issue regarding arbitration clause — Law of policies was BC, no stay of proceedings issued — Arbitration clause in NUFI's policy was stayed to permit orderly resolution of insolvency — Court entitled to use discretion to ignore arbitration provision — NUFI Co. had not confirmed or denied coverage despite demanding mediation — NUFI Co. attempted to wait on value of claim before taking position on coverage.

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s. 119 — considered

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s. 5 — considered

Insurance Act, R.S.O. 1990, c. I.8

s. 123 — considered

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11

Generally — referred to

HEARING regarding proper jurisdiction for dispute regarding insurance liability for wage claims against directors of corporation under protection of *Companies' Creditors Arrangement Act.*

***Paul Walker J.*:**

Introduction

1 Three insurers who issued Directors and Officers liability ("D&O") policies in favour of directors and officers of Pope and Talbot Inc. ("P&T Inc.") and its subsidiaries, including Pope and Talbot Ltd. ("P&T Ltd."), seek a declaration that the proper law of those policies is the law of the State of Oregon.

2 In addition, one insurer, National Union Fire Insurance Co. of Pittsburgh, Pennsylvania, maintains that a mediation and arbitration ("ADR") clause contained in its policy, which is an excess policy, is a condition precedent to any determination of coverage by this Court. As a result, it seeks a stay of proceedings of the upcoming hearing regarding the insurers' purported coverage obligations, insofar as its coverage obligations are concerned.

3 The present application follows my decision concerning territorial competence and *forum conveniens* issued on July 27, 2009 and reported as *Pope & Talbot Ltd., Re*, 2009 BCSC 1014, 76 C.C.L.I. (4th) 212 (B.C. S.C.). The history of the insolvency proceedings, brought initially in Canada pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), is also set out in those reasons for judgment.

4 P&T Ltd. is currently in receivership. PricewaterhouseCoopers Inc. ("PWC") is the receiver. Proceedings under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") are stayed. Previously, P&T Ltd. applied for and received protection from its creditors pursuant to the *CCAA*. The Directors Charge established by the Order of Chief Justice Brenner on November 21, 2007 (during the *CCAA* proceedings), to respond to certain types of claims that may be brought against the directors and officers of, *inter alia*, P&T Ltd. and its parent company, P&T Inc., remains to be drawn upon. Insolvency proceedings brought in Delaware on behalf of P&T Inc. have been deferred to the current Canadian insolvency proceedings by the US Bankruptcy Court for the District of Delaware. That insolvency is akin to Canadian *CCAA* proceedings as opposed to proceedings under the *BIA*.

5 The Directors Charge may only be drawn upon "to the extent that they [directors and officers] do not have coverage under any directors' and officers' insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified" by, *inter alia*, P&T Inc. and P&T Ltd.

6 PWC has asked for a determination of whether any of the policies cover certain wage claims made by former employees of P&T Ltd. pursuant to s. 119 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("*CBCA*"). That determination will be made at a subsequent hearing. The submissions made on behalf of P&T Inc. and P&T Ltd. on this application were made by PWC.

7 The insurers assert that the proper law of the policies is the law of Oregon. The insureds, which in this case are P&T Inc., P&T Ltd., and the directors and officers of those companies, argue that the proper law of the policies is the law of British Columbia. They say that this a case where the language of the policies calls for the application of *dépeçage* (a principle which recognizes more than one proper law of a contract), or alternatively, if there is only one proper law of these policies, it is the law of British Columbia.

Background Facts

8 The insurers are Federal Insurance Company, National Union, and XL Specialty Insurance Company. They carry on business in the United States. They are not registered in BC as they do not directly carry on business in this province or elsewhere in Canada.

9 Federal is incorporated in the State of Indiana, and has its head office in New Jersey. National Union is incorporated in the State of Pennsylvania; its principal place of business, as well as its head office for underwriting purposes, is located in New York City. XL is incorporated in the State of Connecticut; its head office is located in Stamford.

10 The decision to underwrite the Federal policy was made by its underwriters who were, at the time, located in Portland and Los Angeles. As well, persons in Federal's legal department (located in New Jersey) were consulted. Confirmation of coverage was sent by Federal out of its Portland office. Although the evidence does not disclose where its policy was actually issued, the Declarations page states the following address in its header:

> Chubb Group of Insurance Companies
>
> 15 Mountain View Road

Warren, New Jersey 07059

11 The National Union policy was underwritten in New York City and its policy was issued out of that office. XL's underwriting was done at its head office in Stamford; its policy was issued from there as well.

12 Federal's D&O policy is primary. National Union's policy is follow form and sits as the first excess layer in a multi-layered tower. XL issued a form of drop down policy known as a "Cornerstone Policy", which drops down to respond if other underlying insurance does not cover or pay. Even where it does not drop down, that policy also acts as an excess policy.

13 In addition, XL issued a follow form excess policy that sits in the coverage tower two levels above National Union's. That policy was not put in issue on this application.

14 The premiums charged for each policy were in US dollars. The policies do not contain a choice of forum clause or a clause stipulating the proper law of the contract. They are all claims made policies, which means that coverage is provided for claims made during the policy term for a "wrongful act" (a defined term in each policy). This is in contrast to a comprehensive general liability policy, which usually provides coverage for fortuitous events that occur during the policy period as opposed to when the claim is made.

15 The three policies were issued to be in force for one year, effective July 30, 2007. *CCAA* proceedings were first brought almost three months later, on October 29, 2007.

16 Federal had provided coverage to P&T Inc. and its global operations (collectively, "Pope & Talbot Group") for some 22 years. Although its policy was issued as a renewal, it was not a simple renewal as it resulted from considerable negotiations. In fact, Federal (on the letterhead of its parent company Chubb Insurance) sent a notice of non-renewal to P&T Inc.'s risk manager on April 24, 2007. Ultimately, following negotiations, which included policy terms and endorsements, Federal went on risk again for a further one year period, although policy limits were reduced in half (to $5 million) and the premium charged doubled (from $17,500 to $35,000 per million).

17 P&T Inc. is a North American forest products company that sells wood products and pulp. It was founded in 1849. It was incorporated in the State of Delaware, and has its corporate headquarters in Portland, Oregon. It also has an office in Delaware.

18 The majority of head office functions for both its wood products and pulp operations take place in Portland, Oregon. P&T Inc. is a public company that was, until July 2007, traded on the New York Stock Exchange.

19 At the time the policies were made (which in this case means when they were issued), the bulk of P&T Inc.'s operations were located in BC, and were owned and operated by its subsidiary P&T Ltd. P&T Ltd. is a federally incorporated Canadian company. It maintains its registered and records office in Toronto, Ontario. Although P&T Inc. owned other subsidiaries, P&T Ltd. was the primary operating company for P&T Inc. at that time.

20 The revenue stream for the Pope & Talbot Group was derived mainly from its pulp and wood products operations in BC. P&T Ltd. owned seven mills in BC and the US, for both its wood products and pulp operations. In respect of its pulp operations, P&T Ltd. operated three mills: two in BC (in Mackenzie and near Nanaimo) and one in Oregon (in Halsey). In respect of its wood products operations, it operated four mills: three in BC (in Fort St. James, Castlegar, and Grand Forks) and one in South Dakota (in Spearfish). The bulk of the employees (the broker identified a total of 2,373 prior to the policies being issued) working for the Pope & Talbot Group did so for P&T Ltd. Federal's underwriters had this information available to them prior to issuing its policy in July 2007.

21 In addition, and as a result of meetings and communications with representatives of P&T Inc. (that included the broker), underwriters were aware, at the time the insurers went on risk on July 30, 2007, of P&T Inc.'s Canadian subsidiary, P&T Ltd., including its various operations. The evidence shows that of the insurers, at least Federal's underwriters were also aware of:

(a) the revenue and income of the Pope & Talbot Group, including the Canadian operations; and

(b) the deteriorating financial condition suffered by the Pope & Talbot Group, particularly the revenue stream and indebtedness of the various Canadian operations, including:

(i) rapidly diminishing liquidity;

(ii) significant outstanding bond debt;

(iii) plunging stock price when it was announced that covenants relating to long term debt had been breached;

(iv) efforts made to sell assets to satisfy debt;

(v) the significant detrimental effect caused by a then strong Canadian dollar;

(vi) increasing inventory levels over the previous four years;

(vii) the costs of goods were $1.13 for every $1 collected;

(viii) gross and operating margins were at a five year low;

(ix) the interest coverage ratio was negative for the first time since 2003;

(x) debt/equity ratios were at a four year high; and

(xi) bankruptcy had been considered (although it was reported to be "the last option").

22 As part of the application for coverage submitted by the broker (on behalf of the insureds) along with a formal request to renew the Federal policy, Federal's underwriters were also advised of the nature of the business of the Pope & Talbot Group at that time:

Business Summary: Based in Portland, Or, Pope & Talbot is focused in two lines of business, market pulp and softwood lumber, and has industry leading earning leverage to price changes in both commodities. Pope & Talbot, Inc. operates in North America. The Pulp segment manufactures and sells northern bleached softwood kraft chip and sawdust pulp used in various end products, including newsprint, tissue, and coated and uncoated paper, as well as in specialty products, such as fiber cement siding for residential applications and non-woven fabric for surgical gowns. The Wood Products segment manufactures and sells specialty lumber for residential and light construction, and residential repair and remodeling; and produces machine stress rated, long-length, wide-width or premium pine appearance grade lumber. This segment also sells residual wood chips and other by-products from its lumber mill operations. The company sells its products to wholesalers, distributors, remanufacturers, and builders in the United States, Canada, Italy, northern Europe, China, and Japan.

23 Federal asked some very pointed questions before deciding to go on risk again. The evidence discloses that in respect of one "D&O Underwriting Meeting" that was scheduled to take place on June 20, 2007 and postponed to July 3, 2007, Federal asked the following questions:

Please provide a business and financial overview for the pulp and wood products segment. What is the outlook for each business?

