CITATION: 8527504 Canada Inc. v. Liquibrands Inc., 2014 ONSC 7015
COURT FILE NO.: CV-14-10543-00CL
DATE: 20141204

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

BETWEEN:

8527504 CANADA INC.

Applicant

- and –

LIQUIBRANDS INC.

Respondent

Court File No. CV-13-10331-00CL

AND BETWEEN:

8527504 CANADA INC.

Applicant

- and -

SUN PAC FOODS LIMITED

Respondent

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

BEFORE: Newbould J.

COUNSEL: *Harvey Chaiton and Sam Rappos*, for the Applicant

David E. Wires and Krista Bulmer, for the Respondents Liquibrands Inc. and Sun Pac Foods Limited

Anthony J. O'Brien, for the BDO Canada Limited, receiver of Sun Pac Foods Limited

HEARD: November 28, 2014

ENDORSEMENT

[1] The applicant 8527504 Canada Inc.("852") applies for the appointment of a receiver of the assets of the respondent Liquibrands Inc. ("Liquibrands") under security granted by Liquibrands to Bridging Canada Inc. ("Bridging") and assigned to 852.

[2] Liquibrands applies for an order lifting a stay of proceedings in the receivership order of Sun Pac Foods Limited ("Sun Pac") to permit an action commenced by Sun Pac and Liquibrands against 852 and Bridging to proceed and to appoint a receiver of the remaining assets of Sun Pac for the purpose of advancing the litigation. Liquibrands is a secured creditor of Sun Pac in second place after 852 and requests an order directing the receiver to pay into court the balance of funds held by the receiver of Sun Pac from the sale of its assets pending the completion of the law suit. The receiver applies for an order to pay the funds it holds to 852.

[3] Sun Pac was a Canadian manufacturer of private label and branded beverage products, and a manufacturer of croutons and bread crumbs and other private label brands (the "Breadcrumbs Division").

[4] Sun Pac was acquired by Liquibrands in November 2011. Liquibrands is the sole shareholder of Sun Pac. Mr. Csaba Reider is the sole shareholder, officer and director of Liquibrands. He was also the sole officer and director of Sun Pac.

[5] Bridging provides middle-market commercial customers with alternative financing solutions to borrowers who are unable to obtain financing from traditional lenders. 852 is a company related to Bridging and took an assignment of the loans and security for loans made by Bridging to Sun Pac.

[6] On October 1, 2012, Bridging advanced a revolving loan of up to $5 million based on a lending formula under Facility A, $500,000.00 (before facility fees) on January 18, 2013 under a Facility B term loan on equipment, and the balance of the facility B loan, $1,182,524.00 (before facility fees), was advanced on January 31, 2013. The loans were secured on the assets of Sun Pac. Liquibrands guaranteed $1 million of the Sun Pac Facility A loan and provided security over all of its assets to support the guarantee.

[7] Mr. Reider was in discussion with Loblaws to produce private label drinks for Loblaws. However Sun Pac was running short of working capital and in August 2013 was in default of its loan obligations to 852. He decided to sell the Breadcrumbs Division for $3.1 million and he requested additional funding to continue operating.

[8] On September 11, 2013 852, Sun Pac and Liquibrands signed a Forbearance and Amending Agreement dated September 11, 2013. The Forbearance Agreement was entered into to provide Sun Pac with a temporary bridge loan in the hopes of obtaining equity and debt financing for the anticipated Loblaws contract and to complete a sale of the Breadcrumbs Division to repay the bridge loan. In the Forbearance Agreement, Sun Pac acknowledged that it was in default of the terms of its loans.

[9] Notwithstanding the default, 852 agreed not to take any steps to enforce any of the loans or its security prior to the earlier of December 9, 2013 or the occurrence of an Event of Default.

[10] In the Forbearance Agreement, 852 agreed to extend a temporary bridge loan to Sun Pac in two tranches. Facility C was a demand non-revolving loan in the amount of $500,000 less fees. Facility C was advanced to Sun Pac in the amount of $475,000 on or about September 13, 2013.

