

Clerk's Stamp



COURT FILE NUMBER

1903 12504

COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE

EDMONTON

PLAINTIFF

MAYNBRIDGE CAPITAL INC.

DEFENDANTS

VOICE CONSTRUCTION OPCO ULC, VOICE
MANAGEMENT LTD., VOICE
CONSTRUCTION LTD., EARTH & ENERGY
CONSTRUCTION LTD., VOICE HOLDINGS
LTD., and 2012442 ALBERTA LTD.

DOCUMENT

**BRIEF OF LAW FOR ORDER APPROVING
AND VESTING SALE AND OTHER RELIEF**

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS DOCUMENT

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I. INTRODUCTION

1. This brief of law is submitted on behalf of Alvarez & Marsal Canada Inc. (the “**Receiver**”) in its capacity of the court-appointed Receiver and Manager of the Voice Construction OPCO ULC, Voice Management Ltd., Voice Construction Ltd., Earth & Energy Construction Ltd., Voice Holdings Ltd., Voice Holdings Ltd., and 2012442 Alberta Ltd. (collectively, the “**Debtor**”) in support of its application (the “**Application**”) for, among other things, an Order:
 - (a) ratifying the agreement between the Receiver in its capacity as receiver of the Debtor (and not in its personal or corporate capacity) and GD Auction and Appraisals Inc. (“**GDA**”) dated September 17, 2019 for the auction (the “**Auction Proposal**”) of the assets described in the Third Report of the Receiver dated September 23, 2019 (the “**Third Report**”) as the Edmonton Yard Assets (the “**Edmonton Yard Assets**”);
 - (b) sealing the Confidential Appendices 1 and 2 to the Third Report (the “**Confidential Appendices**”); and
 - (c) making declarations with respect to the secured interests of Jim Peplinski Leasing Inc. (“**Peplinski**”), ARI Financial Services Inc. (“**ARI**”), Grand Tire Inc. (“**GTI**”) and Jim Pattison Industries Ltd. (“**Pattison**”)
2. The Application has been brought in accordance with paras 3(h), (k), (l), and (m) of the Order of the Honourable Associate Chief Justice K.G. Nielsen of the Court of Queen’s Bench of Alberta (the “**Court**”) granted June 25, 2019 (the “**Receivership Order**”), which authorized the Receiver to, among other things, execute, assign, issue and endorse documents of whatever nature in respect of any of the Property (as defined in the Receivership Order) for any purpose pursuant to the Receivership Order and market any or all of the Property, sell the Property or any parts thereof, and apply for any vesting order necessary to convey the Property or any parts thereof, free and clear of any liens of encumbrances.¹

¹ *Consent Receivership Order*, granted by the Honourable Associate Chief Justice K.G. Nielsen on June 25, 2019 QB Action No. 1903 12504 [*Consent Receivership Order*] [TAB 1] para 3.

3. The Receiver submits that the relief sought is reasonable and appropriate in the circumstances and at this stage of these proceedings.

II. BACKGROUND

4. A detailed background of the Debtor and the Receiver's activities leading up to the Application is more fully described in the Receiver's First, Second and Third Reports. A brief overview of these proceedings is set out below.

A. The Debtor

5. The Debtor is a body of affiliated corporations carrying on business of providing civil construction services, including, heavy construction, earthworks, contracting services, and environmental management, primarily to the energy and resource sector in Western Canada for over 75 years. The company is headquartered in Edmonton, Alberta.

B. Indebtedness and Security

6. On June 25, 2019, Maynbridge Capital Inc. ("**Maynbridge**") applied to appoint a receiver over the current and future assets, undertakings and properties of the Debtor.
7. Maynbridge, is the assignee and successor in interest of a syndicate of lenders, including their agent, ATB Financial (formerly Alberta Treasury Branches) ("**ATB**"), under the subject syndicate loan agreement. At the time of the appointment of the Receiver, Maynbridge held various security over the Property of the Debtor, including security interests in all present and after-acquired property of the Debtor ("**AIIPAAP**").
8. Each of Maynbridge, Caterpillar Financial Services Limited ("**Caterpillar**"), Peplinski, ARI, GTI and Pattison has registered security interests against some or all of the Edmonton Yard Assets as more thoroughly described in the Third Report.

C. Auction Proposal

9. The Auction Proposal is a no-commission proposal unless the aggregate proceeds of the sale of the Edmonton Yard Assets exceeds a minimum threshold. As set out in more detail in the Confidential Appendices, the minimum threshold exceeds the aggregate appraised liquidation value of the Edmonton Yard Assets.
10. As the Auction Proposal is for an on-site auction, the Receiver's costs are limited to the maximum of \$30,000 for disbursements set out in the Auction Proposal, unless the

minimum threshold is exceeded, at which point the Receivership will share the excess with GDAA as set out in the Auction Proposal.