Please provide an overview of your discussions with your lenders. What changes, if any, will be made to the credit agreement? Have you talked to any outside lenders about the potential of opening a new credit facility?

Please give an overview of any discussion with the rating agencies.

Do you expect any changes to your weighted average cost of capital?

Has the board had any discussions about asset sales/ voluntarily going into bankruptcy?

> What factors will keep the company from going into bankruptcy over the next 12 months. What does the company view as its risk of default over the same time period?
>
> Have you entertained any offers to be purchased?
>
> Please discuss the effects of the Canadian dollar on your business.
>
> . . . . .
>
> Please discuss the senior management and board changes that have occurred over the past 18 months. Are there any more expected changes in the next 12 months? What adjustments has the company gone through as a result of the management changes?

24 Federal's underwriting analysis, prepared as part of its underwriters' analysis when considering whether to renew the policy (and if so, on what terms and price), reveals that Federal well anticipated the possibility of insolvency for the Pope & Talbot Group:

> Pope and Talbot is a troubled company that is going through a very difficult time. There is significant concern that the company may go backrupt [sic] in the next year. The company is seeking alternatives including the sale of a division and the taking on of a private equity interest. I view the private equity buy as the most likely (only because I think that is what management really wants) and the sale of the division as the second most likely outcome (because they have an offer on the table). Bankruptcy will only happen if/when the company makes a mistake and does not enter into one of the two above transactions quickly enough. Regardless, I feel that our risk has increased dramatically as a result of that we must reduce our capacity from 10 M to 5 M and incrase [sic] the rate from $17,500 per million to $35,000 per million.

25 As well, and prior to binding the risk, one of Federal's underwriters advised the broker that it was aware of the prospect of Canadian environmental claims and bankruptcy in the United States. With that knowledge, Federal was prepared to provide coverage to the directors and officers of the Pope & Talbot Group on a worldwide basis that included defence costs cover for Canadian claims and derivative securities coverage that was described by Federal's underwriter as "including the US". Materials presented on behalf of P&T Inc. to Federal's underwriters on July 3, 2007, disclose that there were seven directors of P&T Inc. Evidence tendered by Federal and National Union show that two of them lived in BC. There were six directors of P&T Ltd., four of whom lived in BC.

26 Following negotiations, Federal submitted an insurance proposal to P&T Inc. and the broker for the policy renewal. The premium to be charged by Federal was $150,000.

27 Coverage was ultimately provided on a worldwide basis to the directors and officers of the Pope & Talbot Group as well as to those companies in circumstances where they are required to indemnify the directors and officers.

28 The evidence does not make clear the extent to which National Union and XL were aware of all of the information that Federal possessed concerning the risk. Those insurers did not argue that there was a disparity in knowledge or that the issue even mattered to them.

Determining the Proper Law of a Contract

29 The starting point is to determine the intentions of the parties by examining the contract as a whole: *Consolidated-Bathurst Export Ltd. c. Mutual Boiler & Machinery Insurance Co.* (1979), [1980] 1 S.C.R. 888, 112 D.L.R. (3d) 49 (S.C.C.); and *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2009 BCCA 129, 90 B.C.L.R. (4th) 297 (B.C. C.A.).

30 In *Progressive Homes*, at para. 45, the Court of Appeal adopted the approach to interpretation of insurance policies (which are, of course, contracts) described by Professor Denis Boivin in his text, *Insurance Law* (Toronto: Irwin Law, 2004), at p. 191:

> The main rules of interpretation were established by the Supreme Court of Canada in *Consolidated Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.* First, the words used in the contract must be given their ordinary meaning, with the exception of expressions that have acquired a technical meaning within the industry. ... Second, the contract must be interpreted contextually, having regard to all sections of the agreement. Third, the objective of interpreting the contract is to give effect to the parties' true intentions. Hence, courts should avoid using a literal approach when the result would frustrate the reasonable expectations of either the insurer or the insured. Finally, any ambiguity must be resolved against the interests of the party that wrote the agreement - *contra proferentem.* In other words, ambiguities must be resolved in favour of the insured.

31 Resort to the doctrine of "reasonable expectations" is made when there is an ambiguity in an insurance policy: *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551 (S.C.C.) at para. 71; *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.*, [1993] 1 S.C.R. 252, 99 D.L.R. (4th) 741 (S.C.C.); and *Progressive Homes*, at paras. 44 to 51. Where there is no ambiguity, courts should give effect to the clear language in the contract when reading it as a whole. In *Scalera*, Mr. Justice Iacobucci wrote, at para. 71:

> Where a contract is unambiguous, a court should give effect to the clear language, reading the contract as a whole [citations omitted]. Where there is ambiguity, this Court has noted "the desirability...of giving effect to the reasonable expectations of the parties" [citations omitted].

32 One way of considering the reasonable expectations of the parties is to take "industry practise" into account: *Progressive Homes*, at para. 51. No such evidence was adduced in this case.

33 The proper law of the contract is determined by the expressed intention of the parties. When no express choice is made, courts determine whether the proper law of a contract can be inferred from the circumstances, or failing this, determine the system of law which has the closest and most substantial connection with the subject matter: *Herman v. Alberta (Public Trustee)*, 2002 ABQB 255, 2 Alta. L.R. (4th) 132 (Alta. Q.B.), at para. 6; *Cansulex Ltd. v. Reed Stenhouse Ltd.* (1986), 70 B.C.L.R. 273, 18 C.C.L.I. 24 (B.C. S.C.); and J.-G. Castel, *Canadian Conflict of Laws*, 4th ed. (Toronto: Butterworths, 1997) at p. 593.

34 The proper law of a contract is "the law that the parties intended to apply": *Vita Food Products Inc. v. Unus Shipping Co.*, [1939] 1 All E.R. 513, [1939] A.C. 277 (Nova Scotia P.C.). According to Lord Wright, at p. 521, that intention "is objectively ascertained".

35 The proper law of a contract is determined as at the time the contract is made. Circumstances not existing at the time the contract is formed are not relevant to determining proper law: *Armar Shipping Co. v. Caisse Algerienne d'Assurance et de Reassurance (The Armar)* (1980), [1981] 1 All E.R. 498, [1981] 1 W.L.R. 207 (Eng. C.A.); *Amin Rasheed Shipping Corp. v. Kuwait Insurance Co.*, [1983] 2 All E.R. 884, [1984] A.C. 50 (U.K. H.L.); and *Herman v. Alberta (Public Trustee)*.

36 As Lord Diplock explained in *Amin Rasheed*, at p. 891, contracts do not exist in a "legal vacuum":

> My Lords, contracts are incapable of existing in a legal vacuum. They are mere pieces of paper devoid of all legal effect unless they were made by reference to some system of private law which defines the obligations assumed by the parties to the contract by their use of particular forms of words and prescribes the remedies enforceable in a court of justice for failure to perform any of those obligations; and this must be so however widespread geographically the use of a contract employing a particular form of words to express the obligations assumed by the parties may be.

37 Where the choice of law is expressly made in the contract, courts may not interfere, unless that choice is unlawful or contrary to public policy. In *Vita Food*, Lord Wright explained, at p. 521:

> That intention is objectively ascertained, and, if not expressed, will be presumed from the terms of the contract and the relevant surrounding circumstances ...but, where the English rule that intention is the test applies and where there is an express statement by the parties of their intention to select the law of the contract, it is difficult to see what qualifications

> are possible, provided the intention expressed is *bona fide* and legal, and provided there is no reason for avoiding the choice on the ground of public policy.

38 In *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R. 443, 62 D.L.R. (2d) 138 (S.C.C.), Ritchie J. stated, at p. 448:

> [T]he problem of determining the proper law of a contract is to be solved by considering the contract as a whole in light of all the circumstances which surround it and applying the law with which it appears to have the closest and most substantial connection.

39 Determining the circumstances which constitute the closest and most substantial connection is an inherently fact-specific exercise. Ritchie J. outlined a number of factors that may assist a court in making this determination, citing *Cheshire on Private International Law*, 7th ed., at p. 448:

> [T]he domicil and even the residence of the parties; the national character of a corporation and the place where its principal place of business is situated; the place where the contract is made and the place where it is to be performed; the style in which the contract is drafted, as, for instance, whether the language is appropriate to one system of law, but inappropriate to another; the fact that a certain stipulation is valid under one law but void under another; the economic connexion of the contract with some other transaction; the nature of the subject matter or its *situs*; the head office of an insurance company, whose activities range over many countries; and, in short, any other fact which serves to localize the contract.

40 In *Cansulex*, however, McEachern C.J.S.C. placed less emphasis on the location where the insurance contract was made in determining the applicable law. In that case, the insurance policy was made in the United States on an American policy form, yet BC law applied, due primarily to the fact that the shipping operation was based in Vancouver. McEachern C.J.S.C. noted, at p. 18, that while older case law placed much weight on where the contract was formed, "modern law seems to focus more on other matters... What seems to be most important is the subject of the contract" (at p. 289). He concluded at p. 290 that the factors to be considered in determining the closest and most substantial connection are, in ascending order of importance:

> (a) the policy is deemed to be made in BC as a result of s. 5 of the *Insurance Act*, R.S.B.C. 1996, c. 226;
>
> (b) Aetna underwrote the risk on an American form;
>
> (c) both parties operate worldwide from their respective countries;
>
> (d) the subject matter of the contract is liability insurance; and
>
> (e) claims might be expected to arise for which coverage might be furnished by the policy in Alberta, BC, or worldwide, but not in the United States.

In that case, only factor (b) favoured the application of US law; the other factors were either equal or favoured BC law, particularly (d) and (e). Thus, BC was found to have a much closer connection with the contract than the US (or Alberta, which also was argued).