[11] Facility D was a demand non-revolving loan in the maximum amount of 2 times EBITDA of the Breadcrumbs Division as determined by a report from BDO Canada Limited, less the amount advanced under Facility C. Paragraph 13 of the Forbearance Agreement provided:

> Provided that 852 has received and is satisfied with the report to be prepared by BDO at the expense of Sun Pac, 852 shall, promptly following the execution of this Agreement, advance to Sun Pac as a Facility D Loan advance a single advance in an amount equal to 2 times EBITDA of the Breadcrumbs Division (as defined below) (as determined by BDO in its report to Sun Pac and 852 in its sole discretion), less the Facility C Principal Amount...Each advance shall be conditional on there being no Event of Default under this Agreement and the Loan Agreement.

[12] One event of default contained in the Forbearance Agreement was if Sun Pac failed to have a binding agreement for the sale of the Breadcrumbs Division by November 6, 2013 that was acceptable to 852 in its sole and absolute discretion and failed to close it by December 6, 2013.

[13] BDO prepared a report dated September 25, 2013, which it delivered to Sun Pac and 852 on September 30, 2013. Based on the report, the Facility D loan was to be approximately $1.15 million. 852 took no issue with the amount of the EBITDA as reported by BDO.

[14] 852 did not advance the Facility D loan. There is a dispute among the parties as to whether 852 was in breach of the Forbearance Agreement in failing to advance the loan. I do not intend to get into that issue, although was invited to do so.

[15] On October 4, 2013, 852 informed Mr. Reider that it was not prepared to advance Facility D without certain matters being addressed. According to 852, they were not addressed.

[16] On November 11, 2013, 852's lawyers were informed by Sun Pac's insolvency lawyers that Sun Pac's operations had been shut down on November 7, 2013, at which time all but a few employees were terminated. As a result, 852 commenced an urgent receivership application heard on November 12, 2013. Sun Pac and Liquibrands had counsel attend the hearing but did not oppose the receivership application. BDO was appointed as receiver of Sun Pac on November 12, 2013.

[17] On the morning of November 12, 2013, Liquibrands and Sun Pac commenced an action against 852 and Bridging seeking, *inter alia*, general damages of $100 million for breach of the Forbearance Agreement by not advancing Facility D in the amount of approximately $1.15

million. Sun Pac had signed an agreement with Loblaws made as of September 18, 2013 containing terms regarding the sale of drink products by Sun Pac to Loblaws, and the damage claim is for alleged lost profits that would have been earned under that agreement.

Issues and analysis

(a) Need for leave to continue the action by Sun Pac

[18] Sun Pac and Liquibrands say that the receivership order of November 12, 2013 in which BDO was appointed receiver of Sun Pac has stayed the action commenced that day by Liquibrands and Sun Pac against 852 and Bridging, and asks leave to proceed with that action. This request is based on a misreading of the receivership order, which followed the standard form used in the Commercial List and approved by the Commercial List Users Committee.

[19] Mr. Wires said that he reads paragraph 7 of the order as staying the action. However, paragraph 7 deals with actions against the debtor or its property and states that "no proceeding against or in respect of the debtor or its property shall be commenced or continued" without the consent of the receiver or leave of the court. To read a proceeding "in respect of the debtor or its property" as applying to an action commenced by the debtor would be to ignore the heading in the order for paragraph 7 "NO PROCEEDING AGAINST THE DEBTOR OR THE PROPERTY". It would also ignore paragraph 3(j) of the order which gives the receiver the power "to initiate, prosecute and continue the prosecution of any and all proceedings…now pending or hereafter instituted".

[20] The receiver of Sun Pac is quite entitled to continue the action commenced by Sun Pac against 852 and Liquibrands without the necessity of obtaining leave to do so.

(b) Proceeds of the sale of Sun Pac's assets

[21] The receiver has realized on the assets of Sun Pac and has proposed an interim distribution of $383,381 from the proceeds of Sun Pac's assets to 852 on account of its first

ranking security interest. 852 is owed approximately $4.0 million and will suffer a substantial shortfall on its loans to Sun Pac.

[22] Liquibrands holds security from its wholly owned subsidiary Sun Pac to secure $2.54 million loaned to Sun Pac. Its security ranks second after the security held by 852. Liquibrands asserts that the proceeds held by the receiver of Sun Pac should be paid into court pending the determination of the action by Sun Pac and Liquibrands against 852 and Bridging. It claims that based on the claims in the action, there is a serious issue to be tried regarding 852's claim to the fund. It relies on rule 45.02 that provides:

> 45.02 Where the right of a party to a specific fund is in question, the court may order the fund to be paid into court or otherwise secured on such terms as are just.

[23] I do not see that the rule assists Liquibrands. The test for granting an order preserving a specific fund is threefold: (1) the plaintiff claims a right to the specific fund; (2) there is a serious issue to be tried regarding the plaintiff's claim to the fund; and (3) the balance of convenience favours granting the relief sought. The plaintiff must have a proprietary claim against the specific funds beyond the funds utility to satisfy the plaintiff's claim against the defendant. See *DIRECT TV v. Gillot* (2007), 84 O.R. (3d) 595 at paras. 44 and 59.

[24] Liquibrands cannot meet this test. The money in question results from the proceeds of the sale of the assets of Sun Pac. Liquibrands as a second creditor has security over the assets of Sun Pac second to the security of 852. There is no question that the security of 852 is valid and what Liquibrands is essentially doing is attempting to secure before judgment its claim for damages against 852 and Bridging.

[25] The law suit was started on the morning of November 12, 2013 before the receivership order was made later that day. The court had to be satisfied that the loan to Sun Pac was owed in order to make the receivership order. Sun Pac and Liquibrands were represented in court that day by experienced insolvency counsel and no objection was made to the request for the receivership order. Sun Pac and Liquibrands cannot now contend that the money is not owing to 852 and that Liquibrands has a claim to it. That would amount to a collateral attack on the order.

[26] There is no serious issue to be tried regarding Liquibrands' claim to the proceeds of the sale of Sun Pac's assets held by the receiver. 852 has the right to those proceeds. There may be a serious issue to be tried regarding the claim for damages by Sun Pac and Liquibrands against 852 and Bridging, although I make no such finding, but that is a different matter.

[27] The funds held by the receiver of Sun Pac may be paid out to 852.

(c) Should a receiver of Liquibrands be appointed?

[28] Under the GSA security from Liquibrands to 852, Liquibrands may appoint a receiver over all of the property of Liquibrands upon an event of default. Demand under the guarantee of Liquibrands was made in April, 2014 and no payment was made. Thus there has been an event of default. There is no issue as to the validity of the security.

[29] A receiver may be appointed under section 243(1) of the BIA if it is considered just or convenient to do so. The principles applicable are referred to in *Bank of Montreal v. Carnival National Leasing Ltd.* (2011), 74 C.B.R. (5th) 300.

[30] Liquibrands contends that there should be no receiver appointed pending the outcome of its lawsuit against 852 and Bridging, and relies on *Bank of Montreal v. Wilder*, [1986] 2 S.C.R. 551. In that case the bank breached an agreement not to call the loan for a period of time if guarantees were provided and an injection of capital was made into the customer company, which happened. The guarantors were relieved of liability because of the wrong doing of the Bank. The bank relied on a provision in the guarantee that it could deal with the customer "as the Bank may see fit". It was held that this did provision did not protect the bank. Wilson J. for the Court stated:

> The Bank under the umbrella agreement could have decided to make the business decision to stop financing the Company at any time prior to the June agreement. After that agreement this option was closed to it. It agreed with the Company and with the guarantors that it would continue to finance the Company at least until it had completed the Alberta road projects. It failed to do so despite the fact that the Wilders kept their part of the bargain. The Bank's breach not only increased the guarantors' risk in a way which was "not plainly unsubstantial" and impaired their

> security; it put the principal debtor out of business and into bankruptcy. Such conduct on the part of the Bank cannot, in my opinion, be viewed as within the purview of the clause in the guarantee contracts permitting the Bank to deal with the Company and the guarantors as it "may see fit". I agree with Lambert J.A. that such a clause must be construed as extending to lawful dealings only.

[31] In this case, however, the guarantee given by Liquibrands was much broader than in *Bank of Montreal v. Wilder*. Section 2 of the guarantee provided:

> 2. **Guarantee Unconditional**. The obligations of the guarantor under this guarantee are continuing, unconditional and absolute and...will not be released, discharged, diminished, limited or otherwise affected by (and the Guarantor hereby waives, to the fullest extent permitted by applicable law) *inter alia*:
>
> > (e) the existence of any claim, set-off or other rights which the Guarantor may have at any time against the Debtor, the Creditor, or any other person, whether in connection herewith or any unrelated transactions;
> >
> > (p) any dealing whatsoever with the Debtor or other person or any security, whether negligently or not, or any failure to do so; ...
> >
> > (r) any other act or omission to act or delay of any kind by the Debtor, the Creditor, or any other person or any other circumstances whatsoever, whether similar or dissimilar to the foregoing, which might, but for the provisions of this Section 2, constitute a legal or equitable discharge, limitation or reduction of the Guarantor's obligations hereunder (other than the payment or extinguishment in full of all of the Obligations).
>
> The foregoing provisions apply (and the foregoing waivers will be effective) even if the effect of any action (or failure to take action) by the Creditor is to destroy or diminish the Guarantor's subrogation rights, the Guarantor's right to proceed against the Debtor for reimbursement, the Guarantor's right to recover contribution from any other guarantor or any other right or remedy.

[32] A party may contract out of an equitable rule regarding guarantees. See *Bauer v. Bank of Montreal*, [1980] 2 S.C.R. 102. Liquibrands was represented by counsel at the time it signed the guarantee and there is no reason why the terms are not enforceable. The terms of the guarantee preclude Liquibrands from contending that the guarantee may be unenforceable if it succeeds in its action against 852.

[33] Moreover, in a Subordination, Assignment, Postponement and Standstill Agreement made by Liquibrands and Sun Pac with Bridging at the same time as the guarantee, Liquibrands agreed not to take any steps whereby the priority or rights of 852 might be delayed, defeated, impaired or diminished and agreed not to challenge, object to, compete with or impede in any manner any act taken or proceeding commenced by 852 in connection with the enforcement of 852's security.

[34] Liquibrands also claims that as second secured creditor of Sun Pac, it should have priority over the security of 852 because of the breach by 852 of the Forbearance Agreement. I am not in a position to say that there has been a breach of that agreement and in any event the Subordination, Assignment, Postponement and Standstill Agreement precludes that contention. It provides that Liquibrands consents to the security granted to Bridging by Sun Pac and acknowledges that notwithstanding any priority provided by any principle of law or equity, the security of Liquibrands is unconditionally subordinated to the security held by Bridging. Liquibrands also agreed in that agreement that it would not take any steps whereby the priority of Bridging might be defeated and that it would not challenge any proceeding to enforce that security. 852 holds those rights as assignee from Bridging.

[35] I find that it is just and convenient that a receiver of Liquibrands be appointed and BDO is appointed as receiver of all of its property, assets and undertakings in the form contained at tab 3 of the Application Record.

(d) Procedure for the litigation

[36] The action by Liquibrands and Sun Pac against 852 and Bridging for breach of the Forbearance Agreement is outstanding. Liquibrands requests an order that a different receiver from BDO be appointed as receiver of "the remaining assets" of Sun Pac for the purposes of advancing the litigation. The reason is that BDO, the receiver of Sun Pac, has indicated that it does not wish to spend money on the law suit.

[37] BDO is prepared to market the right to commence the action. There is precedent for such a procedure. In *Central 1 Credit Union v. UM Financial Inc.*, 2012 ONSC 1893 it was held that a

lawsuit by the debtor in receivership constituted collateral that was subject to the existing receivership proceeding. The court appointed receiver subsequently brought a motion seeking court approval to conduct a marketing process for the sale of the claim and that relief was granted by Justice C. Campbell. It seems sensible that now that BDO is the receiver of both Sun Pac and Liquibrands, the two plaintiffs in the action, BDO should be permitted to market the litigation in a marketing process.

[38] No specific marketing process has been proposed. The receiver should propose a marketing process and Sun Pac and Liquibrands can consider whether it is agreeable to the marketing process proposed. If there is agreement to the marketing process, it can be included in the order to be signed reflecting these reasons. If there is no agreement, a further attendance to settle it can be arranged at a 9:30 am conference.

(e) Receiver's motion

[39] The receiver has applied for orders approving the Third Supplement to its First Report, approving its Third Report, approving its fees and disbursements of those of its counsel, approving its statement of receipts and disbursements, and authorizing and directing the receiver to make a distribution to 852 and maintain a holdback in accordance with its Third Report. The relief requested is reasonable and is granted.

Newbould J.

Date: December 4, 2014