11. This is a cost structure that the Receiver has opined in the Third Report is very favourable.
12. Further, the Edmonton Yard incurs approximately \$100,000 in rent charges a month. The Auction Proposal provides that the Receiver will be able to vacate the Edmonton Yard prior to the beginning of November, 2019. As the Debtor was assigned into bankruptcy on August 1, 2019, occupancy in excess of three months from August 1, 2019, triggers a requirement for three months' notice of termination of occupancy or payment in lieu by the Receiver: *Landlord's Rights on Bankruptcy Act*, RSA 2000, c. L-5 at s.

Surrender of possession

6 The trustee may surrender possession at any time, but if the trustee occupies the leased premises for 3 months or more beyond the date of the receiving order or assignment the landlord is entitled to receive 3 months' notice in writing of the trustee's intention to surrender possession, or 3 months' rent instead of notice.

13. An auction of the Edmonton Yard Assets allows the assets to be exposed to the market in a competitive bid process, resulting in realization reflective of the true market for the assets.
14. The Receiver has reviewed and determined that the Auction Proposal is fair and reasonable and in the best interest of the Debtor, the creditors, and shareholders. As set out below, the Receiver has met the test for this Honourable Court to grant the Order approving and ratifying the Auction Proposal.

III. ISSUES

15. The issues to be determined by this Honourable Court are whether it is appropriate and reasonable in the circumstances to:
 - (a) make certain declaration with respect to the security interests claimed in the Edmonton Yard Assets;
 - (b) approve the Auction Proposal;
 - (c) grant a sealing order with respect to the Confidential Supplemental;

IV. SUBMISSIONS

A. Secured Interests in the Edmonton Assets

Peplinski

16. As set out in the legal opinion appended to the Third Report, it is the opinion of counsel to the Receiver, Miller Thomson LLP (“MT”), that Peplinski has a valid security interest in:

2011 Ford 25 passenger airport bus F550 1FDGF5GT1BEA39000

(the “**Peplinski Vehicle**”)

17. As the documents provided by Peplinski show the amount outstanding with respect to the Peplinski Vehicle is a guaranteed residual of \$195.00 plus GST, the Receiver recommends a declaration that Peplinski security be declared valid with respect to the Peplinski Vehicle for a secured amount of \$204.75, including GST.

ARI

18. The ARI leases are individual Motor Vehicle Lease Agreements (“**MVLA**”s) made pursuant to a master Lease Agreement made between ARI and Voice Construction OPCO ULC (“**Voice OPCO**”) (the “ARI Master Lease”).
19. ARI has asserted that it has entered into true leases with the Debtor and is entitled to return of its leased equipment.
20. MT has provided the Receiver with an opinion that the ARI leases are financing leases, not true leases, and, as a result, ARI is only entitled to unpaid financing payments as a secured charge. The MT Opinion, along with the ARI Master Lease and sample MVLA, along with payout invoices, is attached as an Appendix to the Third Report.
21. The legal distinction between true leases and financing leases is set out in *Royal Bank v. Cow Harbour Construction Ltd.*, 2012 ABQB 59 [Tab 2], which summarizes the difference as “paying for the use of the property” in a true lease situation as compared to

“earning equity” in the equipment through a “debt obligation clothed in the guise of a lease”.²

22. Lists of factors to consider when distinguishing between a true lease and a financing lease are found at paras. 51, 56 and 57 of *Cow Harbour*.
23. Pursuant to paragraph 9 of the ARI Master Lease, the ARI leases are open ended, with a sale of the vehicle being contemplated at the end of the lease term. Voice OPCO, as lessee, is entitled to the benefit of any surplus achieved on sale over the “Book Value” and responsible for any shortfall.
24. The Book Value is defined as “the original capitalization cost of the vehicle as specified in the MVLA, less accumulated depreciation at the rate specified in the MVLA for the number of months the vehicle was in service.”
25. In each case for the MVLA, the depreciation period matched the lease term so that at the end of the depreciation period, the Book Value was zero. As a result, Voice OPCO is entitled to all equity that has been built up in the respective vehicle, which is sufficient to classify the leases as financing leases.
26. The ARI leases also satisfy a number of secondary factors confirming that they are financing leases: the vehicles were selected by Voice OPCO, then purchased by ARI, who is in business of financing vehicles and leased to ARI, the total payments under the leases approximate the purchase price, plus financing costs and Voice OPCO was responsible for all insurance, maintenance and damage arising from the leased vehicles.
27. Of the 8 vehicles, the lease terms for 3 vehicles had expired as of the date of the Receivership and all lease payments during the depreciation term appear to have been paid. For the remaining 5 vehicles, one final monthly payment in the depreciation term remains for each vehicle.
28. The ARI Master Lease does provide that ARI is the party to sell the leased vehicles, however, given the intervening receivership, the Court is entitled to determine if the secured creditor or the Receiver is more appropriate to sell the equipment. See, for example:

² “*Cow Harbour*” at para 18 [TAB 2].

- (a) *Royal Bank v. Cow Harbour Construction Ltd.*, 2010 ABQB 637 at paras 41 and 42 **[Tab 3]** whereby an en block sale of equipment was approved in the interests of all stakeholders over the objection of specific equipment lessors;
 - (b) *Integris Credit Union v. Mercedes-Benz Financial Services Canada Corp.*, 2016 BCCA 231 **[Tab 4]**, which granted an application for equipment lessors to remove equipment from a receivership where they had purchase-money security interests and had taken a position from the outset of the receivership that their equipment was to be removed.
29. It is the Receiver's opinion that the sale of the Edmonton Yard Assets by an en block auction is in the interests of all stakeholders.
30. In each instance , there is significant equity in the vehicles subject to the ARI Leases for the benefit of the estate. As a result, the Receiver's recommendation to sell pursuant to the Auction Proposal should be confirmed.
31. As the Auction Proposal is a no-cost proposal unless liquidation values are exceeded, there is no more cost-effective way to realize on the assets. Further, sale by auction is a transparent sale to arm's length parties, which avoids the valuation issues that arise when equipment lessors retake equipment and resell through internal processes.
32. Additionally, the Receiver has spent significant time and expenses to secure all of the equipment of the Debtors for orderly resale. These costs are subject to an allocation against all of the recovered assets, including assets secured by financing lessors: *Winnipeg Motor Express Inc.*, Re 2009 MBQB 204 at para. 51 **[Tab 5]**, leave to appeal refused: 2009 MBCA 110 and *Respec Oilfield Services Ltd.*, Re, 2019 ABQB 277 at para. 32 **[Tab 6]**.
33. The ARI leases do provide that "[t]he account of Lessee will not be credited for net gain realized, plus any tax credits over amounts owed Lessor by Lessee if at the time of the issuance of the credit, Lessee is in default of payment required or in the performance of this Agreement."
34. Although Voice OPCO may be in default under the ARI Master Lease by virtue of the receivership, the anti-depravation rule invalidates contractual provisions that would, as their predominant purpose, deprive the insolvency estate of property: *Capital Steel Inc. v. Chandos Construction Ltd.*, 2019 ABCA 32 **[Tab 7]** at para. 46.

35. Alternately, giving weight to the clause would allow Voice OPCO to lose the benefit of all equity in the vehicle as a result of any default. Such a clause constitutes a penalty, not a reasonable estimate of liquidated damages and is accordingly void: *Super Save Disposal (Alberta) Ltd. v. Shenwei Enterprises Ltd.*, 2017 ABQB 805 at paras 17-19 [Tab 8].
36. Finally, the ARI Lease provides for a \$25.00 monthly rental fee following the term of lease. Given the intervening Receivership and Bankruptcy, and that the equity in each of the ARI vehicles was fully earned prior to the purported monthly rental fee, the Receiver submits that these monthly rental fees should be classified as unsecured rental fees for rent which was not attained to by the Receiver.

GTI

37. GTI has been unable to produce a security agreement to support its security interest in the Edmonton Yard Assets.
38. Pursuant to s. 10(1)(d) of the *PPSA*, a security interest is only enforceable against a third party where the debtor has signed a security agreement that a valid security interest and description of collateral.
39. Without a signed security agreement, GTI cannot have a valid security interest. This does not impact the validity of any garage keeper's lien that GTI has registered.

Jim Pattison

40. Jim Pattison provided a Commercial Motor Vehicle Master Lease Agreement between Jim Pattison Industries and Voice Construction Limited dated March 25, 2011 (the "Master Lease Agreement"), a Master Fleet Management Agreement made between Jim Pattison and Voice OPCO dated August 31, 2015 (the "Fleet Agreement") and 39 separate "Lease Order – Open End" documents made between Jim Pattison and Voice Construction OPCO ULC (the "Leases").
41. The Leases refer to a Commercial Motor Vehicle Master Lease Agreement between Jim Pattison, as lessor, and Voice Construction OPCO ULC however, Jim Pattison could not provide that document.

