

2025 01G 0491

**IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR  
IN BANKRUPTCY AND INSOLVENCY**

**IN THE MATTER OF** the *Companies*  
*Creditors Arrangement Act*, R.S.C.,1985  
c. C-36 as Amended (the “**CCAA**”)

**AND IN THE MATTER OF** an  
application of Karwood Contracting Ltd.,  
Karwood Engineering Ltd., Karwood  
Design Group Ltd., and Karwood  
Ontario Ltd. (the “**Applicants**”)

**MEMORANDUM OF ARGUMENT OF KENT BUILDING SUPPLIES, A DIVISION OF  
J.D. IRVING LIMITED**

| <b>SUMMARY OF CURRENT DOCUMENT</b>                 |  |
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| Court File Number:                                 | 2025 01G 0491  |
| Date of Filing Document:                           | November 7, 2025   |
| Name of Party Filing or Person:                    | Kent Building Supplies, a division of J.D. Irving, Limited   |
| Application to which document being filed relates: | An Application under section 36.1 of the <b>CCAA</b> , applying sections 38 and 95-101 of the <b>BIA</b> |
| Statement of Purpose in Filing:                    | To support application   |

**MEMORANDUM OF ARGUMENT OF KENT BUILDING SUPPLIES, A DIVISION OF  
J.D. IRVING LIMITED**

IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR  
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c. C-36 as Amended (the “CCAA”)

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1. At the hearing of this application, the position of Kent will be that the application is a proceeding between the Monitor and Kent only, and that no other party:
  - a) is entitled to receive notice of the application; or
  - b) has standing to be heard at the hearing of the application.
  
2. Kent will refer to the following authorities:
  - a) **Shaw (Trustee of) v. Nicol Island Development Inc.** (Ont. C.A.) esp. paragraphs 43-46 (TAB 1)
  - b) **Toyota Canada Inc. v. Toronto-Dominion Bank** (Alta C.A.) esp. paragraphs 16-30 (TAB 2)
  - c) **Toyota Canada Inc. v. Toronto-Dominion Bank**, leave to appeal to S.C.C. dismissed (TAB 3)

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

DATED at the City of St. John's, in the Province of Newfoundland and Labrador, this 7<sup>th</sup> day of November, 2025.

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**R. Barry Learmonth, K.C.**  
**LEARMONTH, BOULOS & FITZGERALD**  
Solicitors for the Kent

# TAB 1

▲ **Shaw (Trustee of) v. Nicol Island Development Inc.**

Ontario Judgments

Ontario Court of Appeal

Toronto, Ontario

D.H. Doherty, E.A. Cronk and R.G. Juriansz JJ.A.

Heard: November 6, 2008.

Judgment: April 3, 2009.

Docket: C48494

[2009] O.J. No. 1333 | 2009 ONCA 276 | 51 C.B.R. (5th) 12 | 2009 CarswellOnt 1748 | 248 O.A.C. 35 |  
177 A.C.W.S. (3d) 296

Between Ernst & Young (Thunder Bay) Inc., Trustee of the Estate of Herbert Graham Shaw, Respondent, and Nicol Island Development Incorporated, and Andre Nicol, Appellants And between Northern Lights Credit Union Limited, Respondent, and Nicol Island Development Incorporated, and Andre Nicol, Appellants

(80 paras.)

## **Case Summary**

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**Bankruptcy and insolvency law — Creditors and claims — Creditors — Acting as trustee — Appeal by defendants allowed to extent of limited concession — The defendants' pleadings challenging the plaintiff's status to bring a s. 38 action on behalf of the trustee were struck — The appellate court upheld the decision — Although the motion judge erred in finding that the defendants had no standing to challenge the plaintiff's status as creditor, there was no error in finding that the plaintiff was a creditor — There was no unfair treatment of the defendants or an abuse of process that justified setting aside the s. 38 order — Bankruptcy and Insolvency Act, ss. 38, 38(1).**

**Bankruptcy and insolvency law — Proceedings — Practice and procedure — Pleadings — Appeal by defendants allowed to extent of limited concession — The defendants' pleadings challenging the plaintiff's status to bring a s. 38 action on behalf of the trustee were struck — The appellate court upheld the decision — Although the motion judge erred in finding that the defendants had no standing to challenge the plaintiff's status as creditor, there was no error in finding that the plaintiff was a creditor — There was no unfair treatment of the defendants or an abuse of process that justified setting aside the s. 38 order — Bankruptcy and Insolvency Act, ss. 38, 38(1).**

Appeal by the defendants, Nicol, and his company, Nicol Island Development, from an order obtained by the plaintiff, Northern Lights Credit Union, striking certain paragraphs of the statement of defence. Four months prior to filing for assignment, Shaw granted two mortgages in favour of the defendants using funds from his RRSP. The monies were funneled to Shaw's companies. No payments were ever made on the mortgages, yet they were subsequently discharged by Shaw. When the trustee learned of the mortgages and the discharges, it concluded that the discharges constituted a fraudulent conveyance or preference. The plaintiff was a creditor that held a default judgment against Shaw. It obtained an assignment of the trustee's rights and an order under s. 38 of the Bankruptcy and Insolvency Act allowing it to continue litigation in the trustee's place. The defendants' statement of defence alleged that the plaintiff had no status as a creditor to bring a s. 38 proceeding, as its claims against Shaw were settled prior to obtaining the s. 38 order. Accordingly, the defendants sought dismissal of the plaintiff's action. The motion judge struck the provisions in question, as the default judgment was subsumed in Shaw's bankruptcy

## Shaw (Trustee of) v. Nicol Island Development Inc.

and there was thus no status to settle the case. In any event, settlement was irrelevant to a s. 38 application. The challenge to the plaintiff's status as a creditor was an improper collateral attack. The defendants appealed. HELD: Appeal allowed to the extent conceded, and otherwise dismissed.

The motion judge erred in holding that the defendants did not have standing to challenge the creditor status of the plaintiff. The defendants' allegations of abuse of process, non-disclosure and misrepresentation to the court triggered exceptions to the restrictions on standing in respect of s. 38 orders. There was no restriction on the defendants' standing to seek summary dismissal of the s. 38 action. Nonetheless, the judge did not err in holding that the plaintiff was a creditor of Shaw with standing to obtain the s. 38 order. When Shaw made his assignment in bankruptcy, the plaintiff had an outstanding default judgment against him and filed an unchallenged proof of claim. The assertion that the plaintiff misrepresented its status as a creditor on the basis of an earlier settlement with Shaw was unsustainable. The judge properly found that only the trustee could conclude a settlement with a creditor of Shaw that was binding on the estate. There was no unfair treatment of the defendants or an abuse of process that justified setting aside the s. 38 order. Thus the decision to strike the impugned provisions of the defendants' pleading was valid. The costs provision of the s. 38 order exposing the defendants to potential liability was set aside on consent.

## **Statutes, Regulations and Rules Cited:**

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Bankruptcy and Insolvency Act, *R.S.C. 1985, c. B-3, s. 2, s. 30(1), s. 30(1)(d), s. 30(1)(h), s. 30(1)(i), s. 37, s. 38, s. 38(1), s. 38(2), s. 71, s. 121(1), s. 178(2), s. 187(5), s. 187(9)*

Ontario Rules of Civil Procedure, Rule 20, Rule 21.01(3)(b), Rule 21.01(3)(d), Rule 59.06(2), Rule 76

### **Appeal From:**

On appeal from the order of Justice H.M. Pierce of the Superior Court of Justice, dated December 13, 2007 and reported at *38 C.B.R. (5th) 92*.

## **Counsel**

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Allan D. McKittrick, for the appellants.

Tracey Nieckarz, for the respondent, Northern Lights Credit Union Limited.

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The judgment of the Court was delivered by

**E.A. CRONK J.A.**

### **I. Introduction**

1 This appeal involves a fraudulent preference and conveyance action commenced by the alleged creditor of a bankrupt with leave of the court under s. 38(1) of the *Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3*, as amended (the "Act"). The court is required to consider whether the defendants named in the action have standing to challenge the s. 38(1) court order and the action commenced pursuant to that order, as well as the standing of the plaintiff to obtain relief under s. 38(1) and to maintain the action authorized thereunder.

### **II. Relevant Statutory Provisions**

2 The following provisions of the Act are central to the issues on appeal:

2. In this Act,

Shaw (Trustee of) v. Nicol Island Development Inc.

...

"creditor" means a person having a claim, unsecured, preferred by virtue of priority under section 136 or secured, provable as a claim under this Act;

...

38.(1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

(2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.

...

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.

3 The parties also rely on the following remedial provisions of the Act:

37. Where the bankrupt or any of the creditors or any other person is aggrieved by any act or decision of the trustee, he may apply to the court and the court may confirm, reverse or modify the act or decision complained of and make such order in the premises as it thinks fit.

...

187.(5) Every court may review, rescind or vary any order made by it under its bankruptcy jurisdiction.

...

(9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

I will refer in these reasons to certain other provisions of the Act in the context of the issues to which they relate.

### III. Facts

4 This dispute has a lengthy procedural history. Given the submissions made by the appellants on appeal, a somewhat detailed chronology is necessary.

#### (1) Events Prior to Section 38 Motion

5 In the early 1990s, Herbert Graham Shaw ("Shaw") operated two companies: Shaw Transportation Services (Thunder Bay) Limited ("Shaw Transportation") and Shaw Baking Company Limited ("Shaw Baking"). In 1993, when Shaw Transportation experienced financial difficulties, Shaw decided to access funds in two of his self-directed registered retirement savings plans ("RRSPs") to pay some of Shaw Transportation's debts.

6 However, Shaw did not wish to diminish his retirement fund by collapsing his RRSPs, thereby triggering adverse income tax consequences. He therefore persuaded his friend, the appellant Andre Nicol ("Nicol"), to arrange for the appellant, Nicol Island Development Incorporated ("Nicol Island"), to borrow funds from the RRSPs, to be secured by mortgages granted by Nicol Island on lands owned by it in favour of the trustee of the RRSPs.

## Shaw (Trustee of) v. Nicol Island Development Inc.

**7** On June 17, 1993, Nicol Island borrowed \$37,000 from the RRSPs, the repayment of which was secured by a mortgage in a like amount from Nicol Island to the trustee of the RRSPs and Nicol's personal guarantee. On July 10, 1998, Nicol Island borrowed an additional \$55,000 from the RRSPs. The repayment of this loan was again secured by a mortgage granted by Nicol Island in favour of the trustee of the RRSPs, in the same amount as the loan. It appears that the proceeds of both loans were funnelled, directly or indirectly, to Shaw Transportation. No payments were ever made on the Mortgages by any party.<sup>1</sup>

**8** On June 20, 2003, the respondent, Northern Lights Credit Union Limited (the "Credit Union"), commenced an action against Shaw and his wife, Carol Shaw, on their personal guarantee of Shaw Bakery's indebtedness to the Credit Union (the "Guarantee Action").

**9** Five days later, on June 25, 2003, Shaw arranged for the discharge of the Mortgages, although the full amount of principal and interest owing thereunder remained outstanding (the "Discharges").

**10** On August 18, 2003, when the Shaws did not defend the Guarantee Action, the Credit Union obtained default judgment against them in the amount of \$109,748.58, plus post-judgment interest and costs.

**11** On October 15, 2003, Shaw filed an assignment in bankruptcy under the Act. The respondent, Ernst & Young (Thunder Bay) Inc., was appointed trustee of the bankrupt estate (the "Trustee"). On October 17, 2003, the Trustee filed a notice of stay of proceedings against Shaw in the Superior Court of Justice, the effect of which was to preclude any efforts by the Credit Union to enforce its default judgment against Shaw, without leave of the court. Consequently, at the end of October, the Credit Union filed a proof of claim in Shaw's bankruptcy, in the amount of \$108,863.28. The proof of claim was accepted by the Trustee.

**12** In his sworn statement of creditors and liabilities filed in the bankruptcy, Shaw listed the Credit Union as an unsecured creditor who was owed \$108,200. In his sworn statement of affairs (assets) in the bankruptcy, Shaw did not disclose the Mortgages or the Discharges. Indeed, he indicated that his RRSPs had no value.

**13** Neither Shaw (prior to his bankruptcy) nor his Trustee (after the bankruptcy) moved to set aside the Credit Union's default judgment against Shaw. However, after the default judgment against her was set aside in May 2004, Mrs. Shaw delivered a statement of defence and counterclaim in the Guarantee Action. In her pleading, she challenged the validity of the guarantee granted to the Credit Union and claimed damages of approximately \$5 million on her own behalf and that of her husband for wrongs allegedly committed by the Credit Union in realizing on its security against Shaw Bakery and the Shaws.

**14** Shaw received an automatic discharge from bankruptcy on July 16, 2004. It appears that his discharge was unopposed.

**15** When the Trustee subsequently learned of the Mortgages and the Discharges, it concluded that the Discharges constituted a wrongful settlement, fraudulent conveyance and/or preference without which the Mortgages would have formed part of the assets available in Shaw's bankrupt estate to satisfy creditors. Accordingly, on December 6, 2004, the Trustee moved in the bankruptcy proceeding for various relief against the appellants, including orders: setting aside the Discharges and reinstating the Mortgages; directing the appellants to pay the principal amounts owing under the Mortgages (\$92,000) to the Trustee; and directing a trial of the issues raised on the motion (the "Trustee's Motion").

**16** The appellants countered with a cross-motion in which they sought an order dismissing the Trustee's Motion in its entirety on the ground that it was frivolous and without merit or, in the alternative, dismissing it in respect of the 1993 mortgage on the basis that the 10-year limitation period applicable to actions on a mortgage had expired, among other relief. In their motion materials, the appellants alleged that the RRSP loans to Nicol Island were designed to assist Shaw in his financial difficulties, that the appellants derived no benefit therefrom, that the RRSP

## Shaw (Trustee of) v. Nicol Island Development Inc.

funds were provided to Shaw Transportation or its creditors at Shaw's direction, and that the parties never intended that the appellants should be liable under the Mortgages.

**17** The motions were heard together by Platana R.S.J. of the Superior Court of Justice. On June 9, 2005, he dismissed the appellants' motion, rejected or declined to rule on much of the relief claimed in the Trustee's Motion, and ruled that there should be a trial on a number of the issues raised. He therefore directed the parties to reattend before him to settle the issues for trial.

**18** For various reasons, the directed reattendance before Platana R.S.J. did not take place for almost 18 months. In the intervening period, by letters dated March 14, 2005 to Mrs. Shaw and January 9, 2006 to both Mr. and Mrs. Shaw, counsel for the Credit Union communicated directly with the Shaws regarding the possible settlement of the Guarantee Action. In his January 9 letter, counsel indicated that his client had agreed "to accept your offer that the actions be dismissed on a without costs basis provided that you are responsible for the costs in taking out these Orders". On January 30, 2006, when payment of the required costs was not forthcoming, the Credit Union's counsel informed the Shaws that the Credit Union would not take any further steps concerning the dismissal of the Guarantee Action.

### **(2) Section 38 Motion**

**19** On January 18, 2006, the Credit Union wrote to the Trustee and requested it to move forward with the litigation against the appellants. The Trustee refused to do so as Shaw's estate lacked sufficient funds to finance the litigation. Instead, the Trustee informed the Credit Union that if it obtained an order under s. 38(1) of the Act permitting it to take the proceeding against the appellants in its own name, the Trustee would assign and transfer its interest in the proceeding to the Credit Union in accordance with s. 38(2) of the Act.

**20** In October 2006, the Credit Union moved for an order under s. 38(1) of the Act. In its motion materials, it identified itself as a creditor in Shaw's bankruptcy and indicated that it wished "to continue the proceedings commenced by the Trustee by arranging an appointment to settle the issues and obtain an order directing trial of those issues ...". The Credit Union served its motion materials on the Trustee, but did not serve the appellants or Shaw.

**21** At the time of the s. 38 motion, the Trustee had not assigned its interest in the proceeding to the Credit Union. A formal assignment was delivered in June 2007.

**22** By order dated October 16, 2006, Pierce J. of the Superior Court of Justice (the "Motion Judge") authorized the Credit Union to continue proceedings against the appellants in its own name, provided a procedure for so doing, and directed that the costs of the s. 38 motion were to be in the discretion of the court hearing the proceedings (the "s. 38 Order"). Notice of the s. 38 Order was provided thereafter to the creditors identified in the bankruptcy and to the appellants.

### **(3) The Platana Order**

**23** The Credit Union and the appellants eventually appeared before Platana R.S.J. to settle the terms of his June 9, 2005 order and to resolve the issues to be tried. Although the Trustee did not participate, its former counsel - T. Michael Strickland - appeared for the Credit Union. By order dated December 19, 2006, Platana R.S.J. directed in part that: (i) on consent, the matter was to proceed as a regular trial under the simplified procedure set out in the *Rules of Civil Procedure*; and (ii) the issues to be tried were "as specified in [the] Draft Statement of Issues filed and initialled by counsel" (the "Platana Order").

**24** The parties' Draft Statement of Issues contained no explicit reference to the Credit Union's status as a creditor of the bankrupt or its entitlement to seek the s. 38 Order. The issues identified for trial were confined to the following:

- (1) Were either or both of the Discharges "a settlement, a fraudulent conveyance and/or a fraudulent preference"?

## Shaw (Trustee of) v. Nicol Island Development Inc.

- (2) If so, should either or both of the Discharges be set aside and the Mortgage(s) reinstated?
- (3) In respect of the 1993 mortgage, did the granting of the relevant Discharge extend the applicable limitation period?
- (4) Were the appellants liable to pay the principal amounts, together with interest, owed under the Mortgages?
- (5) If the appellants were liable to pay interest, what rate of interest applied in the circumstances?

The appellants did not appeal the Platana Order.