41 Thus, the analysis prescribed in *Cansulex* is highly-fact specific and contextual. It will by necessity involve the weighing of unique factors in order to determine which system of law has the closest and most substantial connection to the contract in dispute.

42 Section 5 of the *Insurance Act* deems a contract to be made in this province, and says that it must be construed accordingly where it insures a person domiciled or resident in BC at the date of it, or has as its subject matter, property, or an interest in property located in BC.

43 Section 5 is not conclusive: *Cansulex*, at p. 288. It only provides that a policy insuring a person domiciled or resident in the province shall be deemed to be made in the province and shall be construed accordingly; that is to say, it shall be construed

in accordance with the proper law of the contract, which may be the law of another jurisdiction. The place where a contract is made is but one of the factors to be considered in determining the proper law of the contract.

44 Section 5 differs from its counterparts in some other provincial statutes. For example, in Ontario, s. 123 of its *Insurance Act*, R.S.O. 1990, c. I.8, makes application of Ontario law mandatory:

> Where the subject-matter of a contract of insurance is property in Ontario or an insurable interest of a person resident in Ontario, the contract of insurance, if signed, countersigned, issued or delivered in Ontario or committed to the post office or to any carrier, messenger or agent to be delivered or handed over to the insured or the insured's assign or agent in Ontario shall be deemed to evidence a contract made therein, and the contract shall be construed according to the law thereof, and all money payable under the contract shall be paid at the office of the chief officer or agent in Ontario of the insurer in lawful money of Canada.

According to Janet Walker, *Canadian Conflict of Laws*, 6th ed., looseleaf (Markham, Ont.: LexisNexis, 2005) at 31.8.b, unlike s. 5 of the BC *Insurance Act*, this section "indicate[s] that the law of [Ontario] is the proper law a contract of insurance made or deemed to be made in that province, and in such a case the parties are not free to oust the application of that law by an express choice of law clause".

45 Normally, the obligations of parties to a contract will be governed by the same proper law. There are circumstances, however, where the proper law of a contract may be different for different contractual matters or issues. According to J.-G. Castel, at 607:

> While most contractual issues are governed by the proper law, the parties can agree that different contractual issues may be governed by different laws. This is called *dépeçage*. There is no authority to prevent the court from deciding that the objectively ascertained proper law varies according to the contractual issues involved. However, the court will not do this readily or without good reason.
>
> Apart from express or implied agreement to the contrary, the obligations of both parties will be governed by the same proper law.

46 The insurers urge upon me the *obiter dicta* of Davies J. in *Lloyd's Underwriters v. Cominco Ltd.*, 2006 BCSC 1276, 60 B.C.L.R. (4th) 261 (B.C. S.C.), aff'd, 2007 BCCA 249, 67 B.C.L.R. (4th) 101 (B.C. C.A.), aff'd 2009 SCC 11, [2009] 1 S.C.R. 321 (S.C.C.), where he said, at para. 215, that the policy must expressly provide for application of more than one system of law:

> ... I agree with the submission of counsel for Lloyd's that it would not be efficient to have contracts of insurance that may have application in more than one jurisdiction interpreted in accordance with more than one system of law unless the particular policy under consideration expressly provides otherwise.

47 As I read these remarks, they come at the end of the decision and follow a detailed analysis of the issues before him, i.e., territorial competence and *forum conveniens.* It is noteworthy that the remarks of J.-G. Castel - that the agreement of the parties as to the proper law may also be implied - were not put before Davies J. nor were the decisions reached by other courts consistent with that approach.

48 In *Gerling Global General Insurance Co. v. Canadian Occidental Petroleum Ltd.*, 1998 ABQB 714, 64 Alta. L.R. (3d) 174 (Alta. Q.B.), the court looked at the policy "as a whole". Romaine J. concluded that the policy did not disclose an intention that more than one law govern:

> [68] ...Although there may be exceptional circumstances where it may be inferred that a contract is to be governed by the law of more than one jurisdiction, the courts in Canada are reluctant to split the proper law of a contract without good and compelling reason. Even in situations where the contract may be peformed in more than one place, the more usual determination is that the substance of the contract is to be determined by one law only, although the method and manner

> of performance may be regulated by the law of the place of performance (Montreal Trust Co. (supra), Kenton Natural Resources *Co. v. Burkinshaw* (1983), 47 A.R. 321 (Q.B.))...
>
> [69] The Policy does not disclose an intention that more than one law govern the substantive obligations under it, although it anticipates in some clauses the effect of local government action. Nor does it disclose an intention that more than one law govern by providing for payment of premiums in different currencies or in expressing deposit premiums in Canada or U.S. funds. On the contrary, the Policy provides that all deductibles and liability limits are expressed in Canadian funds, regardless of the location of the risk. The mere fact that the locations of the insured properties are in different countries is no indication of an intention to split the proper law of the Policy.

49 In *Commonwealth Insurance Co. v. Canadian Imperial Bank of Commerce* (2005), 21 C.C.L.I. (4th) 226, [2005] O.J. No. 1167 (Ont. S.C.J.), aff'd (2005), 142 A.C.W.S. (3d) 72, [2005] O.J. No. 3656 (Ont. C.A.), at para. 68, Wilton-Siegel J. looked for and did not find an "indication in the Policy of an intention to split the proper law of the Policy" (at para. 68), and then proceeded to adopt the approach taken in *Gerling Global.*

50 This same approach to determining if the parties intended more than one proper law, albeit in a banking as opposed to an insurance context, has been taken by the Queen's Bench Division (Commercial Court) in England. In *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust (No.2)*, [1989] 1 Lloyd's Rep. 608 (Eng. Q.B.), Hirst J. viewed the matter as a "question of mixed fact and law". At p. 619, he said:

> Since, however, this is a question of mixed fact and law, it is necessary for me to consider the proper law on the alternate hypothesis that there was one single contract. The legal position is well established that an English Court will not split the proper law of a contract readily and without good reason, but that it is open for the parties to agree that one aspect be governed by the law of one country and another aspect by the law of another country (Dicey and Morris Conflict of Laws 11th ed., p. 1163). This is based on a very well-known passage in the dissenting judgment of Lord MacDermott in *Kahler v. Midland Bank Ltd*., [1950] A.C. 24 at p. 42, as follows:
>
>> Though there is no authority binding your Lordships to the view that there can be but one proper law in respect of any given contract, it is doubtless true to say that the courts of this country will not split the contract in the sense readily and without good reason. In my opinion, however, there is a good ground for so doing in the somewhat unusual and, as I think compelling circumstances of the present case.

51 In that case, the court implied the intention to split proper law, and distinguished between the law to be applied to a London bank account from the law to be applied to a bank account in New York, in determining the parties' obligations. Hirst J. then determined the proper law, which was not expressly stated, based upon a "substantial connection" test by application of factors similar to some applied in *Cansulex*.

52 One English case has recognized that the proper law of a contract may be split even in the absence of express or implied intention, where a severable part has a closer connection with one jurisdiction than another. PWC cited the decision of the English Court of Queen's Bench in *Libyan Arab Foreign Bank v. Bankers Trust Co.* (1987), [1989] Q.B. 728 (Eng. Q.B.). There, Staughton J. recognized, at p. 747, that, "It is possible, although unusual, for a contract to have a split proper law...: see *Dicey & Morris The Conflict of Laws*, 11th ed. (1987), p. 1163 and *Chitty on Contracts*, 25th ed. (1983), para. 2081", and went on to accept a European Economic Union Convention on the Law Applicable to Contractual Obligations:

> Article 4 of the E.E.C. Convention of 19 June 1980 on the Law Applicable to Contractual Obligations (Official Journal 1980 No. L.266, p. 1) (as I write not yet in force) provides:
>
>> "1. To the extent that the law applicable to the contract has not been chosen in accordance with article 3, the contract shall be governed by the law of the country with which it is most closely connected. Nevertheless, a severable part of the contract which has a closer connection with another country may by way of exception be governed by the law of that other country."

> That such a solution is not necessarily unacceptable to businessmen is shown by one of the Australian printed forms of charterparty, which adopts it.
>
> Mr. Sumptom argues that difficulty and uncertainty would arise if one part of the contract was governed by English law and another by New York law. I do not see that this would be so, or that any difficulty which arose would be insuperable.

In essence, Staughton J. concluded that an English court may sever a portion of a contract and apply a different proper law to it than that which it found applies to the rest of the contract, on the basis that such portion has a "closer connection" to a different legal regime (as opposed to first trying to determine the contractual intent).

53 Determination of proper law in the case at bar, however, may be made on a construction of the terms of the policies. Policy language contained in the instant policies shows that the parties intended the application of *dépeçage*.

Analysis and Disposition - Proper Law

Dépeçage

54 This is not a case where previous insurance policies were simply renewed. The policies issued effective July 30, 2007 resulted from specific negotiations between the parties. The evidence also shows that in Federal's case, significant adjustment was made to the premium and policy limits in view of the poor financial circumstances of the Pope and Talbot Group. In this case, the proper law of the insurance contracts must be determined based on the intention of the parties at the time the subject policies were issued and not in relation to pre-existing policies. Even if I were inclined to consider prior policies in determining proper law, I am not able to do so as none of them are in evidence.

55 A careful review of each of the policies as a whole demonstrates that the parties allowed for the insurers' various coverage obligations to be determined by different legal regimes. The contractual language makes it clear that the principle of *dépeçage* applies to the proper law issue. Each of the three insurance policies expressly provides for the application of different legal regimes to different matters and issues. In fact, Federal and XL acknowledged as much at the conclusion of their oral submissions when they conceded that their policies split the proper law insofar as punitive and exemplary damages are concerned.

Federal's policy

56 Federal's policy contains two separate "coverage sections":

> (a) "Executive Protection Portfolio Executive Liability and Entity Securities Liability Coverage Section"; and
>
> (b) "Executive Protection Portfolio Outside Directorship Liability Coverage Section".

Specific endorsements were added to both sections; some were included in one coverage section but not in the other.

57 Federal's coverage is liability coverage in favour of the directors and officers of the Pope & Talbot Group on a worldwide basis for claims for "wrongful acts" (a defined term) made within the policy period.

58 Federal's policy contains choice of law language in a number of places.

59 The first place it is found is in the definition of "Loss". Federal's obligation to pay punitive and exemplary damages is drafted in such a way as to favour the insureds. Further, Federal did not limit the proper law to that of one jurisdiction. It defined proper law in relation to the jurisdiction most favourable to the insurability of such damages that, at the same time, "has a substantial relationship" to "relevant insureds". The use of the plural is significant since there are multiple insureds residing or domiciled in different jurisdictions having their own legal regimes.

60 The definition of "Loss" in the first coverage section provides, *inter alia*:

Loss means:

(a) the amount that any **Insured Person** (for the purposes of Insuring Clauses 1 and 2) or the **Organization** (for purposes of Insuring Clause 3) becomes legally obligated to pay on account of any covered **Claim**, including but not limited to damages (including punitive or exemplary damages, if and to the extent that such punitive and exemplary damages are insurable under the law of the jurisdiction most favourable to the insurability of such damages provided such jurisdiction has a substantial relationship to the relevant **Insureds**, to the Company, or to the **Claim** giving rise to the damages), judgments, settlements, pre-judgment and post-judgment interest and **Defense Costs**;

[Bold emphasis in original; underline emphasis added]

61 In the first coverage section, an "Insured Person" is defined to mean a director, officer, manager, or in-house general counsel to any "Organization" that is "chartered in the United States of America" or "equivalent to any [such] position ... that is chartered in any jurisdiction other than the United States of America". The definition in the second coverage section is somewhat broader as it includes an employee of an "Organization".

62 Contractual intent is clear - the parties intended a multi-faceted approach to the law applicable to Federal's obligation to pay punitive and exemplary damages, one that permits various legal regimes to apply depending on the nature of the claim and the relationship of a jurisdiction to an "Insured Person", as well as the law applicable to such damages in that jurisdiction.

63 Federal's policy language also acknowledges the potential for a different proper law to apply to each coverage section. Federal excluded from the definition of "Loss", which is covered, any amount not insurable under the law pursuant to which the particular coverage section of the policy, *as opposed to the policy itself*, is construed:

Loss does not include:

... any amount not insurable under the law pursuant to which this coverage section is construed, except as provided above with respect to punitive or exemplary damages;

[Bold emphasis in original; underline emphasis added]

The definition of "Loss" in the second coverage section is the same in substance; notably, though, it does not provide coverage for "Organizations".

64 Thus, Federal's policy recognizes that more than one legal regime may govern the interpretation of the coverage sections therein.

65 That Federal intended to distinguish between coverage sections and the whole of the policy is also demonstrated in the language contained in Endorsement no. 2 to the "General Terms and Conditions" (which are stated to apply to the entire policy). That endorsement concerns termination of the policy and purports to limit Federal's right to terminate the policy or either or both coverage sections for non-payment of premium. There, Federal wrote:

In consideration of the premium charged, it is agreed that, notwithstanding any provision to the contrary in this policy or any endorsement thereto, the Company [Federal] shall only have the right to terminate this policy or any coverage section for non-payment of premium; accordingly, any reference to paragraph (a) of Subsection 11, Termination of Policy or Coverage Section, in this policy or any endorsement thereto, is deleted.

[Emphasis added]

66 Federal added four endorsements to its General Terms and Conditions, as well as sixteen and three to its first and second coverage sections, respectively. They cover a wide range of subjects including waiver of subrogation, termination of policy or coverage section, compliance with applicable trade laws, whistleblowers, exclusion for non-common law countries, reporting,

securities claims, public offerings, representations, changes in exposure, non-entity employment practices, bankruptcy, claims for bodily injury and mental anguish, other insurance, severability, and pollution.

67 Federal specifically referred to the law of Oregon in three endorsements.

68 The first one is Endorsement no. 3 to the General Terms and Conditions (which concerns termination of the policy or coverage sections). It states that it supersedes and takes precedence over other policy provisions unless they comply with applicable insurance laws of Oregon. The wording is not clear inasmuch as the endorsement could be interpreted to apply to policy provisions added by endorsement, or, to the policy as a whole:

> **OREGON AMENDATORY ENDORSEMENT TO THE GENERAL TERMS AND CONDITIONS SECTION**
>
> . . . . .
>
> The regulatory requirements set forth in this Amendatory Endorsement shall supersede and take precedence over any provisions <u>of the policy of any endorsement to the policy</u>, whenever added, that are inconsistent with or contrary to the provisions of this Amendatory Endorsement, unless such policy or endorsement provisions comply with the applicable insurance laws of the state of Oregon.
>
> [Bold emphasis in original; underline emphasis added]

I have underlined the words that create confusion.

69 The heading to the endorsement offers no assistance by virtue of clause 14 of the General Terms and Conditions:

> 14. The descriptions in the headings and sub-headings of this policy are solely for convenience, and form no part of the terms and conditions of coverage.

70 In addition, clause 2 of the General Terms and Conditions stipulates that where any provision in the General Terms and Conditions is inconsistent or in conflict with the terms and conditions of any coverage section, then the terms and conditions of "such coverage section shall control for the purpose of that coverage section".

71 The lack of clarity is amplified because Endorsement no. 3 immediately follows Endorsement no. 2. Endorsement no. 3 sets out a list of seven bases upon which Federal may terminate the policy or any coverage section. Yet, Endorsement no. 2, which does not mention Oregon law, confines the insurer's right to termination ("notwithstanding any provision to the contrary in this policy or any endorsement thereto") for non-payment of premium.

72 Even though I was not, on the application, directed to or asked to resolve the possible inconsistency between the two endorsements, or the drafting issues arising from Endorsement no. 3, I point them out as instances where Federal turned its mind to the prospect of stipulating Oregon law as the proper law for the entire policy. If Endorsement no. 2 supersedes no. 3, which I think it does (especially given that the language of no. 3 is so unclear), then Federal's right to terminate is limited to non-payment of premium and Oregon law does not apply.

73 The second endorsement referring to Oregon law is no. 7 to the first coverage section. It is titled:

> **OREGON AMENDATORY ENDORSEMENT TO THE EXECUTIVE LIABILITY AND ENTITY SECURITIES LIABILITY COVERAGE SECTION**

This endorsement concerns, *inter alia*, the effect of misrepresentations contained in the application for insurance. Unlike Endorsement no. 3 to the General Terms and Conditions, Federal made it clear that Oregon law applied to matters dealt with by this specific endorsement:

> The regulatory requirements of this Amendatory Endorsement shall supersede and take precedence over any provisions of the policy or any endorsement to the policy, whenever added, that are inconsistent with or contrary to the provisions of

this Amendatory Endorsement, unless such policy or endorsement provisions comply with the applicable insurance laws of the state of Oregon.

74 The third endorsement referring to Oregon law is no. 2 to the second coverage section, which also deals with the effect of misrepresentations in the application, and contains the same reference to Oregon law as in Endorsement no.7.

75 Federal's policy also shows that Federal contemplated different types of claims being made against directors and officers as well as "Organizations" (their companies) in various jurisdictions (including non-common law jurisdictions). For example, in the first coverage section:

(a) the definition of "Insured Person" shows that Federal contemplated claims against directors, officers, or managers of an "Organization" "chartered in any jurisdiction other than the United State of America";

(b) the definition of "Securities Claim" includes a claim that "alleges that an *Organization* or any of its *Insured Persons*...violated a federal, state, local or foreign securities law" [Emphasis in original];

(c) Federal excluded coverage for violations of certain statutes such as the Employee Retirement Income Security Act of 1974, claims made for an account of profits from the purchase or sale of securities within the meaning of "Section 16(b) of the Securities Exchange Act of 1934 or...any similar provision of any federal, state, or local statutory law or common law anywhere in the world", and the "Sarbanes-Oxley Act of 2002, or any similar 'whistleblower' protection provision of an applicable federal, state, local or foreign securities law";

(d) in Endorsement no. 6, Federal agreed not to seek allocation of defence costs arising from a "Securities Claim" attributable to alleged violations of ss. 11 or 12 of the Securities Act of 1933; and

(e) separate treatment is given, in Endorsement no. 2 (concerning "non-common law countries") to claims "not venued in the United States of America, Canada, Australia or any other common law jurisdiction".

76 In summary, contemplating claims made in jurisdictions beyond the US and Canada, Federal turned its mind to the proper law governing different provisions and coverage sections of its policy, including those added by endorsement. It specifically added three endorsements referring to Oregon law, yet chose not to include a choice of law clause to govern the entire policy. Instead, Federal used contractual language that demonstrates the parties' intention that the laws from various jurisdictions could govern their rights and obligations under the policy.

77 In my opinion, Federal's submission that its Oregon Amendatory Endorsements show contractual intent that Oregon law is the proper law of the policy is undermined by Federal's specific treatment of punitive damages, the definition of "Loss" in its policy, the effect of Endorsement no. 2 of the General Terms and Conditions, the lack of clarity in Endorsement no. 3 to the General Terms and Conditions, clause 2 of the General Terms and Conditions, and the specific language set out in Endorsements no. 7 and no. 2 to the first and second coverage sections, respectively.

National Union's policy

78 National Union's policy is follow form to Federal's, which means that the provisions contained in Federal's policy are also contained in National Union's policy. As a result, my determination of the proper law issue for Federal's policy applies to National Union's policy unless National Union has specifically added language that expressly or impliedly stipulates a different result.

79 Even though National Union added specific endorsements that identify a legal regime, it did not add a choice of law clause.

80 National Union added nine endorsements dealing with cancellation of the policy, reliance on representations contained in the application for underlying insurance, exhaustion of limits and erosion, notice of change in circumstances (e.g., receivership or sale), when underlying coverage is no longer in effect, and payments. Of those, only two refer to specific jurisdictions.

81 The first, Endorsement no. 1, contains a reference to a jurisdiction, and only in its heading, which reads:

> **OREGON CANCELLATION/NON-RENEWAL AMENDATORY ENDORSEMENT**

There is no reference to choice of law, nor does that endorsement include the type of language used by Federal in its two endorsements (nos. 7 and 2 to the first and second coverage sections, respectively).

82 The second endorsement, no. 8, stipulates that performance of one of its obligations, i.e., payment of loss, "shall only be made in full compliance with all United States of America economic or trade sanction laws or regulations, including, but not limited to, sanctions, laws and regulations administered and enforced by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC")".

83 The drafters of the National Union policy intended the application of a specific legal regime - the rules of the American Arbitration Association - to apply to the performance of mediations and arbitrations of disputes under the ADR clause. As well, National Union turned its mind to and added a choice of forum clause stipulating that mediation or arbitration may be held in any one of several jurisdictions.

84 In its ADR clause, National Union's policy stipulates that non-binding mediation is to be administered by the American Arbitration Association, and that arbitration conducted pursuant to the policy is also to be submitted to that Association and conducted in accordance with its "then-prevailing commercial arbitration rules".

85 With the exception of the ADR clause contained in its policy, National Union's policy is silent as to the choice of any legal regime governing the contract or performance of its obligations.

86 National Union relies upon the ADR clause to stay determination of its coverage obligations. The clause is lengthy. In it, National Union sets out the law to be considered by the mediator or arbitrator when construing or interpreting the policy. As well, the ADR clause contains a choice of forum in respect of mediation or arbitration. It provides, *inter alia*:

> It is hereby understood and agreed that all disputes or differences which may arise under this policy, whether arising before or after termination of this policy, including any determination of the amount of Loss, shall be subject to the dispute resolution process ("ADR") set forth in this clause.
>
> Either the Insurer and the Insureds may elect the type of ADR discussed below; provided, however, that the Insureds shall have the right to reject the Insurer's choice of ADR at any time prior to its commencement, in which case the Insured's choice of ADR shall control.
>
> The Insurer and Insureds agree that there shall be two choices of ADR: (1) non-binding mediation administered by the American Arbitration Association, in which the Insurer and Insureds shall try in good faith to settle the dispute by mediation under or in accordance with its then-prevailing Commercial Mediation Rules; or (2) arbitration submitted to the American Arbitration Association under or in accordance with its then-prevailing commercial arbitration rules, in which the arbitration panel shall be composed of three disinterested individuals. In either mediation or arbitration, the mediator(s) or arbitrators shall have knowledge of the legal, corporate management, or insurance issues relevant to the matters in dispute.
>
> The mediator(s) or arbitrators shall also give <u>due consideration to the general principles of the law of the state where the Named Insured is incorporated in the construction or interpretation of the provisions of this policy; provided however, that the terms, conditions, provisions and exclusions of this policy are to be construed in an even-handed fashion in the manner most consistent with the relevant terms, conditions, provisions or exclusions of the policy.</u> In the event of arbitration, the decision of the arbitrators shall be final and binding and provided to both parties... In the event of mediation, either party shall have the right to commence a judicial proceeding; provided, however, that no such judicial proceeding shall be commenced until the mediation shall have been terminated and at least 120 days shall have elapsed from the date of the termination of the mediation...

> Either choice of ADR may be commenced in either New York, New York; Atlanta, Georgia; Chicago, Illinois; Denver, Colorado; or in the state indicated in Item 1 of the Declarations page as the mailing address for the Named Insured [P&T Inc].
>
> [Emphasis added]

87 That clause means, therefore, that a mediator or arbitrator involved with or hearing a dispute pursuant to the ADR clause would have to, when considering the construction of the insurance policy, give "due consideration" to the law of the State of Delaware since that is where P&T Inc. was incorporated, unless the laws of that State were not even-handed or consistent with the relevant terms of the policy.

XL's policy

88 XL's Cornerstone Policy expressly provides for the application of different legal regimes to determine its coverage obligations.

89 The starting point is the definition of "Loss", which is one of the bases for XL's obligation to pay claims. XL's obligation is to pay for "Loss resulting from a Claim" made during the policy period "for a Wrongful Act". The obligation to pay the various items comprising "Loss" is determined on the basis of their insurability.

90 XL's definition of "Loss" is more expansive than Federal's: it speaks of awards that include pre- and post judgment interest and multiplied damage awards as well as punitive and exemplary damages. The awards set out in the parenthetical expression below are included in the definition of "Loss" where "insurable by law":

> "**Loss**" means damages, judgments, settlements or other amounts (including pre- & post-judgment interest, punitive or exemplary damages, or the multiplied portion of any damage award, where insurable by law) and **Defense Expenses** that the **Insured Persons** are obligated to pay.
>
> [Bold emphasis in original; underline emphasis added]

91 XL makes it clear, in a "Note" contained within the definition of "Loss", that the law governing its obligation to pay punitive, exemplary, or multiplied damages, fines, penalties, or taxes, but not pre- and post judgment interest, is the law of the jurisdiction most favourable to insurability (it "shall control"):

> **Note**
>
> With respect to coverage for punitive, exemplary or multiplied damages or fines, penalties or taxes, the law of the applicable jurisdiction most favourable to the insurability of such amounts shall control.

92 There is also a category excluded from the definition of "Loss" - "matters" uninsurable by the law "pursuant to which the policy is construed":

> **Loss** will not include:
>
> (1) matters which are uninsurable under the law pursuant to which this Policy is construed;...
>
> [Bold emphasis in original; underline emphasis added]

93 "Matters" is not defined in the policy. Dictionary definitions show that this word has a broad meaning. *Black's Law Dictionary*, 8th ed. (2004) defines "matter" as follows:

> **matter**, *n*. **1**. A subject under consideration, esp. involving a dispute or litigation; ... **2**. Something that is to be tried or proved; an allegation forming the basis of a claim or defense.

The *Shorter Oxford Dictionary*, 6th ed. (2007) defines the word to mean, *inter alia*:

> **matter**, *noun*, ... **14 a** An event, circumstance, question, etc., which is or may be an object of consideration or practical concern; in *pl.*, events, circumstances, etc., generally... **15** A thing or things collectively of a particular kind or related to a particular thing, Usu. foll. by *for* or *of*, or with specifying word. ... **16** Material cause; elements of which something consists or out of which it arises.

94 A third category relates to fines, penalties, or taxes imposed by law. They are not covered, as they are specifically excluded by the definition of "Loss", except where they are *insurable by law* and imposed in connection with an "Insured Person's" service to an entity that is financially solvent:

> **Loss** will not include:
>
> . . . . .
>
> (2) fines, penalties or taxes imposed by law; provided, that this DEFINITION (K)(2) will not apply to fines, penalties or taxes that an **Insured Person** is obligated to pay if such fines, penalties or taxes are insurable by law and are imposed in connection with such **Insured Person's** service to an entity included within the definition of **Company** that is financially solvent.
>
> [Bold emphasis in original; underline emphasis added]

95 XL's policy also shows that the insurer contemplated different types of claims being made against the insureds in various jurisdictions. In fact, with the exception of coverage for "Defence Expenses" (a defined term), XL's policy excludes coverage for "Loss" in connection with any claim, *inter alia*, "brought and maintained in a non-common law jurisdiction outside the United States of America or its territories or possessions".

96 Comparing all of the language contained in the definition of "Loss" makes it clear that the parties intended that while one legal regime would apply to the policy, other legal regimes may apply to XL's obligations to pay interest, punitive and exemplary damages, the multiplied portion of any damage award, and fines, penalties, and taxes.

97 XL's policy also contains a term described as a "no action" clause, which purports to operate as a condition precedent to an "Insured Person" bringing an action against XL. Although XL previously relied on this clause as a basis to stay a coverage determination by this Court, during the hearing XL abandoned its reliance on that clause in this case for practical reasons. XL prefers to participate in the looming coverage determination hearing rather than sit on the sidelines; if it won its stay application, XL could be faced with allegations of *res judicata* and issue estoppel from its insureds.

Disposition

98 A careful review of the insurance policies shows that the parties anticipated *dépeçage*. The parties had ample opportunity to select one proper law, especially the law of Oregon. They chose not to do so. This fact alone, however, does not lead to the conclusion that the proper law of the policies is BC law.

99 From examining each policy as a whole, and in particular, contractual language allowing for different policy sections, claims, and "matters" to be interpreted according to different legal regimes, it is clear that the parties intended the proper law to be determined in connection with the substance of the claim made (including relief sought) or matter at issue.

100 The instant case is an exceptional one, created by the parties' contractual intent, which is expressed through the use of specific language drafted by underwriters following lengthy negotiations.

101 For example, in the Federal policy, the parties agreed that voidance of the policy for misrepresentation on the application for insurance is governed by the "applicable insurance laws" of Oregon.

102 Another example is Federal's obligation to provide coverage for punitive and exemplary damages is to be construed in accordance with a legal regime that may be different than the law which governs the coverage section within which that obligation is found.

103 XL's policy, for example, incorporates a definition of "Loss" that states its obligation to provide coverage for "matters" and certain specified claims (set out in the definition of "Loss") is determined on the basis of their insurability by law. The drafters of its policy contemplated, at least for certain specific claims, that a legal regime (most favourable to insurability) may apply that is different than the legal regime by which the rest of the policy is construed.

104 My determination regarding the parties' intent does not mean that the policies exist in a vacuum. This is not a case, as was posited in *Armar Shipping* (at p. 505) where the proper law "float[s] until the carrier, unilaterally, makes a decision". Nor is this is a situation like that in *Amin Rasheed* (at p. 895), where the court was being asked to determine, based on the use of a Lloyd's form much used on an international scale, that the contract is "an internationalised, or floating, contract, unattached to any system of law". The policies in this case are, in fact, connected to more than one jurisdiction and legal regime, e.g., British Columbia, Ontario, Delaware, Oregon, Indiana, New Jersey, Pennsylvania, New York, and Connecticut. In my opinion, this is an extraordinary case, one where the parties intended that a court having taken jurisdiction over the claim or matter in dispute would determine the proper law according to its own laws.

105 The facts in this case are more compelling than those in *Libyan Arab Foreign Bank (No. 2)*: here, the parties' intention to apply *dépeçage*, and to which subject matters, is manifest. Except for the application of Oregon insurance law to deal with misrepresentations contained in the application submitted to Federal, the parties did not specifically set out the laws from a specific jurisdiction(s) to govern their obligations. Proper law is left to be determined by the court hearing the dispute to find based on application of its own laws, taking into account directing language in the policies (e.g., concerning punitive and exemplary damages in Federal's policy and those same damages along with multiplied damage awards, fines, penalties, and taxes in XL's policy).

106 Simply because a court takes jurisdiction, it does not necessarily follow that such jurisdiction's legal regime will be applied as the proper law. Nor does the prospect that more than one court can or does take jurisdiction to determine coverage obligations in the policies affect the analysis. Principles of conflict of laws are flexible enough to deal with fact patterns where more than one forum can take jurisdiction. In *Amin Rasheed*, at p. 888, Lord Diplock said:

> One final comment on what under English conflict rules is meant by "proper law" of a contract may be appropriate. It is the substantive law of the country which the parties have chosen as that by which their mutual legally enforceable rights are to be ascertained, but excluding any renvoi, whether of remission or transmission, that the courts of that country might themselves apply if the matter were litigated before them. For example, if a contract made in England were expressed to be governed by French law, the English court would apply French substantive law to it notwithstanding that a French court applying its own conflict rule might accept a renvoi to English law as the lex loci contractus if the matter were litigated before it.

Thus, proper law may always be ascertained. Moreover, application of repugnant laws from a legal regime arguably connected to the policies may be avoided on the ground of public policy: *Vita Food*, p. 521.

107 That the parties in the instant case intended a multi-faceted approach to the proper law of the contract at the time the policies were issued, tied to the substance of the claims, matters, or coverage sections in issue, is demonstrated by the circumstances existing at the time.

108 D&O liability coverage was being provided on a worldwide basis at a time when the bulk of P&T Inc.'s revenue (and debt) was generated by its Canadian operations, through its subsidiary P&T Ltd. Although the majority of claims could thus be expected to arise from the Canadian operations, underwriters also expressed concern over possible bankruptcy proceedings in the US. Financial insolvency loomed large. An approach to proper law that is claim or matter dependent allowed the insurers to provide worldwide D&O and "Organization" liability coverage in a manner that made commercial sense to the parties having

regard to the particular circumstances existing at the time the policies were issued. This does not mean that the policies exist in a legal vacuum until a claim is made against any or all of the insureds. For example, a dispute between Federal or National Union, on the one hand, and any or all of their insureds, on the other, concerning voidance for misrepresentation in the application will be determined by Oregon law (as per Endorsements no. 7 and no. 2). For the XL policy, the definition of "Loss" mandates that such a dispute would be determined according the law to which the entire policy is construed.

109 Having taken jurisdiction, I must now determine the proper law to be applied. In BC, the approach to determining the proper law of a contract is set out in *Cansulex*. I propose to review the factors outlined by Chief Justice McEachern, in ascending order of importance, to determine the proper law to be applied to the policies:

(a) Where the policy was made

The insurers did not suggest that each policy was made in a different jurisdiction, and instead asserted Oregon was the place where the policies were made. For the reasons set out in (c) below, I cannot find that the policies were made in Oregon. The mere fact that the head office of P&T Inc. and the broker's office were located in Portland and that Federal had an office in Oregon, does not mean that the contracts were made in Oregon. Section 5 of the *Insurance Act* deems them to have been made in BC, a presumption that I find the insurers have not rebutted. This factor favours BC law.

(b) The form of the policy

No evidence was tendered to show that the insurance forms, all written in English, are American, or for that matter, unique to or derived from any particular jurisdiction. The liability concepts expressed in the policies are well known and widely used in D&O and organization claims made insurance policies issued in Canada.

The premium amounts and payment obligations of the insurers are expressed in US dollars, although the latter is expressed in terms of a conversion from foreign currency to US currency. It is not unheard of for non-American companies to do business in US currency.

In my opinion, this factor is neutral.

(c) Where the parties' operations are located

The insurers' head offices and principal places of business are located in States other than Oregon (New York, New Jersey, Indiana, Pennsylvania, and Connecticut). Apart from Federal, there is no evidence to show that the other insurers had offices in Oregon. Federal's decision to accept the risk was made in several jurisdictions: Los Angeles, Portland, and New Jersey. National Union's decision to go on risk was made in New York City. All of XL's underwriting was carried out in Stamford, Connecticut. National Union's policy was issued out of its office in New York City; XL's policy was issued out of its office in Connecticut.

The bulk of the operations of the Pope & Talbot Group were located in British Columbia. Most of its employees were located, and I infer worked, in this jurisdiction. The head office of the parent, P&T Inc., was located in Portland. It was incorporated in Delaware, where its insolvency proceedings were commenced.

In its application for insurance, the strength of the Canadian dollar was cited as a significant reason for its adverse financial position. The remarks made by Federal's underwriters in their underwriting analysis demonstrate that the insurer was aware that the proportion of P&T Inc.'s operations in BC (through its Canadian subsidiary) were significant enough to result in considerable loss to the company when the high Canadian dollar made its products from BC less competitive.

The facts surrounding this factor favour British Columbia law. Nothing other than the location of an office for Federal, some aspect of underwriting by Federal, the location of P&T Inc.'s head office in Oregon, and a mill operated by P&T Ltd. in Halsey favours Oregon law. Having turned their minds to proper law, none of the parties chose Oregon law as the law of their contracts. This omission is telling.

(d) The subject matter of the contract

The subject matter of the contract is worldwide liability insurance for the directors and officers of the Pope & Talbot Group as well as direct coverage for the "Organizations" comprising that Group. Without considering the nature and location of the operations of the Pope & Talbot Group, this factor is neutral. Once they are considered, the law of BC is favoured as the proper law since the majority of the operations of the Pope & Talbot Group, including its employees, were located in BC at the time the policies were made.

(e) Where claims might be expected to arise

The nature and location of the operations of the Pope & Talbot Group at the time the policies were issued shows that, with the possible exception of bankruptcy proceedings in the US, most of the claims could be expected to arise from Canadian operations. This factor favours BC law.

110 In the circumstances, I find that the policies have the closest and most substantial connection with BC.

111 In my respectful view, it would be a facile approach to conclude there is only one proper law governing each policy, given the extraordinary language used in the policies. If I had to, then upon the application of the *Cansulex* factors, I would find the proper law of the policies to be BC law at the time they were made.

112 As McEachern C.J.S.C. said in *Cansulex*, at p. 290: "This is not really a case like *Imperial Life Assurance Co. of Canada v. Colmenares* because it was a reasonable inference in that case that a person applying in Toronto to an Ontario corporation for a policy on a Canadian form would be governed by Canadian law". The facts of this case are more complex than in *Colmaneres*, where a standard form life insurance policy issued by a Canadian insurer was in issue.

113 In this case, the *CBCA* s. 119 claims, which have no equivalent in Oregon, are unique to the Canadian operations of the Canadian subsidiary of P&T Inc. They are brought pursuant to a Canadian statute. The proper law of the policies to determine the insurers' coverage obligations for those claims is BC law.

114 During submissions, the parties referred to the doctrine of reasonable expectations of the parties to support their position on the proper law. I have determined that the policies are not ambiguous in terms of proper law. PWC argued that the policies were ambiguous insofar as the proper law issue is concerned. Even if it could be said that they are ambiguous - with the exception that in the Federal policy Oregon law is stipulated as the proper law for Endorsements nos. 7 and 2, which govern the consequences of misrepresentation - application of the doctrine of reasonable expectations of the parties leads to the same result in respect of the s. 119 claims.

115 In terms of reasonable expectations, the circumstances extant at the time the policies were issued (which I have set out in these reasons for judgment) leads me to conclude that the parties expected BC law to apply to claims flowing out of the operations of P&T Ltd. For claims arising from operations of P&T Inc., the parties expected the proper law would be determined by the State in the United States taking jurisdiction. Federal and National Union are each part of a different group of companies having at least one other insurance company that carries on business in Canada. XL also has a related company that carries on business in this country. In my respectful view, the insurers, having chosen to underwrite coverage for P&T Ltd. and its directors and officers, must be taken to have been aware of s. 5 of the BC *Insurance Act* and other like provisions in other provincial insurance statutes, including Ontario (where P&T Ltd.'s registered and records office is located).

116 The s.119 claims are unique to Canada and arise solely out of the BC operations. The parties would reasonably have expected BC law to apply to determine the insurers' coverage obligations under the policies.

Analysis and Disposition - ADR Clause

117 National Union seeks to stay these proceedings until mediation takes place pursuant to the ADR clause. During submissions, National Union conceded that the clause was procedural and did not affect substantive rights, so that its application can be determined by the *lex fori.*

118 In my previous decision (2009 BCSC 1014, 76 C.C.L.I. (4th) 212 (B.C. S.C.), at paras. 147 to 150), I referred to several decisions holding that the *BIA* confers jurisdiction on Canadian Superior Courts to disrupt private contractual rights: e.g. *GMAC Commercial Credit Corp. - Canada v. TCT Logistics Inc.*, 2006 SCC 35, [2006] 2 S.C.R. 123 (S.C.C.), rev'g in part (2004), 71 O.R. (3d) 54, 238 D.L.R. (4th) 677 (Ont. C.A.); and *Eagle River International Ltd., Re*, 2001 SCC 92, [2001] 3 S.C.R. 978 (S.C.C.).

119 The rationale underlying that point is well set out in the decision of Topolniski J., whose reasoning was affirmed by the Alberta Court of Appeal in *Residential Warranty Co. of Canada Inc., Re*, 2006 ABQB 236, 62 Alta. L.R. (4th) 168 (Alta. Q.B.), aff'd 2006 ABCA 293, 65 Alta. L.R. (4th) 32 (Alta. C.A.):

> [25] A significant objective of the *BIA* is to ensure that all of the property owned by the bankrupt or in which the bankrupt has a beneficial interest at the date of the bankruptcy will, with limited exceptions, vest in the trustee for realization and ratable distribution to creditors. To further this objective, the *BIA* provides for practical, efficient and relatively inexpensive mechanisms for asset recovery, determination of the validity of creditor claims, and distribution of the estate. A fundamental tenet of *BIA* proceedings is that fairness should govern.

120 Resort to inherent jurisdiction may be made to further the objects of the *BIA* where the *Act* does not provide a specific mechanism. In essence, failing specific provision in the statute, the "gap" may be filled by statutory construction, or failing that, then by resort to inherent jurisdiction. According to Topolniski J., the *BIA* expressly preserves the Bankruptcy Court's equitable and ancillary powers. Resort to inherent jurisdiction is "maintained and available as an important but sparingly used tool". At para. 26, he wrote:

> The *BIA* expressly preserves the Bankruptcy Court's equitable and ancillary powers. Accordingly, inherent jurisdiction is maintained and available as an important but sparingly used tool. There are two preconditions to the Court exercising its inherent jurisdiction: (1) the *BIA* must be silent on a point or not have dealt with a matter exhaustively; and (2) after balancing competing interests, the benefit of granting the relief must outweigh the relative prejudice to those affected by it. Inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfilment of the substantive objectives of the *BIA*, including the proper administration and protection of the bankrupt's estate.

121 Topolniski J. also remarked that solutions to *BIA* issues will require judges to consider the realities of commerce and business efficacy:

> [27] Solutions to *BIA* concerns require consideration of the realities of commerce and business efficacy. A strictly legalistic approach is unhelpful in that regard. What is called for is a pragmatic problem-solving approach which is flexible enough to deal with unanticipated problems, often on a case-by-case basis.

122 The same point was made by Farley J. in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 114 D.L.R. (4th) 176, 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List])) at p. 185:

> While the *BIA* is generally a very fleshed-out piece of legislation when one compares it to the *CCAA*, it should be observed that s. 47(2)(c): "The court may direct an interim receiver ... to ... (c) take such other action as the court considers advisable" is not in itself a detailed code. It would appear to me that Parliament did not take away any inherent jurisdiction from the court but in fact provided, with these general words, that the court could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands". It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organised and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability.

123 Section 183(1) of the *BIA* invests Bankruptcy Courts with equitable jurisdiction:

> The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxillary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during their respective terms, as they are now, or may be hereafter, held, and in vacation and in chambers: ...
>
> . . . . .
>
> (c) in the Provinc[e] of...British Columbia, the Supreme Court[.]

124 Although the *BIA* permits Bankruptcy Courts to interfere with leases and creditor agreements in some circumstances, it makes no specific mention of interference with conditions precedent to an insurer's coverage obligations. Nor does the *Act* define what is meant by "auxiliary" or "ancillary" jurisdiction.

125 Dictionary definitions offer little guidance. *Black's Law Dictionary* defines "auxiliary" to mean: "The incidental aid by an equity court to a court of law when justice requires both legal and equitable processes and remedies". The *Shorter Oxford Dictionary* defines it as: "Helpful: giving support or succour; ...subsidiary, additional, anciliary." The word "ancillary" is defined in *Black's Law Dictionary* to mean: "A court's jurisdiction to adjudicate claims and proceedings related to a claim that is properly before the court". The definition contained in the *Shorter Oxford Dictionary* reads: "Subservient, subordinate; auxiliary, providing support".

126 I view the question, in the circumstances of this case, in terms of the Court's inherent jurisdiction to control its own process in order to promote the objects of the *BIA* rather than gap filling through statutory interpretation.

127 The Alberta Court of Appeal, in *Residential Warranty*, added its own remarks concerning the scope of the Bankruptcy Court's reliance on inherent jurisdiction:

> [20] Inherent jurisdiction is not without limits, however. It cannot be used to negate the unambiguous expression of legislative will and moreover, because it is a special and extraordinary power, should be exercised only sparingly and in a clear case. ...
>
> [21] Further limitations are based on the nature of the *BIA* - it is a detailed and specific statute providing a comprehensive scheme aimed at ensuring the certainty of equitable distribution of a bankrupt's assets among creditors. ... However, inherent jurisdiction has been used where it is necessary to promote the objects of the *BIA:* [citations omitted]. It has also been used where there is no other alternative available: [citations omitted] and to accomplish what justice and practicality require: [citation omitted].
>
> . . . . .
>
> [37] Generally, inherent jurisdiction should only be exercised where it is necessary to further fairness and efficiency in legal process and to prevent abuse.

128 In deciding whether inherent jurisdiction should be exercised, the Court of Appeal in *Residential Warranty* considered a number of factors at para. 37, including:

> (a) the stage of the proceedings and the effect of such an order on them -"for example, the ability of the trustee to make distributions and their amount may depend on the determination of the issue";
>
> (b) the need to maintain the integrity of the bankruptcy process - "[t]he equitable distribution of the bankrupt estate must remain at the forefront";
>
> (c) the realistic alternatives in the circumstances;
>
> (d) the impact on the trust claimants and the trust property as well as on other creditors; and

(e) the anticipated time and costs involved.

129 Since my previous decision was handed down, Burnyeat J. of this Court has issued reasons for judgment in *Hayes Forest Services Ltd., Re*, 2009 BCSC 1169, [2009] B.C.J. No. 1725 (B.C. S.C.) where, at para. 22, he confirmed the broad jurisdiction of the Court in *CCAA* proceedings to "decide a dispute...under a [c]ontract...despite the provincial statutory authority and the terms of the [c]ontract". Burnyeat J. also reviewed other decisions from this Court, the Court of Appeal, and various provincial Superior Courts, all of which are to the same effect - a very broad discretion is afforded to courts dealing with *CCAA* proceedings to interfere with private contractual or statutory rights: *Smoky River Coal Ltd., Re*, 1999 ABCA 179, 175 D.L.R. (4th) 703 (Alta. C.A.); *Landawn Shopping Centres Ltd. v. Harzena Holdings Ltd.* (1997), 44 O.T.C. 288, [1997] O.J. No. 4457 (Ont. Gen. Div. [Commercial List])); *T. Eaton Co., Re* (1997), 46 C.B.R. (3d) 293, [1997] O.J. No. 6411 (Ont. Gen. Div.); *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106, [1995] O.J. No. 595 (Ont. Gen. Div. [Commercial List]); *Philip's Manufacturing Ltd., Re* (1991), 60 B.C.L.R. (2d) 311, 9 C.B.R. (3d) 1 (B.C. S.C.); *Playdium Entertainment Corp., Re* (2001), 31 C.B.R. (4th) 302, 18 B.L.R. (3d) 298 (Ont. S.C.J. [Commercial List]), add'l reasons at (2001), 31 C.B.R. (4th) 309, [2001] O.T.C. 828 (Ont. S.C.J. [Commercial List]); *Armbro Enterprises Inc., Re* (1993), 22 C.B.R. (3d) 80, [1993] O.J. No. 4482 (Ont. Bktcy.); *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (B.C. C.A.); *Gauntlet Energy Corp., Re*, 2003 ABQB 718, 336 A.R. 302 (Alta. Q.B.); *Doman Industries Ltd., Re*, 2003 BCSC 376, 14 B.C.L.R. (4th) 153 (B.C. S.C. [In Chambers]); and *Backbay Retailing Corp., Re*, 2008 BCSC 1876, [2008] B.C.J. No. 2784 (B.C. S.C. [In Chambers]).

130 In *Skeena*, the Court of Appeal noted, at para. 37, that in the "exercise of their 'broad discretion' under the *CCAA*, it has become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights".

131 The approach taken by Burnyeat J. in *Hayes Forest Services*, and in the other cases he reviewed, is not confined to *CCAA* proceedings. Courts have interfered with private contractual rights in insolvency cases involving the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11: *Canada (Attorney General) v. Reliance Insurance Co.* (2007), 87 O.R. (3d) 42, 36 C.B.R. (5th) 273 (Ont. S.C.J. [Commercial List]); and *GMAC.* The rationale is explained in the text *Commercial Insolvency in Canada* by Kevin P. McElcheran (Markham, Ont.: LexisNexis Canada Inc., 2005) at p. 4:

> The primary statutory and judicial tool used to preserve value and promote order in the insolvency process is the stay of proceedings to suspend the exercise of individual creditor rights. Stays of proceedings are necessary to achieve many of the objectives of commercial insolvency law. Even in the context of a liquidation of the debtor's assets for distribution to its unsecured creditors under the *BIA* or *WURA*, the statutory stay of proceedings permits the orderly and efficient realization of the debtor's assets, the judicial determination of creditor claims and priorities and the fair distribution of proceeds to creditors by reference to their legal rights.

132 National Union has neither denied nor confirmed coverage despite a demand being made in July 2008, yet wishes to pursue its contractual right to mediate. At one point in the proceeding, National Union submitted that because the claim value does not encroach upon its policy layer, is not necessary for it to provide its coverage position. At another point in the proceeding, National Union submitted that it wished to mediate with its insureds as it was concerned that the claim value might well exceed Federal's limits and encroach into its policy. In a brief written submission provided later, National Union said if there are s. 119 claims the value of which exceed Federal's layer (which, it said, "does not appear certain"), it would deny coverage "for the same reasons as stated by Federal".

133 National Union has been provided with information concerning the underlying claims. Its decision to wait upon the value of the claims made against its insureds before taking a position on cover, especially in view of its potential obligation to advance defence costs in the event Federal's layer is exhausted, should not, in my respectful view, allow it to rely on its ADR clause which would, in effect, stand in the way of the resolution of the Pope & Talbot insolvency.

134 Given National Union's position concerning coverage, there is no good reason for the ADR clause to stand in the way of an orderly and expeditious resolution of the insolvency proceedings.

135 National Union's position is that it is not bound by this Court's determination of the coverage obligations of the other two insurers. PWC and the directors and officers disagree; they submit that National Union would be bound by the doctrine of issue estoppel. If National Union's position is correct, then forcing the parties to mediate will only add to the costs of the proceedings and cause delay. If the Federal and XL policies are found to respond to the s. 119 claims, then an additional hearing will be required to determine National Union's coverage obligations.

136 If there is no coverage afforded by National Union's policy, then to adopt the words of Campbell J. at para. 39 of *Fiber Connections Inc. v. SVCM Capital Ltd.* (2005), 10 C.B.R. (5th) 192, [2005] O.J. No. 3899 (Ont. S.C.J.), leave to appeal to Ont. C.A. granted (2005), 10 C.B.R. (5th) 201, 139 A.C.W.S. (3d) 10 (Ont. C.A. [In Chambers]), appeal abandoned August 5, 2005, the resolution of the Pope & Talbot insolvency is "held hostage" by purported rights where there is no economic benefit to the party asserting them:

> For the purposes of this case, it is not in my view an extension of the concept of inherent jurisdiction, but rather the prevention of one shareholder, with no economic value of his equity, holding all the stakeholders hostages. In this respect, I conclude that the considerations expressed for the exercise of the Court's inherent jurisdiction under the CCAA are applicable under the BIA to the facts of this case. See Algoma Steel Inc., Re (2001), [2002] O.J. 66 (ont. S.C.J. [Commercial List]) at paragraph 5; Doman Industries Ltd., Re., [2004] B.C.J. No. 1402

137 At this stage of the proceedings, all of the parties and participants involved in the Pope & Talbot insolvency need to know whether D&O insurance coverage is available, and if so to what extent, in order to determine what amounts may be paid to claimants from the Directors' Charge (since that Charge is drawn upon only after claims are paid by existing insurance coverage). The integrity of the bankruptcy process is maintained through a stay order.

138 National Union submits that its policy is with the directors and officers, who are not insolvent, so that there is no basis to interfere with private contractual rights. With respect, that submission overlooks the fact that coverage is also afforded to P&T Inc. and P&T Ltd. in circumstances where they indemnify directors and officers (and are permitted by law to do so). It also overlooks the fact that the s. 119 claims made against the directors and officers of P&T Ltd. arise from the insolvency of P&T Ltd., which is an insured under National Union's policy.

139 I was told, during submissions, that National Union wishes to mediate its dispute with its insureds even though the value of the s.119 claims may not exceed Federal's or XL's policy limits. This presumes it will make an offer to its insureds. There is nothing to prevent National Union from doing that or from engaging in settlement discussions with its insureds at any time.

140 In the circumstances, the operation of the ADR clause is stayed.

Summary

141 The parties expressly intended the proper law of their policies to be determined in relation to the substance of the claims or matters in dispute, by the court that has taken jurisdiction doing so in accordance with its own laws. The insurers have drafted their policies in such a way as to incorporate the principle of *dépeçage.* Here, application of the *Cansulex* factors shows that BC law is the proper law to be applied to determine the insurers' coverage obligations in relation to the *CBCA* s. 119 claims.

142 National Union's ADR clause is stayed in order to permit the orderly, expedient, and effective resolution of the insolvency surrounding the Pope & Talbot Group.

143 The parties may speak to the issue of costs.

Order accordingly.

Tab 13

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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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, <u>subject to the restrictions set out in this Act</u>, 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 14

TRANSPLANTING EQUITABLE SUBORDINATION: THE NEW FREE-WHEELING EQUITABLE DISCRETION IN CANADIAN INSOLVENCY LAW?

*Thomas G.W. Telfer**

> 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."[1]

American courts have long grappled with the meaning and scope of the doctrine of equitable subordination. In the United States, under the principles of equitable subordination, a court may in effect alter the statutory distribution scheme by moving a creditor down the priority chain. Subordination will generally reduce or even eliminate the amount that a creditor can recover from the estate.[2] American courts developed the doctrine without any express statutory authority and relied upon their powers available as a "court of equity". The United States Supreme Court in *Pepper v. Litton* noted, "In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate."[3]

While the United States Bankruptcy Code now gives statutory recognition to the principles of equitable subordination,[4] the Code

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* Faculty of Law, University of Auckland, as of January 2002, University of Western Ontario. This is the revised version of a paper presented at the 30th Annual Workshop on Commercial and Consumer Law, held at the Faculty of Law of the University of Toronto on October 20 and 21, 2000. It was also presented at the University of Saskatchewan and the University of Western Ontario. I thank the participants at the Workshop and the seminars for their comments and suggestions. I have also benefited from the comments of Deborah DeMott, Jason Neyers, Charles Rickett, Peter Watts, John Chapman and Jacob Ziegel, who read an earlier draft of the paper. Research assistance was provided by the Chapman Tripp research program.

1. *Re Lifschultz Fast Freight*, 132 F.3d 339 (7th Cir. 1997) at p. 349, quoting D. Skeel, "Markets, Courts, and the Brave New World of Bankruptcy Theory", [1993] Wisc. L. Rev. 465 at p. 506.
2. *Ibid.*, at p. 341.
3. *Pepper v. Litton*, 308 U.S. 295 (1939) at pp. 307-08.
4. 11 U.S.C. s. 510(c).

Tab 15

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

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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

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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

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Lifschultz Fast Freight, Re (1997), 132 F.3d 339 (U.S. C.A. 7th Cir.) — referred to

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Statutes considered:

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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 *Matticks* 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 *Matticks*. 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.

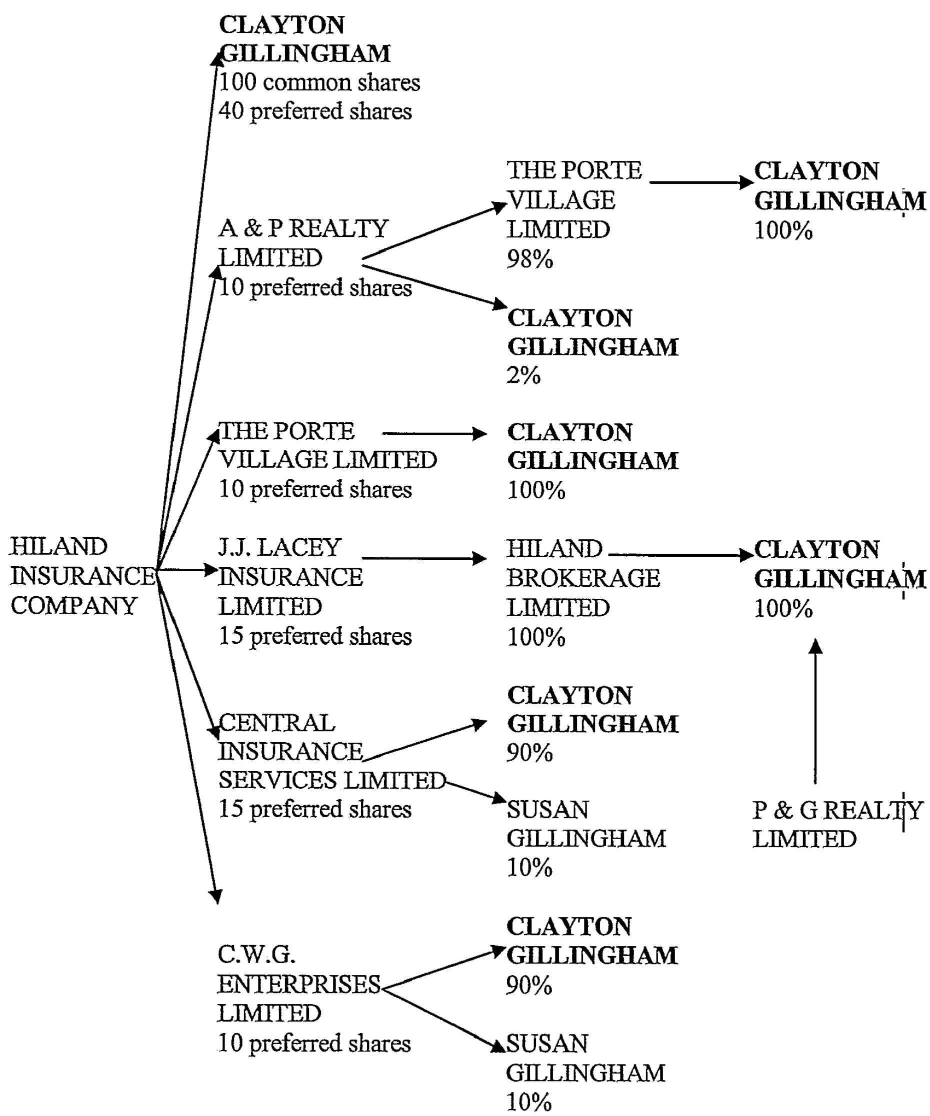
55 Lloyd's shall be entitled to its costs in this matter as against the estate of Lacey and the provisional liquidator of Hiland.

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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