File No. CI 20-01-26627

THE QUEEN'S BENCH
WINNIPEG CENTRE

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

BETWEEN:

WHITE OAK COMMERCIAL FINANCE, LLC,

Applicant,

- and -

NYGÅRD HOLDINGS (USA) LIMITED, NYGARD INC., FASHION VENTURES, INC., NYGARD NY RETAIL, LLC, NYGARD ENTERPRISES LTD., NYGARD PROPERTIES LTD., 4093879 CANADA LTD., 4093887 CANADA LTD., and NYGARD INTERNATIONAL PARTNERSHIP,

Respondents.

MOTION BRIEF OF THE RECEIVER
(NET RECEIVERSHIP PROCEEDS ORDER)

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I. LIST OF DOCUMENTS

1. The First Report of the Receiver dated April 20, 2020;

2. The Supplementary First Report of the Receiver dated April 27, 2020;

3. The Second Report of the Receiver dated May 27, 2020;

4. The Supplementary Second Report of the Receiver dated May 31, 2020;

5. The Third Report of the Receiver dated June 22, 2020;

6. The Fourth Report of the Receiver dated June 27, 2020;

7. The Supplementary Third Report of the Receiver dated June 29, 2020;

8. The Fifth Report of the Receiver dated July 6, 2020;

9. The Sixth Report of the Receiver dated August 3, 2020;

10. The Seventh Report of the Receiver dated September 10, 2020;

11. The Supplementary Seventh Report of the Receiver dated September 14, 2020;

12. The Eighth Report of the Receiver dated September 28, 2020;

13. The Supplementary Eighth Report of the Receiver dated October 12, 2020;

14. The Ninth Report of the Receiver dated November 2, 2020;

15. The Supplementary Ninth Report of the Receiver dated November 10, 2020;

16. The Second Supplementary Ninth Report of the Receiver dated December 30, 2020;

17. The Tenth Report of the Receiver dated January 21, 2021;

18. The Eleventh Report of the Receiver dated February 24, 2021;

19. Twelfth Report of the Receiver dated June 4, 2021; and

20. Notice of Motion of the Receiver dated June 4, 2021 with attached draft form of Net Receivership Proceeds Order.

II. LIST OF AUTHORITIES

Tab

1. *HSBC Bank of Canada v Maple Leaf Loading Ltd.*, 2016 BCSC 361;

2. *JP Morgan Chase Bank N.A. v UTTC United Tri-Tech Corp* (2006), 25 CBR (5th) 156 (Ont SCJ);

3. *DBDC Spadina Ltd. v Walton,* 2015 ONSC 2550;

4. Sections 2 and 3 of *The Mercantile Law Amendment Act*, CCSM c M120;

5. *Gill v Cheema,* 2018 BCSC 1453;

6. *Abakhan v Halpen,* 2008 BCCA 29;

7. *Redstone Investment Corp. (Receiver of), Re*, 2016 ONSC 4453;

8. Rule 6.01 of the *Court of Queen's Bench Rules*, Man Reg 553/88;

9. Section 94 of *The Court of Queen's Bench Act*, CCSM c C280;

10. Sections 2, 42, 43, 49, 69.4 and 183(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3;

11. *Bacic v Millennium Educational & Research Charitable Foundation*, 2014 ONSC 5875;

12. *A. & F. Baillargeon Express Inc.,* (1993) 27 CBR (3d) 36 (QC SC);

13. *Ashley v Marlow Group Private Portfolio Management Inc,* [2006] OJ No 1195 (Ont SCJ [Commercial List]);

14. *In re Republic Airways Holdings Inc.*, 565 B.R. 710, 716 (Bankr. S.D.N.Y. 2017), *aff'd*, 582 B.R. 278 (S.D.N.Y. 2018);

15. *J.P. Capital Corp., Re,* (1995) 31 CBR (3d) 102 (Ont SCJ);

16. *PSINet Ltd., Re* (2002), 33 CBR (4th) 284(Ont SCJ);

17. *Gray Aqua Group of Companies, Re,* 2015 NBQB 107;

18. Section 134 of *The Employment Standards Code*, CCSM c E110;

19. *San Bao Investment Inc., Re,* [2017] BCWLD 2471;

20. *Downtown Eatery (1993) Ltd. v Ontario*, [2001] OJ No 1879 (CA);

21. *Flax Investment Ltd., Re* (1979), 32 CBR (NS) 65 (Ont SC [In Bankruptcy]);

22. *Alberta Treasury Banches v Cogi Limited Partnership,* 2018 ABQB 356; and

23. *Thompson Bros. (Constr.) Ltd. v Jay Vee Sandblasting Ltd.,* 2013 ABQB 670.

III. POINTS TO BE ARGUED

Introduction

1. On March 18, 2020, Richter Advisory Group Inc. was appointed receiver (in such capacity, the "**Receiver**") over all assets, undertakings and properties (the "**Property**") of Nygård Holdings (USA) Limited ("**NUSA**"), Nygard Inc. ("**NI**"), Fashion Ventures, Inc. ("**FV**"), Nygard NY Retail, LLC (together with NUSA, NI and FV, the "**US Debtors**"), Nygard Enterprises Ltd. ("**NEL**"), Nygard Properties Ltd. ("**NPL**"), 4093879 Canada Ltd. ("**879**"), 4093887 Canada Ltd. ("**887**"), and Nygard International Partnership ("**NIP**", and together with NEL, NPL, 879 and 887,the "**Canadian Debtors**", and together with the US Debtors, the "**Debtors**") pursuant to an Order (the "**Receivership Order**") of this Honourable Court made on March 18, 2020, as amended by way of the General Order made on April 29, 2020.

2. The Receiver has now filed the Twelfth Report of the Receiver dated June 4, 2021 (the "**Twelfth Report**"). Among other things, the Twelfth Report provides this Honourable Court with an update as to the actions and activities of the Receiver since the filing of the Eleventh Report of the Receiver dated February 24, 2021, including the Receiver's recommendations with respect to treatment of the Net Receivership Proceeds (as defined in the Twelfth Report). In particular, the Receiver is now seeking an order (the "**Net Receivership Proceeds Order**"):

(a) abridging the time for service of the Notice of Motion of the Receiver and the materials filed in support thereof, such that the motion is properly returnable on the stated hearing date, and dispending with further service thereof;

(b) declaring that each of the Debtors is jointly liable for the debts and liabilities (the "**Common Liabilities**") of each of the other Debtors, and the Debtors are joint debtors with respect to Common Liabilities;

(c) declaring that the assets (the "**Common Assets**") of each of the Debtors shall be treated as "common assets" subject to the Common Liabilities;

(d) declaring that the assets and liabilities of the Debtors are properly to be substantively consolidated for purposes of addressing the claims of creditors of each of the Debtors;

(e) authorizing the Receiver to file assignments in bankruptcy on behalf of each of the Debtors on a basis that reflects the Common Assets and the Common Liabilities, and requesting that the official receiver appoint Richter Advisory Group Inc. as trustee (in its capacity as trustee, the "**Trustee**") in relation to the estates of each of the Debtors in bankruptcy;

3. In the alternative, the Receiver is seeking an order:

(a) authorizing the Receiver to file assignments in bankruptcy on behalf of the Debtors, other than NPL and NEL, in the manner described in subparagraph 2(e) above; and

(b) authorizing the Receiver to file in the Court of Queen’s Bench of Manitoba (Winnipeg Centre) applications for bankruptcy orders in relation to the Debtors NPL and NEL, on a basis that reflects the Common Assets and the Common Liabilities and the substantive consolidation of the estates of the Debtors;

(c) if necessary, lifting the stay of proceedings prescribed by paragraph 12 of the Receivership Order to permit such bankruptcy applications to be made and directing that, for the purposes of such assignments and applications, the locality of the Debtors shall be Winnipeg, Manitoba and Richter Advisory Group Inc. shall be appointed as trustee;

4. The Receiver is further seeking an order:

(a) directing Richter Advisory Group Inc., upon its appointment as Trustee, and in its capacity as trustee in relation to the estates of each of the Debtors in bankruptcy, to make a motion for consolidation of the administration of the estates in bankruptcy of all of the Debtors;

(b) approving the NPL Proceeds Preservation Agreement (as defined in the Twelfth Report);

(c) directing that, in accordance with the NPL Proceeds Preservation Agreement, upon the bankruptcy of NPL, Levene Tadman Golub Law Corporation pay to the Trustee the remaining Preserved Proceeds (as defined in the Twelfth

Report) for the purposes of the consolidated estates in bankruptcy of the Debtors; and

(d) approving the Twelfth Report and the conduct, activities and accounts of the Receiver and its counsel described therein, including the Receiver's updated Interim Statement of Receipts and Disbursements.

5. This Brief is being filed on behalf of the Receiver so as to provide this Honourable Court with the relevant legal authorities dealing with the issues raised in the Twelfth Report and in this motion, and to outline the legal basis for the relief sought by the Receiver. Capitalized terms not otherwise defined herein shall have the meaning given to them in the Twelfth Report.

Allocation of Receivership Costs

6. As set out by Masuhara J. in *HSBC Bank of Canada v Maple Leaf Loading Ltd.*, 2016 BCSC 361, allocation is an exercise in judicial discretion. While the overall result must be fair and equitable, this does not mean all impacted parties must be treated equally. A summary of the general principles of law which govern the allocation of receivership costs is as follows (as cited from *Royal Bank of Canada v Atlas Block Co.*, 2014 ONSC 1531):

> (a) The allocation of such costs must be done on a case-by-case basis and involves an exercise of discretion by a receiver or trustee;
>
> (b) Costs should be allocated in a fair and equitable manner, one which does not readjust the priorities

> between creditors, and one which does not ignore the benefit or detriment to any creditor;
>
> (c) A strict accounting to allocate such costs is neither necessary nor desirable in all cases. To require a receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-à-vis another likely would not be cost-effective and would drive up the overall cost of the receivership;
>
> (d) A creditor need not benefit "directly" before the costs of an insolvency proceeding can be allocated against that creditor's recovery;
>
> (e) An allocation does not require a strict cost/benefit analysis or that the costs be borne equally or on a *pro rata* basis;
>
> (f) Where an allocation appears *prima facie* as fair, the onus falls on an opposing creditor to satisfy the court that the proposed allocation is unfair or prejudicial.

HSBC Bank of Canada v Maple Leaf Loading Ltd., 2016 BCSC 361 at paras 34, 36 [Tab 1]

7. In *JP Morgan Chase Bank N.A. v UTTC United Tri-Tech Corp.* (2006), 25 CBR (5th) 156, the Ontario Superior Court of Justice considered a receiver's proposed allocation with respect to amounts secured by the receiver's charge. The receiver proposed an unequal allocation whereby the receivership costs allocated to each party were determined based on the "category" of claim each creditor had in the receivership. In approving the proposed allocation, Cameron J. noted that:

> The obligation on a Receiver in allocating costs from an insolvency proceeding is to exercise its discretion in an equitable manner that does not readjust the priorities between creditors. The allocation:
>
> (a) should be fair and equitable; and
>
> (b) not ignore the benefit or detriment to any creditor.

> There is however no requirement that the Receiver be obliged to conduct a strict accounting on a cost-benefit basis as between creditor classes: *Hunjan International Inc., Re*, 2006 CarswellOnt 2718 (Ont. S.C.J.) at p. 2 and p. 8.
>
> …
>
> … it has been held that to require the Receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-à-vis another would likely not be cost effective, would drive up the overall receivership cost and would likely be a fool's errand in any event: *Hickman Equipment (1985) Ltd., Re*, [2004] N.J. No. 299 (N.L. T.D.) at p. 6.
>
> Where as in this case, the Receiver was appointed for the benefit of interested parties to ensure that all creditors were treated fairly and to ensure a fair process to deal with the assets, there is no valid reason for a secured creditor to avoid paying its fair share of the receivership costs: *Bank of Nova Scotia v. Norpak Manufacturing Inc.*, [2003] O.J. No. 4818 (Ont. C.A.) at p. 2.

JP Morgan Chase Bank N.A. v UTTC United Tri-Tech Corp (2006), 25 CBR (5th) 156 at paras 42-45 [Tab 2]

8. Similarly, in *DBDC Spadina Ltd. v Walton,* 2015 ONSC 2550, the Ontario Superior Court of Justice considered a "fee allocation methodology" proposed by a receiver that used various factors to calculate the total portion of the professional fees to be allocated to each party. In approving the proposed fee allocation methodology, Newbould J. held that:

> Each case is different. This case involves unusual complexity involving the Manager's responsibility for 31 Schedule B properties and several Schedule C properties, all of which were improperly run by the Waltons before the Manager was appointed. The Manager's task was made no easier by challenges raised from the beginning to the end. I accept that the Fee Allocation Methodology in this case allocates costs in a fair and equitable manner and that the discretion of the Manager has been exercised fairly. The fact that one or more

> interested parties is unhappy with the allocation is perhaps understandable but no basis in this case to change what the Manager has proposed to allocate the costs.

DBDC Spadina Ltd. v Walton, 2015 ONSC 2550, at para 28 [Tab 3]

9. As noted in the Twelfth Report, the allocation of expenses in this case involves the review of a significant number of transactions (in excess of 17,000). A comprehensive review of the transactions, including the settlement of any disputes regarding attribution, would be a time-consuming and expensive exercise to the detriment of unsecured creditors who would ultimately bear the costs associated with such review and any associated litigation.

10. The Receiver has undertaken a reasonably expeditious review process and has produced an "allocation" (as it relates to allocation of costs to NPL) in an effort to minimize costs.

11. In the event this Honourable Court finds that claims to the Net Receivership Proceeds are properly to be determined on a "separate corporation" basis, the Receiver will require an opportunity to undertake a more rigorous allocation process in order to determine, for example:

(a) the relationships between employees of NIP and each of the Debtors in order to account for any benefit, direct or indirect, derived by each of the Debtors (in particular, NI and NPL) to ensure the fair allocation of employee costs and obligations;

(b) the specific corporate overhead expenses to be fairly and equitably allocated against each of the Debtors; and

(c) the extent to which proceeds from the realizations of NIP, NI and NPL assets should fairly share the burden of expenses properly allocable to other Debtors, for which there are no realizations.

Rights of Subrogation and Contribution

12. Pursuant to section 2 of *The Mercantile Law Amendment Act*, CCSM c M120 (the "***MLA Act***"), on payment of a borrower's debt, a surety (or guarantor) becomes subrogated to the rights of the creditor as against the borrower and any co-surety. A surety may recover the full amount owing from the borrower. However, a claim against a co-surety is limited to the proportion of the total debt for which each co-surety is justly liable:

> **Surety entitled to assignment**
>
> **2** Every person who, being surety for the debt or duty of another, or being liable with another for any debt or duty, pays the debt or performs the duty, is entitled to have assigned to him, or to a trustee for him, every judgment, specialty, or other security that is held by the creditor in respect of the debt or duty, whether the judgment, specialty, or other security is or is not deemed at law to have been satisfied by the payment of the debt or performance of the duty; and that person is entitled to stand in the place of the creditor, and to use all the remedies, and, if need be, and upon a proper indemnity, to use the name of the creditor, in any action or other proceeding, at law or in equity, in order to obtain from the principal debtor, or any co-surety, co-contractor, or co-debtor, as in the case may be, indemnification for the advances made and loss sustained by the person who has so paid the debt or

> performed the duty, and the payment or performance so made by the surety is not pleadable in bar of any such action or other proceeding by him.
>
> **Right to recover**
>
> **3** No co-surety, co-contractor or co-debtor is entitled to recover from any other co-surety, co-contractor or co-debtor by the means aforesaid, more than the just proportion to which, as between those parties themselves, the last mentioned person is justly liable.

The Mercantile Law Amendment Act, CCSM c M120, ss 2 and 3 [Tab 4]

13. The general principles of law as they relate to the right of contribution between co-guarantors were summarized by Abrioux J. in *Gill v Cheema,* 2018 BCSC 1453:

> The right to contribution between co-guarantors is rooted in the principles of unjust enrichment.
>
> Paragraph 10.131 of McGuiness, *The Law of Guarantee*, 3rd ed (Markham: LexisNexis, 2013) sets out "five general principles which govern the rights of contribution among co-sureties" which include:
>
> - All co-sureties are bound *prima facie* equally to see to the performance of a guaranteed obligation, and must therefore bear their respective share of any claim made by the creditor equally (or in the proportion as agreed among themselves);
>
> - The right to contribution to which the co-sureties in the case of any particular guaranteed obligation are entitled may be varied by express or implied agreement;
>
> - In the absence of any such agreement, the obligation of each co-surety is determined by dividing the total obligation to which all are liable by the number of solvent sureties;

> - The right of any particular co-surety to recover contribution arises upon payment by the surety of more than his share;
> - However, even prior to the payment of the creditor, a surety may seek equitable relief (similar to the relief that is available in the case of the surety's right to enforce his or her right of indemnification against the principal) . . .

Gill v Cheema, 2018 BCSC 1453, at paras 41-42 [Tab 5]

14. Courts have held that where a guarantor had repaid the whole of an insolvent debtor's indebtedness to a lender, the guarantor is entitled to recover the amount it "over-contributed" in respect of the repayment from its co-guarantors in equal proportions in order to equalize the burden of repayment among co-guarantors.

Abakhan v Halpen, 2008 BCCA 29 [Tab 6]

15. In *Abakhan v Halpen,* 2008 BCCA 29 [*Abakhan*], a lender made demand on three co-guarantors after the principal debtor was assigned into bankruptcy. One of the guarantors made payment to the lender under the guarantees and obtained an assignment of certain remnant debt and the security held by the lender relating to the debt, including all the guarantees of the three co-guarantors. The guarantor subsequently advanced a claim against the two other co-guarantors in relation to the amount paid to the lender under the guarantees, as well as the remnant debt.

16. The Court in *Abakhan* held that the guarantor was precluded from collecting the remnant debt from his co-guarantors as section 34 of the *Law of Equity Act,* RSBC 1996, c 253 (British Columbia), limited the guarantor's claim against his co-guarantors to

the amount paid over and above his proportionate share of the debt repaid to the lender under the guarantees. As such, the guarantor was only entitled to recover one-third of the total amount paid under the guarantees from each co-guarantor.

Abakhan, supra at paras 12-15 and 24 [Tab 6]

17. The Court in *Abakhan* also found that it would be inequitable to allow the guarantor to enforce the lender's security as a creditor against the co-guarantors in a manner that would result in the co-guarantors being made to contribute amounts in excess of their proportionate share of the debt under the guarantees. In doing so, Saunders J.A. noted as follows with respect to the effect of the assignment of the lender's security upon the guarantor's relationship to the co-guarantors:

> Kevin P. McGuinness, in his *The Law of Guarantee*, 2nd ed. (Toronto: Carswell, 1996) addressed the enjoyment of a benefit obtained by a co-surety from the principal in respect to the debt, at p. 516:
>
> > <u>A surety who obtains a counter-security from the principal to which he may look for indemnification in the event that he is called upon to pay must hold that security for the benefit of all his co-sureties.</u> By extension, the surety must bring into the hotch-pot for distribution among all co-sureties any amount which he receives from the realization of the security, even in cases where the surety entered into his commitment on the express understanding with the debtor that the security would be for his own exclusive benefit. <u>The right to share in a security is that of the co-sureties and therefore is not liable to be defeated by any agreement between one of their number and the principal. This right is derived from the equitable principal that equality of treatment is equitable and that sureties should in general bear the burden of the guarantee in equal proportions, and also upon the principal that one co-</u>

> surety must not withdraw something from the estate of the debtor for his exclusive benefit.
>
> While these passages do not address the precise circumstances before us, their general theme is to the effect that one surety may not act to the disadvantage of an equitable sharing of the debt as between the sureties and, where, as here, guarantees of all three co-guarantors are assigned to one guarantor, the two non-holding guarantors are entitled to share the benefit of all the security.
>
> It is said on behalf of Mr. Abakhan that the assignment of the debt permits him to enforce the debt as a creditor. I do not agree … The legal expectation when the guarantees were given was that the burden of the debt guaranteed would be equalized. As I have explained above, in the event Mr. Abakhan obtains judgment for the amount of the remnant debt, that burden would not be equal — Mr. Abakhan would be out of pocket significantly less than either Mr. Halpen or Mr. Diehl.
>
> …
>
> Just as the Court of Chancery in *Reed v. Norris* [(1837), 40 E.R. 678 (Eng. Ch. Div.)] held that a surety cannot settle with a creditor and, instead of treating the settlement as payment of the debt, treat it as an assignment of the whole debt to himself, Mr. Abakhan can not [*sic*] settle with the Bank, obtain an assignment of the remnant debt and enforce it against his co-guarantors. [emphasis added]

Abakhan, supra at paras 22-24 and 28 [emphasis added] [Tab 6]

18. As noted in the Twelfth Report, pursuant to the Credit Agreement, each of the five Canadian Debtors are guarantors (NEL and NPL being limited recourse guarantors) of the amounts owed by the US Debtors, as borrowers under the Credit Agreement, to the Lenders. As such, each guarantor's obligation to contribute towards the equalization of any Canadian Debtor's disproportionate payment of the Lenders' claim is limited to one-fifth (20%) of the total amount paid to the Lenders by the guarantors,

subject to the further qualification that the contributions by NEL and NPL cannot exceed their recourse limit (i.e. $20,000,000.00 USD plus costs) under the Credit Agreement.

19. As the repayments to the Lenders have been allocated equally to NIP and NPL, it appears neither NIP nor NPL can seek contribution from the other under the *MLA Act*. However, NPL and NIP could seek a one-fifth contribution from each of the other guarantors to the extent of their respective overpayments and/or indemnity from each of the borrowers. As the borrowers and the remaining co-guarantors (i.e., the other Debtors) are insolvent and do not have assets, there are, as a practical matter, no subrogated rights or right of contribution to enforce.

Procedural and Substantive Consolidation

20. Procedural or administrative consolidation of multiple estates in bankruptcy permit such estates to be administered in a single proceeding, thereby reducing both the administrative burden on the trustee and administrative costs. Substantive consolidation allows for the assets of affiliated legal entities, typically corporations, to be pooled to create a common fund out of which the claims of creditors of all the entities are jointly satisfied.

Redstone Investment Corp. (Receiver of), Re, 2016 ONSC 4453, at para 7 [*Redstone*] [Tab 7]

21. There is jurisdiction for procedural consolidation pursuant to Rule 6.01 of the *Court of Queen's Bench Rules*, Man Reg 553/88, which provides that the Court may order that proceedings be consolidated and, in such an order, "may give such directions

as are just to avoid unnecessary costs or delay". Procedural consolidation is also consistent with section 94 of *The Court of Queen's Bench Act*, CCSM c 280, which dictates that, "[a]s far as possible, a multiplicity of proceedings shall be avoided."

Court of Queen's Bench Rules, Man Reg 553/88, r 6.01(1) and (2) [Tab 8]
The Court of Queen's Bench Act, CCSM c 280, s 94 [Tab 9]

22. The authority for substantive consolidation in Canada lies under the equitable jurisdiction of the Court granted by section 183(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (the "***BIA***"), which confers equitable jurisdiction on the Court in respect of proceedings under the *BIA*.

Bankruptcy and Insolvency Act, RSC 1985, c B-3 s 183(1) [*BIA*] [Tab 10]
Redstone, supra at para 7 [*Redstone*] [Tab 7]

23. In *Redstone*, G.B. Morawetz, J. of the Ontario Superior Court of Justice undertook a comprehensive review the law as it relates to substantive consolidation of debtor estates in insolvency proceedings, noting as follows:

> The following general principles respecting the doctrine of substantive consolidation represent a summary of Canadian case law:
>
> (i) Are the elements of consolidation present, such as the intertwining of corporate functions and other commonalities across the group?
>
> (ii) Do the benefits of consolidation outweigh the prejudice to particular creditors?
>
> (iii) Is consolidation fair and reasonable in the circumstances?

Redstone, supra at para 78 [Tab 7]

24. The "elements of consolidation" to be considered by this Honourable Court when assessing the appropriateness of substantive consolidation were set out by Kane J. in *Bacic v Millennium Educational & Research Charitable Foundation*, 2014 ONSC 5875:

> The test as to substantive consolidation requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:
>
> (a) difficulty in segregating assets;
>
> (b) presence of consolidated Financial Statements;
>
> (c) profitability of consolidation at a single location;
>
> (d) commingling of assets and business functions;
>
> (e) unity of interests in ownership;
>
> (f) existence of intercorporate loan guarantees; and
>
> (g) transfer of assets without observance of corporate formalities
>
> in order to assess the overall effect of consolidation.

Bacic v Millennium Educational & Research Charitable Foundation, 2014 ONSC 5875 at para 113 [*Bacic*] [Tab 11]

25. As noted by the Court in *Redstone, supra* there is relatively limited treatment of the concept of substantive consolidation in Canada; however, the approach adopted in Canada can be contextualized by an overview of the approach applied in the United States Bankruptcy Court (the "**US Court**"), as the power to order substantive consolidation in the US is derived from the courts' equitable jurisdiction, similar to

Canada. Moreover, case law out of the US Court has been cited with approval in numerous Canadian authorities.

Redstone, supra at paras 48-54 [Tab 7]
See also, *Bacic, supra* at para 110 [Tab 11]
A. & F. Baillargeon Express Inc., Re, (1993) 27 CBR (3d) 36 (Que SC) at paras 14-16 [*A. & F. Baillargeon*] [Tab 12]
Ashley v Marlow Group Private Portfolio Management Inc, [2006] OJ No 1195 (Ont SCJ [Commercial List]) at para 72 [*Marlow Group*] [Tab 13]

26. An extensive review of the law out of the US Court as it relates to substantive consolidation is set out by Lane J. *In re Republic Airways Holdings Inc.*, 565 BR 710, 716 (Bankr SDNY. 2017), *aff'd*, 582 BR 278 (SDNY 2018) [Tab 14].

27. Courts have dismissed motions for substantive consolidation where a Court-appointed officer failed to provide sufficient evidence to allow the Court to adequately consider the potential effect of consolidation on creditors. In such cases, the motions have been dismissed without prejudice to the Court-appointed officer to renew the motion on further and better evidence.

See also, *Marlow Group, supra* at paras 78-80 [Tab 13]
J.P. Capital Corp., Re, (1995) 31 CBR (3d) 102 (Ont SCJ) at paras 13-19 [Tab 15]

28. In *Redstone, supra*, the Ontario Superior Court of Justice dismissed a motion brought by a receiver for the substantive consolidation of the estates of three corporate entities. In determining that substantive consolidation was not appropriate Morawetz J. noted that:

(a) the assets of the corporations were separate and easily identifiable;

(b) all financial statements, audited and unaudited, were prepared on an entity-by-entity basis;

(c) all three corporations had different ownership structures; and

(d) there were no intercorporate loan guarantees of any third party financing.

Redstone, supra at paras 80-85 [Tab 7]

29. Further, the Court in *Redstone* found there would be significant financial prejudice to the creditors of one of the companies if substantive consolidation were ordered. The creditors were primarily comprised of investors in each of the companies. The investors in two of companies acknowledged that financial disclosure made at the time their investments were made revealed that the investments were risky and that they may not recover on their investments. Therefore, the Court found that it would be improper to make an order that would benefit the investors in two of the companies by effectively ameliorating the risks known to the investors (which ultimately materialized) to the detriment of the investors in the other company.

Redstone, supra at paras 86-88 [Tab 7]

30. Courts have held that substantive consolidation is appropriate in circumstances where the affairs of the debtor companies were conducted with a disregard for the "niceties of corporate identity and separate juridical personalities", assets were intermingled, and where, due to the manner in which the corporations were operated and

the state of corporate records, the allocation of value and claims between the corporations would be burdensome.

Bacic, supra at para 100 [Tab 11]
A. & F. Baillargeon, supra at paras 5 and 12-16 [Tab 12]
PSINet Ltd., Re (2002), 33 CBR (4th) 284(Ont SCJ) at paras 2 and 11 [*PSINet Ltd.*] [Tab 16]

31. In *Bacic*, *supra* the Ontario Superior Court of Justice considered whether a bankrupt foundation, which formed part of a larger group of bankrupt companies in receivership, should be isolated and removed from a consolidated distribution recommended by an interim receiver, which included certain related bankrupt companies in receivership and the foundation.

32. The Court in *Bacic* found that the consolidation of the estates of the bankrupt corporations, including the foundation, was appropriate in the circumstances, based upon the following facts:

(a) financial statements were prepared on a consolidated basis, which resulted in assets specific to one company being referred to in financial statements of other companies, including the foundation;

(b) the directing mind of the corporations and the foundation managed the corporations and the foundation as a consolidated entity over eight years;

(c) any attempt to historically trace funding within the foundation would be inappropriate and financially impractical;

(d) any attempt to disengage and isolate the affairs and finances of only the foundation would be an artificial and impractical exercise; and

(e) the interim receiver's opinion that further tracing efforts would produce uncertain results and involve the expenditure of considerably more professional fees, which was to the risk of the creditors of the bankrupt corporations, and not the foundation.

Bacic, supra at paras 101-106 and 114-116 [Tab 11]

33. In *Gray Aqua Group of Companies, Re,* 2015 NBQB 107, the New Brunswick Court of Queen's Bench allowed a motion brought by a proposal trustee for an order approving the filing of a consolidated proposal in respect of eight related corporations. In considering the evidence supporting the consolidated proposal, the Court noted:

> In particular, the Group companies are vertically and financially integrated with a singular management and accounting structure. Moreover, solicitors for the Proposal Trustee submit uncontested evidence that <u>Group companies operated at all times as an integrated enterprise with centralized management, sales and accounting based in Northampton, New Brunswick</u>.
>
> The Group also shares several common senior creditors, which include Callidus Capital Corporation ("Callidus") who acquired debt and security from HSBC Canada ("HSBC") on a number of the Group companies and Business Development Bank of Canada ("BDC"). [emphasis added]

Gray Aqua Group of Companies, Re, 2015 NBQB 107 at paras 5-6 [emphasis added] [Tab 17]

34. Moreover, Courts have consistently found that certain facts signify “a total intermingling of assets, operations and liabilities” of related corporations, including:

(a) holding common bank accounts through which funds are funneled and distributed to pay the expenses and obligations of each of the companies regardless of which entity is legally entitled to the funds and/or responsible for the expense or obligation;

(b) the presence of intercorporate loans being made back and forth between related companies without the observance of typical corporate formalities;

(c) the commingling of records of the related companies such that it is extremely difficult, if not impossible, to identify which records belong to each company;

(d) the use of common head-offices shared by related companies;

(e) one entity employing all employees for a group of companies; and

(f) common ownership and/or control, either directly or indirectly, by one individual in a group of companies and/or each entity having substantially the same officers and directors.

See, *Bacic, supra* at paras 100 and 116 [Tab 11]
A. & F. Baillargeon, supra at paras 12-16 [Tab 12]
PSINet Ltd, supra at paras 2 and 11 [Tab 16]

35. In *A. & F. Baillargeon,* the Quebec Superior Court (Bankruptcy and Insolvency Division) considered a motion brought by a trustee in bankruptcy of five

bankrupt estates seeking the consolidation of the estates. In addition to being appointed as trustee of the five bankrupt companies, the trustee was also appointed as receiver over 21 related companies. The five bankrupt companies and the 21 companies in receivership formed one highly complex group of interrelated companies.

36. In finding that substantive consolidation was appropriate, the Court focused on the fact that the five bankrupt companies operated collectively as one entity with no real distinction as to their customers, banks and assets. In fact, the 26 entities (five bankrupt companies and the 21 companies in receivership) held only four operating bank accounts and a concentration account into which all funds funneled through to the other accounts. The fact that each company did not have their own bank account was found to be a sign of a total intermingling of assets, operations and liabilities. The Court also referred to an article published in the United States which cited a factually analogous United States case in which the American Circuit Court of Appeals upheld an order consolidating certain related entities:

> … We read in that article the following very interesting citation:
>
> > An alternative theme of some recent case law is that the bankruptcy proceedings of affiliated corporations should be consolidated whenever it is impractical to separate their financial affairs. The outstanding example of this proposition is the majority opinion in *Chemical Bank New York Trust Company* vs. *Kheel* ...
>
> a decision of the second American Circuit Court of Appeals.
>
> The enterprise in that case consisted of eight affiliates, which the Referee found were "operated as a single unit with little or no attention paid to the formalities usually observed in independent corporations ...". Upon motion by a major

> creditor, the assets and liabilities of the corporations were consolidated. Chemical Bank, a creditor of one of the stronger affiliates, appealed. The majority opinion in *Kheel* is said in that Article to reflect the following proposition:
>
>> If the relationships between affiliates are so obscured that it is impossible to disentangle their affairs, of course their bankruptcy proceedings should be consolidated. In such a situation even a simplistic reliance argument could not seriously be advanced.
>
> Further on in that same Article, and in the actual *Kheel* case itself, the extract which is of interest reads as follows:
>
>> <u>The debtor corporations are all owned or controlled by the former shipping magnate, Manuel E. Kulukundis. The Referee found that the debtor corporations were operated as a single unit with little or no attention paid to the formalities usually observed in independent corporations, that the officers and directors of all, so far as ascertainable, were substantially the same and acted as figureheads for Kulukundis, that funds were shifted back and forth between the corporations in an extremely complex pattern and in effect pooled together, loans were made back and forth, borrowings made by some to pay obligations of others, freights due some pledged or used to pay liabilities and expenses of others, and withdrawals and payments made from and to corporate accounts by Kulukundis personally not sufficiently recorded on the books.</u>
>
> <u>That recitation reflects very closely the situation in the case of the Baron Group and specifically the five companies with which we are here concerned. It is interesting to note that the resolution of each participating company affixed to that Joint Banking Agreement, Exhibit R-2, is in all cases signed by the same Mr. B. Baillargeon, so that he can readily be seen to be the equivalent of Mr. Kulukundis in the American case cited above.</u> [emphasis added]

A. & F. Baillargeon, supra at paras 14-16 [emphasis added] [Tab 12]

37. The consolidation of related entities for creditor purposes is not limited to the context described above. Certain administrative bodies also have statutory authority

to order that related entities should be treated as one entity in relation to claims of specific creditors. For example, section 134 of *The Employment Standards Code*, CCSM c E110, provides as follows:

> **Determination of single employer by order**
>
> 134(1) Where the director or board determines that associated or related businesses are carried on or have been carried on under common control or direction by or through two or more employers, the director or board may by order declare that the employers named in the order are a single employer for the purpose of this Code.
>
> **Effect of single employer order**
>
> 134(2) Employers that are declared to be a single employer are jointly and severally liable for the payment of wages to all employees of the employers.

The Employment Standards Code, CCSM c E110 at s 134 [Tab 18]

38. In *San Bao Investment Inc., Re,* [2017] BCWLD 2471, the British Columbia Employment Standards Tribunal noted that the purpose of common or single employer provisions in employment standards legislation "… is to ensure that employees are not unfairly disadvantaged where business is conducted through separate legal entities in order to limit risks or minimize tax" (at para 16), and went on to note:

> Corporations and business ventures structured in a way that protects investors while limiting risk and reducing taxes, are entirely legal. Competing with that, however, is the decree of our legislature declaring contrary to the public interest [is] a corporate structure that allows a business to shirk obligations to employees. Rather than outlawing those structures, section 95 permits the Director to ignore them. The Tribunal ought not to capitulate with respect to a structure and management style that would so easily allow an employer to circumvent a fundamental tenet of the *Act*.

San Bao Investment Inc., Re, [2017] BCWLD 2471 at paras 16, 90 [*San Bao*] [Tab 19]

39. The Tribunal provided an overview of the factors to be considered in determining whether common control or direction is present:

> (a) "Common control or direction is clearly established where the same person is in reality the guiding force or managing authority for both businesses..." (*Broadway Entertainment Corp., Re* (July 18, 1996), Doc. D184/96 (B.C. Empl. Stnds. Trib.) , at page 11).
>
> (b) Common control or direction "... is not limited in its application to direct financial or corporate control." (*Invicta Security Systems Corp., Re*, BC EST # D349/96, at page 6).
>
> (c) Common control or direction "... may be determined based on financial contributions from one entity to another (although this factor, standing alone, in not determinative); the fact that one entity is economically dependent on another entity; interlocking shareholdings and directorships; common management principles (e.g., corporate officers and other key employees); sharing of resources (including human resources) among the various entities; asset transfers at non-market transfer prices; operational control by one entity over the affairs of another entity; joint ownership of key assets and operational integration" (*0708964 B.C. Ltd., supra*, at paragraph 32).
>
> (d) "The totality of the business and the inter-relationships of the entities must be examined." (*Invicta Security Systems Corp., Re, supra*, at page 6).

San Bao, supra at para 35 [Tab 19]

40. In *Downtown Eatery (1993) Ltd. v Ontario*, [2001] OJ No 1879 (CA), the Ontario Court of Appeal found that the common employer doctrine was also applicable in a common law context. The Court considered the appeal of an employee who had been

wrongfully dismissed and awarded substantial damages in an action against the employer. Unfortunately, the employer had no assets and consequently the employee was unable to enforce his judgment. In a subsequent action, the employee sued related companies and the two main principals of all the companies in an attempt to widen his net of potential sources of recovery. In allowing the employee's appeal, the Court noted that:

> … although an employer is entitled to establish complex corporate structures and relationships, the law should be vigilant to ensure that permissible complexity in corporate arrangements does not work an injustice in the realm of employment law. At the end of the day, Alouche's situation is a simple, common and important one - he is a man who had a job, with a salary, benefits and duties. He was fired - wrongfully. His employer must meet its legal responsibility to compensate him for its unlawful conduct. The definition of "employer" in this simple and common scenario should be one that recognizes the complexity of modern corporate structures, but does not permit that complexity to defeat the legitimate entitlements of wrongfully dismissed employees.

Downtown Eatery (1993) Ltd. v Ontario, [2001] OJ No 1879 (CA) at para 36 [Tab 20]

41. As noted in the Twelfth Report, there are certain facts present in this case which militate against consolidation, including that:

(a) legal title to real property assets of NPL and certain assets of NI and NIP (e.g. inventory, vehicles) can, in certain cases, be segregated;

(b) certain elements of the clothing business were transacted through NI in the US, including certain leases or warehousing facilities through Edson's and Brause;

(c) NPL and NEL are not included in the consolidated financial statements prepared on a combined basis in respect of all the other Debtors;

(d) to the best of the Receiver's knowledge, the Debtors maintained separate minute books and annual resolutions;

(e) it is unclear to the Receiver what ownership interest and control, if any, Mr. Nygard has with respect to DGM Financial Services Trustee, the ultimate owner of the US Debtors; and

(f) certain written intercompany agreements were made between Debtors with respect to some of their business arrangements.

42. Conversely, there are many facts present in this case which support consolidation, including, among other things, that:

(a) it appears that Mr. Nygard exercised general authority and direction over all of the Debtors and their business affairs;

(b) the directors and officers of all of the Debtors are substantially the same;

(c) the Debtors generally operated using only NIP bank accounts;

(d) all creditors of each of the Debtors were tracked and managed centrally on one consolidated accounts payable sub-ledger, regardless of which Debtor procured or benefited from the goods or services obtained;

(e) NIP incurred and directly paid all, or substantially all, expenses on behalf of the Debtors, regardless of which Debtor procured or benefited from the goods or services obtained, which expenses were captured for accounting purposes (on an inconsistent basis) as intercompany transactions on non-commercial terms;

(f) in the inter-corporate transactions between Debtors, cash rarely changed hands and intercompany accounts were often not settled or paid, as would typically be expected among separate corporations;

(g) NIP advanced substantial funds (or directly incurred obligations) in relation to the development and maintenance of NPL's real property assets, including:

  (i) approximately $8,000,000.00 for the development and maintenance of the NPL Falcon Lake Property, including approximately $2,600,000.00 in labour expenses directly attributable to the NPL Falcon Lake Property;

  (ii) approximately $5,600,000.00 in capital improvements and maintenance costs for the Inkster Property; and

  (iii) approximately $1,000,000.00 in capital improvements and maintenance costs for the Notre Dame Property,

(h) substantially all accounting and payment functions, strategic decision making, communications functions, marketing and pricing decisions, new business development initiatives, negotiation of material contracts and leases, retail and third party supplier/services decisions, design and merchandising, and production and distribution functions were managed centrally from the head office at the Inkster Property in Winnipeg, Manitoba;

(i) the Debtors employed approximately 1550 people, 1450 of which were employed by NIP and 100 of which were employed by NI. NIP funded the overwhelming majority of employee costs notwithstanding that employees provided services and performed functions for, or which benefited, other Debtors;

(j) the IT System is a centralized system used commonly by the Debtors and certain other members of the broader Nygard Organization (approximately 30 companies in total) to maintain the books and records of all of them;

(k) the records of the Debtors are comingled within the IT System;

(l) although certain written intercompany agreements were made between the Debtors with respect to their business arrangements, it appears that the payment terms were not regularly complied with;

(m) the Debtors have recorded in excess of $87,000,000.00 in aggregate intercompany loans as among the Debtors;

(n) it appears that without the centralized services provided by NIP, none of the other Debtors could have carried on business on a stand-alone basis;

(o) the Canadian Debtors took a consolidated approach in relation to the Original NOI Proceedings; and

(p) throughout the Receivership Proceedings, the Debtors' own evidence has consistently presented the Debtors and the Business in a manner which "assumes" a common enterprise (e.g. consistently referring to asset of NPL and NIP as "Nygard Group assets" or "Nygard Group Resources", the use of primarily one affiant on behalf of all Debtors). Attached as Appendix "M" to the Twelfth Report is a summary of the evidence filed by the Debtors for the Court's consideration.

43. As detailed in the Twelfth Report, the Receiver has assessed the relative economic benefits of consolidation balanced against any prejudice to creditors. It appears to the Receiver that:

(a) CRA and perhaps other direct unsecured creditors of NPL, if any, are economically prejudiced by substantive consolidation of the Debtors for creditor purposes; and

(b) employees, landlords, suppliers and other vendors, gift card purchasers, and taxing authorities who are owed debts by NIP, NI and other Debtors (not including NPL) are economically advantaged by substantive consolidation of the Debtors for creditor purposes.

44. In the Receiver's view, the overall benefits of consolidation appear to

outweigh prejudice to any particular creditor.

Bankruptcy Considerations

45. Pursuant to section 49(1) of the BIA:

> **49 (1)** An insolvent person or, if deceased, the executor or administrator of their estate or the liquidator of the succession, with the leave of the court, may make an assignment of all the insolvent person's property for the general benefit of the insolvent person's creditors.

The BIA, *supra* s 49(1) [Tab 10]

46. Section 49(3) of the BIA provides that assignments are to be filed in the "locality of the debtor".

Ibid, s 49(1) [Tab 10]

47. Under the BIA "debtor", "insolvent person", and "locality of the debtor" are defined as follows:

> ***debtor*** includes an insolvent person and any person who, at the time an act of bankruptcy was committed by him, resided or carried on business in Canada and, where the context requires, includes a bankrupt;
>
> …
>
> ***insolvent person*** means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,

(b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

…

locality of a debtor means the principal place

(a) where the debtor has carried on business during the year immediately preceding the date of the initial bankruptcy event,

(b) where the debtor has resided during the year immediately preceding the date of the initial bankruptcy event, or

(c) in cases not coming within paragraph (a) or (b), where the greater portion of the property of the debtor is situated;

The BIA, *supra* s 2 [Tab 10]

48. In *Flax Investment Ltd., Re* (1979), 32 CBR (NS) 65 (Ont SC [In Bankruptcy]), the Ontario Supreme Court considered whether a petition was properly filed in Ontario. The debtor corporation did not carry on business in Ontario in the year preceding the petition. However, the debtor had its head office in Ontario and the principal of the corporation lived in Ontario (but spent a large part of the year in Florida). The Court ultimately found that the petition was properly filed in Ontario. In doing so, the Court noted as follows with respect to the residence of a corporation:

> The residence of the company presents some difficulty. A corporation is resident where its seat of management is located, and a corporation may be resident in more than one place. In this case the head office of the company was at all

> times in Toronto. The accounting books and records were moved to Toronto in the fall of 1978. Mr. Hunter, the president of the company and one of its two beneficial shareholders, resided in Toronto, had his office in Toronto and did business in Toronto on behalf of the company, although he also spent a substantial part of the year in Florida and some time in Manitoba. Mr. Procter, the other director and the secretary of the company, resided in Manitoba, and, as I have said, there is no evidence that he was ever in Toronto during the year. The company was registered to do business in Manitoba, and it leased land and equipment in Manitoba for its farming operations which were managed by Square One.
>
> It is to be noted that the issue of locality is not concerned with a tax or other liability of the company, it is a procedural matter under the Bankruptcy Act which must be considered by a petitioner in ascertaining the court in which to launch his petition. In such a context certainty is a desirable factor… In this case the head office, books of account and the president were all located in Toronto. The remaining officer and director resided in Manitoba, but there is no evidence that the directors' or shareholders' meetings were ever held in Manitoba or in fact at any place at any time. There were two meetings in Manitoba during the year which principally concerned the farm operations, but they would appear to have been between Hunter on behalf of the company and Procter on behalf of Square One, the manager of the company. The farm inventory and leasehold property were located in Manitoba and managed by a third party, but it is to be noted that the definition of "locality" draws a distinction between residence and the location of property.
>
> I find on the evidence that the principal place where the debtor resided during the year immediately preceding the date of the petition was the city of Toronto.

Re Flax Invt. Ltd. (1979), 32 CBR (NS) 65 at paras 14-16 [Tab 21]

49. As noted in the Twelfth Report, it is the Receiver's view that the locality of each of the Debtors, including the US Debtors, is Winnipeg, Manitoba, based on the following:

(a) in the Chapter 15 Proceedings the US Court found that "the Canadian Proceeding is pending in Canada, which is where the Debtors have their "center of main interests"…";

(b) on March 13, 2020, this Honourable Court made an Order which provides, *inter alia*, as follows:

> THIS COURT ORDERS that the Court of Queen's Bench of Manitoba, Winnipeg Centre, is the appropriate forum and this court hereby assumes jurisdiction over proceedings related to the Respondents, including this Receivership Application and the Notices of Intention to Make a Proposal under the Bankruptcy and Insolvency Act R.S.C. 1985, c. B-3 as amended (the "BIA")

(c) during the course of the receivership, the Business was operated by the Receiver in accordance with its mandate, as set out in the Receivership Order made by this Honourable Court;

(d) each of the Debtors' seat of management was located in Canada; and

(e) substantially all of the Debtors' books and records were located at the head office at the Inkster Property.

50. As further noted in the Twelfth Report, on a separate corporation basis:

(a) all of the Debtors, other than FV, has recorded liabilities that amount to more than $1,000.00 (although, FV was a "Borrower" under the Credit Agreement and therefore, may be subject to subrogated claims in excess of $1,000.00);

(b) each of the Debtors, other than NPL, is insolvent (although, the Receiver considers it likely that a more rigorous allocation process would attribute additional costs to NPL with the result that NPL would be determined to be insolvent); and

(c) each of the Debtors has committed an act of bankruptcy.

51. On a consolidated basis, each of the Debtors would be jointly liable for the Common Liabilities, which amount to approximately $77,000,000.00. The Common Assets are not sufficient to enable payment of all of the Common Liabilities.

52. In the alternative, the Receiver is seeking leave to file applications for bankruptcy orders in relation to NPL and NEL, on a basis that reflects the Common Assets and the Common Liabilities and the substantive consolidation of the estates of the Debtors.

53. Pursuant to section 43(1) of the BIA:

> **43 (1)** Subject to this section, one or more creditors may file in court an application for a bankruptcy order against a debtor if it is alleged in the application that
>
> (a) the debt or debts owing to the applicant creditor or creditors amount to one thousand dollars; and
>
> (b) the debtor has committed an act of bankruptcy within the six months preceding the filing of the application.

The BIA, *supra* s 43(1) [Tab 10]

54. Section 43(5) of the BIA provides that the application shall be filed in the "locality of the debtor".

Ibid, s 43(5) [Tab 10]

55. As noted in the Twelfth Report and at paragraph 40 and 42 herein, the Receiver respectfully submits that locality of the NPL and NEL, is Winnipeg, Manitoba, and on a consolidated basis, NPL and NEL, would be jointly liable for the Common Liabilities (which exceeds $1,000.00). As noted above, the Common Assets are not sufficient to enable payment of all the Common Liabilities.

<u>Lifting the Stay</u>

56. If necessary, the Receiver is seeking an Order lifting the stay of proceedings imposed under paragraph 12 of the Receivership Order to permit the Receiver to file applications for bankruptcy orders in relation to NEL and NPL, on a basis that reflects the Common Assets and the Common Liabilities and the substantive consolidation of the estates of the Debtors.

57. Paragraph 12 of the Receivership Order provides as follows:

> THIS COURT ORDERS that no Proceeding against or in respect of the Debtors or the Property (including for greater certainty, any Property located on third-party premises) or any assets located on premises belonging to or leased by the Debtors shall be commenced or continued except with the written consent of the Receiver or with leave of this Court and any and all Proceedings currently under way against or in respect of the Debtors or the Property or any assets located

> on premises belonging to or leased by the Debtors is hereby stayed and suspended pending further Order of this Court…

58. The test for lifting a stay imposed under a receivership order focuses on the totality of the circumstances and relative prejudice to the parties involved in the receivership. Guidance may be drawn from section 69.4 of the BIA in determining whether to lift a stay in a receivership.

Alberta Treasury Banches v COGI Limited Partnership, 2018 ABQB 356 at para 51 [*COGI*] [Tab 22]

59. Pursuant to section 69.4 of the BIA a court may make a declaration that the automatic statutory stay of proceedings imposed pursuant to sections 69 to 69.31 of the BIA no longer operates if it is satisfied that the creditor or person is likely to be materially prejudiced by the continued operation of the stay provisions, or that is it equitable on other grounds to make such a declaration.

BIA, supra s 69.4 [Tab 10]
COGI, supra at para 51 [Tab 22]

60. In *Thompson Bros. (Constr.) Ltd. v Jay Vee Sandblasting Ltd.,* 2013 ABQB 670, the Alberta Court of Queen's Bench granted an application for an order lifting a stay of proceedings imposed under a receivership order to allow certain unsecured creditors to make an application for a bankruptcy order under the BIA in respect of a debtor.

61. In allowing the application to lift the stay of proceedings, the Court considered the totality of the circumstances and the relative prejudice to the parties to the

receivership. In doing so, the Court highlighted certain “significant features” including that, among other things:

(d) there were serious concerns regarding, *inter alia*, the dissipation of assets prior to the receivership;

(e) the receiver had conducted a sale process during the course of the receivership and held sale proceeds which exceeded the amounts of secured claims;

(f) a bankruptcy trustee would have rights and powers which would potentially bring disputes to determination more efficiently than the receivership proceedings appeared likely to do; and

(g) the continuation of the existing receivership to the point that ongoing activities were concluded would not be affected by a bankruptcy order and there was little basis for concern that a bankruptcy trustee would be required to duplicate work already done by the receiver.

Thompson Bros. (Constr.) Ltd. v Jay Vee Sandblasting Ltd., 2013 ABQB 670 at paras 26 and 27 [Tab 23]

62. As noted in the Twelfth Report:

(a) since the commencement of the Receivership Proceedings, the Receiver has been investigating the activities and conduct of the Debtors and their directors, officers and senior management both prior and subsequent to the

Appointment Date and gathering information as to numerous matters related to such conduct, including *inter alia*:

(i) investigating and considering next steps regarding certain Nygard Group vehicles in the possession of or purportedly transferred to certain (now former) employees of the Debtors prior to the Appointment Date; and

(ii) investigating and considering the reliability of the Debtors' books and records and the accounting treatment applied by the Debtors to intercompany transactions (e.g. large "cash advances to PJN" which were booked as repayment of debts between NPL and NIP).

(b) the Receiver estimates Net Receivership Proceeds from the disposition of Property to total approximately $9,900,000.00 following the payment of the Remaining Receivership Expenses;

(c) the Receiver is seeking a recommendation from this Honourable Court that Richter Advisory Group Inc. be appointed as Trustee in relation to the estates of each of the Debtors in bankruptcy, which removes any basis for concern that the Trustee would be required to duplicate work already done by the Receiver; and

(d) assigning the Debtors into bankruptcy would bring to bear the provisions of the BIA that are intended to address the claims of unsecured creditors and additional powers of a trustee as provided in the BIA.

63. Accordingly, the Receiver submits that this Honourable Court should grant the Net Receivership Proceeds Order in the form attached as Schedule "A" to the Receiver's Notice of Motion.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 21st day of June, 2021.

THOMPSON DORFMAN SWEATMAN LLP

Per: "Ross A. McFadyen"
G. Bruce Taylor / Ross A. McFadyen /
Mel M. LaBossiere
Lawyers for Richter Advisory Group Inc.,
the Court-Appointed Receiver

2016 BCSC 361
British Columbia Supreme Court

HSBC Bank of Canada v. Maple Leaf Loading Ltd.

2016 CarswellBC 559, 2016 BCSC 361, [2016] B.C.W.L.D. 2310, 264 A.C.W.S. (3d) 123, 34 C.B.R. (6th) 55

HSBC Bank of Canada, Petitioner and Maple Leaf Loading Ltd., Pro-Trans Ventures Inc., Caterpillar Financial Services Limited, Element Fleet Management Inc., GE Canada Equipment Financing G.P., GE Canada Leasing Services Company, General Electric Canada Equipment Finance G.P., GE Canada Asset Financing Holding Company, GE Techology Finance, GE VFS Canada Limited Partnership, GE Capital Canada Equipment Financing & Leasing Company, Mercedes-Benz Financial Services Canada Corporation, Daimler Truck Financial, Finning International Inc., National Leasing Group Inc., Coast Capital Savings Credit Union, ATCO Structures & Logistics Ltd., Knight Manufacturing Ltd., Dynamic Capital II Corporation, Canadian Western Bank Leasing Inc., James Western Star Truck & Trailer Ltd., Zeemac Vehicle Lease Ltd., Inland Kenworth and Premium Truck & Trailer Inc., Respondents

D.M. Masuhara J., In Chambers

Heard: February 10, 2016
Judgment: March 2, 2016
Docket: Vancouver S144996

Counsel: V. Tickle, for HSBC
H. Lance Williams, for Receiver
P. Rubin, for Caterpillar Financial Services
C. Cash, for James Western Star Truck and Trailer Ltd. and Inland Kenworth
A. Winters, for Element Fleet Management Inc.
M. Sennott, for Knight Manufacturing

Subject: Corporate and Commercial; Insolvency

Headnote

Bankruptcy and insolvency --- Receivers — Fees and expenses
Allocation — Court-appointed receiver was appointed for transportation company MLL — Receiver incurred costs of $1,172,856 in realizing on assets of MLL — Court had approved fees and disbursements of receiver and its legal counsel — Receiver proposed allocation identifying location specific costs and general costs, and allocating those to all secured creditors, including equipment lessors, on pro rata basis taking into account secured creditors' recoveries — Proposed allocation was opposed by equipment lessor CFS — CFS claimed that proposed allocation was readjustment of priorities, there was no connection between allocated costs and CFS, that it did not take into account degree of benefit, direction of CFS and other secured creditors, and that allocation was disproportionate to benefit received — CFS stated that received had sold one piece of CFS's equipment for $142,860 and that proposed allocation to it was $149,768 — Hearing was held to determine

validity of proposed allocation — Receiver was acting to preserve or protect vehicles which benefited all interested parties, including repairers lien holders — Some allocation was warranted — Court was concerned with overall fairness of cost allocation as could be seen in result upon CFS — Pro rata allocation based on number of pieces of equipment greater than $10,000 in value was better correlated to costs than recoveries — Activities of receiver and expenses incurred related directly and indirectly more to hauling equipment as opposed to realization value, which resulted in relative leveling of percentage cost burden.

Table of Authorities

Cases considered by *D.M. Masuhara J., In Chambers*:

Hickman Equipment (1985) Ltd., Re (2004), 2004 NLSCTD 164, 2004 CarswellNfld 263, 5 C.B.R. (5th) 56, *(*sub nom. *Hickman Equipment (1985) Ltd. (Receivership), Re)* 241 Nfld. & P.E.I.R. 294, *(*sub nom. *Hickman Equipment (1985) Ltd. (Receivership), Re)* 716 A.P.R. 294 (N.L. T.D.) — referred to

Lochson Holdings Ltd. v. Eaton Mechanical Inc. (1984), 55 B.C.L.R. 54, 33 R.P.R. 100, 52 C.B.R. (N.S.) 271, 10 D.L.R. (4th) 630, 1984 CarswellBC 572, 53 C.B.R. (N.S.) 177 (B.C. C.A.) — referred to

Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd. (1975), 9 O.R. (2d) 84, 21 C.B.R. (N.S.) 201, 59 D.L.R. (3d) 492, 1975 CarswellOnt 123 (Ont. C.A.) — considered

Royal Bank of Canada v. Atlas Block Co. (2014), 2014 ONSC 1531, 2014 CarswellOnt 2780 (Ont. S.C.J. [Commercial List]) — followed

Royal Bank v. Vulcan Machinery & Equipment Ltd. (1992), 3 Alta. L.R. (3d) 358, 13 C.B.R. (3d) 69, [1992] 6 W.W.R. 307, 1992 CarswellAlta 287 (Alta. Q.B.) — considered

Terra Nova Management Ltd. v. Halcyon Health Spa Ltd. (2006), 2006 BCCA 458, 2006 CarswellBC 2565, 58 B.C.L.R. (4th) 64, 25 C.B.R. (5th) 199 (B.C. C.A.) — considered

Winnipeg Motor Express Inc., Re (2009), 2009 MBQB 204, 2009 CarswellMan 383, 56 C.B.R. (5th) 265, 15 P.P.S.A.C. (3d) 242, 243 Man. R. (2d) 31 (Man. Q.B.) — referred to

Statutes considered:

Personal Property Security Act, R.S.B.C. 1996, c. 359
s. 32 — considered

Repairers Lien Act, R.S.B.C. 1996, c. 404
Generally — referred to

HEARING to determine validity of proposed allocation by receiver.

***D.M. Masuhara J., In Chambers*:**

Introduction

1 This decision deals with a dispute as to the allocation of the costs of the court appointed Receiver of Maple Leaf Loading Ltd. ("MLL"). The Receiver, Ernst & Young Inc., was appointed June 27, 2014. The amount for allocation is $1,172,856 and was approved by this court, November 28, 2014.

2 The Receiver has proposed an allocation identifying location specific costs and general costs, and

allocating those to all secured creditors, including equipment lessors, on a pro rata basis taking into account the secured creditors' recoveries. The basis for the approach taken by the Receiver is set out in its 6th Report of September 10, 2015 and Supplement to the 6th Report of January 18, 2016. The latter report contained the updated allocations proposed.

3 The Receiver's allocation is supported by HSBC Bank Canada ("HSBC") and Element Fleet Management Inc. The GE group of creditors do not oppose the Receiver's allocation.

4 Opposing the allocation are several creditors, including: Caterpillar Financial Services ("Caterpillar"), James Western Star Truck and Trailer Ltd. ("James Western"), Inland Kenworth ("Inland"), and Knight Manufacturing Ltd. ("Knight").

5 James Western and Inland Kenworth are in the transportation industry and regularly repair trucks and equipment; this included the repair of MLL's trucks and equipment over the period before the appointment of the Receiver. They take the position that as repairers lien holders with validly registered liens in the Personal Property Security Registry of British Columbia, they have priority for payment over the Receiver pursuant to s. 32 of the *PPSA* and the *Repairers Lien Act*. The validity of the claims has been vetted and accepted by the Receiver. They also rely on the fact that they were not served with the initial application for the appointment of the Receiver and thus are not subject to the resultant order.

6 Caterpillar also was not served with the initial application but accepts that some allocation of costs to it is warranted, however, takes exception to the $149,768 proposed by the Receiver. Caterpillar submits that at most the amount should be $69,280. This equates to the recovery by the Receiver of the one piece of equipment left by Caterpillar with the Receiver for disposition.

Background

7 The following summary of the background to this insolvency:

8 MLL was a transportation company based in Prince George providing a range of specialized logistic solutions related to the management, handling and transport of ore and other mined products for clients involved in the mining and resource sector in British Columbia, Alberta, and the Yukon Territory. As such MLL had a fleet of heavy hauling equipment, tractors, trailers and pickup trucks that it used to service its customers (the "Hauling Equipment"). At the time of the appointment of the Receiver, there were 239 such units. The units were spread out across a variety locations including in or about Chetwynd, Grande Cache, Stewart, Tumbler Ridge, Watson Lake, Williams Lake, and Willow Creek.

9 The majority of the Hauling Equipment was leased from equipment lessors which included: HSBC, GE Canada Leasing Services Co.; Caterpillar, and Knight Manufacturing Ltd.

10 In addition, MLL financed its operations through credit facilities with HSBC.

11 MLL began to struggle financially in late 2012 and was in violation of its debt covenants with HSBC. Efforts to restructure and refinance MLL were initiated but ultimately failed.

12 In June 2014, HSBC issued demand letters along with Notices of Intention to Enforce its Security.

13 On June 26, 2014, HSBC filed a petition for the appointment of the Receiver.

14 On Friday, June 27, 2014, an *ex parte* application was brought on by HSBC and the order (the "Receivership Order") was granted.

15 On Monday, June 30, 2014, counsel for HSBC served by registered mail all of the named parties to its application a copy of the petition, supporting affidavits, and Receivership Order. This included: Caterpillar,

Element, James Western, Inland, and Knight. Delivery of the materials to each of the materials was on July 10, 2014; July 7, 2014; July 4, 2014; July 4, 2010; and July 2, 2014, respectively.

16 The Receiver in carrying out is duty to realize on MLL's assets, entered into an agreement to sell to Ritchie Bros. Auctioneers (Canada) Ltd. the bulk of MLL's equipment on August 7, 2014. The Receiver was granted short leave to bring on an application for the approval of the agreement for August 13, 2014. A number of creditors objected to the sale and contacted the Receiver from August 8 through August 15, 2014. The objectors were: Caterpillar, Coast Capital Equipment Savings, K-Line Trailer Ltd., Canadian Western Bank, Element, and Darby Kreitz. The Receiver agreed to adjourn the August 13, 2014 hearing to August 19, 2014 to provide additional time to certain creditors who were objecting to the proposed sale to assess the merits of the agreement and to negotiate with the Receiver and Ritchie Bros. The Receiver at that time was dealing with 239 separate pieces of equipment.

17 As a result of the adjournment further negotiations involving the creditors, the Receiver and Ritchie Bros. occurred.

18 Of the nine pieces of equipment that Caterpillar held an interest in, Caterpillar removed eight and left one behind. Element had 19 vehicles and left 16 to be included in the Ritchie Bros. sale.

19 An amended asset purchase agreement was entered into with Ritchie Bros. There were approximately 150 pieces of equipment in the sale.

20 On August 19, 2014, this court approved the amended purchase agreement. The sale closed on August 20, 2014.

21 On November 28, 2014, this court approved the unopposed application of the Receiver for its fees and disbursements and its legal counsel.

22 I now turn to the discussion of the issues.

Discussion

1. Priority of Repairers Liens Holders

23 The Receiver relies upon the terms of the Receivership Order as establishing its priority; more particularly, paras. 16 and 19, which state:

> **RECEIVER'S ACCOUNTS**
>
> 16. The reasonable fees and disbursements of the Receiver and its legal counsel, in each case at their standard rates and charges, shall be entitled to and are hereby granted a charge (the "Receiver's Charge") on the Property, as security for such fees and disbursements, both before and after the making of this Order in respect of these proceedings, and that the Receiver's Charge shall form a first charge on the Property in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, in favour of any Person, but subject to Sections 14.06(7), 81.4(4), and 81.6(2) of the BIA.
>
> . . .
>
> **FUNDING OF THE RECEIVERSHIP**
>
> 19. The Receiver be at liberty and it is hereby empowered to borrow by way of a revolving credit or otherwise, such monies from time to time as it may consider necessary or desirable, provided that the outstanding principal amount does not exceed $500,000. (or such greater amount as this Court may by further Order authorize) at any time, at such rate or rates of interest as the Receiver deems advisable for

> such period or periods of time as it may arrange, for the purpose of funding the exercise of the powers and duties conferred upon the Receiver by this Order, including interim expenditures. The whole of the Property shall be and is hereby charged by way of a fixed and specific charge (the "**Receiver's Borrowings Charge**") as security for the payment of the monies borrowed, together with interest and charges thereon, in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, in favour of any Person, but subordinate in priority to the Receiver's Charge and the charges as set out in Sections 14.06(7), 81.4(4), and 81.6(2) of the BIA.

24 HSBC in support of the Receiver stated that there were urgent circumstances given the mobile nature of the assets. It is uncontroverted that there were a significant number of vehicles spread across many remote locations.

25 The Receiver also submitted that the position taken by the respondents in this hearing was unfair as they were involved in the Receiver's process and received the benefit of the Receiver's efforts. The Receiver points out that only once the majority of the Receiver's work had been completed did they object.

26 James Western and Inland argue that the order has no effect over them as they had not been provided notice, the application having been made *ex parte*. In this regard, they handed up: *Lochson Holdings Ltd. v. Eaton Mechanical Inc.* (1984), 55 B.C.L.R. 54 (B.C. C.A.). These respondents also point to the footnote to para. 16 of the Model Order (the same as the above provision) which specifically sets out that court must not make such an order "unless it is satisfied that the secured creditors who would be materially affected by the order were given reasonable notice and an opportunity to make representations."

27 Further, James Western and Inland argue that based on the common law the receivership does not permit priority over their liens. In support they cite *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.* (1975), 59 D.L.R. (3d) 492 (Ont. C.A.) which is also referenced in *Lochson*. In *Kowal*, the court stated exceptions to the general rule included the following:

> (a) the receiver is appointed at the request of or with the consent or approval of the holders of the security;
>
> (b) the receiver has been appointed to preserve and realize assets for the benefit of all interested parties including secured claims and the secured creditors have been given notice of the application for such appointment; or
>
> (c) the receiver has expended money for the necessary preservation or improvement of the property (generally an emergency situation where there is no time to apply to court beforehand and to provide the secured creditors with notice).

28 These respondents also argue that because of their priority and rights as repairer liens holders they could have simply taken the vehicles subject to their liens and sold them. This they say is a common practice for them as repairers. They assert that assistance from the Receiver was unnecessary.

29 These respondents also meet the argument that they did not take steps to vary the Receivership Order with the comments in *Terra Nova Management Ltd. v. Halcyon Health Spa Ltd.*, 2006 BCCA 458 (B.C. C.A.) where Donald J.A. stated at para. 14:

> In the circumstances of this case, BDC did not have a positive duty to apply to vary the order of Metzger J. in order to preserve its priority. Thus, BDC was entitled to wait until realization to deal with the difficulty created by the order. Having taken the order without naming BDC as a party, giving notice of the application, or securing its consent, Andersen took the risk of a shortfall.

30 As well, these respondent refer to *Royal Bank v. Vulcan Machinery & Equipment Ltd.*, [1992] A.J. No.

1216 (Alta. Q.B.) [*Vulcan*] at para. 49:

> In my opinion, while there may have been a need, indeed an urgent need, for the court-appointed receiver, there was, in my opinion however no such emergent, unusual, or extraordinary need for the appointment of a receiver-manager with the priority clause (Section 14) such as to justify the so-called "double-barrelled" Order as granted therein, which Order, with the priority clause contained therein, had the effect of seriously prejudicing the rights of secured creditors such as Mitsubishi and Mitsui to the point of trammelling their rights. It is all well and good to argue that these parties had rights to apply to vary on a subsequent application; however that, in my view, puts the onus on entirely the wrong party.

31 I am of the view that the lack of notice argument should not prevail in this case. In *Vulcan*, notice of the order was delayed; moreover, the creditors had maintained their opposition to the receiver's involvement with the equipment in which they held an interest. In *Terra Nova*, the delivery of the order did not take place for some two months after the order was granted and I note that in dismissing the appeal, Donald J.A., did not accept the argument that in light of having been served with the order that the respondent could avoid being fixed with actual knowledge of the order, though it did not affect the result. I note that he states that "in the circumstances" of that case a positive duty to apply to vary did not apply. The circumstances inform the consideration of the exceptions. Here, the Receiver acted promptly in serving all of the named parties with the order and supporting materials underlying immediately after obtaining it. There was some urgency in the circumstances. James Western and Inland were represented by counsel throughout the receivership.

32 I find that the Receiver was acting to preserve or protect the vehicles and this benefited all of the interested parties, including the repairers lien holders. I am not persuaded by the bare submission that the repairers lien holders were "at all times ready, willing and able to execute on their repairers/liens but were prevented from doing so by the receivership". There is little to no evidence supporting this. The evidence indicates that the respondents were engaged in discussions with the Receiver shortly after the order. The Receiver's reports identify and comments on the efforts to investigate the numerous liens and issues related to them. It is apparent that there was ongoing communications. James Western and Inland had the opportunity to take the actions it says it was entitled to take but they did not. The evidence of Caterpillar retrieving virtually all of their vehicles from the Receiver militates against this position. I also note that these were at least two court appearances in which Inland or James Western could have applied for a variation.

33 In my view, some allocation is warranted.

2. Allocation

34 Allocation is an exercise in judicial discretion. The overall result must be one that is fair and equitable. This does not necessarily equate to equality. Usually, there will be some who do better than the average and other who do not.

35 There are numerous approaches and methodologies to allocations. In some areas professional careers have been built in propounding allocation methodologies.

36 A summary of the general principles governing the allocation of receiver's costs was recently provided in *Royal Bank of Canada v. Atlas Block Co.*, 2014 ONSC 1531 (Ont. S.C.J. [Commercial List]) at para. 43 by Justice D.M. Brown as follows:

> (a) The allocation of such costs must be done on a case-by-case basis and involves an exercise of discretion by a receiver or trustee;
>
> (b) Costs should be allocated in a fair and equitable manner, one which does not readjust the priorities between creditors, and one which does not ignore the benefit or detriment to any creditor;

(c) A strict accounting to allocate such costs is neither necessary nor desirable in all cases. To require a receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-à-vis another likely would not be cost-effective and would drive up the overall cost of the receivership;

(d) A creditor need not benefit "directly" before the costs of an insolvency proceeding can be allocated against that creditor's recovery;

(e) An allocation does not require a strict cost/benefit analysis or that the costs be borne equally or on a *pro rata* basis;

(f) Where an allocation appears *prima facie* as fair, the onus falls on an opposing creditor to satisfy the court that the proposed allocation is unfair or prejudicial.

37 Other cases handed up on this point included: *Hickman Equipment (1985) Ltd., Re*, 2004 NLSCTD 164 (N.L. T.D.); and *Winnipeg Motor Express Inc., Re*, 2009 MBQB 204 (Man. Q.B.).

38 The Receiver has outlined the allocation approach in its reports. In the Receiver's view some of the costs incurred should be borne by all secured creditors as they benefitted from aspects of the Receivership proceedings. As mentioned, the proposed approach is a "pro rata recovery allocation". It is submitted that allocation methodologies based pro rata on realizations are *prima facie* reasonable. It is submitted that the allocation proposed is reasonable.

39 Caterpillar in opposing the proposed allocation submits that it is unfair, inequitable and prejudicial. Caterpillar's argument included that the proposed allocation is a readjustment of priorities, there is no connection between the allocated costs and Caterpillar, that it does not take into account the degree of benefit, the direction of Caterpillar and other secured creditors, and that the allocation is disproportionate to the benefit received.

40 Caterpillar points to the fact that in the course of the receivership, the Receiver sold one piece of Caterpillar's equipment for approximately $142,860 (net $69,280) and that the proposed allocation to it is $149,768.

41 During the proceedings before me alternative allocations were discussed and during the several week break between hearing dates, the Receiver and Caterpillar discussed additional allocations. One scenario was an allocation by the total number of pieces of equipment in the receivership. A variation to this was to allocate on the total number of pieces greater than $10,000. This value was selected by the Receiver.

42 Having reviewed the actions of the Receiver and the nature of the costs as set out in the Receiver's reports, I am concerned with the overall fairness of the cost allocation as can be seen in the result upon Caterpillar; it seems to me that the pro rata allocation based on number of pieces of equipment greater than $10,000 in value is better correlated to the costs than recoveries. Viewed generally, the activities of the Receiver and the expenses incurred relate directly and indirectly more to the Hauling Equipment as opposed to their realization value. This results in a relative leveling of the percentage cost burden which in this case appears fairer.

Conclusion

43 As a result, I am of the view that the allocation as prepared by the Receiver in its Supplement to the 6th Report of the Receiver at Appendix G (pieces valued at over $10,000) is the allocation which is to be used.

44 The outstanding matters in the Receiver's application notice should be set down for hearing through Trial Scheduling.

Order accordingly.

2006 CarswellOnt 4619
Ontario Superior Court of Justice

JP Morgan Chase Bank N.A. v. UTTC United Tri-Tech Corp.

2006 CarswellOnt 4619, 25 C.B.R. (5th) 156

JP Morgan Chase Bank N.A. v. UTTC United Tri-Tech Corp.

Cameron J.

Heard: July 12, 2006
Judgment: July 25, 2006
Docket: 06-CL-6326

Counsel: Larry Crozier, Stephanie Fraser for Receiver, Ernst & Young Inc.
Brett Harrison for JP Morgan Chase Bank N.A.
Aubrey Kauffman for Laurentian Bank of Canada, Business Development Bank of Canada

Subject: Insolvency

Headnote

Bankruptcy and insolvency --- Interim receiver — Fees and expenses
Interim Receiver sold assets and real property of manufacturing corporation ("property") — Receiver's fees totaled $1,670,000, and it allocated $182,000 of these fees to real property creditor which recovered $2,200,000 and approximately $1,500,000 to personal property creditor which recovered $7,000,000 — Disagreement arose between creditor banks about receiver's charge in respect of receiver's proposed allocation for professional fees and disbursements and sharing of general and specific claims against it — Receiver brought motion for order approving its activities, authorizing it to distribute net proceeds from sale of property, approving its fees and disbursements, and approving its proposed charge for professional fees, disbursements, and claims against it — Motion granted — Most of receiver's effort was devoted to running manufacturing business and arranging for its sale as going concern since significant issues existed relating to employees, suppliers, and customers which devolved on personalty rather than real estate — Sale of real estate and sale of personalty were interdependent and if either sale fell through both creditors would have been left to their own devices and real property might not have realized its value — In circumstances $182,000 out of $1,670,000 was not unfair or inequitable burden for real property creditor to bear — Allocation with respect to receiver's charge for general and specific claims against it was not unfair or inequitable — Each creditor would be liable for respective specific claims by parties interested in personalty or real property and would share pro rata for general claims against receiver according to amount each received.

Bankruptcy and insolvency --- Interim receiver — Powers, duties and liabilities
Interim Receiver sold assets and real property of manufacturing corporation ("property") — Receiver's fees totaled $1,670,000, and it allocated $182,000 of these fees to real property creditor which recovered $2,200,000 and approximately $1,500,000 to personal property creditor which recovered $7,000,000 — Disagreement arose between creditor banks about receiver's charge in respect of receiver's proposed allocation for professional fees and disbursements and sharing of general and specific claims against it — Receiver brought motion for order approving its activities, authorizing it to distribute net proceeds from sale of property, approving its fees and disbursements, and approving its proposed charge for professional fees, disbursements, and claims against it — Motion granted — Most of receiver's effort was devoted to running manufacturing business and arranging for its sale as going concern since significant issues existed relating to employees, suppliers, and customers which devolved on personalty rather than real estate — Sale of real estate and sale of personalty were interdependent

and if either sale fell through both creditors would have been left to their own devices and real property might not have realized its value — In circumstances $182,000 out of $1,670,000 was not unfair or inequitable burden for real property creditor to bear — Allocation with respect to receiver's charge for general and specific claims against it was not unfair or inequitable — Each creditor would be liable for respective specific claims by parties interested in personalty or real property and would share pro rata for general claims against receiver according to amount each received.

Table of Authorities

Cases considered by *Cameron J.*:

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Hickman Equipment (1985) Ltd., Re (2004), 5 C.B.R. (5th) 56, (sub nom. *Hickman Equipment (1985) Ltd. (Receivership), Re)* 241 Nfld. & P.E.I.R. 294, (sub nom. *Hickman Equipment (1985) Ltd. (Receivership), Re)* 716 A.P.R. 294, 2004 NLSCTD 164, 2004 CarswellNfld 263 (N.L. T.D.) — referred to

Hunjan International Inc., Re (2006), 2006 CarswellOnt 2718 (Ont. S.C.J.) — referred to

Hunters Trailer & Marine Ltd., Re (2001), 2001 ABQB 1094, 2001 CarswellAlta 1636, 30 C.B.R. (4th) 206, 305 A.R. 175 (Alta. Q.B.) — followed

Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd. (1975), 9 O.R. (2d) 84, 21 C.B.R. (N.S.) 201, 59 D.L.R. (3d) 492, 1975 CarswellOnt 123 (Ont. C.A.) — considered

Statutes considered:

Personal Property Security Act, R.S.O. 1990, c. P.10
Generally — referred to

MOTION by receiver for order authorizing it to distribute net proceeds from sale of property and approving its proposed charge for professional fees, disbursements, and claims against it.

***Cameron J.*:**

1 Ernst & Young Inc. ("Receiver"), in its capacity as court appointed Interim Receiver and Receiver and Manager of all the assets, undertaking and property ("Property") of UTTC United Tri-Tech Corporation ("UTTC") moves for an Order:

1. approving the activities of the Receiver as described in the Fifth Report of the Receiver dated July 6, 2006 ("Fifth Report");

2. authorizing the Receiver to distribute certain net proceeds from the sale of the Property to JP Morgan Chase Bank, N.A. ("JPM") and to Laurentian Bank of Canada and Business Development Bank (the "Banks") subject to execution of a mutually satisfactory reimbursement agreement from each of JPM and the Banks;

3. approving the fees and disbursements of the Receiver and its lawyers;

4. providing for the allocation of the Receiver's Charge pursuant to the Appointment Order dated March 10, 2006

> i) in respect of the professional fees and disbursements of the Receiver (including legal fees) ("Fees"), the sum of $182,000 to be allocated to the Banks and the balance of some $1.4 million to be allocated to JPM;
>
> ii) in respect of claims against the Receiver in connection with the receivership, other than those resulting from willful misconduct or gross negligence ("General Claims"), JPM and the Banks shall reimburse the Receiver on a *pro rata* basis relative to their distributions from the proceeds of sale of the Property; and
>
> iii) in respect of claims by a party who had an interest in the Personal Property or the Real Property, or proceeds therefrom, that is established to have priority over the respective interests of JPM or the Banks ("Specific Claims"), as the case may be, each of JPM and the Banks shall be individually responsible to reimburse the Receiver for claims ranking in priority to their respective secured positions.

2 The parties are agreed on items 1 and 3 above. The respondent says that the Receiver's Charges:

1. should be allocated in accordance with a "fair and equitable" principle, and
2. should not be liable to a reimbursement agreement.

Facts

3 On July 8, 2005, the Banks and JPM entered into a priority agreement and a creditors agreement.

4 Pursuant to the Priority Agreement:

1. the Banks would rank first on the Cornwall property, and
2. JPM would rank first on the personal property, other than certain listed equipment on which the Banks would rank, without regard to any priority granted by any principle of law or statute, including the *Personal Property Security Act*.

5 They also agreed that any proceeds in respect of collateral would be dealt with according to the provisions of the Priority Agreement.

6 On the same date the parties entered into a Creditors Agreement which provided, in part:

> 2. The Bank [**JPM**] or any of its officers, employees and agents and its representatives and invitees, including any receiver, receiver manager, interim receiver or other similarly appointed official, (each, a "**Representative**") may, provided it gives reasonable notice ("**Access Notice**") to the Creditor [**the Banks**], have access to the Immovable, the Listed Equipment and the Excluded Assets at anytime for the purpose of, amongst others, performing an inspection or removing any of the Bank's Property, holding an auction sale, a private sale or submit bids thereat, the whole without any obstruction or opposition on part of the Creditor, and subject to the priority of the Creditor's rights in respect of the Listed Equipment and the Excluded Assets pursuant to the Priority Agreement.
>
> 3. The Creditor hereby agrees that the Bank Property may be stored and/or utilized at the Immovable and shall not be deemed a fixture or part of the Immovable, but shall at all times be considered personal

property. Without limiting the generality of the provisions contained herein, and subject to the provisions of Section 4 hereof, the Bank will have the same rights as of the Borrower, following the giving of an Access Notice in writing to the Creditor, to use the Immovable, the Listed Equipment and/or the Excluded Assets without interference from Creditor, including to handle inventory, process inventory, complete raw materials and work-in-process handle and ship finished goods and sell inventory and equipment (including, without limitation, by public auction or private sale (and the Lender or any of its Representatives may advertise and conduct such auction or sale at the Immovable and shall use reasonable efforts to notify the Creditor of its intention to hold any such auction or sale) and to take any action to foreclose or realize upon or enforce any of the Bank's Security, and will have the right to perform any operation relating to the Bank's Property, including to dispose of, to sell, to remove, to store temporarily, etc. the Bank's Property, as it may deem useful or necessary, subject to the priority of the Creditor's rights in respect of the Listed Equipment and Excluded Assets, and for a period of time deemed reasonably necessary by the Bank, but in any case not exceeding 120 days (the "**Period**") and provided that during the Period, the Bank shall keep safe and in good order and repair, subject to normal wear and tear, the Immovable, the Listed Equipment and Excluded Assets. If any injunction or stay is issued (including an automatic stay due to a bankruptcy proceeding) that prohibits the Bank and the Creditor from exercising any rights under this Agreement, commencement of the Period shall be deferred until such injunction or stay is lifted or removed. At any time after the Creditor takes action to foreclose or realize upon the Immovable, the Listed Equipment and the Excluded Assets in accordance with the terms of this Agreement and the Priority Agreement, the Creditor may deliver a notice to the Bank requiring that the Period commence on the date of the receipt by the Bank of such notice.

4. During the Period (for greater certainty, regardless of whether the notice commencing the Period was given by the Creditor, the Bank or a Representative), the Bank shall pay to the Creditor, on a *per diem* basis for the period of actual occupancy of the Immovable by the Bank:

(a) Any portion of current interest due and payable under the Creditor's Loans at a rate not in excess of the rate of interest payable as of the date hereof in connection with the aforesaid Loans, with the exception of any amount due and payable on account of arrears of the Borrower or as a result of a default of the Borrower under the terms of the aforesaid loans;

(b) All current utilities, municipal property taxes and similar expenses related solely to the occupation of the Immovable, in amounts consistent with past amounts payable by the Borrower in connection with the Immovable and which, for greater certainty, shall not include any amount due and payable on account of arrears of the Borrower; and

(c) Insurance costs in order to maintain in full force and effect insurance policies relating to the Immovable, the Listed Equipment and the Excluded Assets, as the case may be.

. . . . .

7. Subject to the Creditor's obligations during the Period under this Agreement and provided that it does not interfere with the Bank's rights during the Period under this Agreement, (1) nothing in this Agreement shall be construed as to prevent the Creditor from having reasonable access to the Immovable during the Period to inspect and evaluate the Listed Equipment and Excluded Assets or from commencing any action to foreclose or realize upon or enforce any of its rights as a secured party with respect to the Immovable, the Listed Equipment and Excluded Assets and (2) the Creditor shall be entitled to have access to the Immovable to inspect and evaluation the Listed Equipment and Excluded Assets at the commencement of the Period. Creditor may sell the Immovable and the Listed Equipment during the Period, provided that the purchasers of the Immovable and the Listed Equipment shall have expressly agreed in writing to be bound by the obligations of Creditor under this Agreement with respect to the purchased Immovable and the Listed Equipment until the expiration of Period and the items purchased shall remain in place and shall remain subject to the rights of use and occupancy the Bank and any of its Representatives, in accordance with this Agreement. (Underlining and descriptions added).

7 Thus, under the Creditor's Agreement, JPM could occupy the Cornwall Property for the purpose of carrying on the business of UTTC and selling JPM's collateral. Such occupation would be at JPM's expense and could not exceed 120 days. The Banks could sell the Cornwall Property during this period, as long as the purchaser agreed to respect the 120 day occupation period.

8 As security for its loans JPM held a first charge over substantially all the personal property of UTTC and a second charge over the real property of UTTC.

9 The Banks held a first charge against the real property, consisting of land in Cornwall, Ontario containing a manufacturing facility used by UTTC.

The Receivership Motion

10 On March 7, 2006, counsel to JPM served a Notice of Application and supporting affidavit seeking the appointment of a Receiver over the assets and undertaking of UTTC upon the solicitors for the Banks. The application was returnable on March 10, 2006. Goodman and Carr LLP ("G&C") was retained as counsel on behalf of the Banks.

11 JPM filed an affidavit of William H. Canney Jr., of JPM in support of the receivership application.

12 At paragraph 34 Mr. Canney deposes:

> JP Morgan believes that JP Morgan's collateral position is declining. Recent borrowing base certificates submitted to JP Morgan by UTTC show a steady decline in the value of JP Morgan's collateral. It is not clear whether this is a result of the discovery of additional errors or misstatements made by UTTC prior to January 31, 2006, a deterioration in the value of the collateral, or both. The borrowing base certificate submitted to JP Morgan on March 3, 2006 indicated that the borrowing base had declined resulting in the Revolving Facility exposure exceeding the borrowing base by approximately US$6,218,308.36; however, the certificate reflected a calculation error which if corrected, would have indicated an exposure of CDN$5,793,308.36. <u>JP Morgan is concerned that, unless an interim receiver is appointed immediately, the value of UTTC's business and operations may decline further as suppliers and customers become aware of UTTC's instability</u>. (*Underlining added*)

13 At the time of the Receivership Appointment order, UTTC was indebted to JPM in a principal amount exceeding $12 million (U.S.) and to the Banks in an aggregate amount of $2.2 million (Can.).

14 In proceeding by way of court appointed receivership, JPM was deviating from the terms of the Creditors Agreement. For example, the stay of proceedings prohibited the Banks from selling the Cornwall Property in accordance with paragraph 7 of the Creditors Agreement.

15 On March 9, 2006 G&C sent the following e-mail to Brett Harrison of McMillan Binch Mendelsohn ("MBM"):

> Thank you for sending the material.
>
> <u>With respect to the charges in the order, it is my view that my client's collateral should not be subject to the Receiver's Charge or the Receiver's Borrowing Charge. My client's security is on real property and related fixtures. My client does not need a receiver to realize on its collateral. Similarly my client does not require that the business carry on and incur the costs to be financed by the receiver's borrowings. Thus I would ask for a provision carving out Laurentian's collateral from the Charges</u>.
>
> Aside from the above issues, my client supports the receivership. (*Underlining Added*)

Provisions of the Appointment Order

16 The Appointment Order contains numerous protections for the court appointed Receiver including:

> (i) a prohibition against proceedings against the Receiver without consent or leave of the Court (para. 7);
>
> (ii) protection against liability for employee related claims (para. 13); and
>
> (iii) limitation on environmental liabilities (para. 15).

17 In addition, the Appointment Order contains a general limitation on the Receiver's liability at paragraph 17 as follows:

> THIS COURT ORDERS that the Receiver and its officers, directors, employees, agents and other representatives acting on behalf of the Receiver in its administration of the receivership shall incur no liability or obligation as a result of its appointment or the carrying out the provisions of this Order, save and except for any gross negligence or willful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Receiver by section 14.06 of the BIA or by any other applicable legislation.

18 RECEIVER'S ACCOUNTS

> 18. THIS COURT ORDERS that any expenditure or liability which shall properly be made or incurred by the Receiver, including the fees of the Receiver and the fees and disbursements of its legal counsel, incurred at the standard rates and charges of the Receiver and its counsel, shall be allowed to it in passing its accounts and shall form a first charge on the Property in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, in favour of any Person (the "Receiver's Charge").

19 It is clear that paragraph 18, read in context and as a whole, makes reference to expenditures and liabilities, including, fees, properly incurred in the administration of the estate which would be allowed in a passing of accounts. There is no general indemnity of the Receiver with respect to General Claims or Specific Claims arising from the Receiver's conduct or actions.

20 The Appointment Order does not contain an indemnity in favour of the Receiver, secured by assets of UTTC with respect to General Claims or Specific Claims (as those terms are defined in the Receiver's Factum), as claimed in paragraph 23 of the Receiver's Factum.

21 The terms of paragraph 24A of the Receivership Agreement were negotiated to maintain the provisions of the Creditors Agreement:

> 24A. THIS COURT ORDERS that notwithstanding any other provisions herein, but subject to further order of the Court, the <u>Receiver's Borrowing Charge shall be subordinate to the charges held by Business Development Bank of Canada and Laurentian Bank of Canada with respect to the collateral defined as the "Immovable" and "Excluded Assets"</u> as defined in the creditor agreement made as of July 8, 2005 amongst Business Development Bank of Canada, and Laurentian Bank of Canada and JP Morgan (the "Creditor's Agreement"). The allocation of the said charges to "Listed Equipment", as defined in the Creditors Agreement and <u>the allocation of the Receiver's Charge with respect to the Immovable and Excluded Assets is to be undertaken by the Receiver, subject to further order of the Court</u>. The Receiver shall pay an amount equal to the current interest due and payable under the Creditor's Loans (as defined in the

Creditors Agreement) together with all current utilities, municipal property taxes and similar expenses related solely to the occupation of the Immovable and insurance costs in order to maintain in full force and effect insurance policies relating to the Immovable, and the Excluded Assets, all as defined in the Creditors Agreement.

22 Essentially, paragraph 24A:

(i) recognizes the priority of the Bank's real property security over borrowings of the receiver for the purpose of operating the business of UTTC;

(ii) recognizes the requirement to allocate the Receiver's Charge by the Receiver subject to further order of the Court; and

(iii) reflects JPM's obligation to make the payments referred to in paragraph 4 of the Creditor's Agreement.

Receivership Proceedings

23 On April 18, 2006 an Order was granted by the Court approving the "going concern" sale by the Receiver to a single purchaser or its affiliates of substantially all the Real Property and all the Personal Property.

24 The Receiver operated the UTTC business for an extended period, prepared a comprehensive confidential information memorandum with respect to the business, dealt with numerous potential purchasers with respect to the business, attended on various motions and, ultimately, succeeded in selling the business as going concern on May 1, 2006. The Receiver received net proceeds of approximately $7.1 million for the Personal Property and $2.2 million (Can.) from the sale of Real Property.

25 Most of the work done by the Receiver and its counsel would not have been necessary in order to sell the Cornwall Property alone.

26 The Banks have no complaint with respect to the purchase price secured by the Receiver for the Cornwall Property. The gross sale proceeds slightly exceed the indebtedness owed to the Banks.

27 However, the largest beneficiary of the sale of the real property is JPM as the sale of the Cornwall Property allowed for the sale of the UTTC business as a going concern. It is the understanding of the Banks that if the operating assets of UTTC (i.e. inventory, receivables and equipment) were sold on a liquidation basis, JPM would have recovered less.

28 The Banks were free to sell the Cornwall Property after 120 days independent of JPM's realization on its security. It is a moot point whether they would have received more or less on a separate sale.

29 At present the Receiver is not aware of any General Claims. The Receiver intends, upon further motion to this Court, to seek direction with respect to a claims bar procedure for the purpose of identifying, contesting and resolving any General Claims or Specific Claims. However, pending the outcome of that process, the Receiver is concerned that its rights to indemnification pursuant to the Receiver's Charge from the proceeds be maintained notwithstanding any distribution that may be made to JPM or the Banks. Absent a reimbursement agreement, the only recourse of the Receiver is to the proceeds of sale in accordance with the Appointment Order and the Approval and Vesting Orders made by this Court.

Nature of Dispute

30 The Appointment Order provided that the allocation of the Receivers Charges would be subject to further order of the Court. The parties agree that the Receivers Charge ranks in priority to their respective interests in the Sale Proceeds.

31 The Receivers Charge proposed by the Receiver and agreed to by JPM but not by the Banks, is:

> i) In respect of the professional fees and disbursements by the Receiver (including legal fees), $175,000 (CAD) plus GST plus an additional $7,000 (CAD) plus GST in respect of Excluded Equipment should be paid by the Banks and the balance allocated to JPM;
>
> ii) In respect of General Claims against the Receiver, JPM and the Banks should reimburse the Receiver on a *pro rata* basis relative to their respective distributions from the proceeds of sale; and
>
> (iii) In respect of Specific Claims, each of JPM and the Banks should be individually liable to reimburse the Receiver.

For these purposes:

> a) a “General Claim” is a claim made against the Receiver in connection with the receivership (other than one resulting from its willful misconduct or gross negligence); and
>
> b) a “Specific Claim” is a claim by a party who had an interest in the Personal Property, the Real Property, or proceeds that is established to have a priority over the respective interests of JPM or the Banks.

32 The Banks say that their liability for Receivers Charges should be limited to $100,000 plus GST and that they should not be liable to reimburse for anything as all claims for real estate priorities were settled prior to the closing.

33 In addition, it would allow JPM to do an “end run” around the priorities agreed to in the Priority Agreement and Creditors Agreement.

34 JPM appointed Ernst & Young the Receiver and any indemnity with respect to the operating assets should flow from JPM. However, the Banks agreed to the Receivership subject to priority for the Receiver’s Charge.

Discussion

35 The Receiver’s allocation of Fees to the Banks is based upon a reasonable calculation of that portion of the fees of the Receiver and its advisors that can be attributed to the sale of the Real Property and the administration of the receivership up to the completion of the sale. The warehouse operation of UTTC carried on from the Real Property were closely integrated into the business operations of UTTC. The Real Property and Personal Property were jointly marketed by the Receiver and sold in linked transactions which closed simultaneously. Therefore, while it is impossible to segregate and calculate with precision the professional fees attributable solely to the administration of the receivership in relation to Real Property, the Receiver is satisfied that the amount of $175,000 is reasonable in the circumstances.

36 It is well-settled that at common law, a court-appointed receiver is personally liable for its acts as a receiver but has a correlative right to indemnification on a priority basis out of any assets under its administration. See Kerr & Hunt on *Receivers and Administrators*, 18th ed. (Sweet & Maxwell: London, 2005).

37 This principle is reflected in the Receiver’s Charge as defined in paragraph 18 of the Appointment Order.

38 The Receiver submits that pursuant to the Receiver's Charge indemnification from the assets of UTTC (in this case the Sale Proceeds) is permitted for three categories of claims. These are as follows:

(a) The Fees;

(b) General Claims; and

(c) Specific Claims.

39 It is submitted that, as the Receiver was authorized to realize on the assets of UTTC for the benefit of JPM and the Banks pursuant to a consensual sales process, that the Fees, General Claims and Specific Claims are subject to the Receiver's Charge and properly allocated to these creditors for satisfaction from the Sale Proceeds: *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.* (1975), 59 D.L.R. (3d) 492 (Ont. C.A.) at pp. 3-5.

40 In *Robert F. Kowal Investments Ltd.*, the Ontario Court of Appeal considered whether a Receiver has priority over a mortgagee with respect to its expenses. In its decision, the Court relied upon a passage from *Clark on Receivers*, which began as follows:

> When a court appoints a general receiver of the property of an individual or a corporation, at the instance of a creditor other than a mortgage lienholder, part or all of this property may be covered by liens or mortgages. The general purpose of a general receivership is to preserve and realize the property for the benefit of the creditors in general. No receivership may be necessary to protect or realize the interests of the lienholders. In such cases the mortgagees and lienholders cannot be deprived of their property nor of their property rights and the receivership property cannot as a rule be used nor the business carried on and operated by the receiver in such a way as to subject the mortgagees and lienholders to the charges and expenses of the receivership. A court under such circumstances has no power to authorize expenses for approving or making additions to the property or carrying on the business of the defendant at the expense of prior mortgagees or lienholders without the sanction of such mortgagees or lienholders.

41 The excerpt from *Clark on Receivers* relied upon by the Court of Appeal in the *Robert F. Kowal Investments Ltd.* decision goes on to highlight three exceptions to this general rule, which may be summarized as follows:

(a) Where the Receiver has been appointed at the request of or with the consent of the Mortgagee, the Receiver will be given priority over the security holder;

(b) If the Receiver has been appointed to preserve and realize assets for the benefit of all interested parties, including the mortgagee; and

(c) If the Receiver has expended money for the necessary preservation or improvement of the property.

42 The obligation on a Receiver in allocating costs from an insolvency proceeding is to exercise its discretion in an equitable manner that does not readjust the priorities between creditors. The allocation:

(a) should be fair and equitable; and

(b) not ignore the benefit or detriment to any creditor.

There is however no requirement that the Receiver be obliged to conduct a strict accounting on a cost-benefit basis as between the creditor classes: *Hunjan International Inc., Re,* 2006 CarswellOnt 2718 (Ont. S.C.J.) at p. 2 and p. 8.

43 The Receiver submits that the Proposed Allocation is reasonable and in accordance with general principles established by Canadian insolvency courts.

44 The Receiver submits that the allocation of the Fees is reasonable in the circumstances. Moreover, it has been held that to require the Receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-à-vis another would likely not be cost effective, would drive up the overall receivership cost and would likely be a fool's errand in any event: *Hickman Equipment (1985) Ltd., Re,* [2004] N.J. No. 299 (N.L. T.D.) at p. 6.

45 Where as in this case, the Receiver was appointed for the benefit of interested parties to ensure that all creditors were treated fairly and to ensure a fair process to deal with the assets, there is no valid reason for a secured creditor to avoid paying its fair share of the receivership costs: *Bank of Nova Scotia v. Norpak Manufacturing Inc.*, [2003] O.J. No. 4818 (Ont. C.A.) at p. 2.

46 Although every case is different, the case most directly on point is *Hunters Trailer & Marine Ltd., Re*, [2001] A.J. No. 1638 (Alta. Q.B.) where UMC held mortgages on property and claimed it was a passive creditor. While the risk of loss was greater for the other secured creditors, UMC benefited from the proceedings in that it continued to receive interest and received principle on the sale. However it would be unfair to ignore differences in the type of security held by various creditors and the degree of potential benefit that might be derived by them from the proceedings.

47 In this case, the receivers fees were $1.67 million. Of the sale proceeds, $175,000 and $7,000 were allocated to the Mortgages for their $2.2 million recovery including $28,000 for personalty. Approximately $1.5 million was allocated to the personal property creditor, JPM, for its $7M recovery. Most of the effort was devoted to running the business and arranging for sale, some indefinable part of which was for the benefit of the Banks.

48 The court appointed Receiver's Order cancelled the prior Credit and Priority Agreements. The need for a receivership on short notice resulted from a rapidly depreciating value of the business.

49 The Banks agreed to be responsible for a portion of the receivership costs applicable to the realization on the real property, failing agreement by court determination.

50 The complexity of the receivership was due not to the real property but the sale on a going concern basis of the manufacturing business.

51 There were significant issues relating to employees, suppliers, and customers which devolve on the personalty rather than the real estate.

52 On the other hand, the sale of the real estate was dependent on the sale of personalty, and vice-versa. If either had fallen through, JPM and the Banks would be left to their own devices. There is no guarantee the real estate would have realized its value.

53 The Receiver paid to the Banks interest on the loans and other realty costs in accordance with s. 24A of the Receivership Order pending sale.

54 The Banks did not have to bear the risks of a private sale, including real estate commission.

Conclusion

55 In these circumstances, after weighing all the circumstances, I cannot say that $183,000 out of $1,670,000 was an unfair or inequitable burden for the Banks to bear.

56 Nor can I say that the allocation as between General and Specific Claims is unfair or inequitable. Each will be liable for its respective Specific Claims and will share *pro rata* in General Claims in accord with the amount received. There should be little, if any, General Claims to devolve on the Banks. Operating expenses will be for the account of JPM unless they can be said to rank ahead of the mortgages of the Banks.

Order

57 I grant the motion of the Receiver approving the activities in the Fifth Report, authorizing distribution of the Sale Proceeds subject to a mutually satisfactory reimbursement agreement, approving the fees and disbursements of the Receiver and its lawyer and providing for the allocation of the Receiver's Charge as proposed.

Costs

58 If the parties cannot agree, costs may be addressed in writing. The Receiver's submissions shall be made within 15 days of the release of this order. The Banks shall respond within 10 days thereafter.

Motion granted.

2015 ONSC 2550
Ontario Superior Court of Justice [Commercial List]

DBDC Spadina Ltd. v. Walton

2015 CarswellOnt 5706, 2015 ONSC 2550, 24 C.B.R. (6th) 34, 253 A.C.W.S. (3d) 105, 45 C.L.R. (4th) 313

DBDC Spadina Ltd. and Those Corporations Listed on Schedule A Hereto, Applicants and Norma Walton, Ronauld Walton, The Rose & Thistle Group Ltd. and Eglinton Castle Inc, Respondents and Those Corporations Listed on Schedule B Hereto, to be Bound by the Result

Newbould J.

Heard: April 16, 2015
Judgment: April 20, 2015
Docket: CV-13-10280-00CL

Counsel: Shara Roy for Applicants
Mark Dunn, Michel Schneer for Manager
Lisa S. Corne for Dupont Mortgagees, Florence Leaseholds Limited, Beatrice Leaseholds Limited and Ada Leaseholds Limited
Jack Copelovici, Bram M. Zinman for Cityview Lien Claimants, Fox Contracting Limited, Laser Heating and Air Conditioning Inc. and Gemtec Wall & Ceiling Sytems Ltd.
Lawrence F. Wallach for E. Manson Investments Limited, B & M Handleman Investments Limited, 1363557 Ontario Limited and Martha Sorger

Subject: Contracts; Corporate and Commercial; Insolvency

Headnote

Bankruptcy and insolvency --- Receivers — Fees and expenses
Applicant corporations listed in Schedule A invested in 31 corporations listed in Schedule B — In November 2013, applicant manager was appointed as result of serious mismanagement of Schedule B corporations by respondents — Properties owned by Schedule B corporations were then in various stages of development — Manager granted super-priority charge to secure fees and costs — After several mortgagees objected, however, that priority was made subordinate to prior ranking securities — Manager conducted claims process and sold 21 properties, using proceeds of $165 million pay mortgages of $159 million — Manager's fees and those of its counsel for November 2013 to May 2014 were approved by court order and paid from operating loan that had since been repaid, and proceeds of sale — Manager brought motion for order approving its fees and those of counsel from June 2014 to November 2014 in amount of $1.71 million — Manager also brought motion for order approving method for allocating fees between properties — Certain mortgagees objected on basis that accounts did not separate out actual work done for each property — Certain lien claimants objected on basis that values assigned in certain categories were too high and no fees or disbursements should be paid from trust fund created for lien claimants — Motion granted — Allocation of expenses to separate properties was complex, had to be done on case by case basis in fair and equitable manner, without adjusting priorities between creditors — Strict accounting was too costly and time consuming, and was neither required nor desirable in most cases — Amounts charged by manager and counsel were fair and reasonable in circumstances — Proposed method of allocating fees appeared to be logical and sensible having regard to various tasks manager was required to perform — Method was complicated but was comprehensible, understandable, and capable of review — Doctrine of marshalling had no application — Since charge for fees had super-priority, it ranked

ahead of lien claims.

Table of Authorities

Cases considered by *Newbould J.*:

Bank of Nova Scotia v. Diemer (2014), 20 C.B.R. (6th) 292, 327 O.A.C. 376, 2014 ONCA 851, 2014 CarswellOnt 16721 (Ont. C.A.) — considered

Baxter Student Housing Ltd. v. College Housing Co-operative Ltd. (1975), [1976] 1 W.W.R. 1, 20 C.B.R. (N.S.) 240, 57 D.L.R. (3d) 1, 5 N.R. 515, 1975 CarswellMan 85, 1975 CarswellMan 3, [1976] 2 S.C.R. 475 (S.C.C.) — considered

Confectionately Yours Inc., Re (2002), 2002 CarswellOnt 3002, 164 O.A.C. 84, 36 C.B.R. (4th) 200, 25 C.P.C. (5th) 207, 219 D.L.R. (4th) 72 (Ont. C.A.) — considered

DBDC Spadina Ltd. v. Walton (2015), 2015 CarswellOnt 1692, 2015 ONSC 870 (Ont. S.C.J. [Commercial List]) — considered

Hunjan International Inc., Re (2006), 2006 CarswellOnt 2718, 21 C.B.R. (5th) 276 (Ont. S.C.J.) — considered

Royal Bank of Canada v. Atlas Block Co. (2014), 2014 CarswellOnt 2780, 2014 ONSC 1531 (Ont. S.C.J. [Commercial List]) — considered

Statutes considered:

Construction Lien Act, R.S.O. 1990, c. C.30
s. 77 — considered

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 37.14(1) — considered

MOTION by manager for order approving its fees and those of counsel from June 2014 to November 2014 in amount of $1.71 million, and for order approving method for allocating fees between properties.

***Newbould J.*:**

1 Schonfeld Inc., the Manager of the Schedule B Companies and some of the Schedule C Companies, moves for approval of its fees and disbursements, and those of its counsel, and for approval of a methodology for the allocation of the Manager's fees and those of its counsel among the various Schedule B Companies and Schedule C Properties (the "Fee Allocation Methodology").

2 What led to the appointment of the Manager is well described in several decisions in this matter. Suffice it to say, the 31 Schedule B companies in which Dr. Bernstein through his applicant corporations invested were terribly mismanaged by the Waltons, particularly Ms. Walton, with funds being improperly used for other purposes than contracted for, including the funnelling of money for the Walton's own personal use, and the funds being improperly co-mingled in a Rose & Thistle account. The books and records were at least two years behind when the Manager was appointed and Ms. Walton took steps to do her best to create after the fact accounting records to support her case. Unscrambling the eggs has been far from easy and it has been very

expensive.

3 The properties were in various stages of development. The Manager conducted a claims process and has sold 21 of the Schedule B properties for some $165 million, paying off mortgages of some $159 million. The Manager managed the properties, primarily through a property management company which it supervised. Because many of the properties did not have sufficient cash flow to fund their operations, the Manager was required to negotiate a borrowing arrangement with the applicants.

4 The Manager's fees for the period from November 5, 2013 to December 31, 2013 were approved by order of Justice Wilton-Siegal dated April 25, 2014. The Manager's fees for the period from January 1, 2014 to May 31, 2014, and the fees of the Manager's counsel, Goodmans LLP, for the period from December 9, 2013 to May 27, 2014, were approved by order of Justice Brown dated June 18, 2014. The motion now is to approve fees of the Manager from June 1, 2014 to November 30, 2014 and of its counsel from May 28, 2014 to November 30, 2014, totalling approximately $1.71 million.

5 The Waltons were ordered on several occasions to pay the Manager's fees and expenses. They failed to do so. As authorized by the order appointing the Manager, the Manager has been paid its fees and expenses, and those of Goodmans LLP, on a monthly basis prior to Court approval. These payments were funded by:

(a) a loan from the applicants (which was secured by the Manager's charge), which has since been re-paid; and

(b) the proceeds generated by the sale of certain Schedule B Properties.

6 Pursuant to the order appointing the Manager, the Manager was granted a super-priority charge to secure its costs and fees. However, after the order was granted, a number of mortgagees objected to the priority of the Manager's charge. Following negotiations between these mortgagees, the applicants and the Manager, consent orders dated December 24, 2013, January 6, 2014 and January 20, 2014 were made which, among other things, provided that the Manager's charge would be subordinate to prior ranking security on the properties involved.

7 The Manager's position is that given the number of companies subject to these proceedings and the interconnectedness of the Schedule B and C Companies and their respective properties, it would have been impractical and very expensive to track fees separately for each of the properties. To allocate the fees to each individual company, the Manager has proposed that the fees paid and those to be paid in these proceedings be allocated to the Schedule B Companies, the Schedule C Properties and the Front Street Property based on the Fee Allocation Methodology. The Fee Allocation Methodology calculates a weighting for each Company, based upon a series of categories that, taken together, constitute a proxy for the effort and involvement of the Manager and its counsel with the various Properties.

2. The Fee Allocation Methodology includes the following six separate categories:

(a) *Active Property Management* (40%) — relates to the initial engagement of the Manager, accounting and analysis, operational management, financing, development of a marketing plan, and all other aspects of managing the property (other than the sales process);

(b) *Negotiated Agreements of Purchase and Sale* (10%) — relates to the negotiation of agreements of purchase and sale that advance to the due diligence stage, whether or not they are completed;

(c) *Legal Complexity* (25%) — relates to the level of legal work involved, including the complexity of real estate transactions, sale approval motions and other litigation;

(d) *Claims Process* (10%) — relates to the level of effort involved with respect to conducting a claims process for a particular property, where applicable;

(e) *Manager Interaction with Stakeholders* (10%) — relates to properties carved out where key stakeholders, including mortgagees, tenants and/or shareholders, of such Properties required regular reporting; and

(f) *Property Value* (5%) — relates to an adjustment reflecting the relative property value of a particular Property.

8 The Fee Allocation Methodology assigns a value to each of the above categories on a scale of 1 to 3 (with 1 being little, 2 being moderate, and 3 being complex or high) for each property to reflect the amount of time and effort the Manager and/or its counsel expended for the applicable Property in respect of each such category, other than the "Property Value" category which would be assigned a value on a scale of 1 to 3 based on the value of the applicable property (with 1 applying to property values less than $5 million, 2 applying for property values between $5 million and $10 million, and 3 applying for property values greater than $10 million).

9 The other factor affecting the total amount of an allocation to a property is the period of time that is applied to it.

10 The applicants support the requests of the Manager. Mr. Wallach, who acts for mortgagees of ten properties, also supports these requests.

11 The Dupont mortgagees oppose the approval of the Manager's fees and disbursements and also oppose the Fee Allocation Methodology. They say the accounts do not separate out the work done on each property, and therefore they are unable to know exactly what amount of time was spent by the Manager or its solicitors on the Dupont property. They also take the position that the Manager has overstated the extent of the work required and carried out on the Dupont property by the values of 2 or 3 ascribed to the various categories in the Fee Allocation Methodology. They also contend that even if the fees and the Fee Allocation Methodology are approved, the charges should be allocated in some marshalling fashion so that the properties without any encumbrances should bear the Manager's fees and disbursements.

12 The Cityview lien claimants do not opposed the overall fees and disbursements of the Manager but say that the values used by the Manager for the various categories are too high in some cases and that there has been duplication in the way that work is referred to in more than one category. They also take the position that the Manager should not be able to charge any of its fees and disbursements to a trust fund created by court order that replaced the claims for liens on the Cityview properties.

Analysis

13 Allocating expenses to separate properties involved in a financial meltdown is no easy matter. Recently, in *Royal Bank of Canada v. Atlas Block Co.*, 2014 ONSC 1531 (Ont. S.C.J. [Commercial List]) at para. 43, a case in which some of the costs of a receivership had to be shared between two mortgagees involving more than one property, Brown J. (as he then was) reviewed the authorities and summarized them. He stated:

34. As to the allocation of the fees, the general principles governing the allocation of receiver's costs can be briefly stated:

(i) The allocation of such costs must be done on a case-by-case basis and involves an exercise of discretion by a receiver or trustee;

(ii) Costs should be allocated in a fair and equitable manner, one which does not readjust the priorities between creditors, and one which does not ignore the benefit or detriment to any creditor;

(iii) A strict accounting to allocate such costs is neither necessary nor desirable in all cases. To require a receiver to calculate and determine an absolutely fair value for its services for one group of assets

> vis-à-vis another likely would not be cost-effective and would drive up the overall cost of the receivership;
>
> (iv) A creditor need not benefit "directly" before the costs of an insolvency proceeding can be allocated against that creditor's recovery;
>
> (v) An allocation does not require a strict cost/benefit analysis or that the costs be borne equally or on a pro rata basis;
>
> (vi) Where an allocation appears prima facie as fair, the onus falls on an opposing creditor to satisfy the court that the proposed allocation is unfair or prejudicial.

14 In *Hunjan International Inc., Re* (2006), 21 C.B.R. (5th) 276 (Ont. S.C.J.), C.L. Campbell J. made an apt statement of how creditors will look at allocations from their own perspective. He stated:

> **71** I am mindful that each creditor from its own particular perspective will have a view of what is or is not fair in terms of allocation. There is unlikely to be one specific method that can objectively point to absolute fairness to all parties. The exercise is inevitably one of viewpoint for the creditor and exercise of discretion for the Court.

15 Ms. Corne for the Dupont mortgagees relies on a statement in *Confectionately Yours Inc., Re* (2002), 36 C.B.R. (4th) 200 (Ont. C.A.) of Borins J.A., particularly the last part of his statement in discussing the accounts of a receiver:

> **37** As for the procedure that applies to the passing of the accounts, Bennett indicates at p. 460 that there is no prescribed process. Nonetheless, the case law provides some requirements for the substance or content of the accounts. The accounts must disclose in detail the name of each person who rendered services, the dates on which the services were rendered, the time expended each day, the rate charged and the total charges for each of the categories of services rendered. See, e.g., *Hermanns v. Ingle* (1988), 68 C.B.R. (N.S.) 15 (Ont. Ass. Off.); *Toronto Dominion Bank v. Park Foods Ltd*. (1986), 77 N.S.R. (2d) 202 (S.C.). The accounts should be in a form that can be easily understood by those affected by the receivership (or by the judicial officer required to assess the accounts) so that such person can determine the amount of time spent by the receiver's employees (and others that the receiver may have hired) in respect to the various discrete aspects of the receivership.

16 I do not think this statement is very helpful to our situation. It was a general statement in a case in which the receiver was dealing with one business. The Manager in this case was dealing with approximately 40 companies and different properties and facing issues common to them all, such a co-mingling of funds and tracing funds through different accounts.

17 I agree with the Manager that it would have been extremely costly and time consuming, and somewhat artificial, to keep dockets as suggested by Ms. Corne. As an example, spending time tracing money affected all of the properties, and it would not have been possible to apportion such time in any meaningful or accurate way. Docket entries refer to lawyers who have described in block form several different things done on any particular day, some of which refer to the Dupont property in some way. Only the total time spent by the lawyer for that day is contained in the docket entry. For all of the lawyers and professionals in the Manager's office to take the time each day to separate out the time for each task recorded, even if it could have been done, would have involved enormous time and expense.

18 Ms. Corne for the Dupont mortgagees relies on the recent case of *Bank of Nova Scotia v. Diemer*, 2014 ONCA 851 (Ont. C.A.) involving the receiver of a cattle farm, in which Justice Pepall was critical of the amount of time spent by counsel for the receiver. Pepall J.A. made statements that spoke to the necessity of not

being slavish to hourly rates and hours docketed. She stated:

> **45** In my view, it is not for the court to tell lawyers and law firms how to bill. That said, in proceedings supervised by the court and particularly where the court is asked to give its *imprimatur* to the legal fees requested for counsel by its court officer, the court must ensure that the compensation sought is indeed fair and reasonable. In making this assessment, all the *Belyea* factors, including time spent, should be considered. However, value provided should pre-dominate over the mathematical calculation reflected in the hours times hourly rate equation. Ideally, the two should be synonymous, but that should not be the starting assumption. Thus, the factors identified in Belyea require a consideration of the overall value contributed by the receiver's counsel. The focus of the fair and reasonable assessment should be on what was accomplished, not on how much time it took. Of course, the measurement of accomplishment may include consideration of complications and difficulties encountered in the receivership.

19 Ms. Corne says that because of the way in which the Manager and its solicitors kept dockets, it is not possible to know exactly what time was spent on the Dupont properties and therefore not possible to know if the principles espoused by Pepall J.A. have been met. I disagree. It is possible to measure what has been accomplished and no one has suggested the Manager or its counsel spent too much time on all of the various things that have had to be done or that their rates are too high. What the Dupont mortgagees complain of is that the form of the accounts does not permit one to identify how much time was spent at any one time on the Dupont property and issues arising that affected the property. That is the situation that governs whenever an allocation of expenses needs to be made.

20 I also agree with the Manager that it is too late for the Dupont mortgagees to now complain about the form of the dockets kept by the Manager and its counsel. The Dupont mortgagees were aware of these proceedings from the outset. They retained their counsel in April, 2014. Accounts of the Manager and its counsel in the same form as the accounts now before the court were approved by Wilton-Siegel J. on April 25, 2014 and by Brown J. on June 18, 2014. Counsel for the Dupont mortgagees did not object to these accounts. The first complaint by the Dupont mortgagees to the accounts came in a letter from Ms. Corne on December 9, 2014 when she asked for a breakdown from dockets that contained blocks of time for work done on a variety of properties or the time spent on the Dupont property. On December 14, 2014 Mr. Dunn replied that the Manager was of the view that a strict accounting to allocate time among the assets of the receivership would not be cost-effective and would drive up the overall cost of the proceeding, and that the proposed method of allocating the costs was fair.

21 To recount here everything that the Manager and its counsel have done for the period for which approval of their accounts is sought would be time consuming indeed. I am quite satisfied that what is charged is fair and reasonable. It is one of those situations described by Pepall J.A. in *Diemer* in which the docketed charges are synonymous with what is a fair and reasonable charge. The accounts are approved.

22 The Dupont mortgagees are critical of the way that the Fee Allocation Methodology has been applied to the Dupont property. Reliance is placed on an affidavit of Mr. Jack Brudner. Millwood Management Limited administered the mortgages on the Dupont property on behalf of the Dupont mortgagees and Mr. Brudner is the manager of Millwood. He was a solicitor until his retirement in January 2010. His affidavit was filed to support an argument that the Manager was incompetent, did things that were not required and failed to do things that should have been done.

23 I am afraid I place little reliance on Mr. Brudner's evidence. It is for the most part hearsay and involves assertions with little or no evidence to support the assertions. For example, Mr. Brudner asserted that there was no reason for the Manager to undertake most of the repairs to the property that were made, and he said that "To the best of my knowledge, without inquiry, all of the rented premises were code compliant." This is no cogent evidence. The Manager in his supplemental report made in response to Mr. Brudner's affidavit provided details of what was required and why. In that supplemental report, the Manager disputed substantially all of Mr. Brudner's allegations and provided details on many of them that indicated that Mr. Brudner's affidavit was unreliable. I accept the supplemental report of the Manager and do not accept Mr. Brudner's assertions.

24 The Cityview lien claimants are also critical of the way that the Fee Allocation Methodology has been applied to the Cityview properties. There was one Cityview property in the process of being severed when the Manager was appointed and after the severance was completed, the two separate Cityview parcels were sold by the Manager.

25 The first complaint of the Cityview lien claimants is that that there is "little or no evidence as to the actual time spent...on account of the Cityview Property." This is a reference to the fact that neither the Manager nor its counsel tracked its time separately for each property. This is the same complaint made by the Dupont mortgagees, which I have previously discussed and not accepted. Further, the Manager's docketing practices have been consistent throughout this mandate and have been approved several times. The Cityview lien claimants have not objected to any of the Manager's prior fee approval motions despite the fact that time was not broken out by property. As with the Dupont mortgagees, I think that the time to challenge the Manager's docketing practices has passed.

26 In his factum, Mr. Copelovici contended that the Fee Allocation Methodology is arbitrary and not capable of being reviewed. However in argument, he said that his clients do not see any flaw in the Fee Allocation Methodology but their complaint is in the weighting given to the Cityview properties. In any event, I do not agree that the Fee Allocation Methodology is arbitrary or incapable of being reviewed. The various categories and the different levels of value that can be applied to each category are logical and appear to make sense having regard to the various tasks that the Manager has had to undertake. I agree that when one looks at the details of how the amounts are ascribed to each property, it is somewhat complicated, but it is comprehensible and understandable.

27 Part of the argument of the Cityview lien claimants is that work ascribed to Active Property Management, being 40% of the weighting, is also ascribed to Negotiating Agreements of Purchase and Sale having a 10% weighting, and thus there is "overlap". I do not accept that. The example given of difficulties with a tenant involved property management issues to be sure, but it also complicated the sales process. The same can be said with respect to complaints about "overlapping" involving severance issues and legal complexity. Much of the complaints involve speculation, although counsel for the Cityview lien claimants cross-examined the Manager and undertook written interrogatories. I do not accept that any cogent argument supported by evidence has been made to criticize the way in which the Fee Allocation Methodology has been applied to the Cityview properties.

28 Each case is different. This case involves unusual complexity involving the Manager's responsibility for 31 Schedule B properties and several Schedule C properties, all of which were improperly run by the Waltons before the Manager was appointed. The Manager's task was made no easier by challenges raised from the beginning to the end. I accept that the Fee Allocation Methodology in this case allocates costs in a fair and equitable manner and that the discretion of the Manager has been exercised fairly. The fact that one or more interested parties is unhappy with the allocation is perhaps understandable but no basis in this case to change what the Manager has proposed to allocate the costs.

29 The Dupont mortgagees have argued that if the Fee Allocation Methodology is upheld, the costs should be allocated in accordance with principles of marshalling. Ms. Corne asserts that as the Manager has a charge against all properties and her clients have a charge against only the Dupont property, the Manager should allocate the costs and recover from those properties for which there are no other encumbrances after paying out the prior mortgagees. I do not accept this argument.

30 Ms. Corne relies on the doctrine of marshalling as discussed in *Snell's Equity*, 32nd ed. which states that where there are two creditors of the same debtor, one creditor having a right to resort to two funds of the debtor for payment of his debt and the other creditor having a right to resort to one fund only, the court will "marshal", that is to say arrange the funds so that both creditors are paid as far as possible. However, I do not think it can be said that the Manager is a creditor of the Dupont property owner. The Manager is a court appointed officer with a charge for its fees, which are to be approved by the Court. Even if the Manager could be considered a

creditor, it would not be a creditor in the sense involved in the doctrine of marshalling, which involves a pre-existing secured creditor of a debtor against whom there are other pre-existing secured creditors. As pointed out in *Snell's Equity*, the doctrine cannot be applied against a purchaser of one of the properties, which is a recognition that the doctrine applies only to two secured creditors existing at the time of the insolvency.

31 Moreover, the doctrine of marshalling applies to security granted by one debtor to two creditors, one of whom has been granted more than one parcel by that debtor as security. Here the effect of what the Dupont mortgagees seek would be to cause the pooling of funds of other debtors, not the Dupont property owner. That would not be marshalling. Moreover, it would be unfair to the equity holder of those properties in which there has ended up being equity, being Dr. Bernstein. It would not be a fair and reasonable allocation of costs, as properties in which there is no equity, such as the Dupont property, would bear none of the costs of the Manager, even though these properties with no equity have required the intervention of the Manager and its counsel.

32 The Cityview lien claimants claim that the Manager has no right to the funds that remain after the two Cityview properties were sold, the effect of which would be to provide them with priority over the Manager's charge. I do not accept this contention of the Cityview lien claimants.

33 The November 5, 2013 order appointing the Manager provided for two super-priority charges to secure the Manager's fees and disbursements, the fees and disbursements of the Manager's counsel and amounts borrowed to fund the operation of the Schedule "B" Companies. The Cityview lien claimants contend that there was no authority for the Court to make such an order in light of provisions of 77 of the *Construction Lien Act* which provides that liens "have priority over all judgments, executions, assignments, attachments, garnishments and receiving orders except those executed or recovered upon before the time when the first lien arose". In this case the liens arose before the appointment of the Manager. Reliance is placed on *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.* (1975), [1976] 2 S.C.R. 475 (S.C.C.) which held that an order appointing a receiver and providing priority to money paid to the receiver over "any and all other charges or encumbrances... affecting the lands" was invalidly made as it conflicted with rights of lien holders under the Manitoba *Construction Lien Act.*

34 The Manager's charge was granted in the order of November 5, 2013 appointing the Manager. It provided that the Manager's fees and disbursements and those of its counsel "shall form a first charge on the Property in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise". The Cityview lien claimants were notified of the Manager's appointment by letter dated November 28, 2013, which also specifically stated that the November 5 order provided for "charges that rank ahead of pre-existing security interests in the [Schedule "B" Companies] property." The Cityview lien claimants took no steps to vary or set aside the November 5, 2013 order, or challenge the Court's jurisdiction to grant priority to the Manager's charges at any time. Their argument was first made in their factum dated April 8, 2015.

35 Rule 37.14(1) provides that a party affected by an order obtained on motion without notice may move to set it aside or vary it by a motion "that is served forthwith after the order comes to the person's attention and names the first available hearing date that is at least three days after the service of the notice of motion". As the November 5, 2013 order was received by the Cityview lien claimants by early December, 2013, any motion to vary it was required to be served "forthwith" thereafter. I dealt with this earlier in a similar motion by the Dupont mortgagees and my comments there are equally applicable to the Cityview lien claimants. See *DBDC Spadina Ltd. v. Walton*, 2015 ONSC 870 (Ont. S.C.J. [Commercial List]) in which I stated:

> **15** In *Muscletech Research and Development Inc. (Re)* (2006), 19 C.B.R. (5th) 54 in discussing a comeback motion relating to a CCAA Initial Order, Farley J. stated "Comeback relief, however, cannot prejudicially affect the position of parties who have relied *bona fide* on the previous order in question." I agree entirely with that statement and in my view it is equally applicable to a motion to vary a receivership order, which is essentially what the November 5, 2013 order was, the word Manager instead of Receiver being used in an attempt to put a better face on the order to the marketplace.
>
> **16** The same reasoning underlies the dictates of rule 37.14 that requires a motion to vary to be brought

> "forthwith" after the affected party learns of the rule. A court can vary the strict provisions of the rule in appropriate circumstances, but should be loath to do so if in the interval persons relying on the order would be materially prejudiced.

36 In this case, the Cityview lien claimants knew that the Manager's charge ranked ahead of their liens. They knew that the Manager and its counsel were working to maximize the value of the Cityview property. The Manager also borrowed funds that were required to complete the severance of the Cityview property, which added value for the benefit of all stakeholders, including the Cityview lien claimants. Knowing all of this, the Cityview lien claimants did nothing to challenge the Manager's fees until the Manager's mandate with respect to the Cityview Property was essentially complete. It would not be equitable for the Cityview lien claimants to now challenge the Manager's charges at this late date.

37 Moreover, when 9-11 Cityview was sold, it was approved by two orders of Justice Spence dated February 21, 2014. The Cityview lien claimants consented to the February 21 orders on the condition that amounts sufficient to satisfy the Cityview liens were held back from the sale proceeds pending further order of the Court. A total of $969,583.99 was ordered to be held in trust. There is now some $805,000 left.

38 The orders of Justice Spence provided that all encumbrances against the lands to be sold were to be lifted and that the net proceeds of the sale were to be held in trust by the Manager pending further order of the Court and that all encumbrances, which included the Manager's charges, would attach to the net proceeds from the sale "with the same priority as they had with respect to the [lands sold] immediately prior to the sale...". Thus the orders consented to by the Cityview lien claimants provided for the same priorities as prior to the sale. Those priorities included the Manager's charges under the November 5, 2013 order appointing the Manager.

39 The Cityview lien claimants also argue that if their position opposing the Fee Allocation Methodology is not accepted, an order should be made that the Manager's fees with respect to the Cityview property should be paid on a proportionate basis by all creditors regardless of priority. If that argument were accepted, it would mean that the bulk of the costs would come out of the pocket of the mortgagee of the Cityview property, being a Dr. Bernstein company. I do not accept this contention.

40 Dr. Bernstein's corporation had two mortgages on the Cityview property. There was a dispute between the Cityview lien claimants and the mortgagee as to the priorities for payment from the trust funds held following the sale of the Cityview property. In a settlement agreement of October 15, 2014, between the mortgagee and the Cityview lien claimants, the parties agreed on the priorities of the Bernstein first and second mortgages and the lien claims. The minutes of settlement resolved the priorities as follows:

> (a) The parties agreed that the first mortgage had priority in its entirety over any interests that the Cityview lien claimants may assert in the surplus sale proceeds;
>
> (b) The parties agreed that the second mortgage, less $20,000, had priority over any interests that the Cityview lien claimants may assert in the surplus sale proceeds. It was also agreed that the Cityview lien claimants' claims would have priority over the final $20,000 of the second mortgage.

41 The settlement agreement resolved issues between the Bernstein mortgagees and the Cityview lien claimants as to the right to the funds held in trust. What the Cityview lien claimants now seek in requesting the Manager's fees be split in a proportionate basis would be contrary to the settlement agreement.

Conclusion

42 The fees and disbursements of the Manager and its counsel for the period sought are approved.

43 The Fee Allocation Methodology is also approved.

Motion granted.

End of Document

MANITOBA

THE MERCANTILE LAW AMENDMENT ACT

C.C.S.M. c. M120

LOI MODIFIANT LE DROIT COMMERCIAL

c. M120 de la *C.P.L.M.*

As of 5 Jun 2021, this is the most current version available. It is current for the period set out in the footer below.

Le texte figurant ci-dessous constitue la codification la plus récente en date du 5 juin 2021. Son contenu était à jour pendant la période indiquée en bas de page.

CHAPTER M120

THE MERCANTILE LAW AMENDMENT ACT

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

Guarantee not invalid though consideration does not appear

1 No special promise made by any person to answer for the debt, default, or miscarriage of another person, being in writing, and signed by the party to be charged therewith, or some other person by him thereunto lawfully authorized, shall be deemed invalid to support an action, suit, or other proceeding to charge the person by whom the promise was made, by reason only that the consideration for the promise does not appear in writing, or by necessary inference from the written document.

Surety entitled to assignment

2 Every person who, being surety for the debt or duty of another, or being liable with another for any debt or duty, pays the debt or performs the duty, is entitled to have assigned to him, or to a trustee for him, every judgment, specialty, or other security that is held by the creditor in respect of the debt or duty, whether the judgment, specialty, or other security is or is not deemed at law to have been satisfied by the payment of the debt or performance of the duty; and that person is entitled to stand in the place of the creditor, and to use all the remedies, and, if need be, and upon a proper indemnity, to use the name of the creditor, in any action

CHAPITRE M120

LOI MODIFIANT LE DROIT COMMERCIAL

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

Promesse valable

1 Aucune promesse spéciale faite par une personne de répondre des dettes, du défaut ou des actes dommageables d'une autre personne, constatée par écrit et signée par la partie qui fera l'objet de poursuites à cet égard ou par toute autre personne qu'elle a légalement autorisée à cet effet, n'est réputée sans effet pour soutenir une action, un procès ou autre procédure contre la personne qui a fait la promesse pour la seule raison que la contrepartie de la promesse n'est pas indiquée par écrit ni ne s'infère nécessairement du document écrit.

Cession à la caution

2 Toute personne qui s'est portée caution de la dette ou de l'obligation d'une autre personne ou répond avec une autre personne d'une dette ou d'une obligation et rembourse la dette ou exécute l'obligation est en droit de se faire céder ou de faire céder à un fiduciaire à son profit, tout jugement, contrat scellé ou autre sûreté détenu par le créancier relativement à cette dette ou obligation, que le remboursement de la dette ou l'exécution de l'obligation soit ou non réputé en droit avoir satisfait au jugement, au contrat scellé ou autre sûreté. Cette personne a le droit d'être subrogée au créancier et d'utiliser tous les recours et, au besoin et en or other proceeding, at law or in equity, in order to obtain from the principal debtor, or any co-surety, co-contractor, or co-debtor, as in the case may be, indemnification for the advances made and loss sustained by the person who has so paid the debt or performed the duty, and the payment or performance so made by the surety is not pleadable in bar of any such action or other proceeding by him.

fournissant une indemnisation appropriée, d'utiliser le nom du créancier dans toute action ou autre procédure fondée en common law ou en Équité, en vue d'obtenir du débiteur principal ou de toute cocaution, de tout cocontractant ou de tout codébiteur, selon le cas, une indemnisation pour les avances faites et les pertes subies par la personne qui a ainsi remboursé la dette ou exécuté l'obligation. L'exécution ou le paiement ainsi fait par la caution ne constitue pas une défense au fond opposable à une telle action ou procédure.

Right to recover

3 No co-surety, co-contractor or co-debtor is entitled to recover from any other co-surety, co-contractor or co-debtor by the means aforesaid, more than the just proportion to which, as between those parties themselves, the last mentioned person is justly liable.

Recouvrement

3 Une cocaution, un cocontractant ou un codébiteur n'a le droit de recouvrer d'une autre cocaution, d'un autre cocontractant ou d'un autre codébiteur par les moyens mentionnés ci-dessus que la juste part dont cette dernière personne est, dans les rapports qui unissent ces parties entre elles, justement redevable.

Effect of giving time to a principal debtor

4 Giving time to a principal debtor, or dealing with or altering the security held by the principal creditor, does not of itself discharge a surety or guarantor; in such cases a surety or guarantor is entitled to set up the giving of time or dealing with or alteration of the security as a defence, but the defence shall be allowed in so far only as it is shown that the surety has thereby been prejudiced.

Délai accordé au débiteur principal

4 Le fait d'accorder un délai au débiteur principal ou d'effectuer une opération portant sur la sûreté détenue par le créancier principal n'a pas pour effet de libérer une caution ou un garant; dans un tel cas, la caution ou le garant a droit d'opposer l'octroi du délai ou la négociation ou modification de la sûreté comme défense, mais celle-ci ne peut être admise que dans la mesure où il est prouvé que la caution a ainsi subi un préjudice.

Stipulations as to time

5 Stipulations in contracts as to time or otherwise which would not, before the passing of *The Queen's Bench Act, 1895*, have been deemed to be, or to have become, of the essence of such contracts in a court of equity shall receive in all courts the same construction and effect as they would, prior to the passing of *The Queen's Bench Act, 1895*, have received in equity.

Stipulations relatives au terme

5 Les stipulations contractuelles relatives au terme ou autrement qui n'auraient pas, avant l'adoption de la Loi intitulée « *The Queen's Bench Act, 1895* », été réputées être ou être devenues des conditions essentielles de tels contrats devant un tribunal d'Équité doivent recevoir de tous les tribunaux la même interprétation et le même effet qu'elles auraient reçus en Équité avant l'adoption de la Loi intitulée « *The Queen's Bench Act, 1895* ».

Part performance of obligation

6(1) Part performance of an obligation either before or after a breach of the obligation extinguishes the obligation

Exécution partielle de l'obligation

6(1) L'exécution partielle d'une obligation, soit avant, soit après une violation de l'obligation éteint celle-ci dans les cas suivants, même en l'absence d'une nouvelle contrepartie :

(a) when expressly accepted by a creditor in satisfaction; or

(b) when rendered pursuant to an agreement for that purpose;

though without any new consideration.

Unconscionability

6(2) Notwithstanding subsection (1), an obligation is not extinguished by part performance where a court of competent jurisdiction finds that it is unconscionable to so allow.

Agreement under clause 6(1)(a)

6(3) Subject to any agreement to the contrary, an acceptance by a creditor under clause 6(1)(a) need not be in writing.

Right of revocation

6(4) A creditor may revoke an agreement under clause 6(1)(b) where

(a) the debtor has not commenced performance of the agreement; or

(b) the debtor has commenced performance of the agreement, but fails to continue performance on a date or within a time provided for in the agreement, and it would be unreasonable in the circumstances for the creditor to give the debtor more time to remedy the default.

Transitional

6(5) This section does not affect an obligation arising before the day on which this section comes into force.

S.M. 1992, c. 32, s. 10.

Deceased joint debtors

7 Where any one or more joint contractors, obligors, or partners die, the person interested in the contract, obligation or promise entered into by the joint contractors, obligors, or partners may proceed by action against the representatives of the deceased contractor, obligor, or partner in the same manner as if the contract, obligation, or promise had been joint and several, and this notwithstanding there is another person liable under

a) elle est acceptée expressément par un créancier en paiement;

b) elle a lieu conformément à un accord conclu à cette fin.

Exception

6(2) Malgré le paragraphe (1), une obligation n'est pas éteinte par son exécution partielle si un tribunal compétent estime qu'il est abusif de permettre qu'elle le soit.

Acceptation écrite

6(3) Sous réserve de tout accord contraire, il n'est pas nécessaire que l'acceptation visée à l'alinéa 6(1)a) soit écrite.

Droit de révocation

6(4) Le créancier peut révoquer l'accord visé à l'alinéa 6(1)b) dans les cas suivants :

a) le débiteur n'a pas commencé à l'exécuter;

b) le débiteur a commencé à l'exécuter mais omet de continuer à le faire à la date ou dans le délai qui y est prévu et, dans les circonstances, il serait déraisonnable pour le créancier de donner au débiteur plus de temps pour remédier à son défaut.

Disposition transitoire

6(5) Le présent article ne modifie en rien les obligations qui prennent naissance avant son entrée en vigueur.

L.M. 1992, c. 32, art. 10.

Décès de débiteurs conjoints

7 Lorsqu'un ou plusieurs cocontractants, codébiteurs ou associés décèdent, la personne intéressée au contrat conclu, à l'obligation contractée ou à la promesse faite par les cocontractants, codébiteurs ou associés, peut procéder par voie d'action contre les représentants du défunt de la même manière que si le contrat, l'obligation ou la promesse avait été conjoint et solidaire, en dépit du fait qu'une autre personne the contract, obligation, or promise still living, and an action pending against that person; but the property and effects of shareholders in chartered banks or members of other incorporated companies is not liable to a greater extent than they would have been if this section had not been passed.

responsable aux termes du contrat, de l'obligation ou de la promesse soit encore vivante et qu'une action soit en cours contre cette personne; toutefois, les biens et effets des actionnaires de banques ou de membres d'autres entreprises constituées en corporations ne sont pas sujets à saisie dans une plus grande mesure qu'ils l'auraient été si le présent article n'avait pas été adopté.

2018 BCSC 1453
British Columbia Supreme Court

Gill v. Cheema

2018 CarswellBC 2303, 2018 BCSC 1453, 296 A.C.W.S. (3d) 72

Shavinder Gill (Plaintiff) and Jaswinder (Gus) Cheema, Hardip Gill, Mukhtiar Grewal and Sawinder Hayre (Defendants)

Abrioux J.

Heard: July 24, 2018
Judgment: August 30, 2018
Docket: New Westminster S183214

Counsel: D. MacAdams, Q.C., for Plaintiff
D. Magnus, for Defendants, Hardip Gill, Mukhtiar Grewal and Sawinder Hayre

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

Headnote

Civil practice and procedure --- Trials — Summary trial — Availability — Miscellaneous
Parties were shareholders of company — Plaintiff owned 29.69% of shares, defendant C owned 38.41% of shares, and defendants HG, MG and H owned 8.6%, MG 8.1%, and 15.2% of shares respectively — Company mortgaged property and parties provided joint and several guarantees in support of mortgage — Demands were made on guarantees and mortgagees commenced action on guarantees against plaintiff and defendants — Plaintiff settled claim against him for $600,00 — Defendant C settled claim against him for $135,000 — Defendants HG, MG and H settled claim against them for total of $130,000 — Plaintiff took position that all parties were responsible for paying equal amount of indebtedness and that he had overpaid — Defendants alleged that there was agreement among parties that losses would be allocated in accordance with each person's proportionate share of company — Plaintiff brought action against defendants claiming amount required to equalize payments made by plaintiff and each of defendants to mortgagees — Plaintiff brought application for summary trial judgment against defendants — Application dismissed — It was premature to proceed summarily at this stage — It was not possible to determine from evidentiary record whether there was agreement as alleged by defendants which would displace general principle that all parties should contribute equally towards satisfaction of guaranteed debt — There was no evidence about what parties did or discussed among themselves when potential losses became apparent and/or when demands were made of them on their guarantees — Further examinations for discovery and/or cross-examination on affidavits were required.

Table of Authorities

Cases considered by *Abrioux J.*:

Berthin v. Berthin (2016), 2016 BCCA 104, 2016 CarswellBC 610, 384 B.C.A.C. 59, 663 W.A.C. 59, 76 R.F.L. (7th) 58, 398 D.L.R. (4th) 526, 85 B.C.L.R. (5th) 30 (B.C. C.A.) — followed

Davies v. Canada Shineray Suppliers Group Inc. (2016), 2016 BCSC 1853, 2016 CarswellBC 2796, 37 C.C.E.L. (4th) 198 (B.C. S.C.) — followed

Gichuru v. Pallai (2013), 2013 BCCA 60, 2013 CarswellBC 271, 42 B.C.L.R. (5th) 91, 332 B.C.A.C. 272, 569 W.A.C. 272 (B.C. C.A.) — referred to

Harry Froese Inc. v. 273134 B.C. Ltd. (2018), 2018 BCSC 649, 2018 CarswellBC 977 (B.C. S.C.) — referred to

Morin v. 0865580 B.C. Ltd. (2014), 2014 BCSC 2110, 2014 CarswellBC 3330 (B.C. S.C.) — considered

Peng v. Wang (2018), 2018 BCSC 1231, 2018 CarswellBC 1968 (B.C. S.C.) — referred to

Player Estate v. Janssen-Ortho Inc. (2014), 2014 BCSC 1122, 2014 CarswellBC 1799, 11 C.C.L.T. (4th) 104 (B.C. S.C.) — referred to

Rant v. Ward (1998), 1998 CarswellBC 395, 38 B.L.R. (2d) 82 (B.C. S.C.) — considered

Toppi v. Lavin (2013), [2013] NSWSC 1361 (New South Wales S.C.) — referred to

Statutes considered:

Law and Equity Act, R.S.B.C. 1996, c. 253
s. 34 — considered

Rules considered:

Supreme Court Civil Rules, B.C. Reg. 168/2009
Generally — referred to

R. 9-7(11) — considered

R. 9-7(15)(a) — considered

App. B, s. 2(2)(b) — referred to

APPLICATION by plaintiff for summary trial judgment against defendants.

***Abrioux J.*:**

I: INTRODUCTION

1 Pursuant to the summary trial rule of the *Supreme Court Civil Rules* (*SCCR*) the plaintiff seeks an interim judgment against the defendants jointly and severally in the amount of $193,349.60.

2 The defendants, Messrs. Gill, Grewal and Hayre, are represented in this proceeding by the same counsel. Mr. Cheema was served with notice of the application but did not appear at the hearing.

3 The claim arises from joint and several guarantees provided by the parties in support of a mortgage provided to a numbered company 1364335 Alberta Inc. (the “Alberta Company”) of which they were the shareholders.

4 The Alberta Company was involved in a real estate venture in that province which failed. Demands were made on the plaintiff and the defendants on their guarantees, which resulted in the claims against them being settled shortly before a scheduled trial date.

5 The plaintiff’s settlement amount, which he has partially satisfied, was significantly greater than that of the

defendants.

6 His claim is based on the basis that he has overpaid his "equal share" of the indebtedness. He seeks an amount from the defendants such that all the parties are in the position of having paid or are responsible for paying an equal amount. The amount sought on this summary trial is the alleged overpayment as of September 2017, the plaintiff intending to bring a further application(s) in due course for the increase in the overpayment since that time since his obligations are ongoing.

7 Whether this application should proceed by way of summary trial is largely dependent on whether the court can make the necessary findings of fact or law in relation to one of the principal defences raised; that is, whether contributions between the parties should be equal or in proportion to their respective shareholdings in the Alberta Company.

8 Although there have been examinations for discovery and affidavits filed in support and in opposition to this application, I am of the view, for the reasons that follow, that it is premature for the application to proceed summarily at this stage. The court cannot determine whether there was an agreement as alleged by the defendants based on the evidentiary record. At a minimum, there need to be further examinations for discovery and/or cross-examination on the affidavits of the plaintiff and the defendants which deal with this issue.

II: BACKGROUND

9 The principal background facts relating to the existence of the parties' debt are not in dispute. What is contested is whether:

• the parties' contributions to the Alberta Company's indebtedness pursuant to their respective joint and several guarantees was on an equal basis, that is, 20% each or in proportion to their respective shareholdings; and

• their obligations to the plaintiff are joint and several, or several.

10 The salient facts are summarized in the notice of application and response and include the following.

11 The plaintiff, Shavinder Gill, is an internist. The defendant, Jaswinder (Gus) Cheema (Cheema) is a realtor, the defendant, Hardip Gill (Gill), is a factory worker and the defendants, Mukhtiar Grewal (Grewal) and Sawinder Hayre, are businessmen.

12 The plaintiff and defendants' shareholdings in the Alberta Company were:

• Shavinder Gill (through a B.C. Company he controlled, being 0807999 B.C. Ltd.): 29.69%;

• Cheema: 38.41% ;

• Gill: 8.6%;

• Grewal: 8.1%; and

• Hayre: 15.2%.

13 On or about May 12, 2009, the Alberta Company purchased property for the purposes of developing it and assumed a mortgage from the previous owner of the property, Kanwal Investments Ltd.

14 The assumed mortgage was granted to the Alberta Company by Daljeet Samra and Raghbir Mand in the amount of $1,553,000.00 with an interest rate of 15% per annum (the "Mortgage").

15 On or about July 14, 2009, the plaintiff and the defendants executed joint and several guarantees in writing by which they jointly and severally guaranteed repayment to Samra and Mand of all monies owing under the Mortgage. The mortgagee defendants were all guarantors on the Mortgage.

16 Amarpreet Singh (Singh) and Kanwal Investments Ltd. who were also guarantors of the Mortgage, were not released from their guarantees when the Mortgage was assumed by the Alberta Company.

17 The Alberta Company defaulted on the Mortgage and on or about April 4, 2012, the lenders commenced an action in the Court of Queen's Bench of Alberta against the Alberta Company and others, including Singh, Kanwal Investments and the parties to this action. The Alberta Company defaulted in its obligations to pay under the Mortgage and was therefore indebted to Samra and Mand who demanded payment of the outstanding balance together with interest from the parties pursuant to their guarantees.

18 On April 4, 2012, Samra and Mand commenced an action in the Court of Queen's Bench of Alberta under action number 1201-04386 (the "Alberta Action") naming as defendants the plaintiff and the defendants in this proceeding claiming among other things, that the plaintiff and the defendants had failed to pay the amount owing pursuant to the guarantees executed by each of them.

19 In September 2014, the trial date was approaching in the Alberta Action. According to the plaintiff, Cheema and Gill/Grewal/Hayre (the "Gill Group") failed to take steps to defend the Alberta Action and in essence abandoned him, leaving him to deal with the Alberta Action on his own. The plaintiff had more income and assets than did Cheema and the Gill Group.

20 On September 3, 2014, Samra and Mand settled their claim as against the plaintiff only for the total amount of $600,000 to be paid by way of monthly payments in the amount of $10,000 each, continuing until the total amount was paid. This amount was to be reduced to $5,000 per month if the plaintiff became disabled (the "Plaintiff's Settlement Agreement").

21 Commencing on September 15, 2014 the plaintiff paid to Samra and Mand monthly payments to and including a payment in June 2016 in the amount of $10,000 for each monthly payment as was agreed in the Plaintiff's Settlement Agreement. As of July 15, 2016, the plaintiff reduced his monthly payment to $5,000 per month due to a disability. As of September 30, 2017, the plaintiff had paid Samra and Mand a total of $295,000.

22 In or about September 2014, Cheema signed a settlement agreement in favour of Samra, Mand and a BC numbered company 534785 B.C. Ltd. wherein Cheema agreed to pay to Samra and Mand $135,000.00 by way of monthly payments in the amount of $2,250.00 commencing on September 15, 2014 and continuing until August 15, 2019 (the "Cheema Settlement"). As of September 30, 2017, Cheema had paid Samra and Mand a total of $83,250.00.

23 On September 12, 2014, the Gill Group signed a settlement agreement in favour of Samra and Mand and 534785 B.C. Ltd. wherein the Gill Group agreed to pay to Samra and Mand $130,000.00 by September 19, 2014 (the "Gill Group Settlement"), that amount being paid in September 2014.

24 As security for payment of the settlement amounts, Mand and Samra sought and obtained from the plaintiff a consent judgment against him alone in the amount of $2,500,000; Cheema provided a consent judgment against him alone in the amount of $2,800,000 and the Gill Group provided a consent judgment against them jointly and severally in the amount of $2,800,000.

25 As of September 30, 2017, the plaintiff had paid Samra and Mand a total of $295,000 and owed Samra and Mand an additional $305,000 pursuant to the Plaintiff's Settlement Agreement. At $5,000/month, the plaintiff anticipates making his last payment to Samra and Mand in December 2022.

26 As of September 30, 2017, Cheema had paid to Samra and Mand a total of $83,250.00 thereby owing

them an additional $51,750 pursuant to the Cheema Settlement. At $2,250/month Cheema can anticipate making his last payment to Samra and Mand in August 2019.

27 As a result of the payment of the entire Gill Group Settlement of $130,000 in September 2014, nothing more was owed by them to Samra and Mand as of September 30, 2017.

28 Pursuant to the joint and several guarantees entered into by the parties, the plaintiff has demanded payment from the defendants jointly and severally of the amount he alleges is required to equalize the payments made by the plaintiff and each of the defendants to Samra and Mand.

29 The plaintiff initially made a demand of the defendants of an incorrect sum, but thereafter corrected the demand to what he now says is the correct amount as at September 30, 2017. The demand, which is the amount sought on this summary trial jointly and severally from the defendants, is $193,349.60, being four-fifths of the payment of $295,000 which the plaintiff as of September 30, 2017 had in fact paid Samra and Mand, less one-fifth of the payment of $83,250, which Cheema as of September 30, 2017 had paid Samra and Mand and less one-fifth of $130,002, which the Gill Group as of September 30, 2017 had paid Samra and Mand, which is calculated as follows as:

(4/5 x 295,000) - (1/5 x 83,250) - (1/5 x 130,002) =

236,000 - 16,650 - 26,000.40 = 193,349.60

30 The plaintiff alleges that the defendants have refused or neglected to pay any part of the demand by the plaintiff for payment.

31 The plaintiff has advised the defendants that, based on his view of the legal effect of the joint and several nature of the guarantees to Samra and Mand, he will demand further payments in amounts equal to four-fifths of any and all payments, which the plaintiff pays Samra and Mand after September 30, 2017 less one-fifth of any and all payments, which Cheema and the Gill Group make to Samra and Mand after that date.

32 The defendants allege that there was an agreement between the parties being that at all material times it was understood and agreed to between them that the benefit each party received and their liabilities would be commensurate to their proportionate share of the Alberta Company (the “Agreement”).

33 They allege that the parties operated the Alberta Company in accordance with the Agreement, with each party only contributing funds commensurate to their proportionate share in the Alberta Company when there were capital calls. I will deal with the evidence on this issue below.

III: DISCUSSION

A: The Issues

34 The principal issue in this proceeding is whether there should be equality of contributions among co-guarantors when the co-guarantors have settled with the creditors independently of one another for unequal amounts, which unequal amounts in the aggregate total less than the full amount of the principal debt.

35 Should that be the case, then this leads to a calculation of the amount of the equal contribution of each co-guarantor and whether the defendants are severally or jointly and severally liable to the plaintiff.

B: The Legal Framework

1: Summary Trial

36 Rule 9-7(11) provides that a summary trial application may be dismissed where the court determines the issues raised are not suitable for summary disposition, or the summary trial will not assist in the efficient resolution of the proceeding. The powers of the court hearing a summary trial application are set out in Rule 9-7(15):

> (15) On the hearing of a summary trial application, the court may
>
> (a) grant judgment in favour of any party, either on an issue or generally, unless
>
> (i) the court is unable, on the whole of the evidence before the court on the application, to find the facts necessary to decide the issues of fact or law, or
>
> (ii) the court is of the opinion that it would be unjust to decide the issues on the application . . .

37 Justice Fleming in *Davies v. Canada Shineray Suppliers Group Inc.*, 2016 BCSC 1853 (B.C. S.C.), summarized the applicable principles this way:

> 32 *Inspiration Mgmt. Ltd. v. McDermid St. Lawrence Ltd.* (1989), 36 B.C.L.R. (2d) 202 (C.A.) remains the leading authority on the principles to be applied in deciding the issue of suitability for summary trial. Chief Justice McEachern, writing for the Court of Appeal, identified some of the factors the court may consider in determining whether it would be unjust to give judgment, including the amount involved, the complexity and urgency of the matter, any prejudice likely to arise by reason of delay, the cost of taking the case forward to conventional trial, and the course of the proceedings to date. Other factors include whether the summary trial would take considerable time, whether credibility is a critical factor and has cross examination occurred, and whether the summary trial may create unnecessary complexity in the resolution of the dispute or "result in litigating in slices": *Dahl et al. v. Royal Bank of Canada et al.*, 2005 BCSC 1263at para. 12, aff'd 2006 BCCA 369.

See also *Gichuru v. Pallai*, 2013 BCCA 60 (B.C. C.A.) at paras. 28-35.

38 It is for the application respondents to demonstrate the matter is not suitable for summary trial *Morin v. 0865580 B.C. Ltd.*, 2014 BCSC 2110 (B.C. S.C.) at para. 22.

2: Co-Guarantors

39 In light of my conclusion regarding the suitability of this matter proceeding by way of summary trial, I shall only briefly set out the obligations at law between co-guarantors.

40 Section 34 of the *Law and Equity Act*, R.S.B.C. 1996, c. 253---provides:

> 34 (1) Every person who, being surety for the debt or duty of another or being liable with another for any debt or duty, pays the debt or performs the duty is entitled to have assigned to him or her or to a trustee for him or her every judgment, specialty or other security that is held by the creditor in respect of the debt or duty, whether the judgment, specialty or other security is or is not deemed at law to have been satisfied by the payment of the debt or performance of the duty.
>
> (2) The person who has paid the debt or performed the duty is entitled to stand in the place of the creditor and to use all the remedies and, if necessary and on a proper indemnity, to use the name of the creditor in any action or other proceeding at law or in equity, in order to obtain from the principal debtor, or a co-surety, co-contractor or co-debtor indemnification for the advances made and loss sustained by the person, and the payment or performance made by the surety is not pleadable in bar of any action or other proceeding by him or her.

> (3) A co-surety, co-contractor or co-debtor is not entitled to recover from any other co-surety, co-contractor or co-debtor, by the means referred to in subsections (1) and (2), more than the just proportion to which, as between those parties themselves, the other co-surety, co-contractor or co-debtor is justly liable.

41 The right to contribution between co-guarantors is rooted in the principles of unjust enrichment.

42 Paragraph 10.131 of McGuiness, *The Law of Guarantee*, 3rd ed (Markham: LexisNexis, 2013) sets out "five general principles which govern the rights of contribution among co-sureties" which include:

> • All co-sureties are bound *prima facie* equally to see to the performance of a guaranteed obligation, and must therefore bear their respective share of any claim made by the creditor equally (or in the proportion as agreed among themselves);
>
> • The right to contribution to which the co-sureties in the case of any particular guaranteed obligation are entitled may be varied by express or implied agreement;
>
> • In the absence of any such agreement, the obligation of each co-surety is determined by dividing the total obligation to which all are liable by the number of solvent sureties;
>
> • The right of any particular co-surety to recover contribution arises upon payment by the surety of more than his share;
>
> • However, even prior to the payment of the creditor, a surety may seek equitable relief (similar to the relief that is available in the case of the surety's right to enforce his or her right of indemnification against the principal) . . .

There is no obligation on a surety who seeks contribution to sue all other co-sureties, but (except in the case of the insolvency of one of several co-sureties) the surety seeking contribution may recover from each of his co-sureties only an aliquot part of the total liability according to the number of sureties originally liable.

43 Since the defendants are alleging an agreement that any contribution to the Alberta Company's liabilities would be proportionate to the parties' shareholdings, they have the burden of proof on this issue.

> See: *Toppi v. Lavin*, [2013] NSWSC 1361 (New South Wales S.C.) at para. 23.

3: Suitability for Summary Trial

44 A threshold issue in my view is whether there is an agreement, an express provision, or "necessary inference" between the parties in this proceeding that would displace the general principle that all the parties "should contribute equally towards the satisfaction of the guaranteed debt or obligation irrespective of whether the co-sureties are bound by the same agreement or separate agreements" (*Rant v. Ward* (1998), 38 B.L.R. (2d) 82 (B.C. S.C.) at para. 30). To put the issue another way, what is the "just proportion" the parties owe as between themselves.

45 The evidence relating to this question on this application consists of the following.

46 Mr. Hayre deposes in his affidavit #2 sworn June 26, 2018 that he "understood" that the benefits and liability each of the parties would receive or be responsible for would be commensurate to their proportionate share of the Alberta Company.

47 He refers to an agreement dated May 27, 2009 which is entitled "Claresholm Project Company Policies", which provides in part:

> 1364335 Alberta Inc. and Jortani Homes Inc (Company) shareholders agree to the following: . . .
>
> 2. Management of funds and liabilities.
>
> > a) Company will maintain minimum contingency funds of $10000.00.
> >
> > b) Distribution of funds to the shareholders will be distributed based on the percentage ownership.
> >
> > c) All outstanding bills will be paid as per due dates and/or the understanding with the venders.
> >
> > d) Final decision as to distribution of the funds and as to direction of the company will be made by the majority shareholders . . .
>
> 4. Any policies that may not be covered in this agreement may be decided by majority shareholders.
>
> (the "Agreement")

48 He also deposes that:

> The parties operated the Alberta Company in accordance with the Agreement with each party only putting in money commensurate to their proportionate share in the Alberta Company when there were capital calls.

49 In brief affidavits sworn July 18, 2018 Gill and Grewal confirm, having reviewed Hayre's affidavits #2 and #3 that :

> and . . . Hayre has also explained the contents of those Affidavits to me and I believe the facts sworn in those Affidavits are true to the best of my knowledge and belief.

50 Hayre was examined for discovery on July 13, 2018 and was questioned regarding his affidavit #2. He agreed that the final distribution of funds would be decided by three of five shareholders without regard to their shareholdings. He also agreed that before he signed his guarantee in July 2009, there was no document created which addressed the issue of losses, if any, which may arise in the Alberta Company.

51 Shavinder Gill swore his affidavit #3 on July 12, 2018, that is after Hayre swore affidavit #2 and before the Gill and Grewal affidavits sworn July 18, 2018. He does not state that he had reviewed Hayre #2 nor does he dispute the assertions in that affidavit regarding the alleged "Agreement".

52 The plaintiff was, however, examined for discovery on July 12, 2018. At that time he said he had "no idea" if the money contributed to the Alberta Company was proportionate to the respective shareholdings. Hayre, as I have noted, has sworn that it was.

53 He also agreed that the Alberta Company did not have any cash or funds at hand and that when funds were required, they were injected into the company by the shareholders based on their interest in the company. This included the contingency fund of $10,000 referred to in the Agreement and payments made pursuant to the Mortgage.

54 He also confirmed Hayre's evidence that at the time the Alberta Company was formed, there was no discussion between the parties regarding potential losses, just benefits or distribution of funds. That is because the parties were only thinking positively about the Alberta Company during this timeframe.

55 Whether judgment should be granted at a summary trial is necessarily highly contextual. See *Peng v. Wang*, 2018 BCSC 1231 (B.C. S.C.) at paras. 25-28.

56 I have concluded that it is not possible on the evidentiary record for me to find the facts necessary to decide the issues of fact or law on this application, in particular as to the existence or otherwise of an agreement that losses between the parties would be allocated in accordance with their proportionate shareholdings in the Alberta Company. I am also of the view that it would be unjust to decide this threshold issue/defence on the record as it currently exists.

57 My reasons include the following. First of all, I will not repeat in these reasons the basic principles regarding the enforceability of contracts which are summarized in *Berthin v. Berthin*, 2016 BCCA 104 (B.C. C.A.) at paras. 46-49, but it is not possible for me to determine at this stage whether an enforceable agreement as alleged by the defendants existed between the parties.

58 This issue cannot be resolved by accepting the plaintiff's submission which is essentially to the effect that the defendants have the burden of establishing an enforceable agreement and they have failed to satisfy it. That is because there is evidence from both the plaintiff and the defendants to which I have referred from which an agreement, as alleged, could, but not necessarily should, be found.

59 Secondly, conduct of the parties both before and after an alleged contract is made can be considered to assist in determining whether an enforceable agreement was reached. See: *Harry Froese Inc. v. 273134 B.C. Ltd.*, 2018 BCSC 649 (B.C. S.C.) at para. 83.

60 Viewed within this context, it would also be unfair to both the plaintiff and the defendants if I were to decide this issue, since one of the avenues available would be to find an agreement as alleged based on the conduct of the parties. But this conclusion should not be reached without a more complete examination of the plaintiff and the defendants.

61 Simply put, I am not satisfied that any of the parties have "put their best foot forward". See: *Player Estate v. Janssen-Ortho Inc.*, 2014 BCSC 1122 (B.C. S.C.).

62 I consider the examinations which have occurred to date to be incomplete such that this issue cannot be decided summarily at this stage. There is, for example, no evidence regarding what the parties did or discussed as between themselves, when potential losses should have become apparent and/or when the project failed and demands were made of them on their guarantees.

63 It may be that the evidence of all the parties needs to be given *viva voce* with cross-examination before the court can properly decide this question of the existence of an agreement as alleged. I would add that the plaintiff, or the defendants for that matter, should not be precluded from seeking to have the proceeding heard summarily if and when further examinations take place.

IV: CONCLUSION

64 The application is dismissed with liberty to the parties to reapply for judgment on the claim generally or in relation to a specific issue upon completion of further examinations for discovery and/or cross-examination on affidavits.

65 The plaintiff is granted leave to cross-examine the defendants on the affidavits they have sworn in this proceeding.

66 The defendants are granted leave to further examine the plaintiff for discovery on the question of the agreement as alleged on this application.

67 Although the plaintiff was unsuccessful, costs of the application, under the circumstances, are in the cause at Scale B.

Application dismissed.

2008 BCCA 29
British Columbia Court of Appeal

Abakhan v. Halpen

2008 CarswellBC 110, 2008 BCCA 29, [2008] 7 W.W.R. 510, [2008] B.C.W.L.D. 1448, [2008] B.C.W.L.D. 1550, [2008] B.C.W.L.D. 1551, [2008] B.C.W.L.D. 1552, 165 A.C.W.S. (3d) 499, 250 B.C.A.C. 277, 39 B.L.R. (4th) 1, 40 C.B.R. (5th) 159, 416 W.A.C. 277, 76 B.C.L.R. (4th) 267

George Abakhan (Appellant / Respondent on Cross Appeal / Plaintiff) and Michael Halpen and Dwayne Diehl (Respondents / Appellants on Cross Appeal / Defendants)

Finch C.J.B.C., Hall, Saunders JJ.A.

Heard: October 16, 2007
Judgment: January 23, 2008
Docket: Vancouver CA034664

Proceedings: varying *Abakhan v. Halpen* (2006), 2006 CarswellBC 3323, 2006 BCSC 1979, 29 C.B.R. (5th) 50, 26 B.L.R. (4th) 1 (B.C. S.C.)

Counsel: K. Wedel for Appellant
D.J. Barker for Respondents

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

Headnote

Guarantee and indemnity --- Guarantee — Contract of guarantee — Contribution between co-sureties — Proportion of liability
Plaintiff and defendants were co-guarantors of debt of company and its subsidiaries ("principal debtors") — Company assigned into bankruptcy — Bank issued demands to co-guarantors — Defendants refused pay bank — Plaintiff agreed to pay $225,000 to bank to settle its claim against him and later purchased assignment of remaining principal debt ("remnant debt") and security held by bank, including guarantees — Plaintiff brought action against defendants to recover contribution to payment on guarantee and remnant debt — Plaintiff successfully applied for summary judgment — Judge ordered each defendant to pay plaintiff half of difference between total amount plaintiff paid to bank and plaintiff's proportionate share of original debt — Judge declined plaintiff's claim on remnant debt except to extent of including sum plaintiff paid as consideration for assignment in calculation of amount paid to bank — Plaintiff appealed, seeking full amount of remnant debt — Defendant cross-appealed — Appeal allowed in part; cross-appeal dismissed — Appeal allowed to extent of substituting order against defendants in sum of one-third of $233,000 — Judge was correct in concluding that settlement with bank did not alter nature of relationship between co-guarantors, but incorrect in concluding that defendants remained vulnerable to call on remnant debt from third party — Arrangement between creditor bank and plaintiff did not alter relationship between co-guarantors — Plaintiff had to act in interests of all guarantors in relation to assigned debt instruments and therefore could not reassign them to prejudice of co-guarantors — Advantage plaintiff secured by settlement and assignment was gained for all three — Plaintiff had determined maximum amount for which co-guarantors would be liable to creditor, had paid that amount himself, and was entitled to judgment from each defendant for one-third of that amount.

Guarantee and indemnity --- Guarantee — Assignment of guarantee
Plaintiff and defendants were co-guarantors of debt of company and its subsidiaries ("principal debtors") —

Company assigned into bankruptcy — Bank issued demands to co-guarantors — Defendants refused pay bank — Plaintiff agreed to pay $225,000 to bank to settle its claim against him and later purchased assignment of remaining principal debt (”remnant debt”) and security held by bank, including guarantees — Plaintiff brought action against defendants to recover contribution to payment on guarantee and remnant debt — Plaintiff successfully applied for summary judgment — Judge ordered each defendant to pay plaintiff half of difference between total amount plaintiff paid to bank and plaintiff’s proportionate share of original debt — Judge declined plaintiff’s claim on remnant debt except to extent of including sum plaintiff paid as consideration for assignment in calculation of amount paid to bank — Plaintiff appealed seeking full amount of remnant debt — Defendant cross-appealed — Appeal allowed in part; cross-appeal dismissed — Appeal allowed to extent of substituting order against defendants in amount of one-third of $233,000 plus interest — Judge was correct in concluding that settlement with bank did not alter nature of relationship between co-guarantors, but incorrect in concluding that defendants remained vulnerable to call on remnant debt from third party — Plaintiff’s submission that temporal order in which he first settled bank’s claim against him and then took assignment of debts made him creditor of defendants was contrary to weight of authorities and premise of right of contribution — Arrangement between creditor and plaintiff did not alter relationship between co-guarantors — Plaintiff was not able to seek from his co-guarantors more than their proportionate share of monies he paid to corral debt debt from bank.

Guarantee and indemnity --- Guarantee — Contract of guarantee — Amount recoverable
Plaintiff and defendants were co-guarantors of debt of company and its subsidiaries (”principal debtors”) — Company assigned into bankruptcy — Bank issued demands to co-guarantors — Defendants refused pay bank — Plaintiff agreed to pay $225,000 to bank to settle its claim against him and later purchased assignment of remaining principal debt (”remnant debt”) and security held by bank, including guarantees — Plaintiff brought action against defendants to recover contribution to payment on guarantee and remnant debt — Plaintiff successfully applied for summary judgment — Judge ordered each defendant to pay plaintiff half of difference between total amount plaintiff paid to bank and plaintiff’s proportionate share of original debt — Judge declined plaintiff’s claim on remnant debt except to extent of including sum plaintiff paid as consideration for assignment in calculation of amount paid to bank — Plaintiff appealed seeking full amount of remnant debt — Defendant cross-appealed, alleging that trial judge erred in finding that plaintiff had actually paid $225,000 to bank on guarantee — Appeal allowed; cross-appeal dismissed — It was open to trial judge to find that debt of principal debtors was reduced by amount of $225,000 — Manner in which this was done was matter between bank and plaintiff — Significant aspect was bank’s acknowledgement that debt guaranteed by defendants was reduced by $225,000 and that plaintiff was source of that reduction — There was no basis to interfere with trial judge’s conclusion in this regard.

Table of Authorities

Cases considered by *Saunders J.A.*:

Fowler v. Strickland (1871), 107 Mass. 552 (U.S. Mass.) — considered

Housen v. Nikolaisen (2002), 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, 286 N.R. 1, [2002] 7 W.W.R. 1, 2002 CarswellSask 178, 2002 CarswellSask 179, 2002 SCC 33, 30 M.P.L.R. (3d) 1, 219 Sask. R. 1, 272 W.A.C. 1, [2002] 2 S.C.R. 235 (S.C.C.) — referred to

Manuel v. Hicks Iron Works (1932), 216 Cal. 459, 14 P.2d 756 (U.S. Cal. Sup. Ct.) — considered

Merchants Discount Corp. v. Federal Street Corp. (1938), 300 Mass. 167, 14 N.E.2d 155, 118 A.L.R. 412 (U.S. Mass. Sup. Jud. Ct.) — followed

North American Leasing Ltd. v. Federal Business Development Bank (1989), 37 B.C.L.R. (2d) 216, [1989] 5 W.W.R. 113, 74 C.B.R. (N.S.) 255, 58 D.L.R. (4th) 505, 1989 CarswellBC 349 (B.C. C.A.) — distinguished

Quinn v. Leathem (1901), 70 L.J.P.C. 76, [1901] A.C. 495, 50 W.R. 139, [1900-03] All E.R. Rep. 1 (U.K.

H.L.) — considered

Reed v. Norris (1837), 40 E.R. 678 (Eng. Ch. Div.) — referred to

Statutes considered:

Law and Equity Act, R.S.B.C. 1996, c. 253
s. 34 — considered

s. 34(3) — referred to

APPEAL by plaintiff from judgment reported at *Abakhan v. Halpen* (2006), 2006 CarswellBC 3323, 2006 BCSC 1979, 29 C.B.R. (5th) 50, 26 B.L.R. (4th) 1 (B.C. S.C.), regarding contribution from co-guarantors and recovery of assigned debt; CROSS-APPEAL by defendants regarding sum paid by plaintiff on guarantee.

***Saunders J.A.*:**

1 This appeal concerns the obligations of co-guarantors. The appellant Mr. Abakhan commenced this action against his two co-guarantors, the respondents Mr. Halpen and Mr. Diehl, to recover two sums. The first sum is an amount in contribution to monies Mr. Abakhan said he paid on his guarantee to reduce the debt owing to the creditor bank by the principal debtors. The second sum is the amount of the remnant debt he says he is owed as an assignee of the debt and security the bank held relating to the debt.

2 In his reasons for judgment (2006 BCSC 1979 (B.C. S.C.)) the learned trial judge ordered each respondent to pay Mr. Abakhan one-half the difference between the total amount paid by Mr. Abakhan to the bank and Mr. Abakhan's proportionate share of the original debt. By the order, the trial judge declined Mr. Abakhan's claim on the remnant debt except to the extent of including in his calculation of the total amount paid by Mr. Abakhan to the bank the modest sum he paid as consideration for the assignment.

3 Mr. Abakhan appeals, saying he is entitled to recover from the respondents the entire amount of the remnant debt, in addition to the amounts ordered by the trial judge as contribution to the monies he paid on the guarantee. The respondents cross appeal, saying that the trial judge erred in finding that Mr. Abakhan had actually paid a sum of $225,000 to the bank on his guarantee.

4 The claims arise from financial arrangements between three companies and the Bank of Nova Scotia. Mr. Abakhan, Mr. Halpen and Mr. Diehl guaranteed the debts of the companies to the bank by joint and several guarantees.

5 Monies became owing by the companies to the Bank such that, in 2002, the Bank issued demands upon the companies. This demand was followed in October 2003 by demands upon each of the co-guarantors for principal and interest owing by the companies, then in the amount of $309,568.63.

6 Mr. Halpen and Mr. Diehl made no payment to the Bank in response to the demands. In June 2004, Mr. Abakhan made an arrangement with the Bank settling its claim against him for $225,000. The Bank reflected a payment of that amount in a spreadsheet showing a credit of that amount to the debts of the three companies. The payment was financed by an agreement between the Bank and Mr. Abakhan that he would pay 11 equal annual payments. Six months after this arrangement was concluded, Mr. Abakhan paid the Bank $8,000 in exchange for an assignment of the debt and the security held by the bank relating to the debt, including the promissory notes and all the guarantees of the three co-guarantors. The amount of the remnant debt owing to the Bank at that time was $82,307.55.

7 In the action Mr. Abakhan claimed for contribution to the $225,000 he said had been paid on the companies' debt, as well as the amount of the remnant debt, $82,307.55, plus interest. In defence, the

respondents Mr. Halpen and Mr. Diehl denied that Mr. Abakhan had paid $225,000 on account of the debts, saying that because Mr. Abakhan had agreed with the Bank to pay on a schedule of 11 equal annual payments, they were not obliged to contribute to him monies he was not yet out of pocket. Second, they contended that Mr. Abakhan was not able to collect the remnant debt from them because their exposure to Mr. Abakhan was limited by s. 34 of the *Law and Equity Act*, R.S.B.C., 1996, c. 253 to contribution to amounts that Mr. Abakhan had paid out as a guarantor over and above his proportionate share of the debt.

8 The trial judge found that Mr. Abakhan had paid $225,000 of the companies' debt and, joining that payment to the consideration for the assignment, held that the amount paid by Mr. Abakhan on account of the debt was $233,000. Referring to s. 34(3) of the *Law and Equity Act*, he concluded that the right to contribution related only to the payments over and above Mr. Abakhan's proportionate share of the debt. Thus he subtracted $103,189.54 (one-third of the amount of debt demanded of them by the Bank), from the amount paid by Mr. Abakhan ($233,000), divided the balance equally and ordered Mr. Halpen and Mr. Diehl to each pay Mr. Abakhan $64,905 in contribution. Further, he held that Mr. Abakhan was not entitled to judgment on the assignment of the remnant debt because s. 34 of the *Law and Equity Act* denied him recovery based upon an assignment.

9 In this appeal, Mr. Abakhan challenges the treatment of the remnant debt. He says that the amount of $8,000 that he paid as consideration for the assignment was not payment under the guarantee, and rather should redound to his benefit through a judgment in his favour against Mr. Halpen and Mr. Diehl for the amount of the remnant debt, in addition to the judgment against them for contribution (based upon the amount of $225,000 he paid on the guarantee). If successful, and ignoring interest, Mr. Abakhan will obtain judgment against each of Mr. Halpen and Mr. Diehl for $60,905 as contribution to his payment under the guarantee ($225,000 - $103,189 ÷ 2), and judgment against each of them on the remnant debt for $41,154 ($82,307.55 ÷ 2), for total recovery by him of $204,118. Considering that he paid $233,000, this would put Mr. Abakhan out of pocket approximately $29,000 in respect to the transactions in issue, and Mr. Halpen and Mr. Diehl each out of pocket about $102,000.

10 By cross-appeal, Mr. Halpen and Mr. Diehl challenge the characterization of the $225,000 transaction, saying the companies' debts have not been reduced except by such annual payments as have actually been made.

The Appeal

11 Mr. Abakhan contends that the trial judge erred in his analysis and application of s. 34(3) of the *Law and Equity Act*, and so erred in failing to recognize the separate and unrelated nature of his claim under the assignment of the remnant debt.

12 Section 34 of the *Law and Equity Act* provides:

> 34(1) Every person who, being surety for the debt or duty of another or being liable with another for any debt or duty, pays the debt or performs the duty is entitled to have assigned to him or her or to a trustee for him or her every judgment, specialty or other security that is held by the creditor in respect of the debt or duty, whether the judgment, specialty or other security is or is not deemed at law to have been satisfied by the payment of the debt or performance of the duty.
>
> (2) The person who has paid the debt or performed the duty is entitled to stand in the place of the creditor and to use all the remedies and, if necessary and on a proper indemnity, to use the name of the creditor in any action or other proceeding at law or in equity, in order to obtain from the principal debtor, or a co-surety, co-contractor or co-debtor indemnification for the advances made and loss sustained by the person, and the payment or performance made by the surety is not pleadable in bar of any action or other proceeding by him or her.
>
> (3) A co-surety, co-contractor or co-debtor is not entitled to recover from any other co-surety,

> co-contractor or co-debtor, by the means referred to in subsections (1) and (2), more than the just proportion to which, as between those parties themselves, the other co-surety, co-contractor or co-debtor is justly liable.
>
> [Emphasis added.]

13 In his reasons for judgment the trial judge held that Mr. Abakhan had paid $225,000 on the guarantee and that the two amounts paid by him should be viewed as a global payment:

> [21] In my view, it would be an error to regard the plaintiff's payment towards the principal debt of $225,000 on June 16, 2004, and his payment of $8,000 for an assignment of the Bank of Nova Scotia position as against the principal debtors and the guarantors on December 15, 2004, as separate transactions. On the basis of the evidence before me, I conclude that the plaintiff's payment of $225,000 on June 16, 2004, represents an actual payment of that sum which had the effect of reducing the principal debt by that amount.

14 The judge then addressed the effect of the assignment upon Mr. Abakhan's relationship to his other two co-guarantors:

> [24] On the issue of the effect of the assignment, I am not satisfied that by purchasing an assignment of the outstanding principal debt six months after negotiating a settlement of his own liability to the bank for the principal debt takes the plaintiff outside the scope of s. 34. What was at issue in *North American v. F.B.D.B.* [(1989), 58 D.L.R. (4th) 505 (B.C.C.A.)], the decision relied on by the plaintiff, was whether a creditor of the principal debtor could improve its position by taking an assignment from another creditor which had priority even though the creditor taking the assignment was, as well, a guarantor of some of the principal debtor's liability. In holding that s. 30 did not apply and the plaintiff was not limited to recovering from Sleeping Giant only what it paid on the principal debt ($60,000), but could recover consistent with the assigned priority agreement between FBDB and BCDC 60 percent of its payment of $205,000 from Sleeping Giant for Sleeping Giant's assets, the Court of Appeal ruled, in effect, the plaintiff was not pursuing indemnification, but was pursuing recovery of its shareholders loan to Sleeping Giant.
>
> [25] In the present case, the plaintiff's relationship with the principal debtors was as a guarantor, not a creditor, and his relationship with the defendants was a co-guarantor even after he settled his liability to the bank. At all material times, he retained the right of a co-guarantor to seek contribution from the defendants for any amount he paid in excess of his proportionate share and to recover against the principal debtors. This case, therefore, does not follow the exception identified in the *North American Leasing* decision in which it was not established the plaintiff entered the transaction as a guarantor because he was entering it as a creditor. Although the plaintiff argues that since he had been released by the bank in June of 2004 and therefore was no longer a "guarantor vis-à-vis the bank," in my view, that does not alter his status as a co-guarantor within the meaning of s. 34. Section 34 is clearly concerned with protecting a co-guarantor against being liable to pay another co-guarantor "more than the just proportion to which, as between those parties themselves," the former guarantor "is justly liable."
>
> [26] In his second amended statement of claim dated October 16, 2006, the plaintiff specifically relied on s. 34(3) of the *Law and Equity Act* in seeking a contribution from the defendants in relation to his payment of $225,000 against the principal debt. It is not the plaintiff's position vis-à-vis the creditor which determines his status under s. 34(3). It is his status vis-à-vis his co-guarantors. In the present case, his status brings him squarely within s. 34 which limits his right to a contribution from the defendants in keeping with that section.
>
> [Emphasis added.]

15 Having rejected the claim for the remnant debt, the judge then addressed the amount of contribution to

which Mr. Abakhan was entitled:

> [29] The question as I see it is in relation to in what amount are the proportionate shares of the co-guarantors to be determined. Is it the sum of $309,568.63, which was outstanding when the plaintiff reduced the debt by $225,000 on June 16th, 2004, or is it the sum of $233,000, which the plaintiff has paid in total after paying $8,000 on December 15th, 2004, for an assignment of the debt and the security documents including the guarantees? As I have determined that the plaintiff cannot enforce the assigned debt against the co-guarantors beyond the limits imposed by s. 34(3), could the defendants ever be called upon to pay more than their proportionate share of $233,000? If not, then their respective contributions should be based on a one-third share of that amount. If so, then it should be based on a one-half share of the amount by which the plaintiff's contribution exceeded his proportionate share of the principal debt.
>
> [30] In my view, this is not a case where the debt has been extinguished. What has happened is that the plaintiff has settled his liability by paying $225,000 down on the debt, and has purchased an assignment of the balance of the debt remaining. <u>The fact that s. 34(3) prevents him from pursuing the defendants for the full value of the remaining debt does not mean that the defendants could never be called upon to pay that amount if the plaintiff assigns it to some third party</u>. In my view, therefore, the appropriate disposition is to order that the defendants each pay to the plaintiff $64,905 representing one half of the difference between what the plaintiff paid to reduce the debt ($233,000) and his proportionate share of the original debt, of $309,568.63 ($103,189.54), being the sum of $129,810.46.
>
> [Emphasis added.]

16 Two questions are entwined in the appeal: the nature of the relationship between Mr. Abakhan and his two co-guarantors, Mr. Halpen and Mr. Diehl, after Mr. Abakhan settled with the Bank and subsequently acquired the assignment; and the potential liability of the co-guarantors to a subsequent assignee of the remnant debt.

17 For the reasons that follow, I conclude respectfully that the trial judge was correct in concluding that the settlement with the Bank did not alter the nature of the relationship between the then co-guarantors, but incorrect in concluding that Mr. Halpen and Mr. Diehl remain vulnerable to a call on the remnant debt from a third party.

18 Both of these conclusions derive from the essential character of the original relationship between the parties, a character first laid out in very old authority which has not been altered by recent jurisprudence.

19 A guarantee establishes a relationship of principal and surety between the original debtor and the guarantor. The terms guarantor and surety may be used interchangeably. The word surety is used in s. 34(3) of the *Law and Equity Act* replicated above, the reasons for judgment of the trial judge, and the submissions of the parties refer in the main to the parties as co-guarantors. The distinction in terminology makes no difference.

20 The premise of Mr. Abakhan's submission is that the temporal sequence by which he first settled the Bank's claim against him and then took an assignment of the debt instruments made him a creditor of Mr. Halpen and Mr. Diehl. In my view, this submission is contrary to the weight of authority, the analysis of learned authors on the obligations of co-sureties, and the premise of the right of contribution. For example, Henry Anselm de Colyar, in his *A Treatise on the Law of Guarantees and of Principal and Surety*, 3rd ed. (London: Butterworths, 1897) observes at p. 341-42:

> The doctrine of contribution, as has been remarked before, originally was only a doctrine of the courts of equity, and, as an equitable doctrine, it is not founded *in contract*, but is the result of *general equity*, on the ground of equality of burden and benefit. This independent equity seems to arise from the co-sureties towards each other, *at the inception of the contract*, so that, each of them being supposed to be equally benefited by the credit given to the principal debtor, is bound to bear an equal share of the burden which is the consideration for such credit.

> [Emphasis in original.]

And, at p. 360, he observes as to the equal sharing of benefit:

> [S]ureties are not only entitled to contribution from each other for monies paid in discharge of their joint liabilities for the principal, but they are also entitled to the benefit of all securities which have been taken by any one of them to indemnify himself against such liabilities.
>
> [Emphasis added.]

21 More recently David G.M. Marks and Gabriel S. Moss, in *Rowlatt on the Law of Principal and Surety*, 4th ed. (London: Sweet & Maxwell, 1982) observed at p. 151:

> A surety's right to use securities given to the creditor by the principal is limited to the recoupment of the surety's indemnity against the principal. If the surety makes terms with the creditor and settles the debt for a lesser sum, and then obtains an assignment of the creditor's securities, he cannot recover more from the principal than he has actually paid [citing *Reed v. Norris* (1837), 6 L.J. Ch. 197 at 198, 2 My. & Cr. 361 at p. 374-376].

And at p. 152-3:

> Where a co-surety pays the debt, or more than his proportion of it, and the principal is insolvent, the co-surety is entitled to contribution from his fellow co-sureties to equalise the burden.
>
> . . . . .
>
> The underlying principle of equity is that the creditors' remedies against the co-sureties should be applied so as to apportion the burden rateably. If the remedies have been applied otherwise the court will correct the inequity as between the co-sureties.

22 Kevin P. McGuinness, in his *The Law of Guarantee*, 2nd ed. (Toronto: Carswell, 1996) addressed the enjoyment of a benefit obtained by a co-surety from the principal in respect to the debt, at p. 516:

> A surety who obtains a counter-security from the principal to which he may look for indemnification in the event that he is called upon to pay must hold that security for the benefit of all his co-sureties. By extension, the surety must bring into the hotch-pot for distribution among all co-sureties any amount which he receives from the realization of the security, even in cases where the surety entered into his commitment on the express understanding with the debtor that the security would be for his own exclusive benefit. The right to share in a security is that of the co-sureties and therefore is not liable to be defeated by any agreement between one of their number and the principal. This right is derived from the equitable principal that equality of treatment is equitable and that sureties should in general bear the burden of the guarantee in equal proportions, and also upon the principal that one co-surety must not withdraw something from the estate of the debtor for his exclusive benefit.
>
> [Emphasis added.]

23 While these passages do not address the precise circumstances before us, their general theme is to the effect that one surety may not act to the disadvantage of an equitable sharing of the debt as between the sureties and, where, as here, guarantees of all three co-guarantors are assigned to one guarantor, the two non-holding guarantors are entitled to share the benefit of all the security.

24 It is said on behalf of Mr. Abakhan that the assignment of the debt permits him to enforce the debt as a creditor. I do not agree. Whatever arrangement was made between the creditor and Mr. Abakhan did not alter the relationship between the co-guarantors. The legal expectation when the guarantees were given was that the burden of the debt guaranteed would be equalized. As I have explained above, in the event Mr. Abakhan obtains

judgment for the amount of the remnant debt, that burden would not be equal — Mr. Abakhan would be out of pocket significantly less than either Mr. Halpen or Mr. Diehl.

25 The case of *North American Leasing Ltd. v. Federal Business Development Bank* (1989), 58 D.L.R. (4th) 505, 37 B.C.L.R. (2d) 216 (B.C. C.A.), referred to in the passage from the reasons for judgment replicated above, is relied upon by Mr. Abakhan as establishing his entitlement to judgment on the assignment. But *North American Leasing* was a different case. In *North American Leasing* a creditor became a co-guarantor, and then improved its position as a creditor. The case concerned a contest between creditors and not co-guarantors, and is simply an example of a case in which a creditor successfully improved its position as a creditor. The words of Lord Halsbury in *Quinn v. Leathem*, [1901] A.C. 495 (U.K. H.L.), at 506 are apt: ". . . a case is only an authority for what it actually decides".

26 It is said for Mr. Abakhan that American jurisprudence favours his claim, particularly *Fowler v. Strickland*, 107 Mass. 552 (U.S. Mass. 1871) and *Manuel v. Hicks Iron Works*, 216 Cal. 459, 14 P.2d 756 (U.S. Cal. Sup. Ct. 1932). In *Fowler* the plaintiff payee of a note, endorsed the note and then permitted the payor to negotiate it with a third party for its full amount. Upon learning that the payor would not be able to meet the note at maturity, the plaintiff purchased the note from the third party creditor for a reduced value and successfully sued the payor of the note for its face value. In my view, *Fowler* is unlike the circumstances before us as it does not concern competing claims in equity of co-guarantors or their relationship. In *Manuel* a co-guarantor purchased the promissory note establishing the debt, as well as the guarantee. He then sued the debtor and his co-guarantors, and obtained judgment against each of them (recognizing that he was obliged in that action to pay his proportionate share of the note). On the issue as to the applicable limitation period the co-guarantors argued unsuccessfully that the plaintiff's claim was as a guarantor for contribution, and not as a creditor. While *Manuel* on its face appears to support Mr. Abakhan in his submission that he was entitled to sue as an assignee, the case does not address the issue of equal sharing of the benefit of security obtained by a co-guarantor, and I would decline to follow it for the proposition advanced. I prefer instead the approach taken in *Merchants Discount Corp. v. Federal Street Corp.*, 300 Mass. 167, 14 N.E.2d 155 (U.S. Mass. Sup. Jud. Ct. 1938). In *Merchants Discount Corp.* the Supreme Judicial Court of Massachusetts held that a co-guarantor who acquired the guaranteed note upon part payment of the debt could not enforce the note against the co-guarantors for its full face value.

27 I draw two conclusions. First, Mr. Abakhan was bound to act in the interests of all guarantors in relation to the assigned debt instruments and therefore may not re-assign them to the prejudice of his co-guarantors. This means, contrary to the conclusion of the trial judge, that the advantage that Mr. Abakhan gained by the settlement and assignment of the debt and security was gained for all three. Second, Mr. Abakhan is not able to seek from his co-guarantors more than their proportionate share of the monies he paid to corral the debt from the Bank.

28 Just as the Court of Chancery in *Reed v. Norris* [(1837), 40 E.R. 678 (Eng. Ch. Div.)] held that a surety cannot settle with a creditor and, instead of treating the settlement as payment of the debt, treat it as an assignment of the whole debt to himself, Mr. Abakhan can not settle with the Bank, obtain an assignment of the remnant debt and enforce it against his co-guarantors.

29 I am bolstered in this conclusion by the mischief that may be worked against the principle of equal sharing of the burden of a guarantee by judgment on a remnant debt in circumstances similar to the ones here present. It is easy to conceive of a case in which the first co-guarantor to make payment to a bank may then acquire an assignment of the security instrument and, suing upon it, derive a substantial profit from the transaction. Such a result would offend the long standing principles that govern the relationship of co-guarantors.

30 The appeal was couched in terms of the application of s. 34 of the *Law and Equity Act*. Section 34 limits a guarantor's recovery to a proportionate share of the debt for which, as between the co-guarantors, they are justly liable. Here, by the time of the action, Mr. Abakhan had ensured that he would not be liable for the remnant debt, and had obtained an assignment in his favour. That is, by his action Mr. Abakhan had determined

the maximum amount for which the co-guarantors would be liable to the creditor, had paid that amount himself, and is entitled to a judgment from each of his co-guarantors for one-third that amount.

The Cross Appeal

31 In their cross appeal Mr. Halpen and Mr. Diehl contend that the trial judge erred in finding that Mr. Abakhan had paid $225,000 to the bank on account of the companies' debts.

32 The finding that is challenged is a finding of fact. As is well known, this Court may not interfere with a finding of fact except in limited circumstances: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (S.C.C.).

33 In my view, it was open to the trial judge, on the evidence, to find that the debt of the companies was reduced by the amount of $225,000. That this was done by a separate agreement with the Bank whereby Mr. Abakhan agreed to make 11 equal annual payments is a matter between Mr. Abakhan and the Bank. The significant aspect is the Bank's acknowledgement that the debt guaranteed by Mr. Halpen and Mr. Diehl was reduced by $225,000, and that Mr. Abakhan was the source of that reduction.

34 In summary, I see no basis upon which to interfere with the conclusion of the trial judge on this finding of fact.

Conclusion

35 For the reasons here stated, I would allow the appeal to the extent of setting aside the order and substituting for it an order for judgment in Mr. Abakhan's favour against each of the respondents in the amount of one-third of $233,000 plus interest. I would dismiss the cross appeal.

***Finch C.J.B.C.*:**
I agree.

***Hall J.A.*:**
I agree.

Appeal allowed in part; cross-appeal dismissed.

2016 ONSC 4453
Ontario Superior Court of Justice

Redstone Investment Corp. (Receiver of), Re

2016 CarswellOnt 15863, 2016 ONSC 4453, 271 A.C.W.S. (3d) 248, 40 C.B.R. (6th) 181

IN THE MATTER OF THE RECEIVER OF REDSTONE INVESTMENT CORPORATION AND REDSTONE CAPITAL COROPRATION

AND IN THE MATTER OF A MOTION PURSUANT TO SECTION 101 OF THE COURTS OF JUSTICE ACT, R.S.O. 1990, c. C.43, AS AMENDED

G.B. Morawetz J.

Judgment: October 5, 2016*
Docket: CV-14-10495-00CL

Counsel: Ian Aversa, Jeremy Nemers, for Grant Thornton Limited., in its capacity as Receiver and Manager of Redstone Investment Corporation, Redstone Capital Corporation and 1710814 Ontario Inc. o/a Redstone Management Services
Justin Fogarty, Pavle Masic, for RIC Investors
Grant Moffat, Kyla Mahar, for RCC Investors
Harvey Chaiton, Doug Bourassa, for RMS Investors

Subject: Insolvency

Headnote

Bankruptcy and insolvency --- Miscellaneous
Substantive consolidation — Court appointed receiver over three corporate entities, RI Co., RC Co. and 171 Inc. — Received assigned RI Co. and RC Co. into bankruptcy — RC Co. Investors had priority for any receivership funds over RI Co. Investors by virtue of agreement under which RC Co. was secured creditor of RI Co. — Receiver brought motion to determine whether estates of three companies should be substantively consolidated — Motion dismissed — Extraordinary remedy of substantive consolidation was not appropriate — Elements of consolidation were not present — Assets were held separately — Audited financial statements existed for RI Co. and RC Co. — Governing loan documents clearly set out that companies were separate and that obligations of RI Co. to RC Co. were subject to general security agreement — There was no unity of interest in ownership — Creditor's motivation for investing is not relevant to considerations set out in test for substantial consolidation — There would be significant financial prejudice to creditors of RC Co. if substantive consolidation were ordered.

Table of Authorities

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Bacic v. Millennium Educational & Research Charitable Foundation (2014), 2014 ONSC 5875, 2014 CarswellOnt 14545, 19 C.B.R. (6th) 286 (Ont. S.C.J.) — referred to

Baker & Getty Financial Services Inc., Re (1987), 78 B.R. 139 (U.S. Bankr. N.D. Ohio) — considered

Chemical Bank New York Trust Co. v. Kheel (1966), 369 F.2d 845 (U.S. C.A. 2nd Cir.) — considered

D'Addario v. Ernst & Young Inc. (2014), 2014 ABQB 474, 2014 CarswellAlta 1424, 18 C.B.R. (6th) 189, (sub nom. *Envision Engineering & Contracting Inc. (Bankrupt), Re)* 595 A.R. 153 (Alta. Q.B.) — considered

Eastgroup Properties v. Southern Motel Assoc., Ltd. (1991), 935 F.2d 245, Bankr. L. Rep. P 74, 055 (U.S. C.A. 11th Cir.) — referred to

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In re Auto-Train Corp., Inc. (1987), 810 F.2d 270, Bankr. L. Rep. P 71, 618 (U.S. Ct. App.) — considered

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Nortel Networks Corp., Re (2015), 2015 ONSC 2987, 2015 CarswellOnt 7072, 27 C.B.R. (6th) 175 (Ont. S.C.J. [Commercial List]) — referred to

Northland Properties Ltd., Re (1988), 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146, 1988 CarswellBC 531 (B.C. S.C.) — considered

Northland Properties Ltd., Re (1989), 34 B.C.L.R. (2d) 122, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* [1989] 3 W.W.R. 363, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 73 C.B.R. (N.S.) 195, 1989 CarswellBC 334 (B.C. C.A.) — considered

PSINET Ltd., Re (2002), 2002 CarswellOnt 1261, 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) — referred to

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Sampsell v. Imperial Paper & Color Corp. (1941), 313 U.S. 215 (U.S. Sup. Ct.) — considered

Snider Brothers Inc., Re (1982), 18 B.R. 230 (U.S. Mass.) — considered

Soviero v. Franklin National Bank of Long Island (1964), 328 F.2d 446 (U.S. C.A. 2nd Cir.) — considered

Statutes considered:

Bankruptcy Code, 11 U.S.C.
s. 105(a) — considered

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
s. 183(1) — considered

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

Personal Property Security Act, R.S.O. 1990, c. P.10
Generally — referred to

Words and phrases considered:

substantive consolidation

Under a substantive consolidation, a number of affiliated legal entities, typically corporations, are treated as if they were one entity, resulting in the assets of the various debtors being pooled to create a common fund out of which claims of creditors of all the debtors are jointly satisfied.

MOTION by receiver to determine whether three corporate entities should be substantively consolidated.

***G.B. Morawetz J.*:**

Introduction

1 This motion seeks a determination of whether the estates of three corporate entities — Redstone Investment Corporation ("RIC"), Redstone Capital Corporation ("RCC"), and 1710814 Ontario Inc. o/a Redstone Management Services ("RMS") — should be substantively consolidated.

2 The motion was brought by Grant Thornton Limited in its capacity as court-appointed receiver ("GTL" or the "Receiver") of the property, assets and undertakings of RIC, RCC, and RMS (collectively "Redstone").

3 To facilitate the determination of this issue, Newbould J. granted an order, which, among other things, appointed representative counsel ("RIC Representative Counsel") to represent the interests of parties who hold promissory notes issued by RIC (the "RIC Investors"), representative counsel ("RCC Representative Counsel") to represent the interests of all parties who hold bonds issued by RCC (the "RCC Investors"), and representative counsel ("RMS Representative Counsel") to represent the interests of all parties who invested money with RMS ("RMS Investors").

4 The order of Newbould J. provides that any RIC Investor, RCC Investor, and RMS Investor who is not represented by their respective Representative Counsel will nonetheless be bound by the decision made in respect of this motion.

5 In the absence of substantive consolidation of RIC, RCC, and RMS, the RCC Investors have priority for any receivership funds over the RIC Investors by virtue of an inter-corporate agreement under which RCC is a secured creditor of RIC.

6 The RIC and RMS Investors argue in favour of substantive consolidation; the RCC Investors oppose substantive consolidation; the Receiver put forward an independent legal opinion that it is unlikely substantive consolidation would be ordered in this case.

What is Substantive Consolidation?

7 Under a substantive consolidation, a number of affiliated legal entities, typically corporations, are treated as if they were one entity, resulting in the assets of the various debtors being pooled to create a common fund out of which claims of creditors of all the debtors are jointly satisfied. See: Janis Sarra, *"Corporate Group Insolvencies: Seeing the Forest and the Trees"* (2008) 24 B.F.L.R. 63, at. p. 8.

8 The authority for substantive consolidation of bankrupt estates in Canada lies under the equitable jurisdiction of the Superior Court of Justice granted by s. 183(1) of the *Bankruptcy and Insolvency Act* ("BIA"). See:*A. & F. Baillargeon Express Inc. (Trustee of), Re* [1993] Q.J. No. 884 ("Baillargeon"), at para. 23); *Nortel Networks Corp., Re*, 2015 ONSC 2987 (Ont. S.C.J. [Commercial List]), at para. 216 and *Bacic v. Millennium Educational & Research Charitable Foundation*, 2014 ONSC 5875 (Ont. S.C.J.) .

Background

Procedural History

9 On March 24, 2014, RIC and RCC commenced proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"), with GTL appointed as Monitor.

10 On August 8, 2014, the CCAA proceedings were converted to receivership proceedings and GTL was appointed as Receiver of the property, assets and undertakings of RIC and RCC.

11 On August 12, 2014, the Receiver assigned RIC and RCC into bankruptcy. GTL was appointed trustee in bankruptcy of each estate.

12 On September 17, 2014, the receivership proceedings were expanded, on motion by the Receiver, to include RMS.

13 A *Mareva* injunction has been in place since April 4, 2014, restraining RMS and Mr. Edmond Chin-Ho So, the founder of the Redstone group of companies, from encumbering the assets of RMS (the "Mareva Order").

Redstone Incorporation and Ownership Structure

14 RMS was incorporated on September 19, 2006, and it is wholly-owned by Mr. So. RMS was used to process loans until the establishment of RIC. Starting March 14, 2012, RMS provided administrative services to RIC and RCC through a Management Services Agreement (the "MSA"). The services provided to RIC included seeking out borrowers, reviewing suitability for investment, carrying out due diligence, and maintaining a register of outstanding RIC Notes.

15 RIC was incorporated in Ontario on September 25, 2009, and is also extra-provincially registered in Alberta. RIC was wholly-owned by Mr. So until January 28, 2014, when he transferred 60% of the shares to Mr. Eric Hansen. RIC carried on business as a commercial lender to Canadian small to medium-sized businesses and entrepreneurs seeking capital on a short-term basis. Loans ranged from $250,000 to $2,000,000 and were payable within 30 days to one year. RIC financed its lending activities by way of a continuous offering of unsecured promissory notes ("RIC Notes") distributed under exemptions from the prospectus requirement.

16 RCC was incorporated on December 15, 2011, for the purpose of raising registered funds that would be transferred to RIC. RCC is owned 40% by Mr. So and 60% by Target Capital Inc. ("TCI"). RCC ownership was set up with TCI in voting control so that investments in RCC would qualify as a "deferred plan investment" under Canadian income tax legislation, making it eligible for registered savings plans.

17 RCC raised capital through a continuous offering of unsecured fixed rate bonds ("RCC Bonds") under the same exemptions from the prospectus requirement as the RIC Notes. RCC would then transfer the capital it obtained from investors to RIC so that RIC could use the amounts to fund new loans to third parties.

Leadership and Business Operations of Redstone

18 Mr. So created the Redstone group of companies with the aim of providing short-term high-interest loans to small and medium-sized Canadian companies. Borrowing clients came to RIC directly, through a referral, or from a bank or accounting firm. After conducting due diligence consisting of an assessment of their financial position and financing needs, loans would be arranged.

19 Mr. So is an experienced and educated participant in securities' markets. His formal education includes

completion of three and a half years of a Bachelor of Commerce program at the King's University in Alberta. Upon leaving university, he joined a boutique corporate finance firm, Harris Brown, where he started as a research analyst and ultimately moved into the role of Manager of Finance and Administration. Throughout his employment, he researched target companies, worked in debt lending, and liaised with clients looking for debt or equity financing.

20 Mr. So was the president and chief executive officer ("CEO") of RIC and RCC until January 28, 2014, when he resigned from these roles following his incarceration for unrelated criminal charges. At that time, Mr. Hansen — who had been a consultant providing marketing and investor relations to the Redstone companies since the summer of 2011 — became the sole director and officer of RIC and RCC, until his own resignation on August 8, 2014, when Redstone entered receivership.

21 RIC and RCC shared the same registered office, located at 101 Duncan Mill Road, Suite 400, Toronto, Ontario. Though it had another registered office, RMS used Duncan Mill Road as its principal address.

22 Mr. So had sole signing authority for transfers between the three Redstone entities, though he contends that Mr. Chris Shaule and Mr. Karim Habib, both of whom had acted under him as portfolio analysts for the Redstone companies under contract, did as well. Mr. Shaule was responsible for maintaining the books and records of RIC and RCC. Mr. So himself maintained the books and records of RMS.

23 Mr. Hansen, together with Mr. Shaule and Mr. Habib, engaged in a review of the Redstone companies' financial position starting January 2014. Various financial irregularities came to light, so the Redstone companies and GTL on March 17, 2014, with a view to potentially acting as a court-appointed monitor in a CCAA filing.

The RCC — RIC Loan Agreement and General Security Agreement

24 To facilitate the transfer of funds, RCC and RIC entered into a loan agreement dated January 23, 2012 (the "Loan Agreement"), which provided for a loan between $250,000 and $25,000,000 that would be drawn upon with RCC's pre-approval. The agreement was signed by Mr. So on behalf of both companies. RCC lent RIC approximately $14.5 million under the agreement.

25 As part of this lending arrangement, RIC granted RCC a security interest over all of its property via a General Security Agreement (the "GSA").

26 Mr. So explained on cross-examination that, though he now understands that RCC is the first-ranking secured creditor of RIC due to the GSA, he did not appreciate that the GSA would have this effect until Redstone commenced proceedings under the CCAA in March 2014. This is a point to which I will return later in these reasons.

27 On March 14, 2014, in anticipation of the CCAA proceedings, Mr. Hansen performed a search under the *Personal Property Security Act*, R.S.O. 1990, c. P.10 (the "PPSA") over each of RIC and RCC. The RIC search revealed that RIC had no secured creditors other than TD Bank. The RCC search showed a registration in favour of RIC. Mr. Hansen caused the discharge of the RIC entry against RCC and filed a registration against RIC in RCC's favour. This registration was made prior to the CCAA proceedings.

Redstone Offerings

The Subscription Process

28 RIC Notes and RCC Bonds were issued under a continuous offering made pursuant to exemptions from the prospectus requirement of securities legislation in British Columbia, Alberta, and Ontario. Both RIC and RCC obtained investors under Offering Memoranda ("OM") — documents provided to investors in exempt distributions that set out the business of the company, including liabilities and risk factors. Neither RIC nor

RCC are registered in any capacity with securities regulatory authorities.

29 As part of the subscription process, investors acknowledged receipt of the OM and were advised of the risky nature of the investment in the form of a Subscription Agreement delivered to RIC[1] or RCC,[2] depending on the product to which the investors subscribed (i.e., RIC Notes or RCC Bonds). The investors also provided a Representation Letter, in which the investor set out how they qualified for the exemption used to make the purchase. In addition, RCC Investors provided a specific release for TCI. The Subscription Agreement provides, among other information, that "the Subscriber has received and reviewed the Offering Memorandum" in connection with the purchase of the notes.

30 Each one of the RIC and RCC OM contain a section describing risk factors — "ITEM 8 — RISK FACTORS" — that includes the following statements, respectively:

The purchase of the [RIC Notes] offered hereby is suitable only for sophisticated investors of adequate financial means who can bear the risk of loss associated with an investment in the Company and who have no need for liquidity in this investment. Prospective investors should give careful consideration to the following risk factors in evaluating the merits and suitability of an investment in the Company. The following does not purport to be a comprehensive summary of all the risks associated with an investment in the Company. Rather, the following are only certain particular risks to which the Company is subject. Management urges prospective investors to discuss such risks and other potential risks in detail with their professional advisors prior to making an investment decision.	The purchase of [RCC Bonds] pursuant to this Offering should only be made after consulting with independent and qualified sources of investment and tax advice. Investment in the Bonds at this time is highly speculative. The Corporation's business involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. Purchasers of Bonds must rely on the ability, expertise, judgement [sic], discretion, integrity and good faith of the management of the Corporation. This Offering is suitable for investors who are willing to rely solely upon the management of the Corporation and who could afford a total loss of their investment.

The RIC Offerings

31 RIC issued seven OMs between 2010 and 2013 for the purpose of obtaining investments and one non-offering OM to amend a prior memorandum for deficient disclosure of the Loan Agreement.

32 The four OMs issued prior to the Loan Agreement advised that RIC may subsequently enter loans that could supersede the RIC Notes. These OMs state, "The [Notes] are unsecured, and as a result (i) are subordinate to any secured debt which the Company now has or may hereafter incur, and (ii) purchasers will have no direct recourse to the assets of the Company or any other collateral."

33 However, the April 2012 OM failed to disclose the Loan Agreement entered earlier that year as a material contract. The non-disclosure contravened the requirements for a distribution under the s. 2.9 OM exemption that had been used to make distributions in Alberta and British Columbia. This led the securities regulators of those two provinces to issue deficiency letters to RIC with respect to the April 2012 OM, as well as make cease trade orders.

34 RIC settled with the securities regulators by issuing a non-offering OM on August 30, 2012 (the "Rescission OM"), which included and disclosed the RCC Loan and gave RIC Investors who subscribed under distributions based on the April 2012 OM the opportunity to rescind their investments. One investor accepted the rescission offer and the investment was repaid. The correction brought RIC in compliance with the s. 2.9 requirements. The cease trade orders were revoked by both the Alberta and British Columbia securities commissions in October 2012.[3]

35 The amended April 2012 OM and the two subsequent OMs disclose the Loan Agreement and the GSA

under material contracts. They also outlined risks related to the notes, including that "[t]he present and after acquired personal property of the Company is secured in favour of RCC pursuant to the terms of the RCC Loan Agreement."

36 Since its inception, RIC has issued 925 notes raising $65,474,000. As of February 28, 2014, approximately $23,340,145 of this is outstanding to RIC Investors.

The RCC Offerings

37 RCC issued two OMs, one in 2012 and the other in 2013.[4] The Loan Agreement is discussed in both OMs: the 2012 OM indicates that RCC intends to enter a loan agreement with RIC and the 2013 OM indicates the agreement has been executed.

38 Both OMs include a summary of loan terms and advise of the risks pertaining to the loan. They indicate that the loan would "be secured by way of a General Security Agreement securing all present and after acquired personal property of RIC in favour of [RCC]." In terms of investment risk with respect to RIC, the OMs indicate that "[a] return on investment for a Subscriber under this Offering is dependent upon RIC's ability to meet its obligations of principal and interest pursuant to the RIC Loan." Further, the risks section explains that "[t]here is no assurance or guarantee that [RCC] will be repaid the RIC Loan in accordance with its terms, if at all, and any failure of RIC pursuant to its payment obligations will directly affect the ability of [RCC] to pay interest and redeem the Bonds."

39 The 2013 RCC OM appends the RIC OM issued March 1, 2013, and advises RCC Investors to review it as it details the risk factors that pertain to RIC's business.

40 Since its inception, RCC has issued 710 bonds raising $16,486,000. All of the bonds were issued after the Loan Agreement was executed. As of February 28, 2014, approximately $16,317,602 of this is outstanding to RCC Investors.

41 It is of note, though perhaps not of consequence, that the RIC and RCC OMs which reference the Loan Agreement misstate the minimum loan amount as $150,000, when the agreement actually provides that the minimum loan amount is $250,000.

Receivership: Redstone Assets and Claims

42 Each of RIC, RCC, and RMS maintained separate financial records and bank accounts. Transfers between the companies have been consistently recorded in their respective books. The Receiver undertook an examination of each company's assets.

43 The assets of RIC as of February 28, 2014, consist of its lending portfolio, which includes 35 accounts with loans totaling approximately $24,648,000. The loans are generally secured against the assets of the borrowers and personal guarantees from their respective shareholders. The sole material asset of RCC is its loan to RIC, which totals $14,260,116. According to the Receiver's investigation, RIC and RCC are owed $8,344,714 by RMS.[5]

44 The claims against each corporation and the Receiver's realizations for each estate as of June 2015 are as follows:

Entity	Claims accepted	Total claim amount	Estate amount
RIC	501	$23,434,146	$16,886,899
RCC	683	$15,849,360	$273,129
RMS	9	$9,854,219	$169,279

45 After disbursements, the Receiver holds $13,776,924. If the priority of RCC Investors is recognized, they

would recover approximately 86% of their claims, and the other investors would obtain minimal, if any, recovery. If the Redstone estates are consolidated and the funds divided equally, each investor would recover approximately 28% of their claim.

Law and Argument

46 The RIC and RMS Investors ask me to exercise my equitable discretion and substantively consolidate the estates. The RCC Investors oppose consolidation. Before turning to the parties' interpretation of the facts and their respective arguments, I provide a brief overview of the law surrounding substantive consolidation in Canada and the United States, followed by a description of each party's characterization of the key facts.

47 In determining the appropriateness of substantive consolidation, all counsel referenced *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affir'd *Northland Properties Ltd., Re*, [1989] B.C.J. No. 63 (B.C. C.A.), where the court stated that in determining whether to impose substantive consolidation, the court must balance the economic prejudice to the creditors resulting from continuing corporate separateness against the economic prejudice caused by consolidation. To establish that substantive consolidation is warranted, it must be shown that the "elements of consolidation" are present, and that the consolidation would prevent a harm or prejudice or would effect a benefit generally. The "elements of consolidation" adopted in *Northland* from United States case law were as follows:

(i) difficulty in segregating assets;

(ii) presence of consolidated financial statements;

(iii) profitability of consolidation at a single location;

(iv) co-mingling of assets and business functions;

(v) unity of interests in ownership;

(vi) existence of inter-corporate loan guarantees; and

(vii) transfer of assets without observing corporate formalities.

Substantive Consolidation in the United States: Three Approaches to Assessing What is Just and Equitable in the Circumstances

48 A brief overview is included to contextualize the approach Canadian courts have adopted thus far, given the relatively limited treatment of this concept in Canada, before addressing the parties' arguments on the application of substantive consolidation to their dispute.

49 In the United States, the determination is made under the courts' equitable jurisdiction, similar to Canada. American courts have taken divergent approaches that has led to the articulation of several tests, the first regarding retaining flexibility but recently indicating that orders should be limited to very specific circumstances.

50 The power of U.S. courts to order substantive consolidation is derived not from explicit statutory provisions but rather from the Bankruptcy Court's general powers in s. 105(a) of the *Bankruptcy Code* "to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the *Bankruptcy Code*]". Substantive consolidation has been recognized by the Supreme Court as a power under this section in *Sampsell v. Imperial Paper & Color Corp.*[6] Given its foundation upon an equitable basis, in determining whether to order substantive consolidation courts are guided by what is just and equitable in the circumstances. Three leading approaches led to the evolution of this determination.

First Approach: Three-Part Test

51 In *In re Auto-Train Corp., Inc.*,[7] the Court of Appeals for the District of Columbia Circuit moved away from relying on a list of factors to ascertain whether there has been an abuse of the corporate form and instead adopted a three-part test for determining whether or not to grant a substantive consolidation request:

> 1. Is there a substantial identity between the entities to be consolidated?[8]
>
> 2. Is consolidation necessary to avoid some harm or to realize some benefit?
>
> 3. If a creditor objects and demonstrates that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation, will the demonstrated benefits of consolidation heavily outweigh the harm to the objecting creditor?

Second Approach: Two-Part Test with a Focus on Reliance

52 In *In re Augie/Restivo Baking Co., Ltd.*,[9] the Court of Appeals for the Second Circuit departed from previous cases where determinations were made without regard for creditor reliance and were only based on corporate veil principles pertaining to respecting corporate separateness,[10] and instead set a two-part approach with a focus on reliance:

> 1. Have creditors dealt with the entities as a single economic unit rather than relying on their separate identities in extending credit?
>
> 2. Are the affairs of the debtors so entangled that consolidation will benefit all creditors?

Third Approach: Stricter Focus on Prepetition and Postpetition Consequences of Consolidation

53 In *In re Owens Corning*,[11] the Third Circuit elected to set out a stricter approach, rejecting *Auto-Train* as creating "a threshold not sufficiently egregious and too imprecise for easy measure" and disapproving of the checklist approach used in assessing corporate separateness, holding instead that substantive consolidation is appropriate only when an applicant proves either that:

> 1. Prepetition, the entities for whom consolidation is sought disregarded separateness so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or
>
> 2. Postpetition, their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.

54 Interestingly, all three approaches referenced above focus on the administrative costs of separating the entities with consequent detrimental effect on all creditors. In the case at bar, this is not a factor as the assets are held separately and the books and records, although they may not be pristine, are such that the Receiver can identify the creditors of each entity.

55 I now return to the investors' key positions on this issue in the context of Redstone's receivership.

Credibility, Relevance and Findings of Facts

RIC Investors

56 In support of their submission that consolidation is appropriate, counsel for the RIC Investors contends that the Redstone companies operated as a single entity that shared business functions, resources, personnel, and cash flow, and whose assets are intermingled due to inaccurate recordkeeping. RIC Representative Counsel further highlights the following facts:

• Redstone operates a centralized cash management system, with no protocol of any kind regarding the movement of monies between RCC, RIC or RMS — even though the companies have separate bank accounts, the funds flowed between entities to serve operational needs without having any rules, policies or regulations in place in respect of recording inter-company transfers;

• Evidence by Redstone staff that they saw no distinction between how funds were advanced between RCC and RIC or RMS and RIC, and that they treated the companies interchangeably;

• Redstone personnel discovered millions of dollars of unexplained transactions, bearing the hallmark of fraudulent activity;

• The Receiver discovered an error in the RCC accounting ledger — namely, RCC bond purchases between June and September 2012 totalling $713,722 that were not recorded in the RCC accounting ledger, but the funds from which were paid to RCC and then transferred to RIC — that renders unreliable the Receiver's assertion in its Fourth Report that "transfers between bank accounts were recorded in great detail in the books of records of each of RIC and RCC";

• According to the terms of the MSA, all expenses were to be borne by RMS, but in practice RIC generally held the bulk of cash and covered expenses incurred for the benefit of all three companies, such as fees for any market dealers involved in facilitating the sale of RIC Notes or RCC Bonds, accounting and legal fees or salaries for staff;

• Mr. So's evidence that only in 2013 were attempts made to improve recordkeeping within Redstone. Further, the records before late 2013 are not accurate and make it impossible to know the true inter-company balances;

• The RMS books were never subject to an audit, and though Mr. So employed "auditors" in respect of RIC and RCC, no evidence has been produced as to the quality or assurance level of the audits, nor are any reports or working notes included in the record;

• Mr. So's evidence that he viewed the companies as a single entity, which is how he represented them to investors, and he in fact intended, in late 2013, to amalgamate RIC and RCC and wind down RMS, as a part of which the RIC Notes and RCC Bonds would be exchanged for a new and identical security;

• The representations by Mr. So and Redstone personnel to the Exempt Market Dealers (EMD) who promoted Redstone products were that investments in each company would be treated equally. The marketing materials for RIC and RCC distributed to investors were virtually identical, both describing the same investment terms, interest rates, and risks, and both failing to reference any priority for RCC Investors;

• Evidence of investors that they were led to believe RIC, RCC and RMS were interchangeable, and most investors were never informed of the Loan Agreement and GSA.

RMS Investors

57 Counsel to RMS Investors supports the position of the RIC Investors. In particular, RMS points to evidence by RMS and RIC Investors that they were led to believe there was no distinction between RIC and RMS or RIC and RCC. Further, RMS notes that there is no evidence that the RCC Investors relied on their priority position in making their purchases. Counsel also points to the evidence of various Redstone investors

and others, who swore they made investments in Redstone and were led to believe that there was no distinction between RIC and RMS. Additionally, some of these investors swore that they were not told that RCC had a priority position and that they either did not receive an OM or only received one after the investments were made. Further, RMS Representative Counsel highlights the following evidence:

• Mr. Farouk Haji, whose affidavit detailed the process an Exempt Market Dealing Representative is required to follow prior to a client undertaking a new trade in an exempt market product, did not discuss whether he advised any clients of the priority position of RCC over RIC;

• There is no evidence from any RCC Investor that they relied on the priority position in making their investments;

• Ms. Cynthia Lewis' second investment in RIC, made in February 2011 in the amount of $540,000, was not treated in accordance with the OM in place at the time: she was first assigned RIC security against the ultimate borrower that was discharged in 2011 without her knowledge, and when her promissory note from RIC matured and rolled over in the February 16, 2012, after having already rolled over a number of times, the replacement note was issued by RMS rather than RIC but the language of the note nonetheless required interest payments from RIC. Ms. Lewis advises that Mr. So explained the rollover to RMS as due to RMS being for "friends and family";

• Mr. Chad MacDonald received a promissory note from RMS and RMS agreed to assign him a portion of the security it obtained from the ultimate borrower, Green Dot Finance Inc. However, the Green Dot loan, which formed the security for the investment and which appeared to be an asset of RIC, was sold for full face value to Maple Brook.

RCC Investors

58 RCC Representative Counsel contends that consolidation would unduly prejudice the RCC Investors' interests as this is not a case where corporate formalities were not maintained or the liabilities were not readily identifiable. They point to the following in support of this position:

• The creditor pools of RIC and RCC are different, the creditors invested in each entity based on distinct OMs prepared on a single-entity basis, and the creditors of each entity are identifiable;

• RIC, RCC and RMS each maintained separate bank accounts. The evidence available to the Receiver and its consultants indicated that Mr. So did not treat each of these as one bank account. Transfers between bank accounts were recorded with great detail in the books and records of RIC and RCC;

• On cross-examination, Mr. So's evidence was that he assumed inter-company transfers were recorded in the books of the respective corporations as either receivables or payables. In addition, he advised staff to make best efforts to ensure the transactions pertaining to an entity stay within that entity and be processed through the correct account. He also advised them to record inter-company transfers where necessary. It was his belief and/or hope that this was undertaken properly;

• The assets of each Redstone corporation are different and identifiable. RIC's assets as of February 28, 2014, consisted of its lending portfolio which included 35 accounts with loans totaling approximately $24.648 million. The loans were all secured against the assets of the underlying borrower, and typically were supported by personal guarantees from shareholders where the borrower was a corporation. RCC's sole material asset is the loan receivable from RIC, on a secured basis in the amount of $14,260,116. The assets of RMS are identified by Mr. So in his sworn affidavit as several loan receivables, office furniture and the like, which he valued at $4,706,510. The assets and liabilities of RMS have been the subject of a forensic review undertaken by GTL in its capacity as Monitor and Receiver;

• RIC and RCC had separate audited and unaudited financial statements and did not prepare consolidated financial statements. The most recent audited financial statements for RIC and RCC were dated August 31, 2012. RMS also maintained separate financial records;

• Note 6 of the audited and unaudited financial statements of RCC attached to the RCC 2013 OM states that the loan from RCC to RIC is secured by way of a GSA on all present and after-acquired property of RIC.

Mr. So's Evidence on Cross-Examination

59 As articulated above, counsel to RCC relies on the evidence of Mr. So to support its position. I have reviewed the affidavits and the transcript of Mr. So's cross-examination and have come to the conclusion that his evidence is unreliable and should be disregarded.

60 In many cases, the answers provided by Mr. So on cross-examination belie the fact that he is highly educated and very experienced in the financial field. Mr. So was asked about the inter-company transfers between each of RMS, RIC and RCC. Mr. So answered that when such inter-corporate transfers occur, there would be an appropriate entry, whether a receivable or payable, in the relevant books and records of those companies.

61 Mr. So was also asked about the Cease Trade Order that related to RCC and RIC. He was asked how the issue was resolved. Mr. So answered as follows:

> While Craig Betham took . . . you know, reformatted both OMs for us. And one of the things at that time was that . . . the original RCC OM was a separate OM that was created. Then, what the regulators wanted us to do, because these two companies are basically the same company, or related companies, they wanted us to do a wrapper, a wrap-around OM, so that the RIC OM had to be included in the RCC OM. That was done. Then, the second thing was we had to offer rights of rescission to all investors that invested in the previous OM, so that they had the proper information to decide if they were going to rescind or remain in the company. And then once those two things were done, we were restored back into good standing with the regulators.

62 In addition, Mr. So was asked whether he had certain friends and family who are RIC Investors. He answered in the affirmative. He also understood that if the RIC Investors were successful on this substantive consolidation initiative, it would be reflected in the ultimate distribution to the investors.

63 Mr. So was asked questions with respect to the GSA provided by RIC to RCC, executed January 23, 2012.

> Question 518: Can you tell me, in your own words, what you think this document purports to do?
>
> Answer: I remember that this was when we created Redstone Capital. It was what . . . I believe the lawyers, for Craig Skauge . . . I can't remember who at that time had told us that it was to be put in place in order to make RCC RSP eligible or something of that sort, that there had to be a securities agreement in place into RIC. But one of the things that I wanted to add, was that I had always spoken to him about, that this was, is in *pari passu* with all RIC Investors . . .
>
> Question 528: So it's your evidence today that starting from your years at Harris Brown and subsequently your years at Redstone, where your primary function was to lend money to entities to take security for those loans, that you did not understand what this general security agreement did?
>
> Answer: I understood that RCC was taking a GSA at RIC. Yes, I understood that.
>
> Question 529: So we'll start again. When you executed this document in January 2012.

> Answer: Yes.
>
> Question 530: [D]id you understand that the effect of this document would be to grant a security interest in and to RCC, with respect to RIC's assets?
>
> Answer: I understood that it would be granting a security interest. Yes I did . . .
>
> Question 531: Okay.
>
> Answer: My understanding . . . and which is why all marketing material, and the way that Redstone has always been presented to all investors and EMDss, was that everything was *pari passu*. The only difference between RCC and RIC was RCC was registered funds and RIC were non-registered.
>
> Question 532: I understand that, but I guess. I just want to make sure I understood what you're saying to me. We have established that you understand what a general security agreement is.
>
> Answer: Yes.
>
> Question 533: And what a general security agreement does? And the effect of a general security agreement.
>
> Answer: Yes.
>
> Question 534: And you agree that this document has the effect of a typical general security agreement?
>
> Answer: Yes.
>
> Question 535: And you agree that you have executed this document.
>
> Answer: Yes.
>
> Question 536: But you're telling me that you always had the impression that RIC and RCC would be treated on a *pari passu* basis. I have a hard time how that holds together.
>
> Answer: Well because that's what I had spoken to the lawyers about when we were creating the RCC OM and everything. That it was . . . everyone was always to be *pari passu*. And we were never told differently and that is. Mr. Hansen was even involved in that, when we were creating RCC. I never once told that RCC has a priority over RIC. . . .

64 The foregoing interchange establishes, in my view, that Mr. So's evidence is completely unreliable. It is inconceivable that an individual with a background education in commerce and finance, followed by a lengthy career in the financial industry, could make the statements that Mr. So did. He understands the effect of a GSA, which is that one party is granted security over its assets in favour of another party (the secured party). This is a fundamental and elementary financing concept. I fail to understand how Mr. So can appreciate the effect of a GSA in situations where a Redstone entity is lending money to a borrower, yet fail to understand the effects of the same type of agreement when granted by RIC in favour of RCC. It is impossible to reconcile these positions.

65 I find that Mr. So's attempt to explain this anomaly arose *ex post facto*. Mr. So arrived at his *pari passu* understanding not at the time of granting the security, but subsequent to the collapse of Redstone and the initiation of these proceedings in an attempt to justify that the three entities in question should be consolidated for distribution purposes. The fact that substantive consolidation, if granted, favours his family and friends, cannot be overlooked.

66 I am satisfied that Mr. So knew that RCC was created in order that it could attract eligible funds for

registered investors; that RIC was a separate entity from RCC; that RIC granted a security agreement in favour of RCC; and that the effect of granting such a security agreement resulted in RCC being a secured party holding a security interest in the assets of RIC and, therefore, having priority over RCC.

67 The evidence of Mr. So is replete with contradictions. I find his evidence to be unreliable in all respects, such that I have disregarded it in its entirety. Obviously, this finding is extremely detrimental to the position put forth by counsel on behalf of both RIC Investors and RMS Investors. RMS Investors, to the extent they rely on the evidence of Mr. So.

Investor State of Mind

68 Counsel for the RMS Investors also pointed to evidence of a number of RMS and RIC Investors who claimed they were led to believe that there was no distinction between RIC and RMS or RIC and RCC, and further that there was no evidence that RCC Investors relied on their priority position in making their purchases. In support of this argument, the RMS Investors highlighted the evidence of Cynthia Lewis, Chad MacDonald, Nick DeCesare, Robert Dodd, Dario Mirabella and Ronald Smithers. In my view, the evidence of these individuals carries little weight.

69 Their evidence has to be discounted because it is subjective evidence provided today about their state of mind and knowledge at the time they made the investment a number of years ago. Their evidence is also at odds with the language contained in the loan agreement and OMs. The evidence is suspect as these parties are aware that it is in their best financial interest to take the position that they were led to believe there was no distinction between RIC, RMS and RCC. Indeed, it would be surprising if they did not take such a position. Investors in RIC and RMS stand to receive nominal distribution unless there is substantive consolidation. This is in contrast to a projected distribution of 28% if there is substantive consolidation.

70 A review of the authorities also convinces me that their evidence is of very limited utility and is largely irrelevant. The “elements of consolidation” adopted from U.S. case law were referenced in *Northland*, supra. Absent from this list, and for good reason, is the knowledge or state of mind of the investor or creditor at the time that investments were made or credit was advanced.

71 In my view, a creditor’s motivation for investing is not relevant to any of the considerations set out in the test for substantial consolidation. I considered this issue in a preliminary motion, indexed as *Redstone Investment Corp., Re*, 2016 ONSC 513 (Ont. S.C.J.), at paras. 11 — 15:

> [11] RCC Representative Counsel submits that the evidence in the Bach Affidavit is relevant as it shows Mr. Bach’s motivation for investing in RCC and the actual prejudice he will suffer in the event of substantive consolidation.
>
> [12] The test for substantive consolidation was recently summarized in *Bacic v. Millennium Educational and Research Charitable Foundation*, 2014 ONSC 5875, 19 C.B.R. (6th) 286 at para 113.
>
> It requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:
>
> > a) Difficulty in segregating assets;
> >
> > b) Presence of consolidated Financial Statements;
> >
> > c) Profitability of consolidation at a single location;
> >
> > d) Commingling of assets and business functions;
> >
> > e) Unity of interests in ownerships;

> f) Existence of intercorporate loan guarantees; and,
>
> g) Transfer of assets without observance of corporate formalities.
>
> in order to assess the overall effect of the consolidation. (*Atlantic Yarns Inc., Re*, 2008 NBQB 144 (N.B. Q.B.); *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affirmed in *Northland Properties Ltd., Re* (1988), [1989] B.C.J. No. 63 (B.C. S.C.) and *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]).
>
> [13] In *PSINET*, *supra*, Farley J. held, at para. 11 that consolidation by its very nature will benefit some creditors and prejudice others and, as a result, it is appropriate to look at the overall general effect. This approach was affirmed in *Atlantic Yarns*, *supra*. In *J.P. Capital Corp.*, Re (1995), 31 CBR (3d) 102 (Ont. S.C.) Chadwick J. expressed concern about the consolidation of actions without knowing the effect it will have on all creditors. Chadwick J. wrote, “Although expediency is an appropriate consideration, it should not be done at the possible prejudice or at the expense of any particular creditor.” In considering the relevance of *JP Capital* to this matter, I note that the *J.P. Capital* involved an “extremely complex bankruptcy” touching on a number of companies and assets, the parties were in the midst of cross-examination, and there were issues raised with respect to the actual corporate structure of the various companies and the tracing of the assets in relationship to the parties (para.17).”
>
> [14] In my view, Mr. Bach’s motivation for investing in RCC is not relevant to any of the considerations set out in the test for substantive consolidation. As a result, in determining the overall general prejudice to both sets of creditors, it seems to me that if the evidence is not relevant, refusing leave cannot be prejudicial to Mr. Bach, as an individual creditor. The second part of the Rule 39.02(2) is not applicable as no cross-examination took place and since I have determined that the content of the affidavit is not relevant to the determination of the Substantive Consolidation Hearing, the fourth part of the test need not be considered.
>
> [15] Accordingly, since I have concluded that the Bach Affidavit does not meet the relevance criteria of the Rule 39.02(2) test, the motion seeking leave to deliver the Bach Affidavit as evidence in the Substantive Consolidation Hearing is dismissed.

72 There is a great danger to placing any weight on the state of mind of the investor or creditor in the substantive consolidation analysis. Human nature is such that individuals would be far more likely to recite or recall a fact situation, which, if acceptable, puts them in a better financial position. All that is required would be for the individual to take the position that a number of the RIC Investors and RMS Investors are taking in these proceedings, namely, that they did not know that RCC had priority. This presupposes that the investors did not read the governing documents. It presupposes that the EMDs either did not read the governing documents or did not advise the Investors of the contents of the governing documents.

73 To recognize state of mind would result in an unacceptable level of commercial uncertainty where written contracts could be overridden by parties who voluntarily choose not to read the governing documents.

74 Counsel acknowledges that the consolidation of bankrupt estates was recently authorized in *Bacic*, supra and *D’Addario v. Ernst & Young Inc.*, 2014 ABQB 474 (Alta. Q.B.). In both cases, the assets of the corporations, business functions and financial statements were all co-mingled. However, in deciding to consolidate the estates, the court in each decision explicitly noted that consolidation would not be to the prejudice or expense of a particular creditor. In particular, the court in *D’Addario* found that “no creditor would benefit from consolidation at the expense of any other”. That is clearly not so in this case. The projected distribution for RCC Investors would be reduced from 86% to 28%.

Legal Argument

75 Counsel to RMS Investors referenced the text of Dr. Janis Sarra, *Rescue: The Companies' Creditors Arrangement Act*, 2d ed (Toronto: Carswell, 2013), where the author explains the process to be followed in assessing whether to consolidate estates:

> Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are to be consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

76 Based on the jurisprudence canvassed above, there are two related streams of case law in Canada on the issue of substantive consolidation in either a restructuring or a bankruptcy situation: First, the *Northland* line of cases involving analysis of: (i) the elements of consolidation; and (ii) whether consolidation would prevent a harm or prejudice or would effect a benefit generally. Second, there is a more ad hoc approach involving fact-based analysis guided by the equities.

77 In this case, the essential effect of consolidation would be to avoid the priority arrangement purportedly created by the loan documents, resulting in moderate recoveries to the investors in each of the Redstone entities. Absent consolidation, RCC Investors will receive a projected 86% recovery. RCC Investors and RMS Investors would receive a nominal recovery at best.

78 The following general principles respecting the doctrine of substantive consolidation represent a summary of Canadian case law:

> (i) Are the elements of consolidation present, such as the intertwining of corporate functions and other commonalities across the group?
>
> (ii) Do the benefits of consolidation outweigh the prejudice to particular creditors?
>
> (iii) Is consolidation fair and reasonable in the circumstances?

79 Based on the foregoing — and knowing that the evidence of Mr. So carries no weight and that the evidence of the investors is of very limited import — the analysis of the *Northland* factors supports maintaining the status quo.

(i) Difficulty in Segregating Assets

80 The assets of each of RIC, RCC and RMS are easily identifiable, are not difficult to segregate, and have been segregated as is demonstrated by the Receiver's Statement of Receipts and Disbursements.

(ii) Presence of Consolidated Financial Statements

81 RIC, RCC and RMS did not prepare consolidated financial statements. All financial statements, audited and unaudited, were prepared on an entity-by-entity basis. The financial statements of RIC and RCC were audited. This factor supports maintaining the status quo.

(iii) Co-mingling of Assets and Business Functions

82 The only material asset of RCC is the secured inter-company receivable from RIC, which is not co-mingled with any assets of RIC or RMS. To the extent that any business functions were co-mingled, this can be explained by the MSA between RMS and RIC and the terms of the OMs that confirm that RIC was liable for

all costs incurred by RCC relating to RCC's Offering. As such, this factor supports maintaining the status quo.

(iv) Unity of Interests in Ownership

83 There is no unity of interest in ownership. RIC, RCC and RMS have different ownership structures. RIC is owned 60% by Mr. So and 40% by Mr. Hansen. RCC is owned 60% by TCI and 40% by Mr. So. RMS is wholly-owned by Mr. So.

(v) Existence of Inter-Corporate Loan Guarantees

84 There are no inter-corporate loan guarantees of any third party financing. This factor supports maintaining the status quo.

(vi) Transfer of Assets Without Observance of Corporate Formalities

85 While there is evidence of transfers of assets without observance of corporate formalities, the preponderance of evidence relates to transfers from RIC/RCC to RMS. Prior to the CCAA filing, it was determined that RMS received significant unauthorized cash transfers from RIC estimated to be approximately $8.5 million. The Receiver completed an investigation and prepared an analysis relating to the source and uses of funds relating to RMS. As a result of the analysis, the Receiver determined that there is a total of approximately $8.3 million due from RMS to RIC and RCC. As such, in my view, this factor supports maintaining the status quo.

Prejudice to Creditors

86 In addition to a review of the factors set out above, the court will consider the relative prejudice to creditors that will result from substantive consolidation. In this case, substantive consolidation eliminates the secured inter-company receivable, while it is the only material asset of RCC. The result is, therefore, from an objective standpoint, extremely prejudicial to the RCC Investors as their recoveries (based on available information in the Receiver's Fourth Report) would go from 86% in a status quo scenario to 28% in a substantively consolidated estates scenario. Conversely, the RIC Investors and RMS Investors benefit from the consolidation from effectively no recovery in a status quo scenario to a 28% recovery in a substantively consolidated scenario.

87 Investors in RCC and RIC took calculated risks based upon OMs that disclosed the RCC GSA and RIC loan. The RIC Investors acknowledge that these were risky investments and that they may not recover their investments. Now, facing the very risk they previously acknowledged, the RIC Investors seek to ameliorate the prospect of a negligible recovery against RIC to the prejudice of RCC Investors.

88 As Trainer J. explained in *Northland*, "it would be improper for the court to interfere with or appear to interfere with the rights of the creditors," and that such an appearance would be created if the estates are ordered merged for all purposes. This caution rings true in this case. To order substantive consolidation would require me to ignore written contracts and rely on subjective *ex post facto* evidence.

Conclusion

89 Substantive consolidation is an equitable remedy. The primary aim of this extraordinary remedy is to ensure the equitable treatment of all creditors. It is recognized that as consolidation effectively redistributes wealth among creditors of the related entities, individuals will invariably realize asymmetric losses or gains (see: M. MacNaughton and M. Arzoumanidis, *"Substantive Consolidation in the Insolvency of Corporate*

Groups: A Comparative Analysis" (2007), ANNREVINSOLV 16, at p. 3).

90 In this case, I have concluded that it is not appropriate to invoke this extraordinary remedy. The assets are held separately and audited financial statements exist for RIC and RCC. The governing loan documents clearly set out that the corporations are separate and that the obligations of RIC to RCC are subject to a GSA. Referencing *Northland*, the "elements of consolidation" are not present. Furthermore, there would also be significant financial prejudice to creditors of RCC if substantive consolidation were ordered.

91 In the result, an order shall issue that the three corporate entities are not be to substantially consolidated.

Costs

92 The parties have previously provided costs outlines to the court, which should be incorporated into a draft order for my review.

Motion dismissed.

Footnotes

* A corrigendum issued by the court on October 17, 2016 has been incorporated herein.

1 The RIC OMs state that the subscription documents have to be delivered to RIC at its Duncan Mill Road address for all except subscriptions under RIC's first two OMs: the July 8, 2010 OM directs that forms be sent to Harris Brown & Partners Ltd. as RIC's agent, and the January 20, 2011 OM directs that forms be sent to Sterling Grace as RIC's agent. On February 20, 2014, the registration of Sterling Grace was suspended by the Ontario Securities Commission for several failures, including with respect to acting as an exempt market dealer facilitating subscriptions to Redstone Investment Corporation.

2 The RCC OMs state that the subscription documents be sent to RCC at its Duncan Mill Road address.

3 The cease trade orders were issued on June 7, 2012 in BC and June 15, 2012 in Alberta. The orders were fully revoked on October 4, 2012 in BC and October 10, 2012 in Alberta.

4 The RCC OMs are dated April 3, 2012 and March 1, 2013.

5 As a result of the *Mareva* order, the Monitor undertook a forensic review of two of RMS's bank accounts at the TD Bank. RMS also maintains an account with National Bank. The Receiver also completed an investigation and prepared completed an analysis relating to the sources and use of funds relating to RMS. As a result of this analysis, the Receiver determined that there was a total of $8,344,714 due from RMS to RIC and RCC.

6 313 U.S. 215 (U.S. Sup. Ct. 1941).

7 810 F.2d 270, Bankr. L. Rep. P 71, 618 (U.S. Ct. App. 1987). This test has been adopted by the D.C. Circuit and the Eleventh Circuit: see *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245, Bankr. L. Rep. P 74, 055 (U.S. C.A. 11th Cir. 1991). The necessity of consolidation requirement follows from *Snider Brothers Inc., Re*, 18 B.R. 230 (U.S. Mass. 1982) and the balancing of interests element flows from *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S. Bankr. N.D. Ohio 1987).

8 This is a typical *alter ego* inquiry made in corporate veil cases and generally involves consideration of the seven factors set out in In re Vecco Construction Industries, Inc., 4 B.R. 407 (Bankr. E.D. Va. 1980): 1. Difficulty in

segregating assets; 2. Presence of consolidated financial statements; 3. Profitability of consolidation of a single location; 4. Comingling of assets and business functions; 5. Unity of interests in ownership; 6. Existence of inter-corporate loan guarantees; and 7. Transfers of assets without observance of corporate formalities.

9 860 F.2d 515, Bankr. L. Rep. P 72, 482 (U.S. C.A. 2nd Cir. 1988). This test has been adopted by the Second and Ninth Circuits and followed by the Fourth Circuit.

10 For example, in *Soviero v. Franklin National Bank of Long Island*, 328 F.2d 446 (U.S. C.A. 2nd Cir. 1964), the Second Circuit Court of Appeals focused the inquiry on corporate veil-based principles and specifically looked to whether there was an abuse of the corporate form or structure, including whether the companies at issue operated a single business, had the same directors, shareholders, and staff, or shared accounting records. In *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (U.S. C.A. 2nd Cir. 1966), the court found that substantive consolidation can be authorized where the finances of the entities are hopelessly entangled despite a creditor's reliance on the separate credit of the debtor companies.

11 419 F.3d 195, Bankr. L. Rep. P 80, 343 (U.S. C.A. 3rd Cir. 2005).

End of Document

Manitoba Rules
Man. Reg. 553/88 — Court of Queen's Bench Rules
Part II — Parties and Joinder
Rule 6 — Consolidation or Hearing Together
Where Order May be Made

Man. Reg. 553/88, s. 6.01

s 6.01

Currency

6.01
6.01(1)Order
Where two or more proceedings are pending in which,

(a) there is a question of law or fact in common;

(b) the relief claimed arises out of the same transaction or occurrence or series of transactions or occurrences; or

(c) for any other reason an order ought to be made under this rule;

the court may order that,

(d) the proceedings be consolidated, or heard at the same time or one immediately after the other; or

(e) any of the proceedings be,

(i) stayed until after the determination of any other of them, or

(ii) asserted by way of counterclaim in any other of them.

6.01(2)Directions
In the order, the court may give such directions as are just to avoid unnecessary costs or delay.

Currency
Manitoba Current to S.M. 2021, c. 2 and Man. Reg. 35/2021 (April 29, 2021)

Concordance References
Rules Concordance 23, Joinder of parties

End of Document

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Manitoba Statutes
The Court of Queen’s Bench Act
Part XVII — Miscellaneous (ss. 94-99.1)

S.M. 1988-89, c. 4, s. 94

s 94. Multiplicity of proceedings

Currency

94.Multiplicity of proceedings
As far as possible, a multiplicity of proceedings shall be avoided.

Currency
Manitoba Current to S.M. 2021, c. 2 and Man. Reg. 35/2021 (April 29, 2021)

End of Document

Canada Federal Statutes
Bankruptcy and Insolvency Act
Interpretation

R.S.C. 1985, c. B-3, s. 2

s 2. Definitions

Currency

2.Definitions
In this Act

”affidavit” includes statutory declaration and solemn affirmation; *(”affidavit”)*

”aircraft objects” [Repealed 2012, c. 31, s. 414.]

”application”, with respect to a bankruptcy application filed in a court in the Province of Quebec, means a motion; *(Version anglaise seulement)*

”assignment” means an assignment filed with the official receiver; *(”cession”)*

”bank” means

(a) every bank and every authorized foreign bank within the meaning of section 2 of the *Bank Act*,

(b) every other member of the Canadian Payments Association established by the *Canadian Payments Act*, and

(c) every local cooperative credit society, as defined in subsection 2(1) of the Act referred to in paragraph (b), that is a member of a central cooperative credit society, as defined in that subsection, that is a member of that Association;

(”banque”)

”bankrupt” means a person who has made an assignment or against whom a bankruptcy order has been made or the legal status of that person; *(”failli”)*

”bankruptcy” means the state of being bankrupt or the fact of becoming bankrupt; *(”faillite”)*

”bargaining agent” means any trade union that has entered into a collective agreement on behalf of the employees of a person; *(”agent négociateur”)*

”child” [Repealed 2000, c. 12, s. 8(1).]

”claim provable in bankruptcy,””provable claim” or **”claim provable”** includes any claim or liability provable in proceedings under this Act by a creditor; *(”réclamation prouvable en matière de faillite”* ou *“réclamation prouvable”)*

”collective agreement”, in relation to an insolvent person, means a collective agreement within the meaning of the jurisdiction governing collective bargaining between the insolvent person and a bargaining agent;

(”convention collective”)

”common-law partner”, in relation to an individual, means a person who is cohabiting with the individual in a conjugal relationship, having so cohabited for a period of at least one year; *(”conjoint de fait”)*

”common-law partnership” means the relationship between two persons who are common-law partners of each other; *(”union de fait”)*

”corporation” means a company or legal person that is incorporated by or under an Act of Parliament or of the legislature of a province, an incorporated company, wherever incorporated, that is authorized to carry on business in Canada or has an office or property in Canada or an income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, insurance companies, trust companies or loan companies; *(”personne morale”)*

”court”, except in paragraphs 178(1)(a) and (a.1) and sections 204.1 to 204.3, means a court referred to in subsection 183(1) or (1.1) or a judge of that court, and includes a registrar when exercising the powers of the court conferred on a registrar under this Act; *(”tribunal”)*

”creditor” means a person having a claim provable as a claim under this Act; *(”créancier”)*

”current assets” means cash, cash equivalents — including negotiable instruments and demand deposits — inventory or accounts receivable, or the proceeds from any dealing with those assets; *(”actif à court terme”)*

”date of the bankruptcy”, in respect of a person, means the date of

(a) the granting of a bankruptcy order against the person,

(b) the filing of an assignment in respect of the person, or

(c) the event that causes an assignment by the person to be deemed;

(”date de la faillite”)

”date of the initial bankruptcy event”, in respect of a person, means the earliest of the day on which any one of the following is made, filed or commenced, as the case may be:

(a) an assignment by or in respect of the person,

(b) a proposal by or in respect of the person,

(c) a notice of intention by the person,

(d) the first application for a bankruptcy order against the person, in any case

(i) referred to in paragraph 50.4(8)(a) or 57(a) or subsection 61(2), or

(ii) in which a notice of intention to make a proposal has been filed under section 50.4 or a proposal has been filed under section 62 in respect of the person and the person files an assignment before the court has approved the proposal,

(e) the application in respect of which a bankruptcy order is made, in the case of an application other than one referred to in paragraph (d); or

(f) proceedings under the *Companies’ Creditors Arrangement Act*;

(”ouverture de la faillite”)

”debtor” includes an insolvent person and any person who, at the time an act of bankruptcy was committed by him, resided or carried on business in Canada and, where the context requires, includes a bankrupt; *(”débiteur”)*

”director” in respect of a corporation other than an income trust, means a person occupying the position of director by whatever name called and, in the case of an income trust, a person occupying the position of trustee by whatever name called; *(”administrateur”)*

”eligible financial contract” means an agreement of a prescribed kind; *(”contrat financier admissible”)*

”equity claim” means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

(”réclamation relative à des capitaux propres”)

”equity interest” means

(a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

(”intérêt relatif à des capitaux propres”)

”executing officer” includes a sheriff, a bailiff and any officer charged with the execution of a writ or other process under this Act or any other Act or proceeding with respect to any property of a debtor; *(”huissier-exécutant”)*

”financial collateral” means any of the following that is subject to an interest, or in the Province of Quebec a right, that secures payment or performance of an obligation in respect of an eligible financial contract or that is subject to a title transfer credit support agreement:

(a) cash or cash equivalents, including negotiable instruments and demand deposits,

(b) securities, a securities account, a securities entitlement or a right to acquire securities, or

(c) a futures agreement or a futures account;

(”garantie financière”)

”General Rules” means the General Rules referred to in section 209; *(”Règles générales”)*

”income trust” means a trust that has assets in Canada if

(a) its units are listed on a prescribed stock exchange on the date of the initial bankruptcy event, or

(b) the majority of its units are held by a trust whose units are listed on a prescribed stock exchange on the date of the initial bankruptcy event;

(”fiducie de revenu”)

”insolvent person” means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and

(a) who is for any reason unable to meet his obligations as they generally become due,

(b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

(”personne insolvable”)

”legal counsel” means any person qualified, in accordance with the laws of a province, to give legal advice; *(”conseiller juridique”)*

”locality of a debtor” means the principal place

(a) where the debtor has carried on business during the year immediately preceding the date of the initial bankruptcy event,

(b) where the debtor has resided during the year immediately preceding the date of the initial bankruptcy event, or

(c) in cases not coming within paragraph (a) or (b), where the greater portion of the property of the debtor is situated;

(”localité”)

”Minister” means the Minister of Industry; *(”ministre”)*

”net termination value” means the net amount obtained after netting or setting off or compensating the mutual obligations between the parties to an eligible financial contract in accordance with its provisions; *(”valeurs nettes dues à la date de résiliation”)*

”official receiver” means an officer appointed under subsection 12(2); *(”séquestre officiel”)*

”person” includes a partnership, an unincorporated association, a corporation, a cooperative society or a cooperative organization, the successors of a partnership, of an association, of a corporation, of a society or of an organization and the heirs, executors, liquidators of the succession, administrators or other legal representatives of a person; *(”personne”)*

”prescribed”

(a) in the case of the form of a document that is by this Act to be prescribed and the information to be given therein, means prescribed by directive issued by the Superintendent under paragraph 5(4)(e), and

(b) in any other case, means prescribed by the General Rules;

(”prescrit”)

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

”proposal” means

(a) in any provision of Division I of Part III, a proposal made under that Division, and

(b) in any other provision, a proposal made under Division I of Part III or a consumer proposal made under Division II of Part III

and includes a proposal or consumer proposal, as the case may be, for a composition, for an extension of time or for a scheme or arrangement; *(”proposition concordataire”* ou *“proposition”)*

”public utility” includes a person or body who supplies fuel, water or electricity, or supplies telecommunications, garbage collection, pollution control or postal services; *(”entreprise de service public”)*

”resolution” or **”ordinary resolution”** means a resolution carried in the manner provided by section 115; *(”résolution”* ou *“résolution ordinaire”)*

”secured creditor” means a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property as security for a debt due or accruing due to the person from the debtor, or a person whose claim is based on, or secured by, a negotiable instrument held as collateral security and on which the debtor is only indirectly or secondarily liable, and includes

(a) a person who has a right of retention or a prior claim constituting a real right, within the meaning of the *Civil Code of Québec* or any other statute of the Province of Quebec, on or against the property of the debtor or any part of that property, or

(b) any of

(i) the vendor of any property sold to the debtor under a conditional or instalment sale,

(ii) the purchaser of any property from the debtor subject to a right of redemption, or

(iii) the trustee of a trust constituted by the debtor to secure the performance of an obligation,

if the exercise of the person’s rights is subject to the provisions of Book Six of the *Civil Code of Québec* entitled *Prior Claims and Hypothecs* that deal with the exercise of hypothecary rights;

(”créancier garanti”)

Editor’s Note: S.C. 2001, c. 4, s. 25 replaced the definition of “secured creditor”. S.C. 2001, c. 4, s. 177(1) provides as follows:

(1) The definition of “secured creditor” in subsection 2(1) of the Bankruptcy and Insolvency Act, *as enacted by section 25 of this Act [i.e. 2001, c. 4], applies only to bankruptcies or proposals in respect of which proceedings are commenced after the coming into force of that section, but nothing in this subsection shall be construed as changing the status of any person who was a secured creditor in respect of a bankruptcy or a proposal in respect of which proceedings were commenced before the coming into force of that section.*

*Immediately before the replacement, the definition of **”secured creditor”** read as follows:*

”secured creditor” means a person holding a mortgage, hypothec, pledge, charge, lien or privilege on or against the property of the debtor or any part thereof as security for a debt due or accruing due to him

from the debtor, or a person whose claim is based on, or secured by, a negotiable instrument held as collateral security and on which the debtor is only indirectly or secondarily liable.

"settlement" [Repealed 2005, c. 47, s. 2(1).]

"shareholder" includes a member of a corporation — and, in the case of an income trust, a holder of a unit in an income trust — to which this Act applies; *("actionnaire")*

"sheriff" [Repealed 2004, c. 25, s. 7(3).]

"special resolution" means a resolution decided by a majority in number and three-fourths in value of the creditors with proven claims present, personally or by proxy, at a meeting of creditors and voting on the resolution; *("résolution spéciale")*

"Superintendent" means the Superintendent of Bankruptcy appointed under subsection 5(1); *("surintendant")*

"Superintendent of Financial Institutions" means the Superintendent of Financial Institutions appointed under subsection 5(1) of the *Office of the Superintendent of Financial Institutions Act*; *("surintendant des institutions financières")*

"time of the bankruptcy", in respect of a person, means the time of

(a) the granting of a bankruptcy order against the person,

(b) the filing of an assignment by or in respect of the person, or

(c) the event that causes an assignment by the person to be deemed;

("moment de la faillite")

"title transfer credit support agreement" means an agreement under which an insolvent person or a bankrupt has provided title to property for the purpose of securing the payment or performance of an obligation of the insolvent person or bankrupt in respect of an eligible financial contract; *("accord de transfert de titres pour obtention de crédit")*

"transfer at undervalue" means a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor; *("opération sous-évaluée")*

"trustee" or **"licensed trustee"** means a person who is licensed or appointed under this Act. *("syndic"* ou *"syndic autorisé")*

R.S.C. 1985, c. 31 (1st Supp.), s. 69; 1992, c. 27, s. 3; 1995, c. 1, s. 62(1)(a); 1997, c. 12, s. 1; 1999, c. 28, s. 146; 1999, c. 31, s. 17; 2000, c. 12, s. 8; 2001, c. 4, s. 25; 2001, c. 9, s. 572; 2004, c. 25, s. 7(1), (3)-(8), (10); 2005, c. 3, s. 11; 2005, c. 47, s. 2(1), (3)-(5); 2007, c. 29, s. 91; 2007, c. 36, s. 1; 2012, c. 31, s. 414; 2018, c. 10, s. 82

Note:

S.C. 2000, c. 12, s. 8, amended s. 2(1) by repealing the definition of "child", and adding definitions of "common law partner" and "common law partnership". Pursuant to S.C. 2000, c. 12, s. 21, the amendments apply only to bankruptcies, proposals and receiverships commenced after the coming into force of S.C. 2000, c. 12, s. 21 on July 31, 2000. Prior to its repeal, the definition of "child" read as follows:

"child" includes a child born out of marriage;

Currency
Federal English Statutes reflect amendments current to May 12, 2021

Federal English Regulations are current to Gazette Vol. 155:10 (May 12, 2021)

End of Document

Canada Federal Statutes
Bankruptcy and Insolvency Act
Part II — Bankruptcy Orders and Assignments (ss. 42-49) [Heading amended 2004, c. 25, s. 26.]
Acts of Bankruptcy

R.S.C. 1985, c. B-3, s. 42

s 42.

Currency

42.
42(1)Acts of bankruptcy
A debtor commits an act of bankruptcy in each of the following cases:

(a) if in Canada or elsewhere he makes an assignment of his property to a trustee for the benefit of his creditors generally, whether it is an assignment authorized by this Act or not;

(b) if in Canada or elsewhere the debtor makes a fraudulent gift, delivery or transfer of the debtor's property or of any part of it;

(c) if in Canada or elsewhere the debtor makes any transfer of the debtor's property or any part of it, or creates any charge on it, that would under this Act be void or, in the Province of Quebec, null as a fraudulent preference;

(d) if, with intent to defeat or delay his creditors, he departs out of Canada, or, being out of Canada, remains out of Canada, or departs from his dwelling-house or otherwise absents himself;

(e) if the debtor permits any execution or other process issued against the debtor under which any of the debtor's property is seized, levied on or taken in execution to remain unsatisfied until within five days after the time fixed by the executing officer for the sale of the property or for fifteen days after the seizure, levy or taking in execution, or if any of the debtor's property has been sold by the executing officer, or if the execution or other process has been held by the executing officer for a period of fifteen days after written demand for payment without seizure, levy or taking in execution or satisfaction by payment, or if it is returned endorsed to the effect that the executing officer can find no property on which to levy or to seize or take, but if interpleader or opposition proceedings have been instituted with respect to the property seized, the time elapsing between the date at which the proceedings were instituted and the date at which the proceedings are finally disposed of, settled or abandoned shall not be taken into account in calculating the period of fifteen days;

(f) if he exhibits to any meeting of his creditors any statement of his assets and liabilities that shows that he is insolvent, or presents or causes to be presented to any such meeting a written admission of his inability to pay his debts;

(g) if he assigns, removes, secretes or disposes of or attempts or is about to assign, remove, secrete or dispose of his property with intent to defraud, defeat or delay his creditors or any of them;

(h) if he gives notice to any of his creditors that he has suspended or that he is about to suspend payment of his debts;

(i) if he defaults in any proposal made under this Act; and

(j) if he ceases to meet his liabilities generally as they become due.

42(2)Unauthorized assignments are void or null
Every assignment of an insolvent debtor's property other than an assignment authorized by this Act, made by an insolvent debtor for the general benefit of their creditors, is void or, in the Province of Quebec, null.

Amendment History
1997, c. 12, s. 26; 2004, c. 25, s. 27(1)-(3), (5)

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Canada Federal Statutes
Bankruptcy and Insolvency Act
Part II — Bankruptcy Orders and Assignments (ss. 42-49) [Heading amended 2004, c. 25, s. 26.]
Application for Bankruptcy Order [Heading amended 2004, c. 25, s. 28.]

R.S.C. 1985, c. B-3, s. 43

s 43.

Currency

43.

43(1)Bankruptcy application

Subject to this section, one or more creditors may file in court an application for a bankruptcy order against a debtor if it is alleged in the application that

(a) the debt or debts owing to the applicant creditor or creditors amount to one thousand dollars; and

(b) the debtor has committed an act of bankruptcy within the six months preceding the filing of the application.

43(2)If applicant creditor is a secured creditor

If the applicant creditor referred to in subsection (1) is a secured creditor, they shall in their application either state that they are willing to give up their security for the benefit of the creditors, in the event of a bankruptcy order being made against the debtor, or give an estimate of the value of the applicant creditor's security, and in the latter case they may be admitted as an applicant creditor to the extent of the balance of the debt due to them after deducting the value so estimated, in the same manner as if they were an unsecured creditor.

43(3)Affidavit

The application shall be verified by affidavit of the applicant or by someone duly authorized on their behalf having personal knowledge of the facts alleged in the application.

43(4)Consolidation of applications

If two or more applications are filed against the same debtor or against joint debtors, the court may consolidate the proceedings or any of them on any terms that the court thinks fit.

43(5)Place of filing

The application shall be filed in the court having jurisdiction in the judicial district of the locality of the debtor.

43(6)Proof of facts, etc.

At the hearing of the application, the court shall require proof of the facts alleged in the application and of the service of the application, and, if satisfied with the proof, may make a bankruptcy order.

43(7)Dismissal of application

If the court is not satisfied with the proof of the facts alleged in the application or of the service of the application, or is satisfied by the debtor that the debtor is able to pay their debts, or that for other sufficient cause no order ought to be made, it shall dismiss the application.

43(8)Dismissal with respect to some respondents only

If there are more respondents than one to an application, the court may dismiss the application with respect to one or more of them, without prejudice to the effect of the application as against the other or others of them.

43(9)Appointment of trustee
On a bankruptcy order being made, the court shall appoint a licensed trustee as trustee of the property of the bankrupt, having regard, as far as the court considers just, to the wishes of the creditors.

43(10)Stay of proceedings if facts denied
If the debtor appears at the hearing of the application and denies the truth of the facts alleged in the application, the court may, instead of dismissing the application, stay all proceedings on the application on any terms that it may see fit to impose on the applicant as to costs or on the debtor to prevent alienation of the debtor's property and for any period of time that may be required for trial of the issue relating to the disputed facts.

43(11)Stay of proceedings for other reasons
The court may for other sufficient reason make an order staying the proceedings under an application, either altogether or for a limited time, on any terms and subject to any conditions that the court may think just.

43(12)Security for costs
Applicants who are resident out of Canada may be ordered to give security for costs to the debtor, and proceedings under the application may be stayed until the security is furnished.

43(13)Bankruptcy order on another application
If proceedings on an application have been stayed or have not been prosecuted with due diligence and effect, the court may, if by reason of the delay or for any other cause it is considered just, substitute or add as applicant any other creditor to whom the debtor may be indebted in the amount required by this Act and make a bankruptcy order on the application of the other creditor, and shall, immediately after making the order, dismiss on any terms that it may consider just the application in the stayed or non-prosecuted proceedings.

43(14)Withdrawing application
An application shall not be withdrawn without the leave of the court.

43(15)Application against one partner
Any creditor whose claim against a partnership is sufficient to entitle the creditor to present a bankruptcy application may present an application against any one or more partners of the firm without including the others.

43(16)Court may consolidate proceedings
If a bankruptcy order has been made against one member of a partnership, any other application against a member of the same partnership shall be filed in or transferred to the same court, and the court may give any directions for consolidating the proceedings under the applications that it thinks just.

43(17)Continuance of proceedings on death of debtor
If a debtor against whom an application has been filed dies, the proceedings shall, unless the court otherwise orders, be continued as if the debtor were alive.

Amendment History
1992, c. 27, s. 15; 2004, c. 25, s. 28

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Federal English Statutes reflect amendments current to May 12, 2021
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Canada Federal Statutes
Bankruptcy and Insolvency Act
Part II — Bankruptcy Orders and Assignments (ss. 42-49) [Heading amended 2004, c. 25, s. 26.]
Assignments

R.S.C. 1985, c. B-3, s. 49

s 49.

Currency

49.

49(1)Assignment for general benefit of creditors

An insolvent person or, if deceased, the executor or administrator of their estate or the liquidator of the succession, with the leave of the court, may make an assignment of all the insolvent person's property for the general benefit of the insolvent person's creditors.

49(2)Sworn statement

The assignment must be accompanied by a sworn statement in the prescribed form showing the debtor's property that is divisible among his or her creditors, the names and addresses of all his or her creditors and the amounts of their respective claims.

49(3)Filing of assignment

The assignment made under subsection (1) shall be offered to the official receiver in the locality of the debtor, and it is inoperative until filed with that official receiver, who shall refuse to file the assignment unless it is in the prescribed form or to the like effect and accompanied by the sworn statement required by subsection (2).

49(4)Appointment of trustee

Where the official receiver files the assignment made under subsection (1), he shall appoint as trustee a licensed trustee whom he shall, as far as possible, select by reference to the wishes of the most interested creditors if ascertainable at the time, and the official receiver shall complete the assignment by inserting therein as grantee the name of the trustee.

49(5)Cancellation of assignment

Where the official receiver is unable to find a licensed trustee who is willing to act, the official receiver shall, after giving the bankrupt five days notice, cancel the assignment.

49(6)Procedure in small estates

Where the bankrupt is not a corporation and in the opinion of the official receiver the realizable assets of the bankrupt, after the claims of secured creditors are deducted, will not exceed five thousand dollars or such other amount as is prescribed, the provisions of this Act relating to the summary administration of estates shall apply.

49(7)Future property not to be considered

In the determination of the realizable assets of a bankrupt for the purposes of subsection (6), no regard shall be had to any property that may be acquired by the bankrupt or devolve on the bankrupt before the bankrupt's discharge.

49(8)Where subsection (6) ceases to apply

The official receiver may direct that subsection (6) shall cease to apply in respect of the bankrupt where the official receiver determines that

(a) the realizable assets of the bankrupt, after the claims of secured creditors are deducted, exceed five thousand dollars or the amount prescribed, as the case may be, or

(b) the costs of realization of the assets of the bankrupt are a significant proportion of the realizable value of the assets,

and the official receiver considers that such a direction is appropriate.

Amendment History
1992, c. 1, s. 15; 1992, c. 27, s. 17; 1997, c. 12, s. 29(2); 2004, c. 25, s. 31; 2005, c. 47, s. 33

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Canada Federal Statutes
Bankruptcy and Insolvency Act
Part IV — Property of the Bankrupt (ss. 67-101.2)
Stay of Proceedings

R.S.C. 1985, c. B-3, s. 69.4

s 69.4 Court may declare that stays, etc., cease

Currency

69.4Court may declare that stays, etc., cease
A creditor who is affected by the operation of sections 69 to 69.31 or any other person affected by the operation of section 69.31 may apply to the court for a declaration that those sections no longer operate in respect of that creditor or person, and the court may make such a declaration, subject to any qualifications that the court considers proper, if it is satisfied

(a) that the creditor or person is likely to be materially prejudiced by the continued operation of those sections; or

(b) that it is equitable on other grounds to make such a declaration.

Note:

S.C. 1997, c. 12, s. 65(2), provides as follows:

(2) Subsection (1) [S.C. 1997, c. 12, s. 65(1), which added ss. 69.31 and 69.41 and re-enacted s. 69.4] applies to bankruptcies or proposals in respect of which proceedings are commenced after that subsection comes into force [September 30, 1997].

Amendment History
1992, c. 27, s. 36(1); 1997, c. 12, s. 65(1)

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Canada Federal Statutes
Bankruptcy and Insolvency Act
Part VII — Courts and Procedure(ss. 183-197)
Jurisdiction of Courts

R.S.C. 1985, c. B-3, s. 183

s 183.

Currency

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

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

(b) [Repealed 2001, c. 4, s. 33(2).]

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

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

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

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

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

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

183(1.1)Superior Court jurisdiction in the Province of Quebec
In the Province of Quebec, the Superior Court is invested with the jurisdiction that will enable it to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during its term, as it is now, or may be hereafter, held, and in vacation and in chambers.

183(2)Courts of appeal — common law provinces
Subject to subsection (2.1), the courts of appeal throughout Canada, within their respective jurisdictions, are invested with power and jurisdiction at law and in equity, according to their ordinary procedures, except as varied by this Act or the General Rules, to hear and determine appeals from the courts vested with original jurisdiction under this Act.

183(2.1)Court of Appeal of the Province of Quebec
In the Province of Quebec, the Court of Appeal, within its jurisdiction, is invested with the power and jurisdiction, according to its ordinary procedures, except as varied by this Act or the General Rules, to hear and determine appeals from the Superior Court.

183(3)Supreme Court of Canada

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

Amendment History
R.S.C. 1985, c. 27 (2nd Supp.), s. 10 (Sched., item 2); 1990, c. 17, s. 3; 1993, c. 28, s. 78 (Sched. III, item 6) [Repealed 1999, c. 3, s. 12 (Sched., item 3).]; 1998, c. 30, s. 14(a); 1999, c. 3, s. 15; 2001, c. 4, s. 33(2), (3); 2002, c. 7, s. 83; 2015, c. 3, s. 9

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Federal English Statutes reflect amendments current to May 12, 2021
Federal English Regulations are current to Gazette Vol. 155:10 (May 12, 2021)

2014 ONSC 5875
Ontario Superior Court of Justice

Bacic v. Millennium Educational & Research Charitable Foundation

2014 CarswellOnt 14545, 2014 ONSC 5875, 19 C.B.R. (6th) 286, 246 A.C.W.S. (3d) 751

In the Matter of an Application Pursuant to Section 101 of the Courts of Justice Act, R.S.O. 1990, c. C.43, as Amended

In the Matter of Section 248(3)(b) of the Ontario Business Corporations Act, R.S.O. 1990, Chapter B.16

In the Matter of Section 241(3)(b) of the Canada Business Corporations Act, R.S.C. 1985, c. C-44

In the Matter of Section 253(3)(b) of the Canada Not-for-Profit Corporations Act, S.C. 2009, c.23

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

Lily Bacic, Ronald Ayoub, Sandra Ayoub, Donald Hutchinson, Gloria Hutchinson, Kim Kruk, Dale Hein, Pamela Stone, Caroline Lewandowsky, Lim Lewandowsky, Anne Lefier, Gary McGinn, David Hamilton, James Miller, Helene Lamadleine, Mary Lou Fisher, Allan Brett, Richard Melcer, Stephen Caldwell, Wendy Caldwell, Barry Doucette, Colleen Moore, Michelle Vezeau, David Kornelsen, Kevin Harsh, Luc Maltais, Colleen Maltais, Bob Mech, A.A.N.T. Software Corporation, Terrance Finnigan, James Joss, David Wiskowski, Moe Litwack, Tomy Issa and George Boszormeny, Applicants and Millennium Educational & Research Charitable Foundation (formerly the Thomas C. Assaly Charitable Foundation), Assaly Investment Program Corporation, Assaly Financial Corporation, Act 1 Corp. and Millennium Springs Development & Construction Corp. (aka Millennium Springs Properties Ltd.) Thomas G. Assaly, Karen Floyd-Assaly, and Frank H. Fee, III, Respondents

In the Matter of the Bankruptcy of Millennium Educational & Research Charitable Foundation (formerly the Thomas C. Assaly Charitable Foundation) a registered charity carrying on business in the City of Ottawa, in the Province of Ontario (the “Foundation”)

In the Matter of the Bankruptcy of Assaly Financial Corporation, of the City of Ottawa, in the Province of Ontario, Assaly Investment Program Corporation, of the City of Ottawa, in the Province of Ontario and Act 1 Corp., of the City of Ottawa, in the Province of Ontario (collectively the “Bankrupt Respondent Corporations”)

Kane J.

Heard: June 17, 18, 2014
Judgment: October 17, 2014
Docket: Ottawa 13-57904, 33-165343, 33-165372, 33-165369, 33-165370, 33-165371

Counsel: Martin Black, for Estate of Thomas C. Assaly (the “Estate”)
Jason Dutrizac for Doyle Salewski Inc., court appointed Interim Receiver of the Foundation, Receiver and Manager of the respondent corporations in the Receivership Action, other than the Millennium Educational & Research Charitable Foundation (”Foundation”), and Trustee in the Bankruptcy of the Foundation (the “Trustee”)
Justin R. Fogarty for Applicants in the Receivership Action and Applicants in the Bankruptcy Action

Subject: Corporate and Commercial; Estates and Trusts; Insolvency; Property

Headnote

Bankruptcy and insolvency --- Proving claim — Disallowance of claim — Appeal from disallowance — Grounds
Settlor established charitable foundation in 1989 — Settlor became incapacitated by 2006 — Foundation was essentially controlled by son and his wife — Objects of foundation were changed in 2006, when foundation had $3,813,507 in assets — Foundation and settlor's group of companies became bankrupt — After settlor died, his estate alleged all expenditures from foundation after objects were changed were made for personal benefit of son and his family — Estate made unsecured claim against foundation in amount of $3,813,507 — Trustee in bankruptcy disallowed estate's claim — Estate appealed, alleging settlor's gifts had failed and must be returned to his estate in priority to foundation's creditors and other claimants — Appeal dismissed — Estate failed to establish any error by trustee — Even if son and his wife misappropriated funds from foundation, settlor's gift could not be undone — Nothing indicated settlor imposed any reversionary or residual rights to receive back any portion of foundation's assets — Foundation continued to distribute some money for charitable purposes from 2006 to 2011 so total amount claimed was incorrect — Further, investment funds from various creditors had been channelled through foundation so estate would not have been able to obtain blanket priority — Inherent jurisdiction of court to regulate charities should not be used to achieve such purpose — There was no evidence settlor ever intended to establish trust — Treating group of companies and foundation as consolidated bankrupt was justified — Son had intermixed funds within group of companies and foundation since 2006.

Estates and trusts --- Charities — Nature of gift — Miscellaneous
Settlor established charitable foundation in 1989 — Foundation was essentially controlled by settlor's son and his wife after settlor became incapacitated — Objects of foundation were changed in 2006 — Foundation and settlor's group of companies became bankrupt — After settlor passed away, his estate alleged all expenditures from foundation after objects were changed were made for personal benefit of son and his family — Estate made unsecured claim against foundation — Trustee in bankruptcy disallowed estate's claim — Estate appealed, alleging that gifts made by settlor to create foundation and advance its stated objects had failed and must therefore be returned in first priority to his estate — Appeal dismissed — Estate failed to establish any error by trustee — Even if son and his wife misappropriated funds from foundation, settlor's gift could not be undone — Nothing indicated settlor imposed any reversionary or residual rights to receive back any portion of foundation's assets — Foundation continued to distribute some money for charitable purposes from 2006 to 2011 so total amount claimed was incorrect — Investment funds from various creditors had been channelled through foundation so estate would not have been able to obtain blanket priority — Inherent jurisdiction of court to regulate charities should not be used to achieve such purpose — There was no evidence settlor ever intended to establish trust.

Bankruptcy and insolvency --- Property of bankrupt — Miscellaneous
Consolidation or pooling of assets — Settlor established charitable foundation in 1989 — One of settlor's sons worked within settlor's group of companies — Foundation was essentially controlled by son and his wife after settlor became incapacitated — Objects of foundation were changed — Foundation and settlor's group of companies became bankrupt — After settlor died, his estate alleged all expenditures from foundation after objects were changed were made for personal benefit of son and his family — Estate made unsecured claim against foundation — Trustee in bankruptcy disallowed estate's claim — Estate appealed, alleging settlor's gifts had failed and must be returned to his estate in priority, without allowing any pooling or consolidation of group of companies and foundation's estates, assets or liabilities — Appeal dismissed — Substantive consolidation of assets of bankrupt estate, including foundation, was authorized — Treating group of companies and foundation as consolidated bankrupt was justified — Son had intermixed funds within group of companies and foundation since 2006 and it would be burdensome to allocate value and claims among them.

Table of Authorities

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Atlantic Yarns Inc., Re (2008), 2008 CarswellNB 195, 2008 NBQB 144, 855 A.P.R. 143, 2008 NBBR 144, 333 N.B.R. (2d) 143, 42 C.B.R. (5th) 107 (N.B. Q.B.) — referred to

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Campbell v. MacKenzie (2003), 46 R.F.L. (5th) 321, 27 Alta. L.R. (4th) 362, 2003 ABPC 203, 2003 CarswellAlta 1699 (Alta. Prov. Ct.) — considered

Child v. Chase (1980), [1981] 2 W.W.R. 673, 9 Sask. R. 248, 1980 CarswellSask 161 (Sask. Dist. Ct.) — referred to

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J.P. Capital Corp., Re (1995), 1995 CarswellOnt 53, 31 C.B.R. (3d) 102 (Ont. Bktcy.) — considered

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PSINET Ltd., Re (2002), 33 C.B.R. (4th) 284, 2002 CarswellOnt 1261 (Ont. S.C.J. [Commercial List]) — considered

Richert v. Stewards' Charitable Foundation (2005), 2005 BCSC 211, 2005 CarswellBC 315, 15 E.T.R. (3d) 92, 2005 D.T.C. 5647 (Eng.), [2006] 4 C.T.C. 67 (B.C. S.C.) — referred to

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Singh Estate (Trustee of) v. Shandil (2007), 2007 CarswellBC 1322, 68 B.C.L.R. (4th) 108, (sub nom. *Singh Estate v. Shandil)* 243 B.C.A.C. 148, 32 E.T.R. (3d) 206, [2007] 10 W.W.R. 84, (sub nom. *Singh Estate v. Shandil)* 401 W.A.C. 148, 2007 BCCA 303, 32 E.T.R. (3d) 207 (B.C. C.A.) — referred to

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Generally — referred to

s. 50.1 [en. 1992, c. 27, s. 19] — considered

s. 51(1)(e) — considered

s. 65.2(4) [en. 1992, c. 27, s. 30] — considered

s. 66.14(b) [en. 1992, c. 27, s. 32(1)] — considered

s. 67(1) — considered

s. 67(1)(a) — considered

s. 81.2(1) [en. 1992, c. 27, s. 38(1)] — considered

s. 81.3(8) [en. 2007, c. 36, s. 38] — considered

s. 81.4(8) [en. 2007, c. 36, s. 38] — considered

s. 102(2) — considered

s. 124(2) — considered

s. 128(1) — considered

s. 135 — considered

s. 135(2) — considered

s. 135(4) — considered

s. 183(1) — considered

Canada Not-for-Profit Corporations Act, S.C. 2009, c. 23
s. 22 — referred to

Charities Accounting Act, R.S.O. 1990, c. C.10
Generally — referred to

s. 4 — considered

s. 4(j) — considered

s. 10(1) — considered

APPEAL by estate from disallowance of claim by trustee in bankruptcy.

***Kane J.*:**

1 This is a motion by the Estate:

(1) Appealing the Notice of Disallowance by the Trustee dated May 8, 2014 of the Proof of Claim of the Estate dated April 22, 2014 for an unsecured claim in the amount of $3,813,507 (the "Claim").

(2) For an order declaring the Estate has a first priority claim to the assets, funds and receipts of the Foundation, to the extent of its claim of $3,813,507, in priority to the claims of the Applicants and other creditors of the Foundation.

(3) For an order declaring that the Applicants and other creditors of the Bankrupt Respondent Corporations in the Receivership Action and of the Bankrupt Respondent Corporations, are not to share in the assets, funds and receipts of the Foundation, by way of pooling or consolidation of assets, funds or receipts.

2 The Estate submits that:

(1) Based on s. 135 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "*BIA"*), the gifts and settlements made by the late Thomas C. Assaly to create the Foundation and advance its stated objects have failed and must therefore be returned in first priority to his Estate in priority to the Foundation's creditors and other claimants without allowing any pooling or consolidation of other Respondents' or Bankrupts' estates, assets or liabilities.

(2) As the Settlor of the capital monies of the Foundation, TCA if alive, would have a claim to the assets under receivership on the basis that the purposes of his gift to the Foundation were subject to a condition subsequent that the monies be used for the express purposes of the Foundation.

(3) Gifts of money or property can be made subject to a condition subsequent after the gift has taken effect. Non-fulfillment of the condition subsequent will put an end to the gift whereupon the property reverts to the original owner.

(4) The rights and obligations of the deceased succeed to the Estate Trustee and because the Settlor is entitled to a return of the monies, so is the Estate Trustee.

(5) The position of the Settlor, and therefore his Estate, take priority over claims of any investor in the Bankrupt Respondent Corporations who were defrauded by Thomas G. The Applicants should only have resort to the assets of the corporations in which they invested, not the assets of the Foundation; unless there are funds surplus to the Estate's claim, but only if it can be precisely established what monies, if any, were illegally transferred from the various entities to the Foundation.

(6) The Applicants and other creditors of the Bankrupt Respondent corporations, other than the Foundation, may not share in the assets, funds and receipts of the Foundation, by way of pooling or consolidation of assets, funds or receipts.

(7) In the alternative, the monies held in the Foundation as at the date of the Guardianship Order, namely $3,817,000, are trust property by virtue of the provisions of the *Charities Accounting Act* (the "*CAA"*).

(8) In the further alternative, the Estate is entitled to participate in the monies available for

distribution in this proceeding.

3 The Receiver and Trustee submits that the issues in this appeal are:

(1) Whether the Receiver erred in disallowing the Proof of Claim filed by the Estate of TCA.

(2) If the Receiver erred in disallowing the Proof of Claim, whether the monies held by the Foundation are trust properties by virtue of the *Charities Accounting Act*, Reg. 4/01 ("*CAA*").

(3) Whether, by operation of s. 67(1) of the *Bankruptcy and Insolvency Act* (the "*BIA"*) and after the *CAA*, the Estate of TCA is entitled to payment to the extent $3,813,507 in priority over the claims of the Applicants in the within application and other creditors of the Foundation.

(4) Whether the pooling distribution scheme as recommended by the Interim Receiver, should be implemented and form part of the Claims Bar Order yet to be issued and entered.

Background

4 The Claim was submitted by Robert Assaly, trustee on behalf of the Estate of Thomas C. Assaly ("TCA" or the "Estate") pursuant to the Claims Bar Process created pursuant to s. 50.1, subsections 65.2(4), 81.2(1), 81.3(8), 81.4(8), 102(2), 124(2), 128(1) and paras. 51(l)(e) and 66.14(b) of the *BIA* and the order of this Court dated December 23, 2013.

5 The Estate claims $3,813,507 of assets of the Foundation which were misappropriated by Thomas G. Assaly ("Thomas G.") and his wife Karen Floyd-Assaly ("Karen FA").

6 Prior to his death, TCA, through corporations, developed and controlled considerable corporate real estate assets.

7 Robert Assaly and Thomas G. are each sons of the deceased TCA.

8 Thomas G. worked for his father in one or more of the real estate or development corporations operated by TCA. Theirs was a tumultuous relationship. On occasion, Thomas G. had his employment terminated by his father, or resigned or disappeared from the Assaly corporate activities for periods of time.

1989

9 On July 6, 1989, TCA caused the incorporation of the Thomas C. Assaly Charitable Foundation. The applicants for incorporation were TCA, his two lawyers and his four children.

10 The parties agree that TCA was its sole settlor by way of causing a transfer of assets to the Foundation having an estimated value of some $5 million.

11 There is no evidence whether some or all of that $5 million came from TCA personally or via corporations he controlled. The issue before this Court is whether TCA or his Estate is entitled to assets now in the Foundation.

12 As incorporated, the objects of the Foundation included the following:

(a) To hold, manage, and administer the property of the Corporation for such charitable purposes as may seem expedient from time to time to the board of directors within the scope of the following more particular objects.

(b) To acquire by way of grant gift or purchase, but without public appeal, real and personal property of every class, and to use and apply the principal and income thereof exclusively for the legally charitable purposes herein after mentioned.

(c) To expend by way of grant or gift and to contribute any kind of property and assistance whether by the erection of buildings or other structures, to all matter of legally charitable organizations in Canada for such of their objects as are legally charitable.

(d) To do and to cause to be done all such acts and things as are necessary or incidental to such purposes and objects.

(e) As authorized by by-law:

(i) To borrow money and issue debentures and securities of the corporation.

(ii) To pledge or sell such debentures and securities.

(iii) To secure such borrowings, debentures and securities by mortgage or charge of the real and personal property of the corporation.

1999

13 By Supplementary Letters Patent, dated January 13, 1999, the name of the Foundation was changed to Thomas C. Assaly Charitable Foundation. The original objects of the Foundation continued and included "to hold, manage and administer the property of the Corporation for such charitable purposes as may seem expedient from time to time by the Board of Directors ...".

2000 to 2006

14 TCA was diagnosed with Parkinson's disease.

15 TCA and the Foundation at some point after 2000, commenced litigation against his three sons and Karen FA. TCA swore an affidavit in that action indicating that Thomas G. had been problematic in his employment with his father's corporations and that they had had a falling out regarding the affairs of the Foundation resulting in the departure of Thomas G. and his non-involvement in the Foundation, allegedly since 2002.

16 Guardianship proceedings were commenced as to TCA. The court therein appointed legal counsel to represent TCA. Ultimately, legal guardianship of TCA was ordered.

17 The court appointed legal counsel of TCA, by letter dated April 7, 2006, states that as of that date, TCA was neither a member nor a director of the Foundation.

18 Thomas G. continued as a member and Director of the Foundation and in fact controlled it after his father ceased participation in the Foundation. Karen FA replaced TCA in becoming a member and Secretary of the Foundation.

19 The objects of the Foundation were changed by Supplementary Letters Patent dated August 21, 2006. Object "B" above was amended to state that funds held and/or acquired were to be used to "fund scholarships

and/or bursaries and for research into neurological diseases ... substantially directed to Parkinson's Disease, followed, in priority by Alzheimer's, Multiple Sclerosis and Muscular Dystrophy."

20 As of September 12, 2006, the funds being administered by the Foundation allegedly totalled $3,813,507. This is the amount and the 2006 source of the present claim by the Estate put forward by Robert Assaly.

21 The court notes that Robert Assaly and Thomas G. are potential beneficiaries of any assets flowing from the Foundation into the Estate of their late father.

22 The Estate alleges that after September, 2006, all expenditures from the Foundation were made for the personal benefit of Thomas G. and Karen FA and their children. Such expenditures include the Foundation's purchase and renovation of a residence in the State of Florida ("Canada House") in which Thomas G., Karen FA and their children resided at the time of these proceedings.

23 The Estate acknowledges that the applicants or creditors have been defrauded by Thomas G. but stress that the applicants have never been members of the Foundation.

2007

24 Further Supplementary Letters Patent were issued on September 20, 2007, changing the name of the Foundation to Millennium Educational and Research Charitable Foundation.

Standard of Review

25 Section 135(2) of the *BIA* empowers a trustee to disallow any claim in whole or in part. Any such disallowance is final and conclusive unless appealed pursuant to s. 135(4) of the *BIA* as has occurred in the present case.

26 The Standard of Review on an appeal is correctness where the trustee's decision involves a question of law. (*Business Development Bank of Canada v. Pinder Bueckert & Associates Inc.*, 2009 SKQB 458 (Sask. Q.B.) at para. 20).

Estate's Claim to the Assets of the Foundation

27 The 2006 Supplementary Letters Patent amending the objects of the corporation directed that the properties of the Foundation be used to fund scholarships and research into specified neurological diseases.

28 The Estate submits that these amended objects are an implied condition subsequent and because the condition became incapable of being fulfilled due to the misappropriation of funds of the Foundation by Thomas G., the gift fails and must be returned to the Settlor, or his Estate.

29 There are a number of problems in the argument advanced by the Estate as to this first issue.

30 Subject to conditions, a gift, once complete, cannot be undone: *Richert v. Stewards' Charitable Foundation*, 2005 BCSC 211 (B.C. S.C.), at para 18; *Jardine v. Jardine* [2002 CarswellOnt 3602 (Ont. S.C.J.)], 2002 CanLII 2749, at para 23; and *Singh Estate (Trustee of) v. Shandil*, 2005 BCSC 1448 (B.C. S.C.) at para 19; aff'd 2007 BCCA 303 (B.C. C.A.).

31 There is no evidence of TCA imposing any reversionary or residual rights to receive back any portion of any monies he donated directly or caused to be donated to the Foundation, at any point in time.

32 The Estate advances its claim on the presumption that the $3,813,507 that existed in 2006 is the then

residue of the $5,000,000 donation caused to be made in 1989 by TCA.

33 "[T]he relevant time to assess donative intent is the time of the transfer of property from one party to another" (*Campbell v. MacKenzie*, 2003 ABPC 203 (Alta. Prov. Ct.), at para 6 ("*Campbell*")). As such, the relevant time to assess TCA's intent with respect to any conditions is when he transferred the funds to the Foundation.

34 There is no evidence as to the source of the $5,000,000 which TCA caused to be donated or funded into the Foundation in 1989. The present claim by the Estate is on behalf of the deceased TCA and his Estate. It is the claim of the deceased in his personal capacity.

35 There is no evidence as to any express conditions in 1989.

36 There is no issue that TCA in 1989 caused that funding to flow into the Foundation. The source and therefore the original ownership thereof however are not in evidence. What is known is that the deceased was a very successful developer and owner of real estate and he caused funding of $5,000,000 to be made to the Foundation in 1989.

37 The Estate filed as part of its claim, a 2006 Charity Information Return which shows that the Foundation in 2006 had assets in the amount of the Claim, namely, $3,813,507. Those assets include an account receivable of $885,000 as well as long-term investments in the amount of $2,893,382.

38 Pursuant to line 4,250 of the 2006 return, the $2,893,382 was "not used in the charitable program."

39 A considerable portion of the original $5,000,000 caused to be donated to the Foundation in 1989, had already been expended according to a full and final release between and executed on September 16, 2005, by TCA, Thomas G. and the Foundation. That release records funding provided to the Foundation in 1998 by TCA in the amount of $2,858,329, which is above the $5,000,000 funding in 1989. Combined, these two donations to $7,858,329. Eight years later, there is a maximum of $3,813,507 in the Foundation.

40 As to this 1998 funding of 2.8 million dollars, the release records that the Foundation is irrevocable beneficiary thereof. Pursuant to this release, TCA and Thomas G. forever released each other from any claims and agree not to allow the Foundation to pursue any claims against TCA for any dealings on behalf of the Foundation, provided that all loans to TCA have and will be repaid by him. There appears to have been an issue involving TCA and the Foundation.

41 The objects of the original Foundation in 1989 are broadly stated and provide that the Foundation is to use its principal and income exclusively for legally charitable purposes. The Foundation however is permitted to borrow money, issue debentures, provide security for repayment of such debt and to construct and own real property.

42 The August 21, 2006 Supplementary Letters Patent creating more specific charitable objectives, namely scholarships and research into neurological diseases but repeat the other above earlier general objects.

43 TCA was neither a member nor Director of the Foundation at the time of these 2006 Supplementary Letters Patent. These amended subsequent objects are not conditions associated with or imposed by TCA or his Estate. They are amended objects enacted by the Foundation subsequent to TCA's involvement in the Foundation. These specific neurological objects are not conditions subsequent of TCA.

44 In its present claim of $3,813,507, being the total assets declared in the Information Return in 2006, the Estate disregards all events involving the Foundation during the next eight years.

45 The Estate of TCA incorrectly assumes a freeze was or should be imposed on funds of the Foundation in 2006.

46 The financial records of the Foundation in the years 2006 through 2008, indicate that it continued to distribute some money for charitable purposes.

47 James Meuse was examined under oath by the Receiver on April 29, 2013. Mr. Meuse was a Director of the Foundation from 2008 until February, 2013. Mr. Meuse resigned because expenditures were being made from the Foundation at the direction of Thomas G., for the benefit of Mr. Thomas G.'s children and/or their education.

48 Mr. Meuse states that the charitable donations made by the Foundation stopped in approximately October of 2011 and that no charitable donations were made between then and the time that he resigned in February of 2013.

49 Charitable donations continued to be made by the Foundation after 2006 and it is therefore artificial to state that the Estate has a claim to the extent of the amount of the 2006 listed assets, including the $2.893 million listed as not used for charitable purposes.

50 The combination of: (a) the final release signed by TCA in 2005 evidencing irrevocable donation to the benefit of the Foundation 2.8 million dollars, some or all of which, must be included in the 2006 statement of assets, (b) the opinion of the court appointed solicitor of TCA in 2006 that TCA had no right or interest in and to the Foundation's assets as of that point in time, and (c) the ongoing charitable donations between 2006 and 2011; directly contradicts the position that TCA or his Estate is entitled to payment of the 2006 value of the Foundation in priority to all other claims.

51 The claim by the Estate further ignores the fact that Thomas G. undertook a program in which he systematically transferred assets belonging to other respondent corporations, including investment funds from the Applicants advanced to fund real property developments into the Foundation. The Estate now claims title to such investment funds diverted to the Foundation.

52 Thomas G. operated the respondent corporations as departments of one commercial enterprise.

53 There are affidavits filed by former employees including accountants within the respondent corporations, which indicate that Thomas G. intentionally inter-mingled monies and paid expenses without respecting the separate corporate identities amongst the respondent corporation.

54 The 2007 financial statements of the Foundation indicate that the receipts for that year totalled $1,298,292, of which $1,120,163 is listed as the Enduring Properties. The Enduring Properties are defined under the Foundation's Minutes dated June 24, 2008; as the Florida property in the amount of $725,000, the Donnelly mortgage in the amount of $200,000 and the 1003-Whitney Road property outside of Ottawa of some 148 acres.

55 The Whitney Road property was part of the Nature Walk development set up by Thomas G. under a separate respondent corporation, in which some of the investors were directed to pay their investment funds to the Foundation, which in fact occurred.

56 The Whitney Road property originally was owned by Thomas G. Through a number of inter-corporate investment-related transactions, he sold the Whitney property for $1,500,000 to the corporation he set up to develop that property. Thomas G. received at least partial payment of this sale by the transfer of investment funds from the Applicants who were investing in his proposed real property developments. The Applicants invested the monies to finance the construction of the condominium units and a golf course in this Ontario development which was not built.

57 The Florida property, Canada House, is a large residential home in the State of Florida which was purchased by Thomas G. and Karen FA as their residence, using monies obtained from the Foundation

according to the Receiver/Inspector and the examination of Thomas G. and Karen FA.

58 The Minutes of Settlement between the Applicants, the Receiver and Thomas G. and Karen FA, estimates the realization to the Receiver of a low of $1,851,000 and a high of $2,801,000. Of that amount, Canada House has an estimated low value of $1,200,000 and an estimated high value of $1,400,000.

59 Thomas G., Karen FA and their children resided continuously in Canada House in Florida since approximately February of 2013. Prior to that date, they transferred title of Canada House to the Foundation and established a tax scheme by which seven individuals invested hundreds of thousand dollars for which they received tax benefits as well as a life interest in Canada House.

60 The Receiver determined that since the transfer of Canada House to the Foundation, extensive renovations have been carried out on that property at a cost of some $774,000. The Receiver determined that $380,000 of those renovation costs came from the Foundation. $263,000 and $131,000 of those renovation costs however came from the respondent bankrupt corporations, Assaly Financial Corporation and Assaly Investment Property Corporation respectively.

61 The renovation costs of Canada House have largely been paid by investors who advanced monies intended for development of Ontario projects which never proceeded and then the subsequent transfer of those investment monies from the respondent corporations to the Foundation.

62 In an attempt to distance the assets of the Foundation from these proceedings, Thomas G. and Karen FA, at that point being the only remaining Directors of the Foundation, transferred title of Canada House from the Foundation to themselves in May of 2013. This couple subsequently quit claimed any interest in Canada House to the Receiver on April 3, 2014.

63 The Receiver determined that the investment by the Applicants in Nature Walk occurred in 2009 and the investment by the Applicants in Villa Montague occurred in 2010.

64 The Receiver determined that the residual assets of the Assaly group of companies, including the respondent corporations other than the Foundation, were transferred to the Foundation in the years 2011 and 2012.

65 The Receiver determined that on December 15, 2009, $159,000 was transferred from the respondent Millennium Springs Development Construction Corp. (”MSDC”) and invested on behalf of the Foundation. On January 31, 2011, $80,000 was paid by MSDC for “Florida House office expenses”. On May 9, 2009, $54,000 was transferred to the Foundation.

66 The transfer of assets from the respondent corporations to the Foundation includes the transfer of monies and shares of MSDC and Assaly Financial Corporation, Act 1 Corp. “(AFC”), with a value of approximately $348,000.

67 The Inspector previously reported to this Court that between September, 2011 and February, 2013, Thomas C. authorized the transfer of substantial assets owned by the Assaly Group of respondent corporations to the United States totalling a minimum of $806,564. The documentation disclosed to the Inspector appears to indicate that assets of an even higher value were transferred to the United States during this period of time. Specifically, all investment accounts of MSDC, AFC and AIPC were transferred to the Foundation in 2011.

68 Mr. Thomson on behalf of TD acknowledged on his examination that multiple transfers between the respondent corporate accounts, including the Foundation were common practice as directed by Thomas G.

69 Mr. Thomson acknowledged that at some point by February of 2013 all of the assets of the respondent corporations were consolidated into the Foundation and then moved to Florida.

70 The purchase and establishment of assets by the Foundation in some of its subsidiary corporations derives at least partially from investment monies paid by the applicants or from transfer of their investment monies in some of the respondent corporations to the Foundation.

71 This Court on April 18, 2013, determined that:

(a) All investment accounts of MSDC, AFC and Assaly Investment Program Corporation "(AIPC") were transferred to the Foundation in 2011.

(b) That on the instructions of Thomas G., all residual funds in the bank accounts of the Foundation were transferred from Canada to the United States on February 8, 2013.

(c) The Foundation is a body corporate affiliated to and controls MSDC.

(d) The Foundation is one of the Assaly Group of companies.

(e) The Foundation, MSDC and AIPC are affiliated body corporations under s. 22 of the *Canada Not-For-Profit Corporations Act.*

72 The Receiver has traced the transfer and payment of funds from the respondent corporations as follows:

(a) $463,000 to Thomas G.

(b) $221,000 to Karen FA.

(c) $680,000 to the above couple.

(d) $423,000 for payment against credit cards of the above couple.

73 MSDC, Assaly Investment Program Corporation, C. Assaly Financial Corporation and Act 1 Corporation made an assignment in bankruptcy on September 11, 2013.

74 The Foundation, under the direction of Thomas G., was conducting commercial activity. It did so in the form of the life interest it sold in Canada House. It did so in the form of its majority ownership of the shares in several of the respondent development corporations, all of which Thomas G. controlled.

75 The present assets of the Foundation incorporate the transfer to it of monies and assets belonging to the respondent corporations which were commercial corporations and not charities.

76 It is now highly artificial to attempt to impose a financial silo around each of the respondent corporations, particularly the Foundation, when the directing mind of those corporations carried on business as if each corporation was only a department of one commercial entity.

TCA and Estate's Claim

77 The 2006 Supplementary Letters Patent creating objects of research into neurological diseases originated from Thomas G., after the departure of TCA, cannot be relied upon now as conditions by the Estate requiring that the remaining donation revert to the Estate. The Estate is incorrect in this argument.

78 The Estate is further incorrect as, (a) simple mathematics indicate the vast majority of the original 1989 $5,000,000 donated had been spent by 2006, (b) there is no evidence who specifically donated the $5,000,000,

and (c) TCA made an irrevocable donation to the Foundation of $2,858,000 in 1998.

79 There are no express terms as was contained in the will in the case of *Women's Christian Assn. of London v. McCormick Estate*, 1989 CarswellOnt 533 (Ont. H.C.), and relied upon by the Estate in this case.

80 Case law, for the most part, stands for the principle that powers of revocation must be express: *Child v. Chase*, 1980 CarswellSask 161 (Sask. Dist. Ct.), at para 5; *Eberwein Estate v. Saleem*, 2012 BCSC 250 (B.C. S.C.) ("*Eberwein*") at para 19. As stated in *Young v. Young* (1958), 15 D.L.R. (2d) 138 (B.C. C.A.), at 139 -40 (cited with approval by the Ontario Court of Appeal in *Berdette v. Berdette* (1991), 3 O.R. (3d) 513 (Ont. C.A.) at p. 518 ("*Berdette*")):

> Nothing is clearer than that a gift thus made cannot be revoked unless an express power of revocation is preserved. None can be implied no matter how natural such an implication might be. Here, no matter what the plaintiff's expectations were, no power to revoke the gift to the defendant was reserved; so that was the end of the matter.

81 The Estate, in terms of the decision in *Victoria Order of Nurses for Canada v. Greater Hamilton Wellness Foundation*, 2011 ONSC 5684 (Ont. S.C.J.), is eight years late in seeking the present remedy. As acknowledged in that decision, the Court has jurisdiction under s. 4 of the *CAA* to require that the executor or trustee of the charity pay into court any funds in their hands. Any such order now however would involve payment of substantial and non-traceable amounts of money misappropriated from the applicants or derived from their investment in other for-profit corporations which assets Thomas G. later caused to be transferred to the Foundation which is now bankrupt.

82 The Estate in this argument is attempting to do exactly what it correctly faults Thomas G. for doing, namely ignoring the separate legal entities of these corporations in arguing conditions subsequent entitle the Estate to reimbursement of these 2006 assets.

83 In the face of the irrevocable release signed by TCA in 2005, the Estate cannot now argue there was a condition subsequent to the 1998 funding by TCA that the deceased or his estate is entitled to a refund of any remaining assets of the Foundation because the general charitable objects of the Foundation were, with exceptions, not complied with since 2006 or 2011.

84 The Receiver determined that the donations to the Foundation over the years include donations from parties other than TCA. In that way, the Estate is also attempting to establish priority ahead of those other donors.

85 At one point in time, Robert Assaly was a member of the Foundation's Board of Directors. His involvement in the Foundation and the acrimony, including litigation between Robert, and his brother, Thomas G., must have created knowledge in Robert of the inappropriate manner in which Thomas G. was administering the affairs of the Foundation. It is too late now to apply the stamp of charitable objects to the remaining inter-mingled money and assets within the Foundation which last made a charitable donation in 2011.

86 The provisions of the *CAA* do not provide specifically for the return of an absolute gift to a donor upon a charity's directors non-adherence to the corporate objects. Such remedy however could be available under sections 4(j) and 10(1), as well as under the Court's inherent jurisdiction to regulate charities.

87 That jurisdiction should not be exercised on the facts in this case.

88 The directing mind of a charity cannot improperly divert monies belonging to others into a charity and thereupon use the *CAA* as a shield to defeat creditors who can trace the misappropriation of their investment into a charity. A substantial portion of the assets in the Foundation are monies misappropriated from the Applicant investors or the assets they invested in.

89 The assets of a charitable corporation are not held by it as trustee for its charitable objects but rather are owned by that corporation beneficially, to be used in a fashion consistent with its objects. It is now generally accepted that unrestricted property of a charitable corporation is not to be construed as trust property held by a charitable corporation. As such, a charity may use an unrestricted gift to the full extent of its charitable objects based upon its corporate authority as a legal entity without the involvement of a charitable purpose trust. (*Christian Brothers*, *supra*, 390-91, 701-702 and *Terrence S. Carter*: "Donor-Restricted Charitable Gifts: A practical overview revisited II" September, 2003, at pp. 7-8).

90 The Estate is incorrect in asserting that it has a priority to the remaining assets presently located within the Foundation in priority to the claims of the Applicant creditors.

91 The Appellants are not entitled to money misappropriated from others because the wrongdoer deposited it in a charity.

92 TCA and the Estate have no claim or priority to the assets in the Foundation.

Trust

93 A charity is not immune from liability to those who suffered at its hand. Assets of the charity, owned beneficially or in trust, are available to respond to those liabilities. *Christian Brothers of Ireland in Canada, Re* (2000), 47 O.R. (3d) 674 (Ont. C.A.). The applicants have numerous potential claims against the Foundation which include misappropriation and conversion of their money.

94 As to the argument that TCA intended by his donations to create a trust, the Receiver has determined that no tax returns were ever filed on behalf of any alleged trust nor are there any documents reflecting the creation or the intention to establish such a trust.

95 Such misappropriated assets belonging to the Applicants are, within the meaning of s. 67(1)(a) of the *BIA*, held by the bankrupt in trust for the Applicants.

96 The evidence establishes a lack of certainty of intention and objects as considered in *Christian Brothers of Ireland in Canada, Re* (1998), 37 O.R. (3d) 367 (Ont. Gen. Div. [Commercial List]).

97 The Appellants have failed to establish an error by the Receiver based on trust law.

98 The Estate is not a simple creditor. The deceased caused or donated to the Foundation. The deceased acknowledged the irrevocable nature of the 1998 second donation seven years later in September of 2005.

99 The Estate is not a creditor of the Foundation or other corporate respondents. It has no equal right to share in the consolidated remaining assets in the Foundation.

Consolidation or Pooling

100 As noted by Justice Farley in *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) "... consolidation by its very nature will benefit some creditors and prejudice others ..." The rationale for consolidation of assets between corporations in the present case is justified because the businesses were intertwined, were operated as a single business and the allocation of value and claims between the businesses would be burdensome).

101 The Foundation's business was not since 2006 separate and distinct from the business activities of the other respondent corporations. As previously determined, the activities of the respondent corporations, including the Foundation, since 2006 was operated as part of one business enterprise. That business enterprise misappropriated investors' money and is indebted to the Applicants in an amount which far exceed the best

realizable value of the amalgamated assets of such enterprise.

102 Extensive professional fees have been incurred to date in the inspection, receivership, and bankruptcy proceedings involving this Assaly group of companies, including the Foundation, in Canada and the United States. The Appellants' argument that further assets should be expended in an attempt to historically trace funding within the Foundation is inappropriate and financially impractical given the extent to which existing claims far exceed assets.

103 Even if the monies and assets of the Foundation are trust monies, like the decision in *Christian Brothers*, such trust monies in the Foundation are not held in priority to the Foundation, but are available to the claims of creditors.

104 The 2008 Board of Directors' Minutes of the Foundation demonstrates that the Foundation was carrying on business and was not restricting its activities to charitable purposes.

105 The Foundation's Board of Directors' Minutes dated June 24, 2008, reflect that the transfer of the majority of the shares of Millennium Springs Properties Ltd. and Assaly Investment Program Corporation are transferred to the Foundation. The ownership of the majority control of these corporations, combined with the 2007 financial statements of the Foundation showing the value of the 1003 Whitney Road property and the Donnelly mortgage, both derived from respondent corporations, confirms the commercial business activities and integration of all the respondent corporations into one combined business enterprise in the Foundation, of which Thomas G. was the directing mind.

106 A June 24, 2008 Directors' meeting refers to the Foundation's two new corporations being Millennium Springs Properties Ltd. and Assaly Investment Program Corporation. Millennium Springs Properties Ltd. is also known as Millennium Springs Development & Construction Corp. or MSDC.

107 As to consolidating the bankrupt estates of several parties, the Court has jurisdiction at law and in equity to exercise original, auxiliary and ancillary jurisdiction in bankruptcy pursuant to s. 183(1) of the *BIA*.

108 Substantive consolidation is appropriate where the directing mind of the bankrupt estates has conducted the affairs of the bankrupt with the total disregard for the niceties of corporate identity and separate juridical personalities.

109 In *A. & F. Baillargeon Express Inc., Re* (1993), 27 C.B.R. (3d) 36 (C.S. Que.) para. 5, the corporate records were so hopelessly confused or non-existent that it was next to impossible to know which fixed assets belonged to which of the respective bankrupt company.

110 Notwithstanding the absence of a statutory provision in the *BIA* in empowering the court to consolidate such bankrupt estates, the courts in Canada and the United States have relied upon their inherent jurisdiction to do so, where to do otherwise would be impractical given the intermingling and difficulty in separating access, transactions, and finances between the bankrupt estates. (*A. & F. Baillargeon Express Inc., Re*, *supra*, para. 21 as well as *Associated Freezers of Canada Inc., Re* (1995), 36 C.B.R. (3d) 227 (Ont. Bktcy.)).

111 Intermingling and uncertainty of ownership of assets or supports substantive consolidation. (*Associated Freezers of Canada Inc., Re*, *supra*, para. 5.)

112 Substantive consolidation in this case if permitted, is not to the "prejudice or expense of a particular creditor" namely the Estate, as per *J.P. Capital Corp., Re* (1995), 31 C.B.R. (3d) 102 (Ont. Bktcy.).

113 The test as to substantive consolidation requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:

(a) difficulty in segregating assets;

(b) presence of consolidated Financial Statements;

(c) profitability of consolidation at a single location;

(d) commingling of assets and business functions;

(e) unity of interests in ownership;

(f) existence of intercorporate loan guarantees; and

(g) transfer of assets without observance of corporate formalities

in order to assess the overall effect of consolidation.

(*Atlantic Yarns Inc., Re*, 2008 NBQB 144 (N.B. Q.B.), paras. 33-34 and *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affirmed in *Northland Properties Ltd., Re*, [1989] B.C.J. No. 63 (B.C. C.A.) and *PSINET Ltd., Re, supra*, at para. 11)

114 The above analysis of the facts establishes the difficulty in segregating the assets, the commingling of assets and business functions and the transfer of assets regardless of corporate identities. The facts establish the presence of consolidated financial statements to the extent that assets consisting of some of the developments are specifically referred to in the financial statements of the Foundation.

115 This Court must be cognizant of the Receiver's opinion that further tracing efforts will produce uncertain results and involve the expenditure of considerably more money which is to the risk of the creditors of the bankrupt corporations and not the Foundation.

116 Thomas G. directed and managed the respondent corporations, including the Foundation, as a consolidated commercial entity over eight years. It is artificial and impractical at this point to attempt to disengage and isolate the affairs and finances only of the Foundation.

117 For the reasons stated, substantive consolidation of the assets of the bankrupt Estate, including the Foundation, are hereby authorized.

Conclusion

118 For the above reasons, the appeal of the Estate from the disallowance of its proof of claim is hereby dismissed.

Costs

119 Any party seeking costs shall provide the court with brief written submissions within 30 days. Any reply thereto shall be submitted within 21 days thereafter.

Appeal dismissed.

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1993 CarswellQue 49
Quebec Superior Court, Bankruptcy and Insolvency Division

A. & F. Baillargeon Express Inc., Re

1993 CarswellQue 49, 27 C.B.R. (3d) 36

Re bankruptcy of each of A. & F. BAILLARGEON EXPRESS INC., WESTERN CRATING & MOVING LIMITED, KENWOOD'S MOVING & STORAGE (1986) INC., A. & F. BAILLARGEON EXPRESS (CANADA) INC., and BORISKO BROTHERS MOVING INC. (debtors); RICHTER & ASSOCIATES INC. (trustee-petitioner)

Greenberg J.

Judgment: May 28, 1993
Docket: Docs. S.C. Montreal 500-11-000476-933, 500-11-000519-930, 500-11-000520-938, 500-11-000477-931, 500-11-000478-939

Counsel: *Mark Schrager*, for trustee-petitioner.

Subject: Corporate and Commercial; Insolvency; Estates and Trusts

Headnote

Bankruptcy --- Administration of estate — Trustees — Legal proceedings by trustee

Practice — Consolidation of administration of bankrupt estates — Twenty-six companies forming highly complex group and intermingling assets, operations and liabilities as though they were one company — Five companies in group being bankrupt — Practical approach being appropriate — Expenses of bankruptcy likely to increase if trustee required to administer each of five companies separately — Consolidation of administration of bankrupt estates ordered.

Procédure — Consolidation de l'administration des actifs de sociétés faillies — Vingt-six sociétés formant un regroupement complexe et confondant leurs actifs, opérations et responsabilités comme s'il ne s'agissait que d'une seule compagnie — Cinq sociétés faillies au sein du groupe — Approche pratique étant appropriée — Frais de la faillite susceptibles d'augmenter si le syndic est tenu d'administrer chacune des cinq sociétés séparément — Consolidation de l'administration des actifs des sociétés faillies ordonnée.

The appellant was appointed trustee for each of the five bankrupt companies, as well as interim receiver for 21 other companies. All those companies formed a highly complex group. The five bankrupt companies operated as if they were one, with no distinction as to their customers, banks and assets, and with total disregard for corporate identity and separate judicial personalities. The 26 companies held only four operating bank accounts and one concentration account into which all moneys funnelled through other accounts. There was a total intermingling of assets, operations and liabilities. As interim receiver, the trustee was responsible for collecting the receivables of the 21 non-bankrupt companies.

The trustee brought motions seeking the consolidation of the administration of the five bankrupt estates. The registrar dismissed the motions and the trustee appealed.

Held:

The appeal was allowed.

The concept of protection incorporated into Canadian bankruptcy law in the recent major amendments to the *Bankruptcy and Insolvency Act* (the "Act") justified the court to refer to, and to some extent rely upon, American jurisprudence and authorities, as opposed to the traditional reference to British bankruptcy law and authorities.

In that context, the following statement must be considered in consolidation matters: "If the relationships between affiliates are so obscured that it is impossible to disentangle their affairs, of course their bankruptcy proceedings should be consolidated. In such a situation, even a simplistic reliance argument could not seriously be advanced."

The trustee testified that the records had become hopelessly confused and in many instances were non-existent, so that it was impossible to identify which fixed assets belonged to which of those companies. Also, the customers were billed by whichever company management deemed would be the most expedient.

It was extremely unlikely that there would be any dividend for ordinary creditors but, to the extent that there was any possibility, it was important that the secured creditors realize the maximum possible on their claim. Therefore, if the trustee was required to perform a separate body of work in respect of each of the five companies separately, the expenses of the bankruptcy would be increased and the realization by the secured creditors would be reduced, thereby diminishing the already faint hope of any dividend to the ordinary creditors.

The concern that one creditor might receive an advantage because of the consolidation while another was disadvantaged was diminished by the fact that the likelihood of realization was remote and that it would have been an unnecessary waste of money, time and effort to oblige the trustee to go through the full exercise in respect of each one of those five companies.

The trustee brought the motions in order to be able to have one consolidated list of creditors for the purpose of sending the notice of the calling of the first meeting of creditors, since it would have been nearly impossible to distinguish which creditors related to which specific one of those five companies. The Act contains no statutory provisions dealing with consolidations, nor does the United States *Bankruptcy Act*. However, courts in the United States have adopted that approach when it is necessary and where to do otherwise would be impractical.

Also, the *Companies' Creditors Arrangement Act* does not contain a statutory provision authorizing consolidation, but it has been permitted where companies' affairs were intermingled in a similar fashion.

In bankruptcy matters, the court exercises an equitable as well as a legal jurisdiction and practicality is always necessary. The Act is a businessmen's law and practical business considerations should not be disregarded.

The registrar did not err in his judgment since he did not have the chance to consider the evidence presented on appeal as well as the arguments in law and the jurisprudence, both Canadian and American.

If a creditor feels unjustly prejudiced by the consolidation, it may petition the court pursuant to s. 187(5) of the Act to have the judgment modified, varied, rescinded or otherwise dealt with and the notice to all creditors would contain such information.

. . . . .

L'appelante a été nommée syndic de chacune des cinq sociétés faillies, et séquestre intérimaire de 21 autres sociétés. Toutes ces compagnies formaient un regroupement extrêmement complexe. Les cinq sociétés faillies fonctionnaient comme s'il ne s'agissait que d'une seule compagnie, sans faire de distinction quant à leurs clients, leurs institutions bancaires ou leurs actifs, et sans tenir compte des identités corporatives et personnalités juridiques distinctes de chacune. Les 26 sociétés ne détenaient que quatre comptes d'opérations bancaires et un seul compte consolidé réunissant tout l'argent provenant des autres comptes. Les actifs, opérations et responsabilités étaient entièrement entremêlés. En sa qualité de séquestre intérimaire, le syndic avait la responsabilité de percevoir les comptes recevables des 21 sociétés non faillies.

Le syndic a présenté des requêtes afin que soit ordonnée la consolidation de l'administration des actifs des cinq sociétés faillies. Le registraire a rejeté les requêtes et le syndic en a appelé de cette décision.

Arrêt:

Le pourvoi a été accueilli.

La notion de protection incorporée au droit de la faillite au Canada par les modifications récemment apportées à la *Loi sur la faillite et l'insolvabilité* (la "Loi") justifiait la Cour de référer et, dans une certaine mesure, de s'en remettre à la jurisprudence et à la doctrine américaines, par opposition au renvoi traditionnel au droit de la faillite britannique.

Dans ce contexte, il faut tenir compte de la proposition suivante en matière de consolidation : [Traduction] "Si les rapports existant entre des entreprises affiliées sont tellement embrouillés qu'il est impossible de démêler leurs affaires, alors les procédures de faillite qui les concernent devraient être consolidées. Dans une telle situation, même le plus simple argument de confiance ne pourrait sérieusement être invoqué."

Le syndic a déclaré que les dossiers étaient devenus désespérément confus et, dans plusieurs cas, littéralement inexistants, de sorte qu'il était impossible d'identifier à laquelle de ces sociétés appartenaient les immobilisations. De plus, les factures adressées aux clients provenaient de la société considérée comme étant la plus expéditive.

Il était très peu probable qu'un dividende puisse être versé aux créanciers ordinaires mais, dans la mesure où cela demeurait possible, il était important que les créanciers garantis réalisent le plus gros montant possible de leurs réclamations. Par conséquent, si le syndic se voyait obligé d'exécuter des tâches distinctes pour chacune des cinq sociétés prises séparément, les frais de la faillite augmenteraient et la réalisation des créanciers garantis diminuerait, réduisant ainsi l'espoir déjà précaire qu'un dividende soit éventuellement versé aux créanciers ordinaires.

La crainte qu'un créancier soit avantagé par la consolidation au détriment d'un autre créancier était tempérée par le fait que la probabilité de la réalisation était assez éloignée, et que le fait d'obliger le syndic à effectuer toutes ces tâches pour chacune des cinq sociétés individuellement aurait entraîné une perte inutile d'argent, de temps et d'énergie.

Le syndic a présenté ces requêtes afin de n'avoir qu'une seule liste consolidée des créanciers lorsqu'il serait temps d'envoyer l'avis de convocation de la première assemblée des créanciers, puisqu'il aurait été virtuellement impossible de distinguer à laquelle des cinq sociétés spécifiquement était lié chacun des créanciers. La Loi ne comporte aucune disposition statutaire concernant les consolidations, non plus que la loi américaine sur la faillite. Toutefois, les tribunaux des États-Unis ont adopté cette approche lorsque cela s'avérait nécessaire, et lorsqu'une autre méthode se serait avérée peu pratique.

Par ailleurs, la *Loi sur les arrangements avec les créanciers des compagnies* ne comporte aucune disposition statutaire autorisant la consolidation, bien qu'elle ait été permise dans des cas où les affaires de sociétés étaient confondues de façon similaire.

En matière de faillite, la Cour exerce une juridiction d'équité aussi bien que juridique, et l'aspect pratique est toujours important. La Loi est une loi d'hommes d'affaires, et des considérations d'affaires pratiques ne devraient pas être négligées.

Le registraire n'a pas fait erreur en rendant sa décision puisqu'il n'a pas eu l'opportunité de se pencher sur la preuve soumise en appel, ni sur les arguments invoquant la loi et la jurisprudence, canadiennes et américaines.

Si un créancier devait se considérer injustement désavantagé par suite de la consolidation, il pourrait toujours présenter à la Cour une requête en vertu du par. 187(5) de la Loi afin que le jugement soit modifié, annulé ou autrement révisé, et l'avis aux créanciers comporterait une mention à cet effet.

Table of Authorities

Cases considered:

Chemical Bank New York Trust Co. v. Kheel, 369 F.2d 845 (2d Cir. 1996) — *considered*

Northland Properties Ltd., Re, *(*sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 73 C.B.R. (N.S.) 195, 34 B.C.L.R. (2d) 122, [1989] 3 W.W.R. 363 (C.A.) — *applied*

Statutes considered:

Bankruptcy Act (U.S.).

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

s. 183

s. 187(5)

s. 192(4)

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

Appeal from registrar's decision to dismiss trustee's motions seeking consolidation of administration of five bankruptcy estates.

***Greenberg J.* (orally):**

1 In the five bankruptcy files which appear on today's Roll and which we will now enumerate: A. & F. Baillargeon Express Inc., Western Crating & Moving Limited, Kenwood's Moving & Storage (1986) Inc., A. & F. Baillargeon Express (Canada) Inc. and Borisko Brothers Moving Inc., each of those companies has been declared bankrupt and Richter & Associates Inc. named as Trustee.

2 Those five companies, together with twenty-one others not in bankruptcy, form together what is commonly referred to in the moving trade as the "Baron Group of Companies" and, technically, the parent company bears the name "Baron Moving Systems Inc."

3 The Trustee had petitioned the Registrar of the Court to order the Consolidation of the administration of those five bankruptcy estates, and all five Motions were dismissed by the Registrar on May 26th last. The Trustee now comes before this Court on appeal from those decisions in virtue of s. 192(4) of the *Bankruptcy and Insolvency Act*,[1] hereinafter "the Act".

4 The organigram of the group of twenty-six companies was filed as Exhibit R-1 and is, to say the least, a highly complex one. It has also been proven by the Exhibits and the testimony of the representative of the Trustee that, in the language of the trade, these five companies comprised the "Montreal Branch" in the case of three of them and the "Toronto Branch" in the case of the two others. The three in the first instance, the Montreal Branch, were A. & F. Baillargeon Express Inc., Western Crating & Moving Limited and Kenwood's Moving & Storage (1986) Inc., and the Toronto Branch consisted of the other two companies, A. & F. Baillargeon Express Canada Inc. and Borisko Brothers Moving Inc.

5 It has been demonstrated in the evidence that these five companies operated as if they were one, indistinctly as to their customers, their bank and their assets, with intermingling; trucks being registered with the

Provincial authorities as being the property of one company and yet appearing on the books of another, and moves being booked and executed by one company or another and billed by even a third. There was a total disregard for the niceties of corporate identity and separate juridical personalities.

6 The leading Exhibit in that regard is Exhibit R-2, which is the "Joint Banking Agreement" between the Canadian Imperial Bank of Commerce (hereinafter "the CIBC") and the companies enumerated therein. We note with interest that, even though there is in that Agreement a list of those twenty-six companies, there are among them only four operating accounts with that Bank, so that certainly it is not true to say that each company had its own bank account, which again is in keeping with the total intermingling of assets, operations, liabilities, etc.

7 Part II of that Schedule is entitled the "Concentration Accounts" and indicates only the name of the lead borrower, Baron Moving Systems Inc. & al. Hence, Baron Moving Systems Inc., as the lead borrower, is the only company of the Group which operated a "Concentration Account". It has been explained in evidence and argument how this account is the "nest to which all the robins returned", and this is the resting place of all monies funnelled through other accounts and that, in effect, it is as though we were dealing with only one company.

8 In respect of the other twenty-one not-bankrupt companies of the group of twenty-six, and not therefore among the five companies in respect of which the Trustee now petitions this Court, the Court has previously appointed the same Trustee in the capacity of Interim Receiver, but with powers and seizin limited only to the collection of the accounts receivable.

9 All of those accounts receivable are part of the security of the CIBC, which had invited in the Bank of Nova Scotia as a co-participant, and the latter bank was co-Petitioner on the Bankruptcy Petitions. Accordingly, it is only in respect of the five bankrupt companies that the present proceedings are taken, but the same Trustee is proceeding, as Interim Receiver, to collect the receivables of the other twenty-one companies as well.

10 Traditionally, until the recent major amendments to the Act, Canadian bankruptcy law has been inspired by British bankruptcy law. Thus, it has been common to refer to British authorities and only less frequently to American authorities. However, as a result of those recent amendments, one now speaks of "protection under the Bankruptcy Act", a concept which has been long known to American bankruptcy law but not known to Canadian bankruptcy law as expressed in the former version of the Act.

11 This explains in large part the frequent recourse in the past by debtor companies to the *Companies' Creditors Arrangement Act*,[2] (hereinafter the "CCAA"). The Act now has been reformed to bring it more in line with the spirit of the United States Bankruptcy Act, which we believe gives this Court even greater justification to refer to and to some extent rely upon American jurisprudence and authorities.

12 The attorney for the Trustee has brought to our attention a very well researched article published in the *California Law Review*[3] relative to Consolidations in matters of Bankruptcy and the "Flow-of- Assets Approach". We read in that article[4] the following very interesting citation:

> An alternative theme of some recent case law is that the bankruptcy proceedings of affiliated corporations should be consolidated whenever it is impractical to separate their financial affairs. The outstanding example of this proposition is the majority opinion in *Chemical Bank New York Trust Company* vs. *Kheel* ...[5]

a decision of the second American Circuit Court of Appeals.

13 The enterprise in that case consisted of eight affiliates, which the Referee found were "operated as a single unit with little or no attention paid to the formalities usually observed in independent corporations ...". Upon motion by a major creditor, the assets and liabilities of the corporations were consolidated. Chemical Bank, a creditor of one of the stronger affiliates, appealed. The majority opinion in *Kheel* is said in that Article[6] to reflect the following proposition:

> If the relationships between affiliates are so obscured that it is impossible to disentangle their affairs, of

> course their bankruptcy proceedings should be consolidated. In such a situation even a simplistic reliance argument could not seriously be advanced.

14 Further on in that same Article, and in the actual *Kheel* case itself, the extract which is of interest[7] reads as follows:

> The debtor corporations are all owned or controlled by the former shipping magnate, Manuel E. Kulukundis. The Referee found that the debtor corporations were operated as a single unit with little or no attention paid to the formalities usually observed in independent corporations, that the officers and directors of all, so far as ascertainable, were substantially the same and acted as figureheads for Kulukundis, that funds were shifted back and forth between the corporations in an extremely complex pattern and in effect pooled together, loans were made back and forth, borrowings made by some to pay obligations of others, freights due some pledged or used to pay liabilities and expenses of others, and withdrawals and payments made from and to corporate accounts by Kulukundis personally not sufficiently recorded on the books.

15 That recitation reflects very closely the situation in the case of the Baron Group and specifically the five companies with which we are here concerned. It is interesting to note that the resolution of each participating company affixed to that Joint Banking Agreement, Exhibit R-2, is in all cases signed by the same Mr. B. Baillargeon, so that he can readily be seen to be the equivalent of Mr. Kulukundis in the American case cited above.

16 Also, the Trustee has testified here that the records became so hopelessly confused, and in many instances were non-existent, that it is impossible to know which fixed assets belong to which of those companies. People who did business with them, either as suppliers (therefore creditors) or customers (therefore debtors in respect of those accounts receivable), were simply calling the Montreal office or Branch of that Group of companies, often without distinguishing among them, and were billed indiscriminately as among the Group of companies by the one which management felt was most expedient.

17 The evidence of the Trustee is also to the effect that, in this case, it is extremely unlikely that there will be any dividend for ordinary creditors. However, to the extent that there is any possibility, it is important that the Banks, which are secured, realize the maximum possible on their claims. If we were to oblige the Trustee to perform a separate body of work in respect of each of these five companies, thereby increasing the expenses of the bankruptcy and reducing the realisation by the secured creditors, that would only further diminish the already faint hope of any dividend to the ordinary creditors.

18 During the argument and the evidence, we expressed the concern that a creditor of one of those five companies who might stand to get a larger dividend on an individual company basis than through an intermingled and consolidated basis could be prejudiced, whereas other creditors in respect of other specific companies might be benefited by the mechanism of consolidation.

19 That first concern is largely diminished by the fact that the likelihood of realization is remote and that it would be an unnecessary waste of money, time and effort to oblige the Trustee to go through the full exercise in respect of each one of those five companies. Moreover, the Trustee must by next Monday, today being Friday, send out lists and Notices of the calling of the First Meetings of Creditors.

20 We understand that one meeting will be held in Toronto with respect to the two companies to which we referred as the “Toronto Branch” and another in Montreal with respect to the three to which we referred as the “Montreal Branch” and that, on a practical basis, it would be nearly impossible to distinguish without simply guessing which creditors relate to which specific one of those five companies. The Trustee and the attorneys on his behalf have presented these proceedings in order to be able to have one consolidated list of creditors used to send out the notices for those meetings.

21 It is important to note that the Act has no statutory provision dealing with Consolidations. Of interest also is the fact that the United States Bankruptcy Act has none either. Yet, in spite of the absence of any statutory authority for such a process, the doctrine and the Judgments of the Courts in the United States have adopted that approach where it is necessary and where to do otherwise would be impractical.

22 Another interesting analogy is the case of *Re Northland Properties Ltd.*[8] That case also involved a Group of companies and it was a plan of reorganization under the CCAA, which statute also does not contain a statutory provision authorizing Consolidation. There, the Consolidation for the purposes of that Law in respect of the group of companies whose affairs were intermingled in a similar fashion to that of the Baron Group here was approved by the Appeal Court of British Columbia.

23 There is also the consideration that in Bankruptcy matters the Court exercises an equitable[9] as well as a legal jurisdiction, and that practicality is always the order of the day. It is frequently said in the jurisprudence that the Act is a “businessman’s law” and that practical business considerations should not be disregarded, as they sometimes are in other domains where a strict interpretation of the law must be followed and observed.

24 The decision of this Court is to grant the request of the Trustee in this case. Hence, we wish to make clear that this in no way implies that the Registrar erred in his Judgment, from which this is an Appeal. Most of the evidence presented to us was not presented before him. He did not hear any witness, as we did, and, more importantly, the arguments in law and the jurisprudence, both Canadian and American, as well as the American doctrine, were not laid out before him due to the exigencies of *ex parte* procedures before the Registrar in this Jurisdiction.

25 It is therefore without in any way concluding that he erred in misinterpreting any part of the Act, since no specific provision of the Act was in play before him.

26 Moreover, in virtue of s. 187(5) of the Act, it is always open for this Court to review an Order or Judgment already rendered and to rescind, modify or revise it. Therefore, this Judgment will also require, in its Notice to all the creditors of the five companies, that the Trustee advise that by Judgment of the Court on this day, an Order was given consolidating the administration of the five bankruptcy estates.

27 This must be explained to the creditors at the two meetings, in terms of the reasons which underlay that decision, and it must be pointed out specifically to them that any creditor who feels itself or himself unjustly prejudiced by such a Consolidation may petition the Court pursuant to s. 187(5) to modify, vary, rescind or otherwise deal with or affect the present Judgment.

28 FOR THE REASONS GIVEN ORALLY AND RECORDED, THE COURT:

29 MAINTAINS the appeal in each of the five files;

30 REVERSES and ANNULS the decision of the Registrar in each of those five cases rendered by him on May 26, 1993 with respect to the “Motion for the Consolidation of the Administration of Bankruptcy Estates” dated May 21, 1993 in each of those files and, rendering Judgment on each of those five Motions of May 21, 1993;

31 GRANTS Judgment in accordance with the conclusions thereof;

32 ORDERS the Trustee to inform all Creditors of the five Bankrupt Companies of the present Judgment and generally of the reasons for same and moreover inform them of their right under s. 187(5) of the *Bankruptcy and Insolvency Act* to apply to the Court to review, rescind or vary this Order, if they allege a particular prejudice and can prove same;

33 THE WHOLE with costs against the mass.

Appeal allowed.

Footnotes

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

2 R.S.C. 1985, c. C-36.

3 Volume LXV, p. 720.

4 At pp. 733 and 734.

5 369 F.2d 845 (2d Cir. 1966).

6 At pp. 734 and 735.

7 At p. 846.

8 (1989), (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 34 B.C.L.R. (2d) 122 (C.A.).

9 Section 183 of the Act.

2006 CarswellOnt 3449
Ontario Superior Court of Justice [Commercial List]

Ashley v. Marlow Group Private Portfolio Management Inc.

2006 CarswellOnt 3449, [2006] O.J. No. 1195, 151 A.C.W.S. (3d) 763, 22 C.B.R. (5th) 126, 270 D.L.R. (4th) 744

David Ashley, Alex Chapman, Michael DePencier, Estate of Clive Bennett Mortimer, Bruce Heyland, David Williams and Xenolith (Plaintiffs) and Marlow Group Private Portfolio Management Inc., Marlow Group Securities Inc., Marlow Group Inc., Marlow Private Estate Builders Inc. and Terrence W. Marlow (Defendants)

Mesbur J.

Heard: January 6, 2006
Judgment: January 17, 2006*
Docket: 05-CL-005797

Proceedings: additional reasons at *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006), 2006 CarswellOnt 3419 (Ont. S.C.J. [Commercial List])

Counsel: Tanya Pagliaroli for Plaintiffs (The "Ashley Group")
Derek J. Bell, Raj Sanhi for Receiver, A. Farber & Partners Inc.
Terrence J. O'Sullivan, M. Paul Mitchell for John Goudey, Thomas Abel, Shobana Ananth, Shane Anderson, Donald Bayer, Michael Caicco, Charles Cutts, John Coudey, Arnold H. Hochman, Mark Irwin, Gary Levy, Karen Malatest, Hamish McEwan, Pierre Meunier, Paul Oakley, Barry Reiter, Mike Stroud, Michelle Szames, Stephen Szames, James Turner, John Unger, 2044102 Ontario Inc. (The "Goudey Group")
Arnie Herschorn for Paul Benson, Brenda Benson, 145403 Ontario Inc. (The "Benson Group")
O. Pasparakis for Goodman & Company, Investment Counsel Ltd.
M. McNaughton, B. Wong for Canadian Investor Protection Fund
Roy Lee for Superintendent in Bankruptcy
Jeff Carhart, Arthi Sambasivan for Ron Eden

Subject: Insolvency; Property

Headnote

Bankruptcy and insolvency --- Property of bankrupt — Property in hands of bankrupt agent or broker — Stockbrokers
Defendant, M Inc., was investment advisor and securities dealer — Plaintiffs G Group, B Group and E were customers of M Inc. — M Inc. held securities for plaintiffs which were registered in M Inc.'s name — Receiver was appointed over M Inc.'s assets — Receiver sought order declaring that only securities registered in names of M Inc.'s customers were "customer name securities" under Part XII of Bankruptcy and Insolvency Act, and placing remainder of securities into pool fund to be shared proportionally — G Group brought cross-motion to have its securities declared customer name securities or, alternatively, to have its securities returned under trust claim — B Group and E brought motion to have their securities in limited partnership, CMP, re-registered in their names prior to bankruptcy — Motion granted; cross-motions dismissed — G Group's securities were not customer name securities — Section 253 of Act defines customer name securities as those "registered in the name of the customer" — Fact that all customer assets held by M Inc. had been identified, and that respective owners had confirmed ownership, was not equivalent to registration as contemplated by s. 253 — Proposed

re-wording of s. 253 in Bill C-55, adding “or recorded in appropriate manner” to definition of customer securities, offered no assistance — Ability to identify beneficial owner did not constitute recording in appropriate manner — G Group could not assert trust claim — Under s. 261 of Act, all securities held by M Inc. at date of bankruptcy vested in trustee, except for customer name securities — There was no basis upon which B Group and E could require register of CMP to be altered, as they were not subscribers — CMP’s register showed M Inc. as subscriber for units in question.

Bankruptcy and insolvency --- Consolidation orders and orderly payment of debts
Substantive consolidation of bankrupt estates — Defendant, M, was sole shareholder and officer of four corporate defendants: M Inc., S Inc., E Inc., and G Inc. — M Inc. was investment advisor and securities dealer, S Inc. was securities dealer, E Inc. was life insurance agency, and G Inc. provided management services to other three companies — All four corporate defendants shared premises, telephone, fax, bank accounts, and accounting records — Receiver brought motion for substantive consolidation of bankruptcies of four corporate defendants — Motion dismissed — Receiver did not provide evidence concerning effect of substantive consolidation on creditors of corporate defendants, and whether rights of creditor of any individual company would be adversely affected — Substantive consolidation might not be possible since Part XII of Bankruptcy and Insolvency Act applied to only two corporate defendants — Part XII clearly applied to M Inc. and S Inc., but not to E Inc., as E Inc. was not securities firm — Substantive consolidation might have unintended effect of attempting to deal with E Inc.’s bankruptcy under Part XII — Dismissal was without prejudice to motion’s being renewed on further and better material.

Bankruptcy and insolvency --- Assignments in bankruptcy — Procedure on assignment
Applicability of Part XII of Bankruptcy and Insolvency Act to proceedings — M Inc. was investment advisor and securities dealer — Receiver was appointed over M Inc.’s assets — Receiver brought motion for order that M Inc.’s bankruptcy should proceed under Part XII of Bankruptcy and Insolvency Act, on basis that M Inc. was “securities firm” under s. 258 of Act — Motion granted — M Inc. was securities firm as defined by s. 258 — Section 258 definition includes corporations that buy and sell securities for customers in course of doing business, even if they also engage in other commercial activities — M Inc. clearly bought and sold securities for its customers, whether it did so as its primary business, or ancillary to its primary business of providing investment advice.

Table of Authorities

Cases considered by *Mesbur J.*:

Aeric Inc. v. Canada Post Corp. (1985), [1985] 1 F.C. 127, 56 N.R. 289, 16 D.L.R. (4th) 686, 1985 CarswellNat 23, 1985 CarswellNat 23F (Fed. C.A.) — considered

Associated Freezers of Canada Inc., Re (1995), 36 C.B.R. (3d) 227, 1995 CarswellOnt 944 (Ont. Bktcy.) — considered

J.P. Capital Corp., Re (1995), 31 C.B.R. (3d) 102, 1995 CarswellOnt 53 (Ont. Bktcy.) — considered

New Brunswick v. Estabrooks Pontiac Buick Ltd. (1982), (sub nom. *Estabrooks Pontiac Buick Ltd., Re)* 44 N.B.R. (2d) 201, (sub nom. *Estabrooks Pontiac Buick Ltd., Re)* 116 A.P.R. 201, (sub nom. *Fisherman’s Wharf Ltd., Re)* 144 D.L.R. (3d) 21, (sub nom. *Fisherman’s Wharf Ltd., Re)* 7 C.R.R. 46, 1982 CarswellNB 236 (N.B. C.A.) — considered

Vantage Securities Inc., Re (1998), 1998 CarswellBC 3138, 9 C.B.R. (4th) 169, 64 B.C.L.R. (3d) 148 (B.C. S.C. [In Chambers]) — followed

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

Pt. XII — considered

s. 5(4)(a) — considered

s. 14.06 [en. 1992, c. 27, s. 9(1)] — referred to

s. 67 — considered

s. 183 — considered

s. 253 — referred to

s. 253 “courtier en valeurs mobilières” — considered

s. 253 “customer compensation body” — considered

s. 253 “customer name securities” — considered

s. 253 “securities firm” — considered

s. 255 — considered

s. 261 — referred to

s. 261(1) — considered

s. 262(1) — considered

s. 262(2.1) [en. 1997, c. 12, s. 118] — considered

Canadian Charter of Rights and Freedoms, Part I of the Constitution Act, 1982, being Schedule B to the Canada Act 1982 (U.K.), 1982, c. 11
s. 18 — considered

Limited Partnerships Act, R.S.O. 1990, c. L.16
Generally — referred to

s. 4(1) — referred to

Securities Act, R.S.O. 1990, c. S.5
s. 1(1) “dealer” — referred to

Regulations considered:

Limited Partnerships Act, R.S.O. 1990, c. L.16
General, R.R.O. 1990, Reg. 713

s. 3a [en. O. Reg. 11/91] — referred to

Words and phrases considered

securities firm

Part of the firm’s business must be the buying and selling of securities; it may be its primary business, or it may simply be a part of its overall business. If it is, it is a “securities firm” within the meaning of Part XII [of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, s. 253], in both English and French.

. . .

It is important to note that the definition of "securities firm" under the *Bankruptcy and Insolvency Act* includes a person "required to be registered to enter into securities transactions with the public". . . . However, by stating that the definition includes such persons, it must, by implication be taken to mean that the definition is not limited to such persons. Thus, the definition must include persons who need not be registered in this way.

held for a customer

Surely the plain reading of [the definition of "customer name securities" in s. 253 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985] suggests that cash and securities "held ...for a customer" must mean cash and securities held in trust or for the benefit of a customer.

MOTION by receiver for various orders pertaining to bankruptcy of four related corporate defendants; CROSS-MOTIONS by customers of one corporate defendant regarding securities held for them by that defendant.

***Mesbur J.*:**

Nature of the motion:

1 There is very little jurisprudence concerning Part XII of the *Bankruptcy and Insolvency Act*. At issue on this motion is the correct interpretation of the term "securities firm" within the meaning of Part XII of *Act*, whether trust claims can be made to cash or securities under Part XII, and whether the court should consider compelling the re-registration of certain securities on the eve of a bankruptcy.

2 If the defendants or some of them are found to be securities firms, are assigned into bankruptcy, and if Part XII of the *Bankruptcy and Insolvency Act* applies, then the court must also address whether securities held for the Goudey Group[1], are "customer held securities" within the meaning of s.253 of the *Act*, or whether they would fall into the "customer pool fund" for distribution among all customers on a *pro rata* basis. It must also decide if certain limited partnership units held for the Benson Group[2] and Mr. Eden should be registered in their names prior to a bankruptcy.

3 In addition to the analysis of these broad issues, the court must also consider receiving the Receiver's Third Report, the Supplement to it, and the Receiver's Fourth Report and approving the Receiver's activities described in them. It must also determine whether to authorize the Receiver to assign the defendants other than Terrence W. Marlow into bankruptcy, and whether, in doing so, the court should procedurally and substantively consolidate their bankrupt estates into one bankruptcy estate, so that the assets of all would form one pool against which the creditors of all could claim.

General Factual Background and the Various Stakeholders:

4 The corporate defendants collectively referred to themselves as the "Marlow Group" or the "Marlow Financial Group". The companies making up the group are Marlow Group Private Portfolio Management Inc. ("Management Inc."), Marlow Group Securities Inc. ("Securities Inc."), Marlow Group Inc. ("Group Inc.") and Marlow Private Estate Builders Inc. ("Estate Builders Inc."). I am advised that the proper name of Estate Builders Inc. is "Private Estate Builders Inc.". The title of proceedings will be amended to reflect this correction. The defendant Terrence W. Marlow is the sole shareholder, officer and director of each of these corporate entities.

5 Mr. Marlow operated the four companies out of one office, with one telephone number, one fax number, one set of staff, one bank account, and one set of poorly kept books. He referred to them collectively as Marlow Group, and used letterhead styled "Marlow Financial Group".

6 Through the companies, Mr. Marlow provided a number of investor services. Management Inc. is an investment advisor and securities dealer that was registered as an investment counsel, portfolio manager and limited market dealer with the Ontario Securities Commission (the "OSC"). Securities Inc. is a securities dealer and registered investment dealer that was registered with the Investment Dealers Association of Canada (the "IDA"). Securities Inc. was also, until it ceased to be a member of the IDA, a member of the Canadian Investor Protection Fund (the "CIPF"). Estate Builders Inc. is a life insurance agency, and Group Inc. is a management company that provided services to the other three companies.

7 Mr. Marlow was registered with the OSC as a director and advising and trading officer of Management Inc., as well as its chief compliance officer. Mr. Marlow was also registered with the OSC as a trading officer of both Management Inc. and Securities Inc. Unfortunately, Mr. Marlow apparently suffers from an addiction to crack cocaine, for which he is currently receiving rehabilitative treatment.

8 Because it was a registered investment counsel and portfolio manager, Management Inc. was required to file annual audited financial statements with the OSC within 90 days of its fiscal year ended December 31. It failed to do so following its 2003 year end. After that, the OSC imposed some conditions on Management Inc. One of these was to file a satisfactory reconciliation of its client accounts.

9 Management Inc. then hired a chartered accountant, Wally Rudensky, to help meet the OSC's demands. Mr. Rudensky's reconciliation concluded there was a significant deficiency between the actual cash that Management Inc. had in its accounts, and the amount it was supposed to be holding in trust for its clients. Mr. Rudensky concluded there would be a trust cash shortfall of about $3.3 million. As a result, the OSC immediately suspended Management Inc.'s operations until an audit was complete.

10 Mr. Rudensky worked to complete an audited version of his reconciliation. It disclosed that Management Inc. held a large number of securities for its customers, but very few of these were registered in their clients' names. Management Inc. mostly purchased large blocks of securities, and then allocated them to individual investors, although they did not register them in the clients' names. Some securities were registered in clients' names, but were held in their own personal accounts, unaffiliated with the Marlow Group.

11 The plaintiffs, who are referred to as the "Ashley Group" comprise a group of customers all of whom were essentially in a cash position at this time. They tried to reach an agreement to have Management Inc. return their securities and cash. When that failed, they moved to have the Receiver appointed. Justice Campbell made a Receivership Order on March 9, 2005, appointing A. Farber & Partners Inc. as Receiver over the corporate defendants' assets.

12 This motion began as the Receiver's motion to assign each of the corporate defendants into bankruptcy. Ancillary to that relief, the Receiver suggests that Management Inc. is a "securities firm" as defined in section 253 of the *Act*, and, as a result, the special provisions of Part XII of the *Act* would apply to this bankruptcy. The Receiver seeks a declaration that only those securities that were actually registered, or in the process of being registered, in the name of customers are to be considered as "customer name securities". It also wishes the bankruptcies of the corporate defendants to be consolidated both procedurally and substantively, so that the assets of all would be available to the creditors of all, and the estates would be administered as one estate. In this regard, it asks the court to consider all the corporate defendants as one entity, operating as a securities firm, and subject to Part XII on bankruptcy.

13 In response to the Receiver's motion, other parties and stakeholders responded, and filed cross motions. The Ashley Group supports the Receiver's position completely.

14 The other participants on this motion are other stakeholders. The Goudey Group comprises a group of customers where were in a securities position at the time of the receivership. The Benson Group was similarly situated, as was Mr Eden. The Benson and Eden holdings were in two limited partnerships. Management Inc. holds sufficient securities to meet all its obligations to hold securities for its customers. It is only in the trust

cash area that there is a significant shortfall. The Goudey and Benson Groups, along with Mr. Eden, have all brought cross-motions and oppose the Receiver's motion.

15 The Canadian Investor Protection Fund (CIFP) is a fund that covers customers of CIPF members that have suffered or may suffer financial loss solely as a result of the insolvency of a member. CIPF is a "customer compensation body" under Part XII of the *Bankruptcy and Insolvency Act*. Of all the companies making up the Marlow Group, only Securities Inc. was a CIPF member. CIPF has participated on the motion in response to the Receiver's request for a substantive consolidation of the bankruptcies of the corporate defendants.

16 Finally, the Superintendent in Bankruptcy has intervened pursuant to the provisions of section 5(4)(a) of the *Act*. The guiding principles for the Superintendent's intervention under s 5(4)(a) are set out in subsection 2 of Section VIII of the *Superintendent in Bankruptcy's Programs Effective April 1, 1994*. The guiding principle is stated as:

> The Superintendent may intervene in court under this paragraph where it is a question of national interest or importance concerning the bankruptcy process or where the Superintendent feels it is in the public interest to do so.

17 The Superintendent intervenes here to make submissions on various questions of law relating to the interpretation of Part XII of the *Bankruptcy and Insolvency Act*. The Superintendent is of the view that the legal issues of what constitutes a securities firm, whether trust claims can be advanced under Part XII of the *Act*, and whether a creditor should be able to require a re-registration of securities in order to circumvent Part XII are issues of national importance.

Positions of the various stakeholders:

18 In order to understand the motion and cross motions, it is important to understand the positions of the various stakeholders on the various issues.

The Receiver

19 The Receiver takes the position that the corporate defendants should be assigned into bankruptcy, and that bankruptcy should proceed under the provisions of Part XII of the *Act* because Management Inc. is a securities firm as that term is defined in the *Bankruptcy and Insolvency Act*, and all the companies acted essentially as one entity. The Receiver also says that Part XII prevails in any conflict between it and any other provisions of the *Act*. For that reason, the Receiver suggests that trust claims are not permitted in security firm bankruptcies.

20 The Receiver says that apart from some shares of Stealth Minerals Ltd. actually registered in Individual clients' names, the securities that Management Inc. held for the Goudey Group, the Benson Group, and Mr. Eden are not "customer name securities" as that term is defined in the *Act*. Thus, they say that these securities should, with the remaining cash, be placed in the customer pool fund, to be shared proportionally among all the customers.

21 The Receiver says that it would be contrary to public policy to permit the Benson Group and Mr. Eden to require that their shares be transferred into their names prior to a bankruptcy, and thus convert them into customer name securities in order to avoid their pooling with those of other customers.

The Superintendent of Bankruptcy

22 The Superintendent of Bankruptcy has intervened on this motion in order to support the Receiver's

interpretation of the definition of "securities firm", the Receiver's position that trust claims cannot be made to cash or securities under Part XII, and the Receiver's position that the court should not order the registration of certain securities in the names of certain investors on the eve of bankruptcy. The Superintendent says these legal issues are of national importance and require adjudication.

The Plaintiffs (the Ashley Group)

23 The Ashley Group supports the Receiver's position, and that of the Superintendent in Bankruptcy.

The Goudey Group

24 The Goudey Group puts forward a number of arguments. First, it suggests that Management Inc. is not a securities firm. Second, they say that even if it is, and Part XII applies, their securities are customer name securities, because they can be identified as "theirs". Finally, even if the securities are not customer name securities, the Goudey Group says that they can assert a trust claim to the securities which should be returned to them, and not form part of the customer pool to be shared with other investors.

The Benson Group

25 The Benson Group wants to have Benson's name and address entered on the Register of the CMP 2003 Resource Limited Partnership and the CMP 2004 Resource Limited Partnership ("CMP"). The Benson group has added Goodman & Company, Investment Counsel Ltd. to the motion. Goodman & Company is the Manager appointed by CMP to provide investment, management, administrative and other services in relation to these two limited partnerships. The Benson Group points to these securities being a particular type of tax shelter/limited partnership investment. They say that pursuant to the Limited Partnership Agreement and the provisions of the Prospectus, Goodman & Company is required to list them as the owners of their respective percentage holdings and has failed to do so. The want the court to make an order compelling this registration, prior to the bankruptcy, in order to become customer name securities, and not fall into the customer pool fund.

Mr. Eden

26 Mr. Eden wants to be treated similarly to the Benson Group if they have success, or the Goudey Group, if they have success. Simply put, Mr. Eden wants securities to be returned to him, however that may be accomplished.

Goodman & Company

27 Goodman & Company takes no position on whether it should re-register the CMP partnership units or not. However, it denies that it has acted improperly in failing to register any CMP units in the names of the Benson Group or Mr. Eden. It says that the actual subscriber for the limited partnership units was Management Inc. and that is who is recorded as the subscriber for CMP 2003 and CMP 2004 on the Partnership Register. Goodman & Company wishes to be exonerated of any wrongdoing or impropriety.

Canadian Investor Protection Fund

28 The Canadian Investor Protection Fund has participated on this motion only to oppose the substantive consolidation of the bankruptcies. A substantive consolidation, it says, could prejudice their position. It also takes the position that there are no compelling reasons to order substantive consolidation.

The Law and analysis:

29 In order to put the issues into context, it is important to consider Part XII of the *Bankruptcy and Insolvency Act*, and its purpose. It is a relatively new part of the *Act*, having come into force in 1997, in response to what were seen as undue complexities involved in the bankruptcies of securities firms.

30 Part XII of the *Bankruptcy and Insolvency Act* was enacted to simplify and streamline the administration of a bankrupt securities firm's estate. Before Part XII, administration of these estates was time-consuming, complex, uncertain, and costly to both investors and creditors. Customers of the bankrupt firm would raise trust and tracing concepts, which proved difficult to determine. Often, while waiting for adjudication of these trust claims, the Trustee would have to continue to hold potentially volatile securities, whose value could plummet, while customers battled over their entitlement to them.

31 What Part XII does is to create a particular class of securities that are to be returned to customers. These are called "customer name securities". All other securities and cash held by the bankrupt firm are to be pooled in a "customer pool fund", and distributed among all the customers of the firm on a *pro rata* basis. It is easy to see why some customers would like to avoid the application of Part XII altogether, or, alternatively, have their securities designated as customer name securities, in order to avoid pooling them with other customers.

32 It should be noted that the customer pool fund is paid out before any creditors are paid at all. If significant securities are returned to customers and do not fall into the pool, the pool will obviously be smaller. Here, if the Receiver's position prevails, the customer pool fund of securities and cash will give all the customers a return of about 60 cents on the dollar. If the Ashley/Benson/Eden positions prevail, they will have securities returned to them, and realize about 95 cents on the dollar for their claims, while the Ashley Group customers will receive less than 5 cents on the dollar.

Bankruptcy?

33 Under the terms of the Receivership Order, the Receiver has the power to assign all the corporate defendants, apart from Securities Inc., into bankruptcy. Securities Inc.'s exclusion from this general power was made part of the Receivership Order at CIPF's request, presumably because of CIPF's particular potential obligations on the bankruptcy of one of its members. As a result, an order is required to put Securities Inc. into bankruptcy. As far as the other corporate defendants are concerned, the Receiver seeks approval of its decision to assign them into bankruptcy.

34 There is no question that all the corporate defendants are insolvent, and that it would be in the interests of all the customers and creditors for them to be assigned into bankruptcy. No one now opposes an assignment. The only issue is whether the bankruptcy should proceed under Part XII of the *Act*, or whether it should be a "regular" bankruptcy. Determination of this issue will depend on whether some or all of the corporate defendants are "securities firms", or indeed, whether the Marlow Group should be considered as a single entity which itself is a securities firm.

35 The "securities firm" issue has focused primarily on Management Inc., since it is the company that seems to holding the bulk of the securities and cash for the customers. As to the other corporate defendants, there is no question that Securities Inc. is a securities firm. It, however, has virtually no assets. Estate Builders Inc. is clearly not itself a securities firm. This may be relevant on the issue of substantive consolidation, but is essentially moot, since the company apparently has no assets either. Group Inc. simply provided management services to the other companies. It has some assets. This leaves the question of whether Management Inc. is a securities firm. If the bankruptcies are substantively consolidated, and Management Inc. is a securities firm, then presumably a consolidated bankruptcy would proceed under Part XII.

Securities Firm?

36 Section 258 of the *Bankruptcy and Insolvency Act* defines the term “securities firm” as follows:

> ”securities firm” means a person who carries on the business of buying and selling securities from, to or for a customer, whether or not as a member of an exchange, as principal or agent, and includes any person required to be registered to enter into securities transactions with the public, but does not include a corporate entity that is not a corporation within the meaning of section 2.

37 The French version of the statute contains the following definition:

> « courtier en valeurs mobilières » Toute personne, membre ou non d’une bourse de valeurs, qui achète des titres a un client ou pour celui-ci ou vend des titres a un client ou pour celui-ci, pour son compte ou en qualité de mandataire, et notamment celle qui a l’obligation de s’inscrire pour avoir le droit de conclure avec le public des opérations sur les titres, a l’exception des personnes qui sont exclues de la définition de « personne morale » a l’article 2.

38 The Goudey Group sets much store in the phrase “carries on the business” in the English definition. It takes the position that in order to qualify for treatment under Part XII, a firm’s primary business must be the buying and selling of securities. It says that Management Inc. held itself out primarily as an advisor. It was registered as an investment counsel, portfolio manager and limited market dealer with the OSC. Since Management Inc. never carried on business as a limited market dealer, the Goudey Group concludes that this necessarily implies Management Inc. was no more than an investment counsel and portfolio manager, and thus cannot be considered a securities firm. While the Goudey Group concedes that Management Inc. did buy securities on their behalf, they say it was only incidental to their primary business of investment counsellors. Thus, they say Management Inc. cannot be held to be a securities firm.

39 The Superintendent points to the absence of the phrase “carries on the business” in the French version of the *Act*. Section 18 of the *Charter of Rights and Freedoms* provides in section 18 that both the English and French language versions of a Federal statute are equally authoritative. Therefore, the court must examine both to determine Parliament’s intention. Each version “forms part of the context in which the other must be read”.[3] The court must therefore find a common interpretation for both equally authoritative versions.

40 While the English version includes the term “carries on the business”, the French version does not. A literal translation of the phrase “*Toute personne, membre ou non d’une bourse de valeurs, qui achète des titres a un client ou pour celui-ci ou vend des titres a un client ou pour celui-ci*”, from the French version is “Every person, whether or not a member of an exchange, who buys securities from a customer or for him or sells securities to a customer or for him, ...”.

41 The French version does not contain any language to suggest that buying and selling securities must be the person’s *primary* business. This forms part of the context in which one must read the English version.

42 The Superintendent suggests[4] that “[u]nderstanding the definition of “securities firm” to include a corporation that buys and sells securities for its customers in the course of doing business even if it also engages in other commercial activities is both a reasonable interpretation of the English version and one that is consistent with the French version”. I agree.

43 The Goudey Group says that this approach is equivalent to “reading out” the phrase “carries on the business” in the English version, and thus cannot comply with the “shared meaning rule.”[5] I disagree. What the Goudey Group really wants the court to do is to read in the word “primarily” into the English definition. There is no need to do this. When one gives the usual meaning to all the words in both English and French versions, there is no inconsistency between them. Part of the firm’s business must be the buying and selling of securities; it may be its primary business, or it may simply be a part of its overall business. If it is, it is a “securities firm” within the meaning of Part XII, in both English and French. This interpretation is a reasonable interpretation of the English version, and is also consistent with the French version.

44 The Goudey Group goes on to suggest that "securities firm" should be interpreted to be consistent with the securities law definition of a securities dealer. In this regard, it points to section 1(1) of the *Securities Act*[6] and the definition there of the term "dealer" as "a person or company who trades in securities in the capacity of principal or agent." They point out that this definition differs from the definition of an "advisor", namely "a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities." They suggest that since Management Inc. was registered as an advisor under Ontario legislation, and the Goudey Group retained Management Inc. to provide them with investment advice, Management Inc. must therefore be an advisor, not a dealer, and hence not a securities firm.

45 It would have been an easy matter for Parliament to define "securities firm" in a parallel fashion to provincial securities legislation. It did not. It has created a broad definition in Part XII. The definition carries no ambiguity.

46 Management Inc. clearly bought and sold securities for all of its customers, whether it did so as its primary business, or as ancillary to its primary business of providing investment advice. In this regard, I note that some of the customers signed Private Client Account Agreements with Management Inc. These Agreements provided: "Individual Securities, including stocks and bonds may be purchased from time to time." The Agreements authorized the Marlow Group "to place orders with brokers, investment dealers, banks or trust companies for the purchase and sale of securities."

47 It is important to note that the definition of "securities firm" under the *Bankruptcy and Insolvency Act* includes a person "required to be registered to enter into securities transactions with the public". This, no doubt, includes firms the Goudey Group describes as brokerage firms, or stockbrokers, who must, of course be registered as dealers. Such firms are firms defined as "dealers" under Ontario securities law. However, by stating that the definition includes such persons, it must, by implication be taken to mean that the definition is not limited to such persons. Thus, the definition must include persons who need not be registered in this way. This would encompass a firm like Management Inc.

48 As a result, it is clear that Management Inc. "carried on the business of buying and selling securities from, to or for a customer, whether or not as a member of an exchange, as principal or agent, and includes any person required to be registered to enter into securities transactions with the public". I thus conclude they are a securities firm, and therefore Part XII will apply to their bankruptcy.

Customer Name Securities?

49 Part XII carves out a very limited class of securities that are to be returned to customers when a securities firm goes bankrupt. These are defined as "customer name securities" in section 253 in the following way:

> ”customer name securities” means securities that on the date of bankruptcy of a securities firm are held by or on behalf of the securities firm for the account of a customer and are registered in the name of the customer or are in the process of being so registered.

50 The Goudey Group points to the fact that the term "registered" is nowhere defined in Part XII. They suggest that as a result, it is enough for the securities to be identifiable as belonging to a customer, in order to be a customer name security. They reason that since Management Inc. made allocations of various securities among its customers, those securities can be identified as belonging to the customers. They say that Mr. Rudensky's Account Balance Reconciliation confirms that all of the customer assets held by the Marlow Group have been identified, and the respective owners of those assets have confirmed their ownership. They conclude their argument by stating that this ability to identify the respective owners is equivalent to registration, as contemplated by section 253. To bolster this position, they rely on the re-wording of the section proposed in Bill C-55[7] . There, the definition of customer name securities reads as follows:

> ”customer name securities” means securities that on the date of bankruptcy of a securities firm are held by or on behalf of the securities firm for the account of a customer and are registered or recorded in the appropriate manner in the name of the customer or are in the process of being so registered or recorded, but does not include securities registered or recorded in the appropriate manner in the name of the customer that, by endorsement or otherwise, are negotiable by the securities firm.
>
> [underlining in the original]

51 The Goudey Group suggests that this new definition clearly supports their view that it is enough simply to be able to identify the beneficial owner of a security, since this would constitute “recording in the appropriate manner” in the records of the securities firm. As a result, they say that their securities are customer name securities and must be returned to them. I disagree with this analysis.

52 In my view, the addition of the words “or recorded in the appropriate manner” in the amendments in Bill C-55 are designed to cover situations where there is no actual registration of securities, but there is another specified method of recording ownership. This, for example, would cover limited partnerships for whom the *Limited Partnership Act* requires that general partner to maintain a record of the limited partners. This would be a name “recorded in the appropriate manner.”

53 Here, there is no evidence that any particular securities were recorded in any fashion in the names of the Ashley Group. Bill C-55 offers no assistance. The Ashley Group’s securities are not customer name securities. They will form part of the customer pool fund, unless they can be excluded on the basis of a trust claim.

Trust Claims allowed under Part XII?

54 The provisions of Part XII of the *Act* are paramount if there is a conflict with other parts of the *Act*. Section 255 of Part XII says:

> All the provisions of this Act, in so far as they are applicable, apply in respect of bankruptcies under this Part, but if a conflict arises between the application of the provisions of this Part and the other provisions of this Act, the provisions of this Part prevail.

55 In regular bankruptcies, section 67 of the *Act* applies. It clearly states that assets held in trust by the bankrupt do not form part of the bankrupt estate. In securities firm bankruptcies, Part XII creates a kind of “super-priority” for customers. Section 261(1) vests in the trustee any securities held by the firm itself, as well as any securities and cash held by or for the account of the securities firm for a customer. The trustee is then directed to use these securities and cash to create what is called the “customer pool fund”. All other assets form what is called the “general fund”.

56 By virtue of s. 262(1), the customer pool fund is allocated first to the costs of administration, if there are insufficient funds in the general fund to pay the costs, and then to distribute the balance to all the firm’s customers (except deferred customers) on a *pro rata* basis. Any funds remaining after that distribution are paid into the general fund, which is disbursed according to s. 262(2.1).

57 What does the concept of the customer pool fund do to the notion of trust claims in a Part XII bankruptcy? To date, there is only one reported case in Canada dealing with this issue.[8]

58 In *Vantage*, Brenner J considered a Trustee’s position that any trust claim to either cash or securities held by a securities firm at the date of bankruptcy vests in the Trustee. Justice Brenner held that the plain wording of the language of the section supported that view. In coming to this conclusion he considered both the plain language of the section, as well as the underlying policy of Part XII.

59 In order to discern the policy, Justice Brenner relied on an article by B.D. Turcotte, entitled “Securities Firm Bankruptcies”[9] . That article outlined the historical complexities of securities firm bankruptcies prior to Part XII, particularly the difficulties of sorting out ownership of, or claims to securities that securities firms generally hold in many different ways for their customers. Justice Brenner concluded:

> By passing Part XII, Parliament decided to try to simplify securities firm bankruptcies by doing away with the myriad of competing trust claims and the associated legal costs and time delays in securities firm bankruptcies. Parliament recognized that securities firms deal in principally two assets: cash and securities, and so for those two asset classes, Parliament enacted the new rules in Part XII. Under s. 261, Parliament removed the entire concept of trust law for securities (except where those securities are “customer named securities”) and cash.

60 In the context of the *Vantage* case, Justice Brenner was dealing with the issue of cash. He concluded that by virtue of s. 261, all cash held by a securities firm at the date of bankruptcy vested in the trustee, not just the cash owned beneficially by the securities firm. Section 261 is equally applicable to securities, and I thus agree with Brenner J’s analysis, and find that all securities held by a securities firm at the date of bankruptcy vest it the trustee, not just the securities owned beneficially by the firm. The only exclusion from the pool is those securities that fall into the definition of “customer name securities”. Surely the plain reading of the section suggests that cash and securities “held ...for a customer” must mean cash and securities held in trust or for the benefit of a customer. If cash and securities held in trust for a customer are to vest in the trustee in a securities firm bankruptcy, then clearly this provision is in conflict with the general provisions of section 67 that exclude trust assets from the estate. Since there is a conflict, Part XII prevails, and trust claims must be prohibited.

61 Since I have held that Management Inc. is a securities firm, the Goudey Group’s securities are not customer name securities, and have also found that they cannot assert a trust claim to them, their securities must vest in the trustee, and form part of the customer pool. This addresses the Goudey Group motion. I turn now to the arguments advanced by the Benson Group and Mr. Eden.

Require registration of the Benson Group and Eden securities?

62 The Benson Group and Mr. Eden were also Management Inc. customers. They invested in two limited partnerships, CMP 2003 Resource Limited Partnership and CMP 2004 Resource Limited Partnership (”CMP”), as well as earlier CMP Limited Partnerships for prior years. The CMP limited partnership units are not registered in the Benson Group or Mr. Eden’s names. They say their units should be registered in their names, and ask the court to require Goodman & Company to effect this registration, before any bankruptcy occurs. This, of course, would make their CMP units customer name securities that would be returned to them, since they would be registered in their names prior to bankruptcy.

63 Simply put, the Benson Group and Mr. Eden say that both the Limited Partnership Agreement and the *Limited Partnership Act*[10] require that the names and addresses of all limited partners of the Limited Partnership must be registered in the records of the limited partnership. They also say that Prospectuses for these two limited partnerships state that shares will be registered in the name of a partner, if the partner requests it. They say they have a right to demand registration, and they are doing so now. They go further, and say that Goodman & Company has acted improperly in failing to maintain their names as owners in the records, and further, has made a misrepresentation in the prospectus, namely that it would keep a record of the limited partners.

64 The Benson Group and Mr. Eden say that in the years before 2003, their investments in the CMP limited partnerships for the prior years were registered in their names. They also received their expected tax benefits from the investments, received tax receipts, and were acknowledged by the Limited Partnerships to be limited partners.

65 In the years since, they also received their expected tax receipts for CMP 2003 and 2004. They say that the Receiver says Marlow’s records show Marlow was holding 4500 CMP units on behalf of its customers.

They point to these facts to support their view that they must therefore be limited partners of the 2003 and 2004 CMP limited partnerships, and thus are entitled to registration of their interests. This will make the investments customer name securities.

66 Goodman & Company points out that as far as CMP and its records are concerned, in prior years, the Benson Group and Eden subscribed for the partnership units in their own names. They were recorded as limited partners for these investments. However, it was Management Inc. that subscribed for units in CMP 2003 and 2004. In compliance with its obligations under the *Limited Partnership Act*, and the Limited Partnership Agreement, CMP kept registers for unit subscribers for CMP 2003 and 2004. These register show Management Inc. as the subscriber for these units.

67 As it did for many other securities, Management Inc. purchased blocks of CMP as subscriber, and was thus registered as the holder in its own name. It later allocated them to clients. In my view, this puts the CMP units in exactly the same position as the other securities, which I have found, are not customer name securities. Although the Benson Group and Eden do not assert a trust claim to the CMP units, it is clear to me, on the basis of who subscribed for the units, that Management Inc. was the registered holder, and held the units in trust for the Benson Group and Eden. I see no basis upon which they can require the register to be altered, since they were not the subscribers for these units. I deny their request on this basis. As a result, I need not address whether there are also public policy grounds upon which to deny it as well.

68 This leaves the last issue; that is whether there should be both a procedural and substantive consolidation of the bankruptcies of the corporate defendants, essentially treating them as one bankruptcy of one securities firm.

Procedural and Substantive Consolidation?

69 All the stakeholders support procedural consolidation of the bankruptcy of all the corporate defendants. No one opposes a substantive consolidation apart from the CIPF. In order to assess its position, it is important to consider what the effect of a substantive consolidation would be.

70 Essentially, a substantive consolidation would treat all of the corporate defendants as one entity. The assets of each would fall into one common pool, to be shared by all their creditors on a *pari passu* basis.

71 There is no specific authority in the *Bankruptcy and Insolvency Act* to grant an order for substantive consolidation. It is common ground, however, that the court has the authority to do so under its equitable jurisdiction under section 183 of the *Act*.

72 Few Canadian cases have dealt with substantive consolidation, although the American courts have written extensively on the subject, setting out various, and disparate, tests to support an order for substantive consolidation. We have no such assistance here.

73 The Receiver seeks a substantive consolidation for a number of reasons. Just as it said the “Marlow Group” as a whole should be treated as a securities firm, so it says, the four corporate defendants should be treated as one legal entity for the purposes of bankruptcy. They say it is appropriate to consolidate bankrupt estates in order to avoid multiplicity of proceedings, and where the bankrupt companies have shared or pooled resources, assets, and bank accounts. Also, they say where related companies are organized in an intertwined manner, it will be reasonable that the estates be dealt with *en bloc* to realize the greatest value for all interested parties.[11]

74 The Receiver goes on to say that all four companies operated as an interrelated entity, with shared premises, telephone, fax, bank accounts and accounting records. The Receiver says that they were operated as a single, consolidated enterprise, and should be treated as such for bankruptcy purposes, because to do so would be most expedient and cost-effective.

75 What emerges from the few Canadian cases, however, is that although expediency is an appropriate consideration in deciding whether to grant consolidation, it should not be done at the expense or possible prejudice of any particular creditor.[12] I take this to include any possible prejudice to someone like the CIPF, which as a customer compensation body under the *Act* has some concerns about possible additional expose to claims if there is substantive consolidation, and all creditors, and perhaps customers, then have potential claims against Securities Inc, and thus against the Fund. While there is no evidence of this actually occurring, it is a concern.

76 CIPF also points out that the Receiver wishes to use the only assets of Securities Inc., some cash, to fund the bankruptcy, and thus there is no practical advantage to any of Securities Inc.'s creditors to having a substantive consolidation of all the estates.

77 CIPF says that substantive consolidation profoundly affects the substantive rights of debtors and creditors, and thus should be considered an extreme remedy and carefully scrutinized. It involves more than procedural convenience, which of course can be accomplished by the procedural consolidation that everyone supports.

78 The Receiver has not provided evidence concerning the effect on all the creditors of all the corporate defendants if there is a substantive consolidation, and whether this will adversely affect the rights of any creditor of any individual company. Without that evidence, I cannot determine whether a consolidation would occur at the expense or to the prejudice of any particular creditor. I echo the concerns of Chadwick J in *J.P. Capital Corp., Re*[13] where he stated:

> I am concerned with consolidating the actions which will provide for pari passu distribution without knowing the effect that such an order will have on all creditors. Although expediency is an appropriate consideration it should not be done at the possible prejudice or expense of any particular creditor.

79 I am also concerned about whether there can be a substantive consolidation where Part XII clearly applies to two of the bankrupt companies (Management Inc. and Securities Inc.), but not to Estate Builders Inc. It is a life insurance agency — there is no suggestion that it is also a securities firm. Because of this, I am not persuaded, on the record I have, that all four companies should be treated as a single securities firm for the purposes of Part XII. This has an impact on the claim for consolidation. Although Estate Builders Inc. may not have any assets, or indeed any creditors, substantive consolidation may have the unintended effect of attempting to deal with Estate Builder's bankruptcy under Part XII. Counsel for the receiver was not able to provide me with sufficient evidence to address either of my concerns.

80 For these reasons, the motion for substantive consolidation is dismissed, without prejudice to its being renewed on further and better material. The motion for procedural consolidation of all the corporate bankrupt estates is granted.

Receiver's Third and Fourth Reports

81 There is no objection to the receipt of the Receiver's Third Report, the Supplement to it, and the Receiver's Fourth Report. There is no objection to approving the actions taken by the receiver to date. Accordingly, an order will go as requested in that regard.

82 The receiver raised an issue concerning paragraph 28 of the Receivership Order. It is of particular relevance now, given my disposition of the motion for substantive consolidation. That paragraph relates to the Receiver's use of the assets of Securities Inc. The only asset Securities Inc. has is cash of about $120,000. The Receiver needs access to this money in order to fund its fees as the Trustee on the bankruptcies. Without substantive consolidation, this may create some difficulty. No one opposes these funds being used by the Trustee to administer all the estates. An order will therefore go deleting paragraph 28 of the Receivership Order so that the receiver can access all the money in Securities Inc. to cover trustee's fees on the procedurally

consolidated bankruptcy of the corporate defendants.

Disposition:

83 For all these reasons, an order will go as follows:

(a) Receiving the Third Report of the Receiver dated August 15, 2005, the Supplement to the Third report of the Receiver dated August 17, 2005, and the Fourth Report of the Receiver dated September 30, 2005, and approving the activities of the Receiver set out in them;

(b) Authorizing and directing the Receiver to assign all of the corporate defendants into bankruptcy, and that A. Farber & Partners Inc. shall be the trustee in bankruptcy ("Trustee");

(c) The bankruptcy estates of the corporate defendants shall be procedurally consolidated and administered together;

(d) Dismissing the Receiver's motion for substantive consolidation, without prejudice to its being renewed on further and better material;

(e) The bankruptcies of Management Inc. and Securities Inc. will proceed under Part XII of the *Bankruptcy and Insolvency Act*;

(f) The Goudey Group's motion to have certain securities declared to be customer name securities, or alternatively for a trust to be imposed on them and their being returned is dismissed;

(g) The Benson Group's and Eden's motion for the re-registration of CMP 2003 and 2004 Limited Partnership units into their names is dismissed;

(h) Declaring the 3,346,667 shares in the capital of Stealth Minerals Limited described in paragraph 7 of the Third Report are the only "customer name securities" held by Management Inc. and Securities Inc., and that the remainder of the securities they hold are not customer name securities and shall be grouped into either the "customer pool fund" or the "general fund" as appropriate in accordance with Part XII of the *Bankruptcy and Insolvency Act*;

(i) Deleting paragraph 28 of the Receivership Order of Campbell J. dated March 9, 2005;

(j) That the Trustee shall be authorized to sell sufficient securities and any other property from the bankruptcy estates in order to realize up to $250,000 of net proceeds to fund the costs of the bankruptcy, including without limitation the fees and costs of the Trustee and its counsel, and that the Trustee may apply to the Court at any time and from time to time to sell any further securities or other property from the bankruptcy estate as it may deem necessary to fund the ongoing costs of the bankruptcy;

(k) That after the assigning the corporate defendants into bankruptcy, the Receiver is authorized and directed to bring a motion before this Court to terminate the Receivership in respect of the corporate defendants and to seek approval of its final statement of receipts and disbursements as Receiver, including approval of its fees and costs and fees and costs of its counsel and the costs payable from the estate pursuant to the Order of this Court made on March 9, 2005 to counsel for the Plaintiffs and to seek a discharge of the Receiver in respect of the corporate defendants;

(l) That the Receiver and the Trustee, upon its appointment, shall incur no liability or obligation as a result of the carrying out the provisions of this Order, except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Receiver by the Order dated March 9, 2005, or by section 14.06 of the *Bankruptcy and Insolvency Act*, or any other applicable legislation.

(m) Amending the title of proceedings to change the name "Marlow Private Estate Builders Inc." to "Private Estate Builders Inc.".

84 If the parties are unable to agree on the disposition of costs of the motion and cross motions, they may make brief written submissions to me. The Receiver's are to be delivered within 15 days of the release of these reasons, with all other parties delivering their responses within 15 days following.

Order accordingly.

Footnotes

* Additional reasons at *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006), 2006 CarswellOnt 3419 (Ont. S.C.J. [Commercial List]).

1 John Goudey, Thomas Abel, Shobana Ananth, Shane Anderson, Donald Bayer, Michael Caicco, Charles Cutts, John Coudey, Arnold H. Hochman, Mark Irwin, Gary Levy, Karen Malatest, Hamish McEwan, Pierre Meunier, Paul Oakley, Barry Reiter, Mike Stroud, Michelle Szames, Stephen Szames, James Turner, John Unger, and 2044102 Ontario Inc.

2 Paul Benson, Brenda Benson and 145403 Ontario Inc.

3 *New Brunswick v. Estabrooks Pontiac Buick Ltd.* (1982), 44 N.B.R. (2d) 201 (N.B. C.A.), at paragraph 19, and *Aeric Inc. v. Canada Post Corp.* (1985), 16 D.L.R. (4th) 686 (Fed. C.A.) at p. 707

4 Superintendent's factum, paragraph 12

5 see Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Markham, Ont.: Butterworths, 2002) at 80

6 R.S.O. 1990 c. S.5

7 *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*

8 *Vantage Securities Inc., Re* (1998), 9 C.B.R. (4th) 169 (B.C. S.C. [In Chambers])

9 (1997) 17:3 *Insolvency Bulletin* 75

10 See s. 4(1) of the *Limited Partnership Act*, R.S.O. 1990 c. L.16, and s. 3a of Regulation 713 made under the *Limited Partnership Act*

11 *J.P. Capital Corp., Re* (1995), 31 C.B.R. (3d) 102 (Ont. Bktcy.), and *Associated Freezers of Canada Inc., Re*, [1995] O.J. No. 2862 (Ont. Bktcy.)

12 *Associated Freezers of Canada Inc., Re*, above, at paragraph 5

13 Note 10, above, at paragraph 19

End of Document

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IN RE: REPUBLIC AIRWAYS HOLDINGS INC., et al., Debtors.

Case No. 16–10429 (SHL) (Jointly Administered)

United States Bankruptcy Court, S.D. New York.

April 10, 2017

[565 B.R. 712]

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VEDDER PRICE P.C., Attorneys for Wells Fargo Bank Northwest, N.A., as Owner Trustee, and ALF VI, Inc., 1633 Broadway, 31st Floor, New York, New York 10019, By: Michael J. Edelman, Esq., –and–222 North LaSalle Street, Suite 2600, Chicago, Illinois 60601, By: Douglas J. Lipke, Esq.

DAVIS POLK & WARDWELL LLP, Attorneys for Delta Airlines, Inc., 450 Lexington Avenue, New York, New York 10017, By: Darren S. Klein, Esq.

MEMORANDUM OF DECISION

SEAN H. LANE, UNITED STATES BANKRUPTCY JUDGE

Before the Court is an objection by Wells Fargo Bank Northwest, N.A. ("Wells Fargo"), as owner trustee, and ALF VI, Inc. ("ALF VI"), as owner participant (together, "Residco") to the Debtors' Second Amended Joint Plan of Reorganization under Chapter 11 (the "Plan"). *See* Objection to Confirmation of Debtors' Plan by Residco ("Residco Objection") [ECF No. 1534]. [1] Residco objects to the substantive consolidation provisions in the Debtors' Plan. As the owner trustee and owner participant for seven aircraft leases with the Debtors, Residco holds both lease claims against the operating Debtor, Shuttle America Corporation ("Shuttle"), and

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guarantee claims for those lease obligations against the holding company Debtor, Republic Airways Holdings Inc. ("RAH"). Residco contends that the proposed substantive consolidation provisions in the Plan are improper because they eliminate the guarantee claims that Residco asserts are more valuable, while preserving the lease claims that Residco believes are riskier and thus less valuable. *See* Residco Objection at 1.

The Court held hearings on Residco's Objection on March 8 and 16, 2017. *See* Transcript of Hearing Held on March 8, 2017 ("Hr'g Tr.") [ECF No. 1595]; Transcript of Hearing Held on March 16, 2017 ("March 16th Hr'g Tr.") [ECF No. 1652]. At the hearings, the Court heard testimony from two of the Debtors' officers: Joseph P. Allman, the Chief Financial Officer of the Debtors, and Bryan K. Bedford, the Chief Executive Officer of the Debtors. In addition, Residco presented its own witness, Glenn Davis, the president and CEO of ALF VI. Based on the record and for the reasons set forth below, the Court overrules the Residco Objection. [2]

BACKGROUND

Between June 2001 and November 2003, Wells Fargo and Mitsui & Co. (U.S.A.) ("Mitsui") entered into a series of seven lease transactions with the Debtors, pursuant to which Mitsui leased seven ERJ145 aircraft to the Debtors (the "Residco Leases"). *See* Residco Objection at 4. [3] In December 2013, the Residco Leases were amended and restated as to each of the seven aircraft leases. *See* Debtor's Response to Residco Objection ¶ 17 [ECF No. 1559]. The Residco Leases contained stipulated loss value ("SLV") liquidated damages provisions, which remained unchanged under the 2013 amendments. *See* Residco Objection at 5. These SLV liquidated damages provisions provided a formula to calculate damages if the lessee under the Residco Leases (the "Subsidiary-Lessee Debtor") breached its obligations under the leases. *See* Residco Objection at 5; *see also* Debtors' Response to Residco Objection ¶ 17 (citing Leases § 17.02(c)). The SLV liquidated damages provisions set forth what happens in such an event:

> Lessor ... may demand that Lessee pay ... any unpaid Basic Rent for the Aircraft ... plus, as liquidated damages for loss of bargain and not as a penalty (in lieu of Basic Rent payable for the period commencing after the date specified for payment ...), whichever of the following amounts Lessor, in its sole discretion, shall specify ...: (i) the amount, if any, by which (x) the Stipulated Loss Value computed as of the payment date ... exceeds (y) the aggregate Fair Market Rental Value ... of the Aircraft for the remainder of the

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> Basic Term ... after discounting such Fair Market Rental Value to present worth ..., (ii) the amount, if any, by which (x) the Stipulated Loss Value computed as of the payment date ... exceeds (y) the Fair Market Sales Value ... of the Aircraft ..., or (iii) the amount, if any, by which (x) the aggregate Basic Rent for the remainder of the Basic Term ..., discounted ... to present worth ..., exceeds (y) the Fair Market Rental Value ... of the Aircraft for the remainder of the Basic Term ... after discounting such Fair Market Rental Value to present worth ....

See Debtors' Response to Residco Objection ¶ 17 (citing Leases § 17.02(c)). Under this provision, Residco asserts that the Subsidiary-Lessee Debtor bore the risk that the residual value of the aircraft might decline. *See* Residco Objection at 5. And the SLV liquidated damages provisions turn out to be important. According to Residco, the expected residual value for each of the aircraft was between $7 and $8 million in 2016 and 2017 as of the time the parties first entered into the Residco Leases. *See id.* at 5–6; *see also* Exh. B attached to the Residco Objection. But Residco now believes the fair market value for each aircraft now is not more than $800,000. *See* Residco Objection at 6.

RAH (the "Parent-Guarantor Debtor") guaranteed each of the obligations owed by the Subsidiary-Lessee Debtor. *See* Guarantee, dated as of October 29, 2012, attached as Exh. A to Residco Objection; *see also* Debtors' Response to Residco Objection ¶ 17. The parent guarantee is "an absolute, unconditional and continuing guarantee of payment ...." *See* Guarantee at 1; *see also* Parent Guarantee at 2, attached as Exh. C to Residco Sur-Reply. It states that the "Guarantor understands and agrees that its obligations hereunder shall be continuing, absolute and unconditional without regard to, and Guarantor hereby waives any defense to, or right to seek a discharge of, its obligations hereunder with respect to the validity, legality, regularity or enforceability of any Operative Agreement, any of the Obligations or any collateral security therefor ...." *See* Parent Guarantee at 2; *see also* Residco Objection at 5, 16–17.

In December 2014, ALF VI acquired the owner participation interests held by Mitsui for each of the leases and became the owner participant under the transactions, with Wells Fargo continuing to serve as the owner trustee. *See* Residco Objection at 6; *see also* Hr'g Tr. 118:1–12 (Davis). In April 2016, the Debtors and Residco entered into a Section 1110 stipulation, which was subsequently approved by the Court. *See* So-Ordered Stipulation and Order [ECF No. 540]. Pursuant to the stipulation, between April 2016 and October 2016, the Debtors returned the aircraft to Residco and rejected the leases. *See* Debtors' Response to Residco Objection ¶ 18. Residco filed proofs of claims asserting rejection damages against Shuttle for $72,323,546.00 and claims against RAH under the guarantees for $75,847,798.00. *See id.* ¶ 19. On March 1, 2017, Residco filed amended proofs of claims reducing the claim amounts. *See* Residco Sur-Reply at 4–5; *see also* Exh. E, attached to Residco Sur-Reply.

The treatment of such claims, of course, is subject to the provisions of the plan of reorganization in this case. The Debtors filed their first proposed plan and related disclosure statement in November 2016. [*See* ECF Nos. 1189, 1190]. Amended versions of the plan and disclosure statement were filed on December 12, 2016, and December 19, 2016. [*See* ECF Nos. 1277, 1278, 1311, 1312]. The Court approved the second amended disclosure statement on December 23, 2016. [*See* ECF No. 1358].

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Section 2.2 of the Plan now before the Court provides for substantive consolidation of all the "Consolidated Debtors" ' [4] assets and liabilities and the related elimination of guarantee claims:

> Solely for the purposes specified in the Plan (including voting, Confirmation, and distributions) and subject to Section 2.2(b), (i) all assets and liabilities of the Consolidated Debtors shall be consolidated and treated as though they were merged, (ii) all guarantees of any Consolidated Debtor of the obligations of any other Consolidated Debtor shall be eliminated so that any Claim against any Consolidated Debtor, any guarantee thereof executed by any other Consolidated Debtor and any joint or several liability of any of the Consolidated Debtors shall be one obligation of the Consolidated Debtors and (iii) each and every Claim filed or to be filed in the Chapter 11 Cases against any of the Consolidated Debtors shall be deemed filed against the Consolidated Debtors collectively and shall be one Claim against and, if and to the extent allowed, shall become one obligation of the Consolidated Debtors.

Plan § 2.2(a). Plan consolidation is defined as "the deemed consolidation of the Estates of the Consolidated Debtors, solely for the purposes associated with the confirmation of the Plan and the occurrence of the Effective Date, including voting, Confirmation, and distribution." *See id.* § 1.1(105). [5] With the benefit of substantive consolidation, the Plan estimates that unsecured creditors will receive approximately forty-five cents for every dollar of allowed claims. *See* Plan at 1; *see id.* § 4.3(d)(ii).

In its objection, Residco contends that the Debtors do not satisfy the test for substantive consolidation. More specifically, Residco claims that it relied upon the Debtors' corporate separateness and that the financial affairs of the individual Debtors can be separated. *See* Residco Objection at 24–30. Residco also argues that it would be prejudiced by substantive consolidation because its claims against the Subsidiary-Lessee Debtor and the Parent-Guarantor Debtor could potentially be allowed in different amounts. *See id.* at 10–11, 26–27. On this point, Residco asserts that its lease claims against the Subsidiary-Lessee Debtor based on the SLV liquidated damages provisions may be subject to various defenses—thus making them less valuable—but that its guarantee claims against the Parent-Guarantor Debtor are not subject to such defenses. *See id.* at 15–17 (arguing that the guarantee is absolute, unconditional and not subject to defenses). Therefore, Residco objects to the elimination of its potentially more valuable guarantee claims as part of substantive consolidation. *See* *id.* at 10–11, 17 (contending that the difference in potential allowed claims is over $50 million). Residco proposes that if its lease and guarantee claims are ultimately allowed in different amounts, Residco's recovery should be calculated using the average of its allowed lease claim and allowed guarantee claim for each transaction (the "Average Claims Treatment"), or in the alternative, that its claims should be allowed in the higher

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amount for each lease transaction (the "Higher Claims Treatment"). *See id.* at 18.

The Debtors and the Official Committee of Unsecured Creditors (the "Committee") disagree. *See* Debtors' Response to Residco Objection at ¶¶ 7, 31–35, 38, 40–42, 49, 52, 59; Reply of the Official Committee of Unsecured Creditors in Support of Confirmation of Debtors' Plan ("Committee Reply") ¶¶ 3, 19–24, 28–32 [ECF No. 1558]. They contend that substantive consolidation is appropriate given how the Debtors operate and the benefits to creditors in these cases. They dispute that Residco relied upon the separateness of the Debtors as corporate entities. As to the issue of prejudice, they do not believe that Residco's claims could be allowed in different amounts against the Subsidiary-Lessee Debtor and the Parent-Guarantor Debtor. In any event, they propose to carve out Residco's claims from substantive consolidation to prevent any prejudice from substantive consolidation. While the Debtors and the Committee have revised their initial proposed carve-out for Residco to address comments made by the Court (the "Carve-Out"), [6] Residco continues to argue that the Carve-Out does not protect its rights. *See* Residco Response to Revised Carve-Out ¶¶ 1–3.

DISCUSSION

A. Substantive Consolidation Standard

A court's ability to substantively consolidate has been found to be within "the court's general equitable powers as set forth in [Section] 105" of the Bankruptcy Code. *Union Sav. Bank v. Augie/Restivo Baking Co., Ltd.* (*In re Augie/Restivo Baking Co., Ltd.*), 860 F.2d 515 , 518 n.1 (2d Cir. 1988) ;*see also Bruce Energy Ctr. Ltd. v. Orfa Corp. of Am. (In re Orfa Corp. of Phila.*), 129 B.R. 404 , 413–14 (Bankr. E.D. Pa. 1991). "Substantive consolidation has the effect of consolidating assets and liabilities of multiple debtors and treating them as if the liabilities were owed by, and the assets held by, a single legal entity. In the course of satisfying the liabilities of the consolidated debtors from the common pool of assets, intercompany claims are eliminated and guaranties from co-debtors are disregarded." *In re Worldcom, Inc.* , 2003 WL 23861928, at *35 (Bankr. S.D.N.Y. Oct. 31, 2003) (citations omitted); *see also Augie/Restivo* , 860 F.2d at 518 (describing effect of substantive consolidation). As substantive consolidation may place creditors of one debtor on parity with creditors of a less solvent debtor, "[t]he power to consolidate should be used sparingly because of the possibility of unfair treatment of creditors of a corporate debtor who have dealt solely with that debtor without knowledge of its interrelationship with others." *Chem. Bank N.Y. Trust Co. v. Kheel* , 369 F.2d 845 , 847 (2d Cir. 1966).

To determine whether to approve substantive consolidation bankruptcy courts traditionally have considered a variety of factors, including:

> [t]he presence or absence of consolidated financial statements; [t]he unity of interest and ownership among various corporate entities; [t]he degree of difficulty in segregating and ascertaining individual assets and liabilities; [t]he

[565 B.R. 717]

> transfers of assets without formal observance of corporate formalities; [t]he commingling of assets and business functions; [t]he profitability of consolidation at a single physical location; and [t]he disregard of legal formalities.

In re Worldcom , 2003 WL 23861928, at *35 (citing *Augie/Restivo* , 860 F.2d at 518); *see also In re Drexel Burnham Lambert Grp. Inc.* , 138 B.R. 723 , 764 (Bankr. S.D.N.Y. 1992) (listing factors courts consider in ascertaining whether the interrelationship between entities warrants consolidation).

In *In re Augie/Restivo Baking Co.* , the Second Circuit distilled these considerations into two critical inquiries: whether (i) "creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit"; or (ii) "the affairs of the debtors are so entangled consolidation will benefit all creditors." *Augie/Restivo* , 860 F.2d at 518 (internal quotations and citations omitted); *see also, e.g., In re Worldcom* , 2003 WL 23861928, at *35–36. This test is in the disjunctive and the satisfaction of either prong can justify substantive consolidation. *See Official Comm. of Unsecured Creditors v. Am. Tower Corp.* (*In re Verestar, Inc.*), 343 B.R. 444 , 463 (Bankr. S.D.N.Y. 2006). The first prong, whether creditors relied on a separate existence of the debtors, is "applied from the creditors' perspective." *In re 599 Consumer Elecs., Inc.* , 195 B.R. 244 , 249 (S.D.N.Y. 1996). "The inquiry is whether *creditors* treated the debtors as a single entity, not whether the managers of the debtors themselves, or consumers viewed the [debtors] as one enterprise." *Id.* Under the second prong, courts typically analyze whether the debtors have demonstrated either an operational or a financial entanglement of business affairs. *See In re Leslie Fay Cos., Inc.* , 207 B.R. 764 , 780 (Bankr. S.D.N.Y. 1997) (finding "debtors' operations, cash, and decision-making were all shared such that it would be detrimental to the estates to attempt to disentangle those operations."); *see also Windels Marx Lane & Mittendorf, LLP v. Source Enters., Inc.* (*In re Source Enters., Inc.*), 392 B.R. 541 , 552 (S.D.N.Y. 2008) ("[C]ourts will consider ... whether the entities share costs or obligations; fail to observe corporate formalities; or, in the case of a subsidiary and parent, fail to act independently."). The burden of proving the appropriateness of substantive consolidation is on the debtor. *See In re Jennifer Convertibles, Inc.* , 447 B.R. 713 , 723 (Bankr. S.D.N.Y. 2011).

Another "key factor" courts have considered is whether substantive consolidation "will yield an equitable treatment of creditors without any undue prejudice to any particular group." *In re Food Fair, Inc.* , 10 B.R. 123 , 127 (Bankr. S.D.N.Y. 1981). As an equitable remedy, courts may order substantive consolidation where the benefits to creditors outweigh the harm. *See In re Worldcom* , 2003 WL 23861928, at *35 (citing *Augie/Restivo* , 860 F.2d at 518 –19). To that end, courts in the Second Circuit "use a balancing test to determine whether the relief achieves the best results for all creditors." *Id.* at *36 (citing *Fed. Deposit Ins. Corp. v. Colonial Realty Co.* , 966 F.2d 57 , 60 (2d Cir. 1992)). Indeed, the substantive consolidation factors should be "evaluated within the larger context of balancing the prejudice resulting from the proposed consolidation against the effect of preserving separate debtor entities." *In re Drexel Burnham Lambert Grp. Inc.* , 138 B.R. at 764 –65. As the court in *In re Drexel Burnham Lambert* observed, "substantive consolidation should be ordered where the inequalities of substantive consolidation are outweighed by the practical difficulties of tracing complex transactions between interrelated corporate entities." *Id.* at 765 ;

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see also In re Food Fair , 10 B.R. at 127 ("The difficulty and expense of attempting, at this point in time, to reconstruct separate balance sheets for each of the Debtors so as to allocate expenses, assets and liabilities to each of the various entities far outweigh any possible benefit to creditors."). Courts have discretion in determining whether substantive consolidation is appropriate. *See In re Worldcom* , 2003 WL 23861928, at *36 (citing cases).

Courts have applied these principles in a practical manner. For example, the court in *In re Worldcom, Inc.* , concluded that the substantive consolidation provided in the proposed plan of reorganization was appropriate and satisfied both prongs of the *Augie/Restivo* test. *See id.* at *37. The court found that the debtors' operational and financial affairs were so entangled that even if it were possible to identify and allocate the assets and liabilities of the debtors, it "would take so long and be so costly such that creditors as a whole would be substantially harmed by the effort. Thus, disentangling the financial affairs of the [d]ebtors [was] a practical impossibility." *Id.* The court relied on numerous facts to support its conclusion, including:

> common management and control of the Debtors; the substantial operational integration and entanglement of the Debtors' business operations, ... the existence of centralized administrative functions, such as cash management, purchasing, human resources, and finance, and presentation of products and services to the marketplace on an integrated basis; public financial reporting on a consolidated basis; financial entanglement resulting from internal financial management being conducted on a business line and functional basis, rather than legal entity basis; inability to account accurately and reliably for intercompany claims, resulting from, among other things, a lack of proper internal controls; the Debtors' present inability to create accurate and reliable historical financial statements on a separate legal entity basis ....

Id. In addition, the court found that the cost of disentangling the estates would not be "simply the out-of-pocket expenses to pay the accountants, lawyers, and other professionals ... [but would include] enormous employee resources ... detracting from business operations, as well and the incalculable diminution of enterprise value that likely would result from a protracted chapter 11 case." *Id.*

Moreover, courts can and will fashion substantive consolidation to fit the circumstances of the case. "[I]t is well accepted that substantive consolidation is a flexible concept and that a principal question is whether creditors are adversely affected by consolidation and, if so, whether the adverse effects can be eliminated." *In re Jennifer Convertibles* , 447 B.R. at 723 –24. As an equitable doctrine, courts can craft relief in forms appropriate to the unique facts of a particular case. *See Moran v. H.K. & Shanghai Banking Corp.* (*In re Deltacorp, Inc.*), 179 B.R. 773 , 777 (Bankr. S.D.N.Y. 1995) ("The court is afforded a good deal of discretion in constructing its order of substantive consolidation, and its appropriateness is determined by the court on a *sui generis* basis."); *see also In re Standard Brands Paint Co.* , 154 B.R. 563 , 570 (Bankr. C.D. Cal. 1993) (noting bankruptcy courts have "the power to modify substantive consolidation to meet the specific needs of the case.").

B. The Debtors Satisfy the *Augie/Restivo* Test for Substantive Consolidation

Applying all these principles here, the Court finds that the Debtors satisfy

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both prongs for substantive consolidation under *Augie/Restivo* . Given that these prongs are interrelated, the Court will discuss them together.

As a starting point, the Court finds the Consolidated Debtors operate as a single economic unit. They operate a single business under a single business plan. *See* Declaration of Bryan K. Bedford in Support of Confirmation of Debtors' Plan ("Bedford Decl.") ¶ 17 [ECF No. 1553]. None of the Consolidated Debtors has ever received a credit rating independently from another Consolidated Debtor, and analyst reports routinely discuss the Debtors as a unified enterprise. *See id.* The Consolidated Debtors share the same overhead, management, accounting, and other back-office functions; there are significant intercompany obligations; and there are significant overlaps in the creditor pools due to guarantees. *See id.* ¶ 16. Moreover, the Consolidated Debtors issue consolidated financial statements, are jointly controlled from a shared business headquarters at a common business address, have no separate budgets, use the same cash management system, and file a consolidated tax return. *See id.* Only one of the Consolidated Debtors—Republic Airline—has any business operations. *See id.* By contrast, the parent Debtor RAH has almost no outside trade creditors or vendors but has issued multiple guarantees despite having no operations. *See id.* ¶¶ 15, 16.

The Court also concludes that the record supports that the benefits of substantive consolidation outweigh any harm suffered by creditors. Most importantly, the Debtors are concerned about the cost of conducting an intercompany reconciliation and audit. *See* Hr'g Tr. 203:2–9; *see also id.* 104:23–105:13 (Bedford) (testifying that determining which Debtor owns the cash in RAH's account would require a reconciliation). Significant additional time and expense would be necessary to untangle the assets of the Consolidated Debtors, which would result in a longer period of time spent in Chapter 11. *See* Declaration of Joseph P. Allman in Support of Confirmation of Debtors' Plan ("Allman Decl.") ¶ 4 [ECF No. 1554]; *see also* Hr'g Tr. 203:2–7. It is undisputed that each month in bankruptcy costs the Debtors $3 million to $4 million in administrative expenses. *See* Hr'g Tr. 203:6–7; *cf. In re Worldcom* , 2003 WL 23861928, at *36 (citing cases regarding untangling financial affairs of debtors).

There are also potential business risks arising out of a longer stay in Chapter 11, including potential adverse effects as to the Debtors' pilot situation. It is important to remember that the Debtors' Chapter 11 filings were caused in large part by a pilot shortage, which led to the Debtors being unable to honor their flying obligations to their codeshare partners. *See* First Day Decl. ¶¶ 4–8 (explaining that the pilot shortage made it difficult for the Debtors to maintain performance requirements under their codeshare agreements). This was critical because the Debtors' business model is based on their relationship with their codeshare partners, which are national airlines for whom the Debtors provide regional flying. *See In re Republic Airways Holdings Inc.* , 2016 WL 2616717, at *1 (Bankr. S.D.N.Y. May 4, 2016) (explaining the crucial nature of Debtors' relationship with their codeshare partners, which accounts for substantially all of the Debtors' operating revenue). More specifically, the Debtors' success is based on their codeshare agreements, through which the Debtors provide regional passenger service under the designations of United Express, Delta Connection, and American Eagle. *See* First Day Decl. ¶ 2. While the Debtors have been successful in recruiting and retaining pilots in 2016, they have recently fallen behind their goals for pilot recruitment and retention in 2017. *See* Hr'g Tr.

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27:19–28:2, 28:8–19 (Allman). The Debtors are justifiably concerned that a delay in emergence from Chapter 11 could further negatively impact the Debtors' ability to recruit and retain pilots, particularly in an environment where competition for pilots is fierce. *See* Allman Decl. ¶ 4; *see also* Hr'g Tr. 202:2–7 (noting concern that the Debtors' competitors are "all over [the Debtors'] employees and pilots."). The Debtors are also concerned that a longer stay in Chapter 11 will impact their ability to close on important transactions, thereby negatively affecting their liquidity. *See* Hr'g Tr. 35:9–36:6 (Allman) (describing potential sale-leaseback transaction in which counterparty will not close while the Debtors are in Chapter 11 and that if confirmation does not occur before end of April the counterparty has no commitment to extend or close on the transaction); *see also* Debtors' Response to Residco Objection ¶ 63 n.10 (describing the same sale-leaseback transaction that would give Debtors approximately $21 million in additional liquidity that can be terminated if the sale has not occurred by April 30, 2017).

These findings on substantive consolidation are supported by credible testimony from Mr. Allman and Mr. Bedford on behalf of the Debtors. [7] Turning first to Mr. Bedford, he explained that the Consolidated Debtors operate as

> one economic entity. We don't distinguish between holdings in terms of management, overheads, common functions. We use the holding company as a consolidated treasury account. ... We don't hold ourselves out as Shuttle America or Chautauqua or Republic, the airline, or Republic Holdings on our website. We just hold ourselves out as Republic.

Hr'g Tr. 48:17–49:2 (Bedford). Mr. Bedford further testified that for financial reporting purposes they only have one budget, they make one set of financial reports, and they file a consolidated tax return. *See id.* 49:4–6 (Bedford). The operating entities historically hire the pilots under a master contract in the collective bargaining agreement, but RAH is also a party to that agreement. *See id.* 50:6–12 (Bedford). [8] Mr. Bedford also testified that after the Debtors went public in 2004, most of the Debtors' operating entities' finance transactions are guaranteed at the parent level. *See id.* 57:23–58:2 (Bedford). Turning to whether substantive consolidation would benefit all creditors, Mr. Bedford testified that the potential recovery for creditors in a RAH-only bankruptcy estate would be extremely low, likely one to two cents on the dollar. *See id.* 83:11–19 (Bedford); *see also* Bedford Decl. ¶¶ 18–19 (stating benefits of substantive consolidation include savings of cost and time, including reduction in administrative costs). [9]

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Mr. Allman's testimony also supports substantive consolidation. Mr. Allman testified that "if the Effective Date is further delayed, the pressure will continue on pilot hiring which could result in substantial underperformance by Republic under the postpetition codeshare agreements, which may have a material effect on estimated recoveries for creditors." Allman Decl. ¶ 4. Mr. Allman explained that this conclusion was based on information and updates he receives from pilots and union executive leadership, all of which indicates the Chapter 11 case "is an overhang [and] [c]ertainly, we are aware of pilots that turn offers down and choose to go to other regional airlines that are not in Chapter 11." Hr'g Tr. 26:8–25 (Allman). Mr. Allman also believes that extending the Chapter 11 process would harm "potential recoveries of creditors, primarily because we have obligations to our three mainline partners ...." *Id.* 27:2–5 (Allman). If the Debtors fail to meet the flying requirements in the amended agreements with their codeshare partners, a breach of those agreements would result in administrative claims for damages that would consume much of the economic value that unsecured creditors anticipate receiving under the Plan. *See id.* 34:16–35:1 (Allman). Indeed, such a situation would mirror the unfortunate economic circumstances that lead the Debtors to file Chapter 11 in the first place. *See Republic Airways Holdings* , 2016 WL 2616717, at *1–2 (explaining the Debtors' business model and their inability to perform their obligations under the codeshare agreement with Delta Air Lines, Inc., one of the Debtors' three codeshare partners).

The Court also finds it persuasive that the Committee—of which Residco is a member—supports the Debtors' request for substantive consolidation. The Committee agrees that the cost of untangling the assets would outweigh any benefits that creditors could obtain. *See* Committee Reply ¶ 29. The Committee also agrees that determining the actual value of the assets and liabilities of individual Debtors like RAH would delay distributions and drain estate resources. *See id.* Indeed, the unsecured creditors—the parties that the Committee represents—voted overwhelming in both number (94.12%) and amount (93.8%) to support the Plan, which provides a recovery of approximately forty-five cents on the dollar based on substantive consolidation. *See* Tabulation Summary, attached as Exh. A to Certification of Prime Clerk LLC Regarding the Solicitation of Votes and Tabulation of Ballots Cast on the Debtors' Plan [ECF No. 1552]; *see also* Debtors' Response to Residco Objection ¶ 6 n.3 (setting forth percentages that voted in favor of the Plan).

C. <u>The Residco Objection</u>

Residco makes numerous arguments in opposition to substantive consolidation, none of which the Court finds persuasive. Residco's first argument is a factual one. Based on the testimony of Residco's witness, Mr. Davis, Residco contends that it relied on the corporate separateness of the Debtor entities when entering into the Residco transactions. *See* Hr'g Tr. 108:24–109:1. Mr. Davis testified that, prior to entering into the transactions, ALF VI reviewed public filings and had the understanding that RAH and Chautauqua were

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"very separate entities." *See* Hr'g Tr. 119:1–7 (Davis); *see also id.* 119:13–14 (Davis) (testifying that the public filings stated "that Republic is the holding company and they are the operating subsidiaries."). When asked what he meant by "very separate entities," Mr. Davis explained that he "observed ... that ... the company was described as a holding company with operating subsidiaries. The operating subsidiaries ... are operating separately, or at least it appeared to be because they each were required to operate under FAA rules as separate entities." *Id.* 135:5–10 (Davis). Given this understanding, Mr. Davis insisted that ALF VI would not have entered the transaction without the parent guarantee. *See id.* 119:7–10 (Davis).

But the Court does not find Mr. Davis's conclusion about corporate separateness to be credible. As a threshold matter, Mr. Davis' testimony must be discounted given his limited involvement in the underlying transaction with the Debtors. He has been the president and CEO of ALF VI only since October 2014, just two months before the transaction between ALF VI and the Debtors closed in December 2014. *See id.* 117:10–14, 118:6–12, 132:4–6 (Davis). So while Mr. Davis oversaw the investment in the Debtors, it was initiated before he joined ALF VI. *See id.* 133:18–22 (Davis). Moreover, Mr. Davis had absolutely no direct communication with Republic during the process. *See id.* 135:13–18, 136:4–7, 142:22–143:1 (Davis). Indeed, the only communications for this transaction were the negotiations between Mr. Davis' subordinates and Mitsui; not Republic. *See id.* 135:13–20, 143:2–16 (Davis) (testifying there was no dialogue between ALF VI and Republic regarding the transaction, specifically as to the guarantee). Mr. Davis did not provide any detail about those negotiations that would support his conclusion about corporate separateness.

While having no communications with the Debtors, Mr. Davis did oversee work prepared by subordinates who reviewed due diligence documents, and Mr. Davis believes that he reviewed the operative documents such as the lease and the guarantee. *See id.* 134:5–15 (Davis). But the materials that Mr. Davis reviewed do not support his conclusion about corporate separateness. Mr. Davis conceded that ALF VI only reviewed the consolidated financials of the Debtors, not financials on a Debtor by Debtor basis. *See id.* 160:2–14 (Davis); *see also id.* 138:1–8 (Davis) (stating that he had not done a separate analysis or review of RAH's financials but noting that "other entities that were part of the Republic family of holdings, and those entities had value, and those entities generated cash, and ... the potential to access that through the guarantee was a general—a significant enhancement"); *id.* 136:8–12 (Davis) (testifying that there were not separate financial statements for the subsidiaries). Given that ALF VI only reviewed the Debtors' consolidated financial statements, it is unclear how Mr. Davis could have relied on the corporate separateness of individual Debtors when entering into the Residco transaction. On re-direct, Mr. Davis attempted to explain away this problem. He testified that with respect to the parent guarantee, he looked at "equity value of the net worth of" the other operating entities on a consolidated basis, a value which he says was captured at the parent entity Debtor RAH. *See id.* 159:1–9 (Davis); *see also id.* 160:13–16 (Davis) ("[W]e made our decisions based on consolidated statements which are worth more than ... Chautauqua at that point in time."). But such a statement merely shows that Mr. Davis relied upon the enterprise value of the Debtors—considering all the assets and liabilities of the Debtor entities as a group—rather than

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the corporate separateness of each of the entities.

Residco's second argument fares no better. Pointing to the schedules filed by the Debtors in this case, Residco contends that the Consolidated Debtors did not operate as a "single economic unit." *See* Residco Objection at 25; Residco Sur-Reply at 4. More specifically, Residco points to the Debtors' ability to separate the assets and liabilities of each individual Debtor in the schedules of assets and liabilities filed in these cases. *See* Residco Objection at 25; Residco Sur-Reply at 4. But Residco's argument ignores the limitations to the Debtors' schedules that are set forth in the Debtors' "Summary of Significant Reporting Policies," which states:

> The Debtors use a consolidated cash management system through which the Debtors collect substantially all receipts and pay liabilities and expenses. As a result, *certain payments in the Schedules and Statements may have been made prepetition by one entity on behalf of another entity through the operation of the consolidated cash management system* .

Schedules of Assets and Liabilities for Republic Airways Holdings Inc. (Case No. 1610429 (SHL)) [ECF No. 595] (emphasis added). It is not surprising, then, that the Debtors' schedules specifically note that, "[n]othing contained in the Schedules and Statements shall constitute a waiver of any of the Debtors' rights with respect to these chapter 11 cases and specifically with respect to any issues involving substantive consolidation ...." *Id.* at 1. [10]

These caveats to the Debtors' schedules are consistent with Mr. Bedford's testimony that the Debtors have a "consolidated treasury function for all the operating and parent entities," meaning the parent company operates a "sweep" account, into which the operating entities sweep money. *See* Hr'g Tr. 60:9–13 (Bedford). He testified that the sources of RAH's funds would be borrowings and any cash flow generated by the operating businesses. *See id.* 79:2–5 (Bedford). This testimony further supports the position of the Debtors and the Committee that the schedules do not accurately reflect the value of RAH because the cash shown for RAH is just a cash concentration. *See id.* 79:10–21 (Bedford); *see also* Debtors' Response to Residco Objection ¶ 54 (stating schedules reflect cash concentration, including drawdowns by other Debtors on their secured facilities); *cf.* Committee Reply ¶¶ 31–32 (identifying problems with the Debtors' schedules, including that they (i) use net book values, rather than actual fair market values, (ii) exclude the value of avoidance actions or similar claims, (iii) do not account for the value of unliquidated claim amounts). Given the weight of the evidence, therefore, the Court concludes that the filing of the schedules in these cases does not preclude substantive consolidation. *See In re Murray Indus., Inc.* , 119 B.R. 820 , 822, 830, 832 (Bankr. M.D. Fla. 1990) (granting substantive consolidation where debtors filed their own schedule of assets and liabilities and statement of financial affairs, noting "ultimate question is whether or not it is fair to authorize substantive consolidation after having balanced the equities in light of the record");

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cf. In re Adelphia Commc'ns Corp. , 368 B.R. 140 , 218–19 (Bankr. S.D.N.Y. 2007) (court not reaching a decision on substantive consolidation but noting that it "would be a highly unlikely result" given restated financial statements and the filing of amended schedules, "evidencing an ability to generally determine the assets and liabilities of each [d]ebtor" and the debtors' separate corporate identities and given that the records appeared to correctly reflect how money was spent and for which entity's benefit).

Residco's third argument is prejudice. Residco argues that it may be harmed by substantive consolidation if it retains only its lease claims, which Residco contends are potentially worth $50 million less than Residco's guarantee claims. *See* Residco Objection at 26–27. The potential difference in value arises, Residco argues, based on the possibility that certain affirmative defenses will apply to Residco's lease claims but not its guarantee claims. More specifically, the enforceability of Residco's lease claims depends on whether the SLV liquidated damages provisions in the leases are considered an unenforceable penalty. *See id.* at 14–16; *see also E. Air Lines, Inc. v. Brown & Williamson Tobacco Corp.* (*In re Ionosphere Clubs, Inc.*), 262 B.R. 604 , 614 (Bankr. S.D.N.Y. 2001) ("Courts will not enforce a liquidated damages provision if it operates as a penalty or forfeiture clause."). But Residco argues that its guarantee claims are not subject to such a defense given the language in the guarantees waiving all defenses. *See* Residco Objection at 16–17.

The Debtors and the Committee disagree, arguing that the hypothetical difference in value between the lease and guarantee claims is an "impossibility." *See* Debtors' Response to Residco Objection ¶ 42; *see also* Committee Reply ¶ 3. As to the guarantee claims, the Debtors contend that as a matter of public policy, a party cannot waive defenses to the enforceability of a penalty provision and that bankruptcy courts will not enforce punitive liquidated damages provisions. *See* Debtors' Response to Residco Objection ¶¶ 40–42. If the SLV liquidated damages provisions are unenforceable under the leases, therefore, the Debtors and the Committee contend the SLV liquidated damages provisions are likewise unenforceable under the guarantees. *See id.* ¶¶ 40–42; *see also* Committee Reply ¶ 3. In that event, there can be no difference between Residco's lease and guarantee claims, and thus Residco is not prejudiced by substantive consolidation. *See* Residco Objection at 12 (explaining that the basis for Residco's Objection is that its lease and guarantee claims may be allowed in different amounts); *see also* Debtors' Response to Residco Objection ¶ 42 n.7 (suggesting that even if Residco is successful in arguing the SLV liquidated damages provisions are enforceable, its lease and guarantee claims would be equal and Residco would not be prejudiced).

As a threshold matter, even if Residco is prejudiced, substantive consolidation may still be granted where, as here, the benefits to all creditors greatly outweigh the possible harm to Residco. *See In re Worldcom* , 2003 WL 23861928, at *37 (finding the benefits of substantive consolidation "far outweigh any possible harm to creditors"); *In re Gucci* , 174 B.R. 401 , 414 (Bankr. S.D.N.Y. 1994) (granting substantive consolidation over one creditor's objection where that creditor had not made a clear showing of prejudice and noting that "even if it were found that some creditors may be prejudiced, that, in and of itself, would not necessarily defeat the motion because '[a]ny potential prejudice to creditors ... is greatly outweighed by the much greater for prejudice, harm and waste if substantive consolidation is not

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ordered.' ") (citing *In re Tureaud* , 45 B.R. 658 , 663 (Bankr. N.D. Okla. 1985)); *see cf. In re Drexel Burnham Lambert Grp.* , 138 B.R. at 765 n.9 (stating that if an objecting creditor has shown that (a) it has relied on the separateness of the entities and (b) it will be prejudiced, substantive consolidation may be ordered "only if [the court] determines that the demonstrated benefits of consolidation heavily outweigh the harm.") (citing *Eastgroup Props. v. S. Motel Ass'n, Ltd.* , 935 F.2d 245 , 249 (11th Cir. 1991)).

Moving on to assess the likelihood of prejudice to Residco, the Court must examine whether the SLV liquidated damages provisions would be considered an unenforceable penalty as to either Residco's lease or guarantee claims. This is a matter of state law. *See United Merchs. & Mfrs., Inc. v. Equitable Life Assurance Soc'y of the U.S.* (*In re United Merchs. & Mfrs.,* *Inc.*), 674 F.2d 134 , 141 (2d Cir. 1982). In New York, an enforceable liquidated damages clause "must specify a liquidated amount which is reasonable in light of the anticipated probable harm, and actual damages must be difficult to ascertain as of the time the parties entered into the contract." *In re Ionosphere Clubs* , 262 B.R. at 614 . The party seeking to avoid the liquidated damages bears the burden of demonstrating that such damages are a penalty. *See JMD Holding Corp. v. Cong. Fin. Corp.* , 4 N.Y.3d 373 , 380, 795 N.Y.S.2d 502 , 828 N.E.2d 604 (2005) . As some courts have stated, "[g]uaranties that contain language obligating the guarantor to payment without recourse to any defenses or counterclaims, i.e., guaranties that are 'absolute and unconditional,' have been consistently upheld by New York courts." *Cooperatieve Centrale Raiffeisen – Boerenleenbank, B.A. v. Navarro* , 25 N.Y.3d 485 , 493, 36 N.E.3d 80 (2015) . But other courts have found that as a matter of public policy, a party cannot waive an objection to a liquidated damages clause. *See Bell v. Ebadat* , 2009 WL 1803835, at *3 (S.D.N.Y. June 16, 2009) (citing *Wells Fargo Bank Nw., N.A. v. Energy Ammonia Transp. Corp.* , 2002 WL 31368264, at *2 (S.D.N.Y. Oct. 21, 2002)). Furthermore, "[i]t is well-established that a bankruptcy court, being essentially a court of equity will not enforce a liquidated damages clause that is in reality a penalty." *Hassett v. Revlon, Inc.* (*In re O.P.M. Leasing Servs., Inc.*), 23 B.R. 104 , 110–11 (Bankr. S.D.N.Y. 1982). [11]

The Court lacks the facts necessary to apply these principles to determine the value of Residco's claims. Residco's claims are not before the Court for adjudication on the merits, or even for an estimation proceeding. *See* 11 U.S.C. § 502(c) (permitting estimation of a contingent or unliquidated claim where failure to do so "would unduly delay the administration of the case."); *see also* Hr'g Tr. 177:19–25. The parties have not presented the factual record necessary to determine whether the amounts under the SLV liquidated damages provisions were reasonable in light of the anticipated probable harm or whether damages were difficult to ascertain at the time the parties entered into the contracts. *See* Debtors' Response to Residco Objection

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¶¶ 40–42; *see* Residco Sur-Reply at 17–18 (contending that the Residco Leases are governed by N.Y. U.C.C. § 2A–504 and that, therefore, the sole test for determining enforceability of a liquidated damages provision is whether the formula was "reasonable in light of the then anticipated harm caused by the default or other act or omission."). [12] Moreover, the parties only presented limited legal argument on the enforceability of these SLV liquidated damages provisions. Instead, the focus of the present dispute is on the permissibility of substantive consolidation. Under these circumstances, it is inappropriate now to seek to resolve all the issues associated with the merits and value of Residco's claims.

But more importantly, resolution of these issues today is unnecessary. As an alternative to resolving these legal issues, the Debtors and the Committee have proposed the Carve-Out to address any potential prejudice to Residco. The Carve-Out provides that Residco may opt to have its claims treated as if substantive consolidation had not occurred. More specifically, the Carve-Out provides that if Residco's guarantee claims are allowed in an amount greater than its lease claims—the whole basis for Residco's claim of prejudice—Residco's claims could be carved out from the effect of substantive consolidation and treated as if substantive consolidation had not taken place. *See* Debtors' Response to Residco Objection ¶¶ 8–9. Under the Carve-Out, therefore, Resdico could receive exactly the treatment that it is entitled to as a matter of law without substantive consolidation. Thus, Residco could receive two classes of claims—its guarantee claims against Debtor RAH and its lease claims against Debtor Republic Airline—with recovery for each class of claims to be calculated as if the assets and liabilities of Republic Airline and RAH were valued separately as reorganized entities. *See* Carve-Out, attached as Exh. 1 to Debtors' Reply to Residco Response to Revised Carve-Out. Under the Carve-Out, moreover, Residco would be allowed to opt for such non-consolidated treatment after the value of its claims had been determined—that is, Residco could wait until after it knew whether there was a difference in the amount of its lease and guarantee claims. *See id.* ; *see also* March 16th Hr'g Tr. 39:4–20. The proposed Carve-Out states in full:

> Notwithstanding anything in the Plan to the contrary, in the event that the claims of Wells Fargo Bank Northwest, N.A., as Owner Trustee, and ALF VI, Inc., as Owner Participant (together, "Residco") against RAH (the "Guarantee Claims") in connection with the rejection of the *Amended and Restated Aircraft Lease Agreement* for each of seven EMB–145LR aircraft bearing U.S. registration marks N288SK, N561RP, N259JQ, N286SK, N287SK, N563RP and N562RP are Allowed in a higher amount than the corresponding claims of Residco against Shuttle (the "Lease Claims,"

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> and together with the Guarantee Claims, the "Residco Claims"), Residco may by written notice to the Debtors or Reorganized Debtors (as the case may be) and the Creditors' Committee elect within 14 days of any such determination to treat such claims as not subject to the Plan Consolidation for purposes of determining the amount of any distributions on account of the Residco Claims under the Plan (the "Non-Consolidation Treatment"). Instead, in the event Residco elects the Non-Consolidation Treatment, Residco would be entitled to receive distributions for (i) the allowed amount of the Guarantee Claims, based on an estimated percentage that non-priority general unsecured creditors of RAH would have received in a standalone plan of reorganization for RAH ***plus*** (ii) the allowed amount of the Lease Claims based on an estimated percentage distributions that nonpriority general unsecured creditors of Shuttle would have received in a standalone plan of reorganization for Republic Airline, in each case following the merger of Shuttle into Republic Airline pursuant to the *Order Pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code and Bankruptcy Rule 6004 for Approval of (I) Merger of Shuttle America Corporation into Republic Airline Inc., and (II) Surrender of the Shuttle America Corporation Air Carrier Certificate* [ECF No. 1236] (the "Merger"). For the avoidance of doubt, the Non-Consolidation Treatment is intended to provide Residco with the amounts they would have recovered if the Plan

Consolidation had not taken place. In the event Residco elects the Non-Consolidation Treatment, all rights of the Debtors, Residco and any other party in interest are reserved to ensure that the Non-Consolidation Treatment effectuates such intent; *provided* that the Debtors agree to bear the burden of proof to establish the estimated percentage distributions that would have been received by general unsecured creditors under standalone plans for RAH and Republic Airline (following the Merger). In the event Residco does not timely elect the Non-Consolidation Treatment, the Residco Claims shall be subject to the Plan Consolidation, including (a) the elimination of the Guarantee Claims pursuant to Section 2.2(a) of the Plan and (b) the treatment of the Lease Claims as Class 3(a) Claims.

Carve-Out.

Notwithstanding these robust protections, Residco objects to the Carve-Out. Among other things, Residco contends that it is being singled out for different treatment from other similarly situated creditors. *See* Residco Sur-Reply at 6 (arguing the Carve-Out will cause Residco to be treated worse than other similarly situated creditors); Hr'g Tr. 186:1–18 (arguing Residco will be treated worse because all other creditors without a guarantee will receive forty-five cents on the dollar); *id.* 188:9–10 (arguing that it would be unfair discrimination under Section 1129 if Residco's claims are in a class by themselves). But Residco is incorrect. In fact, Residco's situation is far from unique. More than 90% of the claims against the Debtors who are airline subsidiaries are guaranteed by RAH. *See* Hr'g Tr. 76:15–77:7, 98:12–17 (Bedford). All of the airline subsidiaries' operating leases—not just Residco's—have similar stipulated loss value provisions. *See id.* 75:2–8 (Bedford). The Plan's consolidation provisions apply to all these creditors, each of whom are giving up their guarantee claims under the Plan. *See* Plan § 2.2; Hr'g Tr. 43:17–23 (Bedford); *see, e.g., In re Standard Brands Paint*, 154 B.R. at 566 (noting it is typical in substantive consolidation to eliminate claims, including guarantees,

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between debtors for plan purposes). [13]

Residco nonetheless maintains that it would not receive the same recovery as other unsecured creditors in Class 3(a) if the Parent-Guarantor Debtor, RAH, winds up having assets that lead Residco's claim to be valued at less than forty-five cents on the dollar. *See* Residco Sur-Reply at 5; *see also* Residco Response to Revised Carve-Out ¶ 2; *cf.* Hr'g Tr. 168:8–12 (complaining of cost and discrimination in that every other creditor in Class 3A would receive forty-five cents on the dollar). But there are several problems with Residco's position. In making this argument, Residco mistakenly assumes that it might be forced to receive less than forty-five cents on the dollar, which is the amount that unsecured creditors are to receive under the substantive consolidation provisions of Plan. To the extent that Residco thinks that the forty-five cent recovery offered as part of substantive consolidation is a good deal, however, it is free to take it. *See* Carve-Out (permitting Residco to elect that its claims be treated on a consolidated or unconsolidated basis after the amount of Residco's claims are determined in the claims adjudication process). Indeed, the only reason Residco has not opted for such a recovery is because it chooses not to do so. Stated more directly, Residco wants the ability to opt out of substantive consolidation but only if it can be guaranteed of a recovery that will be greater than what it would receive under substantive consolidation and not if it will receive less. In that sense, Residco very much wants to "have [its] cake and eat it too." [14] *See* March 16th

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Hr'g Tr. 43:11–12; *James Talcott, Inc. v. Wharton* (*In re Cont'l Vending Machine Corp.*), 517 F.2d 997, 1001 (2d Cir. 1975) (concluding that under plan in which unsecured claims were consolidated and secured claims were not, secured creditor "will obtain under the ... plan exactly what it bargained" with each debtor entity); *see also* Ben Zimmer, '*Have Your Cake and Eat It Too*', N.Y. Times, Feb. 18, 2011, http://www.nytimes.com/2011/02/20/magazine/20FOB-onlanguage-t.html (tracing the derivation of the phrase and observing that "[t]he point of the aphorism is that sometimes you have to make a choice between two options that cannot be reconciled."). [15]

In rejecting Residco's position on the Carve-Out, the Court follows the lead of courts that have recognized that substantive consolidation can be tailored to fit the circumstances of the case and ensure that a claimant receives the recovery to which it is entitled. *See In re Cont'l Vending Machine Corp.*, 517 F.2d at 1001; *In re Jennifer Convertibles*, 447 B.R. at 723–24 ("[I]t is well accepted that substantive consolidation is a flexible concept and that a principal question is whether creditors are adversely affected by consolidation and, if so, whether the adverse effects can be eliminated."); *In re Deltacorp*, 179 B.R. at 777 ("The court is afforded a good deal of discretion in constructing its order of substantive consolidation, and its appropriateness is determined by the court on a *sui generis* basis."). For example, the Second Circuit in *In re Cont'l Vending Machine Corp.*, 517 F.2d 997 (2d Cir. 1975), concluded that in the exercise of its equitable powers, a bankruptcy court can permit substantive consolidation as to some claims and not as to others. *See* 517 F.2d at 1001–02 (upholding plan that treated unsecured claims as consolidated and secured claims as unconsolidated). Similarly, the court in *In re Jennifer Convertibles* fashioned a remedy specifically as to affected creditors when it found that the record was deficient regarding the appropriateness of substantive consolidation as to a small number of creditors. *See In re Jennifer Convertibles*, 447 B.R. at 723, 726 (court offered option to pay creditors in full or to supplement the record on substantive consolidation with separate liquidation analysis for the one debtor entity for which separate schedules and a separate statement of financial affairs were prepared); *see also In re Parkway Calabasas Ltd.*, 89 B.R. 832, 837–38 (Bankr. C.D. Cal. 1988) (citing cases in which courts ordered less than complete substantive consolidation or placed conditions thereon). [16]

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Rather than agree to the option of being carved out of substantive consolidation, Residco proposes two ways to treat its claims: a so-called Average Claims Treatment and a Higher Claims Treatment. *See* Residco Objection at 18; Residco Sur-Reply at 1. If Residco's lease and guarantee claims are allowed in different amounts, Residco's Average Claims Treatment provides that it receive the average of its allowed lease claims and allowed guarantee claims for each transaction. *See* Residco Objection at 18; *see also* Residco's Proposed Confirmation Order ¶ 7, attached as Exh. A to Residco Motion to Strike. Under its proposed Higher Claims Treatment, Residco would receive the higher of the lease or guarantee claim for each transaction. *See* Residco Objection at 18 n.8.

But Residco provides no mathematical or legal basis for its proposed Average Claims Treatment. In fact it concedes that the Bankruptcy Code does not provide for such treatment. *See* Hr'g Tr. 170:15–17 (Residco conceding that the Bankruptcy Code does not provide for the averaging method it suggests). Residco instead states that other creditors that hold both primary and guaranty claims "(other than holders who consensually agreed to different treatments) ... are receiving a treatment equal to the average of their two claims." *See* Residco Objection at 32. Residco cites no evidence for this contention. Residco presumably refers to settlements that the Debtors have worked out with other creditors holding dual claims. But such settlements are not a basis for imposing Residco's proposed Average Claims Treatment. *See* Fed. R. Evid. 408 ; *cf. In re Dana Corp.* , 412 B.R. at 62 ("[T]he fact that some claimants have settled while others have not does not, by itself, indicate unequal treatment."). Residco argues the Higher Claims Treatment is supported by the Bankruptcy Code because the Debtors have not yet objected to its claims. But the Debtors have made clear that they intend to do so. Under these circumstances then, Residco's proposed Higher Claims Treatment veers close to a request to adjudicate its claims on the merits, an approach that is inappropriate for reasons previously explained. *See, e.g.,* Hr'g Tr. 193:2–6.

Residco cites one case to support its proposed alternative treatments, *In re F.W.D.C., Inc.* , 158 B.R. 523 (Bankr. S.D. Fla. 1993) . But the Court finds that case to be far different from the one before this Court. The central issue in that case was whether the claim of Chase Manhattan Bank ("Chase") against a debtor-guarantor had to be reduced by its receipt of a third-party debtor's collateral securing the indebtedness. *See F.W.D.C.* , 158 B.R. at 526 . To that end, the court in *F.W.D.C.* approved substantive consolidation subject to the condition that Chase's claim against previously consolidated debtors be preserved and otherwise unaffected. *See id.* at 526, 528 (holding that Chase "was allowed to prove the full amount of its indebtedness, without reduction of its claim to reflect its receipt of [a third-party's] collateral securing such indebtedness against the newly consolidated debtors."). Additionally, it was undisputed in *F.W.D.C.* that the movants' primary purpose for substantive consolidation was to reduce the amount of Chase's claim. *See id.* at 524. By contrast, there is no suggestion that substantive consolidation here was directed at any one creditor. Rather, the record supports that it was proposed for the benefit of the estate given, among other things, the frequent use of guarantees by RAH and the

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efficiency and related cost savings under the Plan. *See* Debtors' Memorandum of Law in Support of Confirmation of Debtors' Plan and in Reply to Responses to the Plan at 16–17 [ECF No. 1557]. Indeed, the result in *F.W.D.C.* lends support to the Carve-Out proposed here, as the Carve-Out's purpose is to prevent any possible prejudice to the affected creditor. [17]

Residco also complains that it has not been given adequate disclosure in advance of what the Carve-Out would mean for Residco. *See* Residco Sur-Reply at 5–6; *see also* Residco Response to Revised Carve-Out ¶ 2. But the Carve-Out was proposed specifically to address Residco's Objection, and to provide it with the non-consolidated treatment that it purports to seek. Thus, there was no reason to propose the Carve-Out earlier because no other creditors have objected to substantive consolidation. Moreover, the fault for any delay in discussing any issues with substantive consolidation appears to rest with Residco. As the Debtors point out, Residco did not voice a concern about substantive consolidation until February 2017, even though substantive consolidation has been on the table in these cases for many months. Indeed, the issue of substantive consolidation goes back to before the Court approved the Debtors' settlement with United Airlines in June 2016, the same month when Residco became a member of the Committee. [18] *See* Hr'g Tr. 200:16–201:7; *see also* Order Granting Authorization to (I) Assume Codeshare and Related Agreements, as amended, with United Airlines, Inc., and (II) Settle Claims Between United Airlines, Inc. and the Debtors ("United Settlement Order") ¶ 12 [ECF No. 678] (stating provisions and effect of the order, any actions taken pursuant thereto, and the codeshare partner's and Debtors' respective rights, obligations, remedies, and protections provided therein and under related agreements shall survive substantive consolidation of the cases); Hr'g Tr. 219:10–19 (Delta arguing Residco saw operating entities get de facto substantive consolidation through settlements and the merger and Residco did not object). A subsequent settlement between the Debtors and American Airlines, Inc., proposed in September 2016 also contained a similar provision contemplating substantive consolidation. *See* Proposed Order ¶ 15, attached as Exh. 1 to Debtors' Motion for Authorization to (I) Assume Codeshare Agreement, as amended, with American Airlines, Inc., (II) Enter Into or Assume Related Agreements, and (III) Settle Claims Between American Airlines, Inc. and the Debtors [ECF No. 957]. The Debtors actively negotiated that settlement in consultation with the Committee. The Debtors also negotiated the Plan, including its substantive consolidation provisions, with the Committee. As a member of the Committee, Residco was thus well aware of the Debtors' intent to pursue substantive consolidation many months before the filing of the Plan but nonetheless

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did not raise its concerns. *See* Debtors' Response to Residco Objection ¶¶ 4–5; Hr'g Tr. 200:24–201:7. Such a delay in raising its concerns prevented the parties from taking steps to address these issues, perhaps even by seeking an adjudication of the merits and value of Residco's claims in advance of confirmation. [19] Such a proactive approach is often taken by parties in large Chapter 11 cases when a particular claim presents issues that are best resolved prior to confirmation. But as the Debtors had no idea that Residco objected to substantive consolidation, the Debtors had no reason to take such a course and, therefore, cannot be fairly criticized for delay in proposing the Carve-Out here. [20]

CONCLUSION

For the reasons stated above, the Court finds that the Debtors have satisfied the standard for substantive consolidation and overrules the Residco Objection. The Court directs that the Plan be amended to include the Carve-Out for Residco's claims, using the language set forth in Exhibit 1 to the Debtors' Reply to the Residco Response to Revised Carve-Out. Having resolved the Residco Objection, the Debtors shall contact the Court as to when it is appropriate to rule on the remaining matters related to confirmation of the Debtors' Plan. [21]

Notes:

[1] Residco filed several pleadings in furtherance of its objection including: Motion of Residco for Leave to File in Further Opposition to Debtors' Plan with Respect to New Matters and Theories Raised in Responses Filed by Debtors and the Creditors' Committee [ECF No. 1568]; Residco (A) Response to Debtors' Proposed Form of Confirmation Order and (B) Motion to Strike Portions of Declarations Submitted by Debtors in Support of Confirmation ("Residco Motion to Strike") [ECF No. 1574]; Reply of Residco, in Further Opposition to Debtors' Plan with Respect to New Matters and Theories Raised in Responses Filed by Debtors and the Creditors' Committee ("Residco Sur–Reply") [ECF No. 1588]; Response of Residco to Revised Alternate Treatment for Residco Submitted by Debtors and Committee ("Residco Response to Revised Carve–Out") [ECF No. 1623].

[2] There were other objections to the Plan that were heard by the Court on the second day of the confirmation hearing on March 16, 2017. This decision does not cover those objections nor does it address the general confirmation requirements that are unrelated to the Residco Objection.

[3] The Residco Leases were originally between Wells Fargo and Mitsui on the one hand and Chautauqua Airlines, Inc. ("Chautauqua") on the other. On January 1, 2015, Chautauqua was consolidated into Shuttle, another Debtor entity. *See* Declaration of Bryan K. Bedford Pursuant to Local Bankruptcy Rule 1007–2 ("First Day Decl.") ¶ 29 [ECF No. 4]. Thus, Shuttle was the successor to Chautauqua on the Residco Leases and the lessee as of the petition date. *See* Residco Objection at 8. On November 28, 2016, this Court granted the Debtors' request for approval of the merger of Shuttle into Republic Airline, Inc. ("Republic Airline") and the surrender of the Shuttle air carrier certificate. *See* Order [ECF No. 1236]. Shuttle merged with Republic Airline on January 31, 2017.

[4] The Plan defines "Consolidated Debtors" as RAH, Republic Airline, Shuttle, and Republic Airways Services, Inc. ("RASI"). Three other Debtor entities, Skyway Airlines, Inc., Midwest Airlines, Inc., and Midwest Air Group, Inc., are defined as the "Liquidating Debtors." *See* Plan § 1.1(44), (84).

[5] Section 2.2(b) of the Plan provides that plan consolidation shall not affect "defenses to any Cause of Action." *See* Plan § 2.2(b).

[6] The Debtors have revised the proposed carve-out in an attempt to resolve the Residco Objection. *See* Residco Carve-Out, attached as Exh. 1 to Debtors' Response to Residco Objection; Notice of Revised Proposed Residco Carve-Out [ECF No. 1622]; Revised Carve-Out Language, attached as Exh. 1 to the Debtors' Reply to Residco Response to Revised Carve-Out [ECF No. 1646]. References in this decision to the "Carve-Out" are to the most recently proposed carve-out, attached as Exhibit 1 to the Debtors' Reply to Residco Response to Revised Carve-Out [ECF No. 1646].

[7] Residco objected to certain statements in the declarations of Mr. Allman and Mr. Bedford. *See* Residco Motion to Strike ¶ 6; *see also* Exh. B, attached to Residco Motion to Strike (setting forth specific objections to statements in the declarations). The Court overruled those objections for the reasons stated on the record at the hearing on March 8, 2017. *See* Hr'g Tr. 16:8–21.

[8] In its cross-examination of Mr. Bedford, Residco relied heavily upon the 10–K and 10–Q statements of the Debtors. *See, e.g.* , Hr'g Tr. 51:17–55:22 (Bedford). But while Residco cites these filings to argue the separateness of the entities, *see* Hr'g Tr. 55:3–5, 55:12–14, the filings refer to the enterprise as a whole. *See* Hr'g Tr. 55:6–11 (Bedford) (testifying the 10–Q for 2015 stated "Unless contacts indicates otherwise, the terms of the company, we, us, our, refer to Republic Airways Holdings and our Subsidiaries."); *see also* Hr'g Tr. 57:10–13.

[9] As this testimony admittedly was a "back of the envelope" valuation, *see* H'rg Tr. 83:16–17 (Bedford), the Court does not accord this conclusion the same weight as would be given to a traditional valuation analysis like the liquidation analysis provided by the Debtors in support of the Plan. As Mr. Bedford is the Debtors' CEO, however, the Court concludes that he would have sufficient knowledge to make such an estimate and, indeed, it is not surprising that he would have a view on such an issue. Accordingly, the Court permitted such testimony at the hearing over the objection of Residco. *See* Hr'g Tr. 84:1–10, 85:17–86:2. In any event, the Court would reach the same conclusion about substantive consolidation even without the benefit of Mr. Bedford's testimony on this issue.

[10] Residco also complains that the Debtors' only justification for substantive consolidation in the disclosure statement was because the codeshare partners "could shuffle claims between Shuttle and Republic Airline." *See* Residco Sur-Reply at 3; Residco Objection at 25, 27–28. But as Residco did not object to the disclosure statement—which was approved in December 2016—the Court rejects Residco's belated criticism of the disclosure statement now. *See* Order Approving Disclosure Statement [ECF No. 1358].

[11] Residco relies heavily on a summary order in *136 Field Point Circle Holding Co., LLC v. Invar Int'l Holding, Inc.* , 644 Fed.Appx. 10 (2d Cir. 2016), where the Second Circuit enforced an unconditional guarantee irrespective of whether the obligations in the underlying lease were enforceable. *See id.* at 12–13 (concluding that given the "plain terms, in broad, sweeping and unequivocal language" in the guarantee, the guarantor was bound to the obligations in the lease, regardless of whether the lease or its provisions were enforceable as to the parties to the lease). But as that summary order makes clear that it is not precedential, it cannot be considered dispositive on this issue.

[12] Indeed, the parties have not even addressed the most basic question of whether we examine these issues at the time Mitsui first entered into the contracts, when the leases were restated in 2013, or when Residco purchased its interests from Mitsui in 2014. The only information provided to the Court are appraisal sheets for Embraer ERJ–145s issued in 2001 to 2003. *See* Exh. B, attached to Residco Objection; *see also* Exh. F, attached to Residco Sur-Reply. The charts state that they provide future base values for years ranging from 2002 through 2023. *See* Exh. B, attached to Residco Objection; Exh. F, attached to Residco Sur-Reply. But there is no foundation for these charts, which were prepared by a third-party, Avitas. As Residco did not acquire its interest from Mitsui until 2014, it is unclear how the charts prepared in years 2001, 2002, 2003, fit into the analysis.

[13] Residco is unique in one thing: it is the only claimant who has objected to substantive consolidation. It appears that Residco is also the only aircraft lessor who has not reached a settlement with the Debtors on its claims, including guarantee claims. *See* Hr'g Tr. 222:9–11. But that fact is irrelevant to any claim of unfair discrimination. "[T]he fact that some claimants have settled while others have not does not, by itself, indicate unequal treatment. The key inquiry under [Section] 1123(a)(4) is not whether all of the claimants in a class obtain the same thing, but whether they have the same opportunity." *Ad Hoc Comm. of Personal Injury Asbestos Claimants v. Dana Corp.* (*In re Dana Corp.*), 412 B.R. 53 , 62 (S.D.N.Y. 2008). "[C]reditors frequently enter into settlements with co-obligors, and, in the end, may receive more than similarly situated creditors under a plan. Absent bad faith, vote manipulation, or similar wrongful conduct, these settlements do not violate the confirmation requirements." *In re Quigley Co., Inc.* , 437 B.R. 102 , 147 n.59 (Bankr. S.D.N.Y. 2010) ; *see cf. Del. Trust Co. v. Energy Future Intermediate Holdings, LLC* (*In re Energy Future Holding Corp.*), 527 B.R. 157 , 168 (D. Del. 2015) ("Parties settle claims for various reasons, such as to avoid litigation risk and expense, and the fact that similar claimants decide to settle claims for different amounts does not indicate unequal treatment."); *In re Dow Corning Corp.* , 244 B.R. 634 , 669 (Bankr. E.D. Mich. 1999) (concluding plan

satisfied "same treatment" requirement where certain classes had the option of pursuing litigation or settlement, noting "any claimant who selects settlement will have done so in a manner that complies with the second clause of § 1123(a)(4)," which permits a holder of a claim to agree to "less favorable treatment").

[14] The Carve-Out comes as close as possible to giving Residco the best of both worlds: the right to consider its recovery on a consolidated and unconsolidated basis. Specifically, the Carve-Out provides that in the event Residco's guarantee claims are allowed in a higher amount than its lease claims Residco has the right to elect which treatment it prefers. *See* Carve-Out. The provision allowing for Residco to elect its treatment after a claim adjudication was not offered in the Debtors' initial carve-out. It was subsequently added by the Debtors in an attempt to ensure that Residco be given broad protection from any unfair discrimination. The Debtors and the Committee suggested this additional language at the continued confirmation hearing held on March 16, 2017. *See* March 16th Hr'g Tr. 33:16–23, 39:4–20. Additionally, the Debtors and the Committee continued to improve the Carve-Out after the hearing, including addressing objections raised in Residco's second sur-reply, which was filed without Court permission after the confirmation hearing was closed. *See* Residco Response to Revised Carve-Out ¶ 3 (complaining for first time that the Carve-Out improperly deprives Residco of its appellate rights); Debtors' Reply to Residco Response to Revised Carve-Out ¶ 6 (Debtors' complaining that Residco improperly filed pleading with a new argument but nonetheless further revising the Carve-Out to reflect that Residco's appeal rights are not affected).

[15] The Debtors contend that it is impossible for Residco to receive worse treatment under the Carve-Out because the enterprise value of the Debtors is $450 million, a valuation which will not increase if the entities are separately valued; thus, Residco will get the same distribution because of the nature of the two claims. *See* Hr'g Tr. 204:5–19. The Debtors argue that under the Carve-Out, therefore, Residco could get a greater recovery but it could never get less. *See id.* 205:1–2; *see also id.* 217:24–218:11 (Committee agreeing with the Debtors' conclusion). Residco's rebuttal to this point was unpersuasive. *See id.* 220:5–15, 221:2–17.

[16] The Court finds that there is no need to establish a separate reserve provision for Residco's claims as the Plan currently protects parties whose claims have not yet been allowed *. See, e.g.* , Hr'g Tr. 213:13–214:16 (explaining the Plan already provides for a reserve and interim true-ups so that there will be enough stock held back under the Plan to distribute once disputed claims become allowed claims).

[17] Residco claims that its recovery will be reduced under the Carve-Out because it will have borne the cost of separately valuing the relevant Debtors. But such a cost will be borne by the estate and will only be necessary because Residco has requested it. *See* Carve-Out (as to cost, the Carve-Out requires the Debtors to conduct a separate analysis of the values of RAH and Republic Airline); Hr'g Tr. 176:24–177:2. Such a cost also would be exactly what a creditor would expect when substantive consolidation has not occurred. In any event, the Court has made clear that, if such a separate valuation is necessary, all parties reserve their right to argue about the methodology of such a calculation. *See* March 16th Hr'g Tr. 28:6–24, 29:13–17, 31:11–16.

[18] ALF VI replaced a member of the original Committee on June 3, 2016. *See* Amended Notice of Appointment of Official Committee of Unsecured Creditors at 2 [ECF No. 630].

[19] For these reasons, the Debtors view the Residco Objection as an "eleventh hour ambush" where Residco is using the threat of delaying confirmation to force the Debtors, the Committee, and other creditors to agree to a preferential settlement with Residco. *See* Hr'g Tr. 201:8–12; Debtors' Response to Residco Objection ¶ 5; Committee Reply ¶ 5.

[20] There are two arguments raised by the Debtors that the Court does not address in this decision. First, the Debtors argue that Residco should be equitably estopped from objecting to substantive consolidation because it was a member of the Committee that was consulted regarding the Plan and that voted in favor of the Plan. *See* Debtors' Response to Residco Objection ¶¶ 61–64. It is unnecessary to address this argument given the Court's ruling on substantive consolidation. Second, the Debtors state that they intend to seek to modify the Plan so that the release and exculpation provisions of the Plan do not apply to Residco given Residco's Objection to the Plan. *See id.* ¶¶ 65–66. As this argument does not relate to the merits of Residco's Objection to substantive consolidation, the Court does not address this issue here.

[21] For the reasons set forth at the hearing on March 16, 2017, it is premature for the Court to address whether the Plan satisfies the request for confirmation under the Bankruptcy Code until such time as the votes on the Plan are finalized. *See* March 16th Hr'g Tr. 15:12–14, 73:7–17, 77:8–11, 81:9–18; [*see also* ECF Nos. 1530, 1531, 1532].

1995 CarswellOnt 53
Ontario Court of Justice (General Division), In Bankruptcy

J.P. Capital Corp., Re

1995 CarswellOnt 53, 31 C.B.R. (3d) 102, 54 A.C.W.S. (3d) 12

RE BANKRUPTCY AND INSOLVENCY ACT

AND RE BANKRUPTCY OF J.P. CAPITAL CORPORATION (Bankruptcy Court File No. 074183)

AND RE BANKRUPTCY OF JOSE PEREZ (Bankruptcy Court File No. 073885)

AND RE BANKRUPTCY OF J.P. CORPORATION (Bankruptcy Court File No. 073910)

Chadwick J.

Judgment: February 28, 1995
Docket: Docs. Ottawa 074183, 073885, 073910

Counsel: *Denis J. Power, Q.C.*, for trustee Deloitte & Touche Inc. *Martin Z. Black*, for bankrupt Jose Perez.

Subject: Corporate and Commercial; Insolvency

Headnote

Bankruptcy --- Administration of estate — Trustees — Legal proceedings by trustee

Administration of estate — Consolidation of estates — Trustee seeking order consolidating three estates and deeming creditors entitled to share pari passu on dividend arising from any realization of assets — Application dismissed without prejudice to trustee to apply once clearer identification of corporate structure, assets and effect of pari passu distribution made.

The individual bankrupt controlled two companies. Shortly before their bankruptcies, the companies were restructured and the individual distanced himself from control of the companies. The trustee in bankruptcy of the three bankrupt estates applied for an order consolidating the estates under one title of proceedings. The trustee also sought an order providing that any realization of assets arising from any of the three estates should be shared pari passu among the creditors of the three estates. The individual bankrupt opposed the application.

Held:

The application was dismissed without prejudice to the trustee to renew the application upon the resolution of certain problems.

There is no specific provision in the *Bankruptcy and Insolvency Act* for the consolidation of actions. However, the general provisions in s. 4 of the Act and the *Rules of Civil Procedure* and *Courts of Justice Act* (Ont.) provide for consolidation in order to avoid multiplicity of proceedings, provided that there are common questions of fact and law or the relief claimed arises out of the same transaction or occurrence or series of transactions or occurrences.

In this case, the application went beyond the mere consolidation of the estates. It also proposed that the assets of the various estates be intermingled. The *Rules of Civil Procedure* and the *Courts of Justice Act* do not provide for the intermingling of assets and distribution from a common pool of funds. The situation was complex. The two bankrupt companies had always maintained separate and distinct bank accounts and acted as separate legal entities. The third bankrupt estate was that of an individual. A consolidation of the estates would undoubtedly make the administration easier; however, without a clearer identification of the corporate structure, assets and possible effect of a pari passu distribution, such an order might result in prejudice to certain creditors.

Table of Authorities

Cases considered:

A. & F. Baillargeon Express Inc., Re (1993), 27 C.B.R. (3d) 36 (C.S. Que.) — *distinguished*

Chemical Bank New York Trust Co. v. Kheel, 369 F. 2d 845 (2d Cir., 1966) — *referred to*

Statutes considered:

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

s. 4

Courts of Justice Act, R.S.O. 1990, c. C.43 —

s. 138

Rules considered:

Ontario, Rules of Civil Procedure —

r. 6.01(1)

Application by trustee in bankruptcy for order consolidating three bankrupt estates under one title of proceedings.

***Chadwick J.*:**

1 The trustee in bankruptcy of the above three bankrupt estates seeks an order consolidating the three estates under one title of proceedings. Further they seek an order that any realization of assets in any of the three bankruptcies shall be deemed to be for the credit of the consolidated proceedings with the intent that all creditors, regardless of which proceeding under which they filed proofs of claim, shall be entitled to share dividends on a pari passu basis in the division of such assets.

2 The application is opposed by counsel on behalf of the bankrupt, Jose Perez, and others.

3 At one time, the two bankrupt companies were controlled by the bankrupt Jose Perez. Shortly before the bankruptcies, there was a restructuring of the corporations and the individual bankrupt Jose Perez distanced himself from the control of these corporations.

4 Beside the bankrupt corporations there are a number of other related corporations which are not part of the bankrupt estate, but in some cases, are creditors of the bankrupt estates.

5 Counsel for the trustee acknowledges that there is no authority in the provisions of the *Bankruptcy and Insolvency Act* ["B.I.A."] to provide for consolidation other than the general provisions of the Act.

6 Section 4 B.I.A. states:

> The practice of the court in civil actions or matters, including the practice in chambers, shall, in cases not provided for by the act or these rules, insofar as it is applicable and not inconsistent with the act or these rules, apply to all proceedings under the act or these rules.

7 The *Courts of Justice Act*, s. 138 and the rules of practice, r. 6.01(1) attempt to avoid multiplicity of proceedings and provide for the consolidation of actions. The rule provides that there must be a common question of fact or law or the relief claim arises out of the same transactions or occurrences or a series of transactions or occurrences.

8 In *Re A. & F. Baillargeon Express Inc.* (1993), 27 C.B.R. (3d) 36, Greenberg J. of the Quebec Superior Court dealt with a similar application. In that case there were five bankrupt companies, and twenty-one related companies that were not bankrupt but an interim receiver had been appointed. The five bankrupt companies were operated as one company with an intermingling of customer lists, bank accounts and assets without any separate corporate identity. In addition, the twenty-one companies that were not bankrupt also operated in a similar manner; there was a total intermingling of assets, operations, creditors and liabilities of all twenty-six companies.

9 The trustee brought a motion seeking the consolidation and the administration of five bankrupt estates. The registrar in bankruptcy dismissed the motion and on appeal Greenberg J. allowed the consolidation order to issue.

10 Greenberg J. acknowledged that there was no provision in the B.I.A. for consolidation of actions, but reviewed the American authorities and in particular an article in Cal. L. Rev., vol. LXV, p. 720 entitled "Flow-of-Assets Approach". The article referred to an American case in *Chemical Bank New York Trust Co. v. Kheel*, 369 F. 2d 845 (2d Cir., 1966) where there was a similar situation where the companies paid no attention to the formalities of a corporation and operated by intermingling all the assets and accounts and were controlled by the same board of directors. In allowing the appeal, Greenberg J. stated at p. 44:

> There is also the consideration that in Bankruptcy matters the Court exercises an equitable as well as a legal jurisdiction, and that practicality is always the order of the day. It is frequently said in the jurisprudence that the Act is a "businessman's law" and that practical business considerations should not be disregarded, as they sometimes are in other domains where a strict interpretation of the law must be followed and observed.

11 I am satisfied that the general provisions of s. 4 of the B.I.A. and the *Rules of Civil Procedure* and the *Courts of Justice Act* in Ontario provide for consolidation of actions in order to avoid multiplicity of proceedings providing there are common questions of fact and law or the relief claimed arises out of the same transaction or occurrence or series of transactions or occurrences.

12 This consolidation application goes further than to consolidate for the purpose of avoiding multiplicity of proceedings and actually intermingles the assets of the corporate bankrupt into one common pool to be distributed on a pari passu basis. Rule 6.01(1) and s. 138 of the *Courts of Justice Act* do not provide for an intermingling of assets and distribution from a common pool of funds.

13 The situation in this application differs somewhat from the facts in *Re A. & F. Baillargeon Express Inc.* in that the two bankrupt corporations maintained distinct and separate bank accounts and have acted as separate legal entities.

14 The other distinguishing factor is that Jose Perez, as an individual, may be in a different position relating to his discharge and that of the corporate bankrupts.

15 A number of the major unsecured creditors are creditors in both estates and some claim guarantees over against the bankrupt Jose Perez. The majority of the creditors although served with this motion have not appeared and in fact have consented to the consolidation.

16 I accept the evidence of Chris St. Germain, senior manager at Deloitte & Touche with reference to the fact that the consolidation of the actions will make the administration easier and no doubt in the long run, will probably save administrative fees.

17 My concern at this time is we are dealing with an extremely complex bankruptcy involving and touching on a number of companies and assets. Cross-examination of various people have been conducted over the past three or four months and have not yet been concluded. The actual corporate structure of the various companies and the tracing of assets in relationship to the parties is clearly in issue.

18 I am concerned with consolidating the actions which will provide for pari passu distribution without knowing the effect that such an order will have on all creditors. Although expediency is an appropriate consideration it should not be done at the possible prejudice or expense of any particular creditor.

19 Under the circumstances the application for consolidation is dismissed without prejudice to the trustee to renew the application once there has been a clearer identification of the corporate structure, the assets, and the effect a pari passu distribution would have on the unsecured creditors.

Application dismissed.

2002 CarswellOnt 1261
Ontario Superior Court of Justice [Commercial List]

PSINet Ltd., Re

2002 CarswellOnt 1261, [2002] O.J. No. 1156, 113 A.C.W.S. (3d) 760, 33 C.B.R. (4th) 284

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

In the Matter of a Plan of Compromise or Arrangement of PSINet Limited, PSINet Realty Canada Limited, PSINetworks Canada Limited and Toronto Hosting Centre Limited, Applicants

Farley J.

Heard: March 14, 2002
Judgment: March 14, 2002
Docket: 01-CL-4155

Counsel: *Lyndon A.J. Barnes*, *Monica Creery*, for Applicants
Geoffrey B. Morawetz, for the Monitor, PricewaterhouseCoopers Inc.
Peter H. Griffin, for PSINet Inc.
Edmond F.B. Lamek, for 360Networks Services Ltd.

Subject: Corporate and Commercial; Insolvency

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Approval by court — "Fair and reasonable"
Corporations proposed consolidated plan of arrangement or compromise — Consolidated plan was approved by creditors at meeting — Unsecured creditors strongly supported consolidated plan — Since meeting of creditors negotiations with respect to some aspects of plan had been ongoing — Corporations brought motion to sanction consolidated plan of arrangement or compromise — As result of negotiations, sanction was unopposed — Motion granted — Consolidated plan avoided complex and potentially litigious issues arising from allocation of proceeds from sale of corporations' assets — Consolidated plan was in strict compliance with statutory requirements and adhered to previous orders of court — Determination was made that all done or purported to be done was authorized by Companies' Creditors Arrangement Act — Creditors had sufficient time to make reasoned decision — As to fairness and reasonableness of plan, perfection was not required — In circumstances, given intertwined nature of business, consolidated plan was appropriate — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Table of Authorities

Cases considered by *Farley J.*:

Associated Freezers of Canada Inc., Re, 36 C.B.R. (3d) 227, 1995 CarswellOnt 944 (Ont. Bktcy.) — considered

Canadian Airlines Corp., Re, 2000 ABCA 238, 2000 CarswellAlta 919, [2000] 10 W.W.R. 314, 20 C.B.R. (4th) 46, 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, 266 A.R. 131, 228 W.A.C. 131 (Alta. C.A. [In Chambers]) — referred to

Canadian Airlines Corp., Re, 2000 ABQB 442, 2000 CarswellAlta 662, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201 (Alta. Q.B.) — considered

Central Guaranty Trustco Ltd., Re, 21 C.B.R. (3d) 139, 1993 CarswellOnt 228 (Ont. Gen. Div. [Commercial List]) — referred to

J.P. Capital Corp., Re, 31 C.B.R. (3d) 102, 1995 CarswellOnt 53 (Ont. Bktcy.) — referred to

Lehndorff General Partner Ltd., Re, 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

Northland Properties Ltd., Re, 73 C.B.R. (N.S.) 175, 1988 CarswellBC 558 (B.C. S.C.) — considered

Northland Properties Ltd., Re, *(*sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 34 B.C.L.R. (2d) 122, *(*sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 73 C.B.R. (N.S.) 195, *(*sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* [1989] 3 W.W.R. 363, 1989 CarswellBC 334 (B.C. C.A.) — referred to

Northland Properties Ltd., Re, 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146, 1988 CarswellBC 531 (B.C. S.C.) — referred to

Sammi Atlas Inc., Re, 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

MOTION by corporations to sanction consolidated plan of arrangement or compromise.

***Farley J.*:**

1 This motion was for the sanctioning of the consolidated plan of arrangement or compromise of the four Canadian applicants under the *Companies' Creditors Arrangement Act* ("CCAA"). The consolidated plan was approved by the creditors of the applicants at meetings held February 28, 2002. Since that time and as permitted by the consolidated plan there have been ongoing negotiations concerning various aspects of the plan. It is a tribute to the expertise and experience of the parties involved and their counsel that they have been able to negotiate resolutions of the various points in issue with the result that this sanction motion is unopposed. I also think it commendable that the Monitor so amply demonstrated the objectivity and neutrality which is the hallmark of a court-appointed officer.

2 I am advised that while the applicants initially considered an unconsolidated plan which had the support of PSINet Inc. ("Inc."), their parent and major creditor, it was considered that the consolidated route was the way to go. The consolidated plan avoids the complex and likely litigious issues surrounding the allocation of the proceeds from the sale of substantially all of the assets of the applicants to Telus Corporation. The consolidated plan also reflected the intertwined nature of the applicants and their business operations, which businesses in essence operated as a single business and with only one of the applicants having employees. I have previously alluded to the incomplete and deficient record keeping of the applicants. While shooting oneself in the foot should not be endorsed, this is another factor favouring consolidation and the elimination of expensive

allocation (amongst the four Canadian applicants) litigation.

3 I note that the consolidated plan also provides that Inc. valued its charge against the assets of PSINet Limited ("Ltd.") one of the applicants to $55 million. The Monitor, PricewaterhouseCoopers Inc. found this to be a reasonable amount and within the range of values which might reasonably be anticipated. Again however I would repeat my observation about incomplete and deficient record keeping.

4 At the February 28th meeting of creditors, a single class of creditors, namely the unsecured creditors, voted on the consolidated plan as it then existed. Secured creditors were not affected by the plan, but were of course characterized as unsecured creditors to the extent that their claim exceeded the expected deficiency in the deemed realization of their security. 92.7% of the creditors voting, representing 98.8% in value of the claims, voted in favour of the plan. Had the votes of Inc. and other creditors affiliated with the applicants been ignored, then 92.5% of the class, representing 87.2% in value voted in favour of the plan.

5 Since the vote, 360Network Services Ltd. (and other affiliates) ("360Networks") have reached agreement with the applicants and Inc. to resolve a motion brought by 360Networks in respect of its concerns regarding the consolidation of the estates of the applicants in the plan of arrangement.

6 Similarly Inc. has made certain concessions as to the plan with an eye to making good on the condition imposed on it to make a material (albeit modest) adjustment so as to compensate the other creditors for the "frustration cost" associated with Inc.'s late blooming discovery of its security vis-à-vis Ltd. and its motion to reperfect this security.

7 The three part test for sanctioning a plan is laid out in *Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.), affirmed (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.); *Sammi Atlas Inc., Re*, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]):

> (a) There must be strict compliance with all statutory requirements and adherence to the previous orders of the court;
>
> (b) All material filed and procedures carried out are to be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA or other orders of the court; and
>
> (c) The plan must be fair and reasonable.

8 It appears to me that parts (a) and (b) have been accomplished, now that Inc. has made the further concessions. The creditors have had sufficient time and information to make a reasoned decision. They have voted in favour of the consolidated plan by a significant margin over the statutory requirement, even where one eliminates the related vote of Inc. and its affiliates. In reviewing the fairness and reasonableness of a plan, the court does not require perfection. As discussed in *Sammi* at p. 173:

> A Plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment... One must look to the creditors as a whole (i.e. generally) and to the objecting creditors (specifically), and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights...

9 There is a heavy onus on parties seeking to upset a plan that the required majority have supported: See *Sammi* at p. 174 citing *Central Guaranty Trustco Ltd., Re*, 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List])

10 The fairness and reasonableness of a plan are shaped by the unique circumstances of each case, within

the context of the CCAA. In *Canadian Airlines Corp., Re*, [2000] 10 W.W.R. 269 (Alta. Q.B.), leave to appeal refused [2000] 10 W.W.R. 314 (Alta. C.A. [In Chambers]) Paperny J. at p. 294 considered factors such as the composition of the unsecured vote, what creditors would receive on liquidation or bankruptcy as opposed to the plan, alternatives available (to the plan and bankruptcy) and the public interest. I have already discussed the first element; the third and fourth do not appear germane here. As to the second, it is clear that the creditors generally are receiving more than in a bankruptcy and to the extent that Inc. is impacted, it has consented to such impact.

11 In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C. S.C.), affirmed (B.C.C.A.), *supra*, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p. 31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect. Here as well the concessions of Inc. have ameliorated that prejudice. Further I am of the view if consolidation is appropriate (and not proceeded with by any applicant for tactical reasons of minimizing valid objections), then it could be inappropriate to segregate the creditors into classes by corporation which would not naturally flow with the result that one or more is given a veto, absent very unusual circumstances (and not present here). I would also note that *Associated Freezers of Canada Inc., Re*, 36 C.B.R. (3d) 227 (Ont. Bktcy.) and *J.P. Capital Corp., Re*, 31 C.B.R. (3d) 102 (Ont. Bktcy.) which referred to prejudice to one creditor were not CCAA cases, but rather *Bankruptcy and Insolvency Act* cases; secondly *Associated Freezers* merely kept the door open for the objecting party to reconsider its position given the short notice and provided that if on reflection it wished to come back to make its submissions, it was entitled to do so for a period of time.

12 In the end result (and with no creditors objecting), I approve and sanction the consolidated plan as amended. Order to issue accordingly as per my fiat.

Motion granted.

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2015 NBQB 107
New Brunswick Court of Queen's Bench

Gray Aqua Group of Companies, Re

2015 CarswellNB 222, 2015 NBQB 107, 1139 A.P.R. 197, 254 A.C.W.S. (3d) 25, 436 N.B.R. (2d) 197

In the Matter of the bankruptcy of Gray Aqua Group of Companies

Reg. Natalie H. LeBlanc

Heard: January 7, 2014
Judgment: May 25, 2015
Docket: NB 19425, Estate No. 51-1780540

Counsel: John D. Stringer, Q. C., Ben R. Durnford, for Ernst & Young Inc. - Trustee
Joshua J.B. McElman, for Business Development Bank of Canada
Ian Purvis, Q.C., for Gray Aqua Farms Ltd, Gray's Aqua Management Ltd, Gray Aqua Processing Ltd., Gray Aqua Group Ltd., Butter Cove Aqua Farms Ltd., Jervis Island Aqua Farms Ltd., Pass-My-Can Aqua Farms Ltd., and Goblin Bay Aqua Farms Ltd.
Celine Leicher, for Europharma Inc.

Subject: Insolvency

Headnote

Bankruptcy and insolvency --- Proposal — Approval by court — General principles
Group filed notices of intention to make proposal ("NOI") — Proposal trustee was appointed — Order allowed for service on all creditors and affected parties to NOIs via telecommunications — Group companies were vertically and financially integrated with singular management and accounting structure — Group companies operated as integrated enterprise with centralized management, sales and accounting based in New Brunswick — Group shared common senior creditors — Proposal trustee brought motion for order to file consolidated proposal to respective and individual creditors — Motion granted — Historically, courts have been reluctant to grant right of consolidation to moving parties on basis of consolidation being seen as extraordinary remedy under Bankruptcy and Insolvency Act — Group was suitable candidate for order for consolidated proposal — All creditors were served and none contested motion — Evidence was sufficiently integrated from financial and practical perspective that it functioned as centralized company — Purpose of Act is to facilitate financial rehabilitation in fair and structured atmosphere while protecting integrity of process and all of its participants, including creditors — Proposal trustee's evidence struck right balance of efficiency and equity that would serve to streamline proposal, create savings for all parties and facilitate faster restructuring of group.

Table of Authorities

Cases considered by *Reg. Natalie H. LeBlanc*:

Ashley v. Marlow Group Private Portfolio Management Inc. (2006), 2006 CarswellOnt 3449, 22 C.B.R. (5th) 126, 270 D.L.R. (4th) 744 (Ont. S.C.J. [Commercial List])

Kitchener Frame Ltd., Re (2012), 2012 ONSC 234, 2012 CarswellOnt 1347, 86 C.B.R. (5th) 274 (Ont. S.C.J. [Commercial List])

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 34 — pursuant to

s. 66 — pursuant to

s. 183 — considered

s. 192 — pursuant to

MOTION brought by proposal trustee for order to file consolidated proposal to respective and individual creditors.

***Reg. Natalie H. LeBlanc*:**

Background

1 On August 21, 2013 various Notices of Intention to Make a Proposal ("NOI") were filed by Gray Aqua Farms Ltd, Gray's Aqua Management Ltd, Gray Aqua Processing Ltd., Gray Aqua Group Ltd., Butter Cove Aqua Farms Ltd., Jervis Island Aqua Farms Ltd., Pass-My-Can Aqua Farms Ltd., and Goblin Bay Aqua Farms Ltd., (collectively the "Group").

2 As a result of the filing of the NOIs, Ernst & Young ("Proposal Trustee) was appointed as the Proposal Trustee ("Proposal Trustee"). On September 24, 2013 the Proposal Trustee presented a Motion for an Order Respecting Service and Accessibility Protocol which was granted. This Order allowed, *inter alia*, for service on all creditors and affected parties to the NOIs filed by the Group via telecommunications.

3 On or about January 7, 2014 solicitors for the Proposal Trustee applied to the Court for an Order allowing the filing of a Consolidated Proposal to the respective and individuals creditors of the Group, pursuant to sections 34, 66, 183 and 192 of the *Bankruptcy and Insolvency Act* (Canada).

4 Evidence contained in various reports from the Proposal Trustee, in particular the sixth report of the Proposal Trustee and the sixth affidavit of Tim Gray, which documents submit evidence supporting the Group's suitability for the filing of a Consolidated Motion.

5 In particular, the Group companies are vertically and financially integrated with a singular management and accounting structure. Moreover, solicitors for the Proposal Trustee submit uncontested evidence that Group companies operated at all times as an integrated enterprise with centralized management, sales and accounting based in Northampton, New Brunswick.

6 The Group also shares several common senior creditors, which include Callidus Capital Corporation ("Callidus") who acquired debt and security from HSBC Canada ("HSBC") on a number of the Group companies and Business Development Bank of Canada ("BDC").

7 It is submitted that the shared and respective creditors of the Group, if an Order allowing a Consolidated Proposal would not be deprived of any rights and would not suffer any measurable prejudice.

8 The largest individual respective group of creditors who require accommodation deriving from a Group company would be the unsecured creditors of Gray Aqua Processing Limited ("GAPL") who are proposed as a distinct class of creditors under a Consolidated Proposal.

Analysis

9 Historically, Courts have been reluctant to grant the right of consolidation to moving parties on the basis of consolidation being seen as an extraordinary remedy under the BIA, *supra.*

10 The BIA is void of any statutory test establishing benchmarks for the consolidation of corporate entities. Limited caselaw on point seems to rely on the equitable jurisdiction of the Court under Section 183.

11 Counsel for the Proposal Trustee submitted two cases for review by the Court. In *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006), 22 C.B.R. (5th) 126 (Ont. S.C.J. [Commercial List]), the consolidation was opposed and ultimately denied by the Court. A thorough review of the issue was nonetheless undertaken by Justice Mesbur of the Ontario Superior Court, Commercial List.

12 Justice Mesbur said the following:

> [70] Essentially, a substantive consolidation would treat all of the corporate defendants as one entity. The assets of each would fall into one common pool, to be shared by all their creditors on a *pari passu* basis.
>
> [71] There is no specific authority in the *Bankruptcy and Insolvency Act* to grant an order for substantive consolidation. It is common ground, however, that the court has the authority to do so under its equitable jurisdiction under section 183 of the *Act.*
>
> [...]
>
> [74] The Receiver goes on to say that all four companies operated as an interrelated entity, with shared premises, telephone, fax, bank accounts and accounting records. The Receiver says that they were operated as a single, consolidated enterprise, and should be treated as such for bankruptcy purposes, because to do so would be most expedient and cost-effective.
>
> [...]
>
> [76] CIPF also points out that the Receiver wishes to use the only assets of Securities Inc., some cash, to fund the bankruptcy, and thus there is no practical advantage to any of Securities Inc.'s creditors to having a substantive consolidation of all the estates.
>
> [77] CIPF says that substantive consolidation profoundly affects the substantive rights of debtors and creditors, and thus should be considered an extreme remedy and carefully scrutinized. It involves more than procedural convenience, which of course can be accomplished by the procedural consolidation that everyone supports.

13 The Court ultimately upheld the objection of the creditor, CIPF, on the basis of a lack of evidence that the creditors would NOT be harmed by the consolidation.

14 The second case cited by the solicitors for the Proposal Trustee was the case of *Kitchener Frame Ltd., Re*, 2012 ONSC 234 (Ont. S.C.J. [Commercial List]) ("Kitchener Frame") whereby a Motion to consolidate was granted by Justice Morawetz.

15 Justice Morawetz made the following observations on substantial consolidations:

> [30].....Although not expressly contemplated under the *BIA*, the Applicants submit that the court may look to its incidental, ancillary and auxiliary jurisdiction under s. 183 of the *BIA* and its equitable jurisdiction to grant an order for substantive consolidation. See *Ashley v. Marlow Group Private Portfolio Management Inc*. (2006) 2006 CANLII 31307 (ON SC), 22 CBR (5th) 126 (Ont. S.C.J.) (Commercial List). In deciding whether to grant substantive consolidation, courts have held that it should not be done at the expense of, or

possible prejudice of, any particular creditor. See *Ashley*, *supra*. However, counsel submits that this court should take into account practical business considerations in applying the *BIA*. See *A & F Baillargeon Express Inc. (Trustee of) (Re)* (1993), 27 CBR (3d) 36.

[31] In this case, the Applicants submit that substantive consolidation inherent in the Consolidated Proposal is appropriate in the circumstances due to, among other things, the intertwined nature of the Applicants' assets and liabilities. Each Applicant had substantially the same creditor base and known liabilities (other than certain Excluded Claims). In addition, KFL had no cash or cash equivalents and the Applicants are each dependant on the Escrow Funds and borrowings under the Restated Senior Secured Loan Agreement to fund the same underlying pension and OPEB obligations and costs relating to the Proposal Proceedings.

[32] The Applicants submit that creditors in neither estate will be materially prejudiced by substantive consolidation and based on the fact that no creditor objected to the substantial consolidation, counsel submits the Consolidated Proposal ought to be approved.

Disposition

16 On the whole, I am satisfied that the Group is a suitable candidate for an Order for a Consolidated Proposal. After a thorough protocol on service was established by the Court, all creditors of the Group were served and none contested the Motion.

17 I am further satisfied by the evidence submitted in the sixth report of the Proposal Trustee and the six affidavit of Tim Gray that the Group is sufficiently integrated both from a financial and practical perspective that it functions as a centralized company for all intents and purposes.

18 The purpose of the BIA is to facilitate financial rehabilitation in a fair and structured atmosphere while protecting the integrity of the process and all of its participants, including creditors.

19 The Proposal Trustee's evidence, including the accommodation of the GAPL creditors, strikes the right balance of efficiency and equity which will ultimately serve to streamline the proposal process, create savings for all parties and facilitating a faster restructuring of the Group.

20 For the above-noted reasons, I grant the Motion for a Consolidated Proposal in the case of the Group companies.

Motion granted.

Manitoba Statutes
The Employment Standards Code
Part 5 — General (ss. 133-138)
Division 2 — Single Employer Declaration

S.M. 1998, c. 29, s. 134

s 134.

Currency

134.

134(1)Determination of single employer by order

Where the director or board determines that associated or related businesses are carried on or have been carried on under common control or direction by or through two or more employers, the director or board may by order declare that the employers named in the order are a single employer for the purpose of this Code.

134(2)Effect of single employer order

Employers that are declared to be a single employer are jointly and severally liable for the payment of wages to all employees of the employers.

Currency

Manitoba Current to S.M. 2021, c. 2 and Man. Reg. 39/2021 (May 14, 2021)

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2017 CarswellBC 577
British Columbia Employment Standards Tribunal

San Bao Investment Inc., Re

2017 CarswellBC 577, [2017] B.C.W.L.D. 2472

An appeal by San Bao Investment Inc. (”Appellant”) of a Determination issued by The Director of Employment Standards (the “Director”) pursuant to Section 112 of the Employment Standards Act R.S.B.C. 1996, C.113 (as amended)

Rajiv K. Gandhi Member

Judgment: February 20, 2017
Docket: D017/17

Counsel: Paula Krawus, Maureen E. Baird, Q.C., for San Bao Investment Inc.
Adele J. Adamic, for Director of Employment Standards

Subject: Public; Employment

Headnote

Labour and employment law --- Employment standards legislation — Definitions — Related employer
July 2016 determination ordered associated employers SB and VH to pay wages totaling $352,023.65 to 14 claimants — Associated employer SB appealed — Appellant did not dispute quantum of amounts awarded or administrative penalties assessed — Appellant disputed finding that it was properly associated with employer VH — Appeal dismissed — Determination did not err in associating appellant and VH — Appellant had no active business, but existed only to source and invest funds in corporate structure — Appellant was not merely an independent financier or lender to VH — Determination did not err in finding appellant and VH operated under common control or direction — Appellant controlled over three-quarters of issued shares of VH's immediate parent — Appellant effectively controlled all issued shares of VH — Same individual was guiding force in management of VH and appellant — Formal requirement for common appointment as prerequisite for application of s. 95 of Employment Standards Act would render provision impotent.

Table of Authorities

Cases considered by *Rajiv K. Gandhi Member*:

Broadway Entertainment Corp., Re (July 18, 1996), Doc. D184/96 (B.C. Empl. Stnds. Trib.) — referred to

Committee for Justice & Liberty v. Canada (National Energy Board) (1976), [1978] 1 S.C.R. 369, 68 D.L.R. (3d) 716, 9 N.R. 115, 1976 CarswellNat 434, 1976 CarswellNat 434F (S.C.C.) — followed

Congrégation des Témoins de Jéhovah de St-Jérôme-Lafontaine c. Lafontaine (Municipalité) (2004), 2004 SCC 48, 2004 CarswellQue 1545, 2004 CarswellQue 1546, 323 N.R. 1, (sub nom. *Congrégation des témoins de Jéhovah de St-Jérôme-Lafontaine v. Lafontaine (Village))* 241 D.L.R. (4th) 83, 49 M.P.L.R. (3d) 157, 17 Admin. L.R. (4th) 165, (sub nom. *Congrégation des témoins de Jéhovah de St-Jérôme-Lafontaine v. Lafontaine (Village))* [2004] 2 S.C.R. 650, 121 C.R.R. (2d) 261, 2004 CSC 48 (S.C.C.) — referred to

Ewachniuk v. British Columbia (Director of Employment Standards) (1998), 1998 CarswellBC 2770, 115 B.C.A.C. 292, 189 W.A.C. 292, 99 C.L.L.C. 210-028, 61 B.C.L.R. (3d) 245 (B.C. C.A.) — considered

Gemex Developments Corp. v. Coquitlam Assessor, Area No. 12 (1998), 1998 CarswellBC 2093, 112 B.C.A.C. 176, 182 W.A.C. 176, 62 B.C.L.R. (3d) 354, [1998] B.C. Stated Case 386 (B.C. C.A.) — referred to

Invicta Security Systems Corp., Re (December 4, 1996), Doc. D349/96, 95/52 (B.C. Empl. Stnds. Trib.) — considered

Jordan Enterprises Ltd., Re (2016), 2016 CarswellBC 2709 (B.C. Empl. Stnds. Trib.) — considered

Mainline Irrigation and Landscaping, Re (2005), 2005 CarswellBC 4427 (B.C. Empl. Stnds. Trib.) — referred to

R. c. Gagnon (2006), 2006 SCC 17, 2006 CarswellQue 3559, 2006 CarswellQue 3560, *(*sub nom. *R. v. G. (L.))* 207 C.C.C. (3d) 353, 37 C.R. (6th) 209, *(*sub nom. *R. v. G. (L.))* 266 D.L.R. (4th) 1, *(*sub nom. *R. v. Gagnon)* 347 N.R. 355, [2006] 1 S.C.R. 621 (S.C.C.) — considered

R. v. M. (R.E.) (2008), 2008 SCC 51, 2008 CarswellBC 2037, 2008 CarswellBC 2038, 83 B.C.L.R. (4th) 44, [2008] 11 W.W.R. 383, 60 C.R. (6th) 1, 235 C.C.C. (3d) 290, 297 D.L.R. (4th) 577, 380 N.R. 47, 260 B.C.A.C. 40, 439 W.A.C. 40, [2008] 3 S.C.R. 3 (S.C.C.) — considered

Remko'b Investments Ltd. v. British Columbia (Director of Employment Standards) (1994), 90 B.C.L.R. (2d) 247, 44 B.C.A.C. 168, 71 W.A.C. 168, 114 D.L.R. (4th) 354, 1994 CarswellBC 174 (B.C. C.A.) — considered

Shaw, Re (August 27, 2010), Doc. D089/10; The 2010A/71 (B.C. Empl. Stnds. Trib.) — referred to

Southgate Inn Inc., Re (April 2, 1998), Doc. D092/98 (B.C. Empl. Stnds. Trib.) — considered

Worldspan Marine Inc., Re (2012), 2012 CarswellBC 843 (B.C. Empl. Stnds. Trib.) — referred to

0708964 B.C. Ltd., Re (2011), 2011 CarswellBC 1765 (B.C. Empl. Stnds. Trib.) — referred to

Statutes considered:

Administrative Tribunals Act, S.B.C. 2004, c. 45
s. 30 — considered

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

Employment Standards Act, R.S.B.C. 1996, c. 113
Generally — referred to

s. 76 — considered

s. 77 — considered

s. 88 — considered

s. 95 — considered

s. 112(1)(a) — considered

s. 112(1)(b) — considered

s. 115 — considered

s. 115(1)(b) — considered

Employment Standards Act, S.B.C. 1980, c. 10
s. 20 — considered

Regulations considered:

Employment Standards Act, R.S.B.C. 1996, c. 113
Employment Standards Regulation, B.C. Reg. 396/95

Generally — referred to

APPEAL by employer from finding that it was an associated employer.

***Rajiv K. Gandhi Member*:**

OVERVIEW

1 Sections 76 and 77 of the *Employment Standards Act* (the "*Act*") impose on the Director of Employment Standards (the "Director") a duty to receive, review and, where appropriate, investigate or adjudicate complaints alleging contraventions of both the *Act* and the *Employment Standards Regulation* (the "*Regulation*").

2 Acting within the scope of that authority, the Director issued a determination (the "Determination") on July 27, 2016, in which San Bao Investment Inc. (the "Appellant") was associated with Viceroy Homes Ltd. ("VHL") under section 95 of the *Act* and ordered to pay wages, in the aggregate amount of $352,023.65, to fourteen separate complainants (and employees of VHL), together with interest calculated according to section 88 of the *Act*, and administrative penalties totalling $1,500.00.

3 The Appellant does not challenge the administrative penalties, or the Director's calculations with respect to the amounts due and owing to each complainant. Rather, it takes issue with the Director's determination that the Appellant should be associated with VHL.

4 The Appellant says that the Director was wrong to do so, and it asks this Tribunal to vary the Determination under section 115(1)(b) of the *Act*, on the basis that the Director:

(a) erred in law; and

(b) failed to observe the principle of natural justice,

both permitted grounds for appeal according to section 112(1)(a) and 112(1)(b).

Extension of Time

5 As a preliminary matter, the Appellant seeks an extension of the time in which to file the appeal. The Director takes no position with respect to this request.

6 The Determination was issued on July 27, 2016. Counsel for the Appellant was not retained until August

30, 2016. The appeal form was filed on September 2, 2016, and the substantive argument subsequently delivered to the Tribunal on October 20, 2016, following a request on October 3, 2016, for a further extension.

7 Extensions should not be granted as a matter of course. The discretion to do so should be exercised sparingly.

8 The Appellant does not offer a particularly compelling or, in fact, any, reason with respect to why it waited almost one month before engaging counsel to deal with the appeal, or why the reasonable time lines set by this Tribunal were unworkable.

9 However, I note that the appeal form was filed before the end of the appeal period, and the delay in filing the substantive argument was not unreasonably long. For these reasons, and largely because the Director does not oppose, I grant the extensions previously requested.

10 That said, I am dismissing the substantive appeal.

11 In doing so, I have reviewed the Determination, together with:

(a) a related determination issued by the Director on July 27, 2016, with respect to Mr. Kuen Yu Kwok, the Appellant's sole director at all times material to the matters addressed in the Determination;

(b) the Director's record, consisting of 432 pages (the "Record");

(c) submissions from the Appellant received on September 2, 2016, October 4, 2016, and, most importantly, October 20, 2016; and

(d) submissions from the Director received on December 9, 2016.

FACTS

12 Facts relevant to this appeal are summarized as follows:

(a) VHL was an Ontario company engaged in the design and manufacture of panelized and pre-cut homes, in part from business premises located in Richmond, British Columbia.

(b) Canada Wood Frame Solutions Inc. ("CWF"), C2 Global Holdings Inc. ("C2"), and the Appellant are or were British Columbia companies.

(c) CWF and C2 were each incorporated in October 2012, shortly before the acquisition of VHL. The Appellant was incorporated in 2008.

(d) VHL was or is a wholly owned subsidiary of CWF, acquired from the previous owner in late 2012, shortly after the incorporation of CWF and C2.

(e) Seventy-eight percent of the outstanding and issued shares of CWF are or were owned by the Appellant. The remaining twenty-two percent are or were owned by C2.

(f) The Directors of VHL included, at varying times, Mr. Kwok, Jasbinder Hayre, and Yan Wang. Officers included Mr. Kwok, Mr. Hayre, Douglas Auer, Robert Hammell, William Simpson, Daniel Fox and Roy Fritz.

(g) Mr. Kwok became a director of VHL in late 2012. For a time, he was also an officer of VHL, using the title of "Managing Director". It is common ground that Mr. Kwok formally resigned as a director of VHL effective February 27, 2015.

(h) The Directors of CWF and C2 are, or at relevant times were, Mr. Kwok, Mr. Hayre, Harpal Dhillon, and Ming Tang Liang.

(i) Mr. Kwok has been the Appellant's sole director since December 2012.

(j) CWF is a holding company. It had no operating business and its sole asset was the issued and outstanding shares it held in the capital of VHL.

(k) The Appellant similarly had no operating business; it was the vehicle by which to solicit investment in VHL, indirectly through CWF. Since 2012, the Appellant's sole asset has been the seventy-eight percent interest it held in CWF.

(l) Mr. Auer, Ms. Zhau, Mr. Hammell, and Mr. Simpson directed the day-to-day operations of VHL, in part.

(m) The Record reflects that between 2014 and at least April 2015, Mr. Kwok had some involvement in managing the affairs of VHL.

(n) Between October 18, 2013, and August 19, 2014, the Appellant made available to VHL loans in the aggregate sum of approximately fourteen million dollars. VHL, in turn, granted to the Appellant a general security over all of the assets of VHL. When VHL made a proposal to its creditors in June 2015, there remained due and payable by VHL to the Appellant almost eleven and one half million dollars.

(o) On June 9, 2015, VHL issued a Notice of Intention to File a Proposal under the provisions of the *Bankruptcy and Insolvency Act* (Canada).

(p) The assets of VHL have since been sold to a new vendor. The Record contains little information about the sale, and no information concerning the terms of sale, the amount payable, the payor, or the date of payment.

13 I could find no information in either the Determination or the Record, with respect to the identity or proportionate interests, in the Appellant, of the Appellant's shareholders.

14 There is also no information in the Determination or the Record with respect to whether or not any funds have been recovered, or will be recoverable, for the complainants in this matter, out of proceeds realized from sale of the VHL assets.

ANALYSIS

Section 95

15 Section 95 of the *Act* provides as follows:

95 If the director considers that businesses, trades or undertakings are carried on by or through more than one corporation, individual, firm, syndicate or association, or any combination of them under common control or direction,

(a) the director may treat the corporations, individuals, firms, syndicates or associations, or any combination of them, as one employer for the purposes of this Act, and

(b) if so, they are jointly and separately liable for payment of the amount stated in a determination, a settlement agreement or an order of the tribunal, and this Act applies to the recovery of that amount from any or all of them.

16 The purpose of section 95 is to ensure that employees are not unfairly disadvantaged where business is conducted through separate legal entities in order to limit risks or minimize tax (*0708964 B.C. Ltd., Re* [2011 CarswellBC 1765 (B.C. Empl. Stnds. Trib.)], BC EST # D015/11, at paragraph 27). However, the Director must be careful in exercising its authority under this provision; section 95 was not intended to extend liability to unrelated parties - "[A] section 95 declaration cannot be made against an entity that was completely independent from the business to whom the employee provided services..." (*0708964 B.C. Ltd.*, *supra*, at paragraph 28).

17 In *Invicta Security Systems Corp., Re* (December 4, 1996), Doc. D349/96, 95/52 (B.C. Empl. Stnds. Trib.), the Tribunal held that the Director may associate parties under section 95 where four conditions are satisfied:

(a) there must be more than one corporation, individual, firm, syndicate or association;

(b) each of these entities must be carrying on a business, trade or undertaking;

(c) there must be common control or direction; and

(d) there must be some statutory purpose for treating the entities as one employer.

18 The first condition is self-evident. So too is the last, at least in my view. I address the argument of the Appellant on that point, below.

19 In my estimation, if they are carrying on businesses, trades or undertakings under common control or direction, the Director may, according to section 95 of the *Act*, treat VHL and the Appellant as one employer.

20 The Appellant says that in doing so, the Director erred in law.

Did the Director err in law by associating VHL and the Appellant according to section 95?

21 An "error of law" exists where:

(a) a section of the Act has been misinterpreted or misapplied;

(b) an applicable principle of general law has been misapplied;

(c) the Director acts in the absence of evidence;

(d) the Director acts on a view of the facts which cannot reasonably be entertained; or

(e) the Director adopts a method of assessment which is wrong in principle.

(see *Gemex Developments Corp. v. Coquitlam Assessor, Area No. 12*, [1998] B.C.J. No. 2275 (B.C. C.A.) at paragraph 9).

22 Several errors of law are alleged in the Appellant's submissions. I address each, in turn.

• The Director erred in finding that VHL and the Appellant were carrying on a business, trade, or undertaking.

23 The Tribunal has previously opined that entities to be associated under section 95 "... must be jointly carrying out some business, trade or other activity, although the business, trade or activity in question need not necessarily be the only one that each entity is carrying on..." (see *0708964 B.C. Ltd.*, *supra*, at paragraph 32).

24 The Appellant argues that it did not carry on business with VHL, and says that the Director was wrong to conclude otherwise. It says that VHL's business of manufacturing panelized and pre-cut homes was entirely different than its "business" which can be described essentially as, firstly, the holding of shares in CWF, parent company of VHL and, secondly, the raising of funds for investment in or loan to VHL.

25 With respect, I disagree.

26 The Appellant had no *active* business, and existed only to source and invest funds in the corporate structure, of which it was a significant part, created in 2012 contemporaneously with the acquisition of VHL from its previous owners. Very clearly, VHL was the operating arm of that structure. The Appellant, having no other business, no other holdings, and no other purpose, was an integral part of the financing arm.

27 In *Remko'b Investments Ltd. v. British Columbia (Director of Employment Standards)* [1994 CarswellBC 174 (B.C. C.A.)], 1994 CanLII 168, the British Columbia Court of Appeal considered section 20 of the *Employment Standards Act*, S.B.C. 1980, what is now section 95. In that instance, the Director sought to associate companies that were very clearly under common control and direction. The issue on appeal was whether or not the business conducted by the primary company was carried on by or though the appellant. In dismissing the appeal, a majority of the Court found that the appellant had no business activity other than financially supporting the primary company, and that the primary company could not operate absent that support:

> *Where company A carries on its business with the financial support of company B, and cannot continue to do so without that support; and where company B has no business activity other than the provision of financial support to company A, then it can reasonably be said that the business of company A is carried on by or through company B*. (*Remko'B*, at paragraph 9, emphasis added).

28 The esteemed Chief Justice McEachern, as he then was, opined in a dissenting opinion that it was irrelevant that the appellant company had no business interests other than investment in the primary company; it was only necessary to show that the business of the primary company was being carried on by or through the appellant company.

29 The Director submits, and I accept, that the facts of this matter closely resemble those in *Remko'B*.

30 The Appellant says that it was nothing more than a financier and lender to VHL, and relies on a decision of this Tribunal in *Jordan Enterprises Ltd., Re* [2016 CarswellBC 2709 (B.C. Empl. Stnds. Trib.)], BC EST # D114/16, to argue against a finding that it carried on business in common with VHL. In *Jordan Enterprises*, I accepted that the associated company was carrying on business, in part, as the financier and lender of the employer company, but rejected the conclusion that both companies were carrying on a common business enterprise.

31 In my view, *Jordan Enterprises* is clearly distinguishable from this matter. In that case, the companies that the Director sought to associate under section 95 were created at different times and for different purposes. Each had different, independent, and well-documented business activities, and no related shareholders, directors, or jointly held assets.

32 Unlike *Jordan Enterprises*, the fact that VHL was incorporated years before the Appellant is not relevant, considering the acquisition of VHL in 2012, and the Appellant's involvement and significant position in a corporate structure created immediately before acquisition. Also unlike *Jordan Enterprises*, there is a commonality of shareholders in this case, in that the Appellant directly or indirectly controls or controlled enough shares in CWF, parent to VHL, to unilaterally direct or influence the day-to-day VHL operations.

33 Despite the assertion otherwise, I am satisfied that the Appellant was not merely an independent financier or lender to VHL, and there is nothing in the Director's conclusion on that matter that I can say is unreasonable or otherwise inconsistent with the Court of Appeal's guidance in *Remko'B*.

34 In concluding that the parties were carrying on a common business, trade, or undertaking, I am satisfied that the Director did not err.

• The Director erred in finding that VHL and the Appellant were operating under common control or direction.

35 According to this Tribunal:

(a) "Common control or direction is clearly established where the same person is in reality the guiding force or managing authority for both businesses..." (*Broadway Entertainment Corp., Re* (July 18, 1996), Doc. D184/96 (B.C. Empl. Stnds. Trib.) , at page 11).

(b) Common control or direction "... is not limited in its application to direct financial or corporate control." (*Invicta Security Systems Corp., Re*, BC EST # D349/96, at page 6).

(c) Common control or direction "... may be determined based on financial contributions from one entity to another (although this factor, standing alone, in not determinative); the fact that one entity is economically dependent on another entity; interlocking shareholdings and directorships; common management principles (e.g., corporate officers and other key employees); sharing of resources (including human resources) among the various entities; asset transfers at non-market transfer prices; operational control by one entity over the affairs of another entity; joint ownership of key assets and operational integration" (*0708964 B.C. Ltd.*, *supra*, at paragraph 32).

(d) "The totality of the business and the inter-relationships of the entities must be examined." (*Invicta Security Systems Corp., Re*, *supra*, at page 6).

36 The Appellant argues that there was no common control or direction, notwithstanding that for a significant period of time Mr. Kwok was either a director, officer, or both of VHL, and at all times a director of the Appellant. It says that Mr. Kwok did not control or influence the day-to-day operations of VHL, did not make decisions relating to employees, had no ability to sway the decisions of the other directors of VHL, and became involved only when the financial difficulties of VHL forced the Appellant to invest funds in order to avoid bankruptcy.

37 I cannot say that I agree with this characterization of the evidence.

38 The Appellant controlled more than three-quarters of the outstanding and issued shares of CWF, the immediate parent of VHL, and as such effectively controlled *all* of the outstanding and issued shares of VHL. Mr. Kwok may not have been the only director of VHL, CWF, or C2, but it is clear from the evidence referenced in the Determination and otherwise included in the Record that he was a guiding force in managing the affairs of both VHL and the Appellant. At material times, Mr. Kwok, before and after resigning as a VHL Director on February 27, 2015:

(a) held himself out, or allowed himself to be held out, as the managing director or owner of VHL;

(b) gave direction to VHL employees;

(c) communicated with VHL employees concerning their wages and delays in paying outstanding wages;

(d) communicated with VHL employees concerning a potential acquisition by new investors;

(e) made arrangements to obtain loans for certain VHL employees in lieu of wages;

(f) solicited investment in the Appellant for advance to VHL;

(g) executed security documents on behalf of VHL in connection with loans and advanced, from time to time, all of which came from the Appellant; and

(h) negotiated the sale of VHL assets to a third party.

39 The economic dependence of VHL on the Appellant is clear, considering the quantum of money advanced to VHL from time to time, and fact that the principal source of that money was the Appellant, according to VHL.

40 Unlike *Jordan Enterprises*, in which the employer company and the associated company had different ownership structures, different directors, and different shareholders, VHL and the Appellant have common governance, and a corporate structure that in appearance is somewhat similar to a set of Matryoshka dolls.

• The Director erred in finding that VHL and the Appellant had common directorship after Mr. Kwok's resignation.

41 The Appellant argues that Mr. Kwok's resignation as a director of VHL from and after February 27, 2015, is conclusive evidence that there was no common control or direction after that date, because Mr. Kwok ceased to have legal authority, or any authority whatsoever, *vis-à-vis* VHL, its operations, and employees. It says that after February 27, 2015, VHL and the Appellant were completely separate entities, operating at arms' length, and maintaining a purely debtor-creditor relationship.

42 I accept that commonality of directors is evidence (albeit not conclusive evidence) of common control or direction. The opposite, however, is not automatically true — the absence of common directors after February 27, 2015, does not also mean the absence of common control or direction.

43 In my opinion, to require the formality of the common appointment of directors as a prerequisite to showing common control and direction is to render section 95 impotent. As this Tribunal noted in *Invicta, supra*, one must consider the totality of the evidence and the relationships between parties.

44 Despite his resignation as a director (a fact acknowledged in the Determination), Mr. Kwok continued, firstly, to hold himself out as both the managing director and the "owner" of VHL, in letters sent after February 27, 2015, and secondly, to take those other steps I noted previously (see paragraph 38 above.)

45 In my view, Mr. Kwok continued to manage or participate in the management of VHL after his resignation in February 2015, and in reaching that conclusion, the Director did not err in law.

46 If not in his capacity as director of VHL, and not in some personal capacity, it would not be unreasonable to conclude that Mr. Kwok did so acting as the Appellant's sole director. (For reasons that I explain below, I do

not believe it crucial or even necessary to arrive at that specific conclusion.)

• The Director erred in finding that VHL and the Appellant had a relationship more than that of a debtor and creditor.

47 The Appellant argues that the facts in this matter demonstrate nothing more than an arms' length relationship between creditor and debtor.

48 The Appellant relies on *Southgate Inn Inc., Re* (April 2, 1998), Doc. D092/98 (B.C. Empl. Stnds. Trib.), in which the Tribunal, at page 9, concluded that "[a] connection, without some degree of control beyond that of landlord/tenant or debtor/creditor, is not sufficient to warrant a finding of liability for the payment of wages to employees of the tenant/debtor's failed business venture."

49 In *Ewachniuk v. British Columbia (Director of Employment Standards)* [1998 CarswellBC 2770 (B.C. C.A.)], 1998 CanLII 6454, the British Columbia Court of Appeal held that that the mere fact that one of the two persons provides needed financial support to a business does not, in turn, make him a "partner" with the principal of that business. Of relevance to this appeal are the words of the trial judge, adopted by Hollinrake, J.:

> *In the end, the most that can be said is that the appellant was a landlord, investor, and shareholder. None of that necessarily leads to the conclusion on a balance of probabilities that he exercised control of the character necessary to bring him within s. 20. Evidence of the appellant being involved in the design or direction of the renovations, of the advertising, of strings attached to the advances of those sums of money, or of participation in the management of the company or restaurant would bring him within s. 20. There is no such evidence.*

50 (What was then section 20 is more or less identical to what is now section 95 of the *Act*.)

51 I am satisfied that, for the reasons previously given (see paragraph 38 above), the Director's conclusion that the relationship of VHL to the Appellant goes beyond that of debtor to creditor, is sound.

52 The Appellant again relies on *Jordan Enterprises* but, in my view, that decision is unhelpful given that the employer company and the associated company in that matter were formed at different times, for different reasons, and had different shareholders, directors, and businesses. That is, the employer company and the associated company were entirely disparate entities; the same cannot be said of VHL and the Appellant.

• The Director erred by misapprehending the evidence.

53 The Appellant argues that the Director misapprehended the evidence by concluding that actions undertaken by Mr. Kwok were in a capacity other than as director of VHL or CWF.

54 It points to the evidence of Mr. Kwok, who says that until his resignation in February 2015, he was acting in his capacity as the director of VHL and, thereafter, in his capacity as director of, basically, anyone but the Appellant.

55 With respect, in making this argument I believe that the Appellant misses the point, entirely.

56 That Mr. Kwok was wearing more than one hat is not disputed. Arguing that Mr. Kwok was wearing his VHL hat on day one, his CWF hat on day three, and his Appellant hat on day two, does not adequately answer the question of whether there is common control and direction.

57 With respect to Mr. Kwok's post-resignation communications, I note the following:

(a) On March 12, 2015, Mr. Kwok sent a letter on VHL letterhead to several VHL employees. In it, he provides detail regarding anticipated VHL financing, and confirms that "we are determined to get Viceroy back on track as quickly as we can." Whether or not I accept the Appellant's argument that Mr. Kwok ceased to have authority vis-à-vis VHL from and after his resignation, it seems to me that he continued to act in some capacity for or with respect to VHL, and it is not unreasonable to conclude that he remained involved in directing the affairs of VHL.

(b) On March 24, 2015, Mr. Kwok sent a second letter, not on letterhead, which he signed as or on behalf of the "Ownership Group". This letter clearly makes reference to efforts to secure funding and to put Viceroy "back on track". It is not clear to me who the "Ownership Group" is, but it would not be patently unreasonable to conclude that it meant the owners of VHL which, given the ownership structure, could be said to include the Appellant.

(c) On April 8, 2015, Mr. Kwok sent a third letter, which he signed as "Owner of Viceroy Homes", and which the Appellant argues means CWF. That particular conclusion is not so easy to draw.

58 Common control and direction does not mean that Mr. Kwok acts in his capacity as director of the Appellant to guide the affairs of VHL. Rather, it means, at least in part, that the same person guides the affairs of VHL and the Appellant.

59 That Mr. Kwok was managing the Appellant is undisputed. That Mr. Kwok was participating in the management of VHL (and holding himself out as a manger both before and after February 27, 2015) is clear, on the evidence.

60 At best, one can opine that the lines between the various roles filled by Mr. Kwok are blurred, and it is difficult to say, with certainty, in what capacity he was acting at any given time. The resulting level of confusion speaks in favour of, not against, the Director's findings, particularly when viewed against the backdrop of a nested ownership structure created in 2012 in order to facilitate the VHL acquisition.

61 In my view, the Director has not misapprehended the evidence.

• The Director erred in finding the existence of a statutory purpose.

62 The Appellant says that the Director erred in failing to properly analyze the evidence in relation to the fourth *Invicta* condition - that is, the Appellant says that the Director did not fully consider whether or there is a statutory purpose for making the one employer declaration.

63 In *Invicta*, the Tribunal said this:

> One of the purposes of the *Act* is to ensure employees in the province receive the basic standards of compensation and conditions of employment. The *Act* not only sets the basic standards of compensation and conditions of employment but also provides a comprehensive scheme for the enforcement of the *Act*, including some collection procedures such as claims of lien, court order enforcement and seizure of assets in appropriate circumstances. It is in the enforcement provisions of the *Act* where Section 95 has been placed. The statutory purpose requirement is met if the one employer determination is for the purpose of enforcing basic standards of compensation and conditions of employment. It is not inconsistent with that purpose to make the one employer declaration for the purpose of facilitating the collection of wages owing under the *Act*.

64 In my view, the Director did not need to consider whether or not, in this case, there was a statutory purpose. I go so far as to suggest that a case-by-case statutory purpose analysis is generally unnecessary; a

statutory purpose for section 95 was established in *Invicta*, and if the purpose of the one employer declaration is to collect unpaid wages, it need not be shown in every case where the collection of wages is the goal.

65 All in all, there is nothing that I can see in the Determination that is incorrect, patently unreasonable, or otherwise constitutes an error of law in one of the five ways enumerated in *Gemex*, and I reject the argument of the Appellant under section 112(1)(a) of the *Act*.

Did the Director violate the principles of natural justice?

66 The Appellant also challenges the Determination on the basis that the Director has failed to observe the principles of natural justice.

67 Those principles require the Director, at all times, to act fairly, in good faith, and with a view to the public interest (*Congrégation des Témoins de Jéhovah de St-Jérôme-Lafontaine c. Lafontaine (Municipalité)*, 2004 SCC 48 (S.C.C.) at paragraph 2). Fairness, in turn, means that all parties involved have the right to notice, the right to know the case to be met and the right to answer it, the right to cross-examine witnesses, the right to a decision on the evidence, and the right to counsel (*Mainline Irrigation and Landscaping, Re* [2005 CarswellBC 4427 (B.C. Empl. Stnds. Trib.)], BC EST # D196/05, at paragraph 15).

68 In this instance, the Appellant argues that the Director failed to:

> (a) provide sufficient reasons for the conclusion that there was common control and direction;
>
> (b) failed to provide sufficient reasons for apparent findings of credibility.
>
> • Sufficiency of Reasons

69 The Tribunal has previously adopted a "functional context-specific approach" when assessing the sufficiency of reasons (see, for example, *Shaw, Re* (August 27, 2010), Doc. D089/10; The 2010A/71 (B.C. Empl. Stnds. Trib.), and *Worldspan Marine Inc., Re* [2012 CarswellBC 843 (B.C. Empl. Stnds. Trib.)], BC EST # D005/12.)

70 Guidelines with respect to this approach and applicable to proceedings under the *Act* were established by the Supreme Court of Canada in *R. v. M. (R.E.)*, 2008 SCC 51 (S.C.C.), starting at paragraph 15:

> (a) courts of appeal considering the sufficiency of reasons should read them as a whole, in the context of the evidence, the arguments, and the trial, with an appreciation of the purposes or functions for which they are delivered;
>
> (b) the objective is not to show how a decision is reached, but why;
>
> (c) every finding or conclusion need not be explained in the process of arriving at a verdict; and
>
> (d) there is no requirement to expound on each piece of evidence or controverted fact, so long as the findings linking the evidence to the verdict can logically be discerned.
>
> • Common Control and Direction

71 In my opinion, the Determination sets out the basis upon which the Director concluded common control and direction:

(a) the Appellant was not a separate, unrelated, investment company, but the company holding the largest interest in VHL, albeit indirectly, and regularly provided financing to VHL, without which VHL would have been bankrupted;

(b) Mr. Kwok was the sole director of the Appellant, a director of VHL until February 2015, and involved in the management of VHL (operating under the title of managing director) both before and after his resignation as an actual VHL director;

(c) Mr. Kwok was making recommendations to the VHL management team, and while his recommendations may not always have been followed, he was clearly part of the ongoing discussion;

(d) Mr. Kwok was the party negotiating with prospective purchasers, and encouraging employees to stay with VHL even in the face of delays in the payment of wages — he was aware that complainants were working without wages, and he was a primary point of contact for them.

72 In explaining why the conclusion of common control and direction was warranted, I am satisfied that the Determination follows the guidelines set out in *M. (R.E.)* The Director set out the appropriate test, the evidence relating to each facet of the test, and the conclusion to be drawn. The Appellant may not agree with the result, but the Determination is intelligible, and the conclusions drawn are tied to evidence in a manner that is logical, if sometimes difficult to read.

• Credibility

73 In arguing that the Director failed to provide sufficient reasons for apparent findings of credibility, the Appellant focuses on what it interprets as the Director's conclusion that Mr. Kwok was acting in his capacity as a director of the Appellant when involving himself in the affairs of VHL.

74 The Appellant says that there was no meaningful analysis of, and no attempt to reconcile, conflicting evidence concerning the various roles occupied by Mr. Kwok. The Appellant says that it has no way of knowing how the Director reconciled contradictory evidence in concluding that Mr. Kwok, at material times, was acting in his capacity as a director of the Appellant.

75 I have some difficulty with this argument. Not only do I not agree that the Director made a finding that Mr. Kwok was acting in his capacity as a director of the Appellant when involving himself in the affairs of VHL, I am of the opinion that the Director had no need to make such a finding. The Director found, and the evidence corroborates a finding, that Mr. Kwok was directing the affairs of the Appellant, and concurrently involved in directing the affairs of VHL. What hat he was wearing at any given time is not as relevant as the fact he was wearing more than one hat.

76 For that reason, it does not appear to me to be detrimental to the Determination that the Director did not, in the Determination, delve into or otherwise expressly address conflicts in the evidence concerning the specific capacity in which Mr. Kwok was acting from time to time.

77 In my view, the Director clearly reviewed evidence uncovered or received during the investigative process, and considered the evidence of each witness material to a section 95 analysis. The Determination sets out in a reasonably clear manner the basis for a conclusion that common control and direction exists.

78 I point out that adequacy, not perfection, is the standard by which the Director's reasons are to be judged, and I am mindful of the comments of the Supreme Court of Canada in *R. c. Gagnon* (2006 SCC 17 (S.C.C.) at paragraph 23):

The requirement for sufficient reasons is not an invitation to an appellate court to substitute its perceptions *of what should have been the factual and credibility findings of the trial judge when a reasonable basis for the trial judge's conclusions exists*.

79 The Determination is not perfect, but it is sufficient. In my opinion, a reasonable basis for the Director's assessment of the evidence has been set out in the Determination.

80 In my opinion, the Appellant has failed to discharge its burden to show a breach of natural justice.

Bias

81 Finally, the Appellant says that the Determination "strongly" suggests that the Director pre-judged the issues, giving rise to a reasonable apprehension of bias.

82 The Appellant says that the Director must act impartially. It points to section 30 of the *Administrative Tribunals Act*. Why, I do not really know, because the Director is not a tribunal, and that section does not apply.

83 The test for bias adopted by the Supreme Court of Canada is set out in *Committee for Justice & Liberty v. Canada (National Energy Board)* (1976), [1978] 1 S.C.R. 369 (S.C.C.), at page 394: "What would an informed person, viewing the matter realistically and practically - and having thought the matter through - conclude"?

84 I do not think I am twisting the Appellant's submissions when I say that it seems like the Appellant is arguing that, because it lost, the Director must have been biased.

85 With respect, the argument is absurd.

86 In the absence of any supporting evidence, the Appellant suggests that the unfavourable finding must have been skewed, because it allows the Director an opportunity to collect wages owned by VHL, in the face of an inability to collect wages from VHL or its directors. It is lost on the Appellant, apparently, that the point of a section 95 declaration is exactly that.

87 Bias is not shown just because the Director makes findings that do not support the positions advanced by the Appellant. To the extent that it calls into question the impartiality of the Director in an investigation or adjudication, an accusation of bias should not be thrown around so lightly or casually.

88 In my view, no right-thinking person would agree that there is bias in the case, or a reasonable apprehension of bias. The Appellant has abjectly failed to satisfy its burden to demonstrate otherwise.

Conclusion

89 The *Act* was intended by our legislature to ensure that employees receive basic standards of compensation.

90 Corporations and business ventures structured in a way that protects investors while limiting risk and reducing taxes, are entirely legal. Competing with that, however, is the decree of our legislature declaring contrary to the public interest a corporate structure that allows a business to shirk obligations to employees. Rather than outlawing those structures, section 95 permits the Director to ignore them. The Tribunal ought not to capitulate with respect to a structure and management style that would so easily allow an employer to circumvent a fundamental tenet of the *Act*.

ORDER

91 For these reasons, the appeal is dismissed, and the Determination confirmed pursuant to section 115 of the *Act*.

Appeal dismissed.

2001 CarswellOnt 1680
Ontario Court of Appeal

Downtown Eatery (1993) Ltd. v. Ontario

2001 CarswellOnt 1680, [2001] O.J. No. 1879, [2001] O.T.C. 257, 105 A.C.W.S. (3d) 434, 147 O.A.C. 275, 14 B.L.R. (3d) 41, 2002 C.L.L.C. 210-008, 200 D.L.R. (4th) 289, 54 O.R. (3d) 161, 8 C.C.E.L. (3d) 186

Downtown Eatery (1993) Ltd. (Respondent/Plaintiff) and Her Majesty the Queen in right of Ontario and Joseph Alouche (Appellant/Defendants)

Joseph Alouche (Appellant/Plaintiff by Counterclaim) and The Landing Strip Inc., The Landing Restaurant Inc., The Landing Restaurant (1993) Limited, Downtown Eatery Limited, Downtown Eatery (1993) Limited, Best Beaver Management Inc. (Ontario Corporation #971712), Best Beaver Management Inc. (Ontario Corporation #1042788), Twin Peaks Inc., Herman Grad and Ben Grossman (Respondents/Defendants by Counterclaim)

McMurtry C.J.O., Borins, MacPherson JJ.A.

Heard: March 6-7, 2001
Judgment: May 22, 2001
Docket: Doc. CA C33989

Proceedings: reversing (March 3, 2000), Doc. 97-CV-129317 (Ont. S.C.J.)

Counsel: *J. Gardner Hodder* , for Appellant
John Conway , for Respondents

Subject: Employment; Public; Torts; Contracts; Corporate and Commercial

Headnote

Employment law --- Termination and dismissal — Practice and procedure — Remedies — General
Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies — Counterclaim was dismissed on basis that since amalgamation and reorganization were not undertaken for purpose of defeating employee's judgment, employee was not entitled to oppression remedy — Employee appealed — Appeal allowed — Intention of depriving employee of judgment was not prerequisite for oppression remedy — Effect of reorganization was unfairly prejudicial or unfairly disregarded employee's interests — Employee had reasonable expectation that employer's affairs would be conducted with view to protecting his interests — B Inc. was profitable at time of reorganizations and directors should have maintained reserve to satisfy contingency that employee's claim may succeed.

Employment law --- Nature of employment relationship — Elements constituting relationship between employer and employee — Existence of contract of employment — Identity of employer — General

Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies — Counterclaim was dismissed on basis that employee was estopped from claiming directors or related companies were his employers and that he failed in any case to establish that doctrine of common employer was appropriate — Employee appealed — Appeal allowed — While trial judge's analysis on estoppel issue was plausible, his conclusion was not, in circumstances, correct — Fact that employee withdrew motion to add directors personally as defendants did not mean employee was precluded from alleging related companies were "common employers" — Employee's employer was consortium of companies which together operated B Inc. — While employer is entitled to establish complex corporate structures for various purposes, structures should not be utilized to work injustice in realm of employment law — Appropriate to enforce judgment not only against common employers, but against merged and successor companies which resulted from reorganization of common employers.

Practice --- Judgments and orders — Res judicata and issue estoppel — Res judicata — Persons subject to — Miscellaneous issues
Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies — Counterclaim was dismissed on basis that employee was estopped from claiming directors or related companies were his employers — Employee appealed — Appeal allowed — While trial judge's analysis on estoppel issue was plausible, his conclusion was not, in circumstances, correct — Fact that employee withdrew motion to add directors personally as defendants did not mean employee was precluded from alleging related companies were "common employers" — Only issue to which doctrine of res judicata applied was that of directors' personal liability as potential common employers.

Corporations --- Shareholders — Shareholders' remedies — Relief from oppression — Miscellaneous issues
Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies pursuant to oppression remedy — Counterclaim was dismissed on basis that amalgamation and reorganization were not undertaken for purpose of defeating employee's judgment, so that employee was not entitled to oppression remedy — Employee appealed — Appeal allowed — Intention of depriving employee of judgment was not prerequisite for oppression remedy — Effect of reorganization was unfairly prejudicial or unfairly disregarded employee's interests — Directors should have maintained reserve to satisfy contingency that employee's claim may succeed.

Table of Authorities

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Olson v. Sprung Instant Greenhouses Ltd. (1985), 41 Alta. L.R. (2d) 325, 12 C.C.E.L. 8, 64 A.R. 321 (Alta. Q.B.) — referred to

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Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc. (1998), 162 D.L.R. (4th) 367, 111 O.A.C. 106, 40 O.R. (3d) 563, 43 B.L.R. (2d) 155 (Ont. C.A.) — referred to

Sinclair v. Dover Engineering Services Ltd. (1987), 11 B.C.L.R. (2d) 176 (B.C. S.C.) — considered

Sinclair v. Dover Engineering Services Ltd. (1988), 49 D.L.R. (4th) 297 (B.C. C.A.) — referred to

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16
Generally — referred to

s. 245 "complainant"(c) — considered

s. 248(1) — considered

s. 248(2) — considered

s. 248(2)(c) — considered

Employment Standards Act, R.S.O. 1990, c. E.14
Generally — referred to

s. 12(1) — considered

APPEAL by employee from judgment reported at 2000 CarswellOnt 634, 2 C.C.E.L. (3d) 66 (Ont. S.C.J.) , allowing in part action for damages for wrongful dismissal and for oppression remedy.

The judgment of the court was delivered by *Borins and MacPherson JJ.A.*:

A. INTRODUCTION

1 In his valuable text, *Canadian Employment Law* (Aurora: *Canada Law Book* , 1999), Stacey Ball states, at p. 4-1:

> The courts now recognize that, for purposes of determining the contractual and fiduciary obligations which are owed by employers and employees, an individual can have more than one employer. The courts now regard the employment relationship as more than a matter of form and technical corporate structure. Consequently, the present law states that an individual may be employed by a number of different companies at the same time.

2 The mechanism whereby the law concludes that an employee may be employed by more than one company at the same time is the common employer doctrine. The doctrine has a well-recognized statutory pedigree in most jurisdictions. For example, in Ontario s. 12(1) of the *Employment Standards Act* , R.S.O. 1990, c. E.14, deems associated or related businesses to be “one employer” for the purpose of protecting the benefits to which employees are entitled under the Act.

3 A major issue in this appeal is the definition and application of the common employer doctrine in a common law context. A dismissed employee sued his employer for wrongful dismissal. Following a trial, he was awarded substantial damages. Unfortunately, the employer company had no assets and consequently the employee was unable to enforce his judgment. In a subsequent action, the employee sued related companies and the two main principals of all the companies in an attempt to widen its net of potential sources of recovery. His principal legal submission in support of his attempt was, and is on this appeal, the common employer doctrine. In *Canadian Employment Law* , Mr. Ball states that “[t]he finding that more than one corporation is the employer may be a benefit when parts of the corporate group are more solvent than others . . . .” (p. 4-1). That is precisely the benefit the dismissed employee seeks to achieve in this litigation.

4 A second important issue in this appeal is the availability of an oppression remedy to a dismissed employee in the context of a corporate reorganization shortly before a wrongful dismissal trial which has the effect of denying the employee any recovery on a judgment he obtains at the trial.

B. FACTS

(1) The parties and the events

5 In 1992, the respondents Herman Grad (”Grad”) and Ben Grosman (”Grosman”) were in the nightclub business in Toronto. They owned and operated two nightclubs, *The Landing Strip* at 191 Carlingview Drive and *For Your Eyes Only* at 557/563 King Street West.

6 The appellant, Joseph Alouche (”Alouche”), was born in Egypt and came to Canada in 1974. He attended the Toronto School of Business, took courses in hotel management and received a diploma. He also took correspondence courses relating to the hospitality industry and computers.

7 In December 1992, Grad offered Alouche a position as manager of the nightclub *For Your Eyes Only* . The only entity specifically identified in the written employment contract was *For Your Eyes Only* . However, the contract also provided that Alouche would receive the health care and insurance benefits available “in our sister organization”, which was not identified by name.

8 Alouche commenced work on December 29, 1992. During the next few months, he received his pay cheques from Best Beaver Management Inc. (”Best Beaver”), a company controlled by Grad and Grosman. In May 1993, Alouche was sent a formal Notice of Discipline on the letterhead of *For Your Eyes Only* for committing several infractions, including:

• the employee, while soliciting in excess of $1,000.00 gratuity only generated sales of $250.00 for the employer.

• the employee allowed numerous waitresses to abandon their assigned sections to solicit gratuities in the amount of $2,800.00.

9 On June 15, 1993, Alouche was dismissed. On October 13, 1993, he commenced an action against Best Beaver. In subsequent proceedings which form the basis for this appeal, Alouche explained the choice of Best Beaver as the defendant in the first action: "I sued Best Beaver . . . because the paycheque that they gave me in *For Your Eyes Only* , it says Best Beaver Management Inc."

10 In the spring of 1996, there was a major reorganization of the Grad-Grosman companies. Best Beaver ceased to do business. In July 1996, Grad discharged Best Beaver's counsel. Shortly before the start of the trial in his wrongful dismissal action in August 1996, Alouche, worried about recovery if successful in the action, moved to add Grad and Grosman as co-defendants to his claim against Best Beaver. Faced with a potential adjournment of the trial to permit Grad and Grosman to retain counsel, Alouche withdrew the motion.

11 The trial proceeded with Best Beaver as the only defendant. Grad, a director of Best Beaver, represented it throughout the trial. The trial judge, Festeryga J., found in favour of Alouche. He awarded Alouche damages of $59,906.76, plus pre-judgment interest of $8,608.36 and costs of $15,387.79.

12 Best Beaver paid Alouche nothing pursuant to the judgment. Two sheriffs, in purported execution of the judgment, attended at the premises of *For Your Eyes Only* and seized $1,855 in cash. This provoked Downtown Eatery (1993) Ltd., which claimed that the money belonged to it, to commence an action against Alouche.[1] Alouche defended the action and counterclaimed against all of the companies controlled by Grad and Grosman and against Grad and Grosman personally. In December 1997, Kiteley J. ordered that the $1,855 seized by the sheriffs be paid into court to the credit of the action.

13 There are other facts relevant to the disposition of the appeal, including two reorganizations of the Grad-Grosman companies. However, we find it convenient to describe those facts in the context of the specific issues to which they relate.

(2) The litigation

14 The trial proceeded before C. Campbell J. in February 2000. The essence of the trial was Alouche's counterclaim in which he sought to recover against any or all of the defendants for his unsatisfied judgment against Best Beaver.

15 Alouche advanced several bases for recovery of his earlier judgment against the *new* defendants. The trial judge addressed three of them in his reasons for judgment - the common employer doctrine, oppression relief under the *Ontario Business Corporations Act* , R.S.O. 1990, c. B.16, and a tracing remedy associated with a fraudulent conveyance.

16 The trial judge dismissed Alouche's counterclaim in its entirety. On the common employer issue, the trial judge rejected Alouche's submissions, both on the merits and because of the concept of estoppel. With respect to a potential oppression remedy, the trial judge held that such a remedy would not be appropriate because the reorganization of the Grad-Grosman companies was not undertaken for the purpose of depriving Alouche of recovery of his judgment against Best Beaver. For similar reasons, he held that the defendants had not made any fraudulent conveyance, and, therefore, a tracing order was not appropriate.

17 The appellant appeals from the trial judge's decision on the common employer and oppression remedy issues. At the hearing of the appeal, the appellant abandoned his appeal on the fraudulent conveyance/tracing

issue.

C. ISSUES

18 The issues on the appeal are:

(1) Did the trial judge err in failing to find that some or all of the respondents were a common employer of the appellant?[2]

(2) Did the trial judge err in failing to find that the conduct of the respondents was “oppressive” or “unfairly prejudicial” as those terms are used in the *Ontario Business Corporations Act* ?

D. ANALYSIS

(1) The common employer issue

19 The trial judge decided this issue against Alouche for two reasons: (1) Alouche was estopped from raising the issue in his counterclaim action to enforce his previous judgment because he had not raised it in his original wrongful dismissal action; and (2) Alouche had not established the prerequisites necessary to identify any of the respondents as a common employer, along with Best Beaver.

(a) Res judicata/estoppel

20 It will be recalled that shortly before the wrongful dismissal trial, Alouche brought a motion to add Grad and Grosman as defendants because he was concerned that Best Beaver might not respond to a judgment against it. Because this motion would have resulted in an adjournment of the trial, Alouche decided to abandon it. The respondents submit that these steps precluded Alouche from raising the issue in the subsequent proceedings. The trial judge briefly reviewed the doctrines of *res judicata* , cause of action estoppel and issue estoppel. It is not entirely clear which of these doctrines he applied. However, it is clear that he agreed with the respondent’s essential submission on this issue. He concluded:

> I am satisfied on the evidence before me that Alouche was content in his wrongful dismissal action to allege that Best Beaver was his employer and to be bound by that conclusion, notwithstanding the possibility of some responsibility on the part of Messrs. Grad and Grosman.
>
> On that basis, Alouche is now estopped from alleging a different or expanded employment obligation when he is now unable to recover on the first judgment.

21 Let us say candidly that this is a plausible analysis and conclusion. On the eve of the wrongful dismissal trial, Alouche was concerned that the corporate reorganization about which he had recently learned might mean that Best Beaver no longer had assets which could potentially satisfy any judgment he obtained. Alouche’s response was to consider, initiate and then abandon adding Grad and Grosman as defendants. In light of these steps, it is plausible to conclude, as the trial judge did, that Alouche considered the general question of whom he should sue and decided to proceed against only Best Beaver.

22 However, in the end we do not think that this conclusion is correct. A particularly valuable discussion of *res judicata* and of issue estoppel is found in this court’s decision in *Minott v. O’Shanter Development Co.* (1999), 42 O.R. (3d) 321 (Ont. C.A.) (*”Minott”*). Laskin J.A. articulated the underlying purpose of the concept of issue estoppel in this fashion, at p. 340:

> Issue estoppel is a rule of public policy, and, as a rule of public policy, it seeks to balance the public

> interest in the finality of litigation with the private interest in achieving justice between litigants. Sometimes these two interests will be in conflict, or, at least there will be tension between them. Judicial discretion is required to achieve practical justice without undermining the principles on which issue estoppel is founded. Issue estoppel should be applied flexibly where an unyielding application of it would be unfair to a party who is precluded from relitigating an issue.

23 In our view, the issue Alouche considered on the eve of his wrongful dismissal trial was whether to sue Grad and Grosman in their personal capacities as potential employers because of his concern that Best Beaver, the corporate entity which he regarded as his employer (because it paid him), might have no assets. Alouche considered this option because, as he testified at the second trial, he regarded them as his employer:

> Q. At the time you signed this agreement that appears at Tab 1 [the employment contract], who did you believe to be your employer?
>
> A. It was Herman Grad. I started working at For Your Eyes Only. That's the only place I know there.

However, in the end, Alouche made a conscious decision not to join Grad and Grosman in the wrongful dismissal action because it would have delayed the trial. Taking account of that decision, the trial judge concluded that Alouche was estopped from suing Grad and Grosman personally as potential employers in his subsequent action. We see no reason to interfere with this component of the trial judge's decision.

24 However, the issue of a potential common employer for Best Beaver, drawn from the stable of Grad-Grosman companies that were closely connected with the operation of the *For Your Eyes Only* nightclub, was not considered by Alouche on the eve of the wrongful dismissal trial. He did not think about adding other companies at that juncture because the only entities of which he was aware were the nightclub, *For Your Eyes Only* , with which he had a contract of employment, and Best Beaver, which issued his pay cheques. He decided to sue Best Beaver "because the paycheque that they gave me in *For Your Eyes Only* , it says Best Beaver Management Inc." This was a perfectly sensible reason for suing Best Beaver.

25 Only later, after he had won a substantial judgment at trial and had been unable to collect on it from Best Beaver, did Alouche begin to think of other companies which might have been closely connected with *For Your Eyes Only* and Best Beaver. That inquiry led him, *for the first time* , to the respondent corporations.

26 In summary, we cannot say that the trial judge erred by concluding that Alouche was estopped from pursuing Grad and Grosman personally as potential common employers in the counterclaim relating to the enforcement of the previous judgment in the wrongful dismissal action. However, we do not think that the common employer issue, as it relates to the corporate respondents, constitutes, in the language of *Minott* , "relitigating an issue". In this appeal, the balance between finality of litigation and achieving justice between litigants should be struck in favour of the latter. The common employer issue relating to the corporate respondents should be determined on the merits.

(b) The merits

27 *For Your Eyes Only* was a simple entity, a single site nightclub in downtown Toronto. Yet, beneath the surface of lights, liquor and entertainment, there was a fairly sophisticated group of companies involved in the operation of the nightclub. Twin Peaks Inc. ("Twin Peaks") was the owner and lessor of the nightclub premises. The Landing Strip Inc. ("The Landing Strip") leased the premises from Twin Peaks. It also owned the trademark for *For Your Eyes Only* and held the liquor and adult entertainment licences. Downtown Eatery Limited ("Downtown Eatery") owned the chattels and equipment at the nightclub and operated it under a licence from The Landing Strip. Best Beaver paid the nightclub employees, including Alouche. In June 1993, all of these companies were owned and controlled by Bengro Corp. and Harrad Corp., the holding companies for Grosman and Grad.

28 The trial judge considered Alouche's common employer argument on the merits. He concluded that Downtown Eatery was "the most logical of the companies to be treated as a co-employer", but that this did not help Alouche because Downtown Eatery amalgamated with Best Beaver in September 1993, and there was nothing fraudulent or even suspicious about the amalgamation.

29 The trial judge then considered The Landing Strip:

> Counsel for Alouche suggests that Landing Strip Inc., which held the lounge license and the franchise trademark, would be logical co-employers. There is nothing in the record before me that would suggest that Alouche ever had a contractual relationship with Landing Strip Inc.

Then, speaking more generally, the trial judge observed that "there has been no holding out here by either the employee or the employer of joint and several liability of more than one company".

30 The common employer doctrine, in its common law context, has been considered by several Canadian courts in recent years. The leading case is probably *Sinclair v. Dover Engineering Services Ltd.* (1987), 11 B.C.L.R. (2d) 176 (B.C. S.C.) , aff'd (1988), 49 D.L.R. (4th) 297 (B.C. C.A.) (*"Sinclair"*). In that case, Sinclair, a professional engineer, held himself out to the public as an employee of Dover Engineering Services Ltd. ("Dover"). He was paid by Cyril Management Limited ("Cyril"). When Sinclair was dismissed, he sued both corporations. Wood J. held that both companies were jointly and severally liable for damages for wrongful dismissal. In reasoning that we find particularly persuasive, he said, at p. 181:

> The first serious issue raised may be simply stated as one of determining with whom the plaintiff contracted for employment in January of 1973. The defendants argue that an employee can only contract for employment with a single employer and that, in this case, that single entity was obviously Dover.
>
> I see no reason why such an inflexible notion of contract must necessarily be imposed upon the modern employment relationship. Recognizing the situation for what it was, I see no reason, in fact or in law, why both Dover and Cyril should not be regarded jointly as the plaintiff's employer. The old-fashioned notion that no man can serve two masters fails to recognize the realities of modern-day business, accounting and tax considerations.
>
> There is nothing sinister or irregular about the apparently complex intercorporate relationship existing between Cyril and Dover. It is, in fact, a perfectly normal arrangement frequently encountered in the business world in one form or another. Similar arrangements may result from corporate take-overs, from tax planning considerations, or from other legitimate business motives too numerous to catalogue.
>
> As long as there exists a sufficient degree of relationship between the different legal entities who apparently compete for the role of employer, there is no reason in law or in equity why they ought not all to be regarded as one for the purpose of determining liability for obligations owed to those employees who, in effect, have served all without regard for any precise notion of to whom they were bound in contract. What will constitute a sufficient degree of relationship will depend, in each case, on the details of such relationship, including such factors as individual shareholdings, corporate shareholdings, and interlocking directorships. The essence of that relationship will be the element of common control.

See also: *Bagby v. Gustavson International Drilling Co.* (1980), 24 A.R. 181 (Alta. C.A.) ; *Olson v. Sprung Instant Greenhouses Ltd.* (1985), 64 A.R. 321 (Alta. Q.B.) ; *Johnston v. Topolinski* (1988), 23 C.C.E.L. 285 (Ont. Dist. Ct.) ; *MacPhail v. Tackama Forest Products Ltd.* (1993), 50 C.C.E.L. 136 (B.C. S.C.) ; and *Jacobs v. Harbour Canoe Club Inc.*, [1999] B.C.J. No. 2188 (B.C. S.C. [In Chambers]) .

31 In Ontario, the common employer doctrine has been considered in several cases. In *Gray v. Standard Trustco Ltd.* (1994), 8 C.C.E.L. (2d) 46 (Ont. Bktcy.) , Ground J. said, at p. 47:

> . . . it seems clear that, for purposes of a wrongful dismissal claim, an individual may be held to be an employee of more than one corporation in a related group of corporations. One must find evidence of an intention to create an employer/employee relationship between the individual and the respective

corporations within the group.

32 In *Jones v. CAE Industries Ltd.* (1991), 40 C.C.E.L. 236 (Ont. Gen. Div.) ("*Jones"*), Adams J. reviewed many of the leading authorities and observed, at p. 249:

> The true employer must be ascertained on the basis of where effective control over the employee resides . . . I stress again that an employment relationship is not simply a matter of form and technical corporate structure.

33 *Sinclair*, *Jacobs v. Harbour Canoe Club Inc.* and *Jones* were all cases involving a 'paymaster' company closely connected with another corporate entity, with both being controlled by the same principals. In all three cases, the courts found that the other company was a common employer. Similarly, in the present appeal, Best Beaver served only as a paymaster for the employees of the nightclubs owned and operated by other Grad and Grosman companies. Accordingly, the question becomes, in Adams J.'s language in *Jones* , "where effective control over the employee resides".

34 In our view, in June 1993 when Alouche was dismissed, there was a highly integrated or seamless group of companies which together operated all aspects of the *For Your Eyes Only* nightclub. Twin Peaks owned the nightclub premises and leased them to The Landing Strip which owned the trademark for *For Your Eyes Only* and, significantly for a nightclub, held the liquor and entertainment licences. Downtown Eatery operated the nightclub under a licence from The Landing Strip and owned the chattels and equipment at the nightclub. Best Beaver served as paymaster for the nightclub employees. Controlling all of these corporations were Grad and Grosman and their family holding companies, Harrad Corp. and Bengro Corp.

35 Grad and Grosman could easily have operated the nightclub through a single company. They chose not to. There is nothing unlawful or suspicious about their choice. As Wood J. said in *Sinclair* , "it is a perfectly normal arrangement frequently encountered in the business world".

36 However, although an employer is entitled to establish complex corporate structures and relationships, the law should be vigilant to ensure that permissible complexity in corporate arrangements does not work an injustice in the realm of employment law. At the end of the day, Alouche's situation is a simple, common and important one - he is a man who had a job, with a salary, benefits and duties. He was fired - wrongfully. His employer must meet its legal responsibility to compensate him for its unlawful conduct. The definition of "employer" in this simple and common scenario should be one that recognizes the complexity of modern corporate structures, but does not permit that complexity to defeat the legitimate entitlements of wrongfully dismissed employees.

37 The trial judge focussed on the absence of a contract between Alouche and any of the potential common employers. With respect, we think this focus is too narrow. A contract is one factor to consider in the employer-employee relationship. However, it cannot be determinative; if it were, it would be too easy for employers to evade their obligations to dismissed employees by imposing employment contracts with shell companies with no assets.

38 The trial judge also observed that there was no holding out by the employer of joint and several liability of more than one company. Again, with respect, we do not attach much significance to this factor. After all, the contract of employment that Alouche signed was with *For Your Eyes Only* , which was only a name, not a legal entity.

39 In these circumstances, when he was wrongfully dismissed, Alouche did his best - he sued the company which had paid him. Later, it turned out that that company had no assets. Yet the nightclub continued in business, various companies continued to operate it and, presumably, Grad and Grosman continued to make money. In these circumstances, Alouche decided to try to collect the money to which a superior court of justice had determined he was entitled. In our view, the common employer doctrine provides support for his attempt.

40 In conclusion, Alouche's true employer in 1993 was the consortium of Grad and Grosman companies which operated *For Your Eyes Only* . The contract of employment was between Alouche and *For Your Eyes Only* which was not a legal entity. Yet the contract specified that Alouche would be "entitled to the entire package of medical extended health care and insurance benefits as available in our sister organization". The sister organization was not identified. In these circumstances, and bearing in mind the important roles played by several companies in the operation of the nightclub, we conclude that Alouche's employer in June 1993 when he was wrongfully dismissed was all of Twin Peaks, The Landing Strip, Downtown Eatery and Best Beaver. This group of companies functioned as a single, integrated unit in relation to the operation of *For Your Eyes Only* .

41 There is a final matter to be considered on the common employer issue. Alouche was dismissed in June 1993. There was a reorganization of Grad and Grosman companies in September 1993. A second reorganization took place in May 1996, three months before the trial in Alouche's wrongful dismissal action. The trial judge found that there was nothing nefarious about these reorganizations; they were undertaken for business reasons unrelated to Alouche's action. We see no reason to disagree with this conclusion.

42 The question which the reorganizations pose is whether Alouche's judgment, which we have determined should be enforced against all of the companies involved in June 1993 in the operation of *For Your Eyes Only* , should also be enforced against the successor or merged companies which have been created by the reorganizations.

43 We have no hesitation answering this question in the affirmative. Grad testified at the trial that he was very careful to protect the positions, seniority and benefits of current employees when he and Grosman were accomplishing the reorganizations. He said:

> Everyone had a job . . . Everyone that worked for one had a job in the other . . . No one would lose anything . . . The employees were not to lose anything, were not to be hurt.

44 This was, of course, admirable treatment of the current employees of the Grad and Grosman companies. It commends itself, in our view, as a just basis for consideration of Alouche's position after the reorganizations. If, as Grad explained, his current employees were not to be hurt in any way by the reorganizations, it seems obvious and fair that a similar result should flow for Alouche, a man who might also be a current employee but for the fact of his wrongful dismissal.

45 We conclude, therefore, that the list of the original common employers should be expanded to include the other corporate respondents.

(2) The oppression issue

46 Alouche contends that the conduct of the respondents, specifically the corporate reorganizations which resulted in Best Beaver ceasing to exist, was "oppressive" or "unfairly prejudicial" as those terms are used in the *Ontario Business Corporations Act* (*"OBCA"*). Section 248 of the *OBCA* provides:

> **248(1)** A complainant . . . may apply to the court for an order under this section.
>
> **(2)** Where, upon an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates,
>
>> *(a)* any act or omission of the corporation or any of its affiliates effects or threatens to effect a result;
>>
>> *(b)* the business or affairs of the corporation or any of its affiliates are, have been or are threatened to be carried on or conducted in a manner; or

> > *(c)* the powers of the directors of the corporation or any of its affiliates are, have been or are threatened to be exercised in a manner,

> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of.

A “complainant”, in addition to being a current or former shareholder, director or officer of the company, is defined in s. 245 to include:

> *(c)* any other person who, in the discretion of the court, is a proper person to make an application under this Part.

Although it appears from the pleadings and the factum that Alouche is advancing the oppression argument against all of the respondents, in oral argument counsel made it clear that the focus of Alouche’s claim on this issue is the respondents Grad and Grosman.

47 As a preliminary matter, we note that there is no question of *res judicata* or estoppel with respect to the appellant’s oppression claim. There was nothing about this claim in the pleadings in the first action, the trial judge in the second action dealt with the claim on the merits, and the respondents in this appeal do not contend that the oppression claim was barred by these doctrines.

48 Turning to the merits, in the Agreed Statement of Facts, facts pertaining to the oppression remedy are sparse. These facts are: Grad and Grosman were directors and officers of Best Beaver at all material times; in September 1993, there was a corporate reorganization of Best Beaver and several of the other corporate respondents in response to apprehended union activities; and in or about March 1996, Best Beaver ceased operations.

49 In his trial testimony, Grad stated that because the “union threat” had disappeared in 1996 there was no need to retain Best Beaver as a separate company. This resulted in Best Beaver ceasing operations in March 1996, followed by a corporate reorganization in May 1996. He testified that these events were not influenced by the pending litigation involving Alouche. Indeed, it was Grad’s belief that Best Beaver would win the lawsuit. He described what occurred as “a business decision”. Grad confirmed that he and Grosman were the owners of Best Beaver and all of the corporate respondents. He also confirmed that “the role and function” of Best Beaver were to pay the employees of the corporations that he and Grosman owned and that the company carried out this role “based on advice from [his] accountants”.

50 Although Grad testified that Alouche’s pending claim did not influence his decision to terminate the operations of Best Beaver in March 1996, he acknowledged that at that time a summer trial date had been fixed for the wrongful dismissal trial. He stated that he discharged Best Beaver’s lawyer about two weeks before the trial began “because there was no money in the account and [Best Beaver] could not afford to pay” the lawyer. At the trial, Grad acted as Best Beaver’s legal representative.

51 Syd Bojarski (”Bojarski”) was a partner in the accounting firm that acted for the corporate respondents and Grad and Grosman. He provided extensive evidence concerning the corporate and financial affairs of these entities. He testified that in each year of its existence, Best Beaver earned a profit. He agreed with counsel for Alouche that Best Beaver’s accumulated profits were available to pay “whatever obligations [Best Beaver] had”. He further agreed that if that company had continued its operations its accumulated profit could have been applied “to satisfy unexpected claims arising from employment [contracts]”.

52 In the following questions and answers Grad was asked to comment on Bojarski’s evidence:

> Q. Mr. Bojarski gave evidence that it was the role and function of Best Beaver Management as a corporation to pay employees until, of course, until it ceased to do that. But that was its obligation, correct?

> A. Yes.
>
> Q. Do you agree with Mr. Bojarski that its obligation was also to pay any claims that individual employees might have against it as employer?
>
> A. It was responsible for all the employees and the management of those people.

53 In dismissing Alouche's claim for an oppression remedy, the trial judge accepted Grad's reasons for the corporate reorganizations of September 1993 and May 1996 and for Best Beaver's cessation of operations in March 1996. He provided the following reasons for dismissing Alouche's claim for an oppression remedy:

> In the case before me, if I had been satisfied that the amalgamation of 1993 or the reorganization of 1996 had been undertaken with the intention of depriving Mr. Alouche of the opportunity to recover against Best Beaver, then an oppression remedy might have been appropriate. In the circumstances where the amalgamation and reorganization took place before he obtained the status of a judgment creditor and those actions were not undertaken for the purpose of depriving him of recovery of judgment, then it would appear that the oppression remedy is not appropriate.

54 At trial, C. Campbell J. also dismissed a claim by Alouche based on the submission that the May 1996 corporate reorganization constituted a fraudulent conveyance resulting in Best Beaver having no assets in the event that he recovered judgment against it. No appeal was taken from this aspect of the judgment. However, the following findings of fact made by the trial judge in deciding this issue are relevant to the oppression remedy issue:

> As noted previously, I am satisfied on the evidence, the reorganization was not entered into for the purpose or with the intent of depriving Alouche from recovering on an anticipated judgment.
>
> I do recognize, however, that the effect of the reorganization left Best Beaver essentially as a non-operating company and that Grad took advantage of this, when faced with the pending trial (by discharging counsel) and by non-payment of the judgment.

55 In our view, this case is similar to *Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc.* (1995), 131 D.L.R. (4th) 399 (Ont. Gen. Div. [Commercial List]), varied (1998), 40 O.R. (3d) 563 (Ont. C.A.) "*Sidaplex-Plastics")* . As in *Sidaplex-Plastics* , Alouche, as a judgment creditor of a corporate party, seeks an oppression remedy in the absence of bad faith or want of probity on the part of individuals who were the directors and shareholders of the corporation. As in *Sidaplex-Plastics* , the corporation, Best Beaver, is no longer in business, having ceased operations in March 1996, at a time when a trial date of August 1996 had been fixed for the wrongful dismissal action against it. Thus, Alouche seeks to invoke the oppression remedy provisions of the *OBCA* against Grad and Grosman in order to rescue himself from the inability of Best Beaver to pay his judgment which resulted from their decision to terminate its business operations and to render it without assets capable of responding to a possible judgment against it.

56 The application of the principles governing s. 248(2) of the *OBCA* to the trial judge's findings of fact and to the evidence in the trial record leads to the conclusion that the trial judge erred in failing to grant an oppression remedy against Grad and Grosman. In our view, the trial judge failed to appreciate that the "oppressive" conduct that causes harm to a complainant need not be undertaken with the intention of harming the complainant. Provided that it is established that a complainant has a reasonable expectation that a company's affairs will be conducted with a view to protecting his interests, the conduct complained of need not be undertaken with the intention of harming the plaintiff. If the effect of the conduct results in harm to the complainant, recovery under s. 248(2) may follow.

57 In *Sidaplex-Plastics* , Blair J. provided a careful and thorough analysis of the principles governing the award of an oppression remedy that was accepted by this court. At p. 403, he stated that it "is well established . .

. that a creditor has status to bring an application as a complainant, pursuant to s. 245(c).” At pp. 403-404, he added:

> Moreover, while some degree of bad faith or lack of probity in the impugned conduct may be the norm in such cases, neither is essential to a finding of “oppression” in the sense of conduct that is unfairly prejudicial to or which unfairly disregards the interests of the complainant, under the OBCA.

Blair J. continued, at p. 404:

> What the OBCA proscribes is “any act *or omission* “ on the part of the corporation which “*effects* “ a result that is unfairly prejudicial to or that unfairly disregards the interests of a creditor. [Emphasis in original.]

58 At p. 404, Blair J. adopted the following factors to be assessed in considering whether an oppression remedy should lie, as described by McDonald J. in *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 40 B.L.R. 28 (Alta. Q.B.) at 57:

> More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: the protection of the underlying expectation of a creditor in its arrangement with the corporation, the extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts, and the detriment to the interests of the creditor. The elements of the formula and the list of considerations as I have stated them should not be regarded as exhaustive. Other elements and considerations may be relevant, based upon the facts of a particular case.

59 In s. 248(2)(c) of the *OBCA* , the legislature has included the exercise of the powers of a company’s directors in targeting the kinds of conduct encompassed by an oppression remedy. In this regard, Blair J. stated, at pp. 405-406:

> Courts have made orders against directors personally, in oppression cases: see, for example, *Canadian Opera Co. v. Euro-American Motor Cars, supra; Prime Computer of Canada Ltd. v. Jeffrey, supra; Tropxe Investments Inc. v. Ursus Securities Corp* ., [1993] O.J. No. 1736 (QL) (Gen. Div.) [summarized 41 A.C.W.S. (3d) 1140]. These cases, in particular, have involved small, closely held corporations, where the director whose conduct was attacked has been the sole controlling owner of the corporation and its sole and directing mind; and where the conduct in question has redounded directly to the benefit of that person.

60 Although the trial judge found that the cessation of Best Beaver’s operations in March 1996 and the subsequent corporate reorganization were not undertaken with the intention of depriving Alouche of the ability to recover against Best Beaver if he were to succeed in his forthcoming action against the company, he went on to find that the effect of this conduct “left Best Beaver essentially as a non-operating company and that Grad took advantage of this, when faced with the pending trial (by discharging counsel) and by non-payment of the judgment”. In our view, there is no question that the acts of Grad and Grosman, as the directors of Best Beaver, in causing the company to go out of business and transferring its assets to other companies within the group of companies they owned and operated in the spring of 1996 in the face of a trial scheduled to begin a few months later, effected a result that was unfairly prejudicial to, or that unfairly disregarded the interests of, Alouche as a person who stood to obtain a judgment against Best Beaver. Moreover, there was nothing that Alouche could have done to prevent the effective winding-up of Best Beaver.

61 In our view, the evidence of Bojarski, with which Grad agreed, is relevant to whether an oppression remedy is appropriate. From Bojarski’s testimony, it is clear that when Best Beaver went out of business it was profitable and that its accumulated profits were available to satisfy any claims arising from employment contracts. The inference can be drawn from this evidence that even though it was abundantly clear to Grad that Alouche’s pending claim might result in a judgment against Best Beaver, he took no steps to ensure that Best Beaver retained a reserve to meet that contingency. Rather, believing that Alouche’s action would fail, he discharged the company’s lawyer and personally assumed its defence at trial. As in *Sidaplex-Plastics* at p. 405,

it was Alouche who was entitled to be protected, and, in our view, it was Grad and Grosman who had the obligation to ensure that such protection continued. See Christopher C. Nicholls, "Liability of Corporate Officers and Directors to Third Parties" (2001), 35 C.B.L.J. 1 at 30 *et seq.*

62 In our view, there are additional inferences that can be drawn from the trial judge's findings of fact and from the evidence at the trial. It was the reasonable expectation of Alouche that Grad and Grosman, in terminating the operations of Best Beaver and leaving it without assets to respond to a possible judgment, should have retained a reserve to meet the very contingency that resulted. In failing to do so, the benefit to Grad and Grosman, as the shareholders and sole controlling owners of this small, closely held company, is clear. By diverting the accumulated profits of Best Beaver to other companies that they owned, they were able to insulate these funds from being available to satisfy Alouche's judgment.

63 For the foregoing reasons, it is our opinion that Alouche has demonstrated his entitlement to an oppression remedy against Grad and Grosman.

E. DISPOSITION

64 We would allow the appeal against all of the respondents. The appellant is entitled to recover from the respondents the amounts he was awarded in the wrongful dismissal action, namely damages of $59,906.76, pre-judgment interest of $8,608.36 and assessed costs of $15,387.79 totalling $83,902.91, together with post-judgment interest thereon from the date of Festeryga J.'s judgment to the date of this order and post-judgment interest thereafter. He is also entitled to recover his costs of the second trial before C. Campbell J. and his costs of the appeal.

Appeal allowed.

Footnotes

1 Downtown Eatery (1993) Ltd. also named Her Majesty the Queen in Right of Ontario as a defendant, presumably on the basis of its alleged responsibility for the sheriffs. This component of the action was subsequently discontinued.

2 In his factum, the appellant identified a separate ground of appeal as the trial judge's failure to permit Alouche to proceed by what he called an 'alter ego' action. In oral argument, the appellant suggested that the common employer doctrine is a sub-species of the alter ego doctrine. Like the trial judge, we do not consider the injection of the nebulous concept of alter ego corporations useful. The common employer doctrine is well-recognized in Canadian law and provides a sound and straightforward foundation on which to assess the corporate relationship issue in this appeal.

1979 CarswellOnt 248
Ontario Supreme Court, In Bankruptcy

Flax Investment Ltd., Re

1979 CarswellOnt 248, [1979] 3 A.C.W.S. 807, 14 C.P.C. 184, 32 C.B.R. (N.S.) 65

Re FLAX INVESTMENTS LIMITED

Saunders J.

Heard: November 23, 1979
Judgment: November 26, 1979
Docket: No. 15194

Counsel: *C. H. Morawetz, Q.C.*, for petitioning creditor.
T. G. Gain, for debtor.

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

Headnote

Bankruptcy --- Bankruptcy and insolvency jurisdiction — Jurisdiction of Courts — Jurisdiction of Bankruptcy Court — Territorial jurisdiction — General

Bankruptcy petitions for receiving orders — Formalities — Place of filing — Locality of debtor — Principal place of carrying on business — Principal place of residence of debtor — The Bankruptcy Act, s. 2.

The debtor corporation was an Ontario corporation having its head office in the city of Toronto in the province of Ontario. The accounting books and records were in Toronto. The president of the company, who was also one of its two beneficial shareholders, resided in Toronto, had his office in Toronto and did business in Toronto on behalf of the company. The other beneficial shareholder resided in Manitoba. The company was registered to do business in Manitoba, and it carried on its farming operations in Manitoba. The question arose as to where the petition should be filed.

Held:

The petition was properly filed in Ontario.

The debtor company did not carry on business in the year preceding the petition in Ontario, but the principal place where the debtor resided during the year immediately preceding the date of the petition was in the province of Ontario.

A petitioning creditor in considering in what court to bring his petition can choose to bring it on the basis of either para. (*a*) or para. (*b*) of the definition of “locality of the debtor” in s. 2 of the Bankruptcy Act, and only if there is no principal place as described in either paragraph may para. (*c*) of the definition section be resorted to. In other words, it is possible in certain cases to bring a petition in either one of two courts.

Annotation

The import of this decision is far-reaching in our modern economy with multi-national companies carrying on business actively in every province of Canada. One must keep in mind, in selecting the forum, the test set out by

the court in *Re Solloway*, 19 C.B.R. 350, [1938] 4 D.L.R. 12, affirmed [1939] O.R. 295, 20 C.B.R. 309, [1939] 2 D.L.R. 617 (C.A.). The present decision really follows *Re Malartic Hygrade Gold Mines Ltd.; Lionel Berube Inc. v. Minaco Equip. Ltd.* (1966), 10 C.B.R. (N.S.) 34 (Ont.). The test seems to be as set out in s. 2 ("locality of a debtor") of the Bankruptcy Act, namely, alternatively, where the debtor carried on business *or* has resided, and only if the petitioner cannot fit himself therein, then he should look to para. (*c*) of that definition in s 2. In Quebec, where there is more than one registrar or bankruptcy district and the residence factor does not seem to apply to a specific district where the debtor resides but to Quebec as a whole (see *Re Boily v. McNulty*, 8 C.B.R. 248, affirmed 42 Que. K.B. 425, 8 C.B.R. 250, which was affirmed [1928] S.C.R. 182, 8 C.B.R. 565, [1928] 1 D.L.R. 926), one should look to the combined effect of paras. (*a*) and (*b*) of the said definition in s. 2 as opposed to the residence test only (see *Re Rotenberg (Janet Frocks)* (1941), 22 C.B.R. 433 (Ont.)).
The learned bankruptcy judge states that the issue of locality is "a procedural matter under the Bankruptcy Act which must be considered by a petitioner in ascertaining the court in which to launch his petition". However, it is submitted that by the use of the word "shall" the directions of the Act are mandatory as opposed to merely procedural. In any event, if the petitioner chooses the wrong place of filing, he can obtain relief under s. 157(10) of the Bankruptcy Act.

M.B. Page, Q.C.

Table of Authorities

Cases considered:

Malartic Hygrade Gold Mines Ltd., Re; Lionel Berube Inc. v. Minaco Equip. Ltd. (1966), 10 C.B.R. (N.S.) 34 (Ont.) — *applied*

Rotenberg (Janet Frocks), Re (1941), 22 C.B.R. 433 (Ont.) — *not agreed with*

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3 ss. 2, 25(5).

Words and phrases considered:

LOCALITY OF DEBTOR

The definition of the "locality of a debtor" presents some interpretative difficulty. The references to the "locality of the debtor" in s. 25(5) [of the *Bankruptcy Act*, R.S.C. 1970, c. B-3] and "the principal place" in the definition suggest that a debtor may have but one locality. On the other hand, the principal place described in para.(a) of the definition may and often is different from the principal place as described in para.(b). In the case of *re Rotenberg (Janet Frocks)* (1941), 22 C.B.R. 433 (Ont.), the then assistant master, in considering a slightly different definition of the section, held in effect that primary consideration should be given to para.(a) and, if that is not conclusive, the residence of the debtor may provide jurisdiction. With respect, I do not agree. There is nothing in the language of the definition which gives primary position, words could have been inserted in para. (b) such as "in cases not coming within paragraph (a)", as was done in drafting para.(c).

RESIDENCE OF A COMPANY

The residence of the company presents some difficulty. A corporation is resident where its seat of management is located and a corporation may be resident in more than one place.

Petition for receiving order.

***Saunders J.* (orally):**

1 Murray Hunter petitions this court that Flax Investments Limited ("the company") be adjudged bankrupt and that a receiving order be made in respect of its property.

2 In the dispute filed on behalf of the company it was admitted that there was a debt owing to Mr. Hunter, and the evidence established that such debt was in excess of $1,000 and was due and unpaid at the date of the petition. Evidence was presented of debts owing to other creditors. Mrs. Streeter, the president and sole owner of Streeter Power Sales and Services Limited, gave evidence as to debts owing to that company for the rental of equipment and the sale of parts. Mr. Tikal, a solicitor in the city of Toronto, gave evidence as to rentals owing to lessors of premises leased to the company, including rentals owing to him personally as a lessor. Mr. Fisher, a chartered accountant, gave evidence as to overdue payment of accounts rendered by him, and finally the petitioning creditor, Mr. Hunter, gave evidence as to the indebtedness of the company to him. Mr. Streeter did not have copies of his invoices, but his testimony was uncontradicted that the equipment and parts that he provided were for the account of the company and not for any other customer. Certain of the evidence of Mr. Tikal was based on information supplied to him by others. Mr. Fisher's invoices were submitted to the company and discussed with both principals of the company. No evidence was called on behalf of the company to contradict the evidence given by its creditors. On the basis of the evidence I am satisfied that the petitioning creditor has established that the company had at the date of the petition ceased to meet its liabilities generally as they become due.

3 The company submits that the petition has been filed in the wrong court. Section 25(5) of the Bankruptcy Act, R.S.C. 1970, c. B-3, provides as follows:

> (5) The petition shall be filed in the court having jurisdiction in the locality of the debtor.

4 And s. 2 contains the following definition of "locality of a debtor":

> 'locality of a debtor' means the principal place
>
> (*a*) where the debtor has carried on business during the year immediately preceding his bankruptcy,
>
> (*b*) where the debtor has resided during the year immediately preceding his bankruptcy,
>
> (*c*) in cases not coming within paragraph (*a*) or (*b*) where the greater portion of the property of such debtor is situated.

5 The company was incorporated under the Ontario Business Corporations Act, R.S.O. 1970, c. 53, on 27th January 1978. The articles of incorporation state that the head office of the company is at the city of Toronto in the municipality of Metropolitan Toronto. The address of the head office is stated as suite 2702, 390 Bay Street, which was the then address of the solicitors who incorporated the company.

6 There was produced a minute book of the company which contained draft by-laws and resolutions. None had been signed, and no entries had been made on the registers or ledgers. Under its incorporating statute the head office of the company must be in Ontario, and there was no evidence that the location in Toronto had ever been changed. In fact, the address in that city was not changed even though the solicitors who incorporated the company no longer occupied the premises.

7 The only beneficial shareholders of the company at any time appear to have been Murray Hunter, the petitioning creditor, and Square One Commodities Incorporated ("Square One"). It would appear, but was not established, that Square One is a corporation which is owned by either Milton Procter or by members of his family or by both Mr. Procter and members of his family. As previously indicated, there is no resolution allotting or transferring shares to Mr. Hunter or to Square One and no evidence that share certificates were ever issued to them. There was also no evidence that officers of the company were ever formally appointed or

directors formally elected. There was an agreement, filed as Ex. 18, which was executed by Mr. Hunter, Square One, Mr. Procter and the company and in which the shareholdings of Mr. Hunter and Square One are confirmed by them with the share interest of Square One being held for it in trust by Mr. Cummings, a Manitoba solicitor. It is agreed by the parties that the directors of the company are Mr. Hunter and Mr. Procter, with Mr. Hunter holding the office of president and Mr. Procter holding the office of secretary.

8 The purposes for the incorporation of the company as set out in its articles are, first, of a real estate or land trading nature and, second, of a farming nature. As described by Mr. Hunter, the enterprise was a joint venture entered into by Mr. Hunter and Mr. Procter through the vehicle of the company. It was proposed to earn income from farming in Manitoba and also to engage in land transactions in that province. Hunter was to provide the initial capital and contracts with potential investors, and Square One was to provide the services of Procter, who knew the farming business and the people in the area and could assist both aspects of the proposed operation. The farm operation commenced in the 1978 season, and Mr. Hunter made advances of funds in the spring and early summer of that year. It would also appear from the evidence that sometime in the year 1978 a transaction or transactions of a land trading nature were completed which resulted in an income to the company of approximately $26,000. In the fall of 1978 Mr. Hunter accompanied by Mr. Fisher went out to Manitoba to obtain information as to the farm operations and returned following that meeting with the books and accounts of the company, which they obtained from Square One. Sometime following the commencement of 1979 there was a falling-out between the principals, as according to Mr. Hunter the manager had failed to properly account for the proceeds of the sale of the farm products. The differences between the parties could not be resolved, and the bankruptcy petition was instituted on 28th August.

9 It would appear that during the year preceding the petition the farm operations were continued in Manitoba. In the fall of 1978 Hunter made efforts to negotiate land transactions which involved correspondence and meetings with potential investors, trips to Manitoba and some showing of properties. No transactions were completed, and after his falling-out with the manager it is clear that Hunter discontinued his efforts. It would be fair to say that, on the evidence, in the last year the farming operations engaged substantially more of the time of the principals than the real estate operations.

10 Mr. Hunter resides and has an office in Toronto but spends a good deal of his time each year in Florida. It would appear that Mr. Procter lives and works in Manitoba, and there is no evidence of his ever having been in Ontario.

11 Against this background it is necessary to consider the issue as to whether the Ontario court has jurisdiction to hear this petition. The definition of the "locality of a debtor" presents some interpretative difficulty. The references to the "locality of the debtor" in s. 25(5) and "the principal place" in the definition suggest that a debtor may have but one locality. On the other hand, the principal place described in para. (*a*) of the definition may and often is different from the principal place as described in para. (*b*). In the case of *Re Rotenberg (Janet Frocks)* (1941), 22 C.B.R. 433 (Ont.), the then assistant master, in considering a slightly different definition of the section, held in effect that primary consideration should be given to para. (*a*) and, if that is not conclusive, the residence of the debtor may provide jurisdiction. With respect, I do not agree. There is nothing in the language of the definition which gives a primary position to para. (*a*) over para. (*b*). To achieve such primary position, words could have been inserted in para. (*b*) such as "in cases not coming within paragraph (*a*)", as was done in drafting para. (*c*).

12 In my opinion the petitioning creditor in considering where to bring his petition can choose to bring it on the basis of either para. (*a*) or para. (*b*), and only if there is no principal place as described in either of such paragraphs may para. (*c*) be resorted to. In other words, it is my view that it is possible in certain cases to bring a petition in either one of two courts.

13 During the year preceding the filing of the petition the company conducted farming operations in Manitoba and certain activities concerning proposed real estate operations in both Manitoba and outside of Manitoba. I am not certain in the context of carrying on business what is meant by the word "place", but I am satisfied on the evidence that the principal place where the company carried on business in the year preceding

the petition was not in the province of Ontario.

14 The residence of the company presents some difficulty. A corporation is resident where its seat of management is located, and a corporation may be resident in more than one place. In this case the head office of the company was at all times in Toronto. The accounting books and records were moved to Toronto in the fall of 1978. Mr. Hunter, the president of the company and one of its two beneficial shareholders, resided in Toronto, had his office in Toronto and did business in Toronto on behalf of the company, although he also spent a substantial part of the year in Florida and some time in Manitoba. Mr. Procter, the other director and the secretary of the company, resided in Manitoba, and, as I have said, there is no evidence that he was ever in Toronto during the year. The company was registered to do business in Manitoba, and it leased land and equipment in Manitoba for its farming operations which were managed by Square One.

15 It is to be noted that the issue of locality is not concerned with a tax or other liability of the company, it is a procedural matter under the Bankruptcy Act which must be considered by a petitioner in ascertaining the court in which to launch his petition. In such a context certainty is a desirable factor. It is difficult for a petitioning creditor, although perhaps not this particular petitioning creditor, before bringing his petition to embark on a fruitful inquiry as to the business, residence and property of the debtor. In this case the head office, books of account and the president were all located in Toronto. The remaining officer and director resided in Manitoba, but there is no evidence that the directors' or shareholders' meetings were ever held in Manitoba or in fact at any place at any time. There were two meetings in Manitoba during the year which principally concerned the farm operations, but they would appear to have been between Hunter on behalf of the company and Procter on behalf of Square One, the manager of the company. The farm inventory and leasehold property were located in Manitoba and managed by a third party, but it is to be noted that the definition of "locality" draws a distinction between residence and the location of property.

16 I find on the evidence that the principal place where the debtor resided during the year immediately preceding the date of the petition was the city of Toronto. Such a finding is consistent with the tests applied in *Re Malartic Hygrade Gold Mines Ltd.; Lionel Berube Inc. v. Minaco Equip. Ltd.* (1966), 10 C.B.R. (N.S.) 34 (Ont.).

17 The receiving order will accordingly issue, and the Clarkson Company Limited will be the trustee.

18 In have endorsed the record as follows.

> For reasons given, receiving order to issue. The Clarkson Company is appointed as trustee. Costs of the petitioning creditor and interim receiver to be paid out of bankrupt estate forthwith, after taxation.

Petition granted.

2018 ABQB 356
Alberta Court of Queen's Bench

Alberta Treasury Branches v. COGI Limited Partnership

2018 CarswellAlta 847, 2018 ABQB 356, [2018] A.W.L.D. 1958, [2018] A.W.L.D. 2002, [2018] A.W.L.D. 2024, 291 A.C.W.S. (3d) 647, 60 C.B.R. (6th) 138

Alberta Treasury Branches (Plaintiff) and COGI Limited Partnership, Canadian Oil & Gas International Inc., and Conserve Oil Group Inc. by its Receiver and Manager MNP Ltd. (Defendants / Applicants) and Firenze Energy Ltd. (Respondent / Cross-Applicant)

K.M. Horner J.

Judgment: May 1, 2018
Docket: Calgary 1501-12220

Counsel: G. Brian Davison, Q.C., Ryan Algar, for COGI Limited Partnership et al
James Hanley, for Firenze Energy Ltd.
Gunnar Benediktsson, for Crescent Point Energy Corp.
Ashley Garbe, for Alberta Energy Regulator

Subject: Civil Practice and Procedure; Contracts; Insolvency; Natural Resources

Headnote

Equity --- Equitable doctrines — Equitable set-off
C Inc. and F Ltd. were joint owners and operators of oil and gas properties in Alberta and Saskatchewan — C Inc. was placed into receivership in October 2015 and stay of proceedings was imposed — F Ltd. assumed role of operator of properties under relevant joint operating agreements — Operatorship transfer order was made January 5, 2016 but due to objection raised by provincial energy regulator F Ltd. did not actually become operator until effective transfer date of September 1, 2016 — During those intervening months C Inc. continued as operator — Receiver claimed that $849,208.44 was owed by F Ltd. to C Inc. under agreements — F Ltd. took position that its indebtedness should be set off against debts it claimed were owed to it by C Inc. — Receiver brought application for payment of amounts owing to C Inc. under agreements — F Ltd. brought cross-application for contractual and/or equitable set-off and for lifting of stay of proceedings made as part of receivership order — Application granted in part; cross-application dismissed — Between operatorship transfer order and effective transfer date C Inc. continued to exercise duties of operator and also bore costs and liabilities associated with operatorship — F Ltd. was aware that C Inc. continued to pay those costs during that time — F Ltd. was retroactively seeking contractual benefits of operatorship without having assumed any of burdens — Unique status of operatorship and ensuring proper function of joint operating agreements in insolvency situations militated against allowing F Ltd. to advance its claims in equitable set-off — F Ltd. did not provide sufficient evidence that it was likely to be materially prejudiced by stay of proceedings or that there was equitable basis to lift it — C Inc.'s failure to pay its portion of operating costs was risk that every operator had to endure when faced with insolvency of joint operator and did not constitute material prejudice or equitable grounds sufficient to justify lifting stay — F Ltd. should not be able to retain funds to satisfy its own claims at expense of C Inc.'s other creditors who might be equally entitled to funds.

Bankruptcy and insolvency --- Bankruptcy and receiving orders — Effect of order
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Natural resources --- Oil and gas — Exploration and operating agreements — Joint operating agreement
C Inc. and F Ltd. were joint owners and operators of oil and gas properties in Alberta and Saskatchewan — C Inc. was placed into receivership in October 2015 and stay of proceedings was imposed — F Ltd. assumed role of operator of properties under relevant joint operating agreements — Operatorship transfer order was made January 5, 2016 but due to objection raised by provincial energy regulator F Ltd. did not actually become operator until effective transfer date of September 1, 2016 — During those intervening months C Inc. continued as operator — Receiver claimed that $849,208.44 was owed by F Ltd. to C Inc. under agreements — F Ltd. took position that its indebtedness should be set off against debts it claimed were owed to it by C Inc. — Receiver brought application for payment of amounts owing to C Inc. under agreements — F Ltd. brought cross-application for contractual and/or equitable set-off and for lifting of stay of proceedings made as part of receivership order — Application granted in part; cross-application dismissed — Between operatorship transfer order and effective transfer date C Inc. continued to exercise duties of operator and also bore costs and liabilities associated with operatorship — F Ltd. was aware that C Inc. continued to pay those costs during that time — F Ltd. was retroactively seeking contractual benefits of operatorship without having assumed any of burdens — Unique status of operatorship and ensuring proper function of joint operating agreements in insolvency situations militated against allowing F Ltd. to advance its claims in equitable set-off — F Ltd. did not provide sufficient evidence that it was likely to be materially prejudiced by stay of proceedings or that there was equitable basis to lift it — C Inc.'s failure to pay its portion of operating costs was risk that every operator had to endure when faced with insolvency of joint operator and did not constitute material prejudice or equitable grounds sufficient to justify lifting stay — F Ltd. should not be able to retain funds to satisfy its own claims at expense of C Inc.'s other creditors who might be equally entitled to funds.

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Statutes considered:

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s. 49 — pursuant to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

APPLICATION by receiver for payment of amounts owing under terms of joint operating agreements; CROSS-APPLICATION by current operator for contractual and/or equitable set-off and for lifting of stay of proceedings.

***K.M. Horner J.*:**

I. Introduction

1 This is an application and cross-application relating to the operation of certain jointly owned oil and gas producing properties following the insolvency of one of the Joint-Operators. The Applicant/Cross-Respondent, MNP Ltd. (the "*Receiver*"), acts as the receiver and manager for the insolvent Joint-Operator, COGI Limited Partnership and Canadian Oil & Gas International Inc. (together, "*COGI*"). The Respondent/Cross-Applicant, Firenze Energy Ltd. ("*Firenze*"), is the current Operator under the relevant joint operating agreements.

2 The Receiver is seeking, among other things, $849,208.44, which it claims is the amount owed by Firenze to COGI due to the operation of the jointly owned oil and gas properties. Meanwhile, Firenze is seeking to have its indebtedness set-off against debts it claims are owed by COGI. Firenze is also seeking to lift the stay of proceedings that currently prevents it from enforcing the payment of what it claims are COGI's share of the costs arising from the operation of the jointly owned oil and gas properties.

3 For the reasons that follow, I grant the Receiver's application in part and dismiss Firenze's cross-application.

II. Background

A. Relationship Between COGI and Firenze

4 COGI and Firenze are (or were) joint owners and operators of oil and gas properties in the Carmangay, Joffre, Nevis/Claresholm, Marten Creek, and Gull Lake areas of Alberta, as well as in Weyburn, Saskatchewan. Pursuant to the Marten Creek and Gull Lake joint operating agreements, COGI and Firenze are 50% working interest partners in those two properties. COGI originally acted as Operator under the Marten Creek and Gull Lake joint operating agreements.

5 The Marten Creek and Gull Lake joint operating agreements both adopt the 1990 CAPL Operating Procedure ("*CAPL 1990*"), which governs the relationship between the parties. In the current circumstances, the most relevant provisions of CAPL 1990 are Articles 202(a), 505(b), 1201, and 1901-02:

(a) Article 202(a) provides for the replacement of the Operator upon bankruptcy, insolvency, or receivership.

(b) Article 505(b) allows the Operator to contractually set-off debts owed by the Joint-Operator if the Joint-Operator fails to pay its portion of the operating expenses. It also prevents a Joint-Operator from claiming set-off against the Operator.

(c) Article 1201 allows the Operator to initiate the procedure for abandoning wells by issuing an abandonment notice to the Joint-Operator, which in effect proposes to abandon certain wells and divide the costs of doing so equally between the parties.

(d) Articles 1901 and 1902 allow the Operator to classify the Joint-Operator as a delinquent party if the Joint-Operator cannot be located or contacted. This classification allows the Operator to withhold the delinquent party's operational proceeds of sale in trust, as well as to recover certain outstanding joint operating expenses from those trust funds.

B. COGI's Insolvency and the Marten Creek/Gull Lake Properties

6 In March 2015, Firenze stopped paying its share of the operating costs for the Marten Creek and Gull Lake properties.

7 On August 28, 2015, Romaine J. granted an order providing COGI with protection from its creditors pursuant to the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*].

8 On October 26, 2015, Macleod J. granted an order placing COGI in receivership and appointing MNP Ltd. as receiver and manager (the "*Receivership Order*"). Paragraph 10 of the Receivership Order imposes a stay of proceedings that precludes creditors from enforcing "all rights and remedies" against COGI, which specifically includes "set-off rights."

9 On December 23, 2015, COGI filed an assignment into bankruptcy pursuant to section 49 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*]. MNP Ltd., as receiver and manager, was appointed as trustee of COGI's estate. The Receiver subsequently retained Niven Fischer Energy Services Inc. ("*Niven Fischer*") to manage COGI's oil and gas assets.

10 On January 5, 2016, I granted a consent order whereby Firenze invoked Article 202(a) of CAPL 1990 in order to replace COGI as Operator under the Marten Creek and Gull Lake joint operating agreements (the "*Operatorship Transfer Order*"). However, the Alberta Energy Regulator (the "*AER*") subsequently objected to the transfer of the relevant well licenses from COGI to Firenze. As a result, COGI continued to act as Operator for several months after the Operatorship Transfer Order was issued.

11 On April 12, 2016, the Receiver demanded payment for what it claims Firenze owes to COGI. Firenze rejected the Receiver's demand on the grounds that it had set-off rights against COGI that significantly reduced the claimed amount.

12 On September 1, 2016, the transfer of most of COGI's well licences became effective and Firenze assumed the role of Operator (the "*Effective Transfer Date*"). Although seven wells remain licenced to COGI, Firenze still acts as Operator for those wells. Much of the $849,208.44 claimed by the Receiver represents the overheard costs incurred while COGI remained Operator between the time of the Operatorship Transfer Order and the Effective Transfer Date.

13 I note that following the AER's objection to the license transfers, the Receiver and Firenze discussed the feasibility of Firenze becoming Operator prior to the transfer of the licences. However, nothing was ever agreed between the parties. Further, at no time did Firenze come back before this Court in an attempt to enforce the Operatorship Transfer Order on notice to the AER prior to the Effective Transfer Date.

14 In October 2016, Firenze issued abandonment notices to the Receiver for 29 wells on the Marten Creek and Gull Lake properties that had become uneconomic or were previously suspended (the "*Abandonment Notice*"). This abandonment process was done in accordance with Article 1201 of CAPL 1990 and Firenze duly sought COGI's share of the abandonment costs.

15 The amounts demanded by Firenze as a result of the Abandonment Notice included speculative future costs that had yet to be incurred. The Receiver responded by informing Firenze that issuing the Abandonment Notice represented the improper invocation of a contractual right that was stayed pursuant to paragraph 10 of the Receivership Order.

16 On November 1, 2016, Firenze issued a Notice to Revoke Take-in-Kind, which retroactively revoked COGI's right to take its production in kind from the Marten Creek and Gull Lake properties (the "*Revocation Notice*"). In taking this action, Firenze again purported to invoke its contractual rights pursuant to Articles 1901 and 1902 of CAPL 1990. This process was effected by classifying COGI as a delinquent party, which allowed Firenze to hold COGI's portion of the proceeds of sale from the Marten Creek and Gull Lake properties in trust.

C. The Carmangay, Joffre, Nevis/Claresholm, and Weyburn Properties

17 Part of the $849,208.44 claimed by the Receiver includes pre-receivership amounts related to the operation of the Carmangay, Nevis/Claresholm, and Weyburn properties. In response, Firenze claims that it is entitled to set-off amounts related to the purchase and sale agreements arising from COGI's sale of its interest in the Weyburn and Nevis/Claresholm properties to Firenze.

D. Positions of the Parties

18 The Receiver argues the $849,208.44 that Firenze allegedly owes to COGI is a valid and payable debt, which cannot be further set-off by Firenze. This argument is premised on the position that Firenze did not become Operator of the Marten Creek and Gull Lake properties until the Effective Transfer Date (i.e. September 1, 2016), which prevents Firenze from setting-off any amounts owed by COGI prior to that date.

19 Any set-off claims arising after September 1, 2016 are also precluded by the stay of proceedings in the Receivership Order. Further, there is no basis to provide Firenze with an equitable right of set-off due to its refusal to pay its share of the operating costs for the Marten Creek and Gull Lake properties after March 2015.

20 Firenze argues that the Receiver's claim of $849,208.44 is not valid because it neglects Firenze's right to contractually and equitably set-off certain other amounts, including those related to the Weyburn and Nevis/Claresholm purchase and sale agreements. Firenze also claims for damages due to COGI's anticipatory breach of the Marten Creek and Gull Lake joint operating agreements. As a result, Firenze asks this Court to only decide the relevant principles of equitable and contractual set-off, and refrain from making a determination on the exact amounts owed without a more fulsome hearing.

21 Firenze's argument is premised on the position that it became *de jure* (if not *de facto*) Operator of the Marten Creek and Gull Lake properties at the time of the Operatorship Transfer Order (i.e. January 5, 2016). Therefore, it should enjoy the relevant contractual right of set-off as of that date.

22 Firenze's cross-application argues that the stay of proceedings should be lifted in order to retroactively ratify the Abandonment Notice and Revocation Notice as effective to their date of issue. This argument is premised on the position that lifting the stay is a practical necessity in the circumstances. Failure to lift the stay would effectively prevent Firenze, as Operator, from taking necessary steps in relation to the joint-operating assets in the ordinary course of business.

23 The Receiver argues there are no grounds for Firenze's cross-application because the denial of a contractual remedy is insufficient to justify lifting the stay of proceedings. Lifting the stay is not a routine matter and Firenze must cite exceptional circumstances to justify it, which Firenze has failed to do. As a result, the Receiver asks this Court to declare that the Abandonment Notice and the Revocation Notice were improperly issued in violation of the stay and, therefore, of no effect.

24 Crescent Point Energy Corp. also made brief submissions in support of the Receiver's position.

III. Issues

25 The hearing of this matter raises two issues that must be determined:

1) Does Firenze have a valid claim for set-off and, if so, to what extent?

2) Should the stay of proceedings be retroactively lifted in order to ratify the Abandonment Notice and the Revocation Notice?

IV. Analysis

26 This matter was heard over the course of a half-day. The evidence before the Court included affidavits of various employees from Firenze and Niven Fischer, as well as transcripts of questioning of those employees. The contents of many of the affidavits and transcripts contradict and challenge each other's fundamental

calculations and conclusions.

27 I agree with Firenze's argument that it would be inappropriate to make a determination on the exact amounts owing without a more fulsome hearing. There is insufficient evidence before the Court at this time to make a proper determination on certain of the more controversial matters. Therefore, my reasons will only address general legal principles as they are applicable to Firenze's claim for set-off and the cross-application to lift the stay of proceedings. If my decision is insufficient to allow the parties to agree on the amounts owing amongst themselves, then they may re-apply to this Court for a more fulsome hearing in the future.

Issue #1: Does Firenze Have a Valid Claim for Set-Off and, if so, to What Extent?

28 Firenze claims both contractual and equitable set-off. Its claim for contractual set-off relates to amounts stemming from the Marten Creek and Gull Lake joint operating agreements. These contractual amounts include things such as outstanding surface lease rentals and property taxes.

29 Firenze's claim for equitable set-off relates to amounts stemming from the Nevis/Claresholm and Weyburn purchase and sale agreements. These equitable amounts include: (1) adjustments to the Nevis/Claresholm purchase and sale agreement due to the cost of paying an unanticipated lien; and (2) adjustments to the Weyburn purchase and sale agreement due to the cost of replacing a defective Group Treater.

A. Contractual Set-Off

30 Firenze's claim to contractual set-off rests in Article 505(b) of CAPL 1990, which allows the Operator to set-off debts owed by the Joint-Operator. As a result, any contractual claim that Firenze may have will be dependent on when precisely it replaced COGI as Operator under the Marten Creek and Gull Lake joint operating agreements.

31 Article 202(a) of CAPL 1990 grants Firenze the contractual right to replace the insolvent COGI as Operator "upon notice to such effect being served by any party to the other parties . . . " However, upon COGI entering CCAA protection on August 28, 2015, this contractual right was stayed. Therefore, Firenze required the Receiver's consent or a court order to effect the transfer of operatorship: *Bank of Montreal v. Bumper Development Corp.*, 2016 ABQB 363 (Alta. Q.B.) at paras 16-18 [*Bumper Development*] (which deals with CAPL 2007); *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 92 A.R. 81, 1988 CarswellAlta 318 (Alta. Q.B.) at paras 48-50 (which deals with CAPL 1981).

32 Based on Article 202(a) of CAPL 1990, Firenze argues that, at the latest, it became Operator as of the date of the Operatorship Transfer Order (i.e. January 5, 2016). The Receiver counters that, due to the intransigence of the AER, COGI remained Operator until the Effective Transfer Date (i.e. September 1, 2016). After all, COGI incurred all of the costs and liabilities associated with being Operator up to that date. This issue is also relevant in that it will determine whether the Receiver can claim those operatorship overhead costs incurred by COGI between the date of the Operatorship Transfer Order and the Effective Transfer Date.

33 I note that updates to the 2007 version of the CAPL Operating Procedure recognize the fact that insolvency-triggered change of operatorship is not an instantaneous process: see Craig Spurn, Jana Prete & Melissa Zerebeski, "The 2007 CAPL Operating Procedure" (2009) 46.2 Alta L Rev 427 at 432-34. Instead, change of operatorship appears to be a function of result rather than intention.

34 I find that Firenze became Operator as of the Effective Transfer Date. As a result, Firenze would only be eligible to claim contractual set-off as of that date (with those rights still subject to the stay of proceedings). The Operatorship Transfer Order did entitle Firenze to become Operator as of the date of that order. However, operatorship never actually transferred until September 1, 2016 due to the impediment of AER regulatory action.

35 The AER delayed the regulatory transfer of the necessary well licences for another nine months after the Operatorship Transfer Order. As a result, COGI remained legally liable for operatorship and was unable to abdicate those liabilities to Firenze. COGI and Firenze attempted to resolve this impasse between themselves, but were unable to do so before the Effective Transfer Date. Further, Firenze chose not to bring the matter back before this Court in order to overcome the regulatory impediments. Therefore, at this juncture, it would be inappropriate to interfere with the discretionary regulatory authority of the AER.

36 The simple fact is that, between the Operatorship Transfer Order and the Effective Transfer Date, COGI continued to exercise the duties of Operator. It also bore the costs and liabilities associated with operatorship. Firenze was fully aware that COGI continued to pay those costs during that time. Yet Firenze now retroactively seeks all of the contractual benefits of operatorship without having assumed any of the requisite burdens. Such a result would be inconsistent with the fundamental purpose and function behind Article 505(b) and CAPL 1990 as a whole.

B. Equitable Set-Off

37 A party may explicitly or implicitly contract out of their right to both contractual and equitable set-off: *National Foundation for Hepatitis C (Trustee of) v. GWE Group Inc.*, 1999 ABQB 66 (Alta. Q.B.) at paras 25-27 (Alta Master).

38 Article 505(b)(iv) of CAPL 1990 precludes a Joint-Operator from claiming a right to set-off in response to an Operator's claims for unpaid amounts. Therefore, Firenze cannot claim in equitable set-off what it contracted out of in CAPL 1990. Firenze can only claim equitable set-off where it is eligible to also claim contractual set-off (as it relates to the Marten Creek and Gull Lake joint operating agreements). What remains is Firenze's equitable set-off claim regarding the Nevis/Claresholm and Weyburn purchase and sale agreements.

39 Paperny J.A. outlined the test for equitable set-off in *Trilogy Energy LP v. SemCAMS ULC*, 2009 ABCA 275 (Alta. C.A.) at para 22, refusing leave to appeal *SemCanada Crude Co., Re*, 2009 ABQB 397 (Alta. Q.B.):

> The chambers judge correctly set out the test for equitable set-off, being the principles laid out in *Holt* at 212. These are that [cites omitted]:
>
> > 1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands.
> >
> > 2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed.
> >
> > 3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross claim.
> >
> > 4. The plaintiff's claim and the cross-claim need not arise out of the same contract.
> >
> > 5. Unliquidated claims are on the same footing as liquidated claims.

40 Most relevant in the present circumstances is the third principle of equitable set-off, which is the "clearly connected" requirement. I find there is no clear connection between COGI, in its role as Operator pursuant to the Marten Creek and Gull Lake joint operating agreements, and Firenze, in its role as purchaser pursuant to the Nevis/Claresholm and Weyburn purchase and sale agreements. Further, it would not be manifestly unjust to allow the Receiver to enforce COGI's claims as Operator without taking into consideration Firenze's claims as purchaser.

41 The lack of a clear connection and manifest injustice is the result of the unique nature of operatorship pursuant to a joint operating agreement. Operatorship is legally distinct from that of a vendor pursuant to a purchase and sale agreement. The unique nature of an Operator was described by Romaine J. in *SemCanada Crude Co., Re*, 2009 ABQB 397 (Alta. Q.B.) at paras 38-68, leave to appeal refused *Trilogy Energy LP v. SemCAMS ULC*, 2009 ABCA 275 (Alta. C.A.).

42 In short, COGI, as vendor, entered into the relevant purchase and sale agreements in its own corporate capacity. Whereas COGI, as Operator, acted under the relevant joint operating agreements for a distinct, special purpose. Operatorship requires that the operating partner act as an administrator over accounts and assets owned by all joint-partners that are subject to the joint operating agreement. This status creates different obligations and liabilities for the Operator when compared to if it was only acting in its own corporate capacity.

43 The special status of COGI, as Operator, creates an important and well recognized legal distinction that prevents a clear connection with its activities as vendor. Firenze may have a separate cause of action against COGI for what it claims is owed pursuant to the purchase and sale agreements. However, the unique status of operatorship, and ensuring the proper function of joint operating agreements in insolvency situations, militates against allowing Firenze to advance its claims in equitable set-off.

44 I make no finding regarding whether Firenze would be able to satisfy the other elements of the equitable set-off test.

Issue #2: Should the Stay of Proceedings be Retroactively Lifted?

45 The Receivership Order's stay of proceedings restrains Firenze from invoking its contractual rights under CAPL 1990, including by issuing the Abandonment Notice and Revocation Notice: *Baytex Energy Ltd. v. MNP Ltd.*, 2012 ABQB 539 (Alta. Q.B.) at para 19 [*Baytex*], citing *Skyservice Airlines Inc., Re*, 2011 ONSC 703 (Ont. S.C.J. [Commercial List]) at paras 77-89, aff'd 2012 ONCA 283 (Ont. C.A.).

46 Firenze therefore requires either the consent of the Receiver or the leave of this Court before issuing the Abandonment Notice and Revocation Notice. However, Firenze received neither the required consent nor leave prior to taking the action that it did. As a result, Firenze now asks this Court to lift the stay *nunc pro tunc* and ratify its otherwise invalid Abandonment Notice and Revocation Notice.

47 Firenze argues the lifting of the stay is necessary because it must be allowed to act in the ordinary course of business in order to fulfill its obligations under the Marten Creek and Gull Lake joint operating agreements. Since both agreements pre-date the Receivership Order, the Receiver remains subject to those agreements: see *Associated Investors of Canada Ltd., Re* (1989), 69 Alta. L.R. (2d) 318, 1989 CarswellAlta 362 (Alta. Q.B.).

48 Firenze also cites the decision in *Bumper Development* at para 19 as authority for the proposition that the stay should be lifted because there is no reason to interfere with its contractual rights when those rights are not affected by security.

49 I note that Firenze concedes its justification for issuing the Abandonment Notice and Revocation Notice is primarily economic in nature. There is currently no outstanding regulatory requirement to abandon the wells cited in the Abandonment Notice. Further, the Revocation Notice is primarily being used to retain enough of the production revenue to cover COGI's outstanding operational expenses and share of the prospective abandonment costs.

50 The Receiver opposes Firenze's cross-application to lift the stay on the grounds that there is no sound reason to grant such an order. It cites *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.*, 2015 ABQB 148 (Alta. Q.B.) at para 44 [*Alignvest QB*], aff'd on other grounds *York Realty Inc. v. Alignvest Private Debt Ltd.*, 2015 ABCA 355 (Alta. C.A.) [*Alignvest CA*], as authority for the proposition that the loss of a pre-receivership contractual right is insufficient justification for lifting the stay. Further, the Receiver argues that lifting the stay would provide Firenze with an inappropriate "leg up" on COGI's secured and unsecured creditors by allowing it

to retain funds otherwise owed to COGI.

A. There are Insufficient Grounds to Lift the Stay

51 In *Alignvest QB* at paras 40-42, citing the Ontario Court of Appeal's decision in *Ma, Re* (2001), 24 C.B.R. (4th) 68, 2001 CarswellOnt 1019 (Ont. C.A.), Romaine J. outlined the relevant test for determining whether to lift a stay of proceedings:

> The test for lifting a stay imposed pursuant to a receivership order focuses on the totality of circumstances and the relative prejudice to the parties involved in the receivership.
>
> Guidance can be drawn from the provisions of section 69.4 of the *BIA* in determining whether a stay in a receivership should be lifted. The Court should be satisfied that the party applying to lift the stay is likely to be materially prejudiced by the stay or that it would be equitable to lift the stay on other grounds. The burden is on the applicant: *Ma, Re*, [2001] O.**J. No. 1189 (Ont. C.A.).
>
> Lifting the stay is not routine: there must be sound reasons to relieve against the stay: *Ma, Re* at para 3.
>
> [The applicant] concedes that in order to show material prejudice, it must show that it would be treated differently or some way unfairly or would suffer worse harm than other creditors if the stay is not lifted: *Golden Griddle Corp. v**. Fort Erie Truck & Travel Plaza Inc.* (2005), 29 C.B.**R. (5th) 62 (Ont. S.C.J.) at paras 18 - 19.

52 In *Alignvest QB* at paras 44-48, Romaine J. found that depriving the applicant of rights that it had specifically bargained for under a lease did not constitute material prejudice. The applicant entered into the contract knowing the risks. A similar conclusion can be drawn in the present circumstances.

53 Firenze has provided insufficient evidence that it is likely to be materially prejudiced by the stay or that there is an equitable basis to lift the stay and ratify the Abandonment Notice and Revocation Notice. There is a distinct lack of special harm that Firenze will suffer if the stay is not lifted. After all, Firenze concedes that it has acted primarily for economic reasons, which is a justification that was rejected by Strekaf J. (as she was then) in *Baytex* at paras 18-19.

54 In other words, there is no regulatory requirement dictating the immediate abandonment of the wells subject to the Abandonment Notice. Firenze is abandoning those wells only because it claims its actions are economically prudent. Even assuming that the abandonment must go forward in the future, those costs may very well be shared by whatever entity steps into COGI's place (which Firenze freely acknowledges).

55 Further, COGI's failure to pay its portion of the operating costs is a risk that every Operator must endure when faced with the insolvency of a Joint-Operator. It does not constitute material prejudice or equitable grounds sufficient to justify lifting the stay to allow the Revocation Notice. Firenze should not, without more, be able to retain funds to satisfy its own claims at the expense of COGI's other creditors (who may be equally entitled to those funds).

56 Firenze's current situation can be distinguished from that of the applicant in *Bumper Development*, wherein Macleod J. did order the stay to be lifted *nunc pro tunc*. In that case, the stay was lifted to grant the applicant its contractual right to take over as Operator under CAPL 2007 (a right which this Court has already granted to Firenze). Had Macleod J. not lifted the stay, it would have caused the applicant material prejudice, as the applicant would have lost its right to operatorship despite having an agreement with the receiver to the contrary. Further, lifting the stay would not have prejudiced the insolvent Joint-Operator's creditors, as the operatorship was not something otherwise secured and transferable.

V. Conclusion

57 I grant the Receiver's application as it relates to defining Firenze's right to contractual and equitable set-off. However, any declaration of the exact amounts owing will require a more fulsome hearing. Further, I dismiss Firenze's cross-application to lift the stay of proceedings *nunc pro tunc*.

58 Firenze became Operator pursuant to the Marten Creek and Gull Lake joint operating agreements as of the Effective Transfer Date (i.e. September 1, 2016). Therefore, Firenze is only eligible to claim any related right to contractual and/or equitable set-off as of that date.

59 Firenze is not eligible to use amounts claimed pursuant to the Weyburn and Nevis/Claresholm purchase and sale agreements to equitably set-off amounts owed pursuant to the Marten Creek and Gull Lake joint operating agreements.

60 The Abandonment Notice and Revocation Notice are subject to the stay of proceedings and were issued without the consent of the Receiver or the leave of this Court. Further, there are insufficient grounds to lift the stay and retroactively ratify those orders. Therefore, the Abandonment Notice and Revocation Notice are declared to be of no effect.

61 If the parties cannot agree on costs then they may apply to this Court for a determination thereof.

Application granted in part; cross-application dismissed.

End of Document

2013 ABQB 670
Alberta Court of Queen's Bench

Thompson Bros. (Constr.) Ltd. v. Jay Vee Sandblasting Ltd.

2013 CarswellAlta 2408, 2013 ABQB 670, [2014] A.W.L.D. 305, [2014] A.W.L.D. 306, 235 A.C.W.S. (3d) 600, 7 C.B.R. (6th) 258

Thompson Bros. (Constr.) Ltd. Plaintiff/Respondent and Jay Vee Sandblasting Ltd., Defendant and BDO Canada Limited, Receiver and MMD Leasing Ltd., Sandra Kirkup and 67017 Manitoba Ltd. Applicants

B.R. Burrows J.

Heard: October 25, 2013
Judgment: November 15, 2013
Docket: Edmonton 1303-03149

Counsel: Greg Heinrichs, Q.C., Deborah Szatylo for Applicants
Sigurd Delblanc for Plaintiff / Respondent
Russell A. Rimer for Receiver
No one for Jay Vee Sandblasting Ltd.

Subject: Insolvency; Civil Practice and Procedure

Headnote

Bankruptcy and insolvency --- Bankruptcy petitions for receiving orders — Stay of petition — Pending outcome of other proceedings
Respondent T Ltd. was secured creditor of J Ltd. and was applicant for receivership order which had been imposed — Secured debt claimed by T Ltd. was $11.75 million; however, there were debts to other priority creditors exceeding $600,000 — Applicants had unsecured claims against J Ltd. exceeding $1.6 million; additionally, were other unsecured creditors whose claims totalled $1.9 million — Since receivership order, receiver had proceeded with sale of assets of J Ltd. — Applicants brought application for order lifting stay of proceedings imposed in receivership order in respect of J Ltd. — Application granted — Proceeds of sale of assets of J Ltd. exceed undisputed amount of secured debt by significant amount — After eight months neither receivership nor court applications have advanced very far toward resolution of disputes between creditors — Bankruptcy trustee would have rights and powers which would potentially bring disputes to determination more quickly and probably more efficiently than current proceedings — There would seem to be little basis for concern that bankruptcy trustee would be required to duplicate work already done by receiver — Lifting stay of proceedings should be granted to permit applicants to bring bankruptcy application.

Bankruptcy and insolvency --- Bankruptcy and receiving orders — Rescission or stay of order
Respondent T Ltd. was secured creditor of J Ltd. and was applicant for receivership order which had been imposed — Secured debt claimed by T Ltd. was $11.75 million; however, there were debts to other priority creditors exceeding $600,000 — Applicants had unsecured claims against J Ltd. exceeding $1.6 million; additionally, were other unsecured creditors whose claims totalled $1.9 million — Since receivership order, receiver had proceeded with sale of assets of J Ltd. — Applicants brought application for order lifting stay of proceedings imposed in receivership order in respect of J Ltd. — Application granted — Proceeds of sale of assets of J Ltd. exceed undisputed amount of secured debt by significant amount — After eight months neither receivership nor court applications have advanced very far toward resolution of disputes between creditors — Bankruptcy trustee would have rights and powers which would potentially bring disputes to determination more

quickly and probably more efficiently than current proceedings — There would seem to be little basis for concern that bankruptcy trustee would be required to duplicate work already done by receiver — Lifting stay of proceedings should be granted to permit applicants to bring bankruptcy application.

Table of Authorities

Cases considered by *B.R. Burrows J.*:

Haunert-Faga v. Faga (2013), 2013 CarswellOnt 11104, 2013 ONSC 5161, 4 C.B.R. (6th) 118 (Ont. S.C.J. [Commercial List]) — considered

Statutes considered:

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

s. 38 — considered

s. 43 — pursuant to

APPLICATION by applicants for order lifting stay of proceedings imposed in receivership order in respect of J Ltd.

***B.R. Burrows J.*:**

1 MMD Leasing Ltd., Sandra Kirkup and 67017 Manitoba Ltd., who I will refer to collectively as the Kirkup Group, seek an order lifting the stay of proceedings imposed in a Receivership Order in respect of Jay Vee Sandblasting Ltd. granted by Thomas J. on March 7, 2013. They seek the lifting of the stay so they can bring a bankruptcy application under *BIA* s. 43 with respect to Jay Vee of which each of them is an unsecured creditor.

2 Thompson Bros. is a secured creditor of Jay Vee and was the applicant for the Receivership Order. The order appointed BDO Canada Ltd. as Receiver.

3 The secured debt claimed by Thompson Bros. is $11.75 million. Of this, $8.15 million was originally owed to the Canadian Western Bank whose security held first priority. Thompson Bros.' secured debt (the amount of which is in issue but which Thompson Bros. claims to be $3.6 million) held second priority. The Bank assigned its debt to Thompson Bros.

4 The First Report of the Receiver dated May 10, 2013 indicates debt to the Canada Revenue Agency and other priority creditors exceeding $600,000.

5 The Kirkup Group has unsecured claims against Jay Vee exceeding $1.6 million. Actions had been commenced in respect of these debts against Jay Vee prior to the receivership. There are other unsecured creditors whose claims total $1.9 million.

6 Since the receivership was ordered there have been two main streams of activity. First, the Receiver has proceeded with the sale of Jay Vee's assets. Second, the Kirkup Group has made a number of applications inspired by its principals' concerns that there was significant pre-receivership dissipation and unremunerated use of the assets of Jay Vee, and that the proper credit has not been made for payments made by Jay Vee in respect of the Thompson Bros.' debt. I will describe these concerns more specifically below.

7 The first stream of activity reached the point on October 25, 2013 of the Court approving the sale of the assets of Jay Vee to Thompson Bros. subject to terms which, among other things, attempted to preserve the

rights of the Kirkup Group to pursue the concerns they have raised in the second stream of activity.

8 The second stream of activity consists of the following applications brought by the Kirkup Group:

a. June 21, 2013 - Application for an order determining:

1. the amount of the debt owed by Jay Vee to Thompson Bros.,

2. the validity of the security taken by Thompson Bros. against Jay Vee,

3. the validity of the security taken by Canadian Western Bank against Jay Vee which was subsequently assigned to Thompson Bros.

In this application the Kirkup Group alleged that Thompson Bros. might not have been a legitimate arms-length creditor of Jay Vee and may have been a mortgagee in possession.

b. July 25, 2013 - Application for an order setting aside the Receivership Order of March 7, 2013, or alternatively, replacing BDO Canada Limited as Receiver with a new Court appointed receiver and other relief.

c. July 29, 2013 - Application for an order directing Paul Sturt, deponent of an affidavit filed by Thompson Bros. in response to the previously filed applications, to provide answers to undertakings, and to questions refused to be answered at Questioning on the affidavit.

d. August 12, 2013 - Application for an order directing Earl Northcott to answer undertakings and questions he refused to answer at Questioning on an affidavit.

e. August 12, 2013 - Application that the first two applications be determined at a trial involving *viva voce* evidence.

9 On September 4, 2013 I granted an order declaring that all security granted by Jay Vee to the Canadian Western Bank was valid and that the amount of the debt it secured was $8,105,776.64. The order was expressed to be without prejudice to the Kirkup Group's right to seek a setoff against the total debt owed to Thompson Bros. by Jay Vee of any amount the Kirkup Group might prove Thompson Bros. is responsible to pay Jay Vee.

10 In the same order I dismissed Kirkup Group's applications to set aside the Receivership Order or alternatively to replace BDO as Receiver. The other Kirkup Group motions listed above were adjourned.

11 Also in the September 4, 2013 order I ordered that if Thompson Bros. was the successful purchaser of Jay Vee's assets (which, as noted, it was) the question of whether and to what extent Thompson Bros. should be required to leave the assets purchased unencumbered, or alternatively the amount of security which Thompson Bros. should be required to post so that the claims advanced by Kirkup Group would not be prejudiced, would be determined at the application for approval of the sale. In fact, at that application, on October 25, 2013, that issue was further adjourned. In the meantime the Receiver was directed to make no distribution of the net proceeds of the sale until further order.

12 The concerns that the Kirkup Group raises in the second stream of activity are more specifically described by Kirkup's counsel in the materials filed on this application as follows:

a. Payments (or at least an August 2012 payment of $300,000) made by Jay Vee to Thompson Bros. has not been credited in the accounting for Jay Vee's debt to Thompson Bros.

b. Payments were made in June, July and August 2012 by Jay Vee to "Thompson individuals" for no apparent reason. Undertakings to advise why these payments were made have not been satisfied.

c. Jay Vee records indicate that two payments totalling $88,000 were made by certified cheque to unknown payees on October 9, 2012. Information explaining these payments has not been provided.

d. The mortgage granted by Jay Vee to Thompson Bros. does not provide for compound interest. Thompson Bros. has improperly calculated the debt using interest compounded monthly.

e. The mortgage granted by Jay Vee to Thompson Bros. secured a debt of $1.5 million that was outstanding on April 24, 2009. It did not secure advances which were made by Thompson Bros. to Jay Vee after that date. Payments by Jay Vee should be credited against the oldest debt - the mortgage debt. If payments were properly credited, no payment should have been credited against advances made by Thompson Bros. to Jay Vee after the mortgage, on August 27, 2009 and August 26, 2010, totalling $650,000, until the mortgage debt was entirely repaid. The accounting records disclosed to date do not confirm that this accounting procedure was followed. If it was, the post April 24, 2009 advances would be wholly outstanding and would now be statute barred. [I note that the Kirkup Group materials do not discuss how the General Security Agreement granted by Jay Vee in favour of Thompson Bros. on April 24, 2009 which appears to grant security in respect of existing and “future obligations, liabilities and indebtedness” fits into this allegation.]

f. There was no documentation providing that interest was payable on advances made by Thompson Bros. to Jay Vee after April 24, 2009. None should be included in the debt claimed in respect of advances made after that date.

g. The debt claimed by Thompson Bros. includes legal fees incurred by Thompson Bros. in relation to the collection of the debts owed to it. The only legal fees that Thompson Bros. can properly claim against Jay Vee are those relating to the mortgage and the enforcement of the mortgage. The legal fees paid, which exceed $140,000, were for services both inside and outside that scope. The portion for services outside that scope are not properly included in the secured debt.

h. Some of the information obtained by the Kirkup Group suggests that for several months prior to the Receivership Order, Thompson Bros. may have been a mortgagee in possession as it was playing a significant role in the day to day operation of Jay Vee. This would open the question of whether Thompson Bros. mismanaged the affairs of Jay Vee during that period in such a way that the amount of the debt owed by Jay Vee to Thompson Bros. should be reduced. An example of such mismanagement could be permitting Norpoint Sandblasting & Painting Ltd. to use Jay Vee’s facility without payment of rent. Other indications of mismanagement in the same period include that there were very substantial reductions in a) the reported value of Jay Vee’s inventory (from $1,968,980 to $20,000), and b) the reported value of Jay Vee’s accounts receivable (from $9,673,782.85 to $323,281.68).

i. Principals of Jay Vee used money of Jay Vee to pay for personal items including expensive vehicles, rent and Court ordered maintenance.

j. Jay Vee funds were paid to both related and unrelated persons and entities for unknown or no reason.

13 The stay of proceedings provision in the Receivership Order states:

No Proceedings Against the Debtor or the Property

8. No Proceeding against or in respect of the Debtor or the Property shall be commenced or continued except with the written consent of the Receiver or with leave of this Court and any and all Proceedings currently under way against or in respect of the Debtor or the Property are hereby stayed and suspended

> pending further Order of this Court, provided, however, that nothing in this Order shall prevent any Person from commencing a proceeding regarding a claim that might otherwise become barred by statute or an existing agreement if such proceeding is not commenced before the expiration of the stay provided by this paragraph 8.

14 The Kirkup Group seek a lifting of the stay to permit them to apply for a bankruptcy order against Jay Vee. They submit that a bankruptcy proceeding would provide a better procedure for the determination of the issues they have raised in the second stream of activity described above than the receivership proceeding provides.

15 In particular they submit that the powers of a trustee in bankruptcy are wider in relevant ways than those of a Court appointed receiver. In that regard they cite the following passages from Bennett on Receiverships, Carswell, 3rd ed., found under the title, “Reasons for Bankruptcy from Unsecured Creditor’s Point of View”:

> • Information: ... bankruptcy affords unsecured creditors through the trustee a right to demand an accounting from the security holder as well as an opportunity of determining whether the security instrument can be attacked. (page 624)
>
> • Investigation: ... the bankruptcy gives all creditors a measure of protection through the mechanics of the Act. Even if the trustee in bankruptcy does not have sufficient proceeds, creditors have the right to fund the trustee or to proceed under section 38 of the *Bankruptcy and Insolvency Act* for a thorough investigation of the affairs of the debtor.
>
> Moreover, once the debtor is placed into bankruptcy, the trustee in bankruptcy acquires causes of action that may not be apparent without an investigation. If the trustee is successful in pursuing the causes of action, the proceeds benefit preferred and unsecured creditors including the security holder who is partially secured.
>
> ... in a bankruptcy situation, the trustee may proceed and recover moneys paid as a preference with the result that such moneys devolve upon all preferred and unsecured creditors. (page 626)

And these passages found under the title, “Causes of Action available only to Trustee in Bankruptcy”:

> • Fraudulent Preferences and Transfers at Undervalue: ... the trustee in bankruptcy may be entitled to attack the security instrument pursuant to the *Bankruptcy and Insolvency Act* as being a fraudulent preference or a transfer at undervalue. (page 630)
>
> ... Aside from any trustee attack that might be made against the security holder, the trustee may also assert any of the causes of action against third parties who have received fraudulent preferences or who have received transfers at undervalue. (page 633)
>
> • Examinations: ... [Pursuant to *BIA* s. 163(1)] [t]he trustee may without an order examine under oath any person reasonably thought to have knowledge of the affairs of the bankrupt. The trustee may require a person to produce any books, documents, correspondence or other papers in that person’s possession or under his or her power relating all or in part to the bankrupt, his or her dealings, or property. In addition, the trustee may require anyone who has or is believed or suspected to have [it] in his or her possession to produce or deliver any property of the bankrupt, including books, documents, or papers. (page 636)
>
> • Creditors’ Remedies - Section 38 Proceedings: ... If the trustee does not have sufficient funds to proceed or receives a legal opinion that the trustee’s cause of action is not meritorious, then it is open for an unsecured creditor including a security holder who has a claim for a deficiency balance, to proceed with such cause of action pursuant to s. 38 of the *Bankruptcy and Insolvency Act*. Creditors may have claims against another creditor who, for example, received a fraudulent preference and may have claims against the security holder and receiver. With respect to both types of claims, creditors do not have any cause of action against them directly as such claims are vested in the trustee in bankruptcy. The creditors must

either obtain an assignment from the trustee or an order under section 38 of the Act.

16 The Kirkup Group also observe that their efforts to this point to have their concerns explored in the receivership have been largely unsuccessful. On April 18, 2013, the Kirkup Group's solicitors wrote to counsel for the Receiver requesting that the Receiver investigate what happened to Jay Vee's inventory and accounts receivable between August 2012 and March 2013. As previously noted the recorded value of the former declined from $1,968,980 to $20,000 and the recorded value of the latter declined from $9,673,782.85 to $323,281.68 in that period. A follow-up letter was sent to the Receiver's counsel on May 6, 2013. There is no indication that the Receiver has responded to these requests.

17 I note that in the Bench Brief filed on August 28, 2013 for the September 4, 2013 application the Receiver's counsel has acknowledged that the Kirkup Group has raised the issues it has and that, at some point, at least some of them must be addressed. That brief also stated that the Receiver has been unable to determine with any degree of certainty the exact amounts owed by Jay Vee to Thompson Bros. though, "it seems apparent on the evidence presented thus far, that the amount owing to Thompson Bros. is definitely in excess of $1.5 Million dollars (*sic*)". I am not aware of any objective determination having been made as to what caused the very significant decline in the stated value of Jay Vee's inventory and accounts receivable in the six months preceding the appointment of the Receiver. So far as I am aware it has not been determined whether any causes of action exist in favour of Jay Vee in connection with whatever those causes were.

18 Thompson Bros. did not file any affidavit or other materials in response to this application. In oral submissions, Mr. Delblanc, counsel for Thompson Bros., submitted that bankruptcy proceedings would be "incredibly expensive". Whether or not this is so, I note that the cost of the bankruptcy proceedings would not reduce the recovery of Thompson Bros. to the extent that, as it claims, it is a fully secured creditor.

19 Mr. Delblanc further submitted that the Kirkup Group is, in this application, seeking equitable relief (the lifting of the stay). He submitted that the Kirkup Group's conduct prior to the Receivership Order should disentitle it to do so. He referred to portions of the questioning of Grant Kirkup and Earl Northcott (the principal of Jay Vee) which, he submitted, showed that Mr. Kirkup caused the mischief which put the company into receivership.

20 Excerpts from the questioning of Mr. Northcott give some indication as to how the recorded value of accounts receivable may have become inflated. He testified that Jay Vee both billed for anticipated work that never materialized and adjusted the date of billings (without cancelling the aged accounts) so as to show accounts receivable being more current than they actually were. This was done to satisfy the margin requirements of the Canadian Western Bank. Mr. Northcott testified that Mr. Kirkup, who was providing accounting services to Jay Vee, both knew of and participated in these manipulations of the records. In his questioning, Mr. Kirkup confirmed that he knew that misrepresentations were being made to the bank.

21 Mr. Delblanc indicated that his clients will be commencing action against Grant Kirkup in connection with his actions in this regard. It seems to me that it is more likely that Jay Vee would have a cause of action arising from them, than that Thompson Bros. would. This is a matter which might properly be investigated and pursued by a bankruptcy trustee. In my view this outweighs any concern that the Kirkup Group does not have clean hands.

22 Counsel for the Canada Revenue Agency, Mr. Segal, appeared and opposed the application. He noted that there is a GST deemed trust which though presently asserted at $10,000 may in fact be less than that or non-existent. While he acknowledged that the priority that would otherwise be accorded to the deemed trust would not be recognized in a bankruptcy, he suggested that the amount in issue is so small that this should not be a factor in determining whether or not to lift the stay. I agree.

23 He also objected that the cost of bankruptcy proceedings would not appear to be justified. He suggested that the disputes that exist between Thompson Bros. and the Kirkup Group should more properly be determined in the applications that have been brought. The costs of determining those issues should be borne by the

disputants. In a bankruptcy, they would be a charge on the residue, if any, available for distribution to unsecured creditors.

24 Mr. Rimer, counsel for the Receiver, observed that the Kirkup Group itself would be responsible to pay the costs of the bankruptcy trustee unless and until it is determined that the Thompson Bros.' debt is not wholly secured. Unless that determination is made, the proceeds of the sale of Jay Vee's assets in the receivership will not extend to the satisfaction of the secured creditor. There will be nothing for unsecured creditors. It may be difficult for the Kirkup Group to find a bankruptcy trustee willing to accept the appointment.

25 It can reasonably be argued that applications in the receivership proceedings have not proved to be an efficient method of having the issues raised by the Kirkup Group determined. The Receiver, probably quite properly, appears to have been focused on the first stream of activity in the receivership - the sale of Jay Vee's assets. The main adversaries in the disputes arising in the second stream of activity, the Kirkup Group and Thompson Bros., appear to have taken entrenched litigation positions which produce more heat than light. It is reasonable to expect that the inquisitorial process employed by a bankruptcy trustee would more likely achieve resolution of the issues than the adversarial setting in which these disputes currently reside.

26 The authorities indicate that in determining whether or not to lift the stay, "... the court must consider the totality of the circumstances and the relative prejudice to both the creditor and the debtor. The Court should consider a balancing of the interests of all affected parties." *Haunert-Faga v. Faga*, 2013 ONSC 5161 (Ont. S.C.J. [Commercial List]) at para. 15.

27 I would summarize the significant features of the circumstances here as follows:

• The Kirkup Group has raised serious concerns regarding the amount owing under the security claimed by Thompson Bros., the dissipation of Jay Vee assets prior to the receivership, and the involvement of Thompson Bros. in the management of Jay Vee prior to the receivership.

• Thompson Bros. has raised serious concerns regarding the involvement of the Kirkup Group in the management of Jay Vee prior to the receivership.

• The proceeds of the sale of the assets of Jay Vee exceed the undisputed amount of the secured debt by a significant amount.

• After eight months neither the receivership nor Court applications have advanced very far toward resolution of the disputes. A bankruptcy trustee would have rights and powers which would potentially bring the disputes to determination more quickly and probably more efficiently than the current proceedings appear likely to do.

• The cost to Thompson Bros. if the disputes were resolved through the bankruptcy process would not be greater than the current proceedings, if, as it asserts, its security extends to the total amount of the sale of the assets of Jay Vee.

• There will be no cost to unsecured creditors unless the bankruptcy trustee determines that there are claims to pursue and they are successfully pursued. Otherwise the applicant for the bankruptcy order, the Kirkup Group, will be responsible for the cost of the bankruptcy proceedings.

• No unsecured creditor other than the CRA has opposed the application. The CRA has not participated in the second stream applications. Mr. Segal's submissions suggest that the CRA is resigned to the conclusion that there will be nothing for unsecured creditors. If in bankruptcy proceedings any funds become available for distribution to preferred and unsecured creditors, the CRA will have been prejudiced by receiving less of a windfall than it might otherwise have received. That is not a real prejudice.

• Beyond the possibly more effective "inquisitional" approach available to a bankruptcy trustee, both the Kirkup Group and Thompson Bros. (to the extent there is a deficiency in its recovery) would, if a bankruptcy order is obtained, acquire the right to apply under *BIA* s. 38 for leave to pursue any Jay Vee cause of action the bankruptcy trustee is not willing to pursue.

• The continuation of the existing receivership to the point that the "first stream" activities are concluded need not be affected by a bankruptcy order. There would seem to be little basis for concern that the bankruptcy trustee would be required to duplicate work already done by the Receiver.

28 Having given due consideration to these circumstances and the positions of affected parties I conclude that the lifting of the stay applied for should be granted. I therefore grant leave to MMD Leasing Ltd., Sandra Kirkup and 67017 Manitoba Ltd. to bring a bankruptcy application under *BIA* s. 43 with respect to Jay Vee Sandblasting Ltd., notwithstanding the stay of proceedings contained in paragraph 8 of the Receivership Order granted herein on March 6, 2013.

Application granted.