42. Contract law limits the application of a contract to the parties to the contract, unless a principled exception applied to relax the doctrine of privity of contract: *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108 [Tab 9].
43. No principled exception applied here to allow the Master Lease Agreement to be binding on Voice OPCO.
44. The Master Lease Agreement also contains a prohibition on assignment by Voice Construction Ltd. at paragraph 22 and an entire agreement clause at paragraph 25.
45. As a result of the doctrine of privity of contract, the Master Lease Agreement with Voice Construction Limited does not apply to the Leases made with Voice OPCO.
46. Each of the Leases constitutes a lease for a term of more than one year. Pursuant to s. 1(1)(t) of the *PPSA*, the interest of a lessor under a lease for a period of more than one year constitutes a security interest, as well as, pursuant to s. 1(1)(l), a purchase-money security interest.
47. Each of the Leases is with respect to equipment that constitutes serial number goods as well as mobile goods under the *PPSA*.
48. As a result, the Leases created deemed security interests in favour of Jim Pattison for the obligations under the Leases, being unpaid monthly rental costs, as well as the amount indicated as the “Guaranteed Residual Value”.
49. Jim Pattison has provided a payout schedule for each of the Leases, per lease, as well as providing a claim for \$80,000 for fuel and maintenance under the Fleet Agreement.
50. There is no security interest created by the Fleet Agreement to secured that obligation against the Leases.
51. Pursuant to the residual priority rules in the *PPSA* in s. 35(4), priority to goods that are equipment that constitute serial number goods under the regulations is determined by order of registration by serial number. As a result, the interests of Jim Pattison are subordinate to Maynbridge with respect to the four vehicles which Maynbridge has first registered by serial number.
52. As set out above with respect to the ARI vehicles, it is appropriate to sell the Jim Pattison vehicles by way of the auction as well. The values set out in Confidential

Appendix 1 show significant equity in 19 of the Jim Pattison vehicles for the benefit of the estate and likely equity in four vehicles. Given the favorable cost structure of the auction, the apparent equity and the synergy of an en bloc auction, the Receiver is seeking to sell all of the Edmonton Yard Assets at auction, including the Jim Pattison vehicles.

B. Approval of Sale and Vesting of Assets

53. The *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 permits the Court to appoint a receiver to do any of the following:
- (a) take possession of all or substantially all of the property of an insolvent person used in relation to the business carried on by the insolvent person;
 - (b) exercise any control that the Court considers advisable over the property and over the insolvent corporation's business; and
 - (c) take any other action that the Court considers advisable.³
54. In carrying out its duties and exercising its powers, a receiver has an obligation to deal with an insolvent company's property in a commercially reasonable manner.⁴

C. Soundair Criteria

55. The criteria to be applied when considering the approval of a sale or, in this case, acceptance of a proposal recommended by a receiver, were first set out by the Ontario Court of Appeal in *Royal Bank v Soundair Corp.*⁵ When considering whether an offer accepted by a receiver should be approved and ratified by the Court, the Court is to consider and determine:
- (a) whether the receiver made sufficient effort to get the best price and has not acted improvidently;
 - (b) the interests of all parties;

³ *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("*BIA*"), s. 243(1) [TAB 10]

⁴ *BIA*, s. 247 [TAB 11]

⁵ *Royal Bank v Soundair Corp.* (1991), 1991 CarswellOnt 205, 7 CBR (3d) 1, 83 DLR (4th) 76 [*Soundair*] [TAB 12].

- (c) the efficacy and integrity of the process by which offers were obtained; and
 - (d) whether there has been unfairness in the working out of the process.
56. The Alberta Courts have adopted these criteria and have applied them in receivership proceedings on numerous occasion.⁶
57. It has been further acknowledge that the Court must place a great deal of confidence in the actions taken and in the opinions formed by a receiver, and should assume that a receiver is acting properly unless the contrary is clearly shown.⁷

i. Sufficient Effort

58. The Receiver is recommending a public auction that will expose the Edmonton Yard Assets to the market. An auction is a valid option for the sale of assets in a receivership.⁸
59. The Receiver submits that the proposed auction constitutes reasonable and sufficient efforts to obtain the best price for Edmonton Yard Assets.

ii. Interest of All Parties

60. Courts have acknowledged that a receiver's primary concern should be to protect the interest of the debtor's creditors.⁹
61. In considering the "interest of all parties", Courts have recognized that a receiver's duty to act in the interests of the general body of creditors does not necessarily mean that the majority rules. Rather, a receiver must consider the interest of all creditors and then act for the benefit of the general body.¹⁰

⁶ *Computershare Trust Company of Canada v Venti Investment Corporation*, 2011 ABQB 726 at para 3 [TAB 13].

