File No. CI20-01-26627

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., C.B-3, AS AMENDED, AN SECTION 55 OF THE COURT OF QUEEN'S BENCH ACT, C.C.S.M., C.C280, AS AMENDED

BETWEEN:

WHITE OAK COMMERCIAL FINANCE, LLC.

Applicant

- and -

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

Respondents

AND

Estate Nos: 31-2627758, 31-2627760, 31-2627764, 31-2627767, and 31-458926

IN THE MATTER OF THE NOTICE OF INTENTION TO FILE A PROPOSAL OF NYGARD PROPERTIES LTD., NYGARD ENTERPRISES LTD., NYGARD INTERNATIONAL PARTNERSHIP, 4093879 CANADA LTD., AND 4093887 CANADA LTD.

MOTION BRIEF OF THE RESPONDENTS

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MOTION BRIEF OF THE RESPONDENTS

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4. Notice of Motion of the Respondents, filed November 5, 2020
5. Affidavit of Greg Fenske, affirmed September 29, 2020
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7. Affidavit of Greg Fenske, affirmed November 5, 2020
8. Frank Bennett, *Bennett on Receiverships*, Third Edition, 2011
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I. ORDERS REQUESTED

1. At the November 9, 2020 hearing the Respondents request the following:

    a. The Receiver be discharged.

    b. In the alternative provide the Respondents with an unredacted copy of the Inkster Offer to Purchase on the condition the Respondents agree to keep the report confidential to themselves, their counsel and AGI on November 9th, 2020.

    c. That the stay be lifted to allow them to file an NOI with a proposal which would include:

        i. a payment of $1,100,000.00, from NEL to NIP, as part of a settlement between NIP, NEL and NPL whereby NIP's debt to NPL will be extinguished and NEL's debt to NIP will be extinguished, as explained in the report of AGI.

        ii. A (gratuitous) payment of $1,000,000 from NPL.

        iii. A further payment equal to the fair market value of the remaining assets of NIP, as to be valued by the proposal Trustee in its report to unsecured creditors.

    d. The requested Inkster Sale Approval and Vesting Order be denied.

    e. The requested Authority to proceed to preserve documents in the manner discussed in the report be denied.

II. RECEIVER'S MANDATE

A. Background and Scope of the Receiver's Appointment

2. The Receiver was appointed pursuant to an Order of this Honourable Court dated March 18, 2020 (the **"Appointment Order").** The Appointment Order was granted

pursuant to an application made by the Applicant (as agent for itself and Second Avenue Capital Partners, LLC who together are the **"Lenders")** pursuant to its rights and remedies available to it pursuant to a credit agreement dated December 30, 2019 (the **"Credit Agreement")** and certain security granted pursuant to various security agreements between the Lenders and the Respondents (collectively, the **"Security Agreements")**

3. The General Order was amended by this Court April 29, 2020 (the **"General Order").** The General Order limited the scope of the Receiver's appointment to "only such property, undertakings and assets of NEL and NPL in which the Applicants have an interest pursuant to the Credit Agreement, and the Loan Documents (as defined in the Credit Agreement).

B. THE RECEIVER SHOULD BE DISCHARGED

4. The Receiver is a receiver, not a trustee in bankruptcy. It does not have the broad powers of a trustee; it absolutely does not have the extraordinary authority to liquidate the assets of each of the respondents, consolidate the proceeds, and then use those proceeds to ensure that one respondent's unsecured creditors are paid in proportion to their claims. The Receiver's authority over the assets of the Respondents is derived *solely* from the orders appointing and affecting it. Those orders are predicated upon the enforceability of the security of the Lenders which applied for the appointment of the Receiver. The debt secured has been paid; the Lenders' rights are spent. The Receiver should be discharged.

5. The Lenders brought this application in order to ensure that they would be repaid their secured advances to the Borrowers. The evidence filed by the Lenders in support of its application was clear on this point. In the affidavit of Robert L. Dean, the Lenders' representative, Dean swore that the Nygård Group:

120. is in urgent need of court supervision with the assistance of a court officer. Accordingly, White Oak, through its counsel, delivered the Demand and Section 244

Notice on February 26, 2020. To date, ***the amounts owing to White Oak have not been repaid.***

121. It is critical that Richter be appointed as Receiver as expeditiously as possible so that it can take immediate steps to preserve and maintain the property of the Nygård Group, which will include the implementation of a process to: (i) identify a liquidator and liquidate the assets, (ii) consider other options for the business ***that would see the Lenders paid in full in the short term****, and (iii) engage a broker to sell the Nygård Group's real estate assets.*[1]

6. With respect to NEL and NPL, this Court in its General Order dated April 29, 2020 (the "**General Order**"), limited the scope of the Receiver's appointment to "***only*** *such property, undertakings and assets of NEL and NPL in which the Applicants have an interest pursuant to the Credit Agreement … and the Loan Documents (as defined in the Credit Agreement)".*[2]

7. The Lenders have achieved their goal: they have been paid in full. In its Ninth Report, the Receiver states:
   Over the course of these Receivership Proceedings, proceeds to date have been generated from realizations on assets of NIP, NPL, and Nygard Inc. Overall, the Receiver presently estimates that ***sufficient proceeds have been generated to date to repay the Lenders*** *(subject to certain Lender claims still under consideration), the Receiver's Charge (to date), the Landlords' Charge and to fund the payment of Potential Priority Claims, with perhaps some "excess" remaining.*[3]

8. The Receiver is not simply in funds to pay the Lenders: it has done so. The Interim Statement of Receipts and Disbursements which forms part of the Ninth Report

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[1] Affidavit of Robert L. Dean affirmed March 9, 2020 (the "**Dean Affidavit**"), at paragraphs 120 and 121
[2] General Order dated April 29, 2020 at paragraph 2, emphasis added
[3] Richter Advisory Group Inc. Ninth Report of the Receiver, (the "**Ninth Report**"), at paragraph 115, page

shows a "Distribution to Lenders" of $66,077,000,[4] and the Receiver has confirmed that:

proceeds from the Property, totaling approximately $66.1 million, were distributed to the Lenders. The Receiver notes that on September 11, 2020, the Lenders returned approximately $1.0 million to the Receiver relating to excess funds held by the Lenders…"[5]

9. (With respect to the "*certain Lender claims*" referred to by the Receiver, in its Seventh Report dated September 10, 2020, the Receiver confirmed that subject to a US $700,000 claim by the Lenders stemming from foreign exchange rating consistencies, and a USD$1,000,000 overpayment by the Receiver to the Lenders (the net outcome of which would be a US $300,000 overpayment to the Lenders), all amounts owing to the Lenders under the Credit Agreement and/or the Receiver's term sheet had been paid in full.)[6]

10. Remarkably, the highly-experienced Receiver assigns no significance whatsoever to the satisfaction of the secured debt owed to the Lenders. Nowhere in its reports to the Court, or in the brief filed on this motion, does the Receiver admit that the satisfaction of that debt has any legal or practical consequences.

11. The satisfaction of the Lenders' claim is, in fact, of the greatest significance, as it means that the receivership cannot continue: the purpose of the receivership has been achieved and any extension of it would be not merely inappropriate, but unlawful. The leading Canadian text on receiverships, *Bennett on Receiverships*, is clear on this point:

[I]f the receiver has successfully managed a debtor's business to the extent of retiring the debt of the security holder, the receiver ought not to continue

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35, emphasis added

[4] Ninth Report, page 48

[5] Ninth Report, paragraph 161(d), page 50

[6] Richter Advisory Group Inc. Seventh Report of the Receiver, at paragraphs 41-44

operating the business. The receiver will be without authority and therefore, notwithstanding its good intentions, the receiver may become a trespasser and liable for damages*. The receiver remains accountable and becomes a fiduciary until a time when the receiver returns the business to the debtor*.[7]

12. To the same effect is the leading text in the United Kingdom, *Kerr & Hunter on Receivers and Administrators*:

12-4 On satisfaction of encumbrance*. A receiver is generally continued until judgments in the action which he has been appointed; but,* ***if the right of the claimant ceases before that time, the receiver will be discharged at once****.*[8]

[…]

26-3 Duty to cease to act*. If, at any stage of his management of the company, the receiver has in his hands sufficient moneys to discharge all of the debts of the company which he is bound to discharge, all possible claims which could be made against him and in respect of which he is entitled to an indemnity, his own remuneration, and all moneys secured by the instrument pursuant to which he was appointed, it will be his duty to cease to act with all due expedition; this should confine his further activities to taking the necessary steps to conclude his administration. If he continues to act, any accounts will be taken against him thereafter with annual rests from the date when he has sufficient moneys in his hands to cover all such amounts.* ***His continuance in possession of the company's assets thereafter might also be regarded by the courts as wrongful, since his appointment is only for the purpose of enabling the encumbrancers, entitled to the benefit of the instrument under which he was appointed, to recover their debt; once his purpose has been achieved, there is no ground for his continuance in office. The effect would be that thereafter he would be in the position of trespasser****.*[9]

13. The law of the United States has been the same since the 1864 decision of the U.S. Supreme Court in *Milwaukee & Minnesota R. Co. v. Soutter*, 69 U.S. 510:

The appointment or discharge of a receiver is ordinarily [a] matter resting wholly within the discretion of the court below. But it is not always and absolutely so.

Thus, where there is a proceeding to foreclose a mortgage given by a railroad corporation on its road &c. -- a long and actively worked road -- a sort of property to

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[7] Frank Bennett, *Bennett on Receiverships*, Third Edition, 2011, at page 605, citations omitted, emphasis added

[8] Muir Hunter Q. C., *Kerr and Hunter on Receivers and Administrators*, Eighteenth Edition, 2005, at page 260, emphasis added

[9] Muir Hunter Q. C., *Kerr and Hunter on Receivers and Administrators*, Eighteenth Edition, 2005, at page 571, citations omitted, emphasis added

a control of which a receiver ought not to be appointed at all, except from necessity, and the amount due on the mortgage is a matter still unsettled and fiercely contested, the appointment or discharge of a receiver is matter belonging to the discretion of the court in which the litigation is pending.

But when the amount due has been passed on and finally fixed by this Court, and the right of the mortgagor to pay the sum thus settled and fixed is clear, the court below has then no discretion to withhold such restoration, and a refusal to discharge the receiver is judicial error *which this Court may correct, supposing the matter (not itself one in the nature of a final decree) to be in any way fairly before it otherwise.*

14. The Receiver should therefore be discharged entirely.

C. NPL IS A SECURED CREDITOR OF THE OTHER RESPONDENTS

15. NPL was subject to the Appointment Order because it was a limited guarantor of the debt owed by the borrower companies to the Lenders. As observed by this Court,[10] NPL's guarantee of the Borrowers' indebtedness was limited to a "*realized value after all costs and expenses, including enforcement costs, of US $20 million*".[11] (The Receiver's assertion that "*the NPL Properties secure obligations totaling approximately $66.9 million…plus "costs and expenses, including enforcement costs" referred to in the Credit Agreement, and ongoing fees and disbursements of the Receiver and its counsel*"[12] is factually incorrect.

16. NPL has satisfied its guarantee. The Receiver has sold real property owned by NPL at 1 Niagara Street in Toronto, (further to a charge/mortgage registered on title to that property in favour of the Lenders), and also sold real property owned by NPL located on Notre Dame Avenue in Winnipeg, (further to a debenture granted by NPL in favour of the Lenders.) The aggregate proceeds of these sales were

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[10] Reasons of this Court dated June 20, 2020, lines 9-17
[11] Ninth Report, paragraph 129(a), pages 39-40
[12] Ninth Report, paragraph 129(a), pages 39-40

approximately $19.6 million, which sum has been paid to the Lenders. NPL need pay no more, because the Lenders have been satisfied in full.

17. Due to its payment on the guarantee, NPL is entitled to the Lenders' security and to stand in the Lenders' place relative to the other respondents, to the extent of US $20 million. This is due to sections 2 and 3 of the *Mercantile Law Amendment Act*, C.C.S.M. c. M120, (the "***Act***"), which are as follows, and the jurisprudence surrounding this statute and its counterparts in other provinces.

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 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.*

18. The leading Canadian textbook on guarantee, McGuiness' *The Law of Guarantee*, elaborates on the significance of the *Act*.

§10.40 […] Under the present rule ***not only is a surety who pays off his principal's debt entitled to a transfer of securities held by the creditor, but he or she is also in all respects entitled to all the equities*** *which the creditor could have enforced.*

[…]

§10.42 A surety is entitled stand in place of the creditor, and to use all the remedies and, on proper indemnity, to sue in the name of the creditor in any action or other proceeding in order to obtain from the principal debtor, or any co-surety, co-contractor or co-debtor, indemnification for the advances made or loss sustained by such person, and the payment or performance made by him is not a defence to such

action or other proceeding by him. However, no co-surety, co-contractor or co-debtor is entitled to recover from any other co-surety, co-contractor or co-debtor more than a just proportion to which, as between themselves, the last mentioned person is justly liable. There is no statutory limit on recovery against the principal, since the principal is obliged to indemnify his sureties in full.

[…]

§10.44 […] A surety for a limited amount has in respect of that amount the same rights as the creditor. ***To the extent of his liability, therefore, the surety is entitled to the benefit of any security held by the creditor in respect of the whole debt****.*

19. The leading Canadian textbook on insolvency, *Bankruptcy and Insolvency Law of Canada*, 4th, by L.W. Houlden and Geoffrey B. Morawetz, agrees.

If a guarantor pays in full the indebtedness of the principal debtor, ***the guarantor is entitled to any security held by the principal creditor and becomes a secured creditor.*** *There is no necessity for any formal transfer of the security to the guarantor; the guarantor stands in the place of the creditor: Re Windham Sales Ltd. (1979), 31 C.B.R. (N.S.) 130, 26 O.R. (2d) 246, 1 P.P.S.A.C. 73, 8 B.L.R. 317, 102 D.L.R. (3d) 459, 1979 CarswellOnt 227 (S.C.).*

20. In *Re Windham Sales Ltd*., Justice Henry quoted section 2 of the *Mercantile Law Amendment Act* of Ontario (which is identical to section 2 of the *Act*), and then held:

5 The law appears to be well settled that upon implementation of the guarantee in a situation such as that before me ***the guarantor stands in the place of the original creditor without the necessity of any formal transfer of any security interest to the guarantor****. It appears to me that this must be the effect of subs. (2): see Re Pathe Frères Phonograph Co. of Can.; Ex parte U.S. Fidelity & Guar. Co. (1921), 50 O.L.R. 644, 2 C.B.R. 21, 64 D.L.R. 628, and Jamieson v. Hotel Renfrew Trustees, [1941] 4 D.L.R. 470 (Ont.).*

21. In *Alberta Treasury Branches v Weatherlock Canada Ltd*., 2011 ABCA 314, the Court of Appeal for Alberta held:

33 ***That subrogation [of the guarantor to the creditor] gives the paying guarantor every remedy, every security, and every means of payment which the creditor had against the other guarantors. That subrogation is automatic, and does not depend in any way on contracts, such as an assignment.*** *See Fridman, op cit. supra at 402-03; Goff and Jones, op cit. supra at paras 3-025 and 3-027; Brown v. Coughlin (1914), 50 S.C.R. 100 (S.C.C.), 104; cf Royal Trust Corp. of Canada v. Rick Holdings Ltd., 1999 ABCA 187, 250 A.R. 156 (Alta. C.A.), (para 2).*

22. In *Bank of Montreal v. Ladacor AMS Ltd*, 2019 ABQB 985, Justice Graesser considered the position of Nomads and 236, guarantors of the debtor Ladacor.

> *47 In this case, Nomads and 236 have paid off BMO's claims against Ladacor.* ***Nomads and 236 are entitled to be subrogated to BMO's claim, and to stand in BMO's shoes with respect to any security BMO held against Ladacor. That means, according to the Receiver, that Nomads and 236 are now the primary secured creditors on any of Ladacor's remaining assets.***
>
> *48 Additionally, as between guarantors who have paid out on their guarantees, Nomads and 236 are entitled to be treated proportionately, so the debt paid off should be apportioned between them. Where guarantors are equally liable to the obligee, the guarantors are considered to be responsible for equal shares of the debt.*
>
> *49 Here, that would mean that each of Nomads and 236 should have paid off half of the debt owed to BMO. Since 236 paid more than half of the BMO debt, there should be an adjustment as between Nomads and 236, in 236's favor.*
>
> *50 The way the Receiver has accounted for this is that the excess of collections over required payments has left a surplus, some of which now stands to the credit of Ladacor.* ***Because 236 paid more than its half of the obligation, 236 is entitled to recover that excess from Ladacor****.*
>
> *51 Of the $5,834,882 paid to satisfy BMO's claims, $4,000,000 came from 236. The remainder came from Nomads. Because of contribution principles between guarantors, each of the guarantors should have paid $2,917,441. 266 overcontributed by $1,082,559. That amount is owed to it by Nomads.*
>
> *[…]*
>
> *53 This analysis and position is well supported by the Receiver's first brief for this application. The Receiver cites:*
>
> *Gerrow v. Dorais, 2010 ABQB 560 (Alta. Q.B.);*
>
> *Mercantile Law Amendment Act 1856, 19 & 20 Vict, c 97;*
>
> *Matticks v. B. & M Construction Inc. (Trustee of), 1992 CarswellOnt 193 (Ont. Bktcy.);*
>
> *Andrews & Millett, Law of Guarantees, 7th Ed (London: Sweet & Maxwell, 2015) at para 11-017;*
>
> *Windham Sales Ltd., Re, 1979 CarswellOnt 227 (Ont. S.C.);*
>
> *Wong v. Field, 2012 BCSC 1141 (B.C. S.C. [In Chambers]);*

EC & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home (District No. 69), 1987 CarswellAlta 25 (Alta. Q.B.); and

Abakhan v. Halpen, 2006 BCSC 1979 (B.C. S.C.) aff'd 2008 BCCA 29 (B.C. C.A.).

[…]

55 I am satisfied that for the purposes of finalizing the Receivership accounts, the monies the Receiver holds to the account of Ladacor and Nomads should be transferred to 236's account as a function of a guarantor's right to subrogation and to contribution rights and obligations as between co-guarantors.

23. Lastly, in *Hoare v. Tsapralis*, [1997] O.J. No. 2195 (Gen. Div.), aff'd (1999) 85 A.C.W.S. (3d) 441 (O.C.A.), Justice Ground held:

8 The plaintiffs, having paid to Rayrus the shortfall on the sale of the Property under power of sale, pursuant to their guarantees, are, in my view, clearly subrogated to all cause[s] of action which Rayrus may have had as a result of breach by Dasl of covenants contained in the mortgage.

24. NPL is therefore clearly entitled to an assignment of the Lenders' security over the other respondents, and to stand in the place of the Lenders relative to those respondents. NPL should have the right to exercise a significant, if not controlling, influence over the manner in which the remaining respondents' affairs are restructured. At a minimum, NPL is entitled to ask the Court to discharge the Receiver and terminate the receivership so that the remaining respondents, or some of them, may make a proposal to their creditors pursuant to the *Bankruptcy and Insolvency Act*, which proposal NPL anticipates would yield more for the unsecured creditors than a protracted, hugely expensive receivership.

D. THE RECEIVER IS WITHOUT AUTHORITY TO SELL THE INKSTER PROPERTY

25. NPL should no longer be in receivership: the Lenders have been paid, NPL has satisfied its guarantee, and NPL stands in the shoes of the Lenders. AGI has also concluded that NPL is *solvent*: it is asset-rich and has no creditors. Further, NPL is a creditor of NIP to the extent of approximately $17 million.

26. However, rather than acknowledge that the Receiver is now a trespasser on NPL's' property, the Receiver's Ninth Report and its brief each assume that the Receiver has authority to liquidate NPL's remaining assets so as to satisfy the unsecured creditors of *other companies*, the debts of which NPL has not guaranteed. To this end, the Receiver has sought an order approving a sale of a property owned solely by NPL and located at 1771 Inkster Boulevard, Winnipeg, Manitoba (the "**Inkster Property**"), and seeks an order approving that sale and vesting title in the Inkster Property in the proposed purchaser, free and clear of all encumbrances.

[I]f assets and liabilities of each Debtor are treated separately] remaining assets of NPL would not be available to pay (e.g.) employees of NIP who have unsecured claims *for unpaid employment amounts, but would only be available to pay unsecured creditors, if any, of NPL.*

[…]

[T]he sale of the Inkster Property is expected to contribute to the accumulation in the receivership of proceeds in excess of the amounts required to satisfy obligations ranking in priority to the claims of unsecured creditors, and therefore contribute to the accumulation of a pool (the "Unsecured Funds") of funds that may be ***available to unsecured creditors of the Nygard Group on a consolidated or other basis.***

[…]

[T]he proceeds of [the sale of the Inkster Property] would result in meaningful recoveries for ***the unsecured creditors of the Debtors' estates****.*

27. The legal impossibility of selling a property owned by (solvent) Company A to satisfy the debts of (insolvent) Company B, when Company A is a creditor of Company B, and vociferously objects to the sale, is obvious.

28. Firstly, the Receiver is without the legal authority to sell the Inkster Property. This Court's General Order held that the Receiver was appointed concerning "*only such property, undertakings and assets of NEL and NPL in which the Applicants have an interest pursuant to the Credit Agreement … and the Loan Documents (as defined in the Credit Agreement)*". As the Lenders has been satisfied in full, they no longer "*have an interest*" in NEL's or NPL's property that could ground a sale of the Inkster

Property by the Receiver. Stated differently, the Lenders' rights against NEL and NPL, conferred by the Credit Agreement and the December 25, 2019 debenture registered on title to the Property, are spent.

29. Secondly, even if the Lenders still had an interest in NPL's property pursuant to the Debenture, the Receiver would be without the legal authority to sell that property for the benefit of the creditors of any company other than NPL (such as the unsecured former employees of NPI). This Court has already held that NPI's assets may be used to pay NPL's creditors, (rather than the creditors of any company in the Nygård Group), under the supervision of the Court:

> ***The provisions of the credit agreement limit the priority of the lenders to proceeds of realization of NPL assets****. If amounts in excess of U.S. $20 million plus costs are collected as a result of the sale of real property and the liquidation process, the funds realized would be available for other creditors* ***of NPL*** *in accordance with the receivership order. If the proceeds exceed the limited recourse amount, the Receiver must determine what other debts and obligations are owed by* ***the debtor****, consider the priority of those claims, and seek further court authorization to use the balance of the proceeds of realization towards the satisfaction of the other debts and obligations.*[13]

30. NPL's assets are not available to NPI's creditors absent an order of this Court, which the Receiver has not sought (on which more below). The Receiver's purpose has been satisfied, it is currently in the position of a trespasser on the Respondents' property, and it should be discharged.

E. THIS COURT CANNOT VEST TITLE IN THE INKSTER PROPERTY IN THE PROPOSED PURCHASER

31. In order for the Receiver to sell the Inkster Property, it must obtain an order approving that sale, but also an order vesting title in that Property in the purchaser free and clear of encumbrances. Such an order is not available.

32. In *Third Eye Capital Corporation v Ressources Dianor Inc*., 2019 ONCA 508, the Court of Appeal for Ontario conducted a lengthy analysis of the law of vesting orders in a receivership context, including all aspects of the court's jurisdiction to make such orders. The primary issue in the case was whether a third-party interest in land in the nature of a Gross Overriding Royalty ("GOR") (an interest in a mining property) could be extinguished by a vesting order granted in a receivership proceeding. The panel began with a definition (a *"vesting order "effects the transfer of purchased assets to a purchaser on a free and clear basis, while preserving the relative priority of competing claims against the debtor vendor with respect to the proceeds generated by the sale transaction")* and then decided that the Court had authority to make a vesting order in a receivership, pursuant to section 243(1) of the *BIA*. The salient element of the decision was its analysis of *when* a vesting order could be made.

> *102 In my view, in considering whether to grant a vesting order that serves to extinguish rights, a court should adopt a rigorous cascade analysis.*
>
> *103 First, the court should assess the nature and strength of the interest that is proposed to be extinguished. The answer to this question may be determinative thus obviating the need to consider other factors.*
>
> *104* ***For instance, I agree with the Receiver's submission that it is difficult to think of circumstances in which a court would vest out a fee simple interest in land.*** *Not all interests in land share the same characteristics as a fee simple, but there are lesser interests in land that would also defy extinguishment due to the nature of the interest. Consider, for example, an easement in active use. It would be impractical to establish an exhaustive list of interests or to prescribe a rigid test to make this determination given the broad spectrum of interests in land recognized by the law.*

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[13] Reasons of this Court dated June 20, 2020, lines 9-17

105 Rather, in my view, a key inquiry is whether the interest in land is more akin to a fixed monetary interest that is attached to real or personal property subject to the sale (such as a mortgage or a lien for municipal taxes), ***or whether the interest is more akin to a fee simple that is in substance an ownership interest in some ascertainable feature of the property itself****. This latter type of interest is tied to the inherent characteristics of the property itself; it is not a fixed sum of money that is extinguished when the monetary obligation is fulfilled. Put differently,* ***the reasonable expectation of the owner of such an interest is that its interest is of a continuing nature and, absent consent, cannot be involuntarily extinguished in the ordinary course through a payment in lieu.***

33. The Court of Appeal then applied its analysis to the facts.

113 Thus, a GOR is an interest in the gross product extracted from the land, not a fixed monetary sum. While the GOR, like a fee simple interest, may be capable of being valued at a point in time, this does not transform the substance of the interest into one that is concerned with a fixed monetary sum rather than an element of the property itself. ***The interest represented by the GOR is an ownership in the product of the mining claim, either payable by a share of the physical product or a share of revenues. In other words, the GOR carves out an overriding entitlement to an amount of the property interest held by the owner of the mining claims.***

114 The Receiver submits that the realities of commerce and business efficacy in this case are that the mining claims were unsaleable without impairment of the GORs. That may be, but the imperatives of the mining claim owner should not necessarily trump the interest of the owner of the GORs.

115 Given the nature of 235 Co.'s interest and the absence of any agreement that allows for any competing priority, there is no need to resort to a consideration of the equities. ***The motion judge erred in granting an order extinguishing 235 Co.'s GORs.***

34. If in a receivership the Court does not have the authority to extinguish a fee simple or similar right held by a third party in real property, absent consent of that third party, then the Court certainly cannot have the authority to vest title in a property owned outright by NPL in a third party, over NPL's objections, for the benefit of fourth parties such as NPI's unsecured creditors.

35. The Receiver has exceeded its authority. It was authorized by the Order appointing it to (a) solicit offers for the Property (as defined in that Order), and (b) retain a realty broker, for the purpose of marketing assets exceeding $200,000 in value. Rather than merely recommending an offer received for the Inkster Property, the Receiver actually *accepted* the offer, which required vesting of the Property in the purchaser free and clear of encumbrances. It was not empowered to do so. Even worse, the day after being served with NPL's motion challenging the Receiver's right to sell the Inkster Property, the Receiver formally amended the agreement of purchase and sale so as to *reduce* the purchase price. The Receiver was not empowered to take any of these steps.

F. THE ESTATES OF THE RESPONDENTS HAVE NOT BEEN CONSOLIDATED

36. By asking the Court to approve the sale of NPL's Inkster Property for the benefit of NPI's unsecured creditors, the Receiver is behaving as if this Court has already granted an order for the substantive consolidation of the estates of the respondents.

> *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. [citation omitted].*
>
> *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").*

37. No such order exists in this case, and the Receiver has never brought a motion for such relief. Instead, the Receiver has explicitly stated that:

> *[i]t is not necessary for the Manitoba Court to presently make any determination as to the manner in which the Unsecured Funds [the proceeds from the Inkster Property] are to be treated, or whether the Nygard Group is to be treated as consolidated, or not, for creditor purposes*.

38. This is tactical. The Receiver has not articulated any justification for the sale of NPL's property *except* the payment of other companies' unsecured creditors. Such a sale therefore *assumes* consolidation of the estates. Rather than attempt to meet

the stringent legal test for substantive consolidation, an extraordinary remedy, the Receiver prefers to get the sale approved (a much lower legal threshold), destroy NPL's ownership interest in the Inkster Property, create a fund out of the proceeds, and then fight over that fund at some point in the hazy future. This is improper, and should be impossible.

39. The Receiver could not meet the test for substantive consolidation. In *Re Redstone Investment Corp. (Receiver of)* 2016 ONSC 4453, G.P. Morawetz J. (now Chief Justice of the Ontario Superior Court) conducted a lengthy analysis of the law surrounding substantive consolidation of estates in receivership. Justice Morawetz concluded:

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?

40. With respect to the aforementioned "elements of consolidation", the factors are 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.

41. Applied to the Receiver's request for approval of the sale of the Inkster Property, the answers to the test established by Justice Morawetz are as follows.

(i) The elements of consolidation are not present.

a. There is no difficulty in segregating NPL's assets from those of the other respondents. NPL is the registered owned of certain real property, including the Inkster Property. Save for the debt owed to it by NPI, NPL has no assets other than the real property.

b. NPL produces its own financial statements, and is not part of the consolidated financial statement shared by other respondents.

c. NPL is a real-estate holding company, and does not conduct an active business. There is, thus, no "single location" at which the business could be consolidated.

d. NPL's assets and business functions (real property and the holding of real property) have not been co-mingled with those of the other respondents. The Credit Agreement distinguished between the respondents, and respective liabilities to the Lenders.

e. There is no "unity" of ownership. NPL is owned by NEL, which does not directly own each of the other respondents.

f. NPL's intercorporate loan guarantee has been satisfied. It does not have any outstanding guarantees of the other respondents' debts.

g. The Receiver has not reported the transfer of assets to or from NPL without corporate formalities.

(ii) NPL is both a secured creditor of NPI in the amount of $17 million, and the owner of the Inkster Property, sought to be sold for the benefit of NPI's unsecured creditors. There can be no argument that NPL will not be seriously prejudiced by an order for consolidation.

(iii) In these circumstances, the answer to Justice Morawetz' third question, (Is consolidation fair and reasonable on all of the circumstances?), must be no. The assets of the respondents should not be substantively consolidated in order to benefit the unsecured creditors of NPI at the expense of NPL, NPI's secured creditor.

42. The facts before Justice Morawetz were more complex that those before this Court, but even in that case he held that substantive consolidation was inappropriate.

> *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 [citation omitted]*
>
> *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.***

43. The result should be the same here, had the Receiver brought a motion for substantive consolidation.

44. It should be noted that on September 29, the day upon which the Respondent served a Notice of Motion seeking to discharge the Receiver, the Receiver (a) asked E/B and Mr. Fenske if they were interested in purchasing Inkster and (b) they purported to firm up a sale to Eighth Avenue.

III. DOCUMENTS

A. ALBERT GELMAN INC. ("AGI")

45. AGI asked for documents and was provided most of those documents. The AGI report at Exhibit A provides a matrix which sets out the documents asked for and the documents received.

46. We disagree that the Receiver provided all of the documents. We further disagree that the Receiver provided the documents in the format that would allow them to be most usable.

47. The AGI Report sets out where some information is lacking.

B. FAWCETT REVIEW – COPIES OF DOCUMENTS

48. Fawcett and Fenske were allowed to review the contents of the servers. They requested copies of certain documents and they were denied. The Receiver has denied the Respondents' request making copies for the Debtors substantially based on the premise that the Receiver is running the Debtor's business and therefore they have no need for these documents. Both in Court and in writing the Debtors have indicated they need the records so they can be reviewed for the purposes of determining whether or not these are the kinds of records that need to be preserved for the litigation. Further because of questions asked by AGI after receipt of the previously referenced documents, it would have allowed Debtors to pass further information on to AGI relating to assets owned by NPL, NIP, and NEL. For the Receiver to state in its report they did not know and could not predict that was the reason the Respondents wanted copies of these documents is not consistent with the facts. To suggest the Respondents had to ask pursuant to the DEFA Order, when it is agreed between the parties that that Order does not apply to the Debtors, makes no sense. To suggest that the Respondent would have to ask Non-Debtors to make a request for debtor documents is not logical. We asked that the Court order the Receiver to produce the material on or before 2:00 on October 12th, 2020 (See Appendix I of the 9th Report)

C. PRESERVATION

49. The Receiver is now on their third plan for preserving the documents which was presented for the first time on November 2nd without supporting documents.

50. The Receiver offered their first plan when they filed their Motion in September. It was not a viable plan.

51. The Receiver, on October 11, 2020 forwarded a further assessment of (the 2nd plan) their proposed options available to preserve the electronic data (the KDL proposal). A completely different plan.

52. The Receiver's third plan for preservation of documents is to use a cloud based solution (see Paragraph 143 – 148 of the 9th Report). Again, a completely different plan. There are no supporting documents with respect to this new solution. There are apparently multiple proposals to host the cloud based solution and currently the estimate for average monthly costs of between $15,000.00 - $30,000.00 (a huge annual range of between $100,000.00 and $300,000.00 per year depending on the custom solution, term of service, and accessibility requirements to the data as described in the report.) The IT staff have apparently also obtained multiple quotes ranging between $100,000 to $300,000.00 from a third party professional to assist the IT staff with the migration of the system to the cloud based solution.

53. Once again there has been no consultation with the debtors and we have not been provided with sufficient information so it is not possible to reasonably comment on this third proposal for preservation of documents.

54. With respect to the physical documents the new storage costs now between $25,000.00 and $50,000.00 per year as opposed to just returning them to the Respondents.

55. The Respondents propose that the easiest and best solution to the preservation issue is to not sell Inkster and leave the servers intact along with the data while an

NOI is proposal is prepared. This saves the data without the extra cost to the unsecured creditors and would allow the new proposal trustee the ability to determine how to best deal with the data and the current market valuation for Inkster.

56. In the alternative, the Receiver would allow the Respondents access to the servers and be able to review the data, and determine what data needs to be preserved thus decreasing the cost. The Respondents estimate half the data is patterns and pictures of clothing that is not relevant to any litigation. A further 25% is invoices and payment records relating to product and is also not relevant. These were items which were stored on the AS400 system.

57. It is important to note the Receiver now agrees all the AS400 information is redundant when it stated at paragraph 147 of the 9th report

> "*that data contained within the AS400 does not appear to be crucial for the purposes of the Receivership Proceeding or for other purposes*" .

Further at paragraph138 of the 9th report the Receiver stated the they destroyed by court order:

> '*primarily marketing/promotional material, past shipping/logistics-related documents and other obsolete material which were abandoned or destroyed on site, as approved by the Document Abandonment order*".

This same redundant information also exists in the AX system, other servers, and in the paper copies and should also not be retained.

58. There is currently no order pronounced by an American court dealing with preservation of data. There is the obligation that all litigants have to preserve relevant documents (set out in paragraph 60 below). The debtors take this obligation seriously. All the American litigation, is currently stayed pursuant to an order of the American bankruptcy court. We need copies of the requested documents to do this analysis.

59. Finally, the Respondents should at least be allowed a reasonable amount of time to determine if this new third plan provider is charging a reasonable fee for the services

or if a competitive quote would better serve the unsecured creditors.

60. The Court of Queen's Bench Rules set out as follows:

Document

30.01(1) In rules 30.02 to 30.11,

(a) **"document"** includes a sound recording, videotape, film, photograph, chart, graph, map, plan, survey, book of account and information recorded or stored by means of any device;

(b) a document shall be deemed to be in a party's power if that party is entitled to obtain the original document or a copy of it and the party seeking it is not so entitled; and

(c) a relevant document is one which relates to any matter in issue in an action.

SCOPE OF DOCUMENTARY DISCOVERY

Disclosure

30.02(1) Every relevant document in an action that is or has been in the possession, control or power of a party to the action shall be disclosed as provided in this Rule, whether or not privilege is claimed in respect of the document.

61. It is the Respondents' position that they should not be treated any differently or be required to do more than other litigants; they should be given the opportunity to determine what is relevant and disclose same in the course of their litigation.

D. DEFA

62. It has been the position of the Respondents throughout that the DEFA Order:
    a. does not apply to the Respondents and
    b. even if it did it just doesn't work in a timely fashion.

The Receiver agrees DEFA does not apply to the debtors but the Receiver takes the position they are the debtors and do not have to share the documents and they will not provide documents to the Respondents. The Respondents request the court

order the Receiver to produce the Fawcett/Fenske documents on or before November 12, 2020 at 2 pm.

63. As set out in the Respondents' motion materials (and in the Affidavit of Greg Fenske, affirmed September 29, 2020, paragraph 15) the document disclosure order cannot address those issues in a timely fashion or at all because:

    a. The DEFA process which has been in use for the past six months is dependent on keyword and other search criteria that are then applied to reports and records which have already been saved to the server. We have not been able to obtain the information that we require as we don't know the names or naming conventions of the documents saved to the servers so the keyword searches have not worked.

    b. The DEFA process has proven to be ineffective, time-consuming and very costly to the creditors and ultimately did not produce the information that we will need for AGI to conduct its mandate.

    c. As set out above, the DEFA process searches for documentation and records already saved to the servers. In order to obtain the information that AGI requires, we will first need to pull the reports that are required from the AX System. Accordingly, the DEFA process cannot be used to produce the current financial reports from the AX System.

    d. As set out in the brief to our motion and as supported by the affidavit by Greg Fenske Edsons and Brause was completed was completely unsatisfactory.

    e. The DEFA order was not filed in court June 2020, immediately thereafter Edsons and Brause attempted to retrieve documents using the DEFA order and were completely dissatisfied because the key word search criteria did not produce the required documents and produced voluminous documents (approx. 80% not required). As a result of Edson and Brause's experience, the Respondents did not make a request pursuant to the DEFA process.

64. It is to be noted that the Respondents are prepared to assume control of the 5,100 boxes that contain copies of the AS400, and other servers user generated electronic files that the Receiver has in its possession and agreed are redundant as previously stated in paragraph 58.

65. The Receiver's new plan does not have the documents being turned over to the Respondents but being held by a third party at great expense to the Debtors and unsecured creditors.

IV. NOI – THE AGI REPORT – NEW PATH TO RESOLUTIONS

66. In the 9th Report the Receiver has made much of what is left to be done. In reality the most important thing left to be done is determining what is a viable proposal for the Unsecured Creditors. The Receiver states that some unnamed persons say they don't want the Receiver to be terminated or there to be a proposal (see paragraph 123(b) of the 9th Report). This is perplexing in that the terms had not yet been proposed. Conversely the largest group of unsecured creditors, the Respondents, have all indicated that they would support a viable proposal. To that end, the Respondent NPL is prepared to infuse $1,000,000 of new money into NIP to enhance the return to unsecured creditors.

67. A summary of the AGI's findings are as set out in paragraph 8:

    a. NIP is insolvent and is in a position to make a viable Proposal to its creditors;

    b. NPL is solvent, has no arm's length creditors, other than CRA, and has sufficient assets to discharge its liabilities to non-arm's length creditors. Accordingly, there is no need for the Inkster, Broadway or other properties owned by NPL to be sold to satisfy its unsecured creditors;

    c. Neither the Inkster Property nor the Broadway Property needs to be sold to satisfy any obligation NPL has as guarantor under the Credit Agreement (defined below) as the Receiver estimates in its Ninth Report that more than sufficient proceeds have been generated to date to repay the Lenders, the Receiver's Charge, the Landlords' Charge and to fund the payment of Potential Priority Claims, with perhaps some "excess" remaining;

    d. NEL is solvent if it is determined that NPL's loan due from NIP is secured (discussed in more detail later in this report); and,

    e. 879Co and 887Co are each insolvent.

68. At paragraph 26 AGI sets out the basis for $1,100,000.00 being paid to NIP.

69. At paragraphs 31 and 32 it explains how the settlement between NIP, NEL and NPL would result in NIP being in receipt of a further $1,100,000.00.

70. It finds that Nygard International is insolvent along with the two numbered companies which are its partners and they would be making a proposal. Conversely NPL and NEL are solvent.

71. The salient terms of the proposed proposal are set out at paragraph 130:

> 130. Pursuant to the Affidavit of Mr. Fenske dated November 5, 2020, the general terms of the proposal contemplated will include the following:
>
> a. a payment of $1,100,000.00, from NEL to NIP, as part of a settlement between NIP, NEL and NPL whereby NIP's debt to NPL will be extinguished and NEL's debt to NIP will be extinguished, as explained in the report of AGI;
>
> b. a (gratuitous) payment of $1,000,000 from NPL; and,
>
> c. a further payment equal to the fair market value of the remaining assets of NIP, as to be valued by the proposal Trustee in its report to unsecured creditors.

72. The conclusions reached by AGI are set out at paragraph 135 and they are based on their review and on information provided to date AGI presents the following conclusions:

> Based on its review and analysis of the information provided to date, AGI's conclusions are as follows: a. NIP is insolvent and is in a position to make a viable Proposal to its creditors;
>
> b. 879Co and 887Co are each insolvent;
>
> c. NPL is solvent;
>
> d. If the loan owing from NIP to NPL is secured, then NEL is solvent.

73. It is in the best interests of the unsecured creditors and the Respondents to lift the stay and allow the NOI to proceed as suggested in the AGI report.

V. CHALLENGE OF FEES OF THE RECEIVER AND COUNSEL

74. As it relates to the 9th Report and as set out in the Respondents' previously filed materials, the fees of the Receiver and the third parties that it has retained are excessive. The Respondents will be challenging these fees. The Receiver's fees and those fees of its consultants, in the amount of approximately 7 million dollars (to satisfy the original secured creditor of US 25 million dollars) is not appropriate. It is of utmost important, in light of all that is set out herein, that the monies of the estate be preserved and the Receiver be limited in its ability to continue to spend these monies. The Receiver and its counsel should attach their statement to an affidavit so they can be cross examined on these fees as set out in the Ontario Court of appeal case *Confectionately Yours Inc., Re* 2002 CanLII 45059.

VI. SUMMARY OF RESPONDENTS' POSITION

75. The debtors generally and NPL (the guarantor) specifically have asked the court, by way of a Notice of Motion on September 29, 2020, to not approve the sale of any more assets of NPL, in particular the Inkster Property.

76. NPI is a respondent in this proceeding solely because of its liability pursuant to a guarantee of the obligations of the Debtor to the Applicant, White Oak. NPI has discharged its liability on that guarantee: the Receiver has realized approximately $20 million from the sale of NPI assets, and used that sum, together with the proceeds from the sale of the Debtor's inventory, to pay the Applicant in full. These facts lead to the following conclusions.

77. Firstly, the Receiver should be discharged. The Applicant has been paid in full, and the Debtor and the guarantor companies have no further liability to the Applicant.

78. Secondly, as a surety which has performed its duty NPI is entitled, pursuant to

section 2 of The Mercantile Law Amendment Act, R.S.M. 1987, c. M120, to have the Applicant's security in respect of the Debtor assigned to it (NPI), and to stand in the place of the Applicant with respect to the Debtor.

79. Thirdly, the Receiver is without authority to sell one of NPI's assets, the Inkster property, to satisfy debts of the Debtor. NPI owes nothing to the Debtor (indeed it has the right to stand in the place of the Debtor's senior secured creditor) and there is no legal justification for selling an NPI asset, over NPI's objections, in such circumstances.

80. Fourthly, as the assignee of the senior secured creditor, NPI should have the right to exercise a significant, if not controlling, influence over the manner in which its Debtor's affairs are re-structured. NPI wishes that the Receiver be discharged and the Debtor make a proposal to its creditors pursuant to the Bankruptcy and Insolvency Act. NPI anticipates that a proposal would yield more for the Debtor's unsecured creditors than the continuation of this receivership.

81. It is respectfully submitted that:

a. The Court should discharge the Receiver;

b. In the alternative,

i. The Court should not approve of the sale of Inkster;

ii. The Court should lift the stay and allow AFI to file an NOI

iii. The Court should not approve of the suggested method of preservation;

iv. The court should not approve of the 9th report and assumed costs and fees.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 5th DAY OF NOVEMBER, 2020.

LEVENE TADMAN GOLUB LAW CORPORATION

WAYNE M. ONCHULENKO

Lawyer for the Respondents

BENNETT

on

RECEIVERSHIPS

Third Edition

by

Frank Bennett

L.S.M., LL.M.

Toronto, Canada

CARSWELL®

11

Discharge

1. GROUNDS

Once the receiver has achieved the goals of the receivership, principally the sale of the debtor's business or property and the distribution of the sale proceeds, the court in the case of a court appointment and the security holder in the case of a private appointment should terminate receiver's appointment and discharge the receiver.

The appointment of the receiver is usually terminated when the estate has been fully administered or the appointment no longer serves any purpose.[1] By that time, the receiver will have taken possession of and disposed of all the debtor's assets, property, and undertaking. Then, the receiver will have no other function, except in the case of a court appointment, to pass its accounts before being discharged. In a court appointment, the court terminates the appointment; it is not terminated automatically. The receiver then proceeds to pass its accounts and, if satisfactory, the court discharges the receiver. In a private appointment, the security holder may change or terminate the appointment of a receiver at will unless there is a prohibition in the security instrument.

There are many situations where a receiver may be discharged if the administration is not completed and another receiver appointed in its place to complete the receivership. In a court appointment, there is a heavier onus on the debtor or third party who seeks to discharge or replace a receiver in the course of the administration than there is upon a party opposing the court appointment in the first instance. The

1 See *Metropolitan Trust Co. of Canada v. Dancorp Developments Ltd.* (1993), 79 B.C.L.R. (2d) 169, 1993 CarswellBC 125 (B.C. Master), appeal dismissed (1993), 1993 CarswellBC 1998 (B.C. S.C.), where the court dismissed an application to discharge the receiver as the receiver had not completed the administration of the estate, and, in particular, the receiver had not resolved warranty issues, obtained tax refunds, and disposed of some of the remaining units of a condominium project at the time of the application.

court considers the delay in bringing the motion, the stage of the proceedings as well as the increased costs in replacing a receiver during the course of administration.[2]

The court or security holder may discharge the receiver in the following situations:

(1) Where the administration has been fully completed.
(2) If there is a conflict of interest with the receiver.

A receiver ought not to continue the appointment if there is any apparent conflict of interest. For example, a receiver who accepts an appointment as trustee in bankruptcy or as trustee under a proposal pursuant to the *Bankruptcy and Insolvency Act* or *vice versa* has a conflict of interest if the creditors are challenging the security instrument under which the appointment was made as being defective, or if the creditors are challenging the enforcement thereof or that the taking of the security is preferential to other creditors.

However, the court may permit the receiver to take both positions if the creditors consent or the inspectors of the bankrupt estate approve the appointment. Even if there is no litigation involving the security, the court may permit the dual position if the major creditors consent or do not oppose, or, in the case of a bankruptcy, the inspectors of the estate consent.[3] In addition, if the receiver is in a conflict of interest position but has taken steps to resolve the conflict, the court will dismiss the application.[4]

In *Re YBM Magnex International Inc.*,[5] the court considered the following factors, acknowledging that there may be additional factors, in deciding whether to remove a receiver:

(a) the gravity of the conflict or potential conflict;
(b) the receiver's qualifications, and the experience and familiarity already gained by the receiver;
(c) the prejudice to the estate in removing the receiver, in particular, the knowledge which would be lost and the time and costs which would be incurred in substituting a new receiver and bringing that person up to speed;
(d) he receiver's conduct, in particular, whether the receiver: (i) has disclosed the conflict or potential conflict from the outset; (ii) has established measures to reduce the dangers of conflicts or potential conflicts; and (iii) has in any way acted improperly;
(e) delay by the applicant in alleging conflict and bringing the motion for removal;
(f) tactical reasons for bringing the motion for removal; and
(g) the wishes of various stakeholders.

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2 *Royal Bank of Canada v. Vista Homes Ltd.* (1985), 63 B.C.L.R. 366, 57 C.B.R. (N.S.) 80, 1985 CarswellBC 475 (B.C. S.C.); *Canada Trustco Mortgage Co. v. York-Trillium Dev. Group Ltd.* (1992), 12 C.B.R. (3d) 220, 1992 CarswellOnt 168 (Ont. Gen. Div.); *Royal Bank of Canada v. Walker Hall Winery Ltd.* (2010), 2010 ONSC 4236 (CanLII), 2010 CarswellOnt 6025 (Ont. S.C.J. [Commercial List]).

3 See Chapter 12 "Bankruptcy and Receivership, 6. Conflict of Interest". See also sections 13.3 and 13.4 of the *Bankruptcy and Insolvency Act.*

4 *Re YBM Magnex International Inc.* (2000), 275 A.R. 352, 9 B.L.R. (3d) 296, 2000 CarswellAlta 1068 (Alta. Q.B.), appeal dismissed (2001), 293 A.R. 337, 23 B.L.R. (3d) 293, 257 W.A.C. 337 (Alta. C.A.).

5 Above. With respect to factor (a), the court considered (i) the existence of the conflict; (ii) the alleged favouritism by the receiver; (iii) the nature of the conflict for auditors affiliated with receivers; and (iv) the conclusion on the nature of the conflict.

(3) If the receiver has breached its duties or has not diligently fulfilled the powers entrusted to it by the court order or in enforcing the rights of the security holder.[6]
(4) If the receiver is negligent or incompetent.[7]

Needless to say, the receiver will not be discharged for minor breaches. The court or the security holder must assess the nature of the breach and the consequences in terms of the receiver's duties and powers and their effect on the debtor and other interested persons. The court reviews the receiver's actions as they unfold, rather than reviewing its actions with the benefit of hindsight.[8]

(5) If the receiver dies, is dissolved, or becomes insolvent.
(6) If there are sufficient facts to show partiality and bias.
(7) If the receiver is dishonest or fraudulent.
(8) If after the appointment, there appears to be no reason or purpose to continue with the receivership as, for example, there are no substantial assets to administer or where the estate would be better administered under the *Bankruptcy and Insolvency Act*.[9]

In *Kotler et al. v. Bayshore Investments Ltd. et al.*,[10] the court discharged the receiver on the basis that the costs of the receivership would lead to a dissipation instead of a preservation of assets.

However, in conflicts between the security holder and the debtor as to who should be the receiver, the court considers the fact the debtor is suing the receiver, the nature of the claims being made against the receiver and the costs to be incurred in substituting a new receiver.[11] In *Prince Albert Fashion Bin et al. v. Prince Albert Credit Union Ltd. et al.*[12] the debenture holder appointed a private receiver who allegedly was selling the debtor's inventory at less than cost. The debtor sued the debenture holder and receiver for damages, obtained an *ex parte* injunction and then

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6 In *Investors Group Trust Co. Ltd. v. Nussbaumer* (1980), 25 B.C.L.R. 133, 1980 CarswellBC 339 (B.C. S.C.), the receiver improperly performed her duties in a mortgage receivership. She failed to take prompt action to find tenants for the properties and took no steps to renegotiate any leases. In view of the fact that the mortgage was going to be redeemed within a short period of time, the court dismissed the application to discharge the receiver.

7 See *Aquilon Capital Corp. v. Sucor* (2010), 357 N.B.R. (2d) 336, 67 C.B.R. (5th) 288, 923 A.P.R. 336 (N.B. Q.B.), where if the privately appointed receiver is acting in good faith and is commercially reasonable in the sale of the debtor's assets, the court will not substitute the receiver or enjoin the receiver from selling.

8 *Canada Trustco Mortgage Co. v. York-Trillium Dev. Group Ltd.* (1992), 12 C.B.R. (3d) 220, 1992 CarswellOnt 168 (Ont. Gen. Div.).

9 In *Re United Maritime Fishermen Co-op* (1988), 87 N.B.R. (2d) 333, 68 C.B.R. (N.S.) 170, 221 A.P.R. 333 (N.B. Q.B.), appeal allowed (1988), 88 N.B.R. (2d) 253, 69 C.B.R. (N.S.) 161, (sub nom. *Cdn. Co-op. Leasing Services v. United Maritime Fishermen Co-op.*) 51 D.L.R. (4th) 618 (N.B. C.A.), the court terminated a receivership where the re-structuring of the debtor appeared no longer feasible so that a trustee in bankruptcy could better serve the creditors and sell the assets without the court.

10 (1982), 41 C.B.R. (N.S.) 223, 1982 CarswellBC 482 (B.C. S.C.), reversed (1982), 42 C.B.R. (N.S.) 127, 1982 CarswellBC 484 (B.C. C.A.).

11 *Royal Bank of Canada v. Vista Homes Ltd.* (1985), 63 B.C.L.R. 366, 57 C.B.R. (N.S.) 80, 1985 CarswellBC 475 (B.C. S.C.).

12 (1980), 37 C.B.R. (N.S.) 160, 1980 CarswellSask 30 (Sask. Q.B.).

applied to substitute a court-appointed receiver for the privately appointed receiver. Although the court refused to substitute the receiver on the grounds that the added cost did not justify another receiver, the court imposed a condition on the privately appointed receiver not to sell below cost without an order of the court or the consent of the debtor.

(9) If a prior encumbrancer appoints its own receiver or applies to the court in a court-appointed receivership for a receiver.[13]

(10) If the receiver requests its own removal where, for example, the receiver is a natural person and is ill or becomes incapable of fulfilling the duties of a receiver.

(11) If the court appoints a receiver, the appointment of a privately appointed receiver is terminated.[14]

(12) If the debtor challenges the validity of the appointment,[15] if a creditor alleges that the security instrument under which the receiver was appointed was a fraudulent conveyance,[16] or if the security holder does not post security pursuant to the order.

(13) If the receiver is in constant conflict with the debtor such that the evidence leaves little doubt that the receiver cannot remain impartial and disinterested.[17]

(14) In a mortgage receivership, if the mortgagee obtains a Rice order,[18] or purchases the property, the effect is to terminate the appointment of the receiver subject to the passing of accounts.[19]

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13 *Imperial Life Assur. Co. v. Glenburn Mtge. Ltd. et al.* (1978), 28 C.B.R. (N.S.) 302, [1979] 1 W.W.R. 245, 1978 CarswellBC 298 (B.C. S.C.), following *Re Metro. Amalg. Estates Ltd.; Fairweather v. The Company*, [1912] 2 Ch. 497 (Eng. Ch. Div.).

14 *Re Slogger Automatic Feeder Co.; Hoare v. Slogger Automatic Feeder Co.*, [1915] 1 Ch. 478 (Eng. Ch. Div.). If the order appointing the receiver is being appealed, the security holder cannot resort to the powers under the instrument in order to sell: *Price Waterhouse Ltd. v. Creighton Holdings Ltd. et al.* (1984), 36 Sask. R. 292, 54 C.B.R. (N.S.) 116, 1984 CarswellSask 39 (Sask. Q.B.).

15 *Mercantile Bank of Can. v. Nelco. Corp.* (1982), 47 C.B.R. (N.S.) 165, 1982 CarswellAlta 332 (Alta. Q.B.).

16 *Royal Bank v. First Pioneer Invts. Ltd. et al.* (1979), 27 O.R. (2d) 352, 32 C.B.R. (N.S.) 280, 106 D.L.R. (3d) 330 (Ont. H.C.), appeal dismissed (1981), 32 O.R. (2d) 121, 39 C.B.R. (N.S.) 147, 121 D.L.R. (3d) 510 (Ont. C.A.), appeal allowed [1984] 2 S.C.R. 125, 5 O.A.C. 195, 52 C.B.R. (N.S.) 225 (S.C.C.).

17 *First Pac. Credit Union v. Grimwood Sports Inc. et al.* (1984), 59 B.C.L.R. 145, 16 D.L.R. (4th) 181, 56 C.B.R. (N.S.) 7 (B.C. C.A.).

In *Azura Management (Hemlock) Corp. v. Hemlock Valley Resorts Inc.* (2006), 22 C.B.R. (5th) 60, 2006 BCSC 824 (CanLII), 2006 CarswellBC 1264 (B.C. Master), where the court dismissed the receiver's motion to approve the sale of the debtor's business, the court also discharged the receiver and substituted another. Here, the receiver's sale price was low, the sale was not in the best interests of the majority of interested parties, and the receiver allowed insufficient time to market the assets so as to create a proper climate to generate offers more closely akin to the fair market value of the property.

18 In Alberta, a Rice order is an order directing a judicial sale in favour of the creditor and granting judgment for the deficiency. See *Morguard Investments Ltd. v. De Savoye* (1988), 27 B.C.L.R. (2d) 155, [1988] 5 W.W.R. 650, 29 C.P.C. (2d) 52 (B.C. C.A.), appeal dismissed [1990] 3 S.C.R. 1077, 52 B.C.L.R. (2d) 160, [1991] 2 W.W.R. 217 (S.C.C.).

19 *Tow-Mor Properties Ltd. v. W.G. Fahlman Ent. Ltd.* (1986), 72 A.R. 81, 62 C.B.R. (N.S.) 297, 1986 CanLII 1907 (Alta. Master).

If the receiver's appointment is terminated before the administration of the estate is completed, the receiver must pass on the balance of the assets and proceeds to the successor receiver, if any, as soon as possible. The terminated receiver remains liable for its actions and will of course have the duty to account fully to the court, to the debtor, to the security holder, and to all other stakeholders. The successor receiver ought to be appointed immediately in order to provide continuity in the administration. If there is any appreciable lapse of time before a successor is appointed, it may be necessary for the security holder to move for a restraining order against the debtor.

In the case where a successor receiver is not appointed, the security holder may have to pursue other remedies that are available such as foreclosing or simply suing for arrears. If the security holder does nothing, the receiver nonetheless remains accountable for its conduct and activities. The receiver must return the debtor's property to the debtor at which time the powers of the directors and officers of the debtor corporation are restored.[20]

On the other hand, if the receiver has successfully managed the debtor's business to the extent of retiring the debt to the security holder, the receiver ought not to continue operating the business. The receiver will be without authority and therefore, notwithstanding its good intentions, the receiver may become a trespasser and liable for damages. The receiver remains accountable and becomes a fiduciary until the time when the receiver returns the business to the debtor.[21]

2. COURT APPOINTMENT

In most cases, a court-appointed receiver proceeds to administer the estate in receivership until completion. Thereafter the security holder can move for an order terminating the appointment and requiring the passing of the receiver's final accounts. However, there are situations where the receivership may be substituted or terminated earlier than by completion. Once the court terminates the appointment, the receiver then passes its accounts while the successor receiver continues with administration. The terminated receiver retains the right to apply to the court under the original order for directions.[22] When the accounts are passed, the receiver obtains an order of discharge. Usually, throughout the receivership, the receiver reports periodically to the court on the stage of the administration and at the same time requests that its conduct and activities be approved to date. The discharge order then protects the receiver from claims for maladministration and any disputes as to the validity of the appointment especially when it is on consent.[23] The order, however, does not protect the court-appointed receiver for gross negligence or wilful misconduct. If the debtor or other creditor wishes to pursue the receiver after its discharge for gross negligence or wilful misconduct, the debtor should post a full indemnity

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20 See below, "4. Refloating the Charge".

21 See *Kennedy v. De Trafford*, [1896] 1 Ch. 762 (Eng. Ch. Div.), appeal dismissed [1897] A.C. 180 (U.K. H.L.).

22 *Deloitte & Touche Inc. v. Ursel Investments Ltd. (Receiver of)*, [1992] 3 W.W.R. 106 at p. 115 (Sask. C.A.).

23 *Re Abacus Cities Ltd.*, [1986] 4 W.W.R. 564, 45 Alta. L.R. (2d) 113, 70 A.R. 55 (Alta. C.A.), leave to appeal refused (1986), 69 N.R. 240 (S.C.C.).

to protect the receiver in the event the claim is dismissed. Such an indemnity can be a payment into court or more conveniently by a letter of credit.[24]

The parties to the receivership action may settle or otherwise provide security to the court's satisfaction, thereby rendering the position of the receiver ineffective or unnecessary. Similarly if the costs of a continued receivership may lead to a dissipation of assets, the court may consider terminating the receivership where there is no likely benefit to be derived for the stakeholders.[25]

In the situation where the receiver may be substituted or replaced, the receiver must continue to act honestly and in good faith and the receiver should deal with the property in a commercially reasonable manner. Where the debtor or other stakeholders allege acts of impropriety, the court has the inherent power to remove its own officer and substitute another in its place prior to the completion of the administration.

If the debtor or a creditor brings a motion for the receiver's termination for cause, the court requires that the receiver report to the court as to the status of the administration in a timely manner. If the receiver does not present an accurate account and a record of receipts and disbursements, the court cannot assess the receiver's remuneration let alone order the discharge.[26]

On the motion for termination and discharge, the security holder and receiver should give notice to all defendants or respondents in the action and to all interested persons.[27] In many cases, only the debtor and guarantors are the defendants, although, depending upon the practice in the particular court, subordinate security holders and execution creditors may have been added as parties if they have not been paid.

The motion to discharge the receiver should be relatively straightforward when the administration has been completed since all the proceedings in the realization of assets will have been finalized, including the passing of the receiver's accounts and taxation. Persons having an interest in the debtor's equity have already had an opportunity to contest the sale proceedings and challenge the receiver's accounts. The court is reluctant to keep the administration open where all issues have been dealt with, except for possible potential claims against the estate or the receiver. In this case, the court analyzes whether such claims are sufficiently remote and hypothetical so that the administration can be finalized.[28] Thus, the motion to discharge the receiver is, in most instances, merely a house-keeping measure in the finalization of the lawsuit and relieves the receiver of any further obligations. The motion may also be a motion for advice and directions on the distribution of the sale proceeds. How-

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24 *Ed Mirvish Enterprises Ltd. v. Stinson Hospitality Inc.*, 2009 CanLII 55113, 2009 CarswellOnt 6167, [2009] O.J. No. 4265 (Ont. S.C.J. [Commercial List]).

25 See *Kotler et al. v. Bayshore Invts. Ltd. et al.* (1982), 41 C.B.R. (N.S.) 223, 1982 CarswellBC 482 (B.C. S.C.), appeal allowed on other grounds (1982), 42 C.B.R. (N.S.) 127, 1982 CarswellBC 484 (B.C. C.A.). See above "1. Grounds".

26 *Guar. Trust Co. of Can. v. 208633 Holdings Ltd.; Northland Bank v. 208633 Holdings Ltd. et al.* (1982), 19 Alta. L.R. (2d) 151, 42 C.B.R. (N.S.) 90, 1982 CanLII 1100 (Alta. Q.B.).

27 The purchaser of assets from the receiver has standing on such a motion where the purchaser has potential liability: *Bank of Montreal v. Probe Explorations Inc.* (2006), 26 C.B.R. (5th) 183, 2006 ABQB 604 (CanLII), 2006 CarswellAlta 1446 (Alta. Q.B.).

28 *Bank of Montreal v. Probe Explorations Inc.* (2006), 26 C.B.R. (5th) 183, 2006 ABQB 604 (CanLII), 2006 CarswellAlta 1446 (Alta. Q.B.).

ever, if the receiver has not taken all reasonable steps to realize the assets, the court may adjourn the motion pending finalization of the estate.[29]

Once the receiver completes the administration, the security holder may then proceed to obtain the receiver's discharge or an order granting the discharge on a fixed date or on the completion of the administration. Where security is posted for the receiver's performance, the receiver's surety will not, however, be discharged until such time as the receiver passes the final accounts and taxes its remuneration.

If the receiver has assets which are unrealizable, as, for example, books and records, the court will direct that the assets be returned to the debtor subject to the security holder's charge if the debt has not been fully satisfied. Where the holder has been repaid, the receiver must deliver such surplus assets and proceeds from realization to any subordinate security holder, the debtor, or the trustee in bankruptcy as the case may be.

As indicated above, the court usually grants the receiver's fees and expenses on a full indemnity basis where the receiver can establish entitlement through dockets and expenses receipts. In addition, where the debtor or other stakeholders challenge the receiver's conduct and activities, the receiver is usually entitled to the full indemnity as well. If the debtor or creditors unsuccessfully attack the receiver for claims of negligence, breach of fiduciary duty, dereliction of duty, abuse of power, or bad faith, the court has the inherent discretion to award full or substantial indemnity costs against the challenger especially where the facts have been litigated in previous proceedings.[30] The court can award costs on a full or substantial indemnity basis where the party can show reprehensible, scandalous, or egregious conduct. Similarly, if the receiver's reputation and integrity are being attacked, the court can award costs against the other party and even against a non-party if unsuccessful.[31]

3. PRIVATE APPOINTMENT

After the receiver disposes the debtor's property, the receiver normally prepares a statement of receipts and disbursements for the security holder and, if requested or required by statute, for the debtor and creditors. Such a statement is needed if the security holder intends to pursue a deficiency balance against the debtor or against any guarantor.

If the receiver does not produce a statement of receipts and disbursements, the debtor can commence a common law cause of action against the security holder for a detailed accounting with respect to the property taken and realized. In addition, the receiver is usually deemed to be the agent of the debtor, and as agent of the

29 *Re Atlantic Travel Service Ltd.* (1982), 44 C.B.R. (N.S.) 218, 1982 CarswellBC 502 (B.C. S.C.).

30 *Toronto Dominion Bank v. Preston Springs Gardens Inc.* (2007), 31 C.B.R. (5th) 167, 2007 ONCA 145 (CanLII), 2007 CarswellOnt 1182 (Ont. C.A.); *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.* (2007), (sub nom. *Bricore Land Group Ltd., Re*) 299 Sask. R. 194, [2007] 9 W.W.R. 79, 33 C.B.R. (5th) 50 (Sask. C.A.), allowing an appeal from (2007), (sub nom. *Bricore Land Group Ltd., Re*) 298 Sask. R. 158, 33 C.B.R. (5th) 46, 2007 SKQB 144 (CanLII) (Sask. Q.B.) with respect to costs where bad faith was not alleged.

31 *Re Party City Ltd.* (2002), 32 C.B.R. (4th) 286, 20 C.P.C. (5th) 156, 2002 CarswellOnt 1116 (Ont. S.C.J. [Commercial List]).

receiver should therefore be accountable. Moreover, the receiver must be in a position to account to others who are entitled to any surplus.[32]

Where the receiver cannot realize an asset, the receiver may return it to the debtor subject to the charge. If the debtor subsequently realizes upon the asset, the holder may enforce its judgment, if any, or re-enforce its security to the extent of any deficiency balance owing.

Upon completion of the administration, the receiver pays out the net proceeds of realization to the security holder. Although the practice is not uniform, the security holder may formally notify the receiver in writing of the termination of the receivership which will end the agency relationship. The notice takes effect when it is given to the receiver even though it may be dated and executed earlier.[33]

If the security holder terminates the appointment of the receiver before completion of the administration, the receiver remains liable to the security holder and to the debtor for its conduct and activities to the date of termination. If a successor receiver is appointed in its place, the security holder directs the first receiver to turn over the files to the second receiver.

Unlike court-appointed receiverships, it is not usually clear when the receivership has been fully administered. Although the receiver may have realized upon the assets and disbursed the proceeds, there is no finality. From time to time, unresolved problems may arise for which the receiver may be responsible. In such cases, the receiver may request indemnification from the security holder initially upon appointment or prior to distribution. An indemnity from an insolvent debtor is worthless.

If the receiver has retired the amounts owing under the security, the receiver is not *pro tanto* discharged notwithstanding that the security holder has been paid in full. The receiver stands charged with the duty to account for the surplus to the debtor and, in this respect, the receiver becomes a fiduciary.[34] If the receiver is aware of competing claims or subsequent security holders of the debtor, the receiver may pay such surplus into court by way of interpleading. Alternatively, the receiver may pay a subsequent security holder upon obtaining a proper indemnity.

If the receiver has realized sufficient proceeds to retire the debt to the security holder together with the remuneration, costs, charges, and expenses, the receiver must deliver up the surplus and any unrealizable assets, subject to the rights of subordinate creditors, to the debtor as soon as possible. In some cases, this may occur before the receiver has completed its administration. If the receiver retains such proceeds and assets for an unreasonable period of time irrespective of whether the receiver has been terminated, both the receiver and the security holder may be liable for trespass and conversion.[35] If the receiver has been terminated, then the security holder might escape liability depending upon when the notice of termination had been given.

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32 *Re B. Johnson & Co. (Bldrs.) Ltd.*, [1955] 1 Ch. 634, [1955] 2 All E. R. 775, [1955] 3 W.L.R. 269 (Eng. C.A.), followed in *Smiths Ltd. v. Middleton*, [1979] 3 All E.R. 842 (Ch. Div.).

33 See *Windsor Refrigerator Co. v. Branch Nominees Ltd.* (1960), [1961] Ch. 375, [1961] 1 All E.R. 277 (Eng. C.A.), where by analogy the appointment took effect from the time it was communicated.

34 *Kennedy v. De Trafford*, [1896] 1 Ch. 762 (Eng. Ch. Div.), appeal dismissed [1897] A.C. 180 (U.K. H.L.).

35 See *Re Goldburg (No. 2); Ex parte Page*, [1912] 1 K.B. 606 (K.B.).

KERR AND HUNTER

on

RECEIVERS AND ADMINISTRATORS

EIGHTEENTH EDITION

BY

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CHAPTER 12

DISCHARGE OF A RECEIVER

12–1 As already stated,[1] the rules regulating the appointment and control of receivers by the court have been substantially amended and codified, by new Rules, CPR 69 and CPR PD 69, revoking and replacing RSC Ord.30, with effect from December 2, 2002, with respect to proceedings commenced on or after that date.[2] The new rules relating to the discharge of receivers are as follows.

The court is now empowered to discharge a receiver, or to terminate his appointment, at any time, and to appoint another receiver in his place.[3] In particular, at the commencement of his appointment, the court may terminate it, if he fails, by the date specified, to give the security which the court has required, or to satisfy the court as to the security which he has in force.[4]

His appointment may also be terminated, if he is proved to have failed to comply with any rule, practice direction or direction of the court.[5]

When the court is discharging a receiver, or terminating his appointment, the court may require him to pay into court any money held by him, or to specify the person (*e.g.* his successor), to whom he must pay over any money, or to transfer any assets still in his possession,[6] and to make provision for the discharge or cancellation of any guarantee given by him as security.[7]

The receiver, or any party to the proceeding, may apply to the court for the receiver to be discharged on completion of his duties.[8]

12–2 **The case law.** The case law on these subjects, as analysed by Sir Raymond Walton, as slightly abridged, has been printed below. Despite the updating of the rules, the principles applicable will no doubt remain much the same.

12–3 **On his own application.** Unless the minutes of the order appointing or continuing a receiver, or a receiver and manager, contain a provision for his discharge,[9] an application to the court is necessary, in order to divest his

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[1] See Ch.5, above.
[2] Civil Procedure (Amendment) Rules, 2002 (SI 2002/2058, rr.2, 26, and Sch.7.
[3] CPR 69.3.
[4] CPR 69.5(2). Under the former rules, if he did not complete the security by the date specified, his appointment terminated.
[5] CPR 69.9(1).
[6] CPR 69.11(1)(a).
[7] CPR 69.11(1)(c).
[8] Insolvency 1986, s.45(1); CPR 69.10.
[9] *Day v Sykes, Walkers & Co.* (1886) 55 L.T. 733; [1886] W.N. 209.

possession.[10] The appointment of a receiver, made previously to the judgment in the action, will not be superseded by the judgment, unless the receiver is appointed only until judgment or further order.[11] But an order to put a purchaser into possession is in itself a discharge of a previous order for a receiver as to the lands mentioned in the subsequent order.[12]

As a general rule, where a receiver has been appointed and has given security, he will not be discharged upon his application, before he has completed his duties, without showing some reasonable cause why he should put the parties to the expenses of a change,[13] otherwise he may have to pay the costs of his removal and of the appointment of his successor. If, however, he can show reasonable cause for his discharge, such as ill-health, he may be discharged and allowed to deduct the costs of and incidental to the application for discharge out of any balance in his hands.[14] As an alternative, if his indisposition be only temporary, he may obtain the leave of the court to appoint an attorney for a limited period.

A manager may find himself in a situation where, without the whole-hearted co-operation of some party to the action, which is not forthcoming and cannot be privately compelled, he is unable to function effectively as a manager. In these circumstances, it is proper for him to apply in the alternative to be discharged, or to have his functions restricted to those which it is possible for him to carry out.[15]

Similarly, if there proves to be no advantage in continuing to carry on a business, either because it cannot be run at a profit, or because the possible profits do not justify the expenses of managing it, the manager, may, and indeed should, make a similar application.[16]

A receiver ought not to make an application for discharge to come on with the further consideration of the action; for the court can, on the further consideration, discharge him without such an application. Accordingly, the costs of a separate application for discharge have been refused.[17]

12–4 On satisfaction of incumbrance. A receiver is generally continued until judgment in the action in which he has been appointed; but, if the right of the claimant ceases before that time, the receiver will be discharged at once.[18] But where the appointment is made in a foreclosure action at the instance of a claimant who is subsequently paid off, another incumbrancer may, on application, obtain leave to be added as claimant, in which case the

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[10] *Thomas v Brigstocke* (1827) 4 Russ. 64; see now CPR 69.10.

[11] See para.5–40, above.

[12] *Ponsonby v Ponsonby* (1825) 1 Hog. 321; *Anon.* (1839) 2 Ir. Eq. R. 416.

[13] *Smith v Vaughan* (1744) Ridg. temp. Hard. 251; *cf. Cox v M'Namara* (1847) 11 Ir. Eq. R. 356.

[14] *Richardson v Ward* (1822) 6 Madd. 266.

[15] *Parsons v Mather & Platt Ltd*, unreported, December 9, 1974, CA (Appeal Court Judgments (Civil Division) No.392A), where (in effect) the manager was relieved of his management duties and restricted to those of a pure receivership.

[16] See *e.g.* the master's order in *Fillippi v Antoniazzi* (1976) R. 2251 unreported of November 1, 1977, directing that the receiver and manager be at liberty to cease trading forthwith at the premises of the partnership business.

[17] *Stilwell v Mellersh* (1851) 20 L.J. Ch. 356.

[18] *Davis v Duke of Marlborough* (1818) 2 Swan. 108.

receivership may be continued.[19] Similarly, if a receiver is appointed for the purpose of satisfying a number of claims, he will not be discharged merely on the application of a satisfied claimant, if some of the other claims are still outstanding.[20] Proceedings may always be stayed without prejudice to the receivership.[21]

Continuance becoming unnecessary. If, in the course of the proceedings, the continuance of a receiver becomes unnecessary, he will be discharged. Thus, where a receiver had been appointed in consequence of the misconduct and incapacity of trustees under a will, he was ordered to be discharged on the appointment of new trustees.[22] Again, where a receiver, who had been appointed in consequence of the executors of a testator's will having refused to act, moved away from the vicinity of the estates over which he had been appointed receiver, the court, on the consent of the other parties, and the executors expressing their willingness to act, made an order that the receiver should pass his accounts.[23] A receiver will be discharged, when the object of his appointment has been fully effected,[24] as, for instance, when arrears of annuity, to obtain which he was appointed, have been paid.[25] **12–5**

Other causes for discharge. A receiver is liable to be discharged for irregularity in carrying in his accounts, for conduct making it necessary to take proceedings to compel him to do so, and for so submitting his accounts that the amount of the balance in his hands cannot be ascertained.[26] So also, if his conduct has been such as to impede the impartial course of justice,[27] or to amount to a gross dereliction of duty,[28] or if his appointment as a receiver has been improper.[29] **12–6**

It is conceived, however, that a charge of misbehaviour against a receiver, for suffering the owner of an estate, over which the receiver was appointed, to remain in part possession of it to the prejudice of the estate, will not be regarded by the court as a sufficient reason for discharging the receiver, for in such a case the parties themselves have caused the loss, by not compelling the owner, by the authority of the court, to deliver up possession to the receiver.[30]

Where a receiver becomes bankrupt, he will be discharged, and another receiver appointed.[31]

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[19] See *Munster, etc., Bank v Mackey* [1917] 1 Ir.R. 49.
[20] *Largan v Bowen* (1803) 1 Sch. & Lef. 296.
[21] *Damer v Lord Portarlington* (1846) 2 Ph. 34; *Paynter v Carew* (1854) 18 Jur. 417; *Murrough v French* (1827) 2 Moll. 497.
[22] *Bainbrigge v Blair* (1841) 3 Beav. 421, 423. It is otherwise where, on the appointment of new trustees, there are questions still outstanding: See *Reeves v Neville* (1862) 10 W.R. 335.
[23] *Davy v Gronow* (1845) 14 L.J. Ch. 134.
[24] *Tewart v Lawson* (1874) L.R. 18 Eq. 490. See, too, *Hoskins v Campbell* [1869] W.N. 59.
[25] *Braham v Lord Strathmore* (1844) 8 Jur. 567.
[26] *Bertie v Lord Abingdon* (1845) 8 Beav. 53.
[27] *Mitchell v Condy* [1873] W.N. 232.
[28] *Re St. George's Estate* (1887) 19 L.R. Ir. 566.
[29] *Re Lloyd* (1879) 12 Ch. D. 447; *Nieman v Nieman* (1889) 43 Ch. D. 198; *Re Wells* (1890) 45 Ch. D. 569; *Brenan v Morrissey* (1890) 26 L.R. Ir. 618.
[30] *Griffith v Griffith* (1751) 2 Ves.Sen. 400.
[31] *Daniell's Chancery Practice* (8th ed.), p.1479.

If a receiver has been wrongly appointed over property belonging to a person who is not a party to the action, he will be discharged, even though there has been an abatement of the claim by the death of a sole defendant.[32]

The court will discharge a receiver upon the application of a prior mortgagee who demands to go into possession as such by himself or by his receiver.[33]

Where a receiver had been appointed in an administration suit, another person, who was willing to act at a lower salary, was ordered to be substituted for him, as receiver, on the application of a mortgagee of a tenant for life of the property.[34]

12–7 Property to be sold. Where estates, over which a receiver has been appointed, have been ordered to be sold, the receiver will be continued, until completion of the sale, in order that he may collect any arrears of rent.[35]

12–8 Balance due to receiver. The receiver of an estate will not be discharged until he has received from the estate any balance found due to him on passing his accounts.[36] In administration actions, a receiver may be discharged on passing his accounts, and be paid his remuneration and costs, without waiting to see whether the estate is sufficient to pay all costs payable out of it.[37]

12–9 Application of one party only. A receiver, being appointed for the benefit of all the parties interested, will not be discharged on the application of that party only at whose instance he was appointed.[38]

12–10 Mode of application to discharge. The application to discharge a receiver appointed in a claim should be made by application notice[39]; the direction for his discharge may be given in the judgment at the trial, or in the order upon further consideration.[40]

In the Queen's Bench Division, an application to discharge a receiver is made to the master by application notice,[41] which may be issued before or after submission of the receiver's final account. In the former case, the order is made, subject to the receiver complying with the usual Central Office regulations; in the latter, on production of the master's certificate, and proof that the receiver has complied with the directions therein.

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[32] *Lavender v Lavender* (1875) 9 Ir.R.Eq. 593.
[33] *Re Metropolitan Amalgamated Estates* [1912] 2 Ch. 497; above, para.2–27.
[34] *Stanley v Coulthurst* (1868) W.N. 305.
[35] See *Quin v Holland* (1745) Ridg. temp. Hard. 295.
[36] *Bertrand v Davies* (1862) 3 Beav. 436.
[37] *Batten v Wedgwood, etc., Co.* (1885) 28 Ch. D. 317.
[38] *Davis v Duke of Marlborough* (1812) 2 Swans. 108; *Bainbrigge v Blair* (1814) 3 Beav. 421, 423.
[39] *Atkin's Court Forms*, Vol.33 (1981 Issue), p.247; forms of order, *Seton* (7th ed.), p.781; see also Palmer's *Company Precedents* (16th ed.), Vol.III, Chap.69.
[40] *Seton* (7th ed.), pp.781, 782.
[41] See now CPR 69.10.

Where, under the former procedure, a bond has been given up on application at the General Filing Department, it will be delivered up on production of the master's order: see below.

Service and appearance. An application for the discharge of a receiver should be served on all the parties.[42] The service of it on the receiver should be personal, and such service will not be dispensed with, unless an order for substituted service is obtained.[43] But a receiver, though served, is not entitled to appear at the hearing of the application, unless some personal charge is made against him. If he appears, he will not be allowed the costs of his appearance,[44] except under special circumstances.[45] **12–11**

Form of order on discharge. If the receiver has not submitted his final account, nor paid over any balance shown thereby, or determined after examination to be due from him, the order discharging him will direct him to do so. **12–12**

The order of discharge may be conditional on the performance of some act by the receiver, or be otherwise contingent on some future event. On proper evidence of compliance or of the happening of the event, the master will indorse on the order a direction that any guarantee given by the receiver is to be cancelled. On production of the order in the Filing Department, Central Office, the guarantee is indorsed with the vacating note and delivered to the solicitor against his receipt.[46]

Effect of discharge. The court has power, by making an order for release and discharge, to protect the receiver from all liability for acts done in the court of his duties. This power should not be exercised without the court first investigating, or making provision for the investigation of, claims of which the court has notice. But the court is not obliged to wait until the end of the limitation period, before protecting its officer against such a claim, if the claimant, having had ample opportunity to do so, neglects to prosecute any claim.[47] **12–13**

Notice to surety. Under the usual form of guarantee, the receiver is bound to give to the surety by post notice of his discharge: and within seven days thereafter, send the surety an office copy of the order discharging him. **12–14**

In an Irish case, in which a receiver was discharged owing to gross dereliction of duty, the order discharging him disallowed his fees and poundage on all accounts not passed within the prescribed time, and directed him to pay interest on the balance (if any) from time to time in his hands, and to pay the costs of the motion to discharge him, of his own discharge, and of the appointment of his successor.[48]

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[42] *Daniell's Chancery Practice* (8th ed.), p.1499.
[43] *Att.-Gen. v Haberdasher's Company* (1838) 2 Jr. 915.
[44] *Herman v Dunbar* (1857) 23 Beav. 312.
[45] *General Share Co. v Wetley Brick Co.* (1882) 20 Ch. D. 260, 267.
[46] CPR 69.11. This does not arise, where the receiver is a licensed insolvency practitioner and is covered by continuous security.
[47] *IRC v Hoogstraten* [1984] 3 W.L.R. 933, at p.944H.
[48] *Re St. George's Estate* [1887] 19 L.R. Ir. 566.

IN COMPANY CASES

12–15 Administrative receivers; vacation of office. There are now special rules dealing with the vacation of office by administrative receivers.[49] Such a receiver must forthwith vacate office, if he ceases to be qualified to act as an insolvency practitioner in relation to the company.[50] Where he vacates office at any time, his remuneration, and any expenses properly incurred by him, and any indemnity to which he is entitled out of the assets of the company, will be charged on and paid out of any property of the company which is in his custody or under his control at that time, in priority to any security held by the person by or on whose behalf he was appointed.[51]

12–16 Resignation of administrative receiver. When an administrative receiver proposes to resign, he must give *at least seven days' notice,* stating the date when he intends his resignation to take effect, to (i) his appointor, (ii) the company, or, if it be in liquidation, the liquidator, and (iii) to the members of the creditors' committee, if any.[52] No such notice is, however, required if he resigns in consequence of the making of an administration order.[53] If the receiver dies in office, his appointor must, *forthwith on becoming aware of the death,* give notice to the same persons.[54] The making of an order does not itself terminate his appointment; but since an order can only be made, where an administrative receiver is in office, with the consent of his appointor,[55] his resignation will necessarily follow.

Where an administrative receiver vacates office on completion of his receivership, or by resignation, or by virtue of having ceased to be qualified as an insolvency practitioner, he must *within 14 days* give notice to the registrar of companies,[56] and *forthwith give notice* to the company or its liquidator, and to the members of the creditors' committee (if any).[57]

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[49] An administrative receiver may now only be removed by the court: Insolvency Act 1986, s.45(1).

[50] Insolvency Act 1986, ss.45(2), 62(2): for the meaning of "insolvency practitioner qualified to act in relation to the company," para.4–7, above.

[51] Insolvency Act, 45(3).

[52] Insolvency Rules 1986, r.3.34(1), (2).

[53] *ibid.,* r.3.33(3). See Ch.14, below, s.1.

[54] *ibid.,* r.3.34(1).

[55] Insolvency Act 1986, Sch.B1, para.15(1)(b).

[56] Insolvency Rules 1986, r.3.35(1), (2).

[57] Insolvency Act 1986, s.45(4); Insolvency Rules 1986 (SI 1986/1925) r.3.35(2): notice may be given by the individual by indorsement, on the notice given of his cessation, to the register of charges: Insolvency Act 1986, s.48—Companies Act 1985, s.405(2); Insolvency Rules 1986, r.3.35(4).

CHAPTER 26

TERMINATION OF ADMINISTRATIVE RECEIVERSHIP

26–1 Displacement of the receiver: general. A receiver appointed by the debenture-holders may, if the court thinks fit, be displaced by the court (but only by the court), on the application of other debenture-holders, or of the appointor, in favour of its own receiver. A receiver appointed by or on behalf of subsequent debenture-holders will be displaced by the appointment of a receiver by or on behalf of prior debenture-holders.[1–2] On the making of an administration order,[3] or the extra-judicial appointment of an administrator and its taking effect, any administrative receiver[4] of the company must vacate office[5]; and any receiver of part of the company's property must vacate office, on being required to do so by the administrator.[6]

26–2 Removal. Just as his appointment takes effect only when communicated to the receiver, so also (in the absence of any special provision) notice of removal, under a power to remove, is effective only when received by him.[7] To the extent to which it is his duty to have paid preferential debts, a receiver who is removed from office must ensure that these are discharged, or that he retains sufficient assets in his hands to meet them, before he parts with the assets. Alternatively (see below), his removal may be accompanied by another appointment, under such circumstances that the receivership may properly be regarded as continuous, in which case he will be justified in transferring the whole of the assets in his hands, save as mentioned below, to the new receiver. If he does not either ensure payment of the preferential debts, or else that the receivership may properly be regarded as continuous, he will be personally liable to any disappointed preferential creditor whose debt he ought to have discharged.[8]

Having regard to the personal liability imposed upon all receivers by statute in respect of their own contracts (save in so far as such contracts

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[1] [2] *Re Maskelyne British Typewriter Co.* [1898] 1 Ch. 133; *Re Slogger Automatic Feeder Co.* [1915] 1 Ch. 478.

[3] See Chap.14 above.

[4] See, as to appointments of administrators, judicial or extra-judicial, Pt III, above.

[5] For the meaning of "administrative receiver", see para.21–1.

[6] Formerly, Insolvency Act 1986 Pt II, s.11(1)(b) (repealed): now, since the Enterprise Act 2002, Pt 10, see Insolvency Act 1986, Sch.B1, para.41(1).

[7] n.6, above para.41(2).

[8] *Windsor Refrigerator Co. Ltd v Branch Nominees Ltd* [1961] Ch. 375, CA; *per* Donovan L.J. at p.398.

may provide, which is unusual, to the contrary), a receiver who has been removed will, like any other agent who has properly made himself liable in respect of his principal's contracts, have a lien on the assets in his hands against all such liabilities personally incurred by him.[9]

Duty to cease to act. If, at any stage of his management of the company, the receiver has in his hands sufficient moneys to discharge all the debts of the company which he is bound to discharge, all possible claims which could be made against him and in respect of which he is entitled to an indemnity, his own remuneration, and all moneys secured by the instrument pursuant to which he was appointed, it will be his duty to cease to act with all due expedition; this should confine his further activities to taking the necessary steps to conclude his administration. If he continues to act, any accounts will be taken against him thereafter with annual rests from the date when he had sufficient moneys in his hands to cover all such amounts.[10] His continuance in possession of the company's assets thereafter might also be regarded by the courts as wrongful, since his appointment is only for the purpose of enabling the encumbrancers, entitled to the benefit of the instrument under which he was appointed, to recover their debt; once this purpose has been achieved, there is no ground for his continuance in office. The effect would be that thereafter he would be in the position of trespasser.[11] **26–3**

For various reasons, the receiver may have sufficient moneys in his hands for the above purpose, but may not be in a position to settle all possible claims which could be made against him and in respect of which he is entitled to an indemnity. He should then request his appointor to apply for his discharge, and should retain sufficient moneys to answer his indemnity, and account at once for any balance to the company. Alternatively, he may (but cannot be forced to) accept an indemnity from the company which may (but cannot be compelled to) offer such indemnity.

Death. If, after the death of a receiver, the company attempted to deal with its assets before the debenture-holders had an opportunity of appointing a new receiver, the company could clearly be restrained by injunction from so acting. In the normal case, an appointment will be promptly made in replacement, and the receivership can then be regarded as continuous,[12] but provision will of course have to be made to ensure the indemnification of the receiver's estate against all liabilities personally incurred by him. **26–4**

Continuity of receivership. Although the only directly relevant decision relates to a special statutory situation,[13] where a new receiver is appointed, **26–5**

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[9] *I.R.C. v Goldblatt* [1972] 498. The debenture holder who procured the removal of the receiver was also held liable. Crown preferences, involved in that case, have been abolished by Enterprise Act 2002, s.251 with effect from September 15, 2003.

[10] *Foxcraft v Wood* (1828) 4 Russ. 487.

[11] *cf. Ashworth v Lord* (1887) 36 Ch. D. 545.

[12] See below.

[13] *Re White's Mortgage* [1943] Ch. 166 (appointment of receiver requiring leave under the Courts (Emergency Powers) Act 1939.

in the place of a receiver who has died or been removed, without undue delay, the receivership may be regarded as continuous.[14] This is particularly important as regards any undischarged statutory duties, such as the duty to discharge preferential debts.[15] If these have not been discharged prior to the death or removal, then his personal representatives or the receiver himself, as the case may be, will, if the receivership can be regarded as being continuous, but not otherwise, be justified in accounting to the new receiver in respect of the entirety of the assets in his hand (save for such portion thereof as is required for his protection against contractual claims), leaving it to the new receiver to complete the statutory obligations in this regard.

If, however, the receivership cannot be regarded as continuous,[16] he cannot safely take this course. Nor, if no further receiver is to be appointed, can he simply take the course of accounting to the company, without first discharging all preferential debts, and distributing, if required, the "prescribed part" to the unsecured creditors.

26–6 Ceasing to act. Upon ceasing to act as such, the receiver or manager is required to render accounts, as set out below, and is also, on so ceasing, is required to give the registrar of companies notice thereof.[17] This notice is entered by the registrar in the register of charges. Default incurs a fine on summary conviction not exceeding one-fifth of the statutory maximum, and on conviction after continued contravention, a default fine not exceeding one-fiftieth of the statutory maximum.[18]

26–7 Vacation of office by administrative receiver. An administrative receiver will automatically vacate office on the making of an administration order[19]; but no such order is made without the consent of his appointor,[20] unless the security whereunder he was appointed is considered by the court to be liable to be set aside as being at an undervalue, or a voidable preference, or an invalid floating charge.[21] The relationship between the appointments of administrators and the appointment and functions of administrative receivers is considered in Chapter 14, above.[22]

Apart therefrom, he may at any time be removed from office by order of the court, but not otherwise.[23] Accordingly, no provision in the debenture

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[14] Insolvency Act 1986, s.46(2): see also s.62(6).

[15] Under Insolvency Act 1986, new s.176A, inserted by Enterprise Act 2002, s.253: see Ch.29, below.

[16] In *Re White's Mortgage*, n.14, above, a delay of 10 months was held to break the continuity of the receivership.

[17] Companies Act 1985 (as amended), s.409(2).

[18] n.17, above s.405(4). All notices under Companies Act 1985, s.405 must be in the prescribed form: see s.405(3). The appropriate form is Form 405(2) in Sch.3 to the Companies (Forms) Regulations 1985 (SI 1985/854).

[19] Formerly under Insolvency Act 1986, s.11(1)(b) (repealed): now under Insolvency Act 1986, Sched. B1, paras 39(1)(a), 41(1).

[20] Formerly under n.19, s.9(3)(a) (repealed); now under Insolvency Act 1986, Schedule B1, para.39(1)(b)(c)(d).

[21] n.19, s.9(3)(a)

[22] See Chap.14 above.

[23] Insolvency Act 1986, s.45(1).

whereunder he was appointed, authorising his removal by the appointor, or by anybody else other than the court, will be effective.

He will similarly vacate office, if he ceases to be qualified to act as an insolvency practitioner in relation to the company[24]; This will be without prejudice to the validity of any acts which he may have carried out, after he ceased to be so qualified.[25] In this event, he must forthwith give notice of his vacation of office to the liquidator of the company, if it is in liquidation, and to the members of the creditors' committee, if there is one.[26] Within 14 days, he must also send a notice to that effect to the registrar of companies.[27]

He may resign, by giving at least seven days' notice of his intention to do so to his appointor and to the company, or, if it is then in liquidation, its liquidator, specifying the date on which he intends his resignation to take effect.[28] Then, within 14 days after his vacation of office, he must send a notice to that effect to the registrar of companies.[29]

If the administrative receiver dies, his appointor must, forthwith upon his becoming aware of the death, give notice of it to the registrar of companies[30] and to the company, or, if it is then in liqnidation, to its liquidator.[31]

He will also, of course, vacate office on the completion of his receivership: all the same, in this case notices must be given as if he had vacated office in consequence of ceasing to be qualified as an insolvency practitioner.[32]

When he vacates office, his remuneration, any expenses properly incurred by him, and any indemnity to which he is entitled out of the assets of the company, will be charged on and paid out of any property of the company which is in his custody or under his control at that time in priority to any security held by his appointor.[33]

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[24] n.23, s.45(2).

[25] Insolvency Act 1986, s.232; Schednle B1, para.104.

[26] Insolvency Rules 1986, r.3.35(1).

[27] Insolvency Act 1986, s.45(4). Such notice may be given by means of an indorsement on the notice required by Companies Act 1985, s.405(2) for the purposes of the register of charges: Insolvency Rules 1986, r.35(2). If an administrative receiver, without reasonable excuse, fails to comply with this obligation, he is liable on summary conviction to a fine not exceeding one-fifth of the statutory maximnm, and on conviction after continued contravention to a daily default fine not exceeding one-fiftieth of the statutory maximum: Insolvency Act 1986, ss.45(5). 430, Sch.10. He is no longer liable to a daily default fine, for continued default: s.45(5), as amended by Companies Act 1989, ss.107, 212, Sch.16.

[28] Insolvency Rules 1986, r.3.33(1), (2). The appropriate form is Form 3.9 in Sch.4: see r.12.7. No notice is necessary if he resigns in consequence of the making of an administration order: *ibid.* r.3.33(3). As appears from the text to nn.4–7 above, the receiver will automatically vacate office on the making of such an order, and the precise import of this subrule is accordingly unclear.

[29] See n.27, above, above.

[30] Insolvency Rules 1986, r.3.34(a). The appropriate form is Form 3.7 in Sch.4 to the Insolvency Rules 1986, r.12.7.

[31] Insolvency Rules 1986, r.3.34(b).

[32] Insolvency Rules 1986, r.3.35(1).

[33] Insolvency Act 1986, s.45(3).

26–8 Floating charge "re-floating" after receiver ceases to act. Where a receiver has ceased to act, for one reason or another,[34] for a period of one month, and no other receiver has been appointed, the floating charge, by virtue of which he was appointed, ceases to attach to the property the subject of the charge, and again subsists as a floating charge.[35]

For the purposes of calculating that period of one month, no account shall be taken of any period when an administration order was in force. A charge to which these provisions apply is sometimes referred to as having "re-floated".[36]

26–9 Accounts to be rendered upon ordinary receiver ceasing to act. On ceasing to act, the receiver must deliver the usual abstract within one month, and must include the figures from the last abstract,[37] up to the date of so ceasing.[38] It will, as in the case of all other abstracts, show the aggregate amount of his receipts and of his payments during all preceding periods since his appointment.[39]

Where a receiver is appointed out of court, and subsequently the same person is appointed administrative receiver in a debenture-holders' action, his accounts are taken in the action: if a different person is appointed, the first receiver may apply by summons to have his accounts taken in the action.[40]

26–10 Accounts upon administrative receiver ceasing to act. Within two months (or such extended period as the court may allow) after ceasing to act as administrative receiver, he must send to the registrar of companies, to the company and to his appointor, and to each member of the creditors' committee (if there is one), the requisite account of his receipts and payments as receiver.

26–11 Balance in accounts due to company. The duty of the receiver to keep accounts and make them available for inspection by the company, as and when required, has already been noted. But whereas the receiver is not a debtor to the company in respect of any intermediate balance which might appear from his accounts to be due to the company, he will be a debtor to the company in respect of the final balance, after discharging all preferential debts and so forth, shown by his accounts to be due to the company. It follows that this balance can be the proper subject of a third party debt order.[41]

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[34] By dying, or losing his qualification, or resigning, or being removed by order of the court.
[35] Insolvency Act 1986, s.62(6).
[36] See n.35, above.
[37] The prescribed form is Form 497 in Sch.3 to the Companies (Forms) Regulations 1985 (SI 1985/854).
[38] Insolvency Act 1986, s.38.
[39] For penalty for default, see Insolvency Act 1986, s.38.
[40] *Practice Note* [1932] W.N. 79.
[41] As envisaged by the judgment in *Seabrook Estate Co. Ltd v Ford* [1949] 2 All E.R. 94, 97.

Remuneration, expenses and indemnity on vacation of office. Where a receiver or manager appointed under powers contained in an instrument, whether or not an administrative receiver, vacates office, his remuneration,[42] expenses properly incurred by him, and any indemnity[43] to which he is entitled out of the assets of the company, are charged on, and are to be paid out of any property of the company which is in his custody or under his control at that time, in priority to any charge or other security held by the person by or on whose behalf he was appointed.[44] **26–12**

Withdrawal of receiver before payment off of debenture holders in full. If a receiver is withdrawn by consent, before the debenture-holders have been paid off in full, any floating charge comprised in their security, having once crystallised, will not refloat automatically, and can only be made so to do by express agreement. A more difficult question is whether, after the withdrawal of a receiver, the debenture-holders are still entitled to a fixed equitable charge on the assets so released to the company; in principle, there appears to be no reason why this charge should not continue to attach to any assets which belonged to the company at the date of crystallisation, and which have not been disposed of during the receivership. The charge would not attach to assets of the company acquired subsequently to the date of crystallisation.[45] The practical results of this position are so inconvenient that it is thought that an intention to waive the fixed charge will readily be implied. **26–13**

Destination of books and papers. The ownership of documents in the possession of a receiver at the end of the receivership may vest in the company, or in the debenture-holders, or may remain with the receiver, depending on their nature. All documents generated by or received by the receiver pursuant to his duty to manage the business of the company, or to dispose of its assets, vest in the company. Documents containing advice and information about the receivership, or about the companies brought into existence by the receiver for the purpose of enabling him to advise the debenture-holders, belong to them. Notes, calculations, working papers and memoranda prepared by the receiver, not pursuant to any duty to prepare them, but better to enable him throughout to discharge his professional duties, belong to the receiver. **26–14**

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[42] As to the court's power to fix his remuneration, see n.33, above.

[43] As to his indemnity, see para.9–17 above. For the indemnity enjoyed by a receiver appointed by the court, see para.8–11 above.

[44] Insolvency Act 1986, s.37(1), (4) (ordinary receivers); s.45(3) (administrative receivers).

[45] *Re Yagerphone* [1935] Ch. 392. The passage in the test was criticised by Russell L.J. in *N.W. Robbie & Co. Ltd v Witney Warehouse Co. Ltd* [1963] 1 W.L.R. 1324 at 1338; but he omitted to observe that it is dealing with the position of future assets, acquired after (i) a crystallisation of the charge and (ii) a subsequent withdrawal of the receiver. It is still submitted that future assets fall within the scope of the floating charge only.

26–15 Transitional provisions of the Insolvency Act 1986. The 17th edition of this work contained, at pp.441 *et seq.* a detailed analysis of the law in force before Insolvency Act 1985 and Insolvency Act 1986 came into force, and of the changes effected by the new legislation, and of the transitional provisions relating to preferential debts.

Railroad Company v. Soutter

69 U.S. 510 (1864)
Decided Jan 1, 1864

DECEMBER TERM, 1864.

1. Though a court below is bound to follow the instructions given to it by a mandate from this, yet where a mandate has plainly been framed, as regards a minor point, on a supposition which is proved by the subsequent course of things to be without base, the mandate must not be *so* followed as to work manifest injustice. On the contrary, it must be construed otherwise, and reasonably. 2. The appointment or discharge of a receiver is ordinarily matter resting wholly within the discretion of the court below. But it is not always and absolutely so. Thus, where there is a proceeding to foreclose a mortgage given by a railroad corporation on its road, c. — a long and actively worked road — (a sort of property to a control of which a receiver ought not to be appointed at all, except from necessity), and the amount due on the mortgage is a matter still unsettled and fiercely
511 contested, the appointment *511 or discharge of a receiver is matter belonging to the discretion of the court in which the litigation is pending. But when the amount due has been passed on and finally fixed by *this* court, and the right of the mortgagor to pay the sum thus settled and fixed is clear, the court below has then no discretion to withhold such restoration; and a refusal to discharge the receiver is judicial error, which this court may correct, supposing the matter (not itself one in the nature of a final decree) to be in any way fairly before it otherwise. If other parties in the case set up claims on the road, which they look to the receiver to provide for and protect, these other claims being disputed, and, in reference to the main concerns of the road, small, — this court will not the less exercise its power of discharge. It will exercise it, however, under conditions, such as that of the company's giving security to pay those other claims, if established as liens.

Mr. Carpenter, for the appellants.

1. The proceedings had in the court below, by which the amount due on the bonds secured by the mortgage to Bronson and Soutter was ascertained and a decree entered, was not according to the direction of the mandate. The decree, indeed, gave the year to pay; but this, and all else that was done, was ordered *before and without* ascertaining what sum was in the receiver's hands. Now, the authority of the inferior court extends only to executing the mandate sent it. They cannot vary it, or give *any other or further* relief.† Under that mandate the court was bound "to ascertain the amount of moneys in the hands of the receiver," and its authority to order a sale arose only "IF" the amount was not sufficient to discharge the interest.

† *Ex parte* Dubuque and Pacific Railroad, Id. 69.

2. The appellants complain of the denial of their petition to the Circuit Court, since the cause was remanded, for leave to pay into court all the money due the complainants in this cause, and for possession of the mortgaged premises.

It is admitted that this order is not such as might be appealed from before a final decree. But, when an appeal is properly taken from a final decree, as it has been decided that the present one is,‡ the appellant may be relieved from any interlocutory order or proceeding by which he is aggrieved. The continuance of the receivership until

the final decree, or until the amount due the complainants is paid into court, is matter of discretion, and not reviewable here. But after the amount due the complainant had been fixed by a final decree, as that also has been in this court,[§] and *517 the owner of the equity of redemption offered to pay that amount into court, the discharge of the receiver was demandable as a matter of right; and its refusal was error, which can be reviewed here.

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‡ See *supra*, p. 440.

§ See *supra*, p. 312.

The Milwaukie and Minnesota Railroad Company was owner of the equity of redemption. As such, it had the right to redeem all prior incumbrances, and the foreclosure under which it was organized extinguished all liens of a date subsequent to that of the mortgage, on the foreclosure of which it came into existence. It was, therefore, entitled to possession, unless some other person could show better right thereto.

Howard's lien was declared by this court to be extinguished.– The language of the Supreme Court is this:

– *Supra*, p. 304.

"Now it appears that each of these judgments were recovered after the date of the mortgage on the La Crosse and Milwaukie Company, upon the foreclosure of which the Milwaukie and Minnesota Company was formed. The liens of these judgments were cut off by its foreclosure; indeed, the judgment of *Howard*, of November, 1858, and the last judgment of Graham and Scott, which was recovered in 1860, never were liens upon any interest in the road of the La Crosse and Milwaukie Railroad Company."

It will be said that this opinion was delivered under a mistake of fact. Perhaps it was so, and perhaps, in a proper proceeding in his case, it may be found that Howard has a valid subsisting lien; but, on this motion, we must consider the presumption to be the other way, and act accordingly.

Chamberlain's opposition demands more respect. He claimed possession under his lease and judgment, which, the case shows, had been vacated by the decree of the District Court. This decree may be erroneous, but cannot be questioned collaterally. It was rendered in a cause in which the complainant, as a judgment creditor, sought to vacate the lease and judgment. *518

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The opposition of the Milwaukie and *St. Paul* Railroad has no foundation except in selfish interest. The motives of that company to keep the road *out* of the hands of its true owners, and *in* the hands of a receiver, interested in his commissions chiefly, are obvious when the topographical position of the rival companies is seen. It is a case where pecuniary motive is as strong as better reasons are weak.

Messrs. Cary and Carlisle, contra.

1. The mandate has been as well observed as in the nature of the difficulties it could be. The obligation of an inferior court to obey the order sent it, is not to be followed to the extent of sacrificing the spirit of the order to its letter.

The denying the appellant's motion to have the receiver pay the money in his hands into court, to discharge him, and to hand the road over to the Milwaukie and Minnesota Company, is so clearly a matter pertaining to the practice of the court below, and so entirely within the discretion of that court, that we have been surprised to hear counsel of Mr. Carpenter's ability, and regard to what positions he asserts, insist upon his right to appeal from it. Such matters *must* be left to discretion, if such a thing as discretion is to exist in an inferior court at all. But if this court will consider a matter in which, from the nature of the case, we think it has no good

opportunity to form a judgment, then we say that both the judgment of Howard and the claim of Chamberlain should control the question. The receiver was appointed on Howard's motion. This court has, indeed, said.– that his lien was discharged. Undoubtedly this idea proceeds on a misapprehension of fact. Howard's judgment in the State court against the La Crosse Company was recovered on the 1st day of May, 1858, and became a lien *prior* to the mortgage under which the Milwaukie and Minnesota Company sprung. This judgment was "sued over" in the Federal court, and judgment obtained there November 28th, 1859; but the record, of course,
519 discloses the original lien of *519 his judgment. The opinion of this court mentions the How ard judgment in the *Federal* court, but makes no mention of the judgment in the State court upon which the judgment of the Federal court was founded. Suing over in the Federal court did not extinguish its lien.

– *Supra*, p. 304.

Chamberlain or Howard — if anybody but the present receiver — should have the road. Chamberlain was a judgment creditor and a lessee of the road. Counsel insist that the effect of that decree in the District Court was to *vacate and annul* the judgment and lease as to all the world, and that they are now of no force or effect, as between the parties thereto. But such, *we* apprehend, is not the effect in law. The effect of that decree was but to postpone the lease to the judgment of another party. The Milwaukie and Minnesota Company can claim no advantage from it.

The attack on the Milwaukie and St. Paul Railroad Company is gratuitous wholly. Legal rights are not to be denied it, merely because the granting of those rights are necessary to its interests and would greatly promote them. Yet this, in effect, is the argument of the other side.

BRONSON and Soutter had filed a bill in the Circuit Court for Wisconsin, against the *La Crosse and Milwaukie* Railroad Company, to foreclose a mortgage given by the said company to them to secure bonds to the extent of one million of dollars, which that company had put into circulation, and the interest to a large amount on which was due and unpaid. To this bill the *Milwaukie and Minnesota* Railroad Company — a company which, on a sale under a mortgage *junior* to that of Bronson and Soutter, was organized, and became, under the laws of Wisconsin, successor in title and interest to the *La Crosse and Milwaukie* Company, and also three other persons, one named Sebre Howard — were made or became defendants, and opposed the prayer for foreclosure. They alleged that the bonds which the mortgage to Bronson and Soutter had been given to secure, had been sold, transferred or negotiated at grossly inadequate prices, fraudulently in fact, and were not held for full value by these persons, who sought by the foreclosure to recover their par. The court below, being of this opinion, gave a decree in that suit to the extent of but fifty cents on the dollar. Coming here by appeal at the last term,– the decree, after an animated, protracted, and very able argument in support of it by *Mr. Carpenter*, in
512 behalf of numerous parties interested, was reversed, and a decree ordered to be entered *512 below for the full amount, *cent* for *cent*.– The suit, at the time of the decree here, had been pending for four years. The mandate from this court ran thus:

– See *supra*, page 283.

– See *supra*, page 312.

"It is ordered that this cause be remanded to the Circuit Court of the United States for the District of Wisconsin, with directions to enter a decree for all the interest due and secured by the mortgage, with costs; that the court *ascertain the amount of moneys in the hands of the receiver or receivers from the earnings of the road covered by the mortgage, which may be applicable to the discharge of the interest*, and apply it to the same; and that *if* the moneys thus applied are not sufficient to discharge the interest due on the first day of March, 1864, *then* to

ascertain the balance remaining due at that date. *And in case such* balance is not paid within one year from the date of the order of the court ascertaining it, *then* an order shall be entered directing a sale of the mortgaged premises."

Upon the filing of this mandate in the court below, the receiver was ordered to make report of the funds in his hands; from which it appeared that he had some $50,000 to $60,000 applicable to the payment of the interest on the bonds in suit.

The Milwaukie and Minnesota Railroad Company, who, as already stated, was an incumbrancer on the road, *junior* to Bronson and Soutter, insisted that instead of this small amount, there was really, or ought to be, in the receiver's hands, between $300,000 and $400,000 applicable to the payment of interest; and asked an order of reference to a master, with instructions to hear testimony, and ascertain and report on this claim. The court made the order, and postponed further action in the case, until the succeeding term in September. At that term it was ascertained that the master would be unable to report on the complicated accounts of the receiver, involving several millions of dollars; and the receiver was again ordered to report the funds actually in his
513 hands. From this second report, it appeared, *513 that he had no money properly applicable to the payment of the debt of Bronson and Soutter, and thereupon the court proceeded to ascertain the amount of interest due on the bonds secured by their mortgage, and entered a decree accordingly, giving the defendant a year to pay it, before a sale of the mortgaged premises.

From this decree the Milwaukie and Minnesota Railroad Company, the already mentioned successors in title and interest to the La Crosse and Milwaukie Railroad Company, appealed; the first ground assigned for their appeal being that the decree was a departure from the mandate of the court, because such decree should not have been rendered *until the accounts of the receiver were adjusted, and it was judicially ascertained how much of the millions he had received ought now to be applied to the payment of complainants' interest*.

But another matter was now presented here.

At the first term of the court below, after the mandate was filed, the Milwaukie and Minnesota Railroad Company proposed to pay all the interest due on the mortgage of Bronson and Soutter, on condition that an order should be made, discharging the receiver, and placing the road and its appurtenances in the possession of them, the Milwaukie Company, just named. Upon the hearing of this petition, the judges of the Circuit Court were divided in opinion, and the application so, necessarily, refused.

The amount of Bronson and Soutter's debt, above mentioned, exclusive of interest, which the Milwaukie and Minnesota Railroad Company proposed to pay, was one million of dollars; and this, added to twelve hundred thousand dollars of prior mortgages, made two millions two hundred thousand dollars, which the road and its appurtenances would have to be worth, in order to secure the debt of Bronson and Soutter. The road on which the mortgage was a lien is ninety-five miles, and runs from Milwaukie to Portage, besides the depots, rolling stock, and other appurtenances belonging to it. It was in good condition. It constitutes a part of the direct line
514 from Milwaukie to the *514 Mississippi, and is one of the valuable railroads of the United States. The gross earnings from this ninety-five miles for the year preceding the application to discharge the receiver, as shown by his reports, were about eight hundred thousand dollars; though the reports showed a large falling off in the receiver's receipts of later time.

In addition to the opposition made to this motion by Bronson and Soutter, it was opposed by one Sebre Howard, who, with the Milwaukie and Minnesota Railroad Company, had been a defendant to their bill, and on whose motion the receiver had been appointed. Howard objected to the discharge, because, as alleged, he had a

judgment of $16,000 against the La Crosse and Milwaukie Railroad Company, which he asserted to be a lien on the road; though whether it was so or not, depended on some questions of fact and law, not perhaps quite clear. This court, assuming a certain state of facts, decided that he had; but it was said that facts had not been well explained to the court.

One Selah Chamberlain, too, opposed it; objecting to the discharge of the receiver, and particularly to delivering the property into possession of appellants, because, as he asserted, he himself was holder of a lien of over $700,000 in the road, and because that lien, according to his view, was secured by a lease which entitled him to the possession of the road. This same Chamberlain had been in possession under his lease for some time prior to the appointment of the receiver, under a contract with the La Crosse and Milwaukie Railroad Company, by which he bound himself to keep down the interest on the various mortgages on the road, including the one on which Bronson and Soutter had filed their bill. This he had failed to do, and he had actually abandoned the possession to the Milwaukie and Minnesota Company, who were in possession at the time the receiver was appointed. His judgment on a suit by the complainants had been assailed, and as it seemed, though counsel denied this view, declared to be fraudulent and void, by a decree of the District Court of the United States; but
515 that question was not finally determined. *515

A *third* railroad company, called the Milwaukie and St. Paul Company, a rival company of the Milwaukie and Minnesota, whose relation to it will appear in the diagram below, also opposed the discharge.

This company was an organization created after the litigation already mentioned, as brought about by the proceedings of Bronson and Soutter to foreclose their mortgage, had commenced. It was no party to preceding suits. It owned the *western* end of the La Crosse and Milwaukie Railroad; that is to say, the road from Portage to La Crosse (one hundred and five miles), and was organized for the purpose of working a road, as its name imports, from Milwaukie to St. Paul; of course, the ownership and control of an eastern end was indispensable to the purpose. This company had procured, in June, 1863, an order from the District Court, that the receiver should deliver to them the eastern end of this road, and all its appurtenances, and they had used them from that
516 day. This court, however, subsequently declared the proceeding of the District Court to have been without *516 jurisdiction, and the order a usurpation of authority.– The interest of this third company was, of course, of a strong character, for the necessities of their situation required that they should own an *eastern* end of the road, to complete their line from Milwaukie, one great terminus of the road to St. Paul.

– Bronson *v.* La Crosse Railroad Company, 1 Wallace, 405.

Mr. Justice MILLER delivered the opinion of the court.

The first ground assigned for the appeal is, that the decree is a departure from the mandate of the court, because it should not have been rendered until the accounts of the receiver were adjusted, and it was judicially ascertained how much of the millions he had received ought now to be applied to the payment of complainants' interest coupons.

This construction of the mandate cannot be sustained. The receiver is the officer of the court, and neither party is responsible for his misfeasance or malfeasance, if any such exists, and it was not, therefore, reasonable that complainants should be delayed in the collection of their debts until the close of a litigation over the receiver's accounts, which might occupy several years. The suit had already been pending four years, and the mandate required the Circuit Court, in its decree *nisi*, to give another year for the payment of the sum found due. To
520 suppose that this court *520 intended, in addition to these five years, to withhold the recovery of complainants for the additional uncertain period which might be necessary to litigate the receiver's accounts, is to impute to it

a manifest injustice. The language of the mandate had reference to the sum *actually* in the receiver's hands, properly applicable to the payment of this debt, and not to what it might turn out on full investigation *ought* to be there for that purpose. This court had no reason to suppose that there would be any controversy with the receiver on the subject, and framed its mandate on the supposition that all the money for which he would be responsible, would be at once forthcoming. If such is not the case, neither the loss nor the delay of ascertaining the fact was intended by this court to be imposed on the complainants. The decree of the court is, therefore, AFFIRMED.

But another order was made by the Circuit Court, of a very important nature, after the return of the case from this court, and before the decree just affirmed, which appellants seek to have reversed.

At the first term of that court after the mandate was filed, the appellant proposed to pay all the money due on complainants' mortgage, on condition that an order should be made discharging the receiver, and placing the road and its appurtenances in the possession of appellants. Upon the hearing of this petition of appellant, the judges of the Circuit Court were divided in opinion, and the application was thereupon refused, as it was not a division upon a subject which is authorized to be certified to this court for its action.

The appellant insists that this court shall now review the order of the Circuit Court on this subject; and while conceding that it is not such an order, as standing alone could be the subject of an appeal, contends, that as the record is properly here on appeal from the final decree which we have just considered, the whole record is open
521 for our inspection, and that it is our duty to correct the error of which he complains in this particular. *521

There is no question but that many orders or decrees, affecting materially the rights of the parties, are made in the progress of a chancery suit, which are not final in the sense of that word in its relation to appeals. The order of the court affirming or annulling a patent, and referring the case to a master for an account, is an instance. The adjudications which the court makes on exception to reports of masters, often involving the whole matter in litigation, are not final decrees; and in these and numerous other cases, if the court can only, on appeal, examine the final or last order or decree which gives the right of appeal, it is obvious that the entire benefit of an appeal must, in many cases, be lost.

The order complained of in this case seems to be one of this class. The complainants are seeking a foreclosure of a mortgage with a view to make their debt. The owner of the equity of redemption in the mortgaged premises comes forward and offers to pay this debt, or all of it that is due, provided his property, which is in the custody of the court, shall then be restored to his possession. The right of the owner to this order is, under ordinary circumstances, very clear, and a refusal by the court to give him this right would seem to call for the revisory power of this court, when the whole case is before it, on the record brought here by appeal from a final decree.

The only doubt which the court could have on the question arises from the principle that the appointment and discharge of a receiver are ordinarily matters of discretion in the Circuit Court, with which this court will not interfere.

As a general rule, this proposition is not denied. But we do not think it applicable to the case before us. While the parties to this suit were fiercely litigating the amount of the mortgage debt, and questions of fraud in the origin of that debt, the appointment, or the discharge of a receiver for the mortgaged property, very properly belonged to the discretion of the court in which the litigation was pending. But when those questions had been passed upon by the Circuit Court, and by this court also on appeal, and the amount of the debt definitely fixed
522 by his court, the right of the defendant *522 to pay that sum, and have a restoration of his property by discharge

of the receiver, is clear, and does not depend on the discretion of the Circuit Court. It is a right which the party can claim; and if he shows himself entitled to it on the facts in the record, there is no discretion in the court to withhold it. A refusal is error — judicial error — which this court is bound to correct when the matter, as in this in stance, is fairly before it. That the order asked for by appellants should have been granted, seems to us very clear.

It was objected by the complainants that the receiver should not be discharged, because the security of the road and its appurtenances was not sufficient to insure the payment of their debt, and, therefore, its receipts should be applied to that purpose through the agency of a receiver.

The amount of complainants' debt, exclusive of the interest (which appellants proposed to pay), was one million of dollars, which, added to twelve hundred thousand dollars of prior mortgages, made the sum of two millions two hundred thousand dollars which the road and its appurtenances should be worth to secure complainants' debt. The road bed on which complainants' mortgage is a lien is ninety five miles from Milwaukie to Portage, besides the depots, rolling stock, and other appurtenances belonging to it. It constitutes a part of the direct line from the former city to the Mississippi River, which is one of the most valuable routes in the United States, both present and prospective. The gross earnings from this ninety-five miles for the year preceding the application to discharge the receiver, as shown by his reports, were about eight hundred thousand dollars; and although these reports show a great falling off in the receiver's receipts since that time, the circumstances which have produced it are not of a character to incline us to continue the road in the possession of a receiver. The road was also in good repair. The decree which we have just affirmed authorizes the complainants, upon default in payment of any future instalment of interest, to apply for and have an order of sale of the road under that decree. Under these circumstances, when appellants propose to pay to me $300,000
523 of *523 $400,000 of complainants' debt before possession is given, it is idle to say that the security of their debt requires the road still to be detained from its lawful owner.

Sebre Howard objects to the discharge of a receiver, because he has a judgment of $16,000 against the La Crosse and Milwaukie Railroad Company, which he claims to be a lien on the road; and as the present receiver has also been appointed receiver in his suit, he claims that his debt must first be paid before he can be discharged.

The idea of appointing or continuing a receiver for the purpose of taking ninety-five miles of railroad from its lawful owners, which is earning a gross revenue of $800,000 per annum, to enforce the payment of a judgment of $16,000, the lien of which is seriously controverted, is so repugnant to all our ideas of judicial proceedings that we cannot argue the question. If Mr. Howard has a valid judgment, the usual modes of enforcing that judgment are open to him, both at law and in chancery; but the extraordinary proceeding of taking millions of dollars worth of property — of such peculiar character as railroad property is — from its rightful possessors, as one of the usual means of collecting such a comparatively small debt, can find no countenance in this court.

Selah Chamberlain objects to the discharge of the receiver, and particularly to delivering the property into possession of appellants, because he says he has a lien of over $700,000 on the road, and because that lien is secured by a lease which entitles him to the possession of the road.

Mr. Chamberlain had been in possession under his lease for some time prior to the appointment of a receiver, under a contract with the La Crosse and Milwaukie Railroad Company, by which he bound himself to keep down the interest on the various mortgages on the road, including the one on which this suit is brought. This he had failed to do, and had actually abandoned the possession to the complainants in this suit, who were in possession at the time the receiver was appointed. His judgment was assailed, and declared to be fraudulent and

524 void by a decree of the District Court of the United States. There is a question whether that decree *524 is binding as between him and the present appellants, which we do not intend to decide here; but we refer to this fact as having strong influence on the question of the propriety of keeping the road in the hands of a receiver for his benefit, or delivering it to him if the receiver is discharged. We shall endeavor to protect his interest, whatever it may be, in any order that shall be made on the subject.

As to the Milwaukie and St. Paul Railway Company, who also resisted this application, we do not see that they have any legal interest in the matter; and the interest which prompts their interference is not such as the court can consider on an application of this kind.

In reference to all these parties we remark again, that the court deprives them of none of their rights to proceed in the courts in the ordinary mode to collect their debts, and that the appointment of receivers by a court to manage the affairs of a long line of railroad, continued through five or six years, is one of those judicial powers, the exercise of which can only be justified by the pressure of an absolute necessity. Such a necessity does not exist here; and the fact that so many years of the exercise of this power has not produced payment of any part of the debts which the receiver was appointed to secure, is an irresistible argument against his longer continuance.

The order of the court dismissing this application is, therefore, REVERSED, and the case remanded to the Circuit Court, with instructions to ascertain the amount due to complainants within some reasonable time to be fixed by said court, and to make an order that on the payment of that sum, with the costs of complainants, into court, the receiver shall be discharged, and the railroad from Milwaukie to Portage City, with all the appurtenances, rolling stock, and other property, real and personal, belonging to said division of road, be delivered by said receiver to the Milwaukie and Minnesota Railroad Company; but that no such discharge of the receiver, or delivery of the road and its appurtenances, shall be made until said company shall first enter
525 into bond *525 with sufficient surety to pay to Sebre Howard and Selah Chamberlain all such sums as may come into the hands of said company, which shall hereafter be found to be rightfully applicable to the payment of their claims, if they shall be established as liens on said road. And the appellants to recover their costs in this court.

ACTION ACCORDINGLY.

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> respect, the sureties cannot have any well-grounded complaint. If, on the other hand, the creditor fails so to do, I take it to be inequitable on his part to sue for the amount of the deficiency which is the result of his own conduct.[121]

§10.39 Clearly a privately appointed receiver and manager can be in no better position *vis-à-vis* the surety than is the creditor who appointed him. If the creditor is liable to the surety for his dealing with the security, then so too should be the receiver.[122] In *Standard Chartered Bank Ltd. v. Walker*,[123] the Court of Appeal rejected the *Latchford* decision, and stated that the creditor and a receiver owed a duty of care toward the surety in respect of the realization of security:

> Clearly the guarantors' liability is dependent upon the company's ... the amount of his liability depends entirely on the amount that the stock realizes when sold with proper care. To my mind he is well within the text of proximity. The receiver owes a duty not only to the company but to the guarantor, to exercise reasonable care in the disposal of the assets.[124]

(I) Assignment of Security

§10.40 The common law recognized the right of a surety to an indemnity from the principal, but that right was in the nature of a right *in personam*. Formerly, where a surety paid off the bond debt of his principal, for which he was bound, he could not require the creditor to assign to him that bond debt, because it was satisfied and extinguished by the very act of payment by the surety.[125] This rule was reversed by statute in England in 1856 section 5 of the *Mercantile Law Amendment Act*.[126] Under the present rule not only is a surety who pays off his principal's debt entitled to a transfer of securities held by the creditor, but he or she is also in all respects entitled to all the equities which the creditor could have enforced.

§10.41 It follows that every person who, being surety for the debt or default 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, 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 the performance of the duty.[127] Unless such an assignment is obtained, a surety

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121 See also *Hoskin v. Price Waterhouse Ltd.*, [1982] O.J. No. 3135, 35 O.R. (2d) 350 (Ont. H.C.J.).

122 *Bank of Montreal v. Western Store Supplies Ltd.*, [1983] N.S.J. No. 381, 57 N.S.R. (2d) 118 (N.S.T.D.).

123 [1982] 3 All E.R. 938 at 942 (C.A.), *per* Lord Denning M.R. See also *MacManus v. Royal Bank*, [1985] N.B.J. No. 44, 55 C.B.R. (N.S.) 238 (N.B.C.A.)

124 *Standard Chartered Bank Ltd. v. Walker*, [1982] 3 All E.R. 938 (C.A.), *per* Lord Denning M.R.

125 H.A. de Colyar, *Law of Guarantees and of Principal & Surety*, 3d ed. (London: Butterworths, 1897) at 326-27.

126 19 & 20 Vict., c. 97.

127 Subsection 2(1) of the *Mercantile Law Amendment Act*. Note that this provision does not refer to liability in respect of the "miscarriage" of another, *cf. Statute of Frauds*, section 4. The English equivalent to this provision is the *Mercantile Law Amendment Act, 1856*, s. 5. In Manitoba, see *Mercantile Law Amendment Act*, R.S.M. 1987, c. M-120, s. 2.

is not purely personal, but is a right in the security, judgment or deed itself.[137] The surety may step into the place of the creditor and enforce the judgment[138] or security[139] even if no actual assignment of those rights has been made, but the surety must obtain leave from the court before he can issue execution.[140] The rights of a surety under section 2 are not affected by the insolvency of the principal. The precise scope of the term "security" is not clear, but given the width of the concept of security in cases dealing with the common law and equitable rights of sureties it is likely that the term would be widely construed by a court.[141]

§10.42 A surety is entitled to stand in the place of the creditor, and to use all the remedies and, on proper indemnity, to sue in the name of the creditor in any action or other proceeding in order to obtain from the principal debtor, or any co-surety, co-contractor or co-debtor, indemnification for the advances made or loss sustained by such person, and the payment or performance made by him is not a defence to such action or other proceeding by him.[142] However, no co-surety, co-contractor or co-debtor is entitled to recover from any other co-surety, co-contractor or co-debtor more than the just proportion to which, as between themselves, the last mentioned person is justly liable.[143] There is no statutory limitation on recovery against the principal, since the principal is obliged to indemnify his sureties in full.

§10.43 The assignment of a security held by the creditor to the surety gives the surety no greater rights than the assignee.[144] An assigned security only stands as security for payments made by the assignee if the payments were made for the purpose of purchasing the assignment.[145]

(2) Benefit of Securities in Favour of the Creditor

§10.44 The surety is also entitled to the benefit of a security as well as to an assignment on payment. Since the release of any security existing at the time when the surety entered into the guarantee will affect the surety's liability under

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137 *Batchellor v. Lawrence* (1861), 9 C.B.N.S. 543, 142 E.R. 214, *per* Erle C.J.

138 *Re M'Myn* (1886), 33 Ch. D. 575.

139 *Re Windham Sales Ltd.*, [1979] O.J. No. 4387, 26 O.R. (2d) 246 (Ont. H.C.J.); *Jamieson v. Hotel Renfrew Ltd. (Trustees of)*, [1941] O.J. No. 232, [1941] 4 D.L.R. 470 (Ont. H.C.J.).

140 *Kayley v. Hothersall et al.*, [1925] 1 K.B. 607 (C.A.).

141 *In Re Earle Pullan Co.* (1968), 12 C.B.R. (N.S.) 136 (O.S.C. in Bank.); *Re Major-Way Trailers* (1964), 7 C.B.R. (N.S.) 198 (B.C.S.C.); *In Re Burnstein* (1964), 6 C.B.R. (N.S.) 298 (O.S.C., in Bank.), in which it was held that the section entitled a surety paying a debtor to the Crown as a creditor to stand in the place of the Crown as a preferred creditor in a bankruptcy.

142 *Mercantile Law Amendment Act*, R.S.O. 1990, c. M.10, s. 2(2); in England, the corresponding provision is found in the *Mercantile Law Reform Act*, s. 5. This statute is part of the received law of some Provinces.

143 *Ibid.*, s. 2(3).

144 *715486 Ontario Ltd. v. Hristovski*, [1998] O.J. No. 4759 at para. 22 (Ont. Gen. Div.), *per* Ferguson J.

145 *715486 Ontario Ltd. v. Hristovski*, [1998] O.J. No. 4759 at para. 33 (Ont. Gen. Div.), *per* Ferguson J.

it (whether the release occurs before or after default) to at least some extent. The right to the benefit of a security arises immediately, rather than on payment. The sureties rights of subrogation are not limited to the rights *in personam* to which the creditor is entitled. It is an ancient principle,[146] founded upon the equitable doctrine of marshaling,[147] that unless otherwise agreed[148] on payment or performance by the surety of the guaranteed obligation,[149] the surety has the right to the benefit of all securities that the creditor has received from the principal debtor in respect of the debt in order to enable the surety to obtain satisfaction for what he has paid.[150] The surety will be released to the extent of any prejudice suffered if the creditor cannot, by reason of what he has done, give the surety the securities in the same condition as they were formerly held by the creditor in respect of the guaranteed debt.[151] If the creditor diminishes or destroys through laches (unreasonable delay) or neglect a security to which the surety would otherwise have been entitled, the creditor is bound to credit the surety with the fair value of the security so prejudiced.[152] The surety's right to receive the benefit of these securities applies irrespective of whether the surety had knowledge of their existence at the time when he became a surety.[153] A surety for a limited

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146 *Morgan v. Seymour* (1638), 1 Rep. Ch. 120, 21 E.R. 525 (Ch.); *Swain v. Wall* (1641), 1 Rep. Ch. 149, 21 E.R. 534 (Ch.), *per* Hutton J.

147 The term "marshaling" refers to the practice in equity of ranking or arranging classes of creditors with respect to the assets of a common debtor so as to provide for the satisfaction of the greatest number of claims. In *Fitallis North America Inc. v. Pigot Construction Ltd.* (1992), 3 P.P.S.A.C. (2d) 30 at 34 (O.G.D.), Austin, J. explained the operation of the doctrine in the following terms:

> Marshaling is an equitable doctrine which applies to protect a creditor who has recourse to one fund of a debtor from the actions of another creditor who has access to more than one fund of the same debtor. ... The court will not interfere with the rights of creditor X against any or all of the funds, but if X resorts to the one funds against which Y has rights, then in appropriate circumstances the court will subrogate Y to the rights of X in the other funds. ... Three conditions must prevail in order for the doctrine to apply: (a) the claim must be against a single debtor; (b) the two funds must be at the debtor's disposal; (c) the two funds must be in existence when the question of marshaling arises.

148 *Bauer v. Bank of Montreal*, [1980] S.C.J. No. 46, [1980] 2 S.C.R. 102 (S.C.C.); but *cf. Pioneer Trust Co. v. 220263 Alberta Ltd.*, [1989] A.J. No. 56, [1989] 4 W.W.R. 154, 94 A.R. 86 at 94 (Alta. Q.B.), *per* Virtue J.; *Canadian Imperial Bank of Commerce v. Morrison*, [1986] N.S.J. No. 378, 33 D.L.R. (4th) 132 (N.S.C.A.).

149 In *Dixon v. Steel*, [1901] 2 Ch. 602 at 607, *per* Cozens-Hardy J. made it clear that while the right of the surety to take an assignment does not arise till payment, the right to the benefit of a security arises at the time when the surety assumes his obligations as such.

150 See, for instance, *Ex p. Crisp* (1744), 1 Atk. 133, 26 E.R. 87 at 135 (L.C.); *Pledge v. Buss* (1860), John 663, 70 E.R. 585 (V.C.); *Duncan, Fox & Co. v. N. & S. Wales Bank* (1880), 6 App. Cas. 1 (H.L.).

151 *Wulf v. Jay* (1872), 7 Q.B. 765 at 764, *per* Hannen J.

152 *Taylor v. Bank of New South Wales* (1886), 11 App. Cas. 596 at 602-03 (P.C.), *per* Lord Watson; *Traders Finance Corp. v. Ross*, [1942] O.J. No. 469, [1942] O.R. 618 (Ont. H.C.J.) *McKay v. O'Hanley* (1910), 8 E.L.R. 115 at 118 (P.E.I.S.C.), *per* Fitzgerald J.; *MacDonald v. Hirsch*, [1932] N.S.J. No. 9, 5 M.P.R. 469 (N.S.S.C.).

153 See, for instance, *Leicestershire Banking Co. v. Hawkins* (1900), 16 T.L.R. 317 (Q.B.); *Duncan, Fox & Co. v. N. & S. Wales Bank* (1880), 6 App. Cas. 1 (H.L.); *Nicholas v. Ridley*, [1904] 1 Ch. 192 (C.A.); *Merchants Bank of London v. Maud* (1871), 16 W.R. 657; *Forbes v. Jackson* (1882), 19 Ch. D. 615.

amount has in respect of that amount the same rights as the creditor. To the extent of his liability, therefore, the surety is entitled to the benefit of any security held by the creditor in respect of the whole debt.[154]

§10.45 The surety's rights with respect to securities existing in respect of the guaranteed obligation are derived from the equitable doctrine imposed upon the principal debtor to indemnify the surety.[155] In addition, it is felt to be inequitable for a creditor to fail to realize against a security which is available to him in respect of the guaranteed debt, and instead to throw the whole liability upon the surety.[156] To compensate the surety for the payment that he has made on the principal's behalf in respect of the guaranteed debt, he is given a right to look to the security held by the creditor in respect of that debt.[157] As mentioned above, this right is based upon general principles of equity that are similar to those which govern the marshaling of funds and securities.[158] The marshaling concept is a requirement imposed upon creditors by equity in those cases where one creditor of a debtor is able to draw upon two or more sources of payment, while a second creditor of that debtor may resort to a lesser number of sources.[159] The goal of the doctrine of marshaling is to ensure that one creditor does not act so as to deprive another creditor of his due proportion of the debtor's estate.[160]

§10.46 The surety is entitled to the benefit of all securities held in respect of the guaranteed debt or obligation, including both those that existed at the time when the guarantee was given,[161] and those that came into existence after the assumption of liability by the surety.[162] The right of the surety to be subrogated to the rights of a secured creditor in respect of collateral securities deposited by the principal will in certain cases enable the surety to step ahead of subsequent

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154 *Goodwin v. Gray* (1874), 22 W.R. 312; see also *Re Hamilton* (1895), 10 Man. R. 573 (C.A.); *Rigney v. Vanzandt* (1856), 5 Gr. 494.

155 *Nicholas v. Ridley*, [1904] 1 Ch. 192 (C.A.); *Yonge v. Reynell* (1852), 9 Hare 809, 122 E.R. 951; *Lord Harberton v. Benntee* (1829), Beat 386.

156 *Aldrich v. Cooper* (1803), 8 Ves. 382, 32 E.R. 402 at 389, *per* Lord Eldon V.C.

157 *First City Capital Ltd. v. Hall*, [1993] O.J. No. 135, 11 O.R. (3d) 792 (Ont. C.A.).

158 *Duncan Fox & Co. v. N. & S. Wales Bank* (1880), 6 App. Cas. 1 at 12 (H.L.), *per* Lord Selborne; *Heyman v. Dubois* (1871), L.R. 13 Eq. 158.

159 Discussed in R.P. Meagher, W.M.C. Gummow & J.R.F. Lehane, *Equity: Doctrines and Remedies* (Sydney: Butterworths, 1975) at 271.

160 See, generally, *Re Cohen, National Prov. Bank v. Katz*, [1960] 1 Ch. 179 at 190 (Ch.), *per* Dankwerts J.

161 *Forbes v. Jackson* (1882), 19 Ch. D. 615 at 621, *per* Hall V.C.; *Campbell v. Rothwell* (1877), 47 L.J.Q.B. 144 at 146, *per* Denman J; *Re Davidson's Estate* (1893), 31 L.R. Ir. 249 (L.J.C.), affd [1894] 1 Ir. 56 (C.A.). In PPSA jurisdictions, there is no obligation to register a financing change statement under the *Personal Property Security Act* in order to protect the surety's rights against a trustee in bankruptcy: *Re Windham Sales Ltd.* (1979), 1 P.P.S.A.C. 73 (Ont. S.C. in bank.).

162 *Mahew v. Crickett* (1818), 2 Swans 185, 36 E.R. 585 at 191 (Ch.), *per* Lord Eldon L.C.; *Pledge v. Buss* (1860), John 663, 70 E.R. 585 (V.C.); *Lake v. Brutton* (1856), 8 De G. M. & G. 440; *Scott v. Knox* (1838), 2 Jo. Ex. Ir. 778; *Campbell v. Rothwell* (1877), 47 L.J.Q.B. 144 at 146, *per* Denman J; *Traders Finance Corp. v. Ross*, [1942] O.J. No. 469, [1942] O.R. 618 (Ont. H.C.J.); *Leicestershire Banking Co. v. Hawkins* (1900), 16 T.L.R. 317 (Q.B.), *per* Mathew J.; but compare *Newton v. Chorlton* (1853), 10 Hare 646, 68 E.R. 1087 (V.C.).

encumbrancers and the general creditors of the principal.[163] This right may be viewed in some respects as being unfair to subsequent encumbrancers and other creditors.

§10.47 The term "security" is given a wide meaning by the courts.[164] It has been held that a guarantee by one partner of a firm under which the creditor has a right of proof against the separate estate of that partner (in addition to the creditor's right of proof against the partnership property) is a security to which a surety may resort.[165] An insurance policy on the life of the principal,[166] or upon his assets,[167] has also been held to be a security of which the surety is entitled to enjoy the benefit. Likewise, a sum of money standing to the credit of the principal, but which is appropriated to a particular purpose under the terms of a contract is considered to be comparable to a security, and the surety has similar rights in respect of that sum as he would have in the case of a genuine security.[168] A right of distress is not a security in the nature of a lien, but a lien arises once that right is exercised against the property concerned.[169]

§10.48 The right of a surety to the benefit of the security interests held by the creditor must be properly understood.[170] If the secured creditor realizes on the security and applies the proceeds so obtained to the payment of the guaranteed debt, then the surety obtains that benefit.[171] If the secured creditor realizes on its

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163 *Badeley v. Consolidated Bank* (1888), 38 Ch.D. 238 (C.A.).

164 *Re Holland, ex p. Alston* (1868), 4 Ch. App. 168; but *cf. Royal Bank of Canada v. Canadian Rocky Mountain Resorts Ltd.*, [1994] A.J. No. 274, 114 D.L.R. (4th) 537 (Alta. C.A.); *Child & Gower Piano Co. v. Gambrel*, [1933] S.J. No. 23, [1933] 2 W.W.R. 273 at 281-282 (Sask. C.A.); see also *Alberta Opportunity Co. v. Schinnour*, [1990] A.J. No. 1125, 78 Alta. L.R. (2d) 48 (Alta. C.A.).

165 *Re Stratton* (1883), 25 Ch. D. 148 at 153 (C.A.), *per* Fry L.J.

166 *Lake v. Brutton* (1856), 8 De G. M. & G. 440; *Heyman v. Dubois* (1871), L.R. 13 Eq. 158 (V.C.); but compare *Dalby v. India & London Life Assurance Co.* (1854), 15 C.B. 365, 139 E.R. 465 (C.P.).

167 *Watts v. Shuttleworth* (1861), 7 H. & N. 353, 158 E.R. 510 (Ex. Ch.). Note, however, that there is no general obligation on the creditor to keep the assets insured: *Bank of Montreal v. Kodiak Log Services Ltd.*, [1984] B.C.J. No. 1317, 6 C.C.L.I. 14 (B.C.S.C.), revd [1984] B.C.J. No. 1955, 8 C.C.L.I. 9 (B.C.C.A.).

168 *Re Sherry, London & County Banking Co. v. Terry* (1884), 25 Ch. D. 692 at 702 (C.A.), *per* Lord Selbourne L.C.; but *cf. Royal Bank of Canada v. Canadian Rocky Resorts Ltd.*, [1994] A.J. No. 274, 114 D.L.R. (4th) 537 at 540 (Alta. C.A.), where such a conclusion was rejected given the tenor of correspondence that had passed between the parties.

169 *Commercial Credit Corp. v. Harry D. Shields Ltd.*, [1980] O.J. No. 3639, 29 O.R. (2d) 106 (Ont. H.C.J.), affd [1981] O.J. No. 2999, 32 O.R. (2d) 703 (Ont. C.A.), *per* R.E. Holland J. and *per* Weatherstone J.A.; *Leavere v. Port Colborne*, [1995] O.J. No. 217, 79 O.A.C. 16 at 19 (Ont. C.A.), *per* Galligan J.A.

170 See, for instance, *Manufacturers Life Insurance Co. v. Zellagate Holdings Inc.*, [1999] O.J. No. 800 at paras. 15, 17, 20 (Ont. Gen. Div.), *per* Whitten J.

171 *Regina Brokerage and Investment Co. v. Waddell*, [1916] S.J. No. 41, 27 D.L.R. 533 at 535 (Sask. S.C.): "... a creditor has securities in his hands for the debt guaranteed, he is entitled to realize upon those securities without releasing the surety. A surety, it is true, is entitled to all the securities in the hands of the creditor if he pays the guaranteed debt. This is to enable him to proceed against the principal debtor and reimburse himself for the monies paid out under his guarantee on behalf of such debts, but where the creditor himself has realized on these securities

security interests in an imprudent (or improvident) manner,[172] then the surety is entitled to be credited with what ought to have been realized had the creditor followed a more prudent course.[173] If the secured creditor calls upon the surety to pay the guaranteed debt, and the surety does so pay, then the secured creditor must deliver its security interest to the surety upon payment. This right arises by virtue of subrogation.

§10.49 The rights of a surety with respect to the security held by the creditor qualifies the general rule that payment of a secured debt by the debtor who granted the security interest will normally[174] discharge the security interest that has been granted. This result grows out of the principle that a mortgage (or other security interest) is granted for a specific purpose, and upon the satisfaction of that purpose, the rights conferred under the mortgage are spent. However, it does not follow that the payment of the amount owing by some third party results in a corresponding evaporation of the security interest. Such a contractual right is granted to secure the performance of the principal debtor. The payment by the surety to the creditor no more constitutes the performance of the principal debtor than the purchase of the security agreement by a third party would constitute such performance. The principal remains obliged to perform, and therefore the security interest continues in respect of such performance.[175] The arrangements as between the surety and the creditor are immaterial to the relationship between the creditor and principal, and to any security interest that the creditor has granted.

(3) Realization of Security and Improvident Realization

§10.50 A secured creditor owes a duty to the principal and any guarantors to take reasonable precautions to obtain the true market value of the charged property on the date the creditor decides to sell the property.[176] There is also a duty to

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and has credited the full value thereof on the guaranteed debt, the surety is in no way prejudiced."

172 *Duca Financial Services Credit Union Ltd. v. Bozzo*, [2006] O.J. No. 4339 at para. 14 (Ont. C.A.), *per* Blair J.A.: "... a guarantor is entitled, from the moment of his or her guarantee, to call for the benefit of all securities held in respect of the guaranteed debt, if needed, and that a creditor has a general obligation to protect and preserve the security and to be in a position to return or reassign the security to the debtor or surety on repayment of the debt. ... Should the mortgaged property be disposed of by power of sale, the mortgagee's obligation is to account for the proceeds of sale."

173 A defence based upon this line of attack is rarely successful. See, generally, on this point: *Royal Bank of Canada v. 2021847 Ontario Ltd.*, [2007] O.J. No. 4994 (Ont. S.C.J.), affd [2008] O.J. No. 3511 (Ont. C.A.); contrast however *Crawford v. New Brunswick (Agricultural Development Board)*, [1997] N.B.J. No. 368, 192 N.B.R. (2d) 68 (N.B.C.A.), *per* Bastarache J.A.

174 There are exceptions, as for instance, in the case of a security interest securing a revolving line of credit.

175 Compare *Standard Trust Co. v. Bank of Nova Scotia*, [2006] N.J. No. 345, 262 Nfld. & P.E.I.R. 319 (Nfld. C.A.).

176 *Bank of Nova Scotia v. Barnard*, [1984] O.J. No. 3218, 46 O.R. (2d) 409 (Ont. H.C.J.); *Royal Bank of Canada v. Cramer*, [1990] O.J. No. 827, 73 O.R. (2d) 677 (Ont. H.C.J.).

HMANALY G§59
Houlden & Morawetz Analysis G§59

Bankruptcy and Insolvency Law of Canada, 4th Edition

THE BANKRUPTCY AND INSOLVENCY ACT

Part V (ss. 127-134)
L.W. Houlden and Geoffrey B. Morawetz

G§59 — Who is a Secured Creditor?

G§59 — Who is a Secured Creditor?

See ss. 127, 128, 129, 130, 131, 132, 133, 134

Section 2(1) defines a secured creditor as follows:

> "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.

In Québec, there are legal hypothecs, in particular the construction legal hypothec. Québec does not have construction liens or trusts; rather, prior rights that create a real right and rights of retention, all of which are a secured claim under s. 2 of the *BIA.*

The *Bankruptcy and Insolvency Act* defines "secured creditor" in s. 2(1) but defers to provincial law for the creation of secured claims. However, provincial legislation that has the effect of re-ordering priorities created by the *Bankruptcy and Insolvency Act* is of no effect: *Husky Oil Operations Ltd. v. Minister of National Revenue* (1993), [1994] 1 W.W.R. 629, 22 C.B.R. (3d) 153, 1993 CarswellSask 27, 11 C.L.R. (2d) 1, 108 D.L.R. (4th) 681, 116 Sask. R. 46, 59 W.A.C. 46 (C.A.), affirmed [1995] 10 W.W.R. 161, 35 C.B.R. (3d) 1, 24 C.L.R. (2d) 131, 128 D.L.R. (4th) 1, 188 N.R. 1, 137 Sask. R. 81, 107 W.A.C. 81, 1995 CarswellSask 739, 1995 CarswellSask 740 (S.C.C.). "Secured creditor" is to be interpreted in accordance with the definition in s. 2(1); provincial legislation cannot affect the interpretation of the term: *Dartmouth (City) v. Barclays Bank of Canada* (1996), 40 C.B.R. (3d) 1, 151 N.S.R. (2d) 264, 440 A.P.R. 264, 1996 CarswellNS 210 (C.A.).

To be a secured creditor, the claim of a creditor must be secured against some asset of the bankrupt. Something has to be identifiable as the subject of the security, either a specific asset or assets or all assets generally: *A.A. Electric Ltd. v. Bank of British Columbia* (1978), 27 C.B.R. (N.S.) 298, 7 Alta. L.R. (2d) 92, 89 D.L.R. (3d) 157 (*sub nom. Re A.A. Elec. Ltd. and Swan Elec. Ltd.*), 21 A.R. 248 (T.D.); *Protz v. Protz* (1997), 49 C.B.R. (3d) 63, 1997 CarswellSask 477 (Sask. Q.B.). The only security contemplated by the *Act* is that which is "on or against the property of the debtor": *Campbell Sharp Ltd. v. Bank of Montreal* (1984), 53 C.B.R. (N.S.) 225, 30 Man. R. (2d) 73 (Q.B.). See also *Re Stenan Const. Ltd.* (1977), 25 C.B.R. (N.S.) 7 (Ont. S.C.); *Asselford Martin Shopping Centers Ltd. v. Ross* (1994), 28 C.B.R. (3d) 130, 1994 CarswellOnt 304 (Ont. Gen. Div.). A creditor holding security on property not belonging to the bankrupt is not a secured creditor: *Re Reeve-Dobie Mines Ltd. (No. 2)* (1921), 1 C.B.R. 540, 64 D.L.R. 534, 50 O.L.R. 499, 1921 CarswellOnt 11 (S.C.).

To be a secured creditor, a person holding a mortgage, hypothec, etc., must be a creditor of the bankrupt: *New Brunswick v. Peat Marwick Thorne Inc.* (1995), 37 C.B.R. (3d) 268, 170 N.B.R. (2d) 373, 435 A.P.R. 373, 1995 CarswellNB 114 (C.A.). A loan agreement that would otherwise

create a secured interest does not fail simply because it contemplates payments to be made from sources that will produce revenue in the future: *Re Bearcat Explorations Ltd.* (2004), 2004 CarswellAlta 1052, 3 C.B.R. (5th) 173, 2004 ABQB 601 (Alta. Q.B.).

Many of the claims of creditors that have or have not been recognized as secured creditors are dealt with in other parts of the book. In the notes to ss. 67-68.1, most of the important secured claims are discussed in detail, see, for example, F§63 "*Personal Property Security Act*", which deals with secured claims under provincial personal property security legislation. In the notes to ss. 70-84, claims, such as judgment creditors and landlords, which have not been recognized as secured claims are reviewed in detail. To avoid repetition, in this section of Houlden and Morawetz only secured claims that are not covered in other parts of the book are discussed. To find where a claim that is not covered in this section is dealt with in the book, reference should be made to the Index.

The registrar of the Alberta Court of Queen's Bench disallowed the appeal of a bank with respect to the claim of the bank that its Homeline Plan secured prior debts owed to the bank. The trustee had disallowed a portion of the secured claims on the ground that the Homeline Plan did not secure prior unsecured debts of the bankrupts, but only the advances made under the Homeline Plan. The issue was whether the terms of the RBC Homeline Plan captured past indebtedness. While there was some merit to the suggestion that the definition of "mortgage" standing alone appeared to capture prior debts, the RBC Homeline Plan had another provision that addressed the indebtedness covered by the security that was inconsistent with this feature of the definition of "mortgage". Registrar Mason was of the view that the definition of "total debt" in the Homeline Plan did not contemplate and made no reference to prior debts, creating an ambiguity which in the circumstances had to be resolved in favour of the bankrupts: *Re Czerwinski* (2009), 2009 CarswellAlta 1366, 2009 ABQB 510 (Alta. Q.B.).

Editor's note: The interpretation of the same creditor's Homeline Plan came before the Ontario Superior Court of Justice in *Dale & Lessmann LLP v. Royal Bank* (2009), 2009 CarswellOnt 5273 (Ont. S.C.J.). Spiegel J. found that the words "and all present and future amounts at any time owing by you as described in the Mortgage" in the definition of "Mortgage" under the Homeline Plan agreement read together with the standard charge terms were at best ambiguous and that on the proper interpretation of the terms that the credit card debt was not secured by the charge.

The Ontario Court of Appeal dismissed an appeal in which the appellant had a writ of seizure and sale against a party that owned an undivided 35% beneficial interest in lands registered under the *Land Titles Act*. The registered owner of the lands holds the land for the debtor and two other corporations under an unregistered trust agreement. Under s. 62(1) of the *Land Titles Act*, notice of an express, implied, or constructive trust "shall not be entered on the register or received for registration." The Court of Appeal concluded that the appellant was not entitled to enforce its writ against the registered owner or over the mortgagees who had provided

construction financing. The Court held that neither the statutory authorities nor the case law support the appellant's entitlement to the relief it sought. Beyond stipulating that a writ of seizure and sale binds the lands of the party named in the writ and authorizing the sheriff to sell those lands even if they are held in the name of a trustee, the *Execution Act* provides no further remedy to a judgment creditor in relation to a writ of seizure and sale. The Court held that the *Execution Act* is a procedural statute that facilitates the collection of debts through the mechanisms contained in it. It does not purport to grant substantive rights to judgment creditors. The *Execution Act* does not authorize effectively adding the legal owner of a property in which a judgment debtor has an unregistered beneficial interest to a writ of seizure and sale against the judgment debtor. The Court held that the execution creditor stands in no better position than the debtor. Accordingly, lands to be sold at the request of an execution creditor are sold subject to the charges, liens, and equities to which they were subject in the hands of the debtor. As the appellant stands in no better position than the debtor, the appellant's entitlement is limited to having the sheriff seize and sell whatever the debtor's interest in the land may be and to share in the proceeds of sale of that interest in accordance with the priorities set out in the *Creditors' Relief Act*. The sheriff steps into the shoes of the execution debtor and can have no higher rights than the execution debtor. The Court also noted that s. 14 of the *Creditors' Relief Act, 2010* does not give an execution creditor priority over subsequent advances made under a charge registered prior to the execution being filed. The Court also held that s. 93(4) of *Land Titles Act* does not create any priorities over a prior registered charge for an execution creditor. Rather, s. 93(4) speaks to the priority of advances made under a previously registered charge following registration of a further transfer, charge, or other instrument executed by the chargor. The appellant as the holder of a writ of seizure and sale does not fall within that section. The Court of Appeal noted that its decision should not be taken as expressing any opinion on if or how an execution creditor seeking to have a sheriff sell a beneficial interest under the *Land Titles Act* might protect its remedies under that Act. The appeal was dismissed: *1842752 Ontario Inc. v. Fortress Wismer 3-2011 Ltd.*, 2020 CarswellOnt 4915, 77 C.B.R. (6th) 165, 2020 ONCA 250 (Ont. C.A.).

(1) — *Guarantors*

To be a secured creditor within the definition in s. 2(1), a person must hold a mortgage, hypothec, etc., "on or against the property of the debtor". Hence, a creditor who holds the guarantee of a third party for the indebtedness of the bankrupt is not a secured creditor: *Re Coughlin & Co.*, 4 C.B.R. 294, [1923] 3 W.W.R. 1177, [1923] 4 D.L.R. 971 , 33 Man. R. 499 (C.A.); *Banque canadienne nationale v. Dufour* (1979), 31 C.B.R. (N.S.) 300 (Que. S.C.); *Campbell Sharp Ltd. v. Bank of Montreal* (1984), 53 C.B.R. (N.S.) 225, 30 Man. R. (2d) 73 (Q.B.).

If a guarantor pays in full the indebtedness of the principal debtor, the guarantor is entitled to any security held by the principal creditor and becomes a secured creditor. There is no necessity

for any formal transfer of the security to the guarantor; the guarantor stands in the place of the creditor: *Re Windham Sales Ltd.* (1979), 31 C.B.R. (N.S.) 130, 26 O.R. (2d) 246, 1 P.P.S.A.C. 73, 8 B.L.R. 317, 102 D.L.R. (3d) 459, 1979 CarswellOnt 227 (S.C.). However, a guarantor who makes partial payment of the amount owing by the principal debtor is not entitled to security held by the principal creditor: *Matticks v. B & M Construction Inc. (Trustee of)* (1992), 15 C.B.R. (3d) 224, 11 O.R. (3d) 156, 1992 CarswellOnt 193 (Gen. Div.); *Ferguson v. Gibson* (1872), L.R. 14 Eq. 379; *Re Howe; Ex parte Brett* (1871), 6 Ch. App. 838, 40 L.J. Bank. 54; it is difficult to see why, if the principal creditor realizes a surplus from the realization of its security, the guarantor is not entitled to reimbursement for the payments made by it.

If the bankrupt has guaranteed payment of a debt, the principal creditor is not a secured creditor in the bankruptcy of the guarantor because it holds security of the principal debtor. The creditor can prove in the bankruptcy of the guarantor for the full amount owing to it, and the trustee in bankruptcy of the guarantor can only demand the security held by the creditor if it pays the debt of the principal debtor in full: *Mather v. C.C.M.T.A. Ltd.*, 14 C.B.R. 292, [1933] 1 W.W.R. 526, [1933] 2 D.L.R. 790 (Sask. K.B.); *Re Crown Royal Clothing Co.* (1969), 15 C.B.R. (N.S.) 203 (Que. S.C.).

A creditor who holds an unsecured guarantee of the bankrupt in support of a secured claim against a subsidiary of the bankrupt can prove a claim against the bankrupt estate as an unsecured creditor without giving credit for the security given by the subsidiary. The creditor must, however, give credit for any payments received on the debt from the subsidiary prior to the date of bankruptcy but not for payments received after that date: *Re Olympia & York Developments Ltd.* (1997), 45 C.B.R. (3d) 85, 143 D.L.R. (4th) 536, 1997 CarswellOnt 657 (Ont. Gen. Div.).

The Ontario Court of Appeal allowed the appeal of a decision of the motion judge and reduced summary judgment against the guarantor of a corporate debt from US$3 million to US$250,000. The motion judge had erred in law by failing to take into account that the amended guarantee limited the exposure of the guarantor to US$3 million less facility and forbearance fees. Pepall J.A. observed that a personal guarantee of corporate indebtedness should only be given after serious deliberation. In this case, the guarantor turned his mind to the language of the guarantee in the expectation that his exposure would be limited. That expectation was not met. The debtor company carried on business as a supplier of information technology products. It defaulted on its obligations to a creditor, which had previously purchased the company's debt from the bank, increasing interest rates and charging a facility fee. The CEO of the debtor company blamed the creditor for the company's increased difficulty in servicing its debt, alleging that its "loan to own" strategy was consuming the equity value of the company's business through debt and fees. There were several negotiated forbearance agreements. The parties negotiated amendments to the guarantee so that the CEO would not be responsible for any portion of the company debt that arose from the creditor's fees, past or future. The creditor subsequently commenced proceedings for appointment of a receiver, approval of a stalking horse asset purchase credit bid agreement

and a sale process, and an order declaring that its nominee company would the successful bidder absent a better offer. The sale was approved and the creditor then sued the former CEO on the guarantee. The Court of Appeal held that the motion judge had erred in law by failing to consider that the amended guarantee served to reduce the company's obligations that were guaranteed; and the judge made a further palpable and overriding factual and mathematical error in calculating the amount owing under the guarantee: *Callidus Capital Corporation v. McFarlane*, 2017 CarswellOnt 11537, 51 C.B.R. (6th) 1, 2017 ONCA 626 (Ont. C.A.).

(2) — *Joint Debt*

To come within the definition of "secured creditor" in s. 2(1), there must be a debt due or accruing due to the secured creditor "from the debtor". Although there was some doubt about whether a person who holds security for a joint and several obligation due by the bankrupt and another is a secured creditor (see *Thomson v. Toronto Dominion Bank* (1970), 15 C.B.R. (N.S.) 177 (Alta. T.D.); *HSBC Bank Canada v. Expressway Concrete Supply Ltd.* (1999), 14 C.B.R. (4th) 1, 1999 CarswellOnt 3582, 1 B.L.R. (3d) 147, 15 P.P.S.A.C. (2d) 128 (Ont. S.C.J.)), it now appears to be settled that such a person is a secured creditor: *Pike v. Bel-Tronics Co.* (2000), 19 C.B.R. (4th) 262, 2000 CarswellOnt 3540 (Ont. S.C.J.); *Re Darwest Oil Services Ltd.* (2001), 25 C.B.R. (4th) 234, 2001 ABQB 416, 2001 CarswellAlta 665 (Alta. Master). See Frederick L. Myers and Monica Creery, *"Pike v. Bel-Tronics:* Secured Creditors Status Restored: Trade Creditors Warned to Protect Their Own Interests", 13 Comm. Insol. R. 1; Case Comment by Jacob Ziegel, 14 C.B.R. (4th) 9; and David E. Baird Q.C., "An Insolvency Update", 18 Nat. Insol. Rev. 33.

Where partners gave securities that they owned individually for a debt due, not from the partners, but from the firm of which they were partners, the creditor was allowed to prove against the separate estate of the partners without showing the security . The partnership and the individual partners are regarded as separate entities: *Re Dutton, Massey & Co.; Ex parte Manchester & Liverpool District Banking Co.*, [1924] 2 Ch. 199, 93 L.J.Ch. 547, 131 L.T. 622, [1924] B. & C.R. 129 (C.A.).

(3) — *Letter of Credit*

See *ante* F§109 "Letters of Credit".

In *Ontario v. Canadian Airlines Corp.* (2001), 29 C.B.R. (4th) 236, 2001 CarswellAlta 1488, 2001 ABQB 983, [2002] 3 W.W.R. 373 (Alta. Q.B.), Romaine J. of the Alberta Court of Queen's Bench was of the opinion that a creditor who had received a stand-by letter of credit from a debtor was a secured creditor but *quaere.*

(4) — *Lienholders*

See *infra* (9) "Mechanics' and Construction Lien Holders".

Section 2(1) defines "secured creditor" to include a person holding a lien on or against the property of the debtor or any part thereof. A lien is any charge of a payment of debt or duty upon either real or personal property: *Chassey v. May*, 35 B.C.R. 113, [1925] 2 W.W.R. 199 (C.A.).

A provincial statute that gives a credit union a lien on any amount standing to the credit of a member for a debt owing by the member makes the credit union a secured creditor: *Ecarnot (Trustee of) v. Western Credit Union Ltd.* (1990), 2 C.B.R. (3d) 286, [1990] 6 W.W.R. 550, 1990 CarswellSask 35, (*sub nom. Ecarnot, Re*) 87 Sask. R. 9 (Q.B.), affirmed, 7 C.B.R. (3d) 207, [1991] 5 W.W.R. 268, (*sub nom. Ecarnot, Re*) 93 Sask. R. 179, 4 W.A.C. 179, 1991 CarswellSask 41 (C.A.).

While a provincial legislature may create a valid statutory lien in favour of a credit union in respect of monies deposited into a joint bank account in the name of the bankrupts, if the account was in an overdraft position at the date of bankruptcy, the credit union would not be entitled to the lien since there would be no property of the bankrupts on which the lien could have attached. A statutory lien arising after the date of bankruptcy on after-acquired property is not valid against a trustee in bankruptcy: *Re Demare* (2004), 49 C.B.R. (4th) 77, 2004 CarswellMan 32, 2004 MBQB 36, 182 Man. R. (2d) 74 (Man. Q.B.).

The *Legal Aid Act* of Ontario creates a lien in favour of the Law Society on the lands of a person who had agreed to contribute to the cost of legal aid received by him or her. If the person receiving the legal aid goes into bankruptcy, the Law Society, by virtue of its lien, is a secured creditor: *Re Calla* (1975), 20 C.B.R. (N.S.) 234, 9 O.R. (2d) 755, 61 D.L.R. (3d) 627, 1975 CarswellOnt 92 (S.C.).

Where a debtor has paid money into court to remove a lien and the debtor then goes into bankruptcy, the money in court is not the property of the bankrupt. The lien attaches to the money in court and, if the lien is valid, is the property of the lienholder: *Van Den Bogerd (Trustee of) v. Paulsen* (2002), 36 C.B.R. (4th) 307, 2002 CarswellSask 541, 2002 SKQB 356 (Sask. Q.B.).

A claim pursuant to the *Forestry Workers Lien for Wages Act* (Ontario) should describe the form of logs or timber on which the lien is claimed, and the nature and location of services provided to support the lien at the time the work was undertaken. However, the standard of identification does not require marking of each log, timber or wood chip; and intermingling of wood at a mill does not defeat a lien claim on the grounds that logs cannot be identified, but it may prevent seizure of specific logs. A large and liberal interpretation of the statute is consistent with the objectives of lien legislation to protect vulnerable forest workers: *Re Buchanan Forest Products Ltd.* (2009), 2009 CarswellOnt 5733, 58 C.B.R. (5th) 184 (Ont. S.C.J.).

The Federal Crown had priority over provincial legislation granting woodworkers lien claims, the *Woodworker Lien Act*, R.S.B.C. 1996, c. 491; as s. 224(1.2) of the *Income Tax Act* applies notwithstanding provincial enactments. The security interest in s. 224(1.2) of the *Income Tax Act* is not required to be in the possession of the tax debtor and the claim of interest as *in rem* interest did not affect the priority: *W. Mullner Trucking Ltd. v. Baer Enterprises Ltd.* (2010), 2010 CarswellBC 371, 61 C.B.R. (5th) 1 (B.C. C.A.).

The Yukon Territory Supreme Court dismissed the application of a lien claimant who wanted to pursue its claim against the bankrupt contractor. Money had been paid into court to vacate the lien. The claimant argued, unsuccessfully, that it was a secured creditor for the portion of its claim relating to the builders' liens or, alternatively, that the funds held in trust did not form part of the bankrupt's estate: *Nelson Drywall Interiors Alberta Inc. v. Dowland Contracting Ltd.*, 2016 CarswellYukon 70, 37 C.B.R. (6th) 265, 2016 YKSC 25 (Y.T. S.C.).

(5) — *Maintenance and Support*

The Manitoba *Judgments Act* provides for the registration of an order or judgment for maintenance against real property of the defendant, and the judgment or order, if so registered, will bind the property while the judgment is in force. The registration of an order for maintenance pursuant to the Act does not give the plaintiff the status of a secured creditor in the bankruptcy of the defendant: *Can. Imperial Bank of Commerce v. McFadzean*, 28 C.B.R. (N.S.) 87, [1978] 5 W.W.R. 750, 90 D.L.R. (3d) 84 (Man. Q.B.).

Where a spouse was granted an equalization payment under the *Matrimonial Property Act*, R.S.A. 2000, c. M-8, and the judgment was registered against the lands jointly owned by the parties, the court concluded that the matrimonial order gave the wife security in the interest of the husband in the lands after the husband made an assignment in bankruptcy. The wife was free to pursue her claim as a secured creditor outside the bankruptcy: *Re Coulthard* (2003), 2003 CarswellAlta 1712, 2003 ABQB 976, 48 C.B.R. (4th) 59, 25 Alta. L.R. (4th) 101 (Alta. Q.B.).

(6) — *Cattle Breeder's Lien*

A creditor who has possession of cattle and who has supplied food, care, etc., to the cattle has a lien on the cattle under the *Cattle Lien Act* of British Columbia and is a secured creditor: *Re Can. Exotic Cattle Breeders' Co-Op.* (1979), 14 B.C.L.R. 183, 31 C.B.R. (N.S.) 217, 103 D.L.R. (3d) 112 (S.C.).

(7) — *Livery Stable Keeper's Lien*

The *Innkeeper's Act* of Ontario confers a lien on the keeper of a livery stable or boarding stable

on every horse or other animal for charges for boarding and caring for the horse or animal. The holder of such a lien is a secured creditor: *Re Rauf* (1974), 20 C.B.R. (N.S.) 143, 5 O.R. (2d) 31, 49 D.L.R. (3d) 345 (S.C.).

(8) — *Maritime Liens*

A maritime lien created by foreign law is a secured claim and will be given effect by Canadian courts: *Ultramar Canada Inc. v. Pierson Steamships Ltd.* (1982), 43 C.B.R. (N.S.) 9 (Fed. T.D.); *Holt Cargo Systems Ltd. v. ABC Containerline N.V. (Trustees of)*, 1997 CarswellNat 508, [1997] F.C.J. No. 409, 1997 CarswellNat 2144, 146 D.L.R. (4th) 736, 46 C.B.R. (3d) 169, (*sub nom. Holt Cargo Systems Inc. v. ABC Containerline N.V. (Bankruptcy)*) 127 F.T.R. 244, [1997] 3 F.C. 187 (Fed. T.D.), affirmed [1999] F.C.J. No. 337, 1999 CarswellNat 381, 1999 A.M.C. 1486, 239 N.R. 114, 173 D.L.R. (4th) 493, [1999] I.L.Pr. 634 (Fed. C.A.), affirmed 2001 CarswellNat 2816, 2001 CarswellNat 2817, 2001 SCC 90, 30 C.B.R. (4th) 6, 207 D.L.R. (4th) 577, 280 N.R. 1 (S.C.C.). The fact that provincial law creates a lien for dockage fees will not create a maritime lien enforceable by an action *in rem* in the Federal Court: *Holt Cargo Systems Inc. v. ABC Containers N.V. (Trustees of), supra.*

A master of a ship is entitled to be reimbursed by the owners of the ship for necessaries ordered by the master and is entitled to a maritime lien for the disbursements. In order to be entitled to such disbursements, the master must be unable to communicate with the owners. Principal and interest on loans obtained by the master for the owners and interest charges on personal lines of credit are not master's disbursements: *Doris v. Ferdinand (The)* (1998), 5 C.B.R. (4th) 182, 155 F.T.R. 236, 1998 CarswellNat 1861 (T.D.).

For a maritime lien, the wages of an employee must be referable to a particular ship. If the source of severance pay is not a contract specific to a ship but to a company service agreement, there is no maritime lien. Company service agreements provide continuous employment notwithstanding the particular voyages or ships on which the employee may from time to time be involved: *Canadian Imperial Bank of Commerce v. "Chene No. 1" (Le)* (2003), 41 C.B.R. (4th) 13, 2003 CarswellNat 619, 2003 CarswellNat 1581, 2003 FCT 292, 2003 CFPI 292, 2003 A.M.C. 1162, 229 F.T.R. 181 (Fed. T.D.).

A company operated a passenger ferry running between two coastal cities and had hired contractors to complete extensive repairs on the vessel. The vessel returned to service, and the company encountered problems with the motor unrelated to the repairs and subsequently declared bankruptcy. The contractors brought an application for an order that the bankruptcy stay of proceedings did not apply to their actions against the company for monies allegedly owed in relation to the repairs and the court granted the order. The court held that the contractors' claims were integrally connected to the operation and navigation of the vessel, and the fact that the ship at the time of the repairs only plied in intra-provincial waters did not change the character of those services to debt claims solely within provincial jurisdiction. The

contractors' repairs enhanced the value of the vessel and their maritime lien claims were secured within the meaning of bankruptcy legislation and the ranking of priorities of various marine claims was a matter for the court to determine pursuant to the principles of federal maritime law. The court further held that claims of the seamen also in pith and substance related to the operation and navigation of the ship and if proven, their wage claims would constitute a maritime lien and they should have the opportunity to argue that their claims were elevated to rank *pari passu* with the other maritime liens; the court therefore granted an order that the statutory stay under s. 69.4 did not apply to their claims under the admiralty action before the federal court: *Nanaimo Harbour Link Corp. v. Abakhan & Associates Inc.* (2007), 2007 CarswellBC 177, 2007 BCSC 109, 31 C.B.R. (5th) 298, 2007 A.M.C. 631 (B.C. S.C.).

The British Columbia Supreme Court granted initial *CCAA* protection to a group of entities involved in the business of designing, manufacturing, and selling custom super yachts. The initial application was opposed by certain creditors on the basis that the B.C. court had no jurisdiction to stay *in rem* maritime law proceedings in the Federal Court. The initial order granted by the B.C. court included, as a matter of comity, a request for recognition and aid of the Federal Court with respect to the initial order. The court was of the view that priority issues as they related to claims of maritime lien holders did not have to be addressed on the initial application: *Sargeant III v. Worldspan Marine Inc.* (2011), 2011 CarswellBC 1444, 2011 BCSC 767 (B.C.S.C. [In Chambers]). For further discussion of this case, see N§59 "Jurisdiction of Courts".

In related decisions, *BBC Chartering Carriers GMBH & CO. KG v. Openhydro Technology Canada Limited*, 2018 CarswellNat 6194, 2018 FC 1098 (F.C.) and *Re OpenHydro Technology Canada Ltd.*, 2018 CarswellNS 861, 2018 NSSC 283 (N.S. S.C.), the Federal Court held that a *BIA* stay of proceedings did not stay *in rem* proceedings in the Federal Court. The Nova Scotia Supreme Court declined to issue an order to stay the Federal Court *in rem* proceedings. If there is to be such a stay, it should be decided by the Federal Court on motion of the debtor and not the Nova Scotia Supreme Court.

In *BBC Chartering Carriers GMBH & CO. KG v. Openhydro Technology Canada Limited*, the plaintiff BBC Chartering Carriers ("BBC") sought default judgment against the defendant being a turbine control centre *in rem* ("TCC" or "*in rem* defendant"). The plaintiff also sought an order for commission or sale of TCC. The defendants did not file a statement of defence and no one appeared on their behalf at the hearing of the motion. In advance of the motion, the court received communications from legal counsel on behalf of the *in personam* defendant, OpenHydro Technology Canada Limited ("OpenHydro"), requesting that the court decline to consider the motion as it had filed a notice of intention to make a proposal pursuant to s. 50.4(1) of the *BIA*. OpenHydro had entered into a charterparty agreement in 2018 for offshore service vessels with BBC, OpenHydro chartering a vessel from BBC for the carriage of the cargo, TCC, which is the *in rem* defendant that was loaded aboard the vessel and transported from Ireland to New Brunswick. BBC invoiced OpenHydro for the agreed upon amount of $871,339. No

payments were made by OpenHydro. Pursuant to the terms of the charterparty agreement, upon default, BBC was entitled to assert a lien on the cargo. This right of lien was the basis of the *in rem* claim against the cargo. The only issue for determination was if default judgment should be granted against the *in rem* defendant, TCC. Justice McDonald noted that pursuant to s. 22(1) of the *Federal Courts Act* (*FCA*), the Federal Court has concurrent original jurisdiction over matters of navigation and shipping; s. 22(2)(1) states that the Federal Court has jurisdiction with respect to "any claim arising out of any agreement relating to the carriage of goods in or on a ship or to the use or hire of a ship whether by charter party or otherwise" and s. 43(2) of the *FCA* states that: 43(2) Subject to subsection (3), the jurisdiction conferred on the Federal Court by s. 22 may be exercised *in rem* against the ship, aircraft or other property that is the subject of the action, or against any proceeds from its sale that have been paid into court. Justice McDonald noted that s. 43(2) of the *FCA* was addressed by the Supreme Court of Canada in *Phoenix Bulk Carriers Ltd. v. "M/V Swift Fortune" (The)*, 2007 CarswellNat 531, (*sub nom.* Phoenix Bulk Carriers Ltd. v. Kremikovtzi Trade) [2007] 1 S.C.R. 588, 2007 SCC 13, which held that s. 43(2) does not require a physical nexus between the cargo and the vessel in order to give rise to *in rem* rights. Rather, s. 43(2) proposes identifiability of the property as the controlling factor so as to ensure that the scope of the *in rem* proceedings is not unduly enlarged: the action *in rem* must relate to the specific property contemplated in the contract at issue. Justice McDonald noted that although the cargo was no longer on the charter vessel and was in fact located on the seafloor, there was a clear nexus between the cargo and the vessel and therefore it was within the court's maritime law jurisdiction. In this case, the arrest of the *in rem* defendant took place in August 2018. OpenHydro's notice of intention under the *BIA* was filed in September 2018. Therefore, the maritime jurisdiction of the federal court was engaged in advance of the *BIA* proceedings. Justice McDonald was satisfied on the facts that the plaintiff was entitled to default judgment against the *in rem* defendant in the amounts invoiced together with interest and ordered accordingly: *BBC Chartering Carriers GMBH & CO. KG v. Openhydro Technology Canada Limited*, 2018 CarswellNat 6194, 2018 FC 1098 (F.C.).

In the related judgment, *Re OpenHydro Technology Canada Ltd.*, the debtor OpenHydro filed a notice of intention to make a proposal pursuant to the *BIA* in September 2018 and a month later, filed a motion requesting that the proceeding be converted to an application pursuant to the *CCAA*. The debtor is a Canadian subsidiary of an Irish energy technology company involved in the business of design and manufacture of marine turbines for electrical generation. The debtor deployed two turbines in Nova Scotia, as part of a demonstration project exploring the generation of electricity through tidal energy. By September 2018, the turbines had been damaged beyond repair and were incapable of generating electricity. In August 2018, a number of creditors of the debtor commenced proceedings in the Federal Court against the "Scotia Tide", a vessel owned by the company. In August 2018, the vessel was arrested pursuant to a Federal Court warrant. Seven creditors advanced *in rem* claims against the vessel. Also in August 2018, another creditor of the debtor, "BBC", commenced *in rem* proceedings in the Federal Court asserting a claim against the Turbine Control Centre ("TCC"), which was associated with the submerged turbines. That equipment was also arrested pursuant to a Federal

Court warrant. On November 1, 2018, the Federal Court granted default judgment in favour of BBC and ordered the sale of the TCC (see case summary immediately above). Justice Wood was prepared to grant the initial order and charging order on the terms proposed, subject to his decision on the scope of the temporary stay. Justice Wood noted that cases that dealt with the relationship between superior courts exercising bankruptcy jurisdiction and the Federal Court's maritime law jurisdiction, also applied to some extent in proceedings under the *CCAA*. Wood J. held that the Federal Court continued to have jurisdiction over the *in rem* claims advanced by the respondents and that the Nova Scotia Supreme Court should not issue the equivalent of an anti-suit injunction preventing the Federal Court from dealing with those claims. Justice Wood held that the *in rem* claims of the respondents being advanced in the Federal Court were exempt from the stay created by the initial order with a request to the Federal Court for aid and recognition. It would then be up to the Federal Court to determine whether it should stay the *in rem* claims and, if so, on what terms: *Re OpenHydro Technology Canada Ltd.*, 2018 CarswellNS 861, 2018 NSSC 283 (N.S. S.C.).

(9) — *Mechanics' and Construction Lien Holders*

A mechanic or construction lien holder who holds a lien against the property of an owner who has become bankrupt is a secured creditor: *Re Rockland Chocolate & Cocoa Co.* (1921), 1 C.B.R. 452, 61 D.L.R. 363, 50 O.L.R. 66 (S.C.); *Re Victoria Bed & Mattress Co.* (1960), 1 C.B.R. (N.S.) 175, 24 D.L.R. (2d) 414 (B.C. S.C.); *Re Panver Const. Ltd.* (1987), 62 C.B.R. (N.S.) 222, 57 O.R. (2d) 758, 23 C.L.R. 233, 34 D.L.R. (4th) 316 (S.C.); *Pisiak v. Dyck* (1986), 63 C.B.R. (N.S.) 151, 32 D.L.R. (4th) 287, 56 Sask. R. 107 (Q.B.); *Dufferin-Custom Concrete v. Carting / Maplehurst Developments Inc.* (1993), 22 C.B.R. (3d) 67, 1993 CarswellOnt 239 (Ont. Gen. Div.); *561861 Ontario Ltd. v. 1085043 Ontario Inc.* (1999), 15 C.B.R. (4th) 146, 49 C.L.R. (2d) 143, 1999 CarswellOnt 2227 (Ont. Gen. Div.). Similarly, a sub-contractor who has a mechanic's or construction lien on the property of the bankrupt is a secured creditor: *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295, 1990 CarswellNS 33 (T.D.).

A mechanics' or construction lien holder who has a lien on the property of an owner from whom the bankrupt is purchasing property but which has reverted to the owner is not a secured creditor. To be a secured claim, a lien must be a lien upon the property of the bankrupt: *Re Reeve-Dobie Mines Ltd. (No. 2)* (1921), 1 C.B.R. 540, 64 D.L.R. 534, 50 O.L.R. 499 (S.C.).

A mechanics' lien on oil and gas wells attaches only to the property on which the oil and gas wells are situate; it does not extend to the proceeds of the sale of the gas and oil from the wells. Accordingly, mechanics' lien holders with this kind of lien are not secured creditors with respect to proceeds of sale that have been paid into court prior to bankruptcy as a result of garnishees: *Halliburton Services Ltd. v. Snowhawk Energy Inc.* (1988), 70 C.B.R. (N.S.) 155, 57 Alta. L.R. (2d) 258, 89 A.R. 32 (Q.B.).

In *Roscoe Enterprises Ltd. v. Wasscon Construction Inc.* (1998), 161 D.L.R. (4th) 725, 1998 CarswellSask 463 (Sask Q.B.), prior to bankruptcy, the debtor paid money into court to remove a mechanic's lien. The lien was satisfied, leaving a substantial sum of money in court. The court held that unpaid mechanics' lienholders were not secured creditors with respect to the money paid into court but that the money was the property of the bankrupt and hence should be paid to the trustee in bankruptcy.

Where a bankrupt is a contractor, the owner of the property on which the work is being performed must retain the statutory holdback for mechanics' lienholders. Although the lienholders are not secured creditors of the bankrupt estate, they have a charge on the holdback, and the trustee in bankruptcy of the contractor is only entitled to the balance (if any) after the liens are discharged. The legal position is not changed by the fact that the holdback has been paid into court: *Forsythe Estate (Trustee of) v. Southport Home Centre Ltd.* (2000), 22 C.B.R. (4th) 71, 2000 PESCTD 104, 197 Nfld. & P.E.I.R. 183, 591 A.P.R. 183, 2000 CarswellPEI 112 (P.E.I. T.D.).

Where the bankrupt is a contractor and liens have been registered by subcontractors and the owner has paid money into court to remove the liens, the money paid into court is not the property of the bankrupt. When the money is paid into court, the liens are not discharged. They cease to attach to the land and holdback but attach instead to the money paid into court: *D & K Horizontal Drilling (1998) Ltd. (Trustee of) v. Alliance Pipeline Ltd.* (2002), 33 C.B.R. (4th) 217, 2002 CarswellSask 168, 216 Sask. R. 199, 2002 SKQB 86, [2002] 6 W.W.R. 497 (Sask. Q.B.), affirmed (2002), 39 C.B.R. (4th) 201, 2002 CarswellSask 825, 2002 SKCA 145, [2003] 4 W.W.R. 29, 227 Sask. R. 250, 287 W.A.C. 250 (Sask. C.A.). If, after the liens are paid in full, there is a surplus, the surplus will be subject to the claims of unpaid creditors who supplied labour and materials to the project: see *ante* F§17 "Trust Fund Provisions of the Mechanics' and Construction Lien Acts".

A receiver manager, in administering a receivership, became aware of builders' lien claims against the interests of the debtor companies. The Court held that while the bank had properly registered its security, s. 22(2) of the Saskatchewan *Builders' Lien Act* gave the lienholders priority over the bank security. The Court noted that the receiver's failure to make an accounting of inventory at the time of its appointment did not extinguish or nullify the lienholders' priority: *KNC Holdings Ltd. v. FTI Consulting Canada Inc.*, 2016 CarswellSask 714, 41 C.B.R. (6th) 267, 2016 SKQB 349 (Sask. Q.B.).

The Ontario Court of Appeal considered the issue of whether the funds owing to or received by a bankrupt contractor and impressed with a statutory trust created by s. 8(1) of the *Construction Lien Act*, R.S.O. 1990, c. C.30 (*CLA*) [now the *Construction Act*, effective 2017] were excluded from distribution to the contractor's creditors, pursuant to s. 67(1)(a) *BIA*. The debtor was deemed bankrupt in 2014. The bankruptcy judge directed the receiver to establish a "paving projects account" and a general post-receivership account, without prejudice to the existing

rights of any party. While the receiver commingled the trust funds received from four projects, the allocation of the funds to each specific project was identifiable because of the receiver's careful accounting. The Court of Appeal cited *British Columbia v. Henfrey Samson Belair Ltd.*, 1989 CarswellBC 711, [1989] 2 S.C.R. 24, [1989] S.C.J. No. 78 (S.C.C.), which held that Parliament only intended s. 67(1)(a) *BIA* to apply to trusts arising under general principles of law, namely trusts that meet the three certainties: certainty of intention, certainty of subject matter, and certainty of object. Section 8(1) *CLA* provides that the amounts in ss. 8(1)(a) and (b) "constitute a trust fund" and s. 8(2) establishes that the contractor or subcontractor "is the trustee of the trust fund created by subsection (1)." Section 8(2) also imposes a statutory trust obligation on the contractor or subcontractor not to appropriate or convert any part of the trust fund until all subcontractors and suppliers have been fully paid for their work. The *CLA* scheme protects subcontractors who are vulnerable due to their lack of privity of contract with the owner who benefits from the improvements they perform. Holdbacks require the owner and other contractors to withhold payments in order to ensure that funds are available to pay subcontractors and suppliers. Liens give subcontractors and suppliers the right to assert a claim directly against the property they have improved. The purpose of s. 8 is to impress money owing to or received by contractors or subcontractors with a statutory trust, a form of security, to ensure payment of suppliers to the construction industry. The trust must be seen as an integral part of the scheme of holdbacks, liens and trusts, designed to protect the rights and interests of those engaged in the construction industry and to avoid the unjust enrichment of those higher up the construction pyramid. That purpose exists outside the bankruptcy context. As valid provincial legislation, the *CLA* benefits from a presumption of constitutionality and should be interpreted to avoid conflict with federal legislation where possible. The Court held that it is appropriate to look to provincial statutory law to determine whether a trust satisfies the three certainties. Section 72 of the *BIA* contemplates the integration of the *BIA* with provincial legislation by providing that the *BIA* "shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property or civil rights that are not in conflict" demonstrates that Parliament intends provincial law to continue to operate in the bankruptcy and insolvency context unless it is inconsistent with the *BIA*. The *CLA* trust does not frustrate the purpose of the *BIA*. To allow s. 8(1) *CLA* trust funds to be distributed to creditors of a bankrupt contractor would provide an "unexpected and unfair windfall" to those creditors. Section 8(1) imposes a deemed statutory trust rather than merely create a statutory trust obligation on the contractor to hold money on trust in a separate account. The s. 8(1) trust is imposed from the time the moneys are owed to the contractor, not just after they are received. Accordingly, the fact that ss. 8(1) and (2) did not require the segregation of amounts received is not determinative because the statute itself, not the act of complying with a statutory obligation to segregate funds, created the trust. The commingling of *CLA* funds from various projects does not mean that the required certainty of subject matter was not present because the funds remained identifiable and traceable. The Court allowed the appeal, set aside the order below and made an order that the funds at issue satisfy the requirements for a trust at law and so were not property of the debtor available for to creditors: *The Guarantee Company of North America v. Royal Bank of Canada*, 2019 CarswellOnt 300, 2019 ONCA 9 (Ont. C.A.).

(10) — *Municipality's Lien for Unpaid Taxes*

A municipality that has a lien for overdue taxes on real property is a secured creditor and does not have to obtain leave under s. 69.4 to enforce its lien. It may proceed to follow the steps set out in provincial legislation for enforcement of the lien and, if the taxpayer does not pay the arrears, to have the property transferred into its name as owner: *Condominium Plan No. 762 0380 v. Edmonton (City)* (2001), 24 C.B.R. (4th) 9, 2001 CarswellAlta 155, 2001 ABQB 97, [2001] 6 W.W.R. 316, 90 Alta. L.R. (3d) 229, 284 A.P.R. 62 (Alta. Q.B.); *Re Perrette Inc., (sub nom. Perrette Inc. (Proposition concordataire de))*, 2000 CarswellQue 610, 24 C.B.R. (4th) 268, [2000] R.J.Q. 1300, [2000] R.D.F.Q. 61, [2001] G.S.T.C. 99 (Que. S.C.).

Insolvent debtor energy companies were placed into receivership, and, subsequently, bankruptcy. Three municipalities sought a priority for tax arrears under the *BIA*. The municipalities were three of six municipalities through which a pipeline operated by the debtor passes. The municipalities did not advance claims as secured creditors, although served with notice. The receiver distributed all the recovered funds to the secured creditors, with no funds remaining. The Alberta Court of Appeal held that the mere fact that the funds have been distributed by the receiver does not render moot an appeal of the order authorizing the distribution. The taxation provisions of the *Municipal Government Act*, R.S.A. 2000, c. M-26 (*MGA*) are tax arrears and the issue was whether the special lien for linear property tax arrears is a secured claim for purposes of the *BIA*. The *MGA* defines linear property as electric power systems, street light systems, telecommunication systems, pipelines, railway property, and wells. The Court held that when the *MGA* provisions are read in their ordinary and grammatical sense and in the context of the scheme of the *Act*, it is apparent that the lien provision does not encompass linear property. The appeal was dismissed: *Northern Sunrise County v. Virginia Hills Oil Corp* (2019) 2019 CarswellAlta 236, 2019 ABCA 61, 67 C.B.R. (6th) 8 (Alta C.A.).

(11) — *Negotiable Instrument Holder*

For voting by a holder of a negotiable instrument, see *ante* G§10 "Creditor with a Claim on a Bill or Promissory Note on Which the Bankrupt is Secondarily Liable".

Section 2(1) provides that "secured creditor" includes a person whose claim is based upon or secured by a negotiable instrument held as collateral security and on which the debtor is only secondarily liable. Where a debtor has endorsed customers' notes and discounted them to its bank as security for the amount owing by the debtor to the bank, the bank is a secured creditor: *Re Hayes* (1934), 16 C.B.R. 10, 7 M.P.R. 535 (P.E.I. S.C.).

(12) — *Real Estate Agent*

A real estate agent who has arranged a sale of the bankrupt's house prior to bankruptcy is not a secured creditor for the amount owing to him or her, even though the sale of the property is completed by the trustee in bankruptcy: *Re Bertrand* (1981), 40 C.B.R. (N.S.) 64 (Que. S.C.). See *ante* F§5 "Trust Property — (5) Express Trusts" for trust claims with respect to real estate agents.

(13) — *Ship Owner's Lien*

If the owner of a vessel charters a vessel to a debtor and the charter provides that the owner will have a lien against cargoes if the hire is not paid, in the bankruptcy of the debtor the owner is a secured creditor for the amount owing for the hire of the vessel with respect to the property of the bankrupt stowed on board the vessel. The term "cargo" as used in the charter contract was held not to be restricted to goods that were carried for hire but included goods of the bankrupt stowed on board the vessel and carried for the bankrupt's own use: *Cooper & Lybrand Ltd. v. Centennial Towing Ltd.* (1980), 35 C.B.R. (N.S.) 211, 22 B.C.L.R. 96 (S.C.).

(14) — *Airport Authorities and Air Navigation Services*

In *Re Canada 3000 Inc.* (2004), 2004 CarswellOnt 149, 3 C.B.R. (5th) 207, (*sub nom. Greater Toronto Airports Authority v. International Lease Finance Corp.*) 69 O.R. (3d) 1, 183 O.A.C. 201, 235 D.L.R. (4th) 618 (Ont. C.A.), additional reasons at (2004), 2004 CarswellOnt 1915, 3 C.B.R. (5th) 288, (*sub nom. Canada 3000 Inc. (Bankrupt), Re*) 186 O.A.C. 116 (Ont. C.A.), the court considered whether the seizure and detention rights of the airport authorities and the operator of Canada's Civil Air Navigation System (NAV Canada) gave them priority over lessors of aircraft to the bankrupt airlines. Under the *Civil Air Navigation Services Commercialization Act* (*CANSCA*), the owners and operators of aircraft are jointly and severally liable for payment of air navigation services, and `owner' includes a person in whose name an aircraft is registered. It was held that the word 'owner' does not include the holder of the legal title where the aircraft has been leased under a true lease. The bankrupt was the registered owner of the aircraft, and the responsibility for the unpaid charges did not lie with the lessors.

Based on the plain meaning of s. 9 of the *Airports Act*, it was not possible to say that Parliament intended to create a lien in favour of the airport authorities in priority to the rights of the lessors as it was not so provided in clear in an unambiguous language.

The remedies created under the detention provisions of both statutes do not create rights in the aircraft that ranked in priority to the interests of the lessors or precluded the exercise by the lessors of their contractual rights to repossession.

The Supreme Court of Canada held that in dealing with aircraft flown in and out of jurisdictions under complex lease arrangements, the only effective collection scheme is to render the aircraft

themselves available for seizure, and thereafter to let those interested in them, including legal titleholders, registered owners, sublessors and operators, to resolve their dispute about where the money is to come from to pay the debts due to the service providers. The detention remedy is against aircraft and their parts, irrespective of who is the ultimate owner of the aircraft and irrespective of any security interests in the aircraft and it is only a right of detention without a right to sell or dispose of the aircraft. No insolvency stay is applicable to the detention remedy where the bankruptcy trustee of the airline or the airline under restructuring claims no economic interest in the aircraft. A judge has wide discretion to grant the remedy and to alleviate the burden and potential unfairness of a detention amongst various owners of aircraft, subject only to the right of the authorities and NAV Canada to be paid in full. Parliament has left the door open for the motions judge to work out an arrangement that is fair and reasonable to all concerned, provided that the object and purpose of the remedy, to ensure the unpaid user fees are paid, is fulfilled: *NAV Canada c. Wilmington Trust Co.* (2006), 2006 CarswellQue 4890, 2006 CarswellQue 4891, (*sub nom. Canada 3000 Inc., Re*), 2006 SCC 24, [2006] S.C.J. No. 24 (*sub nom. Greater Toronto Airports Authority v. International Lease Finance Corp.*) 80 O.R. (3d) 558 (note), (*sub nom. Canada 3000 Inc., (Bankrupt), Re*),, 20 C.B.R. (5th) 1, 349 N.R. 1, [2006] 1 S.C.R. 865, 10 P.P.S.A.C. (3d) 66, 212 O.A.C. 338 (S.C.C.).

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1979 CarswellOnt 227
Ontario Supreme Court, In Bankruptcy

Windham Sales Ltd., Re

1979 CarswellOnt 227, [1979] 3 A.C.W.S. 487, 102 D.L.R. (3d) 459, 1 P.P.S.A.C. 73, 26 O.R. (2d) 246, 31 C.B.R. (N.S.) 130, 8 B.L.R. 317

RE WINDHAM SALES LIMITED

Henry J.

Heard: September 6, 1979
Judgment: September 6, 1979
Docket: No. 07939

Counsel: *K. R. Dore*, for trustee.
M. Slan, for respondent creditor G. McConnell.

Subject: Corporate and Commercial; Insolvency; Property

Headnote

Bankruptcy --- Priorities of claims — Secured claims — Loss of secured status — Effect of P.P.S.A

Personal Property Security --- Perfection of security interest — Registration

Personal Property Security --- Priority of security interest — Security interests versus other interests — Under federal law — Trustee in bankruptcy

Secured creditors — Kinds of security — Chattel mortgages — Chattel mortgage in favour of bank securing loan — Security properly registered — Loan paid off by guarantor — Subsequent bankruptcy of borrower — Guarantor standing in place of original creditor — The Personal Property Security Act.

The debtor borrowed money from the bank which was secured by a chattel mortgage, given by the debtor in November 1977, in respect of which a financing statement was properly registered under the Personal Property Security Act. The loan was guaranteed by M. The debtor defaulted on his obligation to the bank in September 1978, and the guarantor paid off the loan. In December 1978 the debtor filed an assignment in bankruptcy. On the following day a financing

change statement was filed reflecting the interest of the guarantor in the security agreement by way of assignment from the bank.

Held:

The security by way of chattel mortgage of the personal property in question had priority over the trustee's interest, and M. was a secured creditor to the extent of the amount of the payments he had made pursuant to the guarantee. Upon implementation of the guarantee, the guarantor stood in the place of the original creditor without the necessity of any formal transfer of any security interest to the guarantor. The guarantor, prior to the bankruptcy, had acquired by payment under the guarantee the same interest as the bank had in the security. The security interest having been properly protected by due registration of the original financing statement under the Personal Property Security Act, the guarantor was therefore protected in respect of this interest by that registration, his payment under the guarantee and the effect of the Mercantile Law Amendment Act. He was not obliged to register the financing change statement (which is optional and not mandatory), since the perfected security interest at no time ceased to be perfected.

Table of Authorities

Cases considered:

Jamieson v. Hotel Renfrew Trustees, [1941] 4 D.L.R. 470 (Ont.) — *applied*

Re Pathe Frères Phonograph Co. of Can.; Ex parte U.S. Fidelity & Guar. Co. (1921), 50 O.L.R. 644, 2 C.B.R 21, 64 D.L.R. 628 — *applied*

Statutes considered:

Personal Property Security Act, R.S.O. 1970, c. 344, s. 48(1) [re-en. 1973, c. 102, s. 9].

Mercantile Law Amendment Act, R.S.O. 1970, c. 272, s. 2.

Application by trustee for advice and directions relative to question of priorities between guarantor paying off chattel mortgage and trustee.

***Henry J.* (orally):**

1 The trustee applies in effect for advice and directions as to whether a security agreement duly registered under the Personal Property Security Act, R.S.O. 1970, c. 344, takes priority over the interest of the trustee.

2 The facts are not in dispute. The debtor, now the bankrupt, borrowed money from the Royal Bank of Canada which was secured by chattel mortgage, given by the debtor on 4th November 1977, in respect of which a financing statement was properly registered under the Personal Property Security Act. The loan was guaranteed by the respondents herein, Glenn McConnell and Isabel McConnell. The debtor defaulted on his obligation to the bank on 11th September 1978, and the guarantors paid off the loan. On 6th December 1978 the debtor made an assignment in bankruptcy. On the following day a financing change statement was filed, as is permitted by s. 48 (1) [re-en. 1973, c. 102, s. 9] of the Personal Property Security Act, reflecting the interest of the guarantors in the security agreement by way of assignment from the bank. I say, at once, that this registration, which is optional and not mandatory, does not affect the issue before me.

3 The real issue, as Mr. Dore acknowledges, is whether the bank's interest devolved upon the guarantors when payment was made. If it did, that event occurred before the bankruptcy and would be binding on the trustee. The trustee has brought the application mainly, as I understand it, because of uncertainty as to whether it was necessary for the McConnells, upon implementing the guarantee, to call for a formal assignment in writing of the chattel mortgage by the bank to themselves. There was in fact no such assignment.

4 Section 2 of the Mercantile Law Amendment Act, R.S.O. 1970, c. 272, provides as follows:

> 2. — (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 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 the performance of the duty.
>
> (2) Such person is entitled to stand in the place of the creditor, and to use all the remedies and, on proper indemnity, to use the name of the creditor in any action or other proceeding in order to obtain from the principal debtor, or any co-surety, co-contractor or co-debtor, indemnification for the advances made and loss sustained by such person, and the payment or performance made by him is not a defence to such action or other proceeding by him.

5 The law appears to be well settled that upon implementation of the guarantee in a situation such as that before me the guarantor stands in the place of the original creditor without the necessity of any formal transfer of any security interest to the guarantor. It appears to me that this must be the effect of subs. (2): see *Re Pathe Frères Phonograph Co. of Can.; Ex parte U.S. Fidelity & Guar. Co.* (1921), 50 O.L.R. 644, 2 C.B.R. 21, 64 D.L.R. 628, and *Jamieson v. Hotel Renfrew Trustees*, [1941] 4 D.L.R. 470 (Ont.).

6 In the circumstances I am of the opinion that prior to the bankruptcy the guarantors, Mr. and Mrs. McConnell, acquired by payment under the guarantee the same interest as the bank had in the security. That security interest had been properly perfected by due registration of the original financing statement under the Personal Property Security Act. The guarantors were therefore protected in respect of this interest by that registration, their payment under the guarantee, and the effect of the Mercantile Law Amendment Act. While they might have done so, they were not obliged to register the financing change statement, since the perfected security interest at no time ceased to be perfected.

7 The trustee is therefore directed to regard the security by way of chattel mortgage of the personal property in question as having priority over the trustee's interest and Mr. and Mrs. McConnell as secured creditors to the extent of the amount of the payment they have made pursuant to the guarantee.

8 Prior to this application coming before me the trustee and the McConnells very properly agreed that the trustee should sell the chattels constituting the security, and the trustee at present holds the proceeds of the sale pending the direction of the court as to their disposition. They will, of course, be paid over to Mr. and Mrs. McConnell after the trustee has deducted the costs and expenses he has incurred in liquidating the chattels. Counsel have indicated that they do not see any difficulty in agreeing on the amount of these costs and expenses.

9 The respondents will have their costs of this application to be paid by the trustee out of the estate, which are hereby fixed at the amount of $150. The trustee also is entitled to his costs to be paid out of the assets of the estate.

Chattel mortgage securing loan properly registered. Guarantor paying off loan entitled to protection of security.

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2011 ABCA 314
Alberta Court of Appeal

Alberta Treasury Branches v. Weatherlok Canada Ltd.

2011 CarswellAlta 1883, 2011 ABCA 314, [2012] A.W.L.D. 1735, [2012] A.W.L.D. 1737, [2012] A.W.L.D. 1738, [2012] A.W.L.D. 1739, [2012] A.W.L.D. 1775, 210 A.C.W.S. (3d) 52, 343 D.L.R. (4th) 304, 515 A.R. 148, 532 W.A.C. 148, 68 Alta. L.R. (5th) 400

Mark Wesley Trinier also known as Mark Trinier and Deborah Ellen Trinier also known as Debbie Trinier, Appellants (Defendants) and Donald Shurnaik and Debbie Shurnaik, Respondents (Defendants) and Alberta Treasury Branches, Not a Party to the Appeal (Plaintiff) and Weatherlok Canada Inc., Not a Party to the Appeal (Defendant)

Jean Côté, Marina Paperny, R. Paul Belzil JJ.A.

Heard: September 7, 2011
Judgment: November 4, 2011*
Docket: Edmonton Appeal 1103-0033-AC

Proceedings: reversing *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABQB 15, 2011 CarswellAlta 17 (Alta. Q.B.); additional reasons at *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABCA 360, 2011 CarswellAlta 2473 (Alta. C.A.)

Counsel: N.D. Anderson for Appellants
G.J. Lintz for Respondents

Subject: Civil Practice and Procedure; Corporate and Commercial

Headnote

Civil practice and procedure --- Costs — Particular orders as to costs — Costs on solicitor and client basis — General principles
Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded

solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee, loan agreements and assignment were drafted in wide terms, and provided for solicitor-client costs — Assignment contained power of attorney clause which empowered T defendants to do all matters in relation to judgment that plaintiff could do — Court proceedings were against guarantors — Statement of claim recited terms of note and loan agreements which provided for solicitor-client costs — Costs incurred by T defendants in trying to collect from S defendants were incurred under all financial documents — Default judgment taxed solicitor-client costs against S defendants — Since T defendants were paying guarantors, they had every remedy which creditor had against other guarantors — Decision of previous judge clearly stated that costs were to be on solicitor-client basis — Solicitor-client costs were available on default judgment.

Guarantee and indemnity --- Practice and procedure — Guarantee — Liability for costs
Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee provided for solicitor-client costs, and was assigned — Assignment contained power of attorney clause which empowered T defendants to do all matters in relation to judgment that plaintiff could do — Court proceedings were against guarantor — Statement of claim recited terms of note and loan agreements which provided for solicitor client costs — Default judgment taxed solicitor-client costs against S defendants — Since T defendants were paying guarantors, they had every remedy which creditor had against other guarantors — Costs incurred by T defendants in trying to collect from S defendants were incurred under loan documents, guarantee and assignment.

Civil practice and procedure --- Default proceedings — Judgment following default — By signing default judgment — General principles
Costs — Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee provided for

solicitor-client costs — Costs incurred by T defendants in trying to collect from S defendants were incurred under loan documents, guarantee and assignment — Decision of previous judge clearly stated that costs were to be on solicitor-client basis — Previous proceedings were proper — Solicitor-client costs were available on default judgment — Default judgment taxed solicitor-client costs against S defendants — Clerk of court had clear power to grant judgment for any liquidated claim pleaded after default.

Civil practice and procedure --- Costs — Costs of particular proceedings — Miscellaneous
Default judgment — Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee provided for solicitor-client costs — Costs incurred by T defendants in trying to collect from S defendants were incurred under loan documents, guarantee and assignment — Decision of previous judge clearly stated that costs were to be on solicitor-client basis — Previous proceedings were proper — Solicitor-client costs were available on default judgment — Default judgment taxed solicitor-client costs against S defendants — Clerk of court had clear power to grant judgment for any liquidated claim pleaded after default.

Table of Authorities

Cases considered by *Jean Côté J.A.*:

Arbitus Leasing Ltd. v. X-Zibit A Inc. (2006), 405 A.R. 288, 2006 ABQB 764, 2006 CarswellAlta 1416, 34 C.P.C. (6th) 311, 68 Alta. L.R. (4th) 173 (Alta. Q.B.) — considered

Brennan v. Arcadia Coal Co. (1929), [1929] 3 W.W.R. 446, 24 Alta. L.R. 236, [1929] 4 D.L.R. 1025, 1929 CarswellAlta 32 (Alta. C.A.) — followed

British American Co. v. Law & Co. (1892), 21 S.C.R. 325, 1892 CarswellNS 84 (S.C.C.) — referred to

Brown v. Coughlin (1914), 28 D.L.R. 437, 50 S.C.R. 100, 1914 CarswellOnt 423 (S.C.C.) — referred to

Collings, Re (1937), 1937 CarswellOnt 72, 18 C.B.R. 97, [1936] S.C.R. 613, [1937] 1 D.L.R. 409 (S.C.C.) — referred to

Csepregi v. Bygrove (2001), 2001 CarswellAlta 547, 2001 ABCA 108 (Alta. C.A.) —

referred to

Davidson v. Patten (2006), 2006 CarswellAlta 663, 2006 ABQB 370 (Alta. Q.B.) — referred to

Dyck v. Wilkinson (2004), 2004 ABQB 731, 2004 CarswellAlta 1338 (Alta. Q.B.) — referred to

Dykes v. Goczan (1996), 38 Alta. L.R. (3d) 425, 49 C.P.C. (3d) 306, 188 A.R. 352, 1996 CarswellAlta 279 (Alta. Q.B.) — considered

Elliott v. Hill Bros. Expressways Ltd. (1999), 1999 CarswellAlta 138, 41 M.V.R. (3d) 142, 232 A.R. 258, 195 W.A.C. 258 (Alta. C.A.) — referred to

Hill v. Stephen Motor & Aero Co. (1929), 1929 CarswellSask 47, 23 Sask. L.R. 552, [1929] 3 D.L.R. 676, [1929] 2 W.W.R. 97 (Sask. C.A.) — referred to

Hillas & Co. v. Arcos Ltd. (1932), 43 Ll. L. Rep. 359, [1932] UKHL 2, [1932] All E.R. Rep. 494, 147 L.T. 503, 38 Com. Cas. 23 (U.K. H.L.) — referred to

Johnson, Re (1957), 8 D.L.R. (2d) 221, 1957 CarswellSask 16, 21 W.W.R. 289 (Sask. C.A.) — referred to

Klinck v. Drinnan (1985), 1985 CarswellAlta 246, 41 Alta. L.R. (2d) 299, 66 A.R. 321 (Alta. Q.B.) — referred to

McElroy v. Cowper-Smith (1967), [1967] S.C.R. 425, 60 W.W.R. 85, 1967 CarswellAlta 36, 62 D.L.R. (2d) 65 (S.C.C.) — followed

Mills v. Dunham (1891), [1891] 1 Ch. 576, 39 W.R. 289, 7 T.L.R. 238, 60 L.J. Ch. 362 (Eng. C.A.) — referred to

R. v. Frontenac Gas Co. (1915), 1915 CarswellNat 46, *(*sub nom. *Quebec, Jacques Cartier Electric Co. v. R.)* 51 S.C.R. 594, 24 D.L.R. 424 (S.C.C.) — considered

Robinson v. Fiesta Hotel Group Resorts (2008), 2008 ABQB 311, 2008 CarswellAlta 732, 91 Alta. L.R. (4th) 158, 450 A.R. 167, [2008] 12 W.W.R. 152 (Alta. Q.B. [In Chambers]) — referred to

Royal Bank v. Fox (1975), *(*sub nom. *Standard Brands Ltd. v. Fox)* [1976] 2 S.C.R. 2, 6 N.R. 382, 59 D.L.R. (3d) 258, *(*sub nom. *Fox v. Royal Bank)* 13 N.S.R. (2d) 176, 1975 CarswellNS 34, 1975 CarswellNS 34F (S.C.C.) — referred to

Royal Trust Corp. of Canada v. Rick Holdings Ltd. (1999), 250 A.R. 156, 213 W.A.C. 156, 1999 CarswellAlta 591, 1999 ABCA 187 (Alta. C.A.) — referred to

Schwartz v. Longview Motel & Saloon Corp. (1994), 1994 CarswellAlta 80, 18 Alta. L.R.

(3d) 358, *(*sub nom. *Schwartz v. Stinchcombe)* 152 A.R. 241 (Alta. Q.B.) — referred to

Smith v. McPherson (1921), 51 O.L.R. 457, 69 D.L.R. 477 (Ont. C.A.) — referred to

Spiller v. Brown (1973), [1973] 6 W.W.R. 663, 43 D.L.R. (3d) 140, 1973 CarswellAlta 99 (Alta. C.A.) — followed

Standish Hall Hotel Inc. v. R. (1962), 35 D.L.R. (2d) 140, 1962 CarswellNat 298, [1963] S.C.R. 64 (S.C.C.) — referred to

Sulef v. Parkin (1966), 1966 CarswellAlta 49, 57 W.W.R. 236 (Alta. C.A.) — followed

Syncrude Canada Ltd. v. Tibo Steel Products Ltd. (2001), 2001 ABQB 478, 2001 CarswellAlta 741, 292 A.R. 368 (Alta. Q.B.) — referred to

Thimer v. Alberta (Workers' Compensation Board Appeals Commission) (2000), 2000 CarswellAlta 1111, 2000 ABQB 706, 89 Alta. L.R. (3d) 353, 31 Admin. L.R. (3d) 281, 276 A.R. 236 (Alta. Q.B.) — referred to

Wright v. Murray Rosen Professional Corp. (2005), 2005 ABCA 116, 2005 CarswellAlta 332 (Alta. C.A.) — referred to

Yaremchuk v. Haight (2001), 8 M.V.R. (4th) 12, 6 C.P.C. (5th) 112, 89 Alta. L.R. (3d) 311, 2001 ABCA 7, 2001 CarswellAlta 28, 277 A.R. 160, 242 W.A.C. 160 (Alta. C.A.) — referred to

Statutes considered:

Vendors' and Mortgagees' Costs Exaction Act, R.S.A. 1955, c. 357
Generally — referred to

Rules considered:

Alberta Rules of Court, Alta. Reg. 390/68
Generally — referred to

R. 142(1)(a) — referred to

R. 149(1) — referred to

R. 318 — referred to

R. 319 — referred to

R. 321(2) — referred to

R. 321(3) — referred to

R. 327 — referred to

R. 548 — referred to

R. 605(1) — referred to

APPEAL by paying co-guarantors from judgment reported at *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABQB 15, 2011 CarswellAlta 17 (Alta. Q.B.), setting aside order for solicitor-client costs.

Jean Côté J.A.:

A. Introduction

1 The issues here revolve about entitlement to solicitor-client costs after default judgment, and settling and entering formal orders. The respondents and the chambers judge under appeal have raised a number of procedural grounds for objecting to such costs and those orders.

2 The biggest surprise of civil litigation befalls lay people who learn that their real troubles often begin after they win. Collecting on a judgment is often frustrating, even if the debtor has assets. Soon this suit will be eight years old, yet the successful appellants still have achieved limited progress.

B. Facts

3 The appellants and the respondents are two couples who guaranteed the Treasury Branches' loan to a private company. The company did not pay, so the creditor Treasury Branches sued all of them. The respondents neither paid nor defended. So the Treasury Branches signed default judgment against the respondents.

4 Over seven years ago, the appellants paid off the Treasury Branches and got an assignment from it. In the document, the Treasury Branches expressly assigned both its default judgment against the respondents, and also the costs (present or future), and the moneys recoverable. Since the appellants had paid the whole debt and not merely their proportionate share, they moved for contribution from the respondents; i.e. reimbursement of the excess.

5 That post-judgment litigation has limped since. The appellants appeal the latest order (with leave of the Queen's Bench chambers judge who made it).

C. The Latest Proceedings

6 The appeal is from an order whose formal portion reverses a decision of the taxing officer and reduces "costs" from solicitor-client to party-party. The formal order does not confine that costs reduction to any particular stage, nor to any particular issues. The chambers judge even gave some costs to the respondents (judgment debtors).

7 The underlying motion to the chambers judge was an appeal from the Clerk and Taxing Officer's decision of late 2009. The chambers judge heard argument in January and April 2010. His formal order is based on his written Reasons issued on January 10, 2011. They are cited as 2011 ABQB 15 (Alta. Q.B.). They conclude that the appellants were not entitled to solicitor-client costs, and set aside intermediate orders of another Queen's Bench judge giving solicitor-client costs. The Reasons do not purport to disturb the default judgment.

D. Benefit of the Contracts for Solicitor-Client Costs

8 The guarantee to the Treasury Branches is in evidence and calls for solicitor-client costs. That part is quoted toward the end of Part F below.

9 One part of the Reasons of the chambers judge finds no contractual right to solicitor-client costs. It so concludes on the basis that only the default judgment and the debt were assigned. The assignment does include costs present or future.

10 I respectfully disagree with that reasoning.

11 First, the assignment here contains a power of attorney clause. It expressly empowers the appellants to "do all acts matters and things in relation to the judgment as the [Treasury Branches] could do." That widens the assignment and fully links it to the loan documents and to the guarantee.

12 The guarantee is in evidence (Ex C to December 12, 2009 affidavit). It expressly calls for solicitor-and-own-client costs (para 17). The guarantee is signed by both the appellants and the respondents, so the respondents cannot dispute the correctness or justness of solicitor-client costs. Nor is this a contract with strangers, so no assignment of it is necessary. (It is quoted below in Part F.)

13 The debtor company had no money, and the costs were incurred in the suit. That suit, the payment, the default judgment, and steps since, were all on the guarantee. The judgment and later steps were not against the company; the part of the suit against the company went nowhere,

and incurred none of the costs. The court proceedings were against the guarantors. I respectfully suggest that that alone suffices to found all the solicitor-client costs in question here.

14 The statement of claim does recite the terms of the note and loan agreements between the plaintiff Treasury Branches and the company borrower (pp P1-P2). The statement of claim (p P2, para 8) recites that the borrower covenanted to pay "legal costs as between a solicitor and his own client on a full indemnity basis".

15 The statement of claim also recites (paras 9-10) that the appellants contracted to guarantee all that, and (paras 15-16, pp P3-P4) that the respondents also guaranteed the whole indebtedness including "all costs, charges and expenses which may be incurred by the plaintiff in recovering any indebtedness ...". And the statement of claim's prayer expressly calls for solicitor-and-own-client costs (para (g), p P5). The defendants are the company, the appellants and the respondents.

16 So which document was assigned does not matter here, because all three documents give these higher costs.

17 The chambers judge's Reasons are critical of a statement to him by the appellants' counsel, that the underlying contracts ("financial documents") called for solicitor-client costs. Indeed the Reasons purport to upset an earlier order of the same judge because of that statement. But all the above shows that that statement by counsel was accurate.

E. Default Binds Respondents

18 Indeed the various covenants for solicitor-client costs are incontestible. The respondents did not defend, and default judgment was signed against them on April 21, 2004 (7-1/2 years ago). On its face, the default judgment taxes solicitor-client costs against the respondents.

19 In July 2005, the respondents applied to open up that judgment (AR pp P7-8) (and on September 21, 2006, says the appellants' factum, para 7). Argument (written and oral) concedes that the court never did open up the judgment, and it was never appealed. The respondents say that the opening up question was heard in October 2007. In any event, opening up has never happened, and no one suggests that it is going to happen or is still pending.

20 The body of the statement of claim recites what the loan documents say. The recitals are not evidence, but they became stronger than evidence after default judgment. A long line of authority holds that not filing a statement of defence constitutes an admission of the facts alleged in the statement of claim. Older English authority is cited in *Hill v. Stephen Motor & Aero Co.*, [1929] 2 W.W.R. 97 (Sask. C.A.), 98-99, which also adopts the proposition. Though at times some jurisdictions have had express Rules of Court on the topic, that is not necessary.

See *Sulef v. Parkin* (1966), 57 W.W.R. 236 (Alta. C.A.), 239. And most cases cite no Rule saying that.

21 Supreme Court authority for the deemed admission is *McElroy v. Cowper-Smith*, [1967] S.C.R. 425 (S.C.C.), 428, (1967), 60 W.W.R. 85 (S.C.C.), 88. Its majority adopt statements to that effect by Spence J., dissenting on other grounds, who follows the Alberta Court of Appeal.

22 Alberta Court of Appeal authority for the deemed admission is *Brennan v. Arcadia Coal Co.*, [1929] 3 W.W.R. 446 (Alta. C.A.), 448, (1929), 24 Alta. L.R. 236 (Alta. C.A.); *Sulef v. Parkin*, *supra* (citing a 19th Century English textbook); and *Spiller v. Brown*, [1973] 6 W.W.R. 663 (Alta. C.A.), 666. There are similar *dicta* in *Yaremchuk v. Haight*, 2001 ABCA 7, 277 A.R. 160, 6 C.P.C. (5th) 112 (Alta. C.A.).

23 Alberta's Court of Queen's Bench has also held the same, adopting the defaulting defendant's deemed admission of the plaintiff's pleading: *Klinck v. Drinnan* (1985), 66 A.R. 321 (Alta. Q.B.), 325-36, (1985), 41 Alta. L.R. (2d) 299 (Alta. Q.B.) (paras 22-24) (citing much authority); *Schwartz v. Longview Motel & Saloon Corp.* (1994), 18 Alta. L.R. (3d) 358 (Alta. Q.B.), 385 (para 90); *Syncrude Canada Ltd. v. Tibo Steel Products Ltd.*, 2001 ABQB 478, 292 A.R. 368 (Alta. Q.B.), (citing much law); *Dykes v. Goczan* (1996), 188 A.R. 352 (Alta. Q.B.); *Robinson v. Fiesta Hotel Group Resorts*, 2008 ABQB 311, [2008] 12 W.W.R. 152, 450 A.R. 167 (Alta. Q.B. [In Chambers]), 172-73, (2008), 91 Alta. L.R. (4th) 158 (Alta. Q.B. [In Chambers]) (paras 10-12) (citing authority); *Dyck v. Wilkinson*, 2004 ABQB 731 (Alta. Q.B.), [2004] A.R. Uned 657, JDE 0103-01520 (para 9). A Master has held the same, in *AMHC v. Keith Empy Homes* (M July 22 '86) JDE 8603-07910, AUD (M) 109.

24 *Dykes v. Goczan*, *supra*, holds that contrary evidence by the defendant is inadmissible. The same thing is said in 16 *Hals. Laws of Eng.* § 1172-73 and 1559-1561 (4th ed), but in somewhat narrower circumstances than apply to the deemed admission.

25 I have not found any exceptions to the rule which are relevant here. I see no need to discuss here the exceptions, nor their scope, whether based on type of claim, relief sought, relevance of the pleading, or otherwise.

26 Furthermore, this default judgment does not say "costs to be taxed." An integral part of the judgment is an itemized and taxed bill of costs, and the judgment itself awards the bill's total amount. That amount is patently solicitor-client costs. The costs taxed and awarded there are far beyond Schedule C (i.e. beyond party-party costs). The services listed are lengthy and most bear no relation to the few services listed in Schedule C. Nor are any individual amounts from Schedule C (or for individual services) given. This is a solicitor-client bill of costs.

27 The chambers judge relied on *Arbitus Leasing Ltd. v. X-Zibit A Inc.*, 2006 ABQB 764, 405 A.R. 288 (Alta. Q.B.). Even if it were correct, it would be distinguishable here for two

reasons. First, the face of the default judgment here awards solicitor-client costs. Second, where the statement of claim leading to the default judgment recites a covenant for solicitor-client costs, there is no room for any presumption that "costs" mean party-party costs, as explained above.

28 If a formal judgment is ambiguous, the taxing officer may look at the trial judge's Reasons for decision, in order to tax costs: *R. v. Frontenac Gas Co.* (1915), 51 S.C.R. 594 (S.C.C.), 598, 600. (That was a case about solicitor-client expenses.) Cf *Standish Hall Hotel Inc. v. R.* (1962), [1963] S.C.R. 64, 35 D.L.R. (2d) 140 (S.C.C.), 153. If a judgment gives a thing, that thing is not to be presumed then to be taken away by other words in the same judgment: Re *Smith*, *supra*, at p 480 (DLR). One cannot go back further behind the reasons: *Johnson, Re* (1957), 21 W.W.R. 289 (Sask. C.A.), 201.

29 Reasons for decision are to be read reasonably, generously, and not *contra proferentem*: *Elliott v. Hill Bros. Expressways Ltd.* (1999), 232 A.R. 258 (Alta. C.A.), 261 (para 18). Cf. 2 Williston and Rolls, *Law of Civil Procedure* 1046 (1970); Re *Smith v. McPherson* (1921), 51 O.L.R. 457 (Ont. C.A.) , 463, (1921), 69 D.L.R. 477 (Ont. C.A.), 480. That should apply to oral reasons too. Reasons are to be read as a whole, not in little isolated pieces: *Elliott v. Hill Bros. Expressways Ltd.*, *supra* at para 22 (and cf paras 23-27).

30 When there is an express covenant for solicitor-client costs, there is no reason to presume that a judgment does not speak of them.

F. Contribution Among Guarantors

31 Next, I will go beyond the particular technical objections recited above. I turn to substance, and to the general rules about contribution among co-guarantors. The assignment of judgment and debt here is not the only cause of action which the appellants had against the respondents (despite what the Reasons seem to imply).

32 If a guarantor pays the creditor the debt guaranteed (not merely the payor's proportionate share of it), the paying guarantor becomes subrogated to the rights of the creditor so paid: Goff & Jones, *The Law of Restitution*, paras 3-009, 3-025 (7th ed 2007); Maddaugh & McCamus, *The Law of Restitution*, 8-1, 8-2 (2d ed 2004); Fridman, *Restitution*, 403 (2d ed, 1992); *Royal Bank v. Fox* (1975), [1976] 2 S.C.R. 2 (S.C.C.), 7, (1975), 6 N.R. 382, 59 D.L.R. (3d) 258 (S.C.C.) .

33 That subrogation gives the paying guarantor every remedy, every security, and every means of payment which the creditor had against the other guarantors. That subrogation is automatic, and does not depend in any way on contracts, such as an assignment. See Fridman, *op cit. supra* at 402-03; Goff and Jones, *op cit. supra* at paras 3-025 and 3-027; *Brown v. Coughlin* (1914), 50 S.C.R. 100 (S.C.C.), 104; cf *Royal Trust Corp. of Canada v. Rick Holdings*

Ltd., 1999 ABCA 187, 250 A.R. 156 (Alta. C.A.), (para 2).

34 Besides, it is very doubtful that there is any gap or discrepancy here between the guarantee, the loan agreements, and the assignment. All are drafted in wide terms. Obviously the assignment is designed to give to the appellants the Treasury Branches' rights. And the guarantee is designed to enforce all the rights of the Treasury Branches under the loan. A contract should be interpreted to make it workable; it is not a penal statute for courts to construe narrowly and technically. See Burrows, *Interpretation of Documents* 92-94 (2d ed 1946); Broom, *Legal Maxims* 361-69 (10th ed 1939); *Hillas & Co. v. Arcos Ltd.* (1932), 147 L.T. 503 (U.K. H.L.), 514, [1932] UKHL 2 (U.K. H.L.); *British American Co. v. Law & Co.* (1892), 21 S.C.R. 325 (S.C.C.); *Mills v. Dunham*, [1891] 1 Ch. 576 (Eng. C.A.), esp. at 590, (1891), 60 L.J. Ch. 362 (Eng. C.A.).

35 What does the subrogation give here? To answer that, it is useful to look at the precise covenants to pay solicitor-client costs. One covenant in one loan and agreement (the General Security Agreement) was to pay

> all costs and expenses incurred ... **in connection with** any recovery action commenced ... including, without limitation, legal costs as between a solicitor and his own client on a full indemnity basis.
>
> (Statement of Claim, para 8, emphasis added)

The equivalent covenant in another loan agreement (the mortgage) called for:

> ... all costs and expenses incurred by the Plaintiff in respect of exercising or enforcing or attempting to enforce or in pursuance of any right, power, remedy or purpose thereunder, including, without limitation, legal costs as between a solicitor and his own client on a full indemnity basis and an allowance for the time, work and expenses of the Plaintiff or of any agent, solicitor, or servant of the Plaintiff.
>
> (Statement of Claim, para 14)

The guarantee contained the respondents' covenant to pay

> ... all costs, charges, and expenses (including, without limitation, lawyers' fees as between solicitor and his own client on a full indemnity basis) incurred by [the plaintiff] for the ... enforcement of this guarantee ...
>
> (December 12, 2009 affidavit, Ex C)

The appellants and the respondents are all direct original parties to the guarantee. They are bound by it, and can sue and benefit under it. It sets the extent of the obligations, and that expressly includes solicitor-client costs.

36 These covenants about costs are not against public policy. The *Vendors' and Mortgagees' Costs Exaction Act* was repealed by 1965 c 98.

37 The efforts and expenses of the appellants were expended to collect from guarantors on the guarantee. They were not incurred exclusively under the loan; the company (the principal debtor) obviously could not pay, and the steps in question here involved no futile attempts to get money from the company.

38 The topic is costs. The guarantee is to enforce the loan agreements, which were assigned. Given all that, it appears to me beyond doubt that costs incurred by the appellants in trying to collect from the respondents were incurred under all the documents (loan agreements, guarantee, and assignment).

G. Any Discretion?

39 It was argued before us that the chambers judge now appealed from had a "discretion" to deny solicitor-client costs. Given the covenants here, it is doubtful.

40 But even if a discretion existed as to certain items, there is no proper legal ground to exercise such a discretion here. No misconduct or sharp practice by the appellants is even alleged. They ultimately lost no step, in my view. They did not churn, and did not pursue trivia in order to incur huge solicitor-client costs. And most of the steps whose costs were in issue had already been the subject of previous costs decisions.

41 If there was any discretion as to costs, at best it was as to the costs of the "side issue" about contribution for the first $100,000 paid by the appellants before the suit. But any such discretion was that of the first judge (Lewis J.), not the (second) chambers judge now under appeal. So the second judge was not entitled to revisit that. And so even if he was, the Court of Appeal owes him no deference on further appeal on that topic. He purported to sit on appeal from the taxing officer who taxed solicitor-client costs.

42 Besides, the covenants here are for solicitor-and-*own*-client costs, so a mere immoderate amount of costs or of the appellants' steps would likely not remove the right to such costs.

H. Previous Orders

43 The chambers judge's Reasons offered another ground for denying solicitor-client costs. They concluded that there was no order providing for solicitor-client costs. This proposition was not argued earlier.

44 In fact, however, in August and October 2007, Lewis J. had ordered solicitor-client costs. And in January 2008, the very chambers judge now appealed had done the same. Only one of those three previous orders was appealed, and then that appeal was abandoned.

45 The Reasons now under appeal hypothesized that all three of those earlier orders lacked legal effect.

46 First, the Reasons said that this same chambers judge's own previous order of 2008 should somehow be upset because the then-counsel for the appellants had stated that both the guarantee and the loan agreement called for solicitor-client costs. Counsel's statement was accurate; both contracts did (and in any event, one alone would suffice). There was no misrepresentation at all of any sort. Counsel was not required to foresee the narrow and strained interpretation later imposed by the judge's Reasons. Such reasoning would be virtually circular. (And even the *Arbitus* case there relied upon, was not decided until late 2006.)

47 The previous order by the same chambers judge in question was not *ex parte*, and it is not clear how or why it could be upset. There was no suit to upset it for fraud, and such a suit could not possibly succeed. No law on upsetting orders was cited.

48 In my view, the transcript of the decision of the previous judge (pp F19-20) clearly says that costs are to be on a solicitor-client basis.

49 In any event, there is an entered order on the topic, by the former judge, Lewis J. (AR pp F27-28). It clearly states that costs are to be on a solicitor-client basis (para 4). There was no ground for a different judge to revisit that question later.

50 The explanation for that attempt to revisit is found in the "Background Facts" part of the Reasons now under appeal (para 20). It reads as follows:

> Mr. Moroz drafted forms of orders in relation to the appearances before Lewis, J. in October, 2007. Those orders have never been signed by any Judge of the Court, nor have they been filed with the Clerk. Therefore, to this date there are no formal filed orders of Lewis, J. in respect to the two October 2007 hearings.

However, the end of the recital is incomplete. As noted, there *were* settled formal orders of the previous judge filed with the clerk's office (i.e. entered).

51 The chambers judge's Reasons and the respondents argue that the entered orders were nullities or had to be upset by the judge appealed from. They offer two grounds.

52 The first ground suggested for invalidity is that the orders were never signed by a judge.

However, the Rules then in force directed that the *Clerk* sign orders: see Rr 321(2), (3). This was not a case where the opposite party neglected to approve the draft. The parties disagreed as to what the formal order should say. In such circumstances, the Rules called on the *Clerk* to settle the wording: Rr 318, 319. Often judges used to do that, but no Rule called for that, and that practice could not detract from that Rule.

53 The transcript of the sessions before Mr. Christensen shows no objection by anyone to his jurisdiction to settle the wording of these previous orders by Lewis J. pronounced on October 16, 2007 and October 30, 2007. (See transcripts of argument on September 17, 2009, October 27, 2009 and November 5, 2009.) Yet the proper wording was expressly decided at the last session (November 5).

54 Mr. Christensen settled this wording for the formal order, after a formal appointment to do so (AB p P17), and after a contested hearing (transcript, pp F106-F122). He is a Deputy Clerk and so had the power to do so. The formal Appointment refers to him as Clerk, not as Taxing Officer. In practice the Clerk himself almost never acts, and such tasks are performed by Deputy Clerks.

55 The statement in the Reasons under appeal that the "Taxing Officer attempted to settle the terms" is puzzling. Mr. Christensen did so in his capacity as a Deputy Clerk.

56 In my view, the formal order of Lewis J. reflects the transcript of the hearing before him, and the minutes of the order as settled by the Deputy Clerk are correct.

57 The chambers judge now being appealed was not the trier of fact, nor the one to settle the minutes. All that had occurred beforehand. The chambers judge sat in an appellate capacity. The standard of review on appeal from him to the Court of Appeal is therefore correctness.

58 Now I turn to another argument made by the respondents (AR p 200).

59 The respondents rely upon a letter of Wachowich J. responding to an inquiry about an unanswered letter to the previous judge (Lewis J.) who had since retired. Wachowich J. said to go to a judge. His letter did not refer to any specific judge, and even then said to get advice from "a chambers judge ... as to how to deal with the matter, taking into account the Rules of Court that are to be considered ...". In no sense was this letter an order, still less one removing jurisdiction. It did not remove the authority of the Clerk to settle minutes of previous orders, still less make such settlement a nullity. A letter from a judge could not repeal a Rule of Court.

I. Time Limit for Entry

60 The second possible ground to upset the entered order of the previous judge, Lewis J.,

seems not to be a foundation for the Reasons now under appeal (though they recite that the argument was then made: para 28). Nor is this point mentioned in the respondents' "Notice of Appeal from Taxation", which is what was before the chambers judge. The respondents argue that a year having expired, the Clerk had no power to enter the order (old R 327).

61 That Rule gave a time limit for entry, not for settling the contents of an order. It is impossible to enter an order until its wording is either approved or settled.

62 And any breach of R 327 would not produce nullity. The grounds for extending the year are many, and the tests are lax. An unentered order exists and has force, and where parties have relied on it, a later judge should not upset it just because he or she thinks that it is wrong, or because one year has gone by without it being entered.

63 There is full discretion for the court to allow entry of an order despite expiry of a year: *Wright v. Murray Rosen Professional Corp.*, 2005 ABCA 116 (Alta. C.A.), [2005] AR Uned 44, [2005] AJ #274, Calg 0301-0355 AC (March 10/16). Indeed, an extension of time to do so should not be refused unless it would cause real prejudice to the other side: *Csepregi v. Bygrove*, 2001 ABCA 108 (Alta. C.A.), [2001] AR Uned 31, [2001] AUD 1051 (April 17/May 3). At times, fairness requires entering an order late: *Thimer v. Alberta (Workers' Compensation Board Appeals Commission)*, 2000 ABQB 706, 276 A.R. 236 (Alta. Q.B.), 252-53 (paras 53-59).

64 If R 327 was operative before this chambers judge (which is far from clear), his Reasons did not consider the mandatory topic of a time extension. The appellants' factum argues it and calls it "a fiat" (paras 12-14, 27, 37). The appellants' factum also suggests (para 37) that the respondents lay in the weeds for years, and then raised technical objections after it seemed too late to fix them. The respondents' factum does not answer that.

65 The fact that counsel for the respondents refused to sign the draft of the formal order of Lewis J. certainly explains some time gap. The minutes of the proposed order were correct. Why was it not entered promptly? Simply because counsel for the respondents would not approve it as to form, as admitted in the respondents' factum (p 5, para (3)). So it ill lies in the respondents' mouths to complain of the delay in entry.

66 There is no suggestion (let alone evidence) that the appellants caused the delays. Both Lewis J. and Mr. Christensen lost some time over their health issues. Ordinary time hazards of litigation must not destroy an order.

67 For a century, R 548 and similar Rules on extensions of time set by Rules or orders were always generously interpreted. It would be a rare case where someone would lose his rights through a few months' delay which were not wilful, and caused no significant irreparable prejudice. See the cases collected in 1 Stevenson & Côté, *Civil Procedure Encyclopedia*, pp 18-19 and 18-20 (Chapter 18, Part N) (2003).

68 Maybe the factum of the respondents suggests that leave had to occur before entry (p 6, replying to ground 3). If so, that is wrong, because it is expressly contrary to old R 548(2).

69 Rarely, an order can be abandoned by the party getting it; but what happened here was the opposite. The appellants kept trying to enforce the orders which they had obtained and entered, but were thwarted by the respondents' objections and motions.

70 Therefore, solicitor-client costs were the proper basis for the costs of all these proceedings, the previous proceedings were proper, and there was no reason to question, to attack collaterally, nor to reverse, any order to that effect.

J. Can Default Judgments Give Solicitor-Client Costs?

71 The respondents' factum relies on the entire *Arbitus* decision (factum, paras 16(1) and 18), and so do the Reasons under appeal. That decision suggests that a default judgment cannot give solicitor-client costs.

72 The decision in *Arbitus* gave three grounds for not allowing solicitor-client costs on one particular default judgment there. The first and probably biggest point was as follows: default judgments supersede the covenant for solicitor-client costs (405 AR. p 293, at the end of para 19). The Reasons cite only two bits of authority: *Black's Law Dictionary* (no page cited, but maybe the definition of "merger"), and an 1844 decision. The latter decision merely says that one cannot sue a second time on a cause of action after one has got judgment on it. Of course that is not what happened here. And it would create a Catch 22: you cannot sue now because you sued before, and you cannot rely on the judgment because the part of it in your favour is invalid. That would be both unfair and self-contradictory.

73 The second ground stated in the *Arbitus* case was just that the particular default judgment in that case merely said "costs" or maybe "costs to be taxed" with no further detail (p 294 AR, para 22). Of course that is not the situation here, where the default judgment itself awarded solicitor-client costs as described above in Part E.

74 Finally, the *Arbitus* judgment came at the matter a third way. It suggested that a default judgment could not go above party-party costs because R 605(1) did not let a taxing officer go higher than party-party costs "unless ordered". It cited some decisions by taxing officers.

75 With respect, that is another *non sequitur*. Default judgments are not given by taxing officers. These are given by the Clerk of the Court. And the Clerk of the Court had very clear power to grant judgment for any liquidated claim pleaded (or for recovery of a specific asset) after default: old Rr 142 (1)(a), 148(1); cf R 149(1). It is quite common for such default

judgments to compute interest or unit prices in debt, and similar matters. Often the default judgment is for a whole set of accounts with amounts in both directions (e.g. new invoices and then partial payments).

76 To support this third ground, the *Arbitus* judgment took out of context a statement that pleadings and admissions cannot confer on the court a new jurisdiction (pp 294-95). But there is no question about the jurisdiction of the court in the *Arbitus* case, nor the present case. Moreover, there is no doubt about the jurisdiction of the Clerk (or Deputy Clerk) to give default judgment, as noted.

77 There is a somewhat similar brief argument in the respondents' factum in the Court of Appeal (reply to ground of appeal number 2, on p 6). It suggests that only a judge can award costs, and so the Clerk cannot even settle minutes of judgment or sign them, if their subject is entitlement to costs where what the judge pronounced was ambiguous. This proposition seems wrong in principle, and at the very best is circular reasoning. It is clear that pronouncing a decision (or reconsidering it) are totally different from settling the wording of the formal order recording that. Settling asks what was decided, not whether it was correct. See *Davidson v. Patten*, 2006 ABQB 370 (Alta. Q.B.), JDC 0101-00193, [2006] AR Uned 318 (May 18); *Collings, Re* (1937), [1936] S.C.R. 613 (S.C.C.), 614-15, [1937] 1 D.L.R. 409 (S.C.C.) (one judge). Whoever settles the minutes cannot go off on a voyage of discovery of his or her own, and is the servant not the master.

78 The reply by the respondents' factum (to point number 1) implies that the minutes of the orders were settled by a taxing officer who cannot award solicitor-client costs. But the same person (here Mr. Christensen) has two hats. One is Deputy Clerk and the other is Taxing Officer. As noted, he settled the orders in the former capacity.

K. Side Issue?

79 That leaves another argument of the respondents. Their counsel firmly suggested in oral argument to us that even if solicitor-client costs are proper for true collection procedure, they should not extend to (or not yet extend to) another substantive issue. It attempts to see whether the 45% contribution owed by the respondents should include a sum said to have been paid by the appellants to the Treasury Branches on the loan, before the suit and before its default judgment.

80 The first answer to that argument is that the loan contracts and the guarantee antedate the past payment by the appellants which is now in question. That the evidence of the guarantee was filed later, or that the admission of the facts about the loan agreement came later, is irrelevant. In any event, the motions about that payment came after the default judgment. So there is nothing retroactive about this part of the claim for solicitor-client costs.

81 The second answer is that the covenants for solicitor-client costs in all contracts (loan and guarantee) are very broad. (They are quoted above in Part F.) Those extend to indirect or ancillary proceedings.

82 The appellants were only responsible for 55% of the obligations guaranteed, but actually paid the whole thing, and the Treasury Branches' default judgment and security assigned and subrogated to the appellants are for more than the amount the appellants seek from the respondents. Therefore, this one motion to fix the amount (of which the respondents must pay 45%) is connected to the respondents' covenants to pay solicitor-client costs, and connected to the security.

83 The respondents next argue that the question of whether the respondents must pay 45% of the sum paid by the appellants before suit has not yet been decided and is to be tried. They say that it could even be decided against the appellants. That may be true, but the question at the moment is not the costs of some future trial of an issue. The question now is costs of motions on preliminary procedure decided some years ago. In no sense did the appellants lose these motions, and they had to bring them.

84 Sometimes it may be sensible to defer costs awards of interim steps; but given the long gap, and the various contests with the respondents which intervened, such deferral is inappropriate here. The previous judge (Lewis J.) exercised his discretion and decided not to defer them. That costs question was no longer open. Settling terms of a formal order is not an appeal from it on the merits. It is not a reopening of the merits. Counsel who attempt that produce serious delay. Costs now and not years later involve no error in principle. This case has seen too much delay.

85 The appellants should get solicitor-client costs of that issue too.

L. Conclusion

86 I would allow the appeal, reinstate the formal orders of Lewis J. as settled by the Deputy Clerk, reinstate the former costs order dated August 27, 2007 which this chambers judge set aside, and would award the appellants solicitor-client costs (full indemnity) for all steps to date, with no deduction for unreasonableness or overcaution. The order for costs against the appellants should be set aside.

87 If the parties cannot agree on costs, then within 10 days of the date of these Reasons they may each file and serve a submission on costs. These should be double spaced and not exceed 10 pages each.

88 Court of Queen's Bench written Reasons are easily obtained on the Alberta Courts' website. The appeal record should not have used a faxed copy of the Reasons under appeal (with the faxing line and page numbers superimposed and scribbled marginal notes). The appeal record does not state who prepared it. I would deduct $200 from the appellants' disbursements on appeal for those flaws.

***Marina Paperny J.A.*:**
I concur:

***R. Paul Belzil J.A.*:**
I concur:

Appeal allowed.

Footnotes

* Additional reasons at *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABCA 360, 2011 CarswellAlta 2473 (Alta. C.A.).

2019 ABQB 985
Alberta Court of Queen's Bench

Bank of Montreal v. Ladacor AMS Ltd

2019 CarswellAlta 2801, 2019 ABQB 985, [2020] A.W.L.D. 274, 313 A.C.W.S. (3d) 556

Bank of Montreal (Plaintiff) and Ladacor AMS Ltd, Nomads Pipeline Consulting Ltd, 2367147 Ontario Inc, and Donald Klisowsky (Defendants)

Robert A. Graesser J.

Heard: November 26, 2019
Judgment: December 19, 2019
Docket: Edmonton 1803-09581

Counsel: Andrew Wilkinson for Liberty Mutual Insurance Company
James Reid, Keith D. Marlowe for Receiver
Shaun D. Wetmore for Steenhof Entities
Norman D. Anderson for Donald Klisowsky

Subject: Corporate and Commercial; Insolvency; Public

Headnote

Debtors and creditors --- Receivers — Conduct and liability of receiver — General conduct of receiver
Debtors were three related companies, two of which were involved in production of modular structures while third operated hotel — Debtors were placed into receivership, with receiver being appointed by court as receiver/manager — Significant debts were paid off, and receiver proposed that debtors be placed into bankruptcy — Debtors' principal believed one debtor was still solvent — Receiver brought application for order essentially approving receiver's conduct and accounts and proposed assignment of debtors into bankruptcy, and discharging and releasing receiver from any further obligations and any liability — Application granted in part — Anticipated accounts, fees, and disbursements in connection with completion of receivership proceedings were not to be approved until incurred, and discharging and releasing receiver was not appropriate until its work was actually completed, but requested relief was otherwise granted — Since two debtors had paid off secured debts of other debtor as guarantors, they essentially stood in shoes of secured creditor by way of subrogation — Net result was that remaining assets

of debtors were to be transferred to one debtor who paid off most debt, to be followed by assignments into bankruptcy — It was unlikely that debtor with remaining assets would have enough to satisfy unsecured claims, and suggestion that other debtor was solvent was fanciful — Principal's criticisms of receiver's conduct were rejected — Sole effective way of dealing with numerous claims was through statutory process such as bankruptcy.

Table of Authorities

Cases considered by *Robert A. Graesser J.*:

Abakhan v. Halpen (2006), 2006 BCSC 1979, 2006 CarswellBC 3323, 29 C.B.R. (5th) 50, 26 B.L.R. (4th) 1 (B.C. S.C.) — referred to

Abakhan v. Halpen (2008), 2008 BCCA 29, 2008 CarswellBC 110, 39 B.L.R. (4th) 1, 76 B.C.L.R. (4th) 267, 40 C.B.R. (5th) 159, 250 B.C.A.C. 277, 416 W.A.C. 277, [2008] 7 W.W.R. 510 (B.C. C.A.) — referred to

Bank of Montreal v. Tolo-Pacific Consolidated Industries Corp. (2012), 2012 BCSC 1785, 2012 CarswellBC 3719, 97 C.B.R. (5th) 56 (B.C. S.C.) — referred to

EC & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home (District No. 69) (1987), 50 Alta. L.R. (2d) 48, (sub nom. *E C & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home, District No. 69)* 35 D.L.R. (4th) 80, 76 A.R. 281, 25 C.L.R. 110, 1987 CarswellAlta 25 (Alta. Q.B.) — referred to

Gerrow v. Dorais (2010), 2010 ABQB 560, 2010 CarswellAlta 1752, 324 D.L.R. (4th) 332, 34 Alta. L.R. (5th) 112, [2011] 3 W.W.R. 320, 96 C.L.R. (3d) 215, 503 A.R. 65 (Alta. Q.B.) — referred to

Jaycap Financial Ltd v. Snowdon Block Inc (2019), 2019 ABCA 47, 2019 CarswellAlta 160, 68 C.B.R. (6th) 7 (Alta. C.A.) — considered

Matticks v. B. & M Construction Inc. (Trustee of) (1992), 15 C.B.R. (3d) 224, (sub nom. *B & M Construction Inc., Re)* 11 O.R. (3d) 156, 1992 CarswellOnt 193 (Ont. Bktcy.) — referred to

Royal Bank v. Melvax Properties Inc. (2011), 2011 ABQB 167, 2011 CarswellAlta 401, 75 C.B.R. (5th) 294 (Alta. Q.B.) — considered

Western Union Petro International Co Ltd v. Anterra Energy Inc (2019), 2019 ABQB 165, 2019 CarswellAlta 418 (Alta. Q.B.) — considered

Windham Sales Ltd., Re (1979), 26 O.R. (2d) 246, 31 C.B.R. (N.S.) 130, 1 P.P.S.A.C. 73, 8 B.L.R. 317, 102 D.L.R. (3d) 459, 1979 CarswellOnt 227 (Ont. S.C.) — referred to

Wong v. Field (2012), 2012 BCSC 1141, 2012 CarswellBC 2720 (B.C. S.C. [In Chambers]) — referred to

Statutes considered:

Business Corporations Act, S.B.C. 2002, c. 57
Generally — referred to

Guarantees Acknowledgment Act, R.S.A. 2000, c. G-11
Generally — referred to

Personal Property Security Act, R.S.A. 2000, c. P-7
s. 66(1) — referred to

APPLICATION by receiver for order essentially approving receiver's conduct and accounts and proposed assignment of debtors into bankruptcy, and discharging and releasing receiver from any further obligations and any liability.

***Robert A. Graesser J.*:**

Introduction

1 Alvarez & Marsal Canada Inc. LIT (the "Receiver") is the Receiver and Manager of Ladacor AMS Ltd. ("Ladacor"), Nomads Pipeline Consulting Ltd. ("Nomads") and 2367147 Ontario Inc. ("236"). It was appointed receiver and manager of these entities by Court order dated May 18, 2018 (the "Receivership Order"). It now applies for a number of orders:

1. Approving the actions, conduct and activities of the Receiver and its legal counsel outlined in the Receiver's Fourth Report to the Court dated September 3, 2019 and all other reports filed by the Receiver in these receivership proceedings;

2. Approving the Receiver's final statement of receipts and disbursements for the period for May 18, 2018 to August 31, 2019 as set out in the Fourth Report;

3. Approving the accounts, fees and disbursements of the Receiver and its independent legal counsel in connection with the completion of these receivership proceedings, including the costs of this application;

4. Approving the proposed allocation of cash held by the Receiver for Ladacor and Nomads to 236, as set out in the Fourth Report;

5. Approving the Receiver's proposal to assign the Debtors into bankruptcy in accordance with the Receivership Order;

6. Approving the transfer of all funds and property held by or collected by the Receiver, net of costs required to complete the administration of these receivership proceedings, into the bankrupt estates of the Debtors;

7. Declaring that the Receiver has duly and properly discharged its duties, responsibilities and obligations as Receiver;

8. Discharging and releasing the Receiver from any and all further obligations as Receiver and any and all liability in respect of any act done by the Receiver in these receivership proceedings, and its conduct as Receiver pursuant to its appointment in accordance with the Receivership Order, or otherwise; and

9. Authorizing the Receiver to transfer the books and records of the Debtors to the bankruptcy trustee, subject to preserving such records as required by statute.

2 The application was initially heard by Topolniski J on September 13. She approved the Receiver's accounts as set out in the Fourth Report and the Affidavit of Fees, a well as the accounts of the Receiver's counsel, Blake, Cassels & Graydon LLP.

3 Mr. Klisowsky was directed to provide the Receiver's counsel with a list of issues or questions pertaining to the Receiver's findings as reported in the Fourth Report and the Supplemental Report dated September 12, 2019.

4 An application by Hythe & District Pioneer Homes (Advisory Committee) ("Hythe") seeking to lift the stay of proceedings against Ladacor was adjourned to a later date. Hythe was attempting to file an amended statement of defence and counterclaim. It alleges that the work by Nomads was so deficient and defective that the entire project has to be demolished and Hythe will have to start again with a new contractor.

5 Mr. Klisowsky's application in relation to Nomad's potential liability on performance bonds with Liberty Mutual Insurance Company, and Mr. Klisowsky's concerns about Nomad's potential liability to the Government of Canada under the Employment and Social Development Canada Wage Earner Protection Program ("WEPP"), were also adjourned to a later date. The Receiver's discharge application was adjourned as well.

6 The adjourned applications were set down before me on November 27. The Hythe matter had been resolved directly between its counsel and counsel for the Receiver. That still left a number of issues that required resolution. Following submissions and argument, I reserved on all of the issues left to me to decide.

7 I received written submissions from counsel for the Receiver (3 in total), from counsel for Mr. Klisowsky, and from counsel for J. Steenhof & Associates Ltd and 1459428 Ontario Inc. I heard submissions from those counsel as well as from counsel for Liberty Mutual Insurance Company ("Liberty Mutual").

8 There was a significant volume of material put before me. The Receiver had prepared four reports over the course of the receivership, and added a supplement to the Fourth Report and provided a Fifth Report filed October 25, 2019 for the purposes of this application. The Supplement and Fifth Report mainly responded to the issues raised by Mr. Klisowsky.

9 There was an affidavit of fees from Orest Konowalchuk, a senior vice president of the Receiver. There were also were affidavits from John Hermann, from the Bank of Montreal ("BMO"), sworn May 18, 2018, from Mr. Klisowsky sworn September 7, 2019, September 11, 2019, and October 5, 2019, from Larry Slywka, a former employee of Ladacor, sworn October 13, 2019, from Bonnie Erin Richard, another former employee of Ladacor, filed October 25, 2019, and a "secretarial affidavit" from Lindsay Farr, sworn November 20, 2019. There was also an affidavit from Jacob Steenhof, from J. Steenhof & Associates Ltd ("J. Steenhof") and 1459428 Ontario Inc ("145"), sworn October 25, 2019.

10 Each of Mr. Klisowsky, Mr. Slywka, Ms. Richard and Mr. Steenhof were cross-examined on their affidavits and I have the transcripts from their cross-examinations.

Background

11 Most of the background facts are not in dispute. Mr. Klisowsky is the majority shareholder in Nomads (97.28%). His son owns the remaining 2.72% of the shares. Nomads was a Calgary based company whose principal business was the manufacture and production of advanced modular buildings and structures. These structures were generally constructed of sea cans. Part of Nomads' business was investing in other assets. One of those investments is its 90% interest in 236. 236 is an Ontario corporation whose business was the ownership and operation of a Days Inn hotel in Sioux Lookout, Ontario. The remaining 10% of the shares in 236 are owned by J. Steenhof, an Ontario corporation.

12 Ladacor is a wholly owned subsidiary of Nomads. Ladacor came into existence in 2017 and carried on the same advanced modular home business as did Nomads. It appears that the incorporation of Ladacor coincided with a banking change by Nomads.

13 In the latter part of 2017, Nomads began a banking relationship with BMO. Mr. Klisowsky injected some $4,000,000 of capital into Nomads/Ladacor. BMO loaned approximately $4,000,000 to Nomads/Ladacor. Ladacor was the principal debtor. BMO took

typical security from Ladacor. Guarantees of the Ladacor debt to BMO were provided by Nomads, 236 and Mr. Klisowsky.

14 After Ladacor was incorporated, all new work was directed to it, while Nomads completed the work it already had under contract. The work contracted by Nomads was, however, performed for it by Ladacor. Payments, whether from Nomads customers or Ladacor customers, were deposited into Ladacor's bank account with BMO

15 The accounting records and the evidence of Mr. Klisowsky, Mr. Slywka and Ms. Richard show that Nomads and Ladacor essentially operated as one entity. All bills were paid from the Ladacor bank account with BMO, and all of the enterprise employees (but for Mr. Klisowsky, his wife, and his son, were paid by Ladacor.

16 Ladacor entered into a bonding relationship with Liberty Mutual. Ladacor's indemnification obligations to Liberty Mutual were guaranteed by Nomads, 236, and by Mr. Klisowsky.

17 The months following the incorporation of Ladacor were not financially successful. Nomads had a major contract with Hythe that was ongoing and far from completion. Nomads had a large receivable ($2,700,000) owed to it by 1507811 Alberta Ltd on a project in Edmonton known as "Westgate". That project had been completed, but there were ongoing discussions about the outstanding payment.

18 Ladacor was performing the work on ongoing projects that were in various stages of completion, including a project in Banff. The Receiver completed these obligations over the course of the receivership.

19 In May 2018, shortly before the Receivership Order, Ladacor was awarded a sub-contract for work on the new court house in Chateh, Alberta. From the information before me, it is likely that Liberty Mutual had previously provided a bid bond, and subsequently provided a surety bond in favour of the general contractor, Kor Alta Construction Ltd ("Kor Alta"). Physical work on the project had not begun at the time of the Receivership Order, and the Receiver disclaimed the contract. That led to a bond claim by Kor Alta against Liberty Mutual. The claim in favour of Kor Alta is tentatively valued at over $1,000,000. Liberty Mutual seeks indemnification for that amount from each of Ladacor, Nomads, 236, and Mr. Klisowsky.

20 Following the Receivership Order, Hawke Electric, a subcontractor to Nomads, made a bond claim on a labour and material payment bond on the Westgate project against Liberty Mutual. Kor-Alta, the general contractor on the Chateh courthouse project, claimed in excess of $1,000,000 as a result of the termination of the subcontract by the Receiver. Liberty Mutual seeks indemnification for those amounts from each of Ladacor, Nomads, 236 and Mr. Klisowsky.

21 Liberty Mutual values these claims at a total of approximately $1,100,000.

22 The Receiver has reported throughout the receivership on its activities and realizations. A sale of the physical assets of Nomads and Ladacor was conducted in the late fall of 2018. The auction sale netted $606,000. Further physical assets (miscellaneous inventory) netted a further $76,000.

23 The Receiver was successful in collecting most if not all of the $2,700,000 receivable owed to Nomads on the Westgate project. The Receiver collected $1,568,609 owed to Ladacor on the Banff project.

24 Since 236 was also put into receivership, the Receiver took steps to sell 236's main asset, the Days Inn Hotel in Sioux Lookout. Of the roughly $5,000,000 sale proceeds, $4,000,000 were paid by the Receiver to BMO.

25 Ultimately, the time of the Fourth Report, the Receiver had paid off the secured debt to BMO, the Receiver's borrowings from BMO to enable it to carry on the Receivership, the WEPP claims, CRA and Service Canada trust/priority claims, along with its and its lawyer's fees and disbursements.

26 The supplemental report and Fifth Report update the figures. As at the time of that report, October 25, the Receiver was holding $10,398 for Nomads, $722,661 for Ladacor, and $637,241 for 236. The Receiver proposes to allocate all of the available proceeds currently in Ladacor's and Nomads' accounts to 236.

27 All three corporations would then be placed in bankruptcy.

28 Because Nomads and Ladacor had intermingled their physical assets, it was not possible for the Receiver to determine with any degree of certainty what assets belonged to Nomads and what assets belonged to Ladacor. For BMO, the secured creditor, it did not matter. It had reportedly good security against all of the assets regardless of which corporation owned them. For the purposes of the Fourth Report, which was from the date of the Receivership Order to August 31, 2019, the Receiver apportioned the auction proceeds $451,450 to Nomads and $154,407 to Ladacor. Ongoing expenses were apportioned between the two corporations based on the contracting party for the contract being worked on. Employee withholding claims by CRA and WEPP claims were broken down between the two corporations as well.

29 Following receipt of Mr. Klisowsky's cross application and the concerns he expressed over the apportionments in the Fourth Report, the Receiver retained Erin Richard to explain the financial situation and accounting of Nomads and Ladacor while she was comptroller for the final year of their operations. She had worked with the Receiver during the course of the

receivership. Ms. Richard outlined in her affidavit how employees and assets had been apportioned between the two entities. She attempted to determine from the available records what assets had been owned before Ladacor was incorporated. Those would have been Nomads. Because Ladacor had become the main operating entity after the fall of 2017, anything acquired since then was attributed to Ladacor.

30 The same analysis was performed with respect to employees. For the purposes of payroll, withholdings and other employment related issues, the Receiver treated employees who had been employed with Nomads and who stayed on after Ladacor began operating as Nomads employees. Employees hired after Ladacor began operating were treated as Ladacor employees, even though they may have been working on Nomads projects.

31 For accounts payable and monies owed to trade creditors, the Receiver looked at which entity an invoice was addressed to, or which project it related to. If it was addressed to Nomads, or was in relation to a Nomads project, it was attributed to Nomads. And vice versa for Ladacor.

32 There does not appear to be any dispute that the Nomads/Ladacor records did not provide the Receiver with much guidance. There was no written agreement between Nomads and Ladacor when Ladacor assumed all of the operations of the two corporations. There was no asset transfer agreement. There was no agreement transferring Nomads' rights under any of its ongoing contracts to Ladacor. There was no agreement relating to employees.

33 According to Mr. Slywka, when Ladacor assumed the operations, employees at the time were simply told they were now working for Ladacor. It is unclear whether any of the parties Nomads had contracted with were ever told that Ladacor had taken over Nomads' operations, or that Nomads had assigned any rights to Ladacor.

34 Mr. Klisowsky takes issue with the amount of the asset sale proceeds attributed to Ladacor versus Nomads. He challenges Ms. Richard's assessment, noting that she was a relatively new employee at Ladacor. He also takes issue with the allocation of employees between the companies, and says that only his wife and son were Nomads employees, as all other workers worked for Ladacor. That impacts wages paid to the employees (their WEPP claims) as well as claims by the government for employee deductions and other trust claims made by the Government of Canada.

35 Mr. Klisowsky's view is that as at the beginning of 2018, Nomads was essentially a holding company. All of its projects, employees and assets had been transferred to Ladacor. Ladacor performed all of the work on all of the projects contracted to either Nomads or Ladacor. Ladacor paid all of the employee wages, regardless of what project they were working on. Ladacor paid all of the bills whether they were invoiced to Ladacor or to Nomads, as Ladacor had taken over all of the work on all of the ongoing projects.

36 Whatever the arrangement between Nomads and Ladacor was, it was not reduced to writing. There is some suggestion that the merging of operations and the creation of Ladacor was linked to collection activities undertaken against Nomads by Alberta Treasury Board and Finance in relation to a reassessment of tax credits Nomads had been given under a government tax incentive program. A review by the Tax and Revenue Administration revisited the credits given to Nomads for 2012, 2013 and 2014 and assessed Nomads some $769,000. The Provincial government had apparently garnisheed Nomads' former bank, leading to Nomads setting up a new banking relationship with BMO.

37 The best that can be said of the operations of Nomads and Ladacor once Ladacor came into existence is that they operated under Mr. Klisowsky's control as "owner" of both entities. Daryl Nimchuk was the chief operating officer for some time. Ms. Richard was comptroller, and Larry Slywka was Ladacor's production manager. The operations of both Nomads and Ladacor were merged so that all receipts went into the Ladacor bank account and all bills were paid out of that account. There was no internal attempt to separate assets, projects, employee functions, bills or receivables. The reporting to BMO and any financial statements produced were "consolidated", although the two corporations were never consolidated under the *Business Corporations Act*. The joint operation is frequently described internally and on contracts as "Nomads Pipelines Consulting Ltd o/a Ladacor". The internal treatment of the two entities' operations does not reflect either entity's legal rights or obligations.

38 According to the brief filed on behalf of Mr. Klisowsky, and his affidavit evidence, he believes that despite all of the various claims being advanced against it, Nomads remains a solvent entity and that Nomads should not be put into bankruptcy. He points to the large receivable of $2,800,000 secured by a builder's lien against the Hythe project. He claims that there is a good defence to Liberty Mutual's claim against Nomads on the indemnity and guarantee agreement on the bond issued in favour of Kor Alta.

39 Mr. Klisowsky points to the wording of the indemnity agreement and argues that the agreement gave Nomads (or the Receiver when it took over control of Nomads following the Receivership Order) their right to cancel the bond in favour of Kor Alta. The Receiver failed to do so. The Receiver's failure should not be visited on Nomads, such that Nomads should not ultimately have to pay anything to the bonding company.

40 He refers to paragraph 45 of the Indemnity agreement that provides:

> 45. *Termination of the present agreement and its effect upon outstanding Bonds* — The present agreement shall only be terminated by any Indemnitor, upon prior written notice to the Surety by registered mail and at its head office, at least thirty days prior to its effective date; however, the said prior notice of termination will not modify, nor exclude, nor discharge the Indemnitors' obligations relating to Bonds issued prior to the effective date of termination or Bonds issued after the effective date of termination by reason of

> undertakings by the Surety prior to such date, the present agreement will remain in full force and effect as regards the other Indemnitors without any obligation on the part of the Surety to advise such other Indemnitors of such termination.

41 This argument affects Ladacor as well, as it is the primary obligee on the bond and it is required to indemnify Liberty Mutual. The Indemnity Agreement in favour of Liberty Mutual executed by Ladacor, Nomads and 236 by Mr. Klisowsky signing the same. Mr. Klisowsky signed a personal indemnification in favour of Liberty Mutual and there is a *Guarantees Acknowledgement Act* certificate dated January 4, 2018.

Issues

42 The Receiver raises a number of issues and seeks the Court's direction on the following:

> 1. Should the Receiver's apportionment of funds be approved, including its treatment of the contribution and subrogation obligations and rights of the guarantors?
>
> 2. Is there a valid defence on Liberty Mutual's indemnification claims on the bond claims against it?
>
> 3. Has the Receiver erred in apportioning employees, assets and debts?
>
> 4. Should all or any of the entities be put into bankruptcy? and
>
> 5. Should the Receiver's actions be approved?

43 Mr. Klisowky's application challenges a number of the Receiver's recommendations and conclusions and raises a number of issues:

> 1. The validity of the Liberty Mutual claims under the Indemnity Agreement;
>
> 2. The identification and allocation of unsecured debt as between Ladacor and Nomads;
>
> 3. The identification and allocation of the auction proceeds between Ladacor and Nomads;
>
> 4. The identification of employees of Nomads and any claims (CRA and WEPP);
>
> 5. The validity of the Alberta Treasury Board and Finance claim against Nomads;
>
> 6. The proposed subrogation from Nomads and Ladacor to 236;
>
> 7. The claim of J. Steenhof against 236; and

8. The conduct of the Receiver.

44 I will deal with subrogation first as my decision on it will impact a number of the other issues. I will then deal with Mr. Klisowsky's concerns and claims, before dealing with the relief sought by the Receiver.

Subrogation

45 BMO has been paid in full. It received $5,834,882. That included repayment of amounts loaned by BMO to fund the receivership. Most if not all of the funds that were paid to BMO resulted from the sale of 236's hotel in Sioux Lookout and the collection of the $2,600,000 receivable on the Westgate contract owed to Nomads. The principal debtor to BMO was Ladacor. It was the entity that borrowed and received the funds from BMO. The funds that resulted from collections on other Nomads and Ladacor projects and the sale of Nomads' and Ladacor's physical assets were mainly used to pay the ongoing costs of the receivership, including completion of some of the project work, and the Receiver's fees and disbursements.

46 BMO was a secured creditor, subject only to the superior WEPP claims and CRA source deduction claims, and the costs of the receivership. The Receiver argues on this application that guarantors (such as Nomads and 236) are entitled to be subrogated to the claims they have paid out on behalf of the principal debtor, Ladacor.

47 In this case, Nomads and 236 have paid off BMO's claims against Ladacor. Nomads and 236 are entitled to be subrogated to BMO's claim, and to stand in BMO's shoes with respect to any security BMO held against Ladacor. That means, according to the Receiver, that Nomads and 236 are now the primary secured creditors on any of Ladacor's remaining assets.

48 Additionally, as between guarantors who have paid out on their guarantees, Nomads and 236 are entitled to be treated proportionately, so the debt paid off should be apportioned between them. Where guarantors are equally liable to the obligee, the guarantors are considered to be responsible for equal shares of the debt.

49 Here, that would mean that each of Nomads and 236 should have paid off half of the debt owed to BMO. Since 236 paid more than half of the BMO debt, there should be an adjustment as between Nomads and 236, in 236's favor.

50 The way the Receiver has accounted for this is that the excess of collections over required payments has left a surplus, some of which now stands to the credit of Ladacor. Because 236 paid more than its half of the obligation, 236 is entitled to recover that excess from Ladacor.

51 Of the $5,834,882 paid to satisfy BMO's claims, $4,000,000 came from 236. The remainder came from Nomads. Because of contribution principles between guarantors, each of the guarantors should have paid $2,917,441. 266 overcontributed by $1,082,559. That amount is owed to it by Nomads.

52 The Receiver proposes to pay the funds remaining in the Nomads account and the Ladacor account (after holdbacks for further administration costs) in the approximate amount of $465,000 (Receiver's Fifth Report). 236 is expected to have approximately $517,000 in its account, so it will recover $982,001. It will be short by approximately $100,559. Because of it standing into BMO's security, it will be Nomads' only secured creditor to that extent.

53 This analysis and position is well supported by the Receiver's first brief for this application. The Receiver cites:

Gerrow v. Dorais, 2010 ABQB 560 (Alta. Q.B.);

Mercantile Law Amendment Act 1856, 19 & 20 Vict, c 97;

Matticks v. B. & M Construction Inc. (Trustee of), 1992 CarswellOnt 193 (Ont. Bktcy.);

Andrews & Millett, *Law of Guarantees*, 7th Ed (London: Sweet & Maxwell, 2015) at para 11-017;

Windham Sales Ltd., Re, 1979 CarswellOnt 227 (Ont. S.C.);

Wong v. Field, 2012 BCSC 1141 (B.C. S.C. [In Chambers]);

EC & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home (District No. 69), 1987 CarswellAlta 25 (Alta. Q.B.); and

Abakhan v. Halpen, 2006 BCSC 1979 (B.C. S.C.) aff'd 2008 BCCA 29 (B.C. C.A.).

54 J. Steenhof, as an unsecured creditor of 236, and 145 as an unsecured creditor of Nomads on the Hythe project, agree with this analysis, as does Liberty Mutual. Mr. Klisowsky raises no specific objection to this proposal on the part of the Receiver, but suggests that it is premature. He says that the proper contribution between Nomads and 236 can only be calculated once the assets and liabilities of Nomads and Ladacor (as between those entities) have been properly allocated.

55 I am satisfied that for the purposes of finalizing the Receivership accounts, the monies the Receiver holds to the account of Ladacor and Nomads should be transferred to 236's account as a function of a guarantor's right to subrogation and to contribution rights and obligations as between co-guarantors.

Assets and Liabilities of the Debtors

Ladacor

56 There is no doubt that Ladacor is insolvent under any interpretation of "insolvency". It has no remaining assets, other than a contingent interest in the funds proposed to be held back by the Receiver to deal with CRA's post-receivership withholdings claims (discussed below), and a $57,000 GST refund apparently owed to it by CRA. All physical assets have been disposed of. All of Ladacor's projects have been abandoned, completed or wound down. Its receivables have been collected. There are still claims by CRA relating to pre-receivership GST. These claims total $33,446. While these claims presently enjoy priority status, they will drop down to unsecured status in the event of Ladacor's bankruptcy.

57 There is a post-receivership claim relating to source deductions assessed against the Receiver's independent contractors used to complete project work and for other receivership purposes. CRA's position is that these contractors should be treated as employees subject to employment insurance and Canada Pension Plan deductions. While the presently-advanced claim is approximately $10,000, the Receiver anticipates that there are a number of other claims that CRA will advance, depending on its success on the claims already made. The Receiver proposes to withhold $125,000 as a contingency to deal with those funds. It is possible that not all of those funds will be required, and some might ultimately be released back to Ladacor. Conversely, it is possible that the claims and costs of defending Ladacor against them will use up most or all of the contingency amount.

58 The Receiver's records list Ladacor's unsecured creditors. The present list totals approximately $3,500,000 in unsecured claims. That does not include over $1,100,000 from Liberty Mutual under the Indemnity Agreement in favour of Liberty Mutual.

59 The priority claims of CRA have been accounted for in the holdback of $125,000 discussed above. Ladacor's only remaining secured creditors are 236 and Nomads, because they are able to step into BMO's secured position because of their subrogation rights. Since 236's and Nomads' assets were used to pay off BMO, 236 and Nomads have a secured claim against Ladacor for up to $5,834,882, less the approximately $465,000 that will be paid to 236 as a result of this application.

60 It appears from this analysis that Ladacor's unsecured creditors are unlikely to make any recovery at all, as any remaining funds will go to or be attributed to 236 and Nomads, with 236 being able to recover all of any anticipated or hoped-for funds because of its contribution rights against Nomads.

61 It is obvious that Ladacor should be placed into bankruptcy, although it is difficult to see

any advantage to that for Ladacor's unsecured creditors. The bankruptcy would appear to benefit only the creditors of 236, as discussed below.

62 In any event, there needs to be an orderly resolution to the massive amount of unsecured debt owed to Ladacor's creditors and the only way of achieving that is through bankruptcy

236

63 236 has no remaining assets, other than its subrogated claim against Ladacor and its claim against Nomads for contribution so that its and Nomads' contributions to BMO will be equalized. 236's creditors are all unsecured. The major claims are Liberty Mutual's claim for indemnity for bond claims against Ladacor ($1,100,000) and a claim from J. Steenhof for approximately $444,000. It too has a GST claim by CRA ($33,000), which is presently a priority claim but which will become unsecured on bankruptcy. There are only a few other unsecured claims totaling about $40,000.

64 Through its subrogation rights and contribution rights arising out of 236's payments to BMO, 236 will receive all of the remaining cash in the three debtor accounts. There is the possibility that some further funds might come to 236 from Ladacor (any surplus from the CRA holdback discussed above and the GST refund). Any such funds may be available for 236's creditors.

65 It is unlikely that 236 will receive any more than the amount presently suggested by the Receiver. That will not satisfy Liberty Mutual's claim, if the claim is valid and anywhere close to the current amount claimed. If J. Steenhof's claim has any validity, it and Liberty Mutual will recover only a fraction of their claims.

Nomads

66 In his submissions, Mr. Klisowsky emphasizes the $2,800,000 receivable and builder's lien claim Nomads has against Hythe. As discussed below, that claim is hotly disputed by Hythe. Hythe is attempting to amend its statement of defence and counterclaim to advance a claim against Nomads for damages significantly higher than the Nomads claim against Hythe.

67 There are two investments owned by Nomads. The first is 27.5% of the common shares in a private corporation, Testalta Corporation Ltd. Nomads is also owed a shareholder's loan of $220,500. The Receiver has no information on the value of this investment. It says that Mr. Klisowsky has not provided any relevant information that would assist it in valuing this asset. As a result, the Receiver places no value on Nomads' investment in Testalta and the Receiver has no information as to whether the shareholders' loan is recoverable.

68 The second of these investments is a 50% interest in 1878826 Alberta Ltd. This private corporation owns a Studio 6 Hotel in Bruderheim, Alberta. The Receiver's information is that the hotel is presently producing "minimal positive cash flow" and is subject to a mortgage of approximately $3,000,000. Because of the lack of information, the Receiver is unable to place any value on this investment.

69 Nomads has a contingent claim to the $54,236 the Receiver paid into Court to discharge a builder's lien in favour of Hawk Electric, filed against the Westgate project. Those funds are in Court as security for the lien and will remain there until further Court order. It is possible that some of those funds might come back to Nomads.

70 Nomads owns 23 modular storage units which were earmarked for the Hythe project. They remain in storage. Unless the Hythe project can use them, they have little residual value. No information was put before me as to the potential value of these storage units. The main value appears to be the ability to use them for completion of the Hythe project. It seems highly unlikely Nomads or the Receiver will have any further involvement with Hythe, other than in the litigation that has ensued.

71 Nomads is entitled to be indemnified for its payments to BMO by Ladacor and in that regard is a secured creditor, being entitled to step into BMO's security position. There is a possibility that Ladacor may not need all of the CRA contingency it has set up, and that it might recover a pre-receivership GST refund. However, since 236 is entitled to contribution from Nomads to equalize their payments to BMO to pay off Ladacor's debts to BMO, 236 will be entitled to recover any of the required contribution from Nomads as a secured creditor.

72 Having regard to the roughly $100,000 contribution owed to 236 and 236's security position, it appears highly unlikely that any funds will remain for the benefit of any of Nomads' unsecured creditors.

73 By way of liabilities, CRA is a priority creditor in the amount of $152,742 in pre-receivership GST. As with Ladacor, this claim will drop down to unsecured status in the event of Nomads' bankruptcy.

74 Nomads is liable to indemnify Liberty Mutual for both of the bond claims Liberty Mutual is liable for. Those claims total approximately $1,100,000.

75 Alberta Treasury Board and Finance Tax and Revenue Administration has a claim (presumably unsecured) against Nomads following a reassessment of tax credits for 2012, 2013 and 2014 totaling $769,245.68. This claim has been outstanding since some time in 2017. Mr. Klisowsky professes to know nothing about this claim.

76 236 has a claim against Nomads to equalize what the two entities paid out to satisfy Ladacor's debts to BMO in the approximate amount of $100,000, assuming all available funds from Ladacor and Nomads are paid over to 236 as a result of this application.

77 Hythe has recently provided information to the Receiver that the work done by Nomads should be demolished because of defects and mold infestation. The expert report provided states that the cost of repairing the existing work and completing it is likely to be significantly more expensive than demolishing the existing work and starting over again. The intended counterclaim will greatly exceed the amount of Nomads' builder's lien and claim for the value of work it claims to have done. While the relative merits of the positions of Nomads and Hythe are unknown, it seems clear that it will be a long and difficult fight for Nomads to collect anything from Hythe. It is not known what was agreed between the Receiver and Hythe with respect to this application such that Hythe's application to lift the stay of proceedings to allow it to file an amended statement of defence and counterclaim. However, the information presented by the Receiver casts doubt on the recoverability of the claimed receivable.

78 Nomads also has approximately $1,900,000 in debts to creditors, after deducting the Liberty Mutual and Alberta Treasury Board claims. One of the J. Steenhof companies, 145, has a claim against Nomads for work done on the Hythe project, but its hopes of collection are likely tied to its builder's lien.

79 It appears, following this analysis, that anything that Nomads may be able to recover from its few debtors will ultimately go to 236 until its and 236's payments to BMO have been equalized. The absence of information as to the potential value of Nomads' investments in Testalta and 1878826 Alberta Ltd makes it impossible to determine if there is any chance of recovery on either of those investments, or in what amount. The first $100,000 is likely to go to 236 and there are $4,700,000 in other creditors, so even if Nomads' present claim against Hythe were given full value (ignoring Hythe's counterclaim), Nomads would be unable to pay off its unsecured creditors. In my view, the suggestion that Nomads is solvent and should be able to resolve outstanding issues with its creditors is fanciful.

80 Any remaining assets of Ladacor and Nomads will likely end up with 236 and be distributed to its creditors and not to any other creditors of Nomads or Ladacor. The resulting beneficiaries of that scenario are Liberty Mutual and J. Steenhof.

81 236 has no remaining assets other than its subrogated claim against Ladacor and the contribution claim against Nomads. The Receiver proposes to pay Ladacor's remaining funds in the amount of $799,000 less holdbacks and estimated administration costs to 236. Its claim against Ladacor is secured because of its rights to subrogation. However, claims will not satisfy the $4,000,000 236 paid to BMO.

Positions of Liberty Mutual, J. Steenhof and 145

82 Both Liberty Mutual and the Steenhof parties support the Receiver's application. They support the proposal to put all three of the debtor corporations into bankruptcy. They do not oppose any of the other relief sought by the Receiver.

Position of Mr. Klisowsky

83 The foundation of Mr. Klisowsky's disputes with the Receiver's reports and recommendations is that Mr. Klisowsky believes that Nomads remains solvent. Because of its assets, and in particular the Hythe receivable and builder's lien claim, the mis-allocation of debt between Nomads and Ladacor, the invalidity of the Alberta Treasury Board claim and the invalidity of the Liberty Mutual indemnification claims, there is no need to put Nomads into bankruptcy. He argues that Nomads essentially shut down and transferred all of its business to Ladacor. After late 2017, when the transfer took place, all rights and all obligations under existing contracts were assumed by Ladacor. As a result, almost all of the claims against Nomads and Ladacor should be Ladacor's responsibility. Mr. Klisowsky challenges the commercial reasonableness of the Receiver's decision to attribute a significant portion of the creditors to Nomads.

84 Mr. Klisowsky makes the same argument with respect to the physical assets of the enterprise. Effective late 2017, the assets that were eventually auctioned off by the Receiver were mainly assets of Ladacor and not Nomads. Mr. Klisowsky claims that the Receiver did not accurately identify equipment owned by Nomads such that it should be given credit for more of the proceeds of the physical asset sale than it was. The total proceeds of sale were $605,858, of which $451,450 was allocated to Nomads and $154,407 was allocated to Ladacor. Mr. Klisowsky says that most of this should have been allocated to Ladacor.

85 The same holds true for employee claims and the Receiver's treatment of WEPP claims and CRA withholding claims. After the assignment of the business to Ladacor, all employees (but for Mr. Klisowsky's wife and son) became Ladacor employees. Thus none, or almost none, of Nomads' real assets should have been used to pay off the BMO claims. Any remaining claims should be to Ladacor's account. and all the allocation of debt as between Nomads and Ladacor should be attributed to Ladacor.

86 According to Mr. Klisowsky, the Receiver overpaid the WEPP claims and CRA preferred/secured claims because of failing to properly identify what employees worked for Nomads and for Ladacor. From the Receiver's accounting, CRA source deductions for Nomads and Ladacor totaled $322,652. These do not appear to have been broken down between Nomads and Ladacor by the Receiver. The WEPP claims totaled $25,005 (attributed $18,056 to Nomads and $8949 to Ladacor.

87 Mr. Klisowsky says the manner of apportionment of employees was not commercially reasonable.

88 Ultimately, Mr. Klisowsky says that more work needs to be done by the Receiver to properly analyzed and the results amended.

89 Mr. Klisowsky's position with respect to the Liberty Mutual indemnification claims is that if Ladacor had any outstanding bonds, and if there are any valid bond claims, the indemnity agreement should have been terminated by the Receiver immediately on their appointment thus avoiding liability on the bonds. Mr. Klisowsky also takes the position that the Receiver should not have terminated the subcontract with Kor-Alta because that triggered the performance bond claims. Mr. Klisowsky challenges the commercial reasonableness of the Receiver's decision to cancel the contract.

90 Mr. Klisowsky argues that the work done by the Receiver to analyze and quantify the Alberta Finance claim relating to the reversed tax credits is deficient and needs further investigation as to whether the amount claimed is legitimate, whether it can be negotiated, and whether there is a process to appeal the reassessment. Mr. Klisowsky notes that the Alberta Finance claim is the most significant claim against Nomads other than the Liberty Mutual claim and suggests that the Receiver has not yet reached the point of commercial reasonableness in its work on this claim.

91 Mr. Klisowsky also argues that the 145 claim against Nomads on the Hythe project is not valid. It is a claim for $603,000. Additionally, he disputes J. Steenhof's claim for $444,000 against 236. He says there is an issue for trial regarding that claim, as he says that amount represents part of J. Steenhof's investment in 236 and not a debt owed by 236 to J. Steenhof.

92 Mr. Klisowsky argues that assigning any of the debtors into bankruptcy should only be done after the Receiver has completed a proper investigation and analysis of the assets and debts of the debtor corporations. Such a step should only occur when it is commercially reasonable to do so and that point has not been reached.

93 Other issues raised include the reasonableness of the Receiver's actions when heavy rains damaged the roof and other parts of the under-construction Hythe project and its response to the theft of some property from that site.

94 Mr. Klisowsky cites *Royal Bank v. Melvax Properties Inc.*, 2011 ABQB 167 (Alta. Q.B.) in support of his submissions. At the hearing, his counsel also referred to section 66(1) of the *Personal Property Security Act*, RSA 2000 c P-7, and *Bank of Montreal v. Tolo-Pacific Consolidated Industries Corp.*, 2012 BCSC 1785 (B.C. S.C.).

Analysis

1. The validity of the Liberty Mutual claims under the Indemnity Agreement

95 I cannot make any determination as to the validity of the Liberty Mutual claims as I have no documentation supporting the claims against the various bonds. In particular, none of the underlying contracts or subcontracts by Ladacor are in evidence. Mr. Klisowsky suggests that there was no signed contract between Ladacor and Kor-Alta. That may be so. However, that does not answer the matter, as there may well have been a bid bond issued in favour of Kor-Alta during the tendering process. A bid bond secures the successful tenderer's obligation to enter into a contract to perform the work and to provide a performance bond.

96 Mr. Klisowsky's brief seems to suggest that a performance bond and labour and material payment bond were issued, which suggest that there were underlying contracts in existence. But it is premature to try to assess these issues. Liberty Mutual has indemnification agreements from each of Ladacor, Nomads, 236 and Mr. Klisowsky. It does not appear that any of the bond claims have been finalized.

97 Liberty Mutual claims that it is or will be owed approximately $1,100,000 on account of the labour and material payment bond claim by Hawke Electric and the performance bond claim by Kor-Alta. Those claims may be valid and if they are valid, the indemnification agreements appear valid on their face.

98 The defence raised by Mr. Klisowsky: that the Receiver should have terminated the indemnity agreements thereby avoiding liability for the indemnitors, is entirely without merit. His reference to paragraph 45 of the Indemnity Agreement might provide an argument in his favour, it the paragraph ended after the first part of the first sentence. The sentence continues:

> . . . however, the said prior notice of termination will not modify, nor exclude, nor discharge the Indemnitors' obligations relating to Bonds issued prior to the effective date of termination or Bonds issued after the effective date of termination by reason of undertakings by the Surety prior to such date . . .

99 It would make no sense at all for the indemnitors to be able to avoid their liability to indemnify the bonding company for bonds issued before the termination becomes effective. The essence of paragraph 45 is that the indemnitors can avoid liability for future bonds or bonding obligations by giving a 30-day notice. Existing arrangements are not affected.

100 Standard form performance bonds, labour and material payment bonds and bid bonds do not have unilateral termination provisions or cancellation provisions on the part of either party.

Once the bonding company is on the hook for a bonded obligation, the indemnitors are likewise on the same risk.

101 This is so elementary in the bonding world that no authorities need be cited. Mr. Klisowsky's argument here is without merit. If Liberty Mutual is liable on any of the bonds it issued for Ladacor, the indemnitors are almost certainly liable to indemnify Liberty Mutual (subject to the usual types of defences available to guarantors.

102 There is no basis to reject the Liberty Mutual claims from consideration of the merits of putting the debtor corporations into bankruptcy. Undoubtedly there may be litigation as to whether Liberty Mutual has properly paid out any of the claims against it and whether they have acted reasonably. But someone will have to carefully monitor the claims and Liberty Mutual's responses, and in doing so will be a costly venture for whomever is tasked with that.

2. The identification and allocation of unsecured debt as between Ladacor and Nomads

103 This is another area where Mr. Klisowsky's arguments are without merit. A debtor cannot unilaterally pass its debts on to someone else and avoid further liability. Subject to the terms of the contract between the creditor and the debtor, a creditor can assign its rights (like its receivables or benefits accruing under a contract) to a third party. Sometimes that requires the consent or agreement of the debtor or other contracting party, and sometimes not. Nomads might have been able to assign its rights under the contract with Hythe and others to Ladacor, and it might not have been.

104 While Nomads could by contract require another party to satisfy its obligations (such as Ladacor) that is not binding on the creditor. Someone cannot simply go to a creditor and say "I don't owe that to you any more, I assigned my obligations to someone else". If that were possible, every debtor would rush to assign its obligations to a shell company or insolvent entity. Creditors are entitled to look to their debtor for payment or performance and they do not have to try to collect from someone else, unless they have specifically agreed to do that through some valid contractual mechanism.

105 There is no evidence here that any of the Nomads creditors ever agreed to release Nomads and substitute Ladacor is its debtor. As a result, the method used by the Receiver with the assistance of Ms. Richard and others, was commercially reasonable. There were no written agreements between Nomads and Ladacor. Claims on contracts Nomads entered into are likely still Nomads' responsibility. Suppliers who supplied things on Nomads projects are likely still Nomads' creditors.

106 I see no error in principle as to how the Receiver characterized the creditors. The Receiver has made no binding determinations; that would result from a claims process in the

receivership, or the normal claims processes in bankruptcy. No one has suggested that it would be more efficient or effective to have a claims process within the existing Receivership.

107 I do not see that the Receiver's actions in this area have been unreasonable in any way. It was faced with an undocumented mess and the Receiver has done its best to make sense of the disorganization created by the do-it-yourself creation of Ladacor by Mr. Klisowsky.

3. The identification and allocation of the auction proceeds between Ladacor and Nomads

108 There were no transfer documents in evidence as to any transfers of assets between Nomads and Ladacor. No purchase documents were in evidence showing which entity actually purchased an asset in the first place. In the absence of documentation, the approach taken by the Receiver appears to be reasonable. Where an asset appears to have been in Nomads' possession at the time Ladacor came into existence, it remained Nomads'. Anything acquired after Ladacor began operations was attributed to Ladacor.

109 I see nothing in this approach that is unreasonable. Again, any potential errors on the part of the Receiver were caused by the absence of appropriate documentation at the commencement of the receivership.

110 In any event, arguments of this nature do not get Nomads anywhere. The fewer assets Nomads had, the less it contributed to paying off the BMO debt, and the more it would owe to 236's contribution claim.

4. The identification of employees of Nomads and any claims (CRA and WEPP)

111 It does not appear that existing Nomads employees were properly transferred over to Ladacor's employment. Ladacor may well have been making all of the payroll payments once it took over as the operating company. For employment insurance, Canada Pension purposes, and employment standards purposes, the existing employees should have been terminated from Nomads and hired by Ladacor. Records of Employment should have been prepared and filed; accrued vacation pay should have been paid out.

112 The failure to take those steps, however, does not invalidate a successor employer's employment or liability to the workers it has taken on. It creates liabilities for the former employer (in this case Nomads).

113 This is one area where the Receiver may have been incorrect in its treatment of employees and liability for wages and withholdings. I only say "may", as in the circumstances the Receiver faced, it is possible that any unpaid employee (and CRA) could have chosen which

entity to pursue. It would have been possible for Ladacor employees to work on Nomads projects. Nomads could have subcontracted its obligations to Ladacor such that as between Nomads and Ladacor, Ladacor would have all future responsibilities.

114 The absence of any agreement between Nomads and Ladacor makes it virtually impossible to determine what enforceable arrangements between Nomads and Ladacor were made. Consolidated financial statements were prepared. There is no evidence that Nomads and Ladacor had their own financial statements or books once Ladacor came into the picture.

115 There is no evidence that Nomads was ever paid anything by Ladacor for Nomads assets or its ongoing contracts. There is no evidence that Ladacor ever indemnified Nomads against claims from any of Nomads' creditors or contracting parties. Nevertheless, it is possible that most of the employee claims were Ladacor obligations.

116 That being said, the amounts of the claims really makes this a *de minimus* area of concern. Mr. Klisowsky complains of $18,056 of WEPP claims already paid out by the Receiver from Nomads, and disputes the estimated $84,300 in unsecured WEPP claims remaining against Nomads. Charging $18,056 to Ladacor instead of Nomads changes nothing of significance with respect to the results of the receivership and indeed would increase the amount of contribution Nomads would owe to 236. The less attributed to Nomads means the more attributed to 236 such that 236 would itself be a larger creditor of Nomads. That takes on even more significance when 236's status as a secured creditor is factored in, along with the unlikelihood of recovery for any of Nomads' unsecured creditors.

117 While Mr. Klisowsky makes a valid theoretical point, there is no merit to it in substance, as the amounts are too small to make any difference in the overall results.

5. The validity of the Alberta Treasury Board and Finance claim against Nomads

118 The Alberta Finance claim will have to be dealt with whether in the receivership or in a bankruptcy. This is not a claim that was made after the receivership began; it was made against Nomads sometime in 2017. If an appeal period with respect to the reassessment of taxes was missed, it was likely missed long before the Receivership. The Receiver can hardly be faulted for not spending a lot of time investigating an unsecured claim that Nomads appeared to be ignoring and restructuring its affairs to avoid paying.

119 There is nothing unreasonable in the Receiver's approach to this claim. The Receiver did nothing with respect to investigating the validity of any of the unsecured claims, let alone trying to negotiate settlements on them. The main task of the Receiver was to identify secured and preferred claims, and pay out BMO, CRA, Service Canada, and WEPP, so that anything remaining could be properly divided amongst the unsecured creditors.

120 The latter process has yet to occur, and is one of the reasons bankruptcy is a necessary process.

121 I find no fault on the part of the Receiver in this area, and certainly no lack of commercial reasonableness.

6. The claim of J. Steenhof against 236

122 There is little information about the validity of J. Steenhof's claims against 236. Mr. Klisowsky acknowledges that there is a triable issue between 236 and J. Steenhof as to whether the claim is a debt owed to a shareholder or whether the claim relates to the shareholder's investment in the corporation for the purchase of its shares. That needs to be decided in some binding manner. Absent a claims process, the Receiver is not in a position to make any determination. At the end of the day, however, that is really a question for the unsecured creditors of 236. Mr. Klisowsky does not claim to be a creditor of 236, let alone a secured creditor. He claims to be a shareholder. The information suggests that the shareholders of 236 are likely to receive nothing for any shareholders' loans, let alone any equity they may have in that corporation.

123 It is certainly not an issue that can be decided summarily and will likely be a time consuming and expensive exercise.

124 The Receiver cannot be criticized for its approach to this claim and there is nothing commercially unreasonable about maintaining the J. Steenhof claims in the list of unsecured creditors.

Relief sought by Receiver

125 This takes us to the Receiver's requested relief, which I can now deal with having regard to the facts as I have found them.

1. Approving the actions, conduct and activities of the Receiver and its legal counsel outlined in the Receiver's Fourth Report to the Court dated September 3, 2019 and all other reports filed by the Receiver in these receivership proceedings

126 Whether the Receiver should have taken different action after the rain damage to the Hythe project, and whether the Receiver should have taken different action after thefts of equipment or tools from that project, are arguable issues.

127 However, Mr. Klisowsky has not raised any issues or arguments that require further evidence or a trial.

128 In response to Mr. Klisowsky's criticisms of the Receiver, counsel says that it is too late for Mr. Klisowsky to raise these arguments. The Receiver has been transparent throughout; Mr. Klisowsky has been represented throughout and has been present at most if not all of the court appearances. The allocations of assets and employees and payment of secured and preferred claims have been dealt with in the Receiver's various reports and on the court applications approving payments and transactions. Mr. Klisowsky has been silent throughout the proceedings and took no appeals from any of the orders made. Counsel argues that any suggestion that the Receiver has not acted in a commercially reasonable manner is without foundation.

129 Additionally, counsel for the Receiver points out that no expert evidence has been put forward as to what should have been done regarding any of these issues to achieve commercial reasonableness.

130 The Receiver cites *Jaycap Financial Ltd v. Snowdon Block Inc*, 2019 ABCA 47 (Alta. C.A.) on the subject of commercial reasonableness and a receiver's obligation to:

> . . . exercise such reasonable care, supervision and control of the debtor's property as an ordinary person would give to his or her own. A receiver's duty is to discharge the receiver's powers honestly and in good faith. A receiver's duty is that of a fiduciary to all interested stakeholders involving the debtor's assets, property and undertaking (at paragraph 28).

131 The Receiver says that here, it satisfied those obligations and acted in a fully transparent manner having regard to its various reports and court applications.

132 The Receiver cites *Western Union Petro International Co Ltd v. Anterra Energy Inc*, 2019 ABQB 165 (Alta. Q.B.) and argues that the record before me is sufficient to enable me to make a fair and just determination of the issues without requiring more evidence, or a trial.

133 Counsel also refers to the decision in *Royal Bank v. Melvax Properties Inc.*, 2011 ABQB 167 (Alta. Q.B.) where Veit J referred to the weight to be given to the business judgments of others involved in the matter. Here, counsel points to the support the receiver has from Nomads', Ladacor's and 236's largest creditors, Liberty Mutual and the Steenhof parties. The other large creditor, Alberta Finance, has taken no position.

134 The value of the theft was not significant in the overall scheme of things, and the Receiver's actions following the rain damage were aimed towards having Hythe continue on

with some aspects of the construction contract. The objective there was to recover the amounts owed to date, and be able to make valuable use of the containers that still remain in storage. While those efforts ultimately proved unsuccessful, and the benefit of hindsight gives rise to the efficacy of those actions, the Receiver's actions do not appear to be outside the scope of commercial reasonableness. Nor do they approach the gross negligence or willful misconduct level required to have the Receiver liable for any loss resulting from those actions.

135 To the extent that the Receiver's actions have not otherwise been approved in previous orders, I am satisfied that relief should be granted to the Receiver

2. Approving the Receiver's final statement of receipts and disbursements for the period for May 18, 2018 to August 31, 2019 as set out in the Fourth Report

136 With the exception of Mr. Klisowsky's concerns addressed above, no one challenged the appropriateness of the Receiver's final statement of receipts and disbursements for this period. Mr. Klisowsky took no objection to the time spent or the hourly rates, but objected to the completeness of the Receiver's work.

137 I am satisfied that it is appropriate to approve these accounts, and do so (to the extent not already covered by Topolniski J's Order of September 13).

3. Approving the accounts, fees and disbursements of the Receiver and its independent legal counsel in connection with the completion of these receivership proceedings, including the costs of this application

138 While I do not see any problem with the anticipated accounts, fees and disbursements in connection with the completion of the receivership proceedings, I think it is more appropriate to approve these accounts, fees and disbursements when they have been incurred. Hopefully they can be completed within the budgeted amounts.

4. Approving the proposed allocation of cash held by the Receiver for Ladacor and Nomads to 236, as set out in the Fourth Report

139 I acknowledge that the Receiver's work in allocating assets and employees between Ladacor and Nomads may not have resulted in a perfect allocation. That is not because the Receiver's work was deficient or flawed. Rather, it was because of the corporate mess that existed at the time of the Receivership Order. The Receiver had to try to make sense of an undocumented and ill-conceived "takeover" of Nomads by Ladacor. The proposed method of allocation by Mr. Klisowsky is unworkable, especially as it is founded on the incorrect

assumption that Nomads could assign its obligations to Ladacor in a manner that would be binding on its creditors.

140 The reality is that any reallocation of assets would be moot. Putting more assets and liabilities into Ladacor would result in Nomads making a smaller contribution to paying off the BMO debt. That would simply increase the amount of 236's secured claim for contribution from Nomads. While it might leave fewer unsecured creditors for Nomads to have to deal with, the above analysis indicates that Nomads' unsecured creditors are unlikely to make any recovery at all.

141 As such, my conclusion is that no creditor is prejudiced by the allocations that were made by the Receiver between Nomads and Ladacor.

142 The Receiver has, in my view, correctly applied the applicable principles of subrogation and contribution, such that it is appropriate to allocate all of the remaining cash of Ladacor and Nomads to 236.

5. Approving the Receiver's proposal to assign the Debtors into bankruptcy in accordance with the Receivership Order

143 What is left with the three debtor corporations is a paucity of assets and a mountain of claims against them. Only the Liberty Mutual claim involves all three corporations. Total claims (counting Liberty Mutual only once) exceed $7,000,000. None of the claims have been proven. There may be defences to some or many of the claims, and some of the claims may be excessive in amount.

144 Getting to the bottom of all of this will be time consuming and very expensive. Litigation with Hythe has already commenced. Its result is uncertain. Success on that litigation would appear to be the only real chance of any collection for Nomads' unsecured creditors. The only effective way of dealing with the numerous claims is through a statutory process such as bankruptcy. While there are possible ways of dealing with claims in a receivership, no one other than Mr. Klisowsky is recommending that the receivership continue. The Receiver's recommendation is to use the bankruptcy process to deal with the few remaining assets and myriad of claims.

145 I agree with the Receiver's recommendation and accordingly approve its proposal to assign the three debtor corporations into bankruptcy.

6. Approving the transfer of all funds and property held by or collected by the Receiver, net of costs required to complete the administration of these receivership proceedings, into the bankrupt estates of the Debtors

146 Having approved the assignments into bankruptcy, it flows that any funds and property remaining after the administration of the receivership has been completed should be transferred into the respective bankruptcy proceedings.

7. Declaring that the Receiver has duly and properly discharged its duties, responsibilities and obligations as Receiver

147 There is no valid objection to this relief being granted, to the date of this decision and insofar is the Receiver carries out the orders herein.

8. Discharging and releasing the Receiver from any and all further obligations as Receiver and any and all liability in respect of any act done by the Receiver in these receivership proceedings, and its conduct as Receiver pursuant to its appointment in accordance with the Receivership Order, or otherwise

148 This order appears to be premature, as there is still work to be done to carry out the terms of this order. To date, this relief appears appropriate but this relief should be applied for after the Receiver has completed its work and not in advance.

9. Authorizing the Receiver to transfer the books and records of the Debtors to the bankruptcy trustee, subject to preserving such records as required by statute.

149 Having approved the assignments into bankruptcy, this relief flows from that order and is granted.

Application granted in part.

1997 CarswellOnt 1757
Ontario Court of Justice, General Division

Hoare v. Tsapralis

1997 CarswellOnt 1757, [1997] O.J. No. 2195, 10 R.P.R. (3d) 89, 31 O.T.C. 39, 71 A.C.W.S. (3d) 766

David Hoare and Diane Hoare, Plaintiffs and Leon Tsapralis, Mary Tsapralis, Bill Tsapralis, Dorian Capital Inc., and Dasl Holdings Ltd., Defendants

Dorian Capital Inc. and Dasl Holdings Ltd., Plaintiffs by Counterclaim and David Hoare, Diane Hoare, Lisa Hoare, Stephanie Hoare and Alana Hoare, Defendants by Counterclaim

Ground J.

Heard: March 12-14 and 18-19, and April 18, 1997
Judgment: May 16, 1997
Docket: 92-CQ-25808

Counsel: *Robert L. Jenkins*, for plaintiffs.
Jerome Stanleigh, for defendants.

Subject: Corporate and Commercial

Headnote

Guarantee and Indemnity --- Guarantee — Right of guarantor against principal debtor
Plaintiffs guaranteed mortgagor's mortgage — Plaintiffs sold their shares in mortgagor and building on property was subsequently demolished — Mortgagor defaulted in mortgage payments and plaintiffs paid mortgagee's shortfall under guarantees following sale of property — Plaintiffs were clearly subrogated to all causes of action that mortgagee had pursuant to breach of covenants by mortgagor — Mortgagor was liable to plaintiffs in contract but damages resulted from decline in real estate market and not demolition of building — Action was dismissed.

Corporations --- Directors and officers — Liabilities — Negligence
Plaintiffs guaranteed mortgagor's mortgage — Plaintiffs sold their shares in mortgagor and

building on property was subsequently demolished — Mortgagor defaulted in mortgage payments and plaintiffs paid mortgagee's shortfall under guarantees following sale of property — Mortgagor was liable to plaintiffs in tort pursuant to act of waste — No evidence that officer and director of mortgagor acted in his own interest or outside scope of his employment or in manner inconsistent with mortgagor's interests — Action was dismissed against individual defendants — Plaintitffs' damages resulted from decline in real estate market and not demolition of building and action was therefore dismissed.

The mortgagor purchased a property and gave a mortgage to the mortgagee which was personally guaranteed by the plaintiffs. The plaintiffs were the shareholders of the mortgagor at the time. The mortgage provided in part that if the chargor committed or permitted any act of waste on the land, all money secured by the charge would become due and payable at the option of the chargee. The guarantee provided in part that to the extent any payments were made by the guarantor, the guarantor would be subrogated as against the mortgagor to all the rights, privileges and powers to which the mortgagee was entitled prior to the guarantor's payment. An agreement was subsequently entered into which provided for the sale of the plaintiffs' shares to B, in trust for a company to be incorporated. D Inc. was subsequently incorporated to acquire the shares. L and M became the directors and officers of the mortgagor and B was a director and senior officer of D Inc. On the sale of the shares, the plaintiffs were not released from their personal guarantee of the mortgage, nor were the principals of D Inc. or the mortgagor asked for personal guarantees of the mortgage. The building on the property was subsequently demolished without the prior consent of the mortgagee or the plaintiffs. There was evidence that the market value of the property increased as a result of the demolition of the building. The mortgagor subsequently defaulted in its mortgage payments and the property was ultimately sold by power of sale. There had been a severe downturn in the real estate market between the time that the shares were purchased by D Inc. and the time that the property was sold. The plaintiffs paid the shortfall incurred by the mortgagee of over $129,000 pursuant to their guarantees. The mortgagee did not institute proceedings against the mortgagor. The mortgagor's charter was subsequently revoked and it was dissolved. As it had no assets other than the property, no assets were distributed to its shareholder on dissolution. The plaintiffs brought an action against the mortgagor, L, M, B, and D Inc. in contract for breach of the covenant against waste contained in the mortgage and in tort based upon the alleged commission of the tort of waste.

Held: The action was dismissed.

The demolition of the building constituted a breach of the provision in the mortgage and, accordingly, the mortgagee was entitled to bring an action against the mortgagor for damages it incurred as a result of the breach. Given that the plaintiffs paid the shortfall to the mortgagee pursuant to their guarantees, the plaintiffs were clearly subrogated to all causes of action which the mortgagee may have had as a result of the breach by the mortgagor of convenants contained in the mortgage. Accordingly, the mortgagor was liable in contract.

If the result of the act of waste was to impair the security of the mortgagee, the risk of loss to the

plaintiffs of such mortgage was a foreseeable risk and, accordingly, the plaintiffs would have a cause of action in tort against the mortgagor for the damages incurred as a result of being called on their guarantees. Accordingly, the mortgagor was liable in tort. With respect to the individual defendants, there was no evidence that L was acting in his own interest as opposed to the interest of the corporation, that he was acting outside the scope of his employment, or in a manner inconsistent with the objects or interests of the mortgagor. In addition, M was not directly involved in any of the activities related to the redevelopment of the property or the demolition of the building and was therefore even further removed from any potential personal liability. The action should therefore be dismissed against all the defendants other than the mortgagor.

Although the mortgagor was liable in contract and in tort, it was established that the damages incurred by the plaintiffs as a result of being called upon their guarantee resulted from the decline in the real estate market and the demolition of the building did not result in a decrease in the market value of the property or a decrease in the value of the security held by the mortgagee. Accordingly, no damages were payable by the mortgagor as a result of the breach of convenant in the mortgage or as a result of the commission of waste by the mortgagor by the demolition of the building.

Table of Authorities

Cases considered by *Ground, J.*:

Boultbee v. Gzowski (1896), 28 O.R. 285 (Ont. Div. Ct.) — considered

Crawford v. Bugg (1886), 12 O.R. 8 (Ont. H.C.) — considered

Defries v. Milne, [1913] 1 Ch. 98 (Eng. Ch. Div.) — considered

Jacques v. Sirbam Industries Ltd. (1979), 13 R.P.R. 39 (Ont. H.C.) — applied

Montreal Trust Co. of Canada v. ScotiaMcLeod Inc. (1995), 129 D.L.R. (4th) 711, 9 C.C.L.S. 97, 23 B.L.R. (2d) 165, 87 O.A.C. 129, *(*sub nom. *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.)* 26 O.R. (3d) 481 (Ont. C.A.) — applied

ACTION brought by plaintiffs against mortgagor and individual defendants for damages pursuant to breach of covenant against waste contained in mortgage and commission of tort of waste.

***Ground J.*:**

1 This action is brought by the plaintiffs David Hoare and Diane Hoare against the

defendants for damages in the amount of $129,212.25, being the amount the plaintiffs were required to pay as guarantors of a second mortgage (the "Mortgage") to Rayrus Investments Inc. ("Rayrus") secured against property municipally known as 1953 Queen Street East, Toronto (the "Property"), owned by the defendant mortgagor Dasl Holdings Ltd. ("Dasl"). The plaintiffs are the former shareholders of Dasl. The action is brought by the plaintiffs pursuant to their subrogation rights, having paid the shortfall on the Mortgage, in contract for breach of the covenant against waste contained in the Mortgage and in tort based upon the alleged commission of the tort of waste by the defendants.

Background

2 Dasl purchased the Property in 1987 for $300,000 and, in connection with such purchase, gave the Mortgage to Rayrus which was personally guaranteed by the plaintiffs. The Mortgage was increased in 1988 to $358,700. The plaintiffs carried on a real estate brokerage business in the building on the premises. The Property was listed for sale by Dasl in June, 1989, at a price of $849,000 and, after unsuccessful negotiations with two other prospective purchasers and a reduction of the list price to $799,000, an agreement was entered into dated August 25, 1989 (the "Share Purchase Agreement") for a sale of the shares of Dasl by the plaintiffs and their children's trusts to the defendant Bill Tsapralis, in trust for a company to be incorporated. The purchase price of $312,000 for the shares of Dasl provided for in the Share Purchase Agreement appears to have been based on the premise that, if the Property had been purchased directly, unencumbered, the purchase price for the property would have been $680,000. The defendant Dorian Capital Inc. ("Dorian") was the company incorporated by the Tsapralises to acquire the shares of Dasl. The defendants Leon Tsapralis and Mary Tsapralis became the directors and officers of Dasl and Bill Tsapralis was a director and senior officer of Dorian. The charter of Dasl has subsequently been cancelled and the corporation wound up. Surprisingly, on the sale of the shares of Dasl, the plaintiffs were not released from their personal guarantee of the Mortgage to Rayrus on the Property owned by Dasl, nor were the principals of Dorian or Dasl asked for personal guarantees of the Mortgage.

3 Mr. Norman Smith ("Smith") acted as representative for Rayrus and as solicitor for both the plaintiffs and Rayrus on the transaction and appears not to have discussed with the plaintiffs the question of the release of their guarantee or advised them to obtain independent legal advice.

4 It is clear from the evidence that both the plaintiffs and Smith were aware that the Tsapralises intended to demolish the building on the Property and proceed to redevelop the Property. Paragraph 10 of the Share Purchase Agreement in fact provides:

> Upon the execution of this Agreement the Vendors shall execute all documents deemed necessary by the Purchaser for the purposes of applying for a Demolition Permit, Building Permit, Committee of Adjustment Variance or consent.

The share purchase transaction closed on October 24, 1989 at the offices of Bill Tsapralis, who is a lawyer and represented the defendants in the transaction.

5 Subsequent to the closing, the plaintiffs moved their real estate office next door to 1951 Queen Street East and continued to carry on their business there until 1992. The Property remained vacant except for a short period of time during the Christmas season of 1989. The defendants began proceedings to apply to the City of Toronto for a demolition permit and a variance to permit increased density on the Property, retained an architect to prepare plans for a combined retail and commercial building on the Property, entered into negotiations with adjoining neighbours to provide for additional parking for the Property and to convey to the neighbours parcels of land at the rear of the Property, conducted soil tests on the Property and took other steps toward the redevelopment of the Property. The building on the Property was demolished in August of 1990 without Dasl having obtained the prior consent of either Rayrus, as mortgagee, or the plaintiffs, as guarantors of the Mortgage. When Mr. Smith was advised of the demolition by Mr. Hoare, he immediately contacted the defendants to advise them that the demolition was in contravention of the provisions of the Mortgage and negotiations ensued between Dasl and Rayrus with respect to alternative or additional security to Rayrus and with respect to Rayrus postponing its mortgage security to the proposed development agreement with the City of Toronto. Rayrus apparently felt that it required additional security in view of the demolition of the building on the Property and negotiations for additional security continued through to December 1990 but were never completed.

6 During the latter half of 1989, the defendants conducted soil tests on the Property and it was determined that the soil was sufficiently sandy that it would be necessary to insert pylons deep into the Property and to undertake a much more expensive type of foundation construction than was originally contemplated. Also, during this period, Dasl was encountering difficulties and delays in its applications to the City of Toronto and Rayrus refused to postpone its mortgage security to the proposed development agreement with the City of Toronto. In addition, Dasl was encountering difficulties in arranging the necessary financing for the redevelopment of the Property and the real estate market was deteriorating. In view of all these circumstances, Dasl determined to abandon its redevelopment plans and in effect walk away from the Property. The mortgage payment due in January 1991 was not paid and notices of sale under power of sale were issued by Rayrus on January 29, 1991 and February 19, 1991. The Property was listed for sale by Rayrus on the M.L.S. listing service at a list price of $550,000 which was subsequently reduced to $459,000 and the Property was sold to Teamrad Holdings Inc. on April 15, 1991 at a price of $410,000. The shortfall incurred by Rayrus, as first mortgagee and second mortgagee, on the sale of the Property was $129,212.25, which was paid by the plaintiffs pursuant to their guarantees. No proceedings were taken by Rayrus against Dasl.

Issues

7 The issues which arise in this action are as follows:

> 1. Do the plaintiffs have a cause of action in contract as against any of the defendants based upon breach of the terms of the mortgage?
>
> 2. Do the plaintiffs have an action in tort against any of the defendants based upon the tort of waste?
>
> 3. Were the damages incurred by the plaintiffs incurred as a result of the breach of the covenants contained in the mortgage or the tort of waste?
>
> 4. Can the directors and officers of Dasl or Dorian be held personally liable for the tort of waste committed by the corporation, or directly as participants in the tortious act?

Liability in Contract

8 The plaintiffs, having paid to Rayrus the shortfall on the sale of the Property under power of sale, pursuant to their guarantees, are, in my view, clearly subrogated to all cause of action which Rayrus may have had as a result of breach by Dasl of covenants contained in the mortgage. Clause 16 of the standard charge terms of the mortgage provide in part as follows:

> The Chargor will keep the land and the buildings, erections and improvements therein, in good condition and repair according to the nature and description thereof respectively.... If the Chargor shall neglect the buildings, erections and improvements in good condition and repair, or commits or permits any act of waste on the land (as to which the Chargee shall be the sole judge) ... all moneys secured by the Charge shall at the option of the Chargee forthwith become due and payable.

The demolition of the building on the Property constituted a breach of such provision and accordingly Rayrus was entitled to bring action against Dasl for damages which it incurred as a result of such breach and to proceed to sell the Property pursuant to its power of sale.

9 The Guarantor Clause contained in the Mortgage provides:

> IN CONSIDERATION of the Mortgagees advancing the sum of THREE HUNDRED AND FIFTY-EIGHT THOUSAND, SEVEN HUNDRED DOLLARS ($358,700.00) to the Mortgagor on the terms and conditions set out herein and pursuant to this Mortgage, We DIANE HOARE AND DAVID HOARE, do hereby absolutely and unconditionally guarantee to the Mortgagees the due and punctual payment by the Mortgagor of all principal moneys, interest and any other moneys which may now or hereafter become due and owing under the terms of the mortgage herein, and the Guarantors for themselves, their heirs, executors and administrators, covenant with the Mortgagees that if the Mortgagor

> shall at any time make default in the punctual payment of any moneys payable hereunder, they will pay all such moneys to the Mortgagees without any demand being required to be made.
>
> . . . . .
>
> AND payment by the Guarantors of any moneys under its said guarantee shall not in any event be taken to effect the liability of the Mortgagor for payment thereof, but such liability shall remain unimpaired and enforceable by the Guarantors against the Mortgagor and the Guarantors shall, to the extent of any such payments made by it in addition to all other remedies be subrogated as against the Mortgagor to all the rights, privileges and powers to which the Mortgagees was entitled prior to payment by such Guarantors.

The breach of the covenant against waste having been committed by Dasl and the plaintiffs having paid the shortfall on the Mortgage pursuant to their guarantees of payment, the plaintiffs are subrogated to Rayrus' cause of action in contract against Dasl for damages arising from such breach.

Liability in Tort

10 I accept the submission of counsel for the plaintiffs that the tort of waste exists independently of any contractual relationship between the parties. Accordingly, the plaintiffs may have a cause of action in tort based upon the tort of waste against any of the defendants who committed the tortious act. In *Crawford v. Bugg* (1886), 12 O.R. 8 (Ont. H.C.), Rose, J. affirming the decision of MacDougall, Co. J., stated at p. 14-15:

> *An action on the case for waste, it appears, will lie, notwithstanding an express covenant to repair: Kinlyside v. Thornton,* 2 Wm. Bl. 1111; *Marker v. Kenrick,* 12 C.B. 188, 198. But it is said that an action for waste can lie only for that which would be waste if there was not covenant; and that, therefore, proof of a mere breach of covenant, not amounting to waste, will not support the action: *Jones v. Hill,* 7 Taunt. 392: *Bullen* & *Leake's* Prec., 3rd ed. 423. [emphasis added]

11 Finally, in another leading English case on the tort of waste, *Defries v. Milne,* [1913] 1 Ch. 98 (Eng. Ch. Div.), Farwell, L.J. stated at page 108:

> The first is that these damages cannot be recovered at all except in tort ... I think it is clear that the action for waste, and the action on the case in the nature of waste, are both actions for tort, and there is no question of contract at all in waste, in respect of either cause of action. It is quite clear that the other Lords Justices in *Whitham v. Kershaw* (1) did not regard the action as one of contract at all; and it is plain from the judgments of Jervis C.J. and Maule J. in *Marker v. Kenrich* (2) that waste is not an action on covenant, whether express or implied.

12 ”Waste”, in the context of a mortgage, was defined by Carruthers, J. in *Jacques v. Sirbam Industries Ltd.* (1979), 13 R.P.R. 39 (Ont. H.C.) at pp 43 and 44 as “an act or omission by or on behalf of the mortgagor in possession which causes a lasting alteration to the nature of the lands and premises in question to the prejudice of the mortgagee” and in *Black’s Law Dictionary*, 6th ed. (St. Paul: West, 1990) as follows:

> Action or inaction by a possessor of land causing unreasonable injury to the holders of other estates in the same land. An abuse or destructive use of property by one in rightful possession. Spoil or destruction, done or permitted, to lands, houses, gardens, trees, or other corporeal hereditaments, by the tenant thereof, to the prejudice of the heir or of him in reversion or remainder.

13 I think it is beyond question that the demolition of the building on the Property constituted an act of waste and accordingly that Dasl is liable in tort, as well as in contract, for damages incurred as a result of such action. I am satisfied that, if the result of such act of waste was to impair the security of the mortgagee, the risk of loss to the guarantors of such mortgage is a foreseeable risk and, accordingly, that the plaintiffs would have a cause of action in tort against Dasl for the damages incurred by them as a result of being called on their guarantees by Rayrus and having made payment to Rayrus pursuant to their guarantees.

Liability of Dorian

14 I shall deal below with the question of the personal liability of directors and officers of Dasl for the tort of waste. I have great difficulty, however, understanding how there can be any liability on the part of Dorian in tort or otherwise. Dorian’s sole involvement in this matter was as purchaser of the shares of Dasl from the plaintiffs and there is no evidence that Dasl, as a corporate entity, was in any way involved in the redevelopment of the Property or the demolition of the building on the Property. It is conceded by counsel for the plaintiffs that Dorian is not liable in contract as not having been a party to the Mortgage or to any other contractual arrangement with Rayrus.

Implied Indemnity

15 Counsel for the plaintiffs has submitted that the transaction between the plaintiffs and Dasl must be looked at as, in essence, a purchase of real estate subject to a mortgage and that accordingly the case law which implies an obligation on the part of a purchaser of real estate to indemnify a vendor with respect to any charge against the property should be applied to the case at bar. I find this submission difficult to accept. All of the authorities referred to by counsel for the plaintiffs were situations of a purchase and sale of lands subject to a mortgage with the

exception of *Boultbee v. Gzowski* (1896), 28 O.R. 285 (Ont. Div. Ct.) which is a situation of a liability incurred after the purchaser became the owner of shares. In the case at bar, the transaction was clearly structured as a purchase of shares and the charges against the real estate owned by Dasl were clearly in contemplation of all parties and no provision was made for an indemnity with respect to such charges. In fact, the purchase price of the shares was based upon calculations which took into account the amount outstanding on the various mortgages against the Property. If any implied obligation to indemnify could be inferred, it could only be to indemnify with respect to charges against the property purchased, i.e. the shares of Dasl, and no such charges existed.

Liability of Individual Defendants

16 The defendants Leon Tsapralis and Mary Tsapralis were the directors and officers of Dasl and Leon Tsapralis appears to have been the sole operating officer of Dasl who took all proceedings and steps required in connection with the proposed redevelopment of the Property in his capacity as an officer of Dasl and signed all documents on behalf of Dasl. It appears to be the submission of counsel for the plaintiff that, as a result of such actions. Leon Tsapralis is a participant in the tort of waste and accordingly should be held personally liable to the plaintiffs for damages incurred by them as a result of the commission of such tort. I do not accept this submission. There is no evidence that Leon Tsapralis was acting in his own interest as opposed to the interest of the corporation, that he was acting outside the scope of his employment, or in a manner inconsistent with the objects of, or interests of, Dasl. In *Montreal Trust Co. of Canada v. ScotiaMcLeod Inc.* (1995), 26 O.R. (3d) 481 (Ont. C.A.). Finlayson, J.A. accurately summarized the situations where an individual director or officer may be held personally liable at pages 491-492.

> The decided cases in which employees and officers of companies have been found personally liable for actions ostensibly carried out under a corporate name are fact-specific. In the absence of findings of fraud, deceit, dishonesty or want of authority on the part of employees or officers, they are also rare. Those cases in which the corporate veil has been pierced usually involve transactions where the use of the corporate structure was a sham from the outset or was an afterthought to a deal which had gone sour. There is also a considerable body of case-law wherein injured parties to actions for breach of contract have attempted to extend liability to the principals of the company by pleading that the principals were privy to the tort of inducing breach of contract between the company and the plaintiff: see *Ontario Store Fixtures Inc. v. Mmmuffins Inc.* (1989), 70 O.R. (2d) 42 (H.C.J.), and the cases referred to therein. Additionally there have been attempts by injured parties to attach liability to the principals of failed businesses through insolvency litigation. In every case, however, the facts giving rise to personal liability were specifically pleaded. Absent allegations which fit within the categories described above, officers or employees of limited companies are protected from personal liability unless it can be shown that their

> actions are themselves tortious or exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own.

In my view, none of the circumstances outlined by Finlayson, J.A. pertains in the case at bar and I find no basis on which to hold Leon Tsapralis personally liable. Mary Tsapralis was not directly involved in any of the activities related to the redevelopment of the Property or the demolition of the building and appears to have been a passive director and officer of Dasl and accordingly is even further removed from any potential personal liability.

17 With respect to Bill Tsapralis, he was not an officer or director of Dasl and acted as chief executive officer of Dorian. Counsel for the plaintiffs has submitted that, although Bill Tsapralis was not an officer or director of Dasl, he was in fact the directing mind of Dasl and accordingly should be found liable in tort for the waste committed by Dasl. I find it somewhat difficult to accept the premise that one who is neither an officer nor a director of a corporation and holds no shares of the corporation can be found to be the directing mind of the corporation but, in any event, to find that the directing mind of a corporation may be held personally liable, the court would have to find that some of the circumstances outlined by Finlayson, J.A. in *Scotia McLeod*, *supra*, apply and, as indicated above, I find that none of such circumstances apply in this case.

18 Accordingly, I find that Dasl is liable in contract and in tort to the plaintiffs for damages incurred by them as a result of the demolition of the building on the Property but that none of the other defendants is liable to the plaintiffs and that the action should be dismissed as against all of the defendants other than Dasl. My understanding is that the charter of Dasl has been revoked and the company dissolved, that no steps were taken to revive Dasl and that Dasl had no assets other than the Property and accordingly no assets were distributed to its shareholder. Dorian, on dissolution.

Calculation of Damages

19 Although the point may be moot in view of my finding that the action should be dismissed against all of the defendants except Dasl and that Dasl appears to have no assets and has distributed no assets to its former shareholders. I should comment on the question of damages arising in this action. It is the submission of counsel for the plaintiffs that the damages incurred by the plaintiffs resulted from the demolition of the building on the Property. The evidence, in my view, falls far short of establishing that connection. The evidence of witnesses active in the real estate market was that there was a severe downturn in the real estate market between October 24, 1989 when the shares of Dasl were purchased by Dorian and April 15, 1991 when the Property was sold by Rayrus under power of sale. It is significant, in my view, that an offer was made by a neighbouring property owner for the Property in the amount of $600,000 on November 28, 1990 after the demolition had been completed and that the Property was sold under power of sale in April 1991 for $410,000, being a difference of $190,000, or

significantly more than the shortfall on the mortgages on the sale of the Property under power of sale. In addition, certain of the witnesses gave evidence that, in their view, the Property was worth more without the building as a property for potential redevelopment and that the highest and best use of the Property was to demolish the existing building and to redevelop with a larger combined commercial and retail building on the Property. In *Jacques v. Sirbam Industries Ltd.*, *supra*, Carruthers, J. concluded that, although the demolition of a building on the mortgaged property was technically an act of waste, it did not impair the mortgage security but rather improved it in that the property had increased in value as a result of the demolition. At page 44 Carruthers, J. stated, in referring to the demolition of the building on the mortgaged property:

> I find on all of the evidence that the acts of the defendant, although carried out in a somewhat less than desirable fashion, there being no direct notice being given to the plaintiffs, do not impair the security and render it insufficient but rather improve it. There is no evidence that the acts and conducts of the defendant have caused any permanent injury to the security of the plaintiffs so as to render it insufficient.

The words of Carruthers, J. are, in my view, equally appropriate to the case at bar. There is considerable evidence that the shortfall realized on the sale of the Property under power of sale was a direct result of the severe downturn in the real estate market and that the market value of the Property was not decreased but rather increased as a result of the demolition of the building. The evidence was clear that the Property was not viable as a rental property with the building on it and that, even for an owner-user who would carry on business on the Property and lease some part of the building on the Property to other tenants, the highest and best use for the Property was to demolish the existing building and redevelop the Property with a larger building with increased density, the approval for which had been obtained by the defendants in the course of proceeding with their redevelopment plans.

20 Accordingly, I must conclude, on the preponderance of evidence, that the damages incurred by the plaintiffs as a result of being called upon their guarantee did not result from the act of waste by Dasl in demolishing the building on the Property but rather resulted from the decline in the real estate market, that the demolition of the building on the Property did not result in a decrease in the market value of the Property or a decrease in the value of the security held by Rayrus, and that accordingly no damages are payable by Dasl to the plaintiffs as a result of the breach of covenant in the mortgage or as a result of the commission of waste by Dasl by the demolition of the building on the Property. Action dismissed.

Costs

21 Counsel may make brief written submissions to me as to the scale and quantum of costs of this action.

Action dismissed.

1999 CarswellOnt 84
Ontario Court of Appeal

Hoare v. Tsapralis

1999 CarswellOnt 84, 117 O.A.C. 396, 74 O.T.C. 80, 85 A.C.W.S. (3d) 441

David Hoare and Diane Hoare, Plaintiffs/Appellants v. Leon Tsapralis, Mary Tsapralis, Bill Tsapralis, Dorian Capital Inc. and Dasl Holdings Ltd., Defendants/Respondents

Austin, Charron, Moldaver JJ.A.

Heard: January 12, 1999
Judgment: January 18, 1999
Docket: CA C27506

Proceedings: affirming (1997), 10 R.P.R. (3d) 89 (Ont. Gen. Div.)

Counsel: *Robert L. Jenkins*, for the appellants.
Jerome Stanleigh, for the respondents.

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

Headnote

Guarantee and Indemnity --- Guarantee — Right of guarantor against principal debtor
Plaintiffs guaranteed mortgagor's mortgage — Plaintiffs sold their shares in mortgagor and building on property was subsequently demolished — Mortgagor defaulted in mortgage payments and plaintiffs paid mortgagee's shortfall under guarantees following sale of property — Plaintiffs were clearly subrogated to all causes of action that mortgagee had pursuant to breach of covenants by mortgagor — Mortgagor was liable to plaintiffs in contract but damages resulted from decline in real estate market and not demolition of building — Action was dismissed — Plaintiffs' appealed — Appeal dismissed.

Mortgages --- Action on the covenant — Enforcement of covenant — General
Plaintiffs guaranteed mortgagor's mortgage — Plaintiffs sold their shares in mortgagor and building on property was subsequently demolished — Mortgagor defaulted in mortgage payments and plaintiffs paid mortgagee's shortfall under guarantees following sale of property — Plaintiffs were clearly subrogated to all causes of action that mortgagee had pursuant to

breach of covenants by mortgagor — Mortgagor was liable to plaintiffs in contract but damages resulted from decline in real estate market and not demolition of building — Action was dismissed — Plaintiffs' appealed — Appeal dismissed.

Corporations --- Directors and officers — Liabilities — Negligence
Plaintiffs guaranteed mortgagor's mortgage — Plaintiffs sold their shares in mortgagor and building on property was subsequently demolished — Mortgagor defaulted in mortgage payments and plaintiffs paid mortgagee's shortfall under guarantees following sale of property — Mortgagor was liable to plaintiffs in tort pursuant to act of waste — No evidence that officer and director of mortgagor acted in his own interest or outside scope of his employment or in manner inconsistent with mortgagor's interests — Action was dismissed against individual defendants — Plaintitffs' damages resulted from decline in real estate market and not demolition of building and action was therefore dismissed — Plaintiffs' appealed — Appeal dismissed.

APPEAL by plaintiffs from decision reported at (1997) 10 R.P.R. (3d) 89 (Ont. Gen. Div.) dismissing their claim against mortgagor and individual defendants for damages pursuant to breach of covenant against waste contained in mortgage and commission of tort of waste.

Per Curiam:

1 In our view, the issue of damages is dispositive of this appeal. The trial judge found that the shortfall realized on the sale of the property was not caused by the act of waste, i.e. the demolition of the building, but by the severe downturn in the real estate market. He also held that the market value of the property was not decreased but increased by the demolition.

2 In our view, these findings are reasonably supported by the evidence. Consequently, there is no reason to interfere. Even accepting the appellants' argument that the differential in value may not be the only measure of damages in some cases, the appellants' interest in this property was economic only. It follows that the appellants have failed to prove damages and the action was rightly dismissed.

3 In light of this conclusion, we do not find it necessary to deal with the other issues raised on the appeal on the issue of liability. The appeal is dismissed with costs fixed at $2,500.00.

Appeal dismissed.

2019 ONCA 508
Ontario Court of Appeal

Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.

2019 CarswellOnt 9683, 2019 ONCA 508, 11 P.P.S.A.C. (4th) 11, 306 A.C.W.S. (3d) 235, 3 R.P.R. (6th) 175, 435 D.L.R. (4th) 416, 70 C.B.R. (6th) 181

Third Eye Capital Corporation (Applicant / Respondent) and Ressources Dianor Inc. /Dianor Resources Inc. (Respondent / Respondent) and 2350614 Ontario Inc. (Interested Party / Appellant)

S.E. Pepall, P. Lauwers, Grant Huscroft JJ.A.

Heard: September 17, 2018
Judgment: June 19, 2019
Docket: CA C62925

Proceedings: affirming *Third Eye Capital Corp. v. Dianor Resources Inc.* (2016), 41 C.B.R. (6th) 320, 2016 CarswellOnt 15947, 2016 ONSC 6086, Newbould J. (Ont. S.C.J. [Commercial List]); additional reasons at *Third Eye Capital Corp. v. Ressources Dianor Inc. / Dianor Resources Inc.* (2016), 2016 CarswellOnt 18827, 2016 ONSC 7112, 42 C.B.R. (6th) 269, Newbould J. (Ont. S.C.J. [Commercial List])

Counsel: Peter L. Roy, Sean Grayson, for Appellant, 2350614 Ontario Inc.
Shara Roy, Nilou Nezhat, for Respondent, Third Eye Capital Corporation
Stuart Brotman, Dylan Chochla, for Receiver of Respondent, Ressources Dianor Inc./Dianor Resources Inc., Richter Advisory Group Inc.
Nicholas Kluge, for Monitor of Essar Steel Algoma Inc., Ernst & Young Inc.
Steven J. Weisz, for Intervener, Insolvency Institute of Canada

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

Headnote

Natural resources --- Mines and minerals — Remedies — Vesting orders
At request of insolvent company's lender, TE, court appointed receiver over assets, undertaking and property, including mining claims — Certain claims were subject to Gross Overriding

Royalty (GOR) in favour of company from which appellant 235 had acquired royalty rights — Notices of agreements granting GORs were registered on title to surface and mining rights — Order approving bid process for sale of insolvent's mining claims generated two bids, both with condition that GORs be terminated or reduced — Motion judge approved sale to successful bidder TE and granted vesting order purporting to extinguish GORs — Motion judge rejected 235's argument that claims would continue to be subject to GORs after their transfer to TE holding that GORs did not run with land or grant holder of GORs interest in lands over which insolvent held mineral rights — Motion judge also held that ss. 11(2), 100, and 101 of Courts of Justice Act gave him "the jurisdiction to grant a vesting order of the assets to be sold to [TE] on such terms as are just", including authority to dispense with royalty rights — Expert's valuation of royalty rights was found to be fair and receiver paid this amount to 235, which was held in trust — 235 appealed and TE moved for order quashing appeal as moot since 235 did not seek stay of vesting order which operated to extinguish GORs when it was registered on title; however, it was premature to quash appeal — 235 served and filed notice of appeal of sale approval 29 days after motion judge's decision and 8 days after order was signed, issued and entered — Appeal dismissed — Third party interest in land in nature of GORs can be extinguished by vesting order granted in receivership proceeding; however, motion judge erred in concluding that it was appropriate to extinguish them from title given nature of GORs — It was held that GOR was interest in gross product extracted from land, not fixed monetary sum — While GOR, like fee simple interest, may be capable of being valued at point in time, this does not transform substance of interest into one that is concerned with fixed monetary sum rather than element of property itself — Interest represented by GOR was ownership in product of mining claim, either payable by share of physical product or share of revenues — Given nature of 235's interest and absence of any agreement that allowed for any competing priority, there was no need to resort to any further considerations — Motion judge erred in granting order extinguishing 235's GORs, although he had jurisdiction to do so.

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Miscellaneous
At request of insolvent company's lender, TE, court appointed receiver over assets, undertaking and property, including mining claims — Certain claims were subject to Gross Overriding Royalty (GOR) in favour of company from which appellant 235 had acquired royalty rights — Notices of agreements granting GORs were registered on title to surface and mining rights — Order approving bid process for sale of insolvent's mining claims generated two bids, both with condition that GORs be terminated or reduced — TE was successful — Motion judge approved sale to TE and granted vesting order purporting to extinguish GORs — Motion judge rejected 235's argument that claims would continue to be subject to GORs after their transfer to TE holding that GORs did not run with land or grant holder of GORs interest in lands over which insolvent held mineral rights — Motion judge also held that ss. 11(2), 100, and 101 of Courts of Justice Act gave him "the jurisdiction to grant a vesting order of the assets to be sold to [TE] on such terms as are just", including authority to dispense with royalty rights — Expert's valuation of royalty rights was found to be fair and receiver paid this amount to 235, which was held in trust — 235 was unsuccessful in its cross-motion claiming payment for debt owing under Repair

and Storage Liens Act — 235 appealed — In holding that royalty rights created no interest in law, vesting order was granted whereby receiver sold mining rights to third-party purchaser, free and clear of royalty rights — Vesting order was not stayed pending appeal and was executed — Appeal dismissed — Third party interest in land in nature of GORs can be extinguished by vesting order granted in receivership proceeding; however, motion judge erred in concluding that it was appropriate to extinguish them from title given nature of GORs — It was held that GOR was interest in gross product extracted from land, not fixed monetary sum — While GOR, like fee simple interest, may be capable of being valued at point in time, this does not transform substance of interest into one that is concerned with fixed monetary sum rather than element of property itself — Interest represented by GOR was ownership in product of mining claim, either payable by share of physical product or share of revenues — Given nature of 235's interest and absence of any agreement that allowed for any competing priority, there was no need to resort to any further considerations — Motion judge erred in granting order extinguishing 235's GORs, although he had jurisdiction to do so.

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — To Court of Appeal — Time for appeal

At request of insolvent company's lender, TE, court appointed receiver over assets, undertaking and property, including mining claims — Certain claims were subject to Gross Overriding Royalty (GOR) in favour of company from which appellant 235 had acquired royalty rights — Notices of agreements granting GORs were registered on title to surface and mining rights — Order approving bid process for sale of insolvent's mining claims generated two bids, both with condition that GORs be terminated or reduced — Motion judge approved sale to successful bidder TE and granted vesting order purporting to extinguish GORs — Motion judge rejected 235's argument that claims would continue to be subject to GORs after their transfer to TE holding that GORs did not run with land or grant holder of GORs interest in lands over which insolvent held mineral rights — Motion judge also held that ss. 11(2), 100, and 101 of the Courts of Justice Act gave him "the jurisdiction to grant a vesting order of the assets to be sold to [TE] on such terms as are just", including authority to dispense with royalty rights — Expert's valuation of royalty rights was found to be fair and receiver paid this amount to 235, which was held in trust — 235 appealed and TE moved for order quashing 235's appeal as moot since 235 did not seek stay of vesting order which operated to extinguish GORs when it was registered on title, but it was premature to quash appeal — 235 served and filed notice of appeal of sale approval 29 days after motion judge's decision and 8 days after order was signed, issued and entered — Appeal dismissed — Appeal period in Bankruptcy and Insolvency General Rules (BIGR) governed appeal — Under R. 31 of BIGR, notice of appeal must be filed "within 10 days after the day of the order or decision appealed from, or within such further time as a judge of the court of appeal stipulates" — 235 had known for considerable time there could be no sale to TE in absence of extinguishment of GORs and royalty rights; this was condition of sale that was approved by motion judge — 235 was stated to be unopposed to sale but opposed sale condition requiring extinguishment — Jurisdiction to grant approval of sale emanated from BIA and so did vesting component — It would have made little sense to split two elements of order

in circumstances — Essence of order was anchored in BIGR — Accordingly, appeal period was 10 days as prescribed by R. 31 of BIGR and ran from date of motion judge's decision, and 235's appeal was out of time.

Personal property security --- Statutory liens — Miscellaneous

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APPEAL by numbered company from judgment reported at *Third Eye Capital Corp. v. Dianor Resources Inc.* (2016), 2016 ONSC 6086, 2016 CarswellOnt 15947, 41 C.B.R. (6th) 320 (Ont. S.C.J. [Commercial List]), respecting whether third party interest in land in nature of Gross Overriding Royalty could be extinguished by vesting order granted in receivership proceeding and governance of appeal.

***S.E. Pepall J.A.*:**

Introduction

1 There are two issues that arise on this appeal. The first issue is simply stated: can a third party interest in land in the nature of a Gross Overriding Royalty ("GOR") be extinguished by a

vesting order granted in a receivership proceeding? The second issue is procedural. Does the appeal period in the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA") or the *Courts of Justice Act*, R.S.O. 1990, c. C. 43 ("CJA") govern the appeal from the order of the motion judge in this case?

2 These reasons relate to the second stage of the appeal from the decision of the motion judge. The first stage of the appeal was the subject matter of the first reasons released by this court: see *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*, 2018 ONCA 253, 141 O.R. (3d) 192 (Ont. C.A.) ("First Reasons"). As a number of questions remained unanswered, further submissions were required. These reasons resolve those questions.

Background

3 The facts underlying this appeal may be briefly outlined.

4 On August 20, 2015, the court appointed Richter Advisory Group Inc. ("the Receiver") as receiver of the assets, undertakings and properties of Dianor Resources Inc. ("Dianor"), an insolvent exploration company focused on the acquisition and exploitation of mining properties in Canada. The appointment was made pursuant to s. 243 of the BIA and s. 101 of the CJA, on the application of Dianor's secured lender, the respondent Third Eye Capital Corporation ("Third Eye") who was owed approximately $5.5 million.

5 Dianor's main asset was a group of mining claims located in Ontario and Quebec. Its flagship project is located near Wawa, Ontario. Dianor originally entered into agreements with 3814793 Ontario Inc. ("381 Co.") to acquire certain mining claims. 381 Co. was a company controlled by John Leadbetter, the original prospector on Dianor's properties, and his wife, Paulette A. Mousseau-Leadbetter. The agreements provided for the payment of GORs for diamonds and other metals and minerals in favour of the appellant 2350614 Ontario Inc. ("235 Co."), another company controlled by John Leadbetter.[1] The mining claims were also subject to royalty rights for all minerals in favour of Essar Steel Algoma Inc. ("Algoma"). Notices of the agreements granting the GORs and the royalty rights were registered on title to both the surface rights and the mining claims. The GORs would not generate any return to the GOR holder in the absence of development of a producing mine. Investments of at least $32 million to determine feasibility, among other things, are required before there is potential for a producing mine.

6 Dianor also obtained the surface rights to the property under an agreement with 381 Co. and Paulette A. Mousseau-Leadbetter. Payment was in part met by a vendor take-back mortgage in favour of 381 Co., Paulette A. Mousseau-Leadbetter, and 1584903 Ontario Ltd., another Leadbetter company. Subsequently, though not evident from the record that it was the mortgagee, 1778778 Ontario Inc. ("177 Co."), another Leadbetter company, demanded payment

under the mortgage and commenced power of sale proceedings. The notice of sale referred to the vendor take-back mortgage in favour of 381 Co., Paulette A. Mousseau-Leadbetter, and 1584903 Ontario Ltd. A transfer of the surface rights was then registered from 177 Co. to 235 Co. In the end result, in addition to the GORs, 235 Co. purports to also own the surface rights associated with the mining claims of Dianor.[2]

7 Dianor ceased operations in December 2012. The Receiver reported that Dianor's mining claims were not likely to generate any realization under a liquidation of the company's assets.

8 On October 7, 2015, the motion judge sitting on the Commercial List, and who was supervising the receivership, made an order approving a sales process for the sale of Dianor's mining claims. The process generated two bids, both of which contained a condition that the GORs be terminated or impaired. One of the bidders was Third Eye. On December 11, 2015, the Receiver accepted Third Eye's bid conditional on obtaining court approval.

9 The purchase price consisted of a $2 million credit bid, the assumption of certain liabilities, and $400,000 payable in cash, $250,000 of which was to be distributed to 235 Co. for its GORs and the remaining $150,000 to Algoma for its royalty rights. The agreement was conditional on extinguishment of the GORs and the royalty rights. It also provided that the closing was to occur within two days after the order approving the agreement and transaction and no later than August 31, 2016, provided the order was then not the subject of an appeal. The agreement also made time of the essence. Thus, the agreement contemplated a closing prior to the expiry of any appeal period, be it 10 days under the BIA or 30 days under the CJA. Of course, assuming leave to appeal was not required, a stay of proceedings could be obtained by simply serving a notice of appeal under the BIA (pursuant to s. 195 of the BIA) or by applying for a stay under r. 63.02 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194.

10 On August 9, 2016, the Receiver applied to the court for approval of the sale to Third Eye and, at the same time, sought a vesting order that purported to extinguish the GORs and Algoma's royalty rights as required by the agreement of purchase and sale. The agreement of purchase and sale, which included the proposed terms of the sale, and the draft sale approval and vesting order were included in the Receiver's motion record and served on all interested parties including 235 Co.

11 The motion judge heard the motion on September 27, 2016. 235 Co. did not oppose the sale but asked that the property that was to be vested in Third Eye be subject to its GORs. All other interested parties including Algoma supported the proposed sale approval and vesting order.

12 On October 5, 2016, the motion judge released his reasons. He held that the GORs did not amount to interests in land and that he had jurisdiction under the BIA and the CJA to order the property sold and on what terms: at para. 37. In any event, he saw "no reason in logic . . . why

the jurisdiction would not be the same whether the royalty rights were or were not an interest in land": at para. 40. He granted the sale approval and vesting order vesting the property in Third Eye and ordering that on payment of $250,000 and $150,000 to 235 Co. and Algoma respectively, their interests were extinguished. The figure of $250,000 was based on an expert valuation report and 235 Co.'s acknowledgement that this represented fair market value.[3]

13 Although it had in its possession the terms of the agreement of purchase and sale including the closing provision, upon receipt of the motion judge's decision on October 5, 2016, 235 Co. did nothing. It did not file a notice of appeal which under s. 195 of the BIA would have entitled it to an automatic stay. Nor did it advise the other parties that it was planning to appeal the decision or bring a motion for a stay of the sale approval and vesting order in the event that it was not relying on the BIA appeal provisions.

14 For its part, the Receiver immediately circulated a draft sale approval and vesting order for approval as to form and content to interested parties. A revised draft was circulated on October 19, 2016. The drafts contained only minor variations from the draft order included in the motion materials. In the absence of any response from 235 Co., the Receiver was required to seek an appointment to settle the order. However, on October 26, 2016, 235 Co. approved the order as to form and content, having made no changes. The sale approval and vesting order was issued and entered on that same day and then circulated.

15 On October 26, 2016, for the first time, 235 Co. advised counsel for the Receiver that "an appeal is under consideration" and asked the Receiver for a deferral of the cancellation of the registered interests. In two email exchanges, counsel for the Receiver responded that the transaction was scheduled to close that afternoon and 235 Co.'s counsel had already had ample time to get instructions regarding any appeal. Moreover, the Receiver stated that the appeal period "is what it is" but that the approval order was not stayed during the appeal period. Counsel for 235 Co. did not respond and took no further steps. The Receiver, on the demand of the purchaser Third Eye, closed the transaction later that same day in accordance with the terms of the agreement of purchase and sale. The mining claims of Dianor were assigned by Third Eye to 2540575 Ontario Inc. There is nothing in the record that discloses the relationship between Third Eye and the assignee. The Receiver was placed in funds by Third Eye, the sale approval and vesting order was registered on title and the GORs and the royalty interests were expunged from title. That same day, the Receiver advised 235 Co. and Algoma that the transaction had closed and requested directions regarding the $250,000 and $150,000 payments.

16 On November 3, 2016, 235 Co. served and filed a notice of appeal of the sale approval and vesting order. It did not seek any extension of time to appeal. 235 Co. filed its notice of appeal 29 days after the motion judge's October 5, 2016 decision and 8 days after the order was signed, issued and entered.

17 Algoma's Monitor in its *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36

("CCAA") proceedings received and disbursed the funds allocated to Algoma. The $250,000 allocated to 235 Co. are held in escrow by its law firm pending the resolution of this appeal.

Proceedings Before This Court

18 On appeal, this court disagreed with the motion judge's determination that the GORs did not amount to interests in land: see First Reasons, at para. 9. However, due to an inadequate record, a number of questions remained to be answered and further submissions and argument were requested on the following issues:

> (1) Whether and under what circumstances and limitations a Superior Court judge has jurisdiction to extinguish a third party's interest in land, using a vesting order, under s. 100 of the CJA and s. 243 of the BIA, where s. 65.13(7) of the BIA; s. 36(6) of the CCAA; ss. 66(1.1) and 84.1 of the BIA; or s. 11.3 of the CCAA do not apply;
>
> (2) If such jurisdiction does not exist, should this court order that the Land Title register be rectified to reflect 235 Co.'s ownership of the GORs or should some other remedy be granted; and
>
> (3) What was the applicable time within which 235 Co. was required to appeal and/or seek a stay and did 235 Co.'s communication that it was considering an appeal affect the rights of the parties.

19 The Insolvency Institute of Canada was granted intervener status. It describes itself as a non-profit, non-partisan and non-political organization comprised of Canada's leading insolvency and restructuring professionals.

A. Jurisdiction to Extinguish an Interest in Land Using a Vesting Order

(1) Positions of Parties

20 The appellant 235 Co. initially took the position that no authority exists under s. 100 of the CJA, s. 243 of BIA, or the court's inherent jurisdiction to extinguish a real property interest that does not belong to the company in receivership. However, in oral argument, counsel conceded that the court did have jurisdiction under s. 100 of the CJA but the motion judge exercised that jurisdiction incorrectly. 235 Co. adopted the approach used by Wilton-Siegel J. in *Romspen Investment Corp. v. Woods Property Development Inc.*, 2011 ONSC 3648, 75 C.B.R. (5th) 109 (Ont. S.C.J.), at para. 190, rev'd on other grounds, 2011 ONCA 817, 286 O.A.C. 189 (Ont. C.A.). It took the position that if the real property interest is worthless, contingent, or incomplete, the court has jurisdiction to extinguish the interest. However here, 235 Co. held

complete and non-contingent title to the GORs and its interest had value.

21 In response, the respondent Third Eye states that a broad purposive interpretation of s. 243 of the BIA and s. 100 of the CJA allows for extinguishment of the GORs. Third Eye also relies on the court's inherent jurisdiction in support of its position. It submits that without a broad and purposive approach, the statutory insolvency provisions are unworkable. In addition, the *Conveyancing and Law of Property Act*, R.S.O. 1990, c. C. 34 ("CLPA") provides a mechanism for rights associated with an encumbrance to be channelled to a payment made into court. Lastly, Third Eye submits that if the court accedes to the position of 235 Co., Dianor's asset and 235 Co.'s GORs will waste. In support of this argument, Third Eye notes there were only two bids for Dianor's mining claims, both of which required the GORs to be significantly reduced or eliminated entirely. For its part, Third Eye states that "there is no deal with the GORs on title" as its bid was contingent on the GORs being vested off.

22 The respondent Receiver supports the position taken by Third Eye that the motion judge had jurisdiction to grant the order vesting off the GORs and that he appropriately exercised that jurisdiction in granting the order under s. 243 of the BIA and, in the alternative, the court's inherent jurisdiction.

23 The respondent Algoma supports the position advanced by Third Eye and the Receiver. Both it and 235 Co. have been paid and the Monitor has disbursed the funds paid to Algoma. The transaction cannot now be unwound.

24 The intervener, the Insolvency Institute of Canada, submits that a principled approach to vesting out property in insolvency proceedings is critical for a properly functioning restructuring regime. It submits that the court has inherent and equitable jurisdiction to extinguish third party proprietary interests, including interests in land, by utilizing a vesting order as a gap-filling measure where the applicable statutory instrument is silent or may not have dealt with the matter exhaustively. The discretion is a narrow but necessary power to prevent undesirable outcomes and to provide added certainty in insolvency proceedings.

(2) Analysis

(a) Significance of Vesting Orders

25 To appreciate the significance of vesting orders, it is useful to describe their effect. A vesting order "effects the transfer of purchased assets to a purchaser on a *free and clear* basis, while preserving the relative priority of competing claims against the debtor vendor with respect to the proceeds generated by the sale transaction" (emphasis in original): David Bish & Lee Cassey, "Vesting Orders Part 1: The Origins and Development" (2015) 32:4 Nat'l. Insolv. Rev. 41, at p. 42 ("Vesting Orders Part 1"). The order acts as a conveyance of title and also serves to

extinguish encumbrances on title.

26 A review of relevant literature on the subject reflects the pervasiveness of vesting orders in the insolvency arena. Luc Morin and Nicholas Mancini describe the common use of vesting orders in insolvency practice in "Nothing Personal: the *Bloom Lake* Decision and the Growing Outreach of Vesting Orders Against *in personam* Rights" in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2017* (Toronto: Thomson Reuters, 2018) 905, at p. 938:

> Vesting orders are now commonly being used to transfer entire businesses. Savvy insolvency practitioners have identified this path as being less troublesome and more efficient than having to go through a formal plan of arrangement or *BIA* proposal.

27 The significance of vesting orders in modern insolvency practice is also discussed by Bish and Cassey in "Vesting Orders Part 1", at pp. 41-42:

> Over the past decade, a paradigm shift has occurred in Canadian corporate insolvency practice: there has been a fundamental transition in large cases from a dominant model in which a company restructures its business, operations, and liabilities through a plan of arrangement approved by each creditor class, to one in which a company instead conducts a sale of all or substantially all of its assets on a going concern basis outside of a plan of arrangement . . .
>
> Unquestionably, this profound transformation would not have been possible without the *vesting order*. It is the cornerstone of the modern "restructuring" age of corporate asset sales and secured creditor realizations . . . The vesting order is the holy grail sought by every purchaser; it is the carrot dangled by debtors, court officers, and secured creditors alike in pursuing and negotiating sale transactions. If Canadian courts elected to stop granting vesting orders, the effect on the insolvency practice would be immediate and extraordinary. Simply put, the system could not function in its present state without vesting orders. [Emphasis in original.]

28 The authors emphasize that a considerable portion of Canadian insolvency practice rests firmly on the granting of vesting orders: see David Bish & Lee Cassey, "Vesting Orders Part 2: The Scope of Vesting Orders" (2015) 32:5 Nat'l Insolv. Rev. 53, at p. 56 ("Vesting Orders Part 2"). They write that the statement describing the unique nature of vesting orders reproduced from Houlden, Morawetz and Sarra (and cited at para. 109 of the reasons in stage one of this appeal)[4] which relied on 1985 and 2003 decisions from Saskatchewan is remarkable and bears little semblance to the current practice. The authors do not challenge or criticize the use of vesting orders. They make an observation with which I agree, at p. 65, that: "a more transparent and conscientious application of the formative equitable principles and considerations relating to vesting orders will assist in establishing a proper balancing of interests and a framework

understood by all participants."

(b) Potential Roots of Jurisdiction

29 In analysing the issue of whether there is jurisdiction to extinguish 235 Co.'s GORs, I will first address the possible roots of jurisdiction to grant vesting orders and then I will examine how the legal framework applies to the factual scenario engaged by this appeal.

30 As mentioned, in oral submissions, the appellant conceded that the motion judge had jurisdiction; his error was in exercising that jurisdiction by extinguishing a property interest that belonged to 235 Co. Of course, a party cannot confer jurisdiction on a court on consent or otherwise, and I do not draw on that concession. However, as the submissions of the parties suggest, there are various potential sources of jurisdiction to vest out the GORs: s. 100 of the CJA, s. 243 of the BIA, s. 21 of the CLPA, and the court's inherent jurisdiction. I will address the first three potential roots for jurisdiction. As I will explain, it is unnecessary to resort to reliance on inherent jurisdiction.

(c) The Hierarchical Approach to Jurisdiction in the Insolvency Context

31 Before turning to an analysis of the potential roots of jurisdiction, it is important to consider the principles which guide a court's determination of questions of jurisdiction in the insolvency context. In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.), at para. 65, Deschamps J. adopted the hierarchical approach to addressing the court's jurisdiction in insolvency matters that was espoused by Justice Georgina R. Jackson and Professor Janis Sarra in their article "Selecting the Judicial Tool to Get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters"' in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2007* (Toronto: Thomson Carswell, 2008) 41. The authors suggest that in addressing under-inclusive or skeletal legislation, first one "should engage in statutory interpretation to determine the limits of authority, adopting a broad, liberal and purposive interpretation that may reveal that authority": at p. 42. Only then should one turn to inherent jurisdiction to fill a possible gap. "By determining first whether the legislation can bear a broad and liberal interpretation, judges may avoid the difficulties associated with the exercise of inherent jurisdiction": at p. 44. The authors conclude at p. 94:

> On the authors' reading of the commercial jurisprudence, the problem most often for the court to resolve is that the legislation in question is under-inclusive. It is not ambiguous. It simply does not address the application that is before the court, or in some cases, grants the court the authority to make any order it thinks fit. While there can be no magic formula to address this recurring situation, and indeed no one answer, it appears to the authors that

> practitioners have available a number of tools to accomplish the same end. In determining the right tool, it may be best to consider the judicial task as if in a hierarchy of judicial tools that may be deployed. The first is examination of the statute, commencing with consideration of the precise wording, the legislative history, the object and purposes of the Act, perhaps a consideration of Driedger's principle of reading the words of the Act in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament, and a consideration of the gap-filling power, where applicable. It may very well be that this exercise will reveal that a broad interpretation of the legislation confers the authority on the court to grant the application before it. Only after exhausting this statutory interpretative function should the court consider whether it is appropriate to assert an inherent jurisdiction. Hence, inherent jurisdiction continues to be a valuable tool, but not one that is necessary to utilize in most circumstances.

32 Elmer A. Driedger's now famous formulation is that the words of an Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament: *The Construction of Statutes* (Toronto: Butterworth's, 1974), at p. 67. See also *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.), at para. 21; *Montreal (Ville) v. 2952-1366 Québec inc.*, 2005 SCC 62, [2005] 3 S.C.R. 141 (S.C.C.), at para. 9. This approach recognizes that "statutory interpretation cannot be founded on the wording of the legislation alone": *Rizzo*, at para. 21.

(d) Section 100 of the CJA

33 This brings me to the CJA. In Ontario, the power to grant a vesting order is conferred by s. 100 of the CJA which states that:

> A court may by order vest in any person an interest in real or personal property that the court has authority to order be disposed of, encumbered or conveyed.

34 The roots of s. 100 and vesting orders more generally, can be traced to the courts of equity. Vesting orders originated as a means to enforce an order of the Court of Chancery which was a court of equity. In 1857, *An Act for further increasing the efficiency and simplifying the proceedings of the Court of Chancery*, c. 1857, c. 56, s. VIII was enacted. It provided that where the court had power to order the execution of a deed or conveyance of a property, it now also had the power to make a vesting order for such property.[5] In other words, it is a power to vest property from one party to another in order to implement the order of the court. As explained by this court in *Chippewas of Sarnia Band v. Canada (Attorney General)* (2000), 51 O.R. (3d) 641 (Ont. C.A.), at para. 281, leave to appeal refused, [2001] S.C.C.A. No. 63 (S.C.C.), the court's statutory power to make a vesting order supplemented its contempt power by allowing the court

to effect a change of title in circumstances where the parties had been directed to deal with property in a certain manner but had failed to do so. Vesting orders are equitable in origin and discretionary in nature: *Chippewas*, at para. 281.

35 Blair J.A. elaborated on the nature of vesting orders in *Regal Constellation Hotel Ltd., Re* (2004), 71 O.R. (3d) 355 (Ont. C.A.), at para. 33:

> A vesting order, then, had a dual character. It is on the one hand a court order ("allowing the court to effect the change of title directly"), and on the other hand a conveyance of title (vesting "an interest in real or personal property" in the party entitled thereto under the order).

36 Frequently vesting orders would arise in the context of real property, family law and wills and estates. *Trick v. Trick* (2006), 81 O.R. (3d) 241 (Ont. C.A.), leave to appeal refused, (2007), [2006] S.C.C.A. No. 388 (S.C.C.), involved a family law dispute over the enforcement of support orders made under the *Divorce Act*, R.S.C. 1985, c. 3 (2nd Supp.). The motion judge in *Trick* had vested 100 per cent of the appellant's private pension in the respondent in order to enforce a support order. In granting the vesting order, the motion judge relied in part on s. 100 of the CJA. On appeal, the appellant argued that the vesting order contravened s. 66(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P. 8 which permitted execution against a pension benefit to enforce a support order only up to a maximum of 50 per cent of the benefit. This court allowed the appeal and held that a vesting order under s. 100 of the CJA could not be granted where to do so would contravene a specific provision of the *Pension Benefits Act*: at para. 16. Lang J.A. stated at para. 16 that even if a vesting order was available in equity, that relief should be refused where it would conflict with the specific provisions of the *Pension Benefits Act*. In *obiter*, she observed that s. 100 of the CJA "does not provide a free standing right to property simply because the court considers that result equitable": at para. 19.

37 The motion judge in the case under appeal rejected the applicability of *Trick* stating, at para. 37:

> That case [*Trick*] i[s] not the same as this case. In that case, there was no right to order the CPP and OAS benefits to be paid to the wife. In this case, the BIA and the *Courts of Justice Act* give the Court that jurisdiction to order the property to be sold and on what terms. Under the receivership in this case, Third Eye is entitled to be the purchaser of the assets pursuant to the bid process authorized by the Court.

38 It is unclear whether the motion judge was concluding that either statute provided jurisdiction or that together they did so.

39 Based on the *obiter* in *Trick*, absent an independent basis for jurisdiction, the CJA could

not be the sole basis on which to grant a vesting order. There had to be some other root for jurisdiction in addition to or in place of the CJA.

40 In their article "Vesting Orders Part 1", Bish and Cassey write at p. 49:

> Section 100 of the CJA is silent as to any transfer being on a *free and clear* basis. There appears to be very little written on this subject, but, presumably, the power would flow from the court being a court of equity and from the very practical notion that it, pursuant to its equitable powers, can issue a vesting order transferring assets and should, correspondingly, have the power to set the terms of such transfer so long as such terms accord with the principles of equity. [Emphasis in original.]

41 This would suggest that provided there is a basis on which to grant an order vesting property in a purchaser, there is a power to vest out interests on a free and clear basis so long as the terms of the order are appropriate and accord with the principles of equity.

42 This leads me to consider whether jurisdiction exists under s. 243 of the BIA both to sell assets and to set the terms of the sale including the granting of a vesting order.

(e) Section 243 of the BIA

43 The BIA is remedial legislation and should be given a liberal interpretation to facilitate its objectives: *Ford Credit Canada Ltd. v. Welcome Ford Sales Ltd.*, 2011 ABCA 158, 505 A.R. 146 (Alta. C.A.), at para. 43; *Nautical Data International Inc., Re*, 2005 NLTD 104, 249 Nfld. & P.E.I.R. 247 (N.L. T.D.), at para. 9; *Bell, Re*, 2013 ONSC 2682 (Ont. S.C.J.), at para. 125; and *Scenna v. Gurizzan* (1999), 11 C.B.R. (4th) 293 (Ont. S.C.J.), at para. 4. Within this context, and in order to understand the scope of s. 243, it is helpful to review the wording, purpose, and history of the provision.

The Wording and Purpose of s. 243

44 Section 243 was enacted in 2005 and came into force in 2009. It authorizes the court to appoint a receiver where it is "just or convenient" to do so. As explained by the Supreme Court in *Saskatchewan (Attorney General) v. Lemare Lake Logging Ltd.*, 2015 SCC 53, [2015] 3 S.C.R. 419 (S.C.C.), prior to 2009, receivership proceedings involving assets in more than one province were complicated by the simultaneous proceedings that were required in different jurisdictions. There had been no legislative provision authorizing the appointment of a receiver with authority to act nationally. Rather, receivers were appointed under provincial statutes, such as the CJA, which resulted in a requirement to obtain separate appointments in each province or territory where the debtor had assets. "Because of the inefficiency resulting from this

multiplicity of proceedings, the federal government amended its bankruptcy legislation to permit their consolidation through the appointment of a national receiver": *Lemare Lake Logging*, at para. 1. Section 243 was the outcome.

45 Under s. 243, the court may appoint a receiver to, amongst other things, take any other action that the court considers advisable. Specifically, s. 243(1) states:

> 243(1). Subject to subsection (1.1), on application by a secured creditor, a court may appoint a receiver to do any or all of the following if it considers it to be just or convenient to do so:
>
> (a) take possession of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt;
>
> (b) exercise any control that the court considers advisable over that property and over the insolvent person's or bankrupt's business; or,
>
> (c) take any other action that the court considers advisable.

46 "Receiver" is defined very broadly in s. 243(2), the relevant portion of which states:

> 243(2) [I]n this Part, ***receiver*** means a person who
>
> (a) is appointed under subsection (1); or
>
> (b) is appointed to take or takes possession or control — of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt — under
>
> (i) an agreement under which property becomes subject to a security (in this Part referred to as a "security agreement"), or
>
> (ii) a court order made under another Act of Parliament, or an Act of a legislature of a province, that provides for or authorizes the appointment of a receiver or a receiver — manager. [Emphasis in original.]

47 *Lemare Lake Logging* involved a constitutional challenge to Saskatchewan's farm security legislation. The Supreme Court concluded, at para. 68, that s. 243 had a simple and narrow purpose: the establishment of a regime allowing for the appointment of a national

receiver and the avoidance of a multiplicity of proceedings and resulting inefficiencies. It was not meant to circumvent requirements of provincial laws such as the 150 day notice of intention to enforce requirement found in the Saskatchewan legislation in issue.

The History of s. 243

48 The origins of s. 243 can be traced back to s. 47 of the BIA which was enacted in 1992. Before 1992, typically in Ontario, receivers were appointed privately or under s. 101 of the CJA and s. 243 was not in existence.

49 In 1992, s. 47(1) of the BIA provided for the appointment of an interim receiver when the court was satisfied that a secured creditor had or was about to send a notice of intention to enforce security pursuant to s. 244(1). Section 47(2) provided that the court appointing the interim receiver could direct the interim receiver to do any or all of the following:

> 47(2) The court may direct an interim receiver appointed under subsection (1) to do any or all of the following:
>
> (a) take possession of all or part of the debtor's property mentioned in the appointment;
>
> (b) exercise such control over that property, and over the debtor's business, as the court considers advisable; and
>
> (c) take such other action as the court considers advisable.

50 The language of this subsection is similar to that now found in s. 243(1).

51 Following the enactment of s. 47(2), the courts granted interim receivers broad powers, and it became common to authorize an interim receiver to both operate and manage the debtor's business, and market and sell the debtor's property: Frank Bennett, *Bennett on Bankruptcy*, 21st ed. (Toronto: LexisNexis, 2019), at p. 205; Roderick J. Wood, *Bankruptcy and Insolvency Law*, 2nd ed. (Toronto: Irwin Law, 2015), at pp. 505-506.

52 Such powers were endorsed by judicial interpretation of s. 47(2). Notably, in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 114 D.L.R. (4th) 176 (Ont. Gen. Div. [Commercial List]), Farley J. considered whether the language in s. 47(2)(c) that provided that the court could "direct an interim receiver . . . to . . . take such other action as the court considers advisable", permitted the court to call for claims against a mining asset in the Yukon and bar claims not filed by a specific date. He determined that it did. He wrote, at p. 185:

> It would appear to me that Parliament did not take away any inherent jurisdiction from the Court but in fact provided, with these general words, that the Court could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands." It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organized and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability.

See also *Loewen Group Inc., Re* (2001), 22 B.L.R. (3d) 134 (Ont. S.C.J. [Commercial List])[6].

53 Although Farley J. spoke of inherent jurisdiction, given that his focus was on providing meaning to the broad language of the provision in the context of Parliament's objective to regulate insolvency matters, this might be more appropriately characterized as statutory jurisdiction under Jackson and Sarra's hierarchy. Farley J. concluded that the broad language employed by Parliament in s. 47(2)(c) provided the court with the ability to direct an interim receiver to do not only what "justice dictates" but also what "practicality demands".

54 In the intervening period between the 1992 amendments which introduced s. 47, and the 2009 amendments which introduced s. 243, the BIA receivership regime was considered by the Standing Senate Committee on Banking, Trade and Commerce ("Senate Committee"). One of the problems identified by the Senate Committee, and summarized in *Lemare Lake Logging*, at para. 56, was that "in many jurisdictions, courts had extended the power of interim receivers to such an extent that they closely resembled those of court-appointed receivers." This was a deviation from the original intention that interim receivers serve as "temporary watchdogs" meant to "protect and preserve" the debtor's estate and the interests of the secured creditor during the 10 day period during which the secured creditor was prevented from enforcing its security: *Big Sky Living Inc., Re*, 2002 ABQB 659, 318 A.R. 165 (Alta. Q.B.), at paras. 7-8; Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa: Senate of Canada, 2003), at pp. 144-145 ("Senate Committee Report").[7]

55 Parliament amended s. 47(2) through the *Insolvency Reform Act* 2005 and the *Insolvency Reform Act* 2007 which came into force on September 18, 2009.[8] The amendment both modified the scope and powers of interim receivers, and introduced a receivership regime that was national in scope under s. 243.

56 Parliament limited the powers conferred on interim receivers by removing the jurisdiction under s. 47(2)(c) authorizing an interim receiver to "take such other action as the court considers advisable". At the same time, Parliament introduced s. 243. Notably Parliament adopted substantially the same broad language removed from the old s. 47(2)(c) and placed it into s. 243. To repeat,

> 243(1). On application by a secured creditor, a court may appoint a receiver to do any or all of the following if it considers it to be just or convenient to do so:
>
> (a) take possession of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt;
>
> (b) exercise any control that the court considers advisable over that property and over the insolvent person's or bankrupt's business; or,
>
> (c) take any other action that the court considers advisable. [Emphasis added.]

57 When Parliament enacted s. 243, it was evident that courts had interpreted the wording "take such other action that the court considers advisable" in s. 47(2)(c) as permitting the court to do what "justice dictates" and "practicality demands". As the Supreme Court observed in *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140 (S.C.C.): "It is a well-established principle that the legislature is presumed to have a mastery of existing law, both common law and statute law". Thus, Parliament's deliberate choice to import the wording from s. 47(2)(c) into s. 243(1)(c) must be considered in interpreting the scope of jurisdiction under s. 243(1) of the BIA.

58 Professor Wood in his text, at p. 510, suggests that in importing this language, Parliament's intention was that the wide-ranging orders formerly made in relation to interim receivers would be available to s. 243 receivers:

> The court may give the receiver the power to take possession of the debtor's property, exercise control over the debtor's business, and take any other action that the court thinks advisable. This gives the court the ability to make the same wide-ranging orders that it formerly made in respect of interim receivers, including the power to sell the debtor's property out of the ordinary course of business by way of a going-concern sale or a break-up sale of the assets. [Emphasis added.]

59 However, the language in s. 243(1) should also be compared with the language used by Parliament in s. 65.13(7) of the BIA and s. 36 of the CCAA. Both of these provisions were enacted as part of the same 2009 amendments that established s. 243.

60 In s. 65.13(7), the BIA contemplates the sale of assets during a proposal proceeding. This provision expressly provides authority to the court to: (i) authorize a sale or disposition (ii) free and clear of any security, charge or other restriction, and (iii) if it does, order the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

61 The language of s. 36(6) of the CCAA which deals with the sale or disposition of assets of a company under the protection of the CCAA is identical to that of s. 65.13(7) of the BIA.

62 Section 243 of the BIA does not contain such express language. Rather, as mentioned, s. 243(1)(c) simply uses the language "take any other action that the court considers advisable".

63 This squarely presents the problem identified by Jackson and Sarra: the provision is not ambiguous. It simply does not address the issue of whether the court can issue a vesting order under s. 243 of the BIA. Rather, s. 243 uses broad language that grants the court the authority to authorize any action it considers advisable. The question then becomes whether this broad wording, when interpreted in light of the legislative history and statutory purpose, confers jurisdiction to grant sale and vesting orders in the insolvency context. In answering this question, it is important to consider whether the omission from s. 243 of the language found in 65.13(7) of the BIA and s. 36(6) of the CCAA impacts the interpretation of s. 243. To assist in this analysis, recourse may be had to principles of statutory interpretation.

64 In some circumstances, an intention to exclude certain powers in a legislative provision may be implied from the express inclusion of those powers in another provision. The doctrine of implied exclusion (*expressio unius est exclusio alterius*) is discussed by Ruth Sullivan in her leading text *Statutory Interpretation*, 3rd ed. (Toronto: Irwin Law, 2016), at p. 154:

> An intention to exclude may legitimately be implied whenever a thing is not mentioned in a context where, if it were meant to be included, one would have expected it to be expressly mentioned. Given an expectation of express mention, the silence of the legislature becomes meaningful. An expectation of express reference legitimately arises whenever a pattern or practice of express reference is discernible. Since such patterns and practices are common in legislation, reliance on implied exclusion reasoning is also common.

65 However, Sullivan notes that the doctrine of implied exclusion "[l]ike the other presumptions relied on in textual analysis . . . is merely a presumption and can be rebutted." The Supreme Court has acknowledged that when considering the doctrine of implied exclusion, the provisions must be read in light of their context, legislative histories and objects: see *Marche v. Halifax Insurance Co.*, 2005 SCC 6, [2005] 1 S.C.R. 47 (S.C.C.), at para. 19, *per* McLachlin C.J.; *Copthorne Holdings Ltd. v. R.*, 2011 SCC 63, [2011] 3 S.C.R. 721 (S.C.C.), at paras. 110-111.

66 The Supreme Court noted in *Turgeon v. Dominion Bank* (1929), [1930] S.C.R. 67 (S.C.C.), at pp. 70-71, that the maxim *expressio unius est exclusio alterius* "no doubt . . . has its uses when it aids to discover intention; but, as has been said, while it is often a valuable servant, it is a dangerous master to follow. Much depends upon the context." In this vein, Rothstein J.

stated in *Copthorne*, at paras. 110-111:

> I do not rule out the possibility that in some cases the underlying rationale of a provision would be no broader than the text itself. Provisions that may be so construed, having regard to their context and purpose, may support the argument that the text is conclusive because the text is consistent with and fully explains its underlying rationale.
>
> However, the implied exclusion argument is misplaced where it relies exclusively on the text of the . . . provisions without regard to their underlying rationale.

67 Thus, in determining whether the doctrine of implied exclusion may assist, a consideration of the context and purpose of s. 65.13 of the BIA and s. 36 of the CCAA is relevant. Section 65.13 of the BIA and s. 36 of the CCAA do not relate to receiverships but to restructurings and reorganizations.

68 In its review of the two statutes, the Senate Committee concluded that, in certain circumstances involving restructuring proceedings, stakeholders could benefit from an insolvent company selling all or part of its assets, but felt that, in approving such sales, courts should be provided with legislative guidance "regarding minimum requirements to be met during the sale process": Senate Committee Report, pp. 146-148.

69 Commentators have noted that the purpose of the amendments was to provide "the debtor with greater flexibility in dealing with its property while limiting the possibility of abuse": Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *The 2018-2019 Annotated Bankruptcy and Insolvency Act* (Toronto: Thomson Reuters, 2018), at p. 294.

70 These amendments and their purpose must be read in the context of insolvency practice at the time they were enacted. The nature of restructurings under the CCAA has evolved considerably over time. Now liquidating CCAAs, as they are described, which involve sales rather than a restructuring, are commonplace. The need for greater codification and guidance on the sale of assets outside of the ordinary course of business in restructuring proceedings is highlighted by Professor Wood's discussion of the objective of restructuring law. He notes that while at one time, the objective was relatively uncontested, it has become more complicated as restructurings are increasingly employed as a mechanism for selling the business as a going concern: Wood, at p. 337.

71 In contrast, as I will discuss further, typically the nub of a receiver's responsibility is the liquidation of the assets of the insolvent debtor. There is much less debate about the objectives of a receivership, and thus less of an impetus for legislative guidance or codification. In this respect, the purpose and context of the sales provisions in s. 65.13 of the BIA and s. 36 of the CCAA are distinct from those of s. 243 of the BIA. Due to the evolving use of the restructuring powers of the court, the former demanded clarity and codification, whereas the law governing

sales in the context of receiverships was well established. Accordingly, rather than providing a detailed code governing sales, Parliament utilized broad wording to describe both a receiver and a receiver's powers under s. 243. In light of this distinct context and legislative purpose, I do not find that the absence of the express language found in s. 65.13 of the BIA and s. 36 of the CCAA from s. 243 forecloses the possibility that the broad wording in s. 243 confers jurisdiction to grant vesting orders.

Section 243 — Jurisdiction to Grant a Sales Approval and Vesting Order

72 This brings me to an analysis of the broad language of s. 243 in light of its distinct legislative history, objective and purposes. As I have discussed, s. 243 was enacted by Parliament to establish a receivership regime that eliminated a patchwork of provincial proceedings. In enacting this provision, Parliament imported into s. 243(1)(c) the broad wording from the former s. 47(2)(c) which courts had interpreted as conferring jurisdiction to direct an interim receiver to do not only what "justice dictates" but also what "practicality demands". Thus, in interpreting s. 243, it is important to elaborate on the purpose of receiverships generally.

73 The purpose of a receivership is to "enhance and facilitate the preservation and realization of the assets for the benefit of creditors": *Hamilton Wentworth Credit Union Ltd. (Liquidator of) v. Courtcliffe Parks Ltd.* (1995), 23 O.R. (3d) 781 (Ont. Gen. Div. [Commercial List]), at p. 787. Such a purpose is generally achieved through a liquidation of the debtor's assets: Wood, at p. 515. As the Appeal Division of the Nova Scotia Supreme Court noted in *Bayhold Financial Corp. v. Clarkson Co.* (1991), 108 N.S.R. (2d) 198 (N.S. C.A.), at para. 34, "the essence of a receiver's powers is to liquidate the assets". The receiver's "primary task is to ensure that the highest value is received for the assets so as to maximise the return to the creditors": *National Trust Co. v. 1117387 Ontario Inc.*, 2010 ONCA 340, 262 O.A.C. 118 (Ont. C.A.), at para. 77.

74 This purpose is reflected in commercial practice. Typically, the order appointing a receiver includes a power to sell: see for example the Commercial List Model Receivership Order, at para. 3(k). There is no express power in the BIA authorizing a receiver to liquidate or sell property. However, such sales are inherent in court-appointed receiverships and the jurisprudence is replete with examples: see e.g. *bcIMC Construction Fund Corp. v. Chandler Homer Street Ventures Ltd.*, 2008 BCSC 897, 44 C.B.R. (5th) 171 (B.C. S.C. [In Chambers]), *Royal Bank v. Fracmaster Ltd.*, 1999 ABCA 178, 11 C.B.R. (4th) 230 (Alta. C.A.), *Skyepharma PLC v. Hyal Pharmaceutical Corp.* (1999), 12 C.B.R. (4th) 87 (Ont. S.C.J. [Commercial List]), aff'd (2000), 47 O.R. (3d) 234 (Ont. C.A.).

75 Moreover, the mandatory statutory receiver's reports required by s. 246 of the BIA direct a receiver to file a "statement of all property of which the receiver has taken possession or control that *has not yet been sold or realized*" during the receivership (emphasis added):

Bankruptcy and Insolvency General Rules, C.R.C. c. 368, r. 126 (”BIA Rules”).

76 It is thus evident from a broad, liberal, and purposive interpretation of the BIA receivership provisions, including s. 243(1)(c), that implicitly the court has the jurisdiction to approve a sale proposed by a receiver and courts have historically acted on that basis. There is no need to have recourse to provincial legislation such as s.100 of the CJA to sustain that jurisdiction.

77 Having reached that conclusion, the question then becomes whether this jurisdiction under s. 243 extends to the implementation of the sale through the use of a vesting order as being incidental and ancillary to the power to sell. In my view it does. I reach this conclusion for two reasons. First, vesting orders are necessary in the receivership context to give effect to the court’s jurisdiction to approve a sale as conferred by s. 243. Second, this interpretation is consistent with, and furthers the purpose of, s. 243. I will explain.

78 I should first indicate that the case law on vesting orders in the insolvency context is limited. In *New Skeena Forest Products Inc. v. Kitwanga Lumber Co.*, 2005 BCCA 154, 9 C.B.R. (5th) 267 (B.C. C.A.), the British Columbia Court of Appeal held, at para. 20, that a court-appointed receiver was entitled to sell the assets of New Skeena Forest Products Inc. free and clear of the interests of all creditors and contractors. The court pointed to the receivership order itself as the basis for the receiver to request a vesting order, but did not discuss the basis of the court’s jurisdiction to grant the order. In 2001, in *Loewen Group Inc., Re*, Farley J. concluded, at para. 6, that in the CCAA context, the court’s inherent jurisdiction formed the basis of the court’s power and authority to grant a vesting order. The case was decided before amendments to the CCAA which now specifically permit the court to authorize a sale of assets free and clear of any charge or other restriction. The Nova Scotia Supreme Court in *Enterprise Cape Breton Corp. v. Crown Jewel Resort Ranch Inc.*, 2014 NSSC 420, 353 N.S.R. (2d) 194 (N.S. S.C.) stated that neither provincial legislation nor the BIA provided authority to grant a vesting order.

79 In *Anglo Pacific Group PLC c. Ernst & Young Inc.*, 2013 QCCA 1323 (C.A. Que.), the Quebec Court of Appeal concluded that pursuant to s. 243(1)(c) of the BIA, a receiver can ask the court to sell the property of the bankrupt debtor, free of any charge. In that case, the judge had discharged a debenture, a royalty agreement and universal hypothecs. After reciting s. 243, Thibault J.A., writing for the court stated, at para 98: “It is pursuant to paragraph 243(1) of the BIA that the receiver can ask the court to sell the property of a bankrupt debtor, free of any charge.” Although in that case, unlike this appeal, the Quebec Court of Appeal concluded that the instruments in issue did not represent interests in land or ‘real rights’, it nonetheless determined that s. 243(1)(c) provided authority for the receiver to seek to sell property free of any charge(s) on the property.

80 The necessity for a vesting order in the receivership context is apparent. A receiver

selling assets does not hold title to the assets and a receivership does not effect a transfer or vesting of title in the receiver. As Bish and Cassey state in "Vesting Orders Part 2", at p. 58, "[a] vesting order is a vital legal 'bridge' that facilitates the receiver's giving good and undisputed title to a purchaser. It is a document to show to third parties as evidence that the purported conveyance of title by the receiver — which did not hold the title — is legally valid and effective." As previously noted, vesting orders in the insolvency context serve a dual purpose. They provide for the conveyance of title and also serve to extinguish encumbrances on title in order to facilitate the sale of assets.

81 The Commercial List's Model Receivership Order authorizes a receiver to apply for a vesting order or other orders necessary to convey property "free and clear of any liens or encumbrances": see para. 3(l). This is of course not conclusive but is a reflection of commercial practice. This language is placed in receivership orders often on consent and without the court's advertence to the authority for such a term. As Bish and Cassey note in "Vesting Orders Part 1", at p. 42, the vesting order is the "holy grail" sought by purchasers and has become critical to the ability of debtors and receivers to negotiate sale transactions in the insolvency context. Indeed, the motion judge observed that the granting of vesting orders in receivership sales is "a near daily occurrence on the Commercial List": at para. 31. As such, this aspect of the vesting order assists in advancing the purpose of s. 243 and of receiverships generally, being the realization of the debtor's assets. It is self-evident that purchasers of assets do not wish to acquire encumbered property. The use of vesting orders is in essence incidental and ancillary to the power to sell.

82 As I will discuss further, while jurisdiction for this aspect of vesting orders stems from s. 243, the exercise of that jurisdiction is not unbounded.

83 The jurisdiction to vest assets in a purchaser in the context of a national receivership is reflective of the objective underlying s. 243. With a national receivership, separate sales approval and vesting orders should not be required in each province in which assets are being sold. This is in the interests of efficiency and if it were otherwise, the avoidance of a multiplicity of proceedings objective behind s. 243 would be undermined, as would the remedial purpose of the BIA.

84 If the power to vest does not arise under s. 243 with the appointment of a national receiver, the sale of assets in different provinces would require a patchwork of vesting orders. This would be so even if the order under s. 243 were on consent of a third party or unopposed, as jurisdiction that does not exist cannot be conferred.

85 In my view, s. 243 provides jurisdiction to the court to authorize the receiver to enter into an agreement to sell property and in furtherance of that power, to grant an order vesting the purchased property in the purchaser. Thus, here the Receiver had the power under s. 243 of the BIA to enter into an agreement to sell Dianor's property, to seek approval of that sale, and to request a vesting order from the court to give effect to the sale that was approved.

86 Lastly, I would also observe that this conclusion supports the flexibility that is a hallmark of the Canadian system of insolvency — it facilitates the maximization of proceeds and realization of the debtor's assets, but as I will explain, at the same time operates to ensure that third party interests are not inappropriately violated. This conclusion is also consonant with contemporary commercial realities; realities that are reflected in the literature on the subject, the submissions of counsel for the intervener, the Insolvency Institute of Canada, and the model Commercial List Sales Approval and Vesting Order. Parliament knew that by importing the broad language of s. 47(2)(c) into s. 243(1)(c), the interpretation accorded s. 243(1) would be consistent, thus reflecting a desire for the receivership regime to be flexible and responsive to evolving commercial practice.

87 In summary, I conclude that jurisdiction exists under s. 243(1) of the BIA to grant a vesting order vesting property in a purchaser. This jurisdiction extends to receivers who are appointed under the provisions of the BIA.

88 This analysis does not preclude the possibility that s. 21 of the CLPA also provides authority for vesting property in the purchaser free and clear of encumbrances. The language of this provision originated in the British *Conveyancing and Law of Property Act, 1881*, 44 & 45 Vict. ch. 41 and has been the subject matter of minimal judicial consideration. In a nutshell, s. 21 states that where land subject to an encumbrance is sold, the court may direct payment into court of an amount sufficient to meet the encumbrance and declare the land to be free from the encumbrance. The word "encumbrance" is not defined in the CLPA.

89 G. Thomas Johnson in Anne Warner La Forest, ed.,*Anger & Honsberger Law of Real Property*, 3rd ed., loose-leaf (Toronto: Thomson Reuters, 2017), at]§34:10 states:

> The word "encumbrance" is not a technical term. Rather, it is a general expression and must be interpreted in the context in which it is found. It has a broad meaning and may include many disparate claims, charges, liens or burdens on land. It has been defined as "every right to or interest in land granted to the diminution of the value of the land but consistent with the passing of the fee".

90 The author goes on to acknowledge however, that even this definition, broad as it is, is not comprehensive enough to cover all possible encumbrances.

91 That said, given that s. 21 of the CLPA was not a basis advanced before the motion judge, for the purposes of this appeal, it is unnecessary to conclusively determine this issue.

B. Was it Appropriate to Vest out 235 Co's GORs?

92 This takes me to the next issue — the scope of the sales approval and vesting order and whether 235 Co.'s GORs should have been extinguished.

93 Accepting that the motion judge had the jurisdiction to issue a sales approval and vesting order, the issue then becomes not one of "jurisdiction" but rather one of "appropriateness" as Blair J.A. stated in *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]), at para. 42, leave to appeal refused, (1998), 32 C.B.R. (4th) 21 (Ont. C.A.). Put differently, should the motion judge have exercised his jurisdiction to extinguish the appellant's GORs from title?

94 In the first stage of this appeal, this court concluded that the GORs constituted interests in land. In the second stage, I have determined that the motion judge did have jurisdiction to grant a sales approval and vesting order. I must then address the issue of scope and determine whether the motion judge erred in ordering that the GORs be extinguished from title.

(1) Review of the Case Law

95 As illustrated in the first stage of this appeal and as I will touch upon, a review of the applicable jurisprudence reflects very inconsistent treatment of vesting orders.

96 In some cases, courts have denied a vesting order on the basis that the debtor's interest in the property circumscribes a receiver's sale rights. For example, in *1565397 Ontario Inc., Re* (2009), 54 C.B.R. (5th) 262 (Ont. S.C.J.), the receiver sought an order authorizing it to sell the debtor's property free of an undertaking the debtor gave to the respondents to hold two lots in trust if a plan of subdivision was not registered by the closing date. Wilton-Siegel J. found that the undertaking created an interest in land. He stated, at para. 68, that the receiver had taken possession of the property of the debtor only and could not have any interest in the respondents' interest in the property and as such, he was not prepared to authorize the sale free of the undertaking. Wilton-Siegel J. then went on to discuss five "equitable considerations" that justified the refusal to grant the vesting order.

97 Some cases have weighed "equitable considerations" to determine whether a vesting order is appropriate. This is evident in certain decisions involving the extinguishment of leasehold interests. In *Meridian Credit Union Ltd. v. 984 Bay Street Inc.*, [2005] O.J. No. 3707 (Ont. S.C.J.), the court-appointed receiver had sought a declaration that the debtor's land could be sold free and clear of three non-arm's length leases. Each of the lease agreements provided that it was subordinate to the creditor's security interest, and the lease agreements were not registered on title. This court remitted the matter back to the motion judge and directed him to consider the equities to determine whether it was appropriate to sell the property free and clear of the leases: see *Meridian Credit Union Ltd. v. 984 Bay Street Inc.*, [2006] O.J. No. 1726 (Ont. C.A.). The motion judge subsequently concluded that the equities supported an order

terminating the leases and vesting title in the purchaser free and clear of any leasehold interests: *Meridian Credit Union Ltd. v. 984 Bay Street Inc.*, [2006] O.J. No. 3169 (Ont. S.C.J.).

98 An equitable framework was also applied by Wilton-Siegel J. in *Romspen*. In *Romspen*, Home Depot entered into an agreement of purchase and sale with the debtor to acquire a portion of the debtor's property on which a new Home Depot store was to be constructed. The acquisition of the portion of property was contingent on compliance with certain provisions of the *Planning Act*, R.S.O. 1990, c. P.13. The debtor defaulted on its mortgage over its entire property and a receiver was appointed.

99 The receiver entered into a purchase and sale agreement with a third party and sought an order vesting the property in the purchaser free and clear of Home Depot's interest. Home Depot took the position that the receiver did not have the power to convey the property free of Home Depot's interest. Wilton-Siegel J. concluded that a vesting order could be granted in the circumstances. He rejected Home Depot's argument that the receiver took its interest subject to Home Depot's equitable property interest under the agreement of purchase and sale and the ground lease, as the agreement was only effective to create an interest in land if the provisions of the *Planning Act* had been complied with.

100 He then considered the equities between the parties. The mortgage had priority over Home Depot's interest and Home Depot had failed to establish that the mortgagee had consented to the subordination of its mortgage to the leasehold interest. In addition, the purchase and sale agreement contemplated a price substantially below the amount secured by the mortgage, thus there would be no equity available for Home Depot's subordinate interest in any event. Wilton-Siegel J. concluded that the equities favoured a vesting of the property in the purchaser free and clear of Home Depot's interests.[9]

101 As this review of the case law suggests, and as indicated in the First Reasons, there does not appear to be a consistently applied framework of analysis to determine whether a vesting order extinguishing interests ought to be granted. Generally speaking, outcomes have turned on the particular circumstances of a case accounting for factors such as the nature of the property interest, the dealings between the parties, and the relative priority of the competing interests. It is also clear from this review that many cases have considered the equities to determine whether a third party interest should be extinguished.

(2) Framework for Analysis to Determine if a Third Party Interest Should be Extinguished

102 In my view, in considering whether to grant a vesting order that serves to extinguish rights, a court should adopt a rigorous cascade analysis.

103 First, the court should assess the nature and strength of the interest that is proposed to be

extinguished. The answer to this question may be determinative thus obviating the need to consider other factors.

104 For instance, I agree with the Receiver's submission that it is difficult to think of circumstances in which a court would vest out a fee simple interest in land. Not all interests in land share the same characteristics as a fee simple, but there are lesser interests in land that would also defy extinguishment due to the nature of the interest. Consider, for example, an easement in active use. It would be impractical to establish an exhaustive list of interests or to prescribe a rigid test to make this determination given the broad spectrum of interests in land recognized by the law.

105 Rather, in my view, a key inquiry is whether the interest in land is more akin to a fixed monetary interest that is attached to real or personal property subject to the sale (such as a mortgage or a lien for municipal taxes), or whether the interest is more akin to a fee simple that is in substance an ownership interest in some ascertainable feature of the property itself. This latter type of interest is tied to the inherent characteristics of the property itself; it is not a fixed sum of money that is extinguished when the monetary obligation is fulfilled. Put differently, the reasonable expectation of the owner of such an interest is that its interest is of a continuing nature and, absent consent, cannot be involuntarily extinguished in the ordinary course through a payment in lieu.

106 Another factor to consider is whether the parties have consented to the vesting of the interest either at the time of the sale before the court, or through prior agreement. As Bish and Cassey note, vesting orders have become a routine aspect of insolvency practice, and are typically granted on consent: "Vesting Orders Part 2", at pp. 60, 65.

107 The more complex question arises when consent is given through a prior agreement such as where a third party has subordinated its interest contractually. *Meridian*, *Romspen*, and *Firm Capital Mortgage Fund Inc. v. 2012241 Ontario Ltd.*, 2012 ONSC 4816, 99 C.B.R. (5th) 120 (Ont. S.C.J. [Commercial List]) are cases in which the court considered the appropriateness of a vesting order in circumstances where the third party had subordinated its interests. In each of these cases, although the court did not frame the subordination of the interests as the overriding question to consider before weighing the equities, the decisions all acknowledged that the third parties had agreed to subordinate their interest to that of the secured creditor. Conversely, in *Winick v. 1305067 Ontario Ltd.* (2008), 41 C.B.R. (5th) 81 (Ont. S.C.J. [Commercial List]), the court refused to vest out a leasehold interest on the basis that the purchaser had notice of the lease and the purchaser acknowledged that it would purchase the property subject to the terms and conditions of the leases.

108 The priority of the interests reflected in freely negotiated agreements between parties is an important factor to consider in the analysis of whether an interest in land is capable of being vested out. Such an approach ensures that the express intention of the parties is given sufficient

weight and allows parties to contractually negotiate and prioritize their interests in the event of an insolvency.

109 Thus, in considering whether an interest in land should be extinguished, a court should consider: (1) the nature of the interest in land; and (2) whether the interest holder has consented to the vesting out of their interest either in the insolvency process itself or in agreements reached prior to the insolvency.

110 If these factors prove to be ambiguous or inconclusive, the court may then engage in a consideration of the equities to determine if a vesting order is appropriate in the particular circumstances of the case. This would include: consideration of the prejudice, if any, to the third party interest holder; whether the third party may be adequately compensated for its interest from the proceeds of the disposition or sale; whether, based on evidence of value, there is any equity in the property; and whether the parties are acting in good faith. This is not an exhaustive list and there may be other factors that are relevant to the analysis.

(3) The Nature of the Interest in Land of 235 Co.'s GORs

111 Turning then to the facts of this appeal, in the circumstances of this case, the issue can be resolved by considering the nature of the interest in land held by 235 Co. Here the GORs cannot be said to be a fee simple interest but they certainly were more than a fixed monetary interest that attached to the property. They did not exist simply to secure a fixed finite monetary obligation; rather they were in substance an interest in a continuing and an inherent feature of the property itself.

112 While it is true, as the Receiver and Third Eye emphasize, that the GORs are linked to the interest of the holder of the mining claims and depend on the development of those claims, that does not make the interest purely monetary. As explained in stage one of this appeal, the nature of the royalty interest as described by the Supreme Court in *Bank of Montreal v. Dynex Petroleum Ltd.*, 2002 SCC 7, [2002] 1 S.C.R. 146 (S.C.C.), at para. 2 is instructive:

> . . . [R]oyalty arrangements are common forms of arranging exploration and production in the oil and gas industry in Alberta. Typically, the owner of minerals *in situ* will lease to a potential producer the right to extract such minerals. This right is known as a working interest. A royalty is an unencumbered share or fractional interest in the gross production of such working interest. A lessor's royalty is a royalty granted to (or reserved by) the initial lessor. An overriding royalty or a gross overriding royalty is a royalty granted normally by the owner of a working interest to a third party in exchange for consideration which could include, but is not limited to, money or services (e.g., drilling or geological surveying) (G. J. Davies, "The Legal Characterization of Overriding Royalty Interests in Oil and Gas" (1972), 10 *Alta. L. Rev.* 232, at p. 233). The rights and obligations of the two types of

> royalties are identical. The only difference is to whom the royalty was initially granted. [Italics in original; underlining added.]

113 Thus, a GOR is an interest in the gross product extracted from the land, not a fixed monetary sum. While the GOR, like a fee simple interest, may be capable of being valued at a point in time, this does not transform the substance of the interest into one that is concerned with a fixed monetary sum rather than an element of the property itself. The interest represented by the GOR is an ownership in the product of the mining claim, either payable by a share of the physical product or a share of revenues. In other words, the GOR carves out an overriding entitlement to an amount of the property interest held by the owner of the mining claims.

114 The Receiver submits that the realities of commerce and business efficacy in this case are that the mining claims were unsaleable without impairment of the GORs. That may be, but the imperatives of the mining claim owner should not necessarily trump the interest of the owner of the GORs.

115 Given the nature of 235 Co.'s interest and the absence of any agreement that allows for any competing priority, there is no need to resort to a consideration of the equities. The motion judge erred in granting an order extinguishing 235 Co.'s GORs.

116 Having concluded that the court had the jurisdiction to grant a vesting order but the motion judge erred in granting a vesting order extinguishing an interest in land in the nature of the GORs, I must then consider whether the appellant failed to preserve its rights such that it is precluded from persuading this court that the order granted by the motion judge ought to be set aside.

C. 235 Co.'s Appeal of the Motion Judge's Order

117 235 Co. served its notice of appeal on November 3, 2016, more than a week after the transaction had closed on October 26, 2016.

118 Third Eye had originally argued that 235 Co.'s appeal was moot because the vesting order was spent when it was registered on title and the conveyance was effected. It relied on this court's decision in *Regal Constellation* in that regard.

119 Justice Lauwers wrote that additional submissions were required in the face of the conclusion that 235 Co.'s GORs were interests in land: First Reasons, at para. 21. He queried whether it was appropriate for the court-appointed receiver to close the transaction when the parties were aware that 235 Co. was considering an appeal prior to the closing of the transaction: at para. 22.

120 There are three questions to consider in addressing what, if any, remedy is available to 235 Co. in these circumstances:

(1) What appeal period applies to 235 Co.'s appeal of the sale approval and vesting order;

(2) Was it permissible for the Receiver to close the transaction in the face of 235 Co.'s October 26, 2016 communication to the Receiver that "an appeal is under consideration"; and

(3) Does 235 Co. nonetheless have a remedy available under the *Land Titles Act*, R.S.O. 1990, c. L.5?

(1) The Applicable Appeal Period

121 The Receiver was appointed under s. 101 of the CJA and s. 243 of the BIA. The motion judge's decision approving the sale and vesting the property in Third Eye was released through reasons dated October 5, 2016.

122 Under the CJA, the appeal would be governed by the *Rules of Civil Procedure*, r. 61.04(1) which provides for a 30 day period from which to appeal a final order to the Court of Appeal. In addition, the appellant would have had to have applied for a stay of proceedings.

123 In contrast, under the BIA, s. 183(2) provides that courts of appeal are "invested with power and jurisdiction at law and in equity, according to their ordinary procedures except as varied by" the BIA or the BIA Rules, to hear and determine appeals. An appeal lies to the Court of Appeal if the point at issue involves future rights; if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings; if the property involved in the appeal exceeds in value $10,000; from the grant of or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed $5,000; and in any other case by leave of a judge of the Court of Appeal: BIA, s. 193. Given the nature of the dispute and the value in issue, no leave was required and indeed, none of the parties took the position that it was. There is therefore no need to address that issue.

124 Under r. 31 of the BIA Rules, a notice of appeal must be filed "within 10 days after the day of the order or decision appealed from, or within such further time as a judge of the court of appeal stipulates."

125 The 10 days runs from the day the order or *decision* was rendered: *Moss, Re* (1999), 138 Man. R. (2d) 318 (Man. C.A. [In Chambers]), at para. 2; *Koska, Re*, 2002 ABCA 138, 303 A.R. 230 (Alta. C.A.), at para. 16; *7451190 Manitoba Ltd v. CWB Maxium Financial Inc et al*, 2019

MBCA 28 (Man. C.A.) (in Chambers), at para. 49. This is clear from the fact that both r. 31 and s. 193 speak of "order *or* decision" (emphasis added). If an entered and issued order were required, there would be no need for this distinction.[10] Accordingly, the "[t]ime starts to run on an appeal under the *BIA* from the date of pronouncement of the decision, not from the date the order is signed and entered": *Koska, Re*, at para. 16.

126 Although there are cases where parties have conceded that the BIA appeal provisions apply in the face of competing provincial statutory provisions (see e.g. *Ontario Wealth Management Corp. v. Sica Masonry and General Contracting Ltd.*, 2014 ONCA 500, 323 O.A.C. 101 (Ont. C.A.) (in Chambers), at para. 36 and *Impact Tool & Mould Inc. (Receiver of) v. Impact Tool & Mould Inc. (Trustee of)*, 2013 ONCA 697 (Ont. C.A.), at para. 1), until recently, no Ontario case had directly addressed this point.

127 Relying on first principles, as noted by Donald J.M. Brown in *Civil Appeals* (Toronto: Carswell, 2019), at 2:1120, "where federal legislation occupies the field by providing a procedure for an appeal, those provisions prevail over provincial legislation providing for an appeal." Parliament has jurisdiction over procedural law in bankruptcy and hence can provide for appeals: *Solloway, Mills & Co., Re* (1934), [1935] O.R. 37 (Ont. C.A.). Where there is an operational or purposive inconsistency between the federal bankruptcy rules and provincial rules on the timing of an appeal, the doctrine of federal paramountcy applies and the federal bankruptcy rules govern: see *Moore, Re*, 2013 ONCA 769, 118 O.R. (3d) 161 (Ont. C.A.), at para. 59, aff'd 2015 SCC 52, [2015] 3 S.C.R. 397 (S.C.C.); *Alberta (Attorney General) v. Moloney*, 2015 SCC 51, [2015] 3 S.C.R. 327 (S.C.C.), at para. 16.

128 In *Business Development Bank of Canada v. Astoria Organic Matters Ltd.*, 2019 ONCA 269 (Ont. C.A.), Zarnett J.A. wrote that the appeal route is dependent on the jurisdiction pursuant to which the order was granted. In that case, the appellant was appealing from the refusal of a judge to grant leave to sue the receiver who was stated to have been appointed pursuant to s. 101 of the CJA and s. 243 of the BIA. There was no appeal from the receivership order itself. Thus, to determine the applicable appeal route for the refusal to grant leave, the court was required to determine the source of the power to impose a leave to sue requirement in a receivership order. Zarnett J.A. determined that by necessary implication, Parliament must be taken to have clothed the court with the power to require leave to sue a receiver appointed under s. 243(1) of the BIA and federal paramountcy dictated that the BIA appeal provisions apply.

129 Here, 235 Co.'s appeal is from the sale approval order, of which the vesting order is a component. Absent a sale, there could be no vesting order. The jurisdiction of the court to approve the sale, and thus issue the sale approval and vesting order, is squarely within s. 243 of the BIA.

130 Furthermore, as 235 Co. had known for a considerable time, there could be no sale to Third Eye in the absence of extinguishment of the GORs and Algoma's royalty rights; this was a

condition of the sale that was approved by the motion judge. The appellant was stated to be unopposed to the sale but in essence opposed the sale condition requiring the extinguishment. Clearly the jurisdiction to grant the approval of the sale emanated from the BIA, and as I have discussed, so did the vesting component; it was incidental and ancillary to the approval of the sale. It would make little sense to split the two elements of the order in these circumstances. The essence of the order was anchored in the BIA.

131 Accordingly, I conclude that the appeal period was 10 days as prescribed by r. 31 of the BIA Rules and ran from the date of the motion judge's decision of October 5, 2016. Thus, on a strict application of the BIA Rules, 235 Co.'s appeal was out of time. However, in the circumstances of this case it is relevant to consider first whether it was appropriate for the Receiver to close the transaction in the face of 235 Co.'s assertion that an appeal was under consideration and, second, although only sought in oral submissions in reply at the hearing of the second stage of this appeal, whether 235 Co. should be granted an extension of time to appeal.

(2) The Receiver's Conduct

132 The Receiver argues that it was appropriate for it to close the transaction in the face of a threatened appeal because the appeal period had expired when the appellant advised the Receiver that it was contemplating an appeal (without having filed a notice of appeal or a request for leave) and the Receiver was bound by the provisions of the purchase and sale agreement and the order of the motion judge, which was not stayed, to close the transaction.

133 Generally speaking, as a matter of professional courtesy, a potentially preclusive step ought not to be taken when a party is advised of a possible pending appeal. However, here the Receiver's conduct in closing the transaction must be placed in context.

134 235 Co. had known of the terms of the agreement of purchase and sale and the request for an order extinguishing its GORs for over a month, and of the motion judge's decision for just under a month before it served its notice of appeal. Before October 26, 2016, it had never expressed an intention to appeal either informally or by serving a notice of appeal, nor did it ever bring a motion for a stay of the motion judge's decision or seek an extension of time to appeal.

135 Having had the agreement of purchase and sale at least since it was served with the Receiver's motion record seeking approval of the transaction, 235 Co. knew that time was of the essence. Moreover, it also knew that the Receiver was directed by the court to take such steps as were necessary for the completion of the transaction contemplated in the purchase and sale agreement approved by the motion judge pursuant to para. 2 of the draft court order included in the motion record.

136 The principal of 235 Co. had been the original prospector of Dianor. 235 Co. never took issue with the proposed sale to Third Eye. The Receiver obtained a valuation of Dianor's mining claims and the valuator concluded that they had a total value of $1 million to $2 million, with 235 Co.'s GORs having a value of between $150,000 and $300,000, and Algoma's royalties having a value of $70,000 to $140,000. No evidence of any competing valuation was adduced by 235 Co.

137 Algoma agreed to a payment of $150,000 but 235 Co. wanted more than the $250,000 offered. The motion judge, who had been supervising the receivership, stated that 235 Co. acknowledged that the sum of $250,000 represented the fair market value: at para. 15. He made a finding at para. 38 of his reasons that the principal of 235 Co. was "not entitled to exercise tactical positions to tyrannize the majority by refusing to agree to a reasonable amount for the royalty rights." In *obiter*, the motion judge observed that he saw "no reason in logic . . . why the jurisdiction would not be the same whether the royalty rights were or were not an interest in land": at para. 40. Furthermore, the appellant knew of the motion judge's reasons for decision since October 5, 2016 and did nothing that suggested any intention to appeal until about three weeks later.

138 As noted by the Receiver, it is in the interests of the efficient administration of receivership proceedings that aggrieved stakeholders act promptly and definitively to challenge a decision they dispute. This principle is in keeping with the more abbreviated time period found in the BIA Rules. Blair J.A. in *Regal Constellation*, at para. 49, stated that "[t]hese matters ought not to be determined on the basis that 'the race is to the swiftest'". However, that should not be taken to mean that the race is adjusted to the pace of the slowest.

139 For whatever reasons, 235 Co. made a tactical decision to take no steps to challenge the motion judge's decision and took no steps to preserve any rights it had. It now must absorb the consequences associated with that decision. This is not to say that the Receiver's conduct would always be advisable. Absent some emergency that has been highlighted in its Receiver's report to the court that supports its request for a vesting order, a Receiver should await the expiry of the 10 day appeal period before closing the sale transaction to which the vesting order relates.

140 Given the context and history of dealings coupled with the actual expiry of the appeal period, I conclude that it was permissible for the Receiver to close the transaction. In my view, the appeal by 235 Co. was out of time.

(3) Remedy is not Merited

141 As mentioned, in oral submissions in reply, 235 Co. sought an extension of time to appeal *nunc pro tunc*. It further requested that this court exercise its discretion and grant an

order pursuant to ss. 159 and 160 of the *Land Titles Act* rectifying the title and granting an order directing the Minings Claim Recorder to rectify the provincial register so that 235 Co.'s GORs are reinstated. The Receiver resists this relief. Third Eye does not oppose the relief requested by 235 Co. provided that the compensation paid to 235 Co. and Algoma is repaid. However, counsel for the Monitor for Algoma states that the $150,000 it received for Algoma's royalty rights has already been disbursed by the Monitor to Algoma.

142 The rules and jurisprudence surrounding extensions of time in bankruptcy proceedings is discussed in Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *Bankruptcy and Insolvency Law of Canada*, 4th ed., loose-leaf (Toronto: Thomson Reuters, 2009). Rule 31(1) of the BIA Rules provides that a judge of the Court of Appeal may extend the time to appeal. The authors write, at pp. 8-20-8-21:

> The court ought not lightly to interfere with the time limit fixed for bringing appeals, and special circumstances are required before the court will enlarge the time . . .
>
> In deciding whether the time for appealing should be extended, the following matters have been held to be relevant:
>
> > (1) The appellant formed an intention to appeal before the expiration of the 10 day period;
> >
> > (2) The appellant informed the respondent, either expressly or impliedly, of the intention to appeal;
> >
> > (3) There was a continuous intention to appeal during the period when the appeal should have been commenced;
> >
> > (4) There is a sufficient reason why, within the 10 day period, a notice of appeal was not filed . . . ;
> >
> > (5) The respondent will not be prejudiced by extending the time;
> >
> > (6) There is an arguable ground or grounds of appeal;
> >
> > (7) It is in the interest of justice, i.e., the interest of the parties, that an extension be granted. [Citations omitted.]

143 These factors are somewhat similar to those considered by this court when an extension of time is sought under r. 3.02 of the *Rules of Civil Procedure*: did the appellant form a *bona fide* intention to appeal within the relevant time period; the length of and explanation for the delay; prejudice to the respondents; and the merits of the appeal. The justice of the case is the overarching principle: see *Enbridge Gas Distribution Inc. v. Froese*, 2013 ONCA 131, 114 O.R.

(3d) 636 (Ont. C.A.) (in Chambers), at para. 15.

144 There is no evidence that 235 Co. formed an intention to appeal within the applicable appeal period, and there is no explanation for that failure. The appellant did not inform the respondents either expressly or impliedly that it was intending to appeal. At best, it advised the Receiver that an appeal was under consideration 21 days after the motion judge released his decision. The fact that it, and others, might have thought that a longer appeal period was available is not compelling seeing that 235 Co. had known of the position of the respondents and the terms of the proposed sale since at least August 2016 and did nothing to suggest any intention to appeal if 235 Co. proved to be unsuccessful on the motion. Although the merits of the appeal as they relate to its interest in the GORs favour 235 Co.'s case, the justice of the case does not. I so conclude for the following reasons.

1. 235 Co. sat on its rights and did nothing for too long knowing that others would be relying on the motion judge's decision.

2. 235 Co. never opposed the sale approval despite knowing that the only offers that ever resulted from the court approved bidding process required that the GORs and Algoma's royalties be significantly reduced or extinguished.

3. Even if I were to accept that the *Rules of Civil Procedure* governed the appeal, which I do not, 235 Co. never sought a stay of the motion judge's order under the *Rules of Civil Procedure*. Taken together, this supports the inference that 235 Co. did not form an intention to appeal at the relevant time and ultimately only served a notice of appeal as a tactical manoeuvre to engineer a bigger payment from Third Eye. As found by the motion judge, 235 Co. ought not to be permitted to take tyrannical tactical positions.

4. The Receiver obtained a valuation of the mining claims that concluded that the value of 235 Co.'s GORs was between $150,000 and $300,000. Before the motion judge, 235 Co. acknowledged that the payment of $250,000 represented the fair market value of its GORs. Furthermore, it filed no valuation evidence to the contrary. Any prejudice to 235 Co. is therefore attenuated. It has been paid the value of its interest.

5. Although there are no subsequent registrations on title other than Third Eye's assignee, Algoma's Monitor has been paid for its royalty interest and the funds have been distributed to Algoma. Third Eye states that if the GORs are reinstated, so too should the payments it made to 235 Co. and Algoma. Algoma has been under CCAA protection itself and, not surprisingly, does not support an unwinding of the transaction.

145 I conclude that the justice of the case does not warrant an extension of time. I therefore would not grant 235 Co. an extension of time to appeal *nunc pro tunc*.

146 While 235 Co. could have separately sought a discretionary remedy under the *Land*

Titles Act for rectification of title in the manner contemplated in *Regal Constellation*, at paras. 39, 45, for the same reasons I also would not exercise my discretion or refer the matter back to the motion judge to grant an order pursuant to ss. 159 and 160 of the *Land Titles Act* rectifying the title and an order directing the Mining Claims Recorder to rectify the provincial register so that 235 Co.'s GORs are reinstated.

Disposition

147 In conclusion, the motion judge had jurisdiction pursuant to s. 243(1) of the BIA to grant a sale approval and vesting order. Given the nature of the GORs the motion judge erred in concluding that it was appropriate to extinguish them from title. However, 235 Co. failed to appeal on a timely basis within the time period prescribed by the BIA Rules and the justice of the case does not warrant an extension of time. I also would not exercise my discretion to grant any remedy to 235 Co. under any other statutory provision. Accordingly, it is entitled to the $250,000 payment it has already received and that its counsel is holding in escrow.

148 For these reasons, the appeal is dismissed. As agreed by the parties, I would order Third Eye to pay costs of $30,000 to 235 Co. in respect of the first stage of the appeal and that all parties with the exception of the Receiver bear their own costs of the second stage of the appeal. I would permit the Receiver to make brief written submissions on its costs within 10 days of the release of these reasons and the other parties to reply if necessary within 10 days thereafter.

***P. Lauwers J.A.*:**
I agree.

***Grant Huscroft J.A.*:**
I agree.

Appeal dismissed.

Footnotes

1 The original agreement provided for the payment of the GORs to 381 Co. and Paulette A. Mousseau-Leadbetter. The motion judge noted that the record was silent on how 235 Co. came to be the holder of these royalty rights but given his conclusion, he determined that there was no need to resolve this issue: at para. 6.

2 The ownership of the surface rights is not in issue in this appeal.

3 Although in its materials filed on this appeal, 235 Co. stated that the motion judge erred in making this finding, in oral submissions before this court, Third Eye's counsel confirmed that this was the position taken by 235 Co.'s counsel before the motion judge, and 235 Co.'s appellate counsel, who was not counsel below, stated that this must have been the submission made by counsel for 235 Co. before the motion judge.

4 To repeat, the statement quoted from Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *Bankruptcy and Insolvency Law of Canada*, 4th ed., loose-leaf (Toronto: Carswell, 2009), at Part XI, L]§21, said:
A vesting order should only be granted if the facts are not in dispute and there is no other available or reasonably convenient remedy; or in exceptional circumstances where compliance with the regular and recognized procedure for sale of real estate would result in an injustice. In a receivership, the sale of the real estate should first be approved by the court. The application for approval should be served upon the registered owner and all interested parties. If the sale is approved, the receiver may subsequently apply for a vesting order, but a vesting order should not be made until the rights of all interested parties have either been relinquished or been extinguished by due process. [Citations omitted.]

5 Such orders were subsequently described as vesting orders in *An Act respecting the Court of Chancery*, C.S.U.C. 1859, c. 12, s. 63. The authority to grant vesting orders was inserted into the *The Judicature Act*, R.S.O. 1897, c. 51, s. 36 in 1897 when the Courts of Chancery were abolished. Section 100 of the CJA appeared in 1984 with the demise of *The Judicature Act*: see *An Act to revise and consolidate the Law respecting the Organization, Operation and Proceedings of Courts of Justice in Ontario*, S.O. 1984, c. 11, s. 113.

6 This case was decided before s. 36 of the *Companies' Creditors Arrangements Act*, R.S.C. 1985, c. C-36 ("CCAA") was enacted but the same principles are applicable.

7 This 10 day notice period was introduced following the Supreme Court's decision in *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.*, [1982] 1 S.C.R. 726 (S.C.C.) which required a secured creditor to give reasonable notice prior to the enforcement of its security.

8 *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*, S.C. 2005, c. 47 ("*Insolvency Reform Act* 2005"); *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, S.C. 2007, c. 36 ("*Insolvency Reform Act* 2007").

9 This court allowed an appeal of the motion judge's order in *Romspen* and remitted the matter back to the motion judge for a new hearing on the basis that the motion judge applied an incorrect standard of proof in making findings of fact by failing to draw reasonable inferences from the evidence, and in particular, on the issue of whether Romspen had expressly or implicitly consented to the construction of the Home Depot stores: see *Romspen Investment Corp. v. Woods Property Development Inc.*, 2011 ONCA 817, 286 O.A.C. 189 (Ont. C.A.).

10 *Ontario Wealth Management Corp. v. Sica Masonry and General Contracting Ltd.*, 2014 ONCA 500, 323 O.A.C. 101 (Ont. C.A.) (in Chambers) a decision of a single judge of this court, states, at para. 5, that a signed, issued, and entered order is required. This is generally the case in civil proceedings unless displaced, as here by a statutory provision. *Smoke, Re* (1989), 77 C.B.R. (N.S.) 263 (Ont. C.A.), that is relied upon and cited in *Ontario Wealth Managements Corporation*, does not address this issue.

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

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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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(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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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).

DATE: 20020919
DOCKET: C36486

COURT OF APPEAL FOR ONTARIO

CATZMAN, DOHERTY AND BORINS JJ.A.

IN THE MATTER OF THE PROPOSALS OF

CONFECTIONATELY YOURS, INC., BAKEMATES INTERNATIONAL INC., MARMAC HOLDINGS INC., CONFECTIONATELY YOURS BAKERIES INC., and SWEET-EASE INC.

) Martin Teplitsky,
) for the appellants
) Barbara and Mario Parravano
)
) Benjamin Zarnett and
) David Lederman,
) for the respondent
) KPMG Inc.
)
) Katherine McEachern,
) for the respondent
) Laurentian Bank of Canada
)
) Heard: April 8, 2002

On appeal from an order of Justice James M. Farley of the Ontario Superior Court of Justice dated April 18, 2001.

BORINS J.A.:

[1] [1] This is an appeal by Mario Parravano and Barbara Parravano from the assessment of a court-appointed receiver's fees and disbursements, including the fees of its solicitors, Goodmans, Goodman and Carr and Kavinoky and Cook, consequent to the receiver's motion to pass its accounts. The motion judge assessed the fees and disbursements in the amounts presented by the receiver. The appellants ask that the order of the motion judge be set aside and that the receiver's motion to pass its accounts be heard by a different judge of the Commercial List, or that the accounts be referred for

assessment, with the direction that the appellants be permitted to cross-examine both a representative of the receiver and of the solicitors in respect to their fees and disbursements.

Introduction

[2] [2] On October 3, 2000, on the application of the Laurentian Bank of Canada (the "bank"), Spence J. appointed KPMG Inc. ("KPMG") as the receiver and manager of all present and future assets of five companies ("the companies"). Collectively, the companies carried on a large bakery, cereal bar and muffin business that employed 158 people and generated annual sales of approximately $24 million. The companies were owned by Mario and Barbara Parravano (the "Parravanos") who had guaranteed part of the companies' debts to the bank. Upon its appointment, KPMG continued to operate the business of the companies pending analysis as to the best course of action. As a result of its analysis, KPMG decided to continue the companies' operations and pursue "a going concern" asset sale.

[3] [3] Paragraph 22 of the order of Spence J. reads as follows:

> **THIS COURT ORDERS** that, prior to the passing of accounts, the Receiver shall be at liberty from time to time to apply a reasonable amount of the monies in its hands against its fees and disbursements, including reasonable legal fees and disbursements, incurred at the standard rates and charges for such services rendered either monthly or at such longer or shorter intervals as the Receiver deems appropriate, and such amounts shall constitute advances against its remuneration when fixed from time to time.

[4] [4] The receiver was successful in attracting a purchaser and received the approval of Farley J. on December 21, 2000, to complete the sale of substantially all of the assets of the companies for approximately $6,500,000. The transaction closed on December 28, 2000.

[5] [5] The receiver presented two reports to the court for its approval. In the first report, presented on December 15, 2000, KPMG outlined its activities from the date of its appointment and requested approval of the sale of the companies' assets. The second report, which is the subject of this appeal, was presented on February 2, 2001. The second report contained the following information:

- • an outline of KPMG's activities subsequent to the sale of the companies' assets;
- • a statement of KPMG's receipts and disbursements on behalf of the companies;
- • KPMG's proposed distribution of the net receipts;
- • a summary of KPMG's fees and disbursements supported by detailed descriptions of the activities of its personnel by person and by day;
- • a list of legal fees and disbursements of its solicitors supported by detailed billings.

In its second report, KPMG recommended that the court, *inter alia*, approve its fees and disbursements, as well as the fees and disbursements of Goodmans, calculated on the basis of hours multiplied the hourly rates of the personnel. The total time billed by KPMG was 3,215 hours from October 3, 2000 to December 31, 2000 at hourly rates that ranged from $175 to $550. Its disbursements included the fees and disbursements of its solicitors. Each report was signed on behalf of KPMG by its Senior Vice-President, Richard A. Morawetz.

[6] [6] In summary, KPMG sought approval of the following:

- • receiver's fees and disbursements of $1,080,874.93, inclusive of GST.
- • legal fees of Goodmans of $209,803.46, inclusive of GST.
- • legal fees of Goodman and Carr of $92,292.32, inclusive of GST.
- • legal fees of Kavinoky & Cook of $2,583.23.

[7] [7] The Parravanos objected to the amount of the fees and disbursements of KPMG and Goodmans. Their grounds of objection were that the time spent and the hourly rates charged by the receiver and Goodmans were excessive. They submitted that the fees of KPMG and Goodmans were not fair and reasonable. They also sought to cross-examine Mr. Morawetz with respect to their grounds of objection. The motion judge refused to permit Mr. Pape, counsel for the Parravanos, to cross-examine Mr. Morawetz on the ground that a receiver, being an officer of the court, is not subject to cross-examination on its report. However, the motion judge permitted Mr. Pape as the judge's "proxy" to ask questions of Mr. Morawetz, who was not sworn. The motion judge then approved the fees and disbursements of the receiver and Goodmans in the amounts as submitted in the receiver's report without any reduction.

[8] [8] The appellants appeal on the following grounds:

(1) The motion judge exhibited a demonstrable bias against the appellants and their counsel as a result of which the appellants were denied a fair hearing;

(2) The motion judge erred in holding that on the passing of its accounts a court-appointed receiver cannot be cross-examined on the amount of the fees and disbursements in respect to which it seeks the approval of the court; and

(3) The motion judge erred in finding that the receiver's fees and disbursements, and those of its solicitors, Goodmans, were fair and reasonable.

[9] [9] For the reasons that follow, the appellants have failed to establish that they were denied a fair hearing on the grounds that the motion judge was biased against them and their counsel and that they were not permitted to cross-examine the receiver's representative, Mr. Morawetz, on the receiver's accounts. As I will explain, the examination of Mr. Morawetz that was permitted by the motion judge afforded the appellants' counsel a fair opportunity to challenge the remuneration claimed. As well, the appellants have provided no grounds on which the court can interfere with the motion judge's finding that the receiver's accounts were fair and reasonable. However, the accounts of the receiver's solicitors, Goodmans, stand on a different footing. The motion judge failed to give these accounts separate consideration. I would, therefore, allow the appeal to that extent and order that there be a new assessment of Goodmans' accounts.

Reasons of the motion judge

[10] [10] The reasons of the motion judge are reported as *Re Bakemates International Inc.* (2001), 25 C.B.R. (4th) 24.

[11] [11] In the first part of his reasons, the motion judge provided his decision on the request of the appellants' counsel to cross-examine Mr. Morawetz with respect to the receiver's accounts. He began his consideration of this issue at p. 25:

Perhaps it is the height – or depth – of audacity for counsel for the Parravanos to come into court expecting that he will be permitted (in fact using the word "entitled") to cross-examine the Receiver's representative

> (Mr. Richard Morawetz) in this court appointed receivership concerning the Receiver's fees and disbursements (including legal fees).

After reviewing two of his own decisions – *Re Anvil Range Mining Corp.* (2001), 21 C.B.R. (4th) 194 (Ont. Sup. Ct.) and *Mortgage Insurance Co. of Canada v. Innisfill Landfill Corp.* (1995), 30 C.B.R. (3d) 100 (Ont. Gen. Div.) – the motion judge concluded that because a receiver is an officer of the court who is required to report to the court in respect to the conduct of the receivership, a receiver cannot be cross-examined on its report.

> [12] [12] In support of this conclusion, the motion judge relied on the following passage from his reasons for judgment in *Mortgage Insurance* at pp. 101-102:
>
> > As to the question of there not being an affidavit of the Receiver to cross-examine on, I am somewhat puzzled by this. I do not understand that a Receiver, being an officer of the Court and being appointed by Court Order is required to give his reports by affidavit. I note that there is a jurisprudence to the effect that it would have to be at least unusual circumstances for there to be any ability of other parties to examine (cross-examine in effect) the Receiver on any report. However, I do acknowledge that in, perhaps what some might characterize as a tearing down of an institution in the rush of counsel "to get to the truth of the matter" (at least as perceived by counsel), Receivers have sometimes obliged by making themselves available for such examination. Perhaps the watchword should be the three Cs of the Commercial List – cooperation, communication and common sense. Certainly, I have not seen any great need for (cross-) examination when the Receiver is willing to clarify or amplify his material when such is *truly* needed [emphasis added].
>
> [13] [13] As authority for the proposition that a receiver, as an officer of the court, is not subject to cross-examination on his or its report, the motion judge relied on *Avery v. Avery*, [1954] O.W.N. 364 (H.C.J.) and *Re Mr. Greenjeans Corp.* (1985), 52 C.B.R. (N.S.) 320 (Ont. H.C.J.). He went on to say at p. 26 that when there are questions about a receiver's compensation, "[t]he more appropriate course of action" is for the disputing party "to interview the court officer [the receiver] . . . so as to allow the court officer the opportunity of clarifying or amplifying the material in response to questions".

[14] [14] The motion judge noted on p. 26 that the appellants' counsel had "not provided any factual evidence/background to substantiate that there were unusual circumstances" in respect to the rates charged and the time spent by the receiver. Consequently, he concluded that it was not an appropriate case to exercise what he perceived to be his discretion to allow the Parravanos' counsel to cross-examine Mr. Morawetz on the passing of the receiver's accounts. At p. 27, he stated: "Mr. Pape has not established any grounds for doing that."

[15] [15] Nevertheless, the motion judge did permit Mr. Pape to question Mr. Morawetz. His explanation for why he did so, the conditions that he imposed on Mr. Pape's examination, and his comments on Mr. Pape's "interview" of Mr. Morawetz, are found at p. 27:

> Mr. Pape has observed that Mr. Morawetz is here to answer any questions that I may have as to the fees and disbursements. While Mr. Pape has no right or entitlement to cross-examine Mr. Morawetz with respect to the fees and disbursements – and he ought to have availed himself of any last minute follow-up interview/questions last week if he thought that necessary, I see no reason why Mr. Pape may not be permitted to ask appropriate questions to Mr. Morawetz covering these matters – in essence as my proxy. However, Mr. Pape will have to conduct himself appropriately (as I am certain that he will – and I trust that I will not be disappointed), otherwise the questioning will be stopped as I would stop myself if I questioned inappropriately. Mr. Morawetz is under an obligation already as a court appointed officer to tell the truth; it will not be necessary for him to swear another/affirm [sic] – he may merely acknowledge his obligation to tell the truth. It is redundant but I think necessary to point out that this is not the preferred route nor should it be regarded as a precedent.
>
> [There then followed the interview of Mr. Morawetz by Mr. Pape and submissions. I cautioned Mr. Pape a number of times during the interview that he was going beyond what was reasonable in the circumstances and that Mr. Morawetz was entitled to give a full elaboration and explanation.]

[16] [16] In the second part of his reasons, the motion judge considered the amount of the compensation claimed by the receiver

and its solicitors, Goodmans. He began at p. 27 by criticizing Mr. Pape "for attempting to show that Mr. Morawetz was not truthful or was misleading" in the absence of any expert evidence from the appellants in respect to the time spent and the hourly rates charged by the receiver in the course of carrying out its duties.

[17] [17] In assessing the receiver's accounts, the motion judge made the following findings:

(1) (1) This was an operating receivership in which the receiver operated the companies for three months so that the companies' assets could be sold as a going concern.

(2) (2) Usually, an operating receivership will require a more intensive and extensive use of a receiver's personnel than a liquidation receivership.

(3) (3) The receivership was difficult and "rather unique".

(4) (4) Mr. Morawetz scrutinized the bills before they were finalized "so that inappropriate charges were not included".

(5) (5) It was not "surprising" that the receiver was required to use many members of its staff to operate the companies' businesses given what he perceived to be problems created by the Parravanos.

(6) (6) It was necessary to use the receiver's personnel to conduct an inventory count in a timely and accurate way for the closing of the sale of the companies' assets.

(7) (7) Mr. Morawetz "had a very good handle on the work and the worth of the legal work".

[18] [18] The motion judge assessed, or passed, the receiver's accounts, including those of its solicitors, Goodmans, in the amounts requested by the receiver in its report. He gave no effect to the objections raised by the appellants. On a number of occasions, he empahsized that there was no contrary evidence from the appellants that, presumably, might have caused him to reduce the fees claimed by the receiver or its solicitors.

[19] [19] He referred to Spence J.'s order appointing KPMG as the receiver, in particular para. 22 of the order as quoted above, and observed at p. 30:

> While certainly not determinative of the issue, that order does contemplate in paragraph 22 a charging system based on standard rates (i.e. docketed hours x hourly rate multiplicand). That would of course be subject to scrutiny – and adjustment as necessary.

[20] [20] He also noted that the appellants had relied on his own decision in *BT–PR Realty Holdings Inc. v. Coopers & Lybrand*, [1997] O.J. No. 1097 in which he had said:

> [An indemnity agreement] is not a licence to let the taxi meter run without check. The professional must still do the job economically. He cannot take his fare from the court house to the Royal York Hotel via Oakville.

As to the application of this observation to the circumstances of this case, the motion judge said at pp. 31-32:

> I am of the view that subject to the checks and balances of *Chartrand v. De la Ronde* (1999), 9 C.B.R. (4th) 20 (Man. Q.B.) a fair and reasonable compensation can in proper circumstances equate to remuneration based on hourly rates and time spent. Further I am of the view that the market is the best test of the reasonableness of the hourly rates for both receivers and their counsel. There is no reason for a firm to be compensated at less than their normal rates (provided that there is a fair and adequate competition in the marketplace). See *Chartrand*; also *Prairie Palace Motel Ltd. v. Carlson* (1980), 35 C.B.R. (N.S.) 312 (Sask. Q.B.). No evidence was led of lack of competition (although I note that Mr. Pape asserts that legal firms and accounting firms had a symbiotic relationship in which neither would complain of the bill of the other). What would be of interest here is whether the rates presented are in fact sustainable. In other words are these firms able to collect 100 cents on the dollar of their "rack rate" or are there write-offs incurred related to the collection process?

Issues and Analysis

[21] [21] In my view, there are three issues to be considered. The first issue is the alleged bias of the motion judge against the appellants and their counsel. The second issue is the proper procedure to be followed by a court-appointed receiver on seeking court approval of its remuneration and that of its solicitor. This procedural issue arises from the second ground of appeal in which the appellants assert that the motion judge erred in precluding their lawyer from cross-examining the receiver in respect to the remuneration that it requested. The third issue is whether the motion judge erred in finding that the remuneration requested by the receiver for itself and its solicitor was fair and reasonable.

(1) Bias

[22] [22] I turn now to the first issue. If I am satisfied that the appellants were denied a fair hearing because the motion judge exhibited a demonstrable bias against the appellants and their counsel, it will be unnecessary to consider the other grounds of appeal since the appellants would be entitled to a new hearing before a different judge. As I will explain, I see no merit in this ground of appeal.

[23] [23] The appellants submit that the motion judge acted with bias against their counsel, Mr. Pape. They rely on the following circumstances as demonstrating the motion judge's bias:

- the motion judge took offence to Mr. Pape having arranged for a court reporter to be present at the hearing.

- the motion judge was affronted by Mr. Pape's request to cross-examine Mr. Morawetz on the receiver's accounts.

- the first paragraph of the motion judge's ruling with respect to Mr. Pape's request to cross-examine Mr. Morawetz (which is quoted in para. 11) demonstrates that the motion judge was not maintaining his impartiality.

- in his ruling the motion judge curtailed the scope of the questions Mr. Pape was permitted to ask Mr. Morawetz and admonished Mr. Pape that he would "have to conduct himself properly".

- Mr. Pape's examination of Mr. Morawetz was curtailed by multiple interjections by the motion judge favouring the receiver.

- the motion judge's ruling on the passing of the receiver's accounts disparaged the appellants and Mr. Pape, in particular, by commenting with sarcasm and derision on Mr. Pape's lawyering.

[24] [24] Public confidence in the administration of justice requires the court to intervene where necessary to protect a litigant's right to a fair hearing. Any allegation that a fair hearing was denied as a result of the bias of the presiding judge is a serious matter. It is particularly serious when made against a sitting judge by a senior and respected member of the bar.

[25] [25] The test for reasonable apprehension of bias on the part of a presiding judge has been stated by the Supreme Court of

Canada in a number of cases. In dissenting reasons in *Committee for Justice and Liberty v. Canada (National Energy Board)* (1976), 68 D.L.R. (3d) 716 at 735, which concerned the alleged bias of the chairman of the National Energy Board, Mr. Crowe, de Grandpré J. stated:

> The proper test to be applied in a matter of this type was correctly expressed by the Court of Appeal. As already seen by the quotation above, the apprehension of bias must be a reasonable one, held by reasonable and right-minded persons, applying themselves to the question and obtaining thereon the required information. In the words of the Court of Appeal [at p. 667], that test is "what would an informed person, viewing the matter realistically and practically - and having thought the matter through - conclude. Would he think that it is more likely than not that Mr. Crowe, whether consciously or unconsciously, would not decide fairly?"

[26] [26] This test was adopted by a majority of the Supreme Court of Canada in *R. v. S. (R.D.)* (1997), 151 D.L.R. (4th) 193. Speaking for the majority, Cory J. expanded upon the test at pp. 229-230:

> This test has been adopted and applied for the past two decades. It contains a two-fold objective element: the person considering the alleged bias must be reasonable, and the apprehension of bias itself must also be reasonable in the circumstances of the case. . . . . Further the reasonable person must be an *informed* person, with knowledge of all the relevant circumstances, including "the traditions of integrity and impartiality that form a part of the background and apprised also of the fact that impartiality is one of the duties the judges swear to uphold"[emphasis in original].

[27] [27] Cory J. concluded at pp. 230-31:

> Regardless of the precise words used to describe the test, the object of the different formulations is to emphasize that the threshold for a finding of real or perceived bias is high. It is a finding that must be carefully considered since it calls into question an element of judicial integrity. Indeed an allegation of reasonable apprehension of bias calls into question not simply the personal integrity of the judge, but the integrity of the entire administration of justice. . . . . Where reasonable grounds to make such an allegation

arise, counsel must be free to fearlessly raise such allegations. Yet, this is a serious step that should not be undertaken lightly.

[28] [28] My review of the transcript of the proceedings and the reasons of the motion judge leads me to conclude that the appellants have failed to satisfy the test. The most that can be said about the motion judge's reaction to the presence of a court reporter, his interjections during the cross-examination of Mr. Morawetz and his reference to Mr. Pape's lawyering in his reasons for judgment, is that he evinced an impatience or annoyance with Mr. Pape. In the circumstances of this case, the motion judge's impatience or annoyance with Mr. Pape does not equate with judicial support for either Mr. Morawetz or the receiver. To the extent that the motion judge's interjections during the examination of Mr. Morawetz reveal his state of mind, they suggest only some impatience with Mr. Pape and a desire to keep the examination moving forward. They did not prevent counsel from conducting a full examination of Mr. Morawetz.

[29] [29] Considered in the context of the entire hearing, the circumstances relied on by the appellants do not come close to the type of judicial conduct that would result in an unfair hearing. I would not, therefore, give effect to this ground of appeal.

(2) The procedure to be followed on the passing of the accounts of a court-appointed receiver

[30] [30] In my view, the motion judge erred in equating the procedure to be followed for approving the receiver's conduct of the receivership with the procedure to be followed in assessing the receiver's remuneration. The receiver's report to the court contained information on its conduct of the receivership as well as details of items such as the fees the receiver paid to its solicitors during the receivership. Such details also relate to or support the receiver's passing of its accounts. However, it is one thing for the court to approve the manner in which a receiver administered the assets it was appointed by the court to manage, but it is a different exercise for the court to assess whether the remuneration the receiver seeks is fair and reasonable (applying the generally accepted standard of review).

[31] [31] Moreover, the rule that precludes cross-examination of a receiver was made in the context of a receiver seeking approval of its report, not in the context of the passing of its accounts. When

a receiver asks the court to approve its compensation, there is an onus on the receiver to prove that the compensation for which it seeks court approval is fair and reasonable.

[32] [32] As I will explain, the problem in this case was that the receiver's accounts were not verified by an affidavit. They were contained in the receiver's report. As a matter of form, I see nothing wrong with a receiver including its claim for compensation in its final report, as the receiver has done in this case. However, as I will discuss, the receiver's accounts and those of its solicitors should be verified by affidavit. Had KPMG verified its claim for compensation by affidavit, and had its solicitors done so, the issue that arose in this case would have been avoided.

[33] [33] The inclusion of the receiver's accounts, including those of its solicitors, in the report had the effect of insulating them from the far-ranging scrutiny of a properly conducted cross-examination when the motion judge ruled that the receiver, as an officer of the court, was not subject to cross-examination on the contents of its report. Assuming, without deciding, that the ruling was correct, its result was to preclude the appellants, and any other interested person or entity, that had a concern about the amount of the remuneration requested by the receiver, from putting the receiver to the proof that the remuneration, in the context of the duties it carried out, was fair and reasonable. When I discuss the third issue, I will indicate how the court is to determine whether a receiver's account is fair and reasonable.

[34] [34] A thorough discussion of the duty of a court-appointed receiver to report to the court and to pass its accounts is contained in F. Bennett, *Bennett on Receiverships*, 2nd ed. (Scarborough: Carswell, 1999) at 443 *et seq.* As Bennett points out at pp. 445-446:

> **. . .** the court-appointed receiver is neither an agent of the security holder nor of the debtor; the receiver acts on its own behalf and reports to the court. The receiver is an officer of the court whose duties are set out by the appointing order. **. . .** Essentially, the receiver's duty is to report to the court as to what the receiver has done with the assets from the time of the appointment to the time of discharge.

A report is required because the receiver is accountable to the court that made the appointment, accountable to all interested parties, and because the receiver, as a court officer, is required to discharge its duties properly. Generally, the report contains two parts. First, the report contains a narrative description about what the

receiver did during a particular period of time in the receivership. Second, the report contains financial information, such as a statement of affairs setting out the assets and liabilities of the debtor and a statement of receipts and disbursements. At p. 449 Bennett provides a list of what should be contained in a report, which does not include the remuneration requested by the receiver. As Bennett states at p. 447, the report need not be verified by affidavit.

> [35] [35] The report is distinct from the passing of accounts. Generally, a receiver completes its management and administration of a debtor's assets by passing its accounts. The court can adjust the fees and charges of the receiver just as it can in the passing of an estate trustee's accounts; the applicable standard of review is whether those fees and charges are fair and reasonable. As stated by Bennett at p. 471, where the receiver's remuneration includes the amount it paid to its solicitor, the debtor (and any other interested party) has the right to have the solicitor's accounts assessed.
> [36] [36] I accept as correct Bennett's discussion of the purpose of the passing of a receiver's accounts at pp. 459-60:
>
> > One of the purposes of the passing of accounts is to afford the receiver judicial protection in carrying out its powers and duties, and to satisfy the court that the fees and disbursements were fair and reasonable. Another purpose is to afford the debtor, the security holder and any other interested person the opportunity to question the receiver's activities and conduct to date. On the passing of accounts, the court has the inherent jurisdiction to review and approve or disapprove of the receiver's present and past activities even though the order appointing the receiver is silent as to the court's authority. The approval given is to the extent that the reports accurately summarize the material activities. However, where the receiver has already obtained court approval to do something, the court will not inquire into that transaction upon a passing of accounts. The court will inquire into complaints about the calculations in the accounts and whether the receiver proceeded without specific authority or exceeded the authority set out in the order. The court may, in addition, consider complaints concerning the alleged negligence of the receiver and challenges to the receiver's remuneration. *The passing of accounts allows for a detailed analysis of the accounts, the manner and the circumstances in which they were incurred, and the time that the receiver took to perform its duties. If there are any triable issues, the court*

can direct a trial of the issues with directions [footnotes omitted] [emphasis added].

[37] [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.

[38] [38] Bennett states that a receiver's accounts and a solicitor's accounts should be verified by affidavit (at pp. 462-63).[1] [1] I agree. This conclusion is supported by both case law and legal commentary. Nathanson J. in *Halifax Developments Limited v. Fabulous Lobster Trap Cabaret Limited* (1983), 46 C.B.R. (N.S.) 117 (N.S.S.C.), adopted the following statement from *Kerr on Receivers*, 15th ed. (London: Sweet & Maxwell, 1978) at 246: "It is the receiver's duty to make out his account and to verify it by affidavit."[2] [2] In *Holmested and Gale on the Judicature Act of Ontario and rules of practice*, vol. 3, looseleaf ed. (Toronto: Carswell 1983) at 2093, the authors state: "[t]he accounts of a receiver and of a liquidator are to be verified by affidavit." In *In-Med Laboratories Ltd. v. Director of Laboratories Services (Ont.)*, [1991] O.J. No. 210 (Div. Ct.) Callaghan C.J.O.C. held that the bill of costs submitted by a solicitor "should be supported by an affidavit

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[1] [1] Among suggested precedents prepared for use in Ontario, at pp. 755-56, Bennett includes a precedent for a Receiver's Report on passing its accounts. The report is in the form of an affidavit in which the receiver, *inter alia*, includes a statement verifying its requested remuneration and expenses.

[2] [2] Although the practice in England formerly required that a receiver's accounts be verified by affidavit, the present practice is different. Now the court becomes involved in the scrutiny of a receiver's accounts, requiring their proof by the receiver, only if there are objections to the account. See R. Walton & M. Hunter, *Kerr on Receivers & Administrators*, 17th ed. (London: Sweet & Maxwell, 1989) at 239.

. . . substantiating the hours spent and the disbursements". This court approved that practice in *Murano v. Bank of Montreal* (1998), 163 D.L.R. (4th) 21 at 52-53 (Ont. C.A.), in discussing the fixing of costs by a trial judge under rule 57.01(3) of the *Rules of Civil Procedure* (as it read at that time). In addition, I note that on the passing of an estate trustee's accounts, rule 74.18(1)(a) requires the estate trustee to verify by affidavit the estate accounts which, by rule 74.17(1)(i), must include a statement of the compensation claimed by the estate trustee. However, if there are no objections to the accounts, under rule 74.18(9) the court may grant a judgment passing the accounts without a hearing. Thus, the practice that requires a court-appointed receiver to verify its statement of fees and disbursements on the passing of its accounts conforms with the general practice in the assessment of the fees and disbursements of solicitors and trustees.

[39] [39] The requirement that a receiver verify by affidavit the remuneration which it claims fulfils two purposes. First, it ensures the veracity of the time spent by the receiver in carrying out its duties, as provided by the receivership order, as well as the disbursements incurred by the receiver. Second, it provides an opportunity to cross-examine the affiant if the debtor or any other interested party objects to the amount claimed by the receiver for fees and disbursements, as provided by rule 39.02(1). In the appropriate case, an objecting party may wish to provide affidavit evidence contesting the remuneration claimed by the receiver, in which case, as rule 39.02(1) provides, the affidavit evidence must be served before the party may cross-examine the receiver.

[40] [40] Where the receiver's disbursements include the fees that it paid its solicitors, similar considerations apply. The solicitors must verify their fees and disbursements by affidavit.

[41] [41] In many cases, no objections will be raised to the amount of the remuneration claimed by a receiver. In some cases, however, there will be objections. Objecting parties may choose to support their position by tendering affidavit evidence. In some instances, it may be necessary for the court before whom the receiver's accounts are to be passed to conduct an evidentiary hearing, or direct the hearing of an issue before another judge, the master or another judicial officer. This situation would usually arise where there is a conflict in the affidavit evidence in respect to a material issue. The case law on the passing of accounts referred to by the parties indicates that evidentiary hearings are quite common. See, *e.g.*, *Canadian Imperial Bank of Commerce v. Barley Mow Inn Inc.* (1996), 41 C.B.R. (3d) 251 (B.C.C.A.); *Hermanns v. Ingle*,

supra; *Belyea & Fowler v. Federal Business Development Bank* (1983), 46 C.B.R. (N.S.) 244 (N.B.C.A.); *Walter E. Heller, Canada Limited v. Sea Queen of Canada Limited* (1974), 19 C.B.R. (N.S.) 252 (Ont. S.C., Master); *Olympic Foods (Thunder Bay) Ltd. v. 539618 Ontario Inc.* (1989), 40 C.P.C. (2d) 280 (Ont. S.C.); *Cohen v. Kealey & Blaney* (1988), 26 C.P.C. (2d) 211 (Ont. C.A.). These and other cases also illustrate that courts employ careful scrutiny in determining whether the remuneration requested by a receiver is fair and reasonable in the context of the duties which the court has ordered the receiver to perform. I will now turn to a discussion of what is "fair and reasonable".

(3) Fair and reasonable remuneration

[42] [42] As I stated earlier, the general standard of review of the accounts of a court-appointed receiver is whether the amount claimed for remuneration and the disbursements incurred in carrying out the receivership are fair and reasonable. This standard of review had its origin in the judgment of this court in *Re Atkinson*, [1952] O.R. 685 (C.A.); aff'd [1953] 2 S.C.R. 41, in which it was held that the executor of an estate is entitled to a fair fee on the basis of *quantum meruit* according to the time, trouble and degree of responsibility involved. The court, however, did not rule out compensation on a percentage basis as a fair method of estimating compensation in appropriate cases. The standard of review approved in *Re Atkinson* is now contained in s. 61(1) and (3) of the *Trustee Act*, R.S.O. 1990, c. T.23. Although *Re Atkinson* was concerned with an executor's compensation, its principles are regularly applied in assessing a receiver's compensation. See, *e.g.*, *Ibar Developments Ltd. v. Mount Citadel Limited and Metropolitan Trust Company* (1978), 26 C.B.R. (N.S.) 17 (Ont. S.C., Master). I would note that there is no guideline controlling the quantum of fees as there is in respect to a trustee's fees as provided by s. 39(2) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

[43] [43] Bennett notes at p. 471 that in assessing the reasonableness of a receiver's compensation the two techniques discussed in *Re Atkinson* are used. The first technique is that the quantum of remuneration is fixed as a percentage of the proceeds of the realization, while the second is the assessment of the remuneration claimed on a *quantum meruit* basis according to the time, trouble and degree of responsibility involved in the receivership. He suggests that often both techniques are employed to arrive at a fair compensation.

[44] [44] The leading case in the area of receiver's compensation is *Belyea*. At p. 246 Stratton J.A. stated:

> There is no fixed rate or settled scale for determining the amount of compensation to be paid a receiver. He is usually allowed either a percentage upon his receipts or a lump sum based upon the time, trouble and degree of responsibility involved. The governing principle appears to be that the compensation allowed a receiver should be measured by the fair and reasonable value of his services and while sufficient fees should be paid to induce competent persons to serve as receivers, receiverships should be administered as economically as reasonably possible. Thus, allowances for services performed must be just, but nevertheless moderate rather than generous.

[45] [45] In considering the factors to be applied when the court uses a *quantum meruit* basis, Stratton J.A. stated at p. 247:

> The considerations applicable in determining the reasonable remuneration to be paid to a receiver should, in my opinion, include the nature, extent and value of the assets handled, the complications and difficulties encountered, the degree of assistance provided by the company, its officers or its employees, the time spent, the receiver's knowledge, experience and skill, the diligence and thoroughness displayed, the responsibilities assumed, the results of the receiver's efforts, and the cost of comparable services when performed in a prudent and economical manner.

[46] [46] In an earlier case, similar factors were employed by Houlden J. in *Re West Toronto Stereo Center Limited* (1975), 19 C.B.R. (N.S.) 306 (Ont. S.C.) in fixing the remuneration of a trustee in bankruptcy under s. 21(2) of the *Bankruptcy Act*, R.S.C. 1970, c. B-3. At p. 308 he stated:

> In fixing the trustee's remuneration, the Court should have regard to such matters as the work done by the trustee; the responsibility imposed on the trustee; the time spent in doing the work; the reasonableness of the time expended; the necessity of doing the work, and the results obtained. I do not intend that the list which I have given should be exhaustive of the matters to be considered, but in my judgment they are the more important items to be taken into account.

These factors were applied by Henry J. in *Re Hoskinson* (1976), 22 C.B.R. (N.S.) 127 (Ont. S.C.).

> [47] [47] The factors to be considered in assessing a receiver's remuneration on a *quantum meruit* basis stated in *Belyea* were approved and applied by the British Columbia Court of Appeal in *Bank of Montreal v. Nican Trading Co.* (1990), 78 C.B.R. (N.S.) 85 (B.C.C.A.). They have also been applied at the trial level in this province. See, *e.g.*, *MacPherson v. Ritz Management Inc.*, [1992] O.J. No. 506 (Gen. Div.).
>
> [48] [48] The *Belyea* factors were also applied by Farley J. (the motion judge in this case) in *BT-PR Realty Holdings*, *supra*, which was an application for the reduction of the fees and charges of a receiver. In that case the debtor had entered into the following indemnity agreement with the receiver:
>
> > Guarantee payment of Coopers & Lybrand Limited's professional fees and disbursements for services provided by Coopers & Lybrand Limited with respect to the appointment as Receiver of each of the Companies. It is understood that Coopers & Lybrand Limited's professional fees will be determined on the basis of hours worked multiplied by normal hourly rates for engagements of this type.

In reference to the indemnity agreement, Farley J. made the comment referred to above that "[t]his is not a license to let the taxi meter run without check."

> [49] [49] He went on to add at paras. 23 and 24:

While sufficient fees should be paid to induce competent persons to serve as receivers, receiverships should be administered as economically as reasonably possible: see *Belyea v. Federal Business Development Bank* (1983), 46 C.B.R. (N.S.) 244 (N.B.C.A.). Reasonably is emphasized. It should not be based on any cut rate procedures or cutting corners and it must relate to the circumstances. It should not be the expensive foreign sports model; but neither should it be the battered used car which keeps its driver worried about whether he will make his destination without a breakdown.

> [50] [50] Farley J. applied the list of factors set out in *Belyea* and *Nican Trading* and added "other material considerations" pertinent to assessing the accounts before him. He concluded at para. 24:

> In the subject case C&L charged on the multiplicand basis. Given their explanation and the lack of any credible and reliable evidence to the contrary, I see no reason to interfere with that charge. It would also seem to me that on balance C&L scores neutrally as to the other factors and of course, the agreement as to the fees should be conclusive if there is no duress or equivalent.

[51] [51] I am satisfied that in assessing the compensation of a receiver on a *quantum meruit* basis the factors suggested by Stratton J.A. in *Belyea* are a useful guideline. However, they should not be considered as exhaustive of the factors to be taken into account as other factors may be material depending on the circumstances of the receivership.

[52] [52] An issue that has arisen in this appeal has been the subject of consideration by the courts. It is whether a receiver may charge remuneration based on the usual hourly rates of its employees. The appellants take the position that the receiver's compensation based on the hourly rates of its employees has resulted in excessive compensation in relation to the amount realized by the receivership. The appellants point out that the compensation requested is approximately 20% of the amount realized. As I noted in paragraph 20, the motion judge held that "subject to checks and balances" of *Chartrand v. De la Ronde*, and *Prairie Palace Motel Ltd. v. Carlson*, a "fair and reasonable compensation can in proper circumstances equate to remuneration based on hourly rates and time spent". It is helpful to consider these cases.

[53] [53] In *Chartrand* the issue was whether a master had erred in principle in reducing a receiver's accounts, calculated on the basis of its usual hourly rates, on the ground that the entity in receivership was a non-profit federation. Although Hamilton J. was satisfied that the master had appropriately applied the factors recommended in *Belyea*, she concluded that the master had erred in reducing the receiver's compensation because the federation was a non-profit organization. She was otherwise in agreement with the master's application of the *Belyea* criteria to the circumstances of the receivership. However, she added at p. 32:

> Having said that, I do not interpret the *Belyea* factors to mean that fair and reasonable compensation cannot equate to remuneration based on hourly rates and time spent.

By this comment I take Hamilton J. to mean that there may be cases in which the hourly rates charged by a receiver will be reduced if the application of one or more

of the *Belyea* factors requires the court to do so to constitute fair and reasonable remuneration. I presume that this is what the motion judge had in mind when referring to "the checks and balances" of *Chartrand*.

> [54] [54] In *Prairie Palace Motel* the court rejected a submission that a receiver's fees should be restricted to 5% of the assets realized and stated at pp. 313-14:
>
> > In any event, the parties to this matter are all aware that the receiver and manager is a firm of chartered accountants of high reputation. In this day and age, if chartered accountants are going to do the work of receiver-managers, in order to facilitate the ability of the disputing parties to carry on and preserve the assets of a business, there is no reason why they should not get paid at the going rate they charge all of their clients for the services they render. I reviewed the receiver-manager's account in this matter and the basis upon which it is charged, and I have absolutely no grounds for concluding that it is in any way based on client fees which are not usual for a firm such as Touche Ross Ltd.

Conclusion

(1) Bias

> [55] [55] As I concluded earlier, the motion judge did not exhibit bias against the appellants or their counsel rendering the hearing unfair.

(2) Cross-examination of the receiver

> [56] [56] The appellants did not have an opportunity to cross-examine Mr. Morawetz or another representative of the receiver in respect to its remuneration. Nor did they have an opportunity to cross-examine a representative of the receiver's solicitors, Goodmans, in respect to their fees and disbursements. This was as a result of the process sanctioned by the motion judge on the passing of the receiver's accounts in implicitly not requiring that the receiver's and the solicitors' accounts be verified by affidavit. Whether the appellants' lack of an opportunity to cross-examine the appropriate person in respect to these accounts should result in a new assessment being ordered, or whether this should be considered as a harmless error, requires further examination of the process followed

by the motion judge in the context of the procedural history of the receiver's passing of its accounts.

[57] [57] Mr. Pape was not the appellants' original solicitor. The appellants were represented by another lawyer on February 9, 2001 when the receiver moved for approval of its accounts. The bank, which was directly affected by the receiver's charges, supported the fees and disbursements claimed by the receiver. Another creditor expressed concern that the receiver's fees were extremely high, but did not oppose their approval. Only the appellants opposed their approval. On February 16, 2001, which was the first return of the motion, the motion judge granted the appellants' request for an adjournment to February 26, 2001 to provide them a reasonable opportunity to review the receiver's accounts.

[58] [58] On February 26, 2001, the appellants requested a further adjournment to enable them to obtain an expert's opinion commenting on the fees of the receiver and its solicitors. The motion judge granted an adjournment to April 17, 2001 on certain terms, including the requirement that the receiver provide the appellants with curricula vitae and professional designations of its personnel, which the receiver did about two weeks later. The appellants' counsel informed the motion judge that he intended to examine "one or two people" from the receiver about its fees, whether or not they filed an affidavit. It appears that this was satisfactory to the motion judge who wrote in his endorsement: "A reporter should be ordered; counsel are to mutually let the court office know as to what time and extent of time a reporter will be required."

[59] [59] On March 13, 2001, the receiver wrote to the appellants to advise them of its position that any cross-examination in respect of the receiver's report to the court was not permitted in law. However, the receiver said that it would accept and respond to written questions about its fees and disbursements. On April 4, 2001, the appellants gave the receiver twenty-nine written questions. The receiver answered the questions on April 10, 2001, and invited the appellants, if necessary, to request further information. The receiver offered to make its personnel available to meet with the appellants and their counsel to answer any further questions about its fees. By this time, Mr. Pape had been retained by the appellants. He did not respond to the meeting proposed by the receiver, but, rather, wrote to the receiver on April 12, 2001 stating that arrangements had been made for a court reporter to be present to take the evidence of the receiver at the hearing of the motion on April 17, 2001.

[60] [60] This set the stage for the motion of April 17, 2001 at which, as I have explained, the motion judge ruled that the appellants were precluded from cross-examining the receiver's representative, Mr. Morawetz, on the receiver's accounts, but nevertheless permitted Mr. Pape, as his "proxy", to question Mr. Morawetz, as an unsworn witnesses, about the accounts. In the discussion between the motion judge and counsel for all the parties concerning the propriety of Mr. Pape having made arrangements for the presence of a court reporter, it appears that every one had overlooked the motion judge's earlier endorsement that a reporter should be ordered for the passing of the accounts.

[61] [61] Although the appellants had obtained an adjournment to obtain expert reports about the receiver's fees, no report was ever provided by the appellants. They did file an affidavit of Mrs. Parravano, but did not rely on it at the hearing of the motion.

[62] [62] It appears from the motion judge's reasons for judgment and what the court was told by counsel that the practice followed in the Commercial List permits a receiver to include its request for the approval of its fees and disbursements in its report, with the result that any party opposing the amounts claimed is not able to cross-examine the receiver, or its representative, about the receiver's fees. In denying the appellants' counsel the opportunity to cross-examine Mr. Morawetz under oath, at p. 26 of his reasons, the motion judge referred to the practice that is followed in the Commercial List: "The more appropriate course of action is to proceed to interview the court officer [the receiver] with respect to the report so as to allow the court officer the opportunity of clarifying or amplifying the material in response to questions. That course of action was pointed out to the Parravanos and their previous counsel . . . ."

[63] [63] Mr. Pape, before the motion judge, and Mr. Teplitsky, in this court, submitted that neither the practice of interviewing the receiver, nor the opportunity given to Mr. Pape to question Mr. Morawetz as the motion judge's proxy, is an adequate and effective substitute for the cross-examination of the receiver under oath. I agree. However, as I will explain, I am satisfied that in the circumstances of this case Mr. Pape's questioning of Mr. Morawetz was an adequate substitute for cross-examining him. It is well-established, as a matter of fundamental fairness, that parties adverse in interest should have the opportunity to cross-examine witnesses whose evidence is presented to the court, and upon which the court is asked to rely in coming to its decision. Generally speaking, in conducting a cross-examination counsel are given wide latitude and

few restrictions are placed upon the questions that may be asked, or the manner in which they are asked. See J. Sopinka, S. N. Lederman, A. W. Bryant, *The Law of Evidence in Canada*, 2nd ed. (Toronto: Butterworths, 1999) at paras. 16.6 and 16.99. As I observed earlier, in the cases in which the quantum of a receiver's fees has been assessed, cross-examination of the receiver and evidentiary hearings appear to be the norm, rather than the exception.

[64] [64] In my view, the motion judge was wrong in equating the receiver's report with respect to its conduct of the receivership with its report as it related to its claim for remuneration. As the authorities indicate, the better practice is for the receiver and its solicitors to each support its claim for remuneration by way of an affidavit. However, the presence or absence of an affidavit should not be the crucial issue when it comes to challenging the remuneration claimed. Whether or not there is an affidavit, the interested party must have a fair opportunity to challenge the remuneration at the hearing held for that purpose. I do not think that an interested party should have to show "special" or "unusual" circumstances in order to cross-examine a receiver or its representative, on its remuneration.

[65] [65] Where the accounts have been verified by affidavit, rule 39.02(1) provides that the affiant may be cross-examined by any party of the proceedings. Although there is a *prima facie* right to cross-examine upon an affidavit, the court has discretion to control its own process by preventing cross-examination or limiting it, where it is in the interests of justice to do so. See, *e.g.*, *Re Ferguson and Imax Systems Corp.* (1984), 47 O.R. (2d) 225 (Div. Ct.). It would, in my view, be rare to preclude cross-examination where the accounts have been challenged. Similarly, where the accounts have not been verified by affidavit, the motion judge has discretion to permit an opposing party to cross-examine the receiver, or its representative. In my view, the threshold for permitting questioning should be quite low. If the judge is satisfied that the questioning may assist in determining whether the remuneration is fair and reasonable, cross-examination should be permitted. In this case, I am satisfied that the submissions made by Mr. Pape at the outset of the proceedings were sufficient to cross that threshold.

[66] [66] Thus, whether or not there is an affidavit, the opposing party must have a fair opportunity to challenge the remuneration claimed. That fair opportunity requires that the party have access to the relevant documentation, access to and the co-operation of the receiver in the review of that material prior to the

passing of the accounts, an opportunity to present any evidence relevant to the appropriateness of the accounts and, where appropriate, the opportunity to cross-examine the receiver before the motion judge, or on the trial of an issue or an assessment, should either be directed by the motion judge.

[67] [67] In this case, I am satisfied that the appellants had a fair opportunity to challenge the remuneration of the receiver and that the questioning of Mr. Morawetz was an adequate substitute for cross-examining him. I base my conclusion on the following factors:

- The appellants had the report for over two months.
- The appellants had access to the backup documents for over two months.
- The appellant had been given two adjournments to procure evidence.
- The appellants had the opportunity to meet with the receiver and in fact did meet with the receiver.
- The appellants submitted a detailed list of questions and received detailed answers. Mr. Pape expressly disavowed any suggestion that those answers were unsatisfactory or inadequate.
- The motion judge allowed Mr. Pape to question the receiver for some 75 pages. That questioning was in the nature of a cross-examination. I can find nothing in the transcript to suggest that Mr. Pape was precluded form any line of inquiry that he wanted to follow. Certainly, he did not suggest any such curtailment.
- Mr. Pape was given a full opportunity to make submissions.

(3) The remuneration claimed by the receiver and its solicitor

[68] [68] Having found no reason to label the proceedings as unfair in any way as they concern the receiver's remuneration, I shall now consider, on a correctness standard if there is any reason to interfere with the motion judge's decision on the receiver's remuneration.

[69] [69] In my view, the motion judge was aware of the relevant principles that apply to the assessment of a receiver's remuneration as discussed in *Belyea* and the other cases that I have reviewed. He considered the specific arguments made by Mr. Pape. He had the receiver's reports, the backup documents, the opinion of Mr. Morawetz, all of which were relied on, properly in my view, to support the accounts submitted by the receiver. Against that, the motion judge had Mr. Pape's submissions based on his personal

view of what he called "human nature" that he argued should result in an automatic ten percent deduction from the times docketed by the receiver's personnel. In my view, the receiver's accounts as they related to its work were basically unchallenged in the material filed on the motion. I do not think that the motion judge can be criticized for preferring that material over Mr. Pape's personal opinions.

[70] [70] In addition, the position of the secured creditors is relevant to the correctness of the motion judge's decision. The two creditors who stood to lose the most by the passing of the accounts accepted those accounts.

[71] [71] The terms of the receiving order of Spence J. are also relevant, although not determinative. Those terms provided for the receiver's payment "at the standard rates and charges for such services rendered". Mr. Morawetz's evidence was that these were normal competitive rates. There was no evidence to the contrary, except Mr. Pape's personal opinions. It is telling that despite the two month adjournment and repeated promises of expert evidence from the appellants, they did not produce any expert to challenge those rates.

[72] [72] However, the accounts of the receiver's solicitors, Goodmans, stand on a different footing. Mr. Morawetz really could not speak to the accuracy or, except in a limited way, to the reasonableness of those accounts. There was no representative of Goodmans for the appellants to question or cross-examine. The motion judge did not give these accounts separate consideration. In my view, he erred in failing to do so. Consequently, I would allow the appeal to that extent.

Result

[73] [73] For the foregoing reasons, I would allow the appeal to the extent of setting aside the order of the motion judge approving the accounts of the receiver's solicitors, Goodmans, and order that the accounts be resubmitted, verified by affidavit, and that they be assessed by a different judge who may, in his or her discretion, direct the trial of an issue or refer the accounts for assessment by the assessment officer. In all other respects, the appeal is dismissed. As success is divided, there will be no costs.

Released: September 19, 2002

"S. Borins J.A."

“I agree M. A. Catzman J.A.”

“I agree Doherty J.A.”