**25** The parties dispute certain of the events at the December 2006 court attendance. In particular, in an affidavit filed on the motions that gave rise to this appeal, Strickland swore that, during this attendance, the appellants' counsel raised the issue of the Credit Union's status as a "proper creditor" of Shaw and, therefore, its entitlement to the s. 38 Order. However, he also said that the appellants' counsel did not "elaborate on why [the appellants] suspected that [the Credit Union] was not a proper creditor", nor was it suggested that the appellants suspected that the Credit Union had released Shaw from any claims. On the contrary, Strickland deposed that when he agreed to provide the appellants with a copy of the Credit Union's proof of claim in bankruptcy, Platana R.S.J. asked the appellants' counsel whether that information "would be sufficient". In response, counsel for the appellants allegedly "made no further objections and abandoned their argument" regarding the Credit Union's status as a proper plaintiff.

**26** The appellants maintain that they did not abandon the creditor status issue during their appearance before Platana R.S.J. They rely on affidavit evidence from Nicol that the appellants did not learn of the "settlement" of the Guarantee Action until February 2007. But the appellants do not deny that the question of the Credit Union's creditor status was raised before Platana R.S.J. Nor have they adduced any evidence that contradicts Strickland's version of what was said before Platana R.S.J. on this issue.

#### **(4) The Competing Motions**

**27** At the end of January 2007, in reliance on the s. 38 Order, the Credit Union instituted a fresh action against the appellants, claiming essentially the same relief as had been sought on the Trustee's Motion (the "s. 38 Action").

**28** The appellants responded to the s. 38 Action in two ways. First, in their statement of defence, they put in issue: (i) the Credit Union's status as a creditor of Shaw and its standing to seek the s. 38 Order; (ii) the alleged settlement of the Credit Union's claims against the Shaws; (iii) the validity of the Guarantee Action; and (iv) the Credit Union's failure to disclose the alleged settlement to Platana R.S.J. and on the s. 38 motion.

**29** Next, the appellants moved for orders dismissing the Trustee's Motion and the s. 38 Action and setting aside the s. 38 Order, among other relief. The stated grounds for the motion included claims that the Credit Union had no standing or capacity to initiate the s. 38 Action or to seek the s. 38 Order, that the s. 38 Order was obtained on the Credit Union's false representation that it was a creditor of Shaw and without full and fair disclosure of all material facts, and that the s. 38 Action was based on a request for the payment of a settled account.

**30** While the appellants' motion was brought under several rules of the *Rules of Civil Procedure*, it was framed principally as a motion to dismiss the s. 38 Action under subrules 21.01(3)(b) and (d) and as a motion for summary judgment under Rule 76 (the simplified procedure) or, in the alternative, under Rule 20. Importantly, although the appellants sought to set aside the s. 38 Order under rule 59.06(2), they did not invoke the authority of the court under s. 187(5) of the Act to rescind or vary an order made in the bankruptcy or under s. 37 of the Act for relief against the Trustee concerning its assignment in favour of the Credit Union.

**31** For its part, the Credit Union brought its own cross-motion for an order under rules 25.11 and 38.10 striking those paragraphs of the appellants' pleading that dealt with the Credit Union's creditor status, the alleged settlement

## Shaw (Trustee of) v. Nicol Island Development Inc.

with the Shaws, and alleged defects in the s. 38 motion, primarily on the basis that they raised issues unrelated to the issues ordered for trial.

**32** These competing motions proceeded before the Motion Judge. By order dated December 13, 2007, [2007] O.J. No. 4979, she dismissed the appellants' motion and granted the relief sought by the Credit Union. In the Motion Judge's view: (i) the impugned paragraphs of the appellants' pleading raised a new issue that was outside the scope of the issues to be tried under the Platana Order; (ii) no binding settlement was entered into by the Credit Union with Shaw - rather, the settlement discussions relied on by the appellants "could only have been with Carol Shaw"; (iii) the Credit Union was a creditor of Shaw at the time of his assignment in bankruptcy and, therefore, was eligible to seek an order under s. 38(1) of the Act; and (iv) the appellants' challenge to the Credit Union's creditor status constituted an impermissible collateral attack on the s. 38 Order.

**33** The appellants appeal from the Motion Judge's ruling.

#### IV. Issues

**34** The appellants raise four issues:

- (1) Did the Motion Judge err by holding that the appellants did not have standing to challenge the creditor status of the Credit Union?
- (2) Did the Motion Judge err by holding that the Credit Union was a creditor of Shaw with standing to seek the s. 38 Order?
- (3) Did the Motion Judge err by failing to set aside the s. 38 Order on the basis of the alleged unfair treatment of the appellants and abuse of process?
- (4) Did the Motion Judge err by striking the impugned paragraphs of the appellants' pleading?

#### V. Analysis

##### (1) Applicable Interpretive Principles

**35** It is well-established that an overly narrow, legalistic approach to the interpretation of the Act is to be avoided: *Mercurie v. A. Marquette & Fils Inc.*, [1977] 1 S.C.R. 547, at p. 556. Lloyd W. Houlden, Geoffrey B. Morawetz and Janis P. Sarra in *The 2009 Annotated Bankruptcy and Insolvency Act* (Toronto: Thomson Carswell: 2008) note at p. 2:

The general approach to the *Act* by the courts has been that it is a commercial statute, the administration of which is largely in the hands of business people and technical objections should, therefore, not be given effect to beyond what is necessary for the proper interpretation of the *Act* ... Litigation and court proceedings are to be avoided, thus maximizing the return to creditors. [Citations omitted.]

**36** The general purpose of the Act is described by these authors at p. 3 of the above-cited text in part as follows: The *Act* was passed to provide for the orderly and fair distribution of the property of a bankrupt among his or her creditors on a *pari passu* basis.

...

The *Act* permits the setting aside of preferences, settlements, and other fraudulent transactions so that all ordinary creditors may share equally in the administration of the bankrupt's assets. [Citations omitted.]

**37** The central issues in this case concern s. 38(1) of the Act. In *Toyota Canada Inc. v. Imperial Richmond Holdings Ltd.* (1994), 27 C.B.R. (3d) 1, at paras. 14-15, leave to appeal to S.C.C. refused, [1994] S.C.C.A. No. 346, the Alberta Court of Appeal expressed the purpose of s. 38 in this fashion:

In my view, its primary purpose is to ensure that the bankrupt's assets are preserved for the benefit of the creditors. It provides the mechanism for creditors to proceed with an action when the trustee refuses or fails

## Shaw (Trustee of) v. Nicol Island Development Inc.

to act; thereby ensuring that assets of the bankrupt (which may otherwise go unrecovered) are available to creditors willing to finance the litigation.

The secondary purpose, relating to notice, is to make sure the section operates fairly. While it is fair that those parties willing to accept the risks and costs of litigation receive a preference in terms of recovering their losses, the right to that preference must be shared with all creditors.

See also, *Jaston & Co. v. McCarthy* (1998), 8 C.B.R. (4th) 25 (B.C.C.A.), at paras. 48-50; *Penfold v. Provenzano* (1996), 30 O.R. (3d) 230 (Ont. Gen. Div.), at para. 18.

38 The appellants rely on the following statement in *Toyota* at para. 6 to urge, in effect, a strict constructionist approach to s. 38: "[as] the right of a creditor to bring an action under s. 38 is purely statutory, a creditor must bring itself strictly within the provisions of the section in order to exercise the powers provided by it" (citations omitted.)

39 This passage from *Toyota* cannot be taken out of context. *Toyota* holds at para. 23, that a "purposive" approach to the interpretation of s. 38 is required to meet the objectives of preserving the bankrupt's assets, while still providing fairness to creditors. On this basis, the court in *Toyota* concluded that mere procedural irregularities associated with a s. 38 motion could not operate to defeat the purpose of the provision but, rather, could be cured under s. 187(9) of the Act.

40 The purposive approach to the construction of s. 38 adopted in *Toyota* accords with the modern process of statutory interpretation favoured by the Supreme Court of Canada, as first described in E.A. Driedger, *Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) at p. 87:

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 also *Bell ExpressVu Ltd. Partnership v. Rex*, [2002] 2 S.C.R. 559, at para. 26; *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at para. 21.

41 Our consideration of the issues on appeal must proceed in recognition of these settled interpretive principles. I turn now to the threshold issue whether the appellants had standing to challenge the s. 38 Order and the proceeding authorized by it.

## (2) The Appellants' Standing

42 The appellants argue that the Motion Judge erred by holding that their challenge to the Credit Union's creditor status constituted "a collateral attack on the [s. 38 Order] which the defendants had no standing to make", such that it was not open to the appellants to challenge the s. 38 Order and the s. 38 Action. In the particular circumstances of this case, I agree.

43 A s. 38 motion is a proceeding between a trustee in bankruptcy and a creditor of the bankrupt. There is no requirement under the Act that either the bankrupt or the proposed defendant receive notice of a s. 38 motion: *Krupp MaK Maschinenbau GmbH v. Black* (1996), 154 N.S.R. (2nd) 321 (N.S.C.A.), at paras. 19 and 25-27, leave to appeal to S.C.C. refused, [1997] S.C.C.A. No. 144; *Formula Atlantic Financial Corp. v. Canada (Attorney General)* (1994), 34 C.B.R. (3d) 50 (B.C.C.A.), at para. 8; *Re Salloum* (1990), 1 C.B.R. (3d) 204 (B.C.C.A.), at para. 27; *Bank of British Columbia v. McCracken* (1986), 61 C.B.R. (N.S.) 287 (B.C.C.A.), at paras. 8-9; *Re Swerdlow* (1985), 57 C.B.R. (N.S.) 180 (Ont. S.C.), at para. 17.

44 Similarly, as a general rule, neither the bankrupt nor the proposed defendant has standing to be heard on a s. 38 motion. This rule recognizes that so long as the s. 38 order in question merely authorizes the proceeding to be brought, the rights of the intended defendant will not be affected and no prejudice will be suffered: see *Formula Atlantic*, at para. 8; *Krupp*, at para. 25.

45 However, the courts have recognized certain limited exceptions to this general standing rule. In *McCracken*, the British Columbia Court of Appeal held at paras. 9-10 that where an order under a predecessor version of s. 38(1) of the Act purported to impose on the intended defendant obligations in the conduct of the authorized litigation, directed the defendant to take specific steps in that litigation, or subjected the defendant to costs, the defendant had standing to move to vary the order in question. Further, in *Formula Atlantic*, the same appellate court indicated at para. 13 that the general standing restriction will be displaced where necessary "to prevent [the court's] process being used so as to perpetrate a fraud". There is also authority for the proposition that a defendant named in a s. 38(1) proceeding has standing under s. 187(5) of the Act to challenge the order authorizing the proceeding on the basis of alleged procedural irregularities: see *Jaston & Co.*

46 Thus, if a proposed or named defendant seeks to challenge the validity of a s. 38 order, the appropriate practice is to bring an application for review under s. 187(5) of the Act. To proceed otherwise - for example, by bringing a motion under the *Rules of Civil Procedure* as the appellants did here - will generally constitute an improper collateral attack on the s. 38 order: see *Caisse Populaire Vanier Ltée v. Bales* (1991), 2 O.R. (3d) 456 (Ont. Gen. Div.), at p. 460.

47 In this case, relying on *Krupp* and *Formula Atlantic*, the Motion Judge held that the appellants' challenge to the Credit Union's creditor status was an impermissible collateral attack on the s. 38 Order. The Motion Judge's reasons do not suggest that this holding was based on the appellants' failure to bring a variation motion under s. 187(5) of the Act. Rather, the Motion Judge appears to have concluded that it was not open to the appellants to challenge the finding - implicit in the s. 38 Order - that the Credit Union was a creditor of Shaw. For three reasons, I disagree.

48 First, the appellants' objection to the s. 38 Order rested on allegations of abuse of process, non-disclosure, procedural irregularities, fraud and misrepresentation to the court. These serious claims triggered the exceptions to the restriction on standing that generally applies to challenges of s. 38 orders. They required the scrutiny of the court to ensure that the administration of justice and the integrity of the bankruptcy process had not been undermined.

49 Second, there were two aspects to the appellants' motion before the Motion Judge. In addition to their request that the s. 38 Order be set aside, the appellants also sought summary judgment and dismissal of the s. 38 Action. There was no restriction on the appellants' standing to seek the latter relief. The Motion Judge was obliged to address both components of the appellants' motion.

50 Finally, the costs provision of the s. 38 Order exposed the appellants to potential liability for the costs of the s. 38 motion. The Credit Union accepts that the appellants had standing to seek to set aside this costs provision and, further, that it should be set aside. I agree with this concession.

51 I recognize that the appellants did not invoke the remedial jurisdiction of the court under ss. 37 or 187(5) of the Act in their notice of motion filed with the Motion Judge. It is unclear on this record whether they relied on these statutory provisions in their submissions before the Motion Judge - neither provision is mentioned in her reasons.

52 However, the potential application of these provisions was fully argued before this court without objection by the Credit Union. Indeed, on appeal, the Credit Union relied on s. 187(9) of the Act, although that provision was not cited by it in its cross-motion before the Motion Judge. In these circumstances, I do not regard the appellants' failure to explicitly 'plead' ss. 37 and 187(5) of the Act as fatal to their standing to attack the s. 38 Order and the s. 38 Action.

### **(3) The Credit Union's Standing**

53 There are three prerequisites to the invocation of s. 38(1): (i) the applicant for a s. 38 order must be a creditor of the bankrupt; (ii) the applicant must request the trustee in bankruptcy to take the proceeding that the applicant

## Shaw (Trustee of) v. Nicol Island Development Inc.

believes would be for the benefit of the estate of the bankrupt; and (iii) the trustee must refuse or neglect to take the requested proceeding. Where these prerequisites are satisfied, the court, in the exercise of its discretion, may grant leave to the applicant to take the proposed proceeding in its own name and at its own expense and risk, subject to notice of the contemplated proceeding being given to the bankrupt's other creditors.

**54** Only the first prerequisite is at issue in this case. The appellants argue that the Credit Union was not a creditor of Shaw at the time of his bankruptcy and when the s. 38 Order was obtained, since the Credit Union had settled its claims against Mr. and Mrs. Shaw. As a result, the appellants submit, the Credit Union had no standing to seek the s. 38 Order or to commence the s. 38 Action.

**55** The Motion Judge disagreed. She reasoned as follows:

[28] Firstly, Herbert Shaw did not obtain an order setting aside [the Credit Union's] default judgment against him. There was, therefore, no *lis* between the parties to settle. The default judgment against Herbert Shaw was subsumed in his bankruptcy. Mr. Shaw had no case to settle and no status to settle it, unlike his wife, Carol Shaw. Despite the correspondence directed to both Herbert and Carol Shaw, I conclude that the settlement discussions could only have been with Carol Shaw.

...

[30] Secondly, s. 38 [of the Act] allows the Bankruptcy Court to authorize a creditor to stand in the shoes of the trustee when the trustee refuses to act.

...

[34] I conclude that [the Credit Union], having been a creditor of Herbert Shaw upon his assignment in bankruptcy, was a creditor eligible to make a s. 38 application pursuant to the [Act], as it has done. Even if a settlement subsequent to the bankruptcy were possible in law, it would be irrelevant to a s. 38 application.

**56** In my view, the Motion Judge did not err in holding that the Credit Union was a creditor of Shaw on the date of his bankruptcy. It follows that she correctly concluded that the Credit Union was eligible to seek relief under s. 38(1) of the Act.

**57** The word "creditor" is broadly defined under s. 2 of the Act as a person having a secured, unsecured or preferred claim "provable as a claim" under the Act. Pursuant to s. 121(1) of the Act, a debt or liability "to which the bankrupt is subject *on the day on which the bankrupt becomes bankrupt*" is deemed to be a claim "provable in proceedings under this Act" (emphasis added). Thus, the date of bankruptcy is the relevant time at which to assess creditor status under the Act.

**58** In this case, when Shaw made his assignment in bankruptcy, the Credit Union had an outstanding default judgment against him. In its capacity as a judgment-creditor, the Credit Union filed an unchallenged proof of claim in bankruptcy. Shaw himself acknowledged the Credit Union's status as one of his unpaid creditors in his sworn statement of creditors and liabilities, filed in the bankruptcy. On these facts, as the debt owed by Shaw to the Credit Union was a debt to which Shaw was subject on the day on which he became bankrupt, the debt was deemed to be

## Shaw (Trustee of) v. Nicol Island Development Inc.

a claim provable in the bankruptcy proceeding by virtue of s. 121(1) of the Act. Accordingly, as of that date, the Credit Union fit squarely within the definition of "creditor" under s. 2 of the Act.

**59** The appellants challenge both the sufficiency and the accuracy of the evidence of the Credit Union's creditor status adduced on the s. 38 motion. They contend that the Credit Union lost its creditor status prior to the date of and for the purpose of the s. 38 motion by entering into a final and binding settlement of its claims against Shaw. The fact of that settlement, the appellants say, constituted an "acknowledge[ment]", "recognition", and "confirm[ation]" by the Credit Union that it had no claim against Shaw both at the time of bankruptcy and at the time of the s. 38 motion. I disagree.

**60** For the purpose of a s. 38 motion, the court need only be satisfied on a balance of probabilities that the applicant is a creditor of the bankrupt: see *DeGroot v. Canadian Imperial Bank of Commerce* (1996), 45 C.B.R. (3d) 132 (Ont. Gen. Div.), at para. 7, aff'd (1998), 37 O.R. (3d) 651 (C.A.), leave to appeal to S.C.C. refused, [1998] S.C.C.A. No. 149.

**61** In this case, the Credit Union's s. 38 motion was supported by an affidavit sworn by its Vice-President of Lending, B. Brian MacDonald. In his affidavit, MacDonald set out the date of Shaw's bankruptcy, the Credit Union's request of the Trustee to proceed with the claim against the appellants, the Trustee's refusal to do so, and the Trustee's expressed willingness to assign its interest in the proceeding to the Credit Union. He also swore that the Credit Union was a creditor of Shaw's bankrupt estate. Although the Credit Union's proof of claim in bankruptcy did not form part of MacDonald's affidavit, Shaw's sworn statement of creditors and liabilities, in which he acknowledged the Credit Union as one of his unpaid creditors at the date of bankruptcy, was attached as an exhibit to the affidavit.

**62** Thus, the MacDonald affidavit afforded some evidence that the Credit Union had a claim provable in Shaw's bankruptcy, such that it was a creditor of Shaw. Although not extensive, that evidence was sufficient to establish the Credit Union's standing to bring a s. 38 motion. The MacDonald affidavit also provided evidence that the other statutory prerequisites for relief under s. 38(1) had been satisfied.

**63** The appellants' real complaint is that the Credit Union misrepresented its status as a creditor of Shaw on the s. 38 motion since the Credit Union had earlier settled its claims against Shaw. In my opinion, on this record, this assertion is unsustainable.

**64** On Shaw's assignment in bankruptcy, all his property vested in the Trustee by operation of s. 71 of the Act.<sup>2</sup> Further, under ss. 30(1)(d), (h) and (i) of the Act, the Trustee became empowered to bring, institute or defend proceedings relating to Shaw's property, to compromise and settle any debts owing to Shaw, and to compromise any claim made by or against Shaw's estate.<sup>3</sup> I therefore agree with the Motion Judge's apt observation that, at the time of the alleged settlement, "Shaw had no case to settle and no status to settle it." Only the Trustee could conclude a settlement with a creditor of Shaw that was binding on Shaw's bankrupt estate, as distinct from his wife. This did not occur.

**65** More importantly, Shaw was discharged from bankruptcy on July 16, 2004 - many months before the date of the March 2005 and January 2006 settlement correspondence. By virtue of s. 178(2) of the Act,<sup>4</sup> the effect of that discharge was to release Shaw from his debt to the Credit Union. Consequently, at the time of the settlement correspondence, there was no debt owing from Shaw to the Credit Union that was susceptible to compromise. Only the Credit Union's claim against Mrs. Shaw continued. It follows that the Credit Union did not forfeit its creditor status by entering into a binding post-bankruptcy settlement with Shaw.

**66** In light of this conclusion, it is unnecessary to consider the Credit Union's additional argument that since the Shaws failed to pay the costs of dismissing the Guarantee Action, no binding settlement was ever finalized with them. The issue whether the Credit Union relinquished its claims against Mrs. Shaw, who is not a party to this appeal, remains to be determined in other proceedings - for example, in the outstanding Guarantee Action against

## Shaw (Trustee of) v. Nicol Island Development Inc.

Mrs. Shaw. For the purpose of this appeal, the critical point is that no final and binding settlement was entered into with Shaw himself.

67 It is in this context that the appellants' submission that the Motion Judge erred by holding that the evidence of the alleged settlement was "irrelevant to a s. 38 application" must be considered. To the extent that this comment signified the Motion Judge's conclusion that the settlement correspondence did not affect the Credit Union's creditor status in Shaw's bankruptcy, I agree.

68 However, if this statement was intended to indicate that evidence of post-bankruptcy events can never be relevant to the determination of creditor status for the purpose of a s. 38 order, I respectfully disagree. I would not rule out the possibility that post-bankruptcy events may inform a s. 38 creditor status review in a proper case. For example, evidence confirming that a creditor's claim was paid in full after the initial date of bankruptcy and before the date of a s. 38 motion would clearly be relevant on a motion to rescind or vary a s. 38 order subsequently granted to the creditor. But that is not this case.

69 I add this final observation. The claim sought to be pursued under the authority of the s. 38 Order was not the Credit Union's claim against Shaw. As I have said, that claim was extinguished by operation of law on Shaw's discharge from bankruptcy.<sup>5</sup> The claim that formed the subject-matter of the proposed s. 38 proceeding was that of the Trustee regarding the Mortgages and the Discharges. The information relevant to that claim, which was unaffected by any alleged settlement between the Credit Union and Shaw, was included in the affidavit materials filed by the Credit Union on the s. 38 motion.

(4)

**Alleged Unfair Treatment and Abuse of Process**

70 In support of their claim of unfair treatment and abuse of process, the appellants argue that: (i) it was an abuse of process and contrary to public policy for the Credit Union to settle its claims against Shaw and to thereafter seek to pursue such claims against his estate through an action authorized under s. 38(1) of the Act; (ii) the Credit Union failed to make full disclosure of all material facts and misrepresented its creditor status before Platana R.S.J. and on the s. 38 motion, with the result that the court was misled regarding the Credit Union's standing to bring the s. 38 motion; and (iii) the s. 38 Order merely authorized the continuation of the proceeding commenced by the Trustee, rather than the initiation of a fresh action by the Credit Union. I would not give effect to these submissions.

71 As I have already indicated, no settlement of the Credit Union's claims against Shaw effective against his bankrupt estate had been concluded at the time of the s. 38 motion. The Credit Union's proof of claim in bankruptcy had been accepted by the Trustee and evidence of its status as a creditor of Shaw on the day on which Shaw became bankrupt was adduced on the s. 38 motion. Further, the Credit Union's status as a "creditor" of Shaw within the meaning of that term as defined under the Act had not been displaced by any post-bankruptcy event. As a result, the Credit Union did not mislead the court by failing to mention the settlement correspondence during the December 2006 attendance before Platana R.S.J.<sup>6</sup> or on the s. 38 motion - there was no settlement with Shaw - or by representing on the s. 38 motion that it was one of Shaw's creditors.

72 A creditor obtaining a s. 38 order advances not his or her own cause of action but, rather, the trustee's cause of action: *Re Zammit (1998)*, 3 C.B.R. (4th) 193 (Ont. Gen. Div.), at para. 4. The proceeding authorized by a s. 38 order is brought on the basis that the trustee in bankruptcy has the right to bring the action, and the creditor with a s. 38 order is taking the action as if the creditor were the trustee. As the Motion Judge indicated, once a s. 38 order is made, the creditor to whom it is granted stands in the shoes of the trustee: see for example, *Swerdlow*, at para. 17. This accords with the intended purpose of s. 38(1) of the Act, namely, to ensure that the bankrupt's assets are preserved for the benefit of all creditors.

73 Accordingly, on the s. 38 motion, the Credit Union was not pursuing its own claim in bankruptcy against Shaw

## Shaw (Trustee of) v. Nicol Island Development Inc.

based on its default judgment against him in the Guarantee Action. Rather, it was seeking leave of the court to proceed with the Trustee's claim against the appellants in relation to the Mortgages and the Discharges.

**74** I do not accept that the issues of the validity of the alleged settlement and the Credit Union's status as a creditor were 'in play' when the Credit Union commenced the s. 38 motion, such that disclosure of the settlement correspondence by the Credit Union was necessary.

**75** Contrary to the appellants' submission, the agreed issues for trial under the Platana Order did not encompass a challenge to the Credit Union's creditor status. Although the appellants claim that they did not learn of the alleged settlement until late February 2007, some two months after the date of the Platana Order, it was Strickland's uncontradicted evidence that the issue whether the Credit Union was a proper creditor of Shaw was known to and raised by the appellants when the issues for trial were settled *on consent*. It may therefore be expected that if the appellants intended to pursue this issue, some express mention of it would have been included in the agreed issues for trial. This did not occur.

**76** I also note that the Credit Union provided the appellants with a copy of its proof of claim in bankruptcy and Shaw's statement of creditors and liabilities in early January 2007. With this information in hand, the appellants were positioned to move to vary the Platana Order when, on their evidence, they learned in February 2007 of the alleged settlement. They failed to do so.

**77** Finally, the assertion that the s. 38 Order authorized only the continuation of the proceeding initiated by the Trustee, rather than the commencement of a new action by the Credit Union, does not assist the appellants. Proceedings commenced under the authority of s. 38(1) of the Act are undertaken at the expense and risk of the moving party and, hence, are conducted in the name of the creditor who obtains the s. 38 order. Furthermore, s. 38(1) contemplates the continuance of existing proceedings as well as the commencement of a new proceeding. See Houlden, Morawetz and Sarra, at pp. 107 and 109.

**78** In this case, the s. 38 Action involves precisely the same issues as authorized for trial under the Platana Order. There is no evidence of any prejudice to the appellants occasioned by the fact that the authorized s. 38(1) proceeding was initiated by way of a statement of claim delivered by the Credit Union in its own name. Further, there is no evidence that the Trustee took any steps in respect of the matters authorized for trial under the Platana Order. On the contrary, the Trustee, in effect, consented to the s. 38 Order by inviting the Credit Union to apply for it and by thereafter formally assigning its interest in the proceeding to the Credit Union.<sup>7</sup> That said, as the s. 38 Action is essentially duplicative of the Trustee's Motion, I agree with the appellants that the Trustee's Motion should be stayed. I did not understand the Credit Union to assert otherwise.

(5)

**Order Striking Parts of the Appellants' Pleading**

**79** During oral argument before this court, counsel for the appellants acknowledged that if the s. 38 Order is not set aside on the basis of the appellants' creditor status argument, the Motion Judge's discretionary decision to strike the impugned paragraphs of the appellants' pleading must stand. I agree.

**VI. Disposition**

**80** For these reasons, I would allow the appeal in part, by setting aside paragraph nine of the s. 38 Order - the costs provision - and staying the Trustee's Motion. In all other respects, I would dismiss the appeal. As the respondent has been successful on the main issues before this court, it is entitled to its costs of the appeal on a partial indemnity basis, fixed in the total amount of \$5,000, inclusive of disbursements and GST. There is no basis on which to interfere with the Motion Judge's costs award in the amount of \$4,000 in favour of the respondent.

Shaw (Trustee of) v. Nicol Island Development Inc.

E.A. CRONK J.A.

D.H. DOHERTY J.A.:— I agree.

R.G. JURIAN SZ J.A.:— I agree.

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- 1 I refer in these reasons to the 1993 and 1998 mortgages, collectively, as the "Mortgages".
  - 2 Section 71 of the Act provides: "On a bankruptcy order being made or an assignment being filed with an official receiver, a bankrupt ceases to have any capacity to dispose of or otherwise deal with their property, which shall, subject to this Act and to the rights of secured creditors, immediately pass to and vest in the trustee named in the bankruptcy order or assignment ..."
  - 3 In material part, s. 30(1) of the Act reads as follows: "The trustee may, with the permission of the inspectors, do all or any of the following things: ... (d) bring, institute or defend any action or other legal proceeding relating to the property of the bankrupt; ... (h) compromise and settle any debts owing to the bankrupt; (i) compromise any claim made by or against the estate..."
  - 4 Section 178(2) of the Act states: "Subject to subsection (1) [which does not apply in this case], an order of discharge releases the bankrupt from all claims provable in bankruptcy."
  - 5 Shaw's discharge from bankruptcy prior to the s. 38 motion did not bring the bankruptcy to an end. The discharge of the bankrupt is not a bar to a subsequent s. 38 motion: see *Gladstone v. Bronson Granite and Marble Ltd.* (1998), 4 C.B.R. (4th) 265 (Ont. Gen. Div.).
  - 6 By the time of the December 2006 court attendance, only the March 2005 'settlement' letter had been delivered - to Mrs. Shaw alone.
  - 7 Although the appellants complained in their factum of the late delivery of the Trustee's assignment, this issue was wisely not pursued during oral argument. The late delivery of the assignment was a procedural irregularity on the s. 38 motion, capable of being cured under s. 187(9) of the Act: see *Jaston & Co.*; *Penfold*.

**TAB 2**

◆ *Toyota Canada Inc. v. Toronto-Dominion Bank (Alta. C.A.)*

Alberta Judgments

Alberta Court of Appeal

Edmonton, Alberta

Lieberman, Belzil and Conrad JJ.A.

July 4, 1994.

[1994] A.J. No. 520 | 1994 ABCA 261 | [1994] 9 W.W.R. 380 | 21 Alta. L.R. (3d) 336 | 155 A.R. 241 |  
27 C.B.R. (3d) 1 | 48 A.C.W.S. (3d) 1101

IN THE MATTER OF Bankruptcy of International Warranty Company Limited Between Toyota Canada Inc. and Hyundai Auto Canada Inc., Respondents (Plaintiffs, and The Toronto-Dominion Bank; HongKong Bank of Canada, 351224 Alberta Ltd., now known as 488638 Alberta Ltd., Edwin E. Bean, Terry A. Bean, Alfred Milke, 288314 Alberta Ltd., 322680 Alberta Ltd., now known as Sharpewood Holdings Ltd., Ronald L. Funnell, Garry A. Levang, Ralph Meyers, and Robert Farquhar, Appellants (Defendants), and Imperial Richmond Holdings Ltd., 321149 Alberta Ltd., 288314 Alberta Ltd., 351224 Alberta Ltd., now known as 488638 Alberta Ltd., 322680 Alberta Ltd., now known as Sharpewood Holdings Ltd., 349189 Alberta Inc., Lloyds Bank Canada, now known as Hongkong Bank of Canada, HongKong Bank of Canada; The Toronto-Dominion Bank, Edwin E. Bean, Ronald L. Funnell, Alfred Milke, Terry A. Bean, James Wilkins, Richard Heyman, Dale Mather, Del Manary, Robert Nelson, Henry A. Smith, Garry A. Levang, Ralph Meyers, Robert Farquhar, Jim Patterson, Alan N. Parkinson, B.A.B. Newell, Ron F. King, Arthur Odamura, D. Cameron, Rodney I.J. Child, Gerry Peterson, and Robert Blades, Defendants

(18 pp.)

## **Case Summary**

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### **Statutes, Regulations and Rules Cited:**

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Bankruptcy and Insolvency Act, S.C. 1992, c. 27, ss. 2, 187(9), 187(11). Limitation of Actions Act, R.S.A. 1980, c. L-15.

#### **Bankruptcy — Actions, commencement — Leave to commence action — Actions by creditors.**

The defendants appealed from a judgment authorizing T and H, creditors of the bankrupt, to commence this action. The trustee had refused to commence proceedings because the estate did not have the required funds. The order was made and the statement of claim issued on the last day of the limitation period. Notice was given to creditors only then. The issue was whether the statement of claim was valid since it was issued without notice to other creditors. The cause of action was that of the bankrupt. The judge below found that the intention of section 2 of the Bankruptcy and Insolvency Act was to preclude any opportunity for preference of one creditor over others, which he satisfied by the terms of his order.

HELD: The appeal was dismissed.

The purpose of section 2 was to ensure that the bankrupt's assets were preserved for the benefit of the creditors. Requiring notice before the statement of claim was issued could lead to unreasonable results. Furthermore, if notice was required, it was procedural and any irregularity could be cured under section 187(11). The defendants were not prejudiced by the failure to give notice and no creditor was harmed.

V.L. Lirette, for the Respondents. M.M. Simpson, for the appellant, Toronto-Dominion Bank. M.J. McCabe, for the Appellant, HongKong Bank of Canada. R. Sadownik, for the Appellants, 351224 Alberta Ltd., now known as 488638 Alberta Ltd., Edwin E. Bean, Terry A. Bean, Alfred Milke.

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The judgment of the Court was delivered by

**CONRAD J.A.**

1 The question of law in this appeal is whether a statement of claim issued pursuant to s. 38 of the Bankruptcy Act, *R.S.C. 1985, c. B-3* (now known as the Bankruptcy and Insolvency Act, S.C. 1992, c. 27, s. 2) ("the Bankruptcy Act"), without prior notice to other creditors, is a nullity. I am of the view it is not, and would dismiss the appeal.

The Facts

2 The respondents, Toyota Canada Inc. ("Toyota") and Hyundai Auto Canada Limited ("Hyundai") are two of the main creditors of International Warranty Company Limited ("International") who went into receivership by court order, December 31, 1987. On November 9, 1992, an order was obtained under the Bankruptcy Act appointing a trustee in bankruptcy. Toyota and Hyundai forwarded a letter, on November 10, 1992, to the trustee requesting him to commence the proceeding which is the subject-matter of this appeal. The trustee, by letter dated November 18, 1992, communicated that he had made a decision not to pursue the litigation because the estate did not have the required funds. He proceeded without consultation with the inspectors, as it was not possible to prepare a proper list of creditors, or have a first meeting of creditors, in time to avoid the limitation risk that existed with respect to the action.

3 November 23rd was the last day under the Limitation of Actions Act, R.S.A. 1980, c. L-15 for filing the statement of claim. On that date, Toyota and Hyundai, on notice to the trustee of International, made application for an order under s.38 of the Bankruptcy Act, authorizing them to take proceedings in this action. It is common ground that the cause of action in this suit is that of the bankrupt, and it is only by virtue of s. 38 that Toyota and Hyundai have the right to sue. While notice of that application was given to parties other than the trustee (including the appellant Lloyds Bank Canada), generally the creditors were not served.

4 The Chambers Judge granted the application of Toyota and Hyundai, authorizing them to commence proceedings. That order included the following paragraph:

Subject to paragraph 12, all benefits to be derived from the proceedings authorized by this Order together with the costs of same shall belong exclusively to the applicants and to such other creditors of the bankrupt who may within sixty (60) days of service upon them of the notice of the granting of this Order agree to contribute pro rata according to the amount of their respective claims to the expense and risk of such proceedings, and who within the like time in writing directed to the law firm of Reynolds, Mirth, Richards & Farmer, solicitors for the applicants, signify their agreement pursuant to the form of agreement attached as Schedule "B" to this Order. The applicants shall also within 60 days of this Order provide security in the amount of 5% of their claims, less all costs and fees incurred by them in accordance with paragraph 14 hereof.

On November 23rd, the trustee assigned to Toyota and Hyundai its interest in this cause of action. Pursuant to the order and the assignment, the statement of claim was issued that day, and thereafter notice to creditors was served on all known creditors. Of the creditors served, five elected to become involved in the action with the plaintiffs, and signed a written agreement.

5 Several of the named defendants sought to set aside the order of the Chambers Judge and strike the statement of claim as being a nullity. At the time of that application, the limitation period for commencing this action had expired. The judge dismissed the application, and the appellants now appeal from that order. Although many issues were raised before the Chambers Judge, the hearing of this appeal revolved around the failure to give notice to creditors prior to issuance of the statement of claim.

Analysis

6 Section 38 of the Bankruptcy Act provides the mechanism for creditors to proceed with an action of the bankrupt where the trustee refuses or fails to act, without which Hyundai and Toyota would have no cause of action against the defendants. Since the right of a creditor to bring an action under s. 38 is purely statutory, a creditor must bring itself strictly within the provisions of the section in order to exercise the powers provided by it (see *In re Andrew Motherwell (1924)*, 4 C.B.R. 484 (Ont.S.C.) at 486; *Re Points of Call Airlines Ltd. (1990)*, 80 C.B.R. 157 (B.C.S.C.) at 164).

7 Section 38 of the Bankruptcy Act reads as follows:

- (1) Where a creditor requests the trustee to take any proceedings that in his opinion would be for the benefit of the estate of the bankrupt and the trustee refuses or neglects to take the proceedings, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.
- (2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.
- (3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

8 The appellants rely on the decision in *B.N.R. Holdings Ltd. v. Royal Bank of Canada*, [1993] 2 W.W.R. 471 (B.C.C.A.) for the proposition that notice is a condition precedent to the validity of the action. In *B.N.R. Holdings Ltd.*, supra, Seaton, J.A. comments on the distinction between s. 38 applications and those brought under s. 69 to allow continuation of a creditor's action, when he states at p. 479:

In the cases that granted leave nunc pro tunc that have been brought to our attention, it could be said that there was a cause of action when the proceedings were commenced. In those cases, suing a trustee (ss. 37 and 215) or a bankrupt (s. 69), the plaintiff has a claim that it cannot present without leave. In cases under s. 38, on the other hand, the plaintiff has no claim to present. Until the trustee assigns the claim the plaintiff has no status to start the action. That is not a mere technical error. The plaintiff has no cause of action absent the assignment. It can only receive the assignment after complying with the statute.

He also sets out what he considers to be the five conditions to obtaining a s. 38 order:

- (1) The creditor must request the trustee to take proceedings,
- (2) The trustee must refuse or neglect to take proceedings,
- (3) The creditor must apply to the court for an order authorizing it to take proceedings in its own name,
- (4) Notice of the contemplated proceedings must be given to the other creditors,
- (5) The trustee must assign and transfer the claim to the creditor.

With respect to those five conditions, Seaton, J.A. commented at p. 479:

These are not just procedural steps. The assignment is essential - it is the foundation for the action. Clearly each of the other steps must precede the assignment.

9 This reasoning differs from that in *Imprimerie Canadienne Gazette v. Turcotte (1991)*, 50 Q.A.C. 152 (Que.C.A.), where the Quebec Court of Appeal approves its earlier decisions requiring that the pursuing creditor must satisfy two conditions precedent: first, to ask the trustee to take proceedings, and second, if the trustee refuses, to obtain the Court's authorization. Fish, J.A. states at p. 156-7:

Case law also favours the position that the permission of the inspectors is not required under s. 38(1). As mentioned earlier, this court has set out two conditions precedent for an action under s. 38: failure or

## Toyota Canada Inc. v. Toronto-Dominion Bank (Alta. C.A.)

refusal of the trustee to take an action when requested to do so, and permission of the court. There is no mention, as a further requirement, that the inspectors authorize the proceeding: see *Bank of Montreal v. Elliott and Manifattura Lane Gaetano Marzotto*, supra.

**10** I approach this issue in two stages: firstly, does the section require that the notice be given before the action is commenced; and, secondly, if it does, is it a condition precedent or merely a procedural irregularity which can be cured?

**11** The Chambers Judge did not deal squarely with the jurisdictional issue of notice, but certainly took a purposive approach to interpretation of the section. He found that the intention of s. 38 in requiring notice, was to preclude any opportunity for preference of one creditor over others, which he satisfied by the terms of his order. Following the application to vary his order, the Chambers Judge stated:

Five creditors have agreed to participate and will join in sharing the costs and potential benefits. They are not precluded from joining even if the notice was given after the action was commenced and after the limitation period has expired. The cause of action is affected by the limitation period. The cause of action has not been altered, nor have any parties been added to the cause of action that would cause difficulties. They are not prejudiced by lack of notice before the statement of claim was issued. The policy objective of section 38, to preclude an opportunity for preference of one creditor over others, is not frustrated. It must be noted that if the Plaintiffs had failed to commence the action immediately then the other creditors would have been prejudiced. All creditors would have lost the opportunity to bring the action forever.

(A.B. 91)

**12** The general rule of interpretation of the Bankruptcy Act has been commented on specifically by the Supreme Court of Canada in *Mercure v. Marquette & Fils Inc.*, [1977] 1 S.C.R. 547, at p. 556 where it is stated:

Before going on to another point it is perhaps not inappropriate to recall that the Bankruptcy Act, while not business legislation in the strict sense, clearly has its origins in the business world. Interpretation of it must take these origins into account. It concerns relations among businessmen, and to interpret it using an overly narrow, legalistic approach is to misinterpret it. It seems to me that appellant is urging the Court to so interpret it.

**13** Similarly, in *Re Andrew Motherwell of Canada Ltd.* (1924), 55 O.L.R. 294 (Ont.S.C.) the Court commented on the interpretation of the predecessor to the present s. 38, and stated at p. 298:

Any interpretation to be given to the meaning and scope of sec. 35 should be a liberal one, and not a construction that would debar a creditor, if he is prepared to undertake the risk, of the right to proceed for his own benefit.

**14** What then is the purpose of section 38? In my view, its primary purpose is to ensure that the bankrupt's assets are preserved for the benefit of the creditors. It provides the mechanism for creditors to proceed with an action when the trustee refuses or fails to act; thereby ensuring that assets of the bankrupt (which may otherwise go unrecovered) are available to creditors willing to finance the litigation.

**15** The secondary purpose, relating to notice, is to make sure the section operates fairly. While it is fair that those parties willing to accept the risks and costs of litigation receive a preference in terms of recovering their losses, the right to that preference must be shared with all creditors. To ensure that no creditor receives an unfair advantage over another, the section requires that notice be given to all other creditors. The interpretation of the requirement of notice should be approached with this distinction, and purpose, in mind.

**16** It is necessary to address the meaning of the words "...the creditor may obtain an order...on notice being given the other creditors of the contemplated proceeding..." in s. 38(1). There appear to be three alternative interpretations:

- (1) "contemplated proceeding" refers to the application for a s. 38 order, and therefore notice to the creditors of that application is required before the application for a s. 38 order is made;

## Toyota Canada Inc. v. Toronto-Dominion Bank (Alta. C.A.)

- (2) "contemplated proceeding" refers to the statement of claim, and "on notice" should be read to mean "after notice". This means that notice is required before the statement of claim has been issued;
- (3) "contemplated proceeding" refers to that proceeding contemplated by the order (in this case the statement of claim), and while notice must be given, the timing of that notice is flexible. The reason for the phrase "contemplated proceeding" is because at the time the order is made the proceeding is only "contemplated". This interpretation would mean that the order may be obtained, but there will be a condition in the order to give notice and to do such other things as the court directs.

**17** At first blush, the first alternative appears to technically fit best with subsections 38(2) and (3). Section 38(2) provides that "...on the order being made...the trustee shall assign and transfer to the creditor..." all his interest in the action. Section 38(3) then provides that the creditor is entitled to the benefit of the proceeding to the extent of its claim and costs. Since the duty to assign occurs immediately on the making of the order, a strict reading would require that it is only the creditor that receives the assignment who would have an opportunity to participate. If that were true, notice would be required before the application so that those creditors who were interested in participating could be assignees.

**18** There is, however, authority to support the position that the application stage only requires notice to the trustee. Fish, J.A. in *Imprimerie Canadienne Gazette*, supra, dealt with this issue at p. 157, where he says:

In *Re Parallels Restaurant Ltd.* (1988), 68 C.B.R. (N.S.) 266 (B.C.S.C.), it was held that the issue under s. 20 (now s. 38), at least initially, is between the trustee and the pursuing creditor. Notice therefore does not have to be given to the defendant or to the other creditors until after the court order is made; nor is the trustee obliged to call a meeting of the creditors before deciding not to proceed with the action. See also: *Re Swerdlow* (1985), 57 C.B.R. (N.S.) 180 (Ont. S.C.); *Re Wagon Stop Inc.* (1979), 30 C.B.R. (N.S.) 63 (Ont. S.C.)

**19** In fact, the position taken by the appellants is the second alternative interpretation, namely, that notice is required before the statement of claim has been issued. As a matter of statutory interpretation, they argue the words "on notice being given" must be read "after notice being given", and cite *R. v. Arkwright*, 12 Adol. & E., N.S., 960, 966 as authority for the proposition.

**20** The respondents opt for the third interpretation, and say that the timing of the notice is not mandated by the section, and the requirements of the section are met by the judge providing for notice to the creditors, along with any other terms and conditions he sees fit, so that the objects of the Act can be met. In any event, they say the obligation is directory only, and not substantive, and can be cured.

**21** The Alberta Court of Appeal commented on the issue of notice in *Transamerica Commercial Financial Corp., Canada v. Computer Corp. Systems Inc.* (1993), 10 Alta.L.R. (3d) 337, where the Court said at p. 340:

...no notice was given to the other creditors. To this day, it is not clear they know that the judge transferred away from them at least some of the fruit of the litigation. They were entitled to notice. It is no answer to say it was a better deal than any other offer. They should decide, or at least have a chance to be heard on the point. That is why s. 38 requires notice to the creditors. It is at least equally vital that they know of a proposed assignment to a shareholder.

While this quote is helpful on the importance of notice, I do not read it as demanding that notice occur prior to commencement of proceedings as long as creditors' rights are preserved.

**22** On a strict interpretation, I acknowledge that both alternatives (2) and (3) present difficulties because s. 38(2) and (3) appear to suggest that only the creditor who receives the assignment would obtain the benefit. In my view, that is far too narrow an approach. The judge can, as he did in this case, provide for one creditor to receive the assignment on terms and conditions that allow others to join in and participate. Requiring notice before the statement of claim can lead to unreasonable, if not absurd, results. The definition of creditor under the Bankruptcy Act is a broad one and a bankruptcy may occur near the end of a limitation period, when ascertainment of an

## Toyota Canada Inc. v. Toronto-Dominion Bank (Alta. C.A.)

exhaustive list of creditors would not be possible. It is also easy to imagine a lawsuit proceeding, past its prescription date, and suddenly a "new creditor" appears. Would the section intend the action to be a nullity? I think not. It goes against the primary object of the Act to suggest that a failure of notice to creditors should defeat the cause of action. Notice is unrelated to the main purpose.

**23** I accept that the proper approach to interpretation is a purposive one, and the third interpretation best meets the purpose. It meets the objectives of preserving the bankrupt's assets, while still providing fairness to creditors.

**24** The defendants to the action have no interest in what creditors participate and share in the proceeds of the action. If the bankrupt has an asset in the nature of a cause of action, the defendants cannot be heard to complain if the suit is pursued on behalf of the bankrupt's estate, if done within the limitation period. They are not prejudiced because the cause of action exists, albeit in another person. The words "on notice being given to the other creditors of the contemplated proceeding" simply means that the other creditors must be given notice of the proceedings contemplated by the order. It must be a condition contained within the order. A judge can address, having regard to all the circumstances of the application, the timing of the notice and the means of participation in both the lawsuit and the proceeds. I agree with the trial judge's comments, quoted earlier, with respect to the ability of creditors to apply to participate subsequent to the commencement of the action.

**25** In the event I am wrong on the interpretation of and the timing of notice under s. 38, I would find that notice is not a condition precedent and could be cured if necessary. I recognize this appears to be contrary to the decision in *B.N.R. Holdings Limited v. Royal Bank of Canada*, supra. However, in that case the Court was dealing with a fact situation where the action was commenced without an order under s. 38, and the Court ruled on whether the action could be saved by the issuance of an order under s. 38 nunc pro tunc. Any discussion on the issue of notice to the creditor is obiter dicta. The case was not dealing with the interpretation of the notice provision or the timing of notice. Thus a provision in the order for notice would suffice, if my interpretation is correct. In any event, I prefer the reasoning in *Imprimerie Canadienne Gazette* that there are only two conditions precedent to the commencement of proceedings. Firstly, failure or refusal of the trustee to act, and secondly, the court order under s. 38.

**26** Moreover, this is more consistent with the holding of the Supreme Court of Canada in *Traders Finance Corporation Ltd. v. Emilien Levesque*, [1961] S.C.R. 83, dealing with a similar provision. The Supreme Court, at page 87, said: "Cette obligation est une conséquence et non une condition du droit préférence et du droit de poursuivre pour l'exercer." The assignment of the action to the creditor is not a condition precedent to the action being brought, but a consequence of the order under s. 38. Thus, the creditor's right to carry on the action does not flow from the assignment by the trustee, but is a function of law upon the granting of the s. 38 order. Nor does it flow directly from notice. Notice is required to deal with the results of the order.

**27** In my view, if notice is required, it is merely procedural, and any irregularity can be cured. Section 187 of the Bankruptcy Act allows that procedural irregularities may be cured. Section 187(9) reads:

- (9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of the opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

**28** No substantial injustice has been caused by the failure to give notice before the statement of claim was issued. The defendants are not prejudiced. If the action against them has merit, they are liable, and not entitled to any benefit directed solely for the protection of the creditors. The action was brought against the defendants in time and they suffer no substantial injustice. In addition, no creditor can be said to have been harmed. The judge has jurisdiction to impose whatever conditions may be necessary to do justice. In this case all creditors were given notice of the proceedings after the statement of claim was issued. No creditor has been precluded from joining the action in terms of contributing to the costs and sharing in the proceeds. The creditors could have suffered harm if the statement of claim had not been issued when it was, as the limitation period was about to expire. Any substantial injustice that may have occurred would, in any event, be curable by order under s. 187(11) of the

Toyota Canada Inc. v. Toronto-Dominion Bank (Alta. C.A.)

Bankruptcy Act which allows the court "...to extend the time either before or after the expiration date..." for doing any act or thing for which the time is limited. Therefore the court could permit service of notice on the creditors after the statement of claim has been issued. But as all the creditors have already been notified in the proceeding, this step is unnecessary.

**29** In summary, the notice required by s. 38(1) need not be served prior to the commencement of the proceeding, and is most properly dealt with by the court when granting the order, to ensure that all creditors are provided with ample opportunity to participate in the action in such manner as the court directs. There is ample jurisdiction in section 38 for a judge to deal with all the issues required to do justice between creditors. Even if notice was required prior to issuance, it is not a substantive condition nullifying the statement of claim.

**30** The appeal is dismissed.

CONRAD J.A.

LIEBERMAN J.A.:— I concur.

BELZIL, J.A.:— I concur.

**TAB 3**

 **Toyota Canada Inc. v. Toronto-Dominion Bank (S.C.C.)**

Supreme Court of Canada Rulings on Applications for Leave to Appeal and Other Motions

Supreme Court of Canada

Record created: September 6, 1994.

File No.: 24273

[1994] S.C.C.A. No. 346 | 29 C.B.R. (3d) 153

In the matter of the bankruptcy of International Warranty Company Limited Between Hongkong Bank of Canada, 351224 Alberta Ltd., now known as 488638 Alberta Ltd., Edwin E. Bean; Terry A. Bean and Alfred Milke v. Toyota Canada Inc. and Hyundai Auto Canada Inc.

**Appeal From:**

ON APPEAL FROM THE COURT OF APPEAL FOR ALBERTA

**Case Summary**

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**Status:**

Application for leave to appeal dismissed with costs (without reasons) December 1, 1994.

**Catchwords:**

**Commercial law — Bankruptcy — Creditor and debtor — Statutory right of a creditor to proceed with an action of the bankrupt where the trustee refuses or fails to act — Whether a statement of claim issued pursuant to s. 38 of the Bankruptcy Act, R.S.C. 1985, c. B-3 (now the Bankruptcy and Insolvency Act, S.C. 1992, c. 27, s. 2), without prior notice to other creditors, is a nullity.**

**Counsel**

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Cruikshank Karvellas, for the motion. Reynolds, Mirth, Richards & Farmer, contra.

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**Chronology:**

1. Application for leave to appeal:  
FILED: September 6, 1994. S.C.C. Bulletin, 1994, p. 1304.  
SUBMITTED TO THE COURT: October 19, 1994. S.C.C. Bulletin, 1994, p. 1597.  
DISMISSED WITH COSTS: December 1, 1994 (without reasons).  
S.C.C. Bulletin, 1994, p. 1861.  
Before: Lamer C.J. and Cory and Iacobucci JJ.

**Procedural History:**

Judgment on application: Application for an order rescinding

Toyota Canada Inc. v. Toronto-Dominion Bank (S.C.C.)

an order under s. 38 of the Bankruptcy Act as being a nullity and striking the Respondents statement of claim as a nullity dismissed.

Alberta Court of Queen's Bench - In Bankruptcy, Miller

J., May 14, 1994.

140 A.R. 1; [1994] A.J. No. 371.

Judgment on appeal: Appeal dismissed.

Alberta Court of Appeal, Lieberman, Belzil and Conrad

J.J.A., July 4, 1994.

[1994] A.J. No. 520.

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