⁷ *Soundair supra*, [TAB 12] at para 14.

⁸ See *Cobrico Developments Inc. v Tucker Industries Inc.*, 2000 ABQB 766 [Cobrico] [TAB 14]

⁹ *Cobrico*, *Ibid.* [TAB 14]

¹⁰ *Alberta Treasury Branches v Elaborate Homes Ltd.*, 2014 ABQB 350 [Elaborate Homes] at para 61 [TAB 15] citing *Scanwood Canada Ltd., Re*, 2011 NSSC 189, 305 NSR (2d) 34.

62. The Debtor's primary secured creditor, Maynbridge, supports the Receiver's acceptance of the Auction Proposal. The Receiver expects that Maynbridge will suffer a shortfall in respect of its indebtedness following the final distribution in this receivership.
63. The other creditors who have priority claims to the Edmonton Yard Assets are the secured creditors, reviewed above, and the parties who can prove that they hold valid garage keeper's liens.
64. By virtue of paragraph 9 of the proposed Sale Approval and Vesting Order, the priority of all parties to the assets will continue in the proceeds, unaffected by the sale.
65. The auction is a cost effective means for realizing on the equipment and addressing the priority claims for all creditors.
66. The appraisal suggests that there is equity in each piece of the Edmonton Yard Assets ahead of the claims of lien holders and specific equipment lessors.
67. In these circumstances, it is commercially reasonable and in the best interest of the Debtor's stakeholders that the Auction Proposal receive court approval.

iii. The Efficacy and Integrity of the Process

68. When dealing with property of an insolvent corporation, the Court should assume that a receiver has acted properly unless the contrary is clearly demonstrated.¹¹
69. The Receiver submits that there is nothing improper about the acceptance of the Auction Proposal. The timing of the auction is also driven by the need to vacate the Edmonton Yard in a timely manner.
70. The Receiver has conducted itself with integrity and in good faith in considering and negotiating with GDAA and ultimately accepting the Auction Proposal.

iv. Unfairness in the Process

71. The Receiver submits that it acted reasonably, prudently, fairly, and not arbitrarily in accepting the Auction Proposal.

¹¹ See *Crown Trust Co. et al Rosenberg et al* (1986), 60 OR (2d) 87 (Ont HC), especially paras 65 and 77 [TAB 16]

72. No party was materially prejudiced or disadvantaged by the Receiver negotiating and accepting the Auction Proposal.
73. Based on the forgoing, the Receiver submits that the *Soundair* criteria have been satisfied by the Receiver and that the Receiver has acted in a commercially reasonable manner in accepting the Auction Proposal.
74. The Court should therefore grant an Order approving the Receiver's acceptance of the Auction Proposal and vesting the Equipment with the purchasers on closing of the auction.

D. Sealing Order

75. The Receiver seeks a sealing order with respect to the Confidential Appendices of the Receiver's Third Report.
76. The Court's authority to grant sealing orders is contemplated under Rule 6.28 and Division 4 of Part 6 of the *Alberta Rules of Court*.¹²
77. The seminal case of *Sierra Club of Canada v Canada (Minister of Finance)* provides the guiding principles in granting sealing orders and publications bans. Justice Iacobucci for the Court accepted that a confidentiality or sealing order could be granted when:
 - (a) such an order is necessary in order to prevent a serious risk to an important interest, including a commercial interest, in the context of litigation because reasonably alternative measures will not prevent the risk; and
 - (b) the salutary effects of the confidentiality order outweigh its deleterious effects, including the effects on the right to free expression, which includes public interest in open and accessible court proceedings.¹³
78. In the insolvency context, it is common when assets are being sold pursuant to a court process to seal various bids and other commercially sensitive material, such as

¹² *Alberta Rules of Court*, AR 124/2010, Division 4 of Part 6 including Rule 6.28 [TAB 17].

¹³ *Sierra Club of Canada v Canada (Minister of Finance)*, 2002 SCC 41 at para 45 [TAB 18].

valuations, in case a further bidding process is required should the transaction being approved falls through.¹⁴

79. The Ontario courts have further noted that sealing orders in this context are normally granted to maintain fair play so that competitors and potential purchasers do not obtain an unfair advantage by obtaining such information while others have to rely on their own resources.¹⁵
80. In *Alberta Treasury Branches v Elaborate Homes Ltd.*, Justice K.G. Neilsen (as he was then) accepted the reasons and rational of the Ontario Courts and acknowledged that it is common practice in the insolvency context that information relating to the sale of the assets of an insolvent corporation be kept confidential until after the sale is completed pursuant to a court order.¹⁶
81. The Receiver submits that in these circumstances it is necessary to seal Confidential Appendices to prevent a real and substantial risk of harm to commercial interest. The Confidential Appendices contain appraisals with respect to the Equipment and other Property of the Debtor. If such information was to be made public, any subsequent sales process conducted by the Receiver, could be compromised to the detriment of the Debtor, the Debtor's creditors, and BSC.
82. Release of the information prior to the conclusion the Receiver's sales and marketing efforts of the Property may cause irreparable harm to the fairness of any sales process the Receiver may conduct. This would negatively impact the stakeholders of the Debtor, who have an interest in ensuring the highest value possible is received for the Property.
83. The Receiver further submits that salutary effects of a sealing of the Confidential Supplemental outweigh any deleterious effects that may be caused by the sealing.
84. The sealing of the Confidential Appendices is essential to the Receiver satisfying the *Soundair* principles as required by this Court, and therefore it is both reasonable and appropriate for the Court to seal the Confidential Appendices on the Court Record.

¹⁴ *Look Communications Inc v Look Mobile Corp*, 2009 CarswellOnt 7952 (Ont SCJ [Commercial List] at para 17 [TAB 19].

¹⁵ *887574 Ontario Inc v Pizza Pizza Ltd*, 1994 CarswellOnt 1214, [1994] OJ No 3112 [TAB 20] at para 24.

¹⁶ *Elaborate Homes supra.* at para 54 [TAB 15].

V. RELIEF CLAIMED

85. Based upon the materials filed and the foregoing submission, the Receiver respectfully requests, among other things:
- (a) An Order approving the Auction Proposal and vesting title of the Edmonton Yard Assets with the respective purchasers on closing of the auction;
 - (b) An Order with respect to the security interests in the Edmonton Yard Assets as set out in greater detail in the Application;
 - (c) An Order sealing the Confidential Appendices of the Receiver's Third Report on the Court record until the Receiver has completed its sales process of the Property of the Debtor;
 - (d) An Order approving the activities of the Receiver as set out in the Third Report;

Such further or other relief as may be requested of the Court by the Receiver.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 23TH DAY OF SEPTEMBER, 2019

MILLER THOMSON LLP

Per: _____

Rick Reeson, QC
Stephanie Wanke
Counsel for the Applicant,
ALVAREZ & MARSAL CANADA INC. in its
capacity as Receiver of Voice Construction
OPCO ULC, Voice Management Ltd.,
Voice Construction Ltd., Earth & Energy
Construction Ltd., Voice Holdings Ltd.,
Voice Holdings Ltd., and 2012442 Alberta
Ltd.

TABLE OF AUTHORITIES

TAB

1. *Consent Receivership Order* granted by Associate Chief Justice K.G. Nielsen dated June 25, 2019.
2. *Royal Bank v. Cow Harbour Construction Ltd.*, 2012 ABQB 59.
3. *Royal Bank v. Cow Harbour Construction Ltd.*, 2010 ABQB 637.
4. *Integris Credit Union v. Mercedes-Benz Financial Services Canada Corp.*, 2016 BCCA 231.
5. *Winnipeg Motor Express Inc., Re* 2009 MBQB 204.
6. *Respec Oilfield Services Ltd., Re*, 2019 ABQB 277.
7. *Capital Steel Inc. v. Chandos Construction Ltd.*, 2019 ABCA 32.
8. *Super Save Disposal (Alberta) Ltd. v. Shenwei Enterprises Ltd.*, 2017 ABQB 805.
9. *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R.
10. *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s. 243(1).
11. *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s. 247.
12. *Royal Bank v Soundair Corp.* (1991), 1991 CarswellOnt 205, 7 CBR (3d) 1, 83 DLR (4th) 76.
13. *Computershare Trust Company of Canada v Venti Investment Corporation*, 2011 ABQB 726, 2011 CarswellAlta 2304.
14. *Cobrico Developments Inc. v Tucker Industries Inc.*, 2000 ABQB 766, 2000 CarswellAlta 1211.
15. *Alberta Treasury Branches v Elaborate Homes Ltd.*, 2014 ABQB 350, 2014 CarswellAlta 921.
16. *Crown Trust Co. et al Rosenberg et al* (1986), 60 OR (2d) 87 (Ont HC).
17. *Alberta Rules of Court*, AR 124/2010, Division 4 of Part 6 including Rule 6.28.

18. *Sierra Club of Canada v Canada (Minister of Finance)*, 2002 SCC 41, 2002 CarswellNat 822.
19. *Look Communications Inc v Look Mobile Corp*, 2009 CarswellOnt 7952 (Ont SCJ [Commercial List]).
20. *887574 Ontario Inc v Pizza Pizza Ltd*, 1994 CarswellOnt 1214, [1994] OJ No 3112.

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DEFENDANTS VOICE CONSTRUCTION OPCO ULC,
VOICE MANAGEMENT LTD., VOICE
CONSTRUCTION LTD., EARTH &
ENERGY CONSTRUCTION LTD., VOICE
HOLDINGS LTD. and 2012442 ALBERTA
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DOCUMENT **CONSENT RECEIVERSHIP
ORDER**

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I hereby certify this to be a true copy of the original.


for Clerk of the Court

DATE ON WHICH ORDER WAS PRONOUNCED: June 25, 2019
LOCATION WHERE ORDER WAS PRONOUNCED: EDMONTON, ALBERTA
NAME OF JUSTICE WHO MADE THIS ORDER: K.G. Nielsen

UPON the Application of Maynbridge Capital Inc. ("Maynbridge"), in respect of Voice Construction OPCO ULC, Voice Management Ltd., Voice Construction Ltd., Earth & Energy Construction Ltd., Voice Holdings Ltd. and 2012442 Alberta Ltd. (collectively referred to herein as the "Debtor"); AND UPON having read the Application and the Affidavit of Stephen Davies, sworn on _____, filed; AND UPON having read the consent of Alvarez & Marsal Canada Inc. to act as receiver and receiver-manager (the "Receiver") of the Debtor, filed; AND UPON hearing counsel for Maynbridge, and any other interested party present;

IT IS HEREBY ORDERED AND DECLARED THAT:

SERVICE

1. The time for service of the notice of application for this order (the "Order") is hereby abridged and service thereof is deemed good and sufficient.

APPOINTMENT

2. Pursuant to section 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA"), and sections 13(2) of the *Judicature Act*, R.S.A. 2000, c.J-2, and 65(7) of the *Personal Property Security Act*, R.S.A. 2000, c.P-7, Alvarez & Marsal Canada Inc. is hereby appointed Receiver, without security, of all of the Debtor's current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate, including all proceeds thereof (the "Property").

RECEIVER'S POWERS

3. The Receiver is hereby empowered and authorized, but not obligated, to act at once in respect of the Property and, without in any way limiting the generality of the foregoing, the Receiver is hereby expressly empowered and authorized to do any of the following where the Receiver considers it necessary or desirable:
 - (a) to take possession of and exercise control over the Property and any and all proceeds, receipts and disbursements arising out of or from the Property;
 - (b) to receive, preserve and protect the Property, or any part or parts thereof, including, but not limited to, the changing of locks and security codes, the relocating of Property to safeguard it, the engaging of independent security personnel, the taking of physical inventories and the placement of such insurance coverage as may be necessary or desirable;
 - (c) to manage, operate and carry on the business of the Debtor, including the powers to enter into any agreements, incur any obligations in the ordinary course of business, cease to carry on all or any part of the business, or cease to perform any contracts of the Debtor;
 - (d) to engage consultants, appraisers, agents, experts, auditors, accountants, managers, counsel and such other persons from time to time and on whatever basis, including

on a temporary basis, to assist with the exercise of the Receiver's powers and duties, including without limitation those conferred by this Order;

- (e) to purchase or lease machinery, equipment, inventories, supplies, premises or other assets to continue the business of the Debtor or any part or parts thereof;
- (f) to receive and collect all monies and accounts now owed or hereafter owing to the Debtor and to exercise all remedies of the Debtor in collecting such monies, including, without limitation, to enforce any security held by the Debtor;
- (g) to settle, extend or compromise any indebtedness owing to or by the Debtor;
- (h) to execute, assign, issue and endorse documents of whatever nature in respect of any of the Property, whether in the Receiver's name or in the name and on behalf of the Debtor, for any purpose pursuant to this Order;
- (i) to undertake environmental or workers' health and safety assessments of the Property and operations of the Debtor;
- (j) to initiate, prosecute and continue the prosecution of any and all proceedings and to defend all proceedings now pending or hereafter instituted with respect to the Debtor, the Property or the Receiver, and to settle or compromise any such proceedings. The authority hereby conveyed shall extend to such appeals or applications for judicial review in respect of any order or judgment pronounced in any such proceeding, and provided further that nothing in this Order shall authorize the Receiver to defend or settle the action in which this Order is made unless otherwise directed by this Court.
- (k) to market any or all the Property, including advertising and soliciting offers in respect of the Property or any part or parts thereof and negotiating such terms and conditions of sale as the Receiver in its discretion may deem appropriate.
- (l) to sell, convey, transfer, lease or assign the Property or any part or parts thereof out of the ordinary course of business,
 - (i) without the approval of this Court in respect of any transaction not exceeding \$250,000, provided that the aggregate consideration for all such transactions does not exceed \$1,000,000; and

- (ii) with the approval of this Court in respect of any transaction in which the purchase price or the aggregate purchase price exceeds the applicable amount set out in the preceding clause,

and in each such case notice under subsection 60(8) of the *Personal Property Security Act*, R.S.A. 2000, c. P-7 or any other similar legislation in any other province or territory shall not be required.

- (m) to apply for any vesting order or other orders (including, without limitation, confidentiality or sealing orders) necessary to convey the Property or any part or parts thereof to a purchaser or purchasers thereof, free and clear of any liens or encumbrances affecting such Property;
- (n) to report to, meet with and discuss with such affected Persons (as defined below) as the Receiver deems appropriate all matters relating to the Property and the receivership, and to share information, subject to such terms as to confidentiality as the Receiver deems advisable;
- (o) to register a copy of this Order and any other orders in respect of the Property against title to any of the Property, and when submitted by the Receiver for registration this Order shall be immediately registered by the Registrar of Land Titles of Alberta, or any other similar government authority, notwithstanding section 191 of the *Land Titles Act*, R.S.A. 2000, c. L-4, or the provision of any other similar legislation in any other province or territory and notwithstanding that the appeal period in respect of this Order has not elapsed and the Registrar of Land Titles shall accept all Affidavits of Corporate Signing Authority submitted by the Receiver in its capacity as Receiver of the Debtor and not in its personal capacity;
- (p) to apply for any permits, licences, approvals or permissions as may be required by any governmental authority and any renewals thereof for and on behalf of and, if thought desirable by the Receiver, in the name of the Debtor;
- (q) to enter into agreements with any trustee in bankruptcy appointed in respect of the Debtor, including, without limiting the generality of the foregoing, the ability to enter into occupation agreements for any property owned or leased by the Debtor;

- (r) to exercise any shareholder, partnership, joint venture or other rights which the Debtor may have;
- (s) to assign the Debtor(s) into bankruptcy; and
- (t) to take any steps reasonably incidental to the exercise of these powers or the performance of any statutory obligations;

and in each case where the Receiver takes any such actions or steps, it shall be exclusively authorized and empowered to do so, to the exclusion of all other Persons (as defined below), including the Debtor, and without interference from any other Person.

DUTY TO PROVIDE ACCESS AND CO-OPERATION TO THE RECEIVER

4. (i) The Debtor, (ii) all of its current and former directors, officers, employees, agents, accountants, legal counsel and shareholders, and all other persons acting on its instructions or behalf, and (iii) all other individuals, firms, corporations, governmental bodies or agencies, or other entities having notice of this Order (all of the foregoing, collectively, being "**Persons**" and each being a "**Person**") shall forthwith advise the Receiver of the existence of any Property in such Person's possession or control, shall grant immediate and continued access to the Property to the Receiver, and shall deliver all such Property (excluding Property subject to liens the validity of which is dependent on maintaining possession) to the Receiver upon the Receiver's request.
5. All Persons shall forthwith advise the Receiver of the existence of any books, documents, securities, contracts, orders, corporate and accounting records, and any other papers, records and information of any kind related to the business or affairs of the Debtor, and any computer programs, computer tapes, computer disks, or other data storage media containing any such information (the foregoing, collectively, the "**Records**") in that Person's possession or control, and shall provide to the Receiver or permit the Receiver to make, retain and take away copies thereof and grant to the Receiver unfettered access to and use of accounting, computer, software and physical facilities relating thereto, provided however that nothing in this paragraph 5 or in paragraph 6 of this Order shall require the delivery of Records, or the granting of access to Records, which may not be disclosed or provided to the Receiver due to the privilege attaching to solicitor-client communication

or documents prepared in contemplation of litigation or due to statutory provisions prohibiting such disclosure.

6. If any Records are stored or otherwise contained on a computer or other electronic system of information storage, whether by independent service provider or otherwise, all Persons in possession or control of such Records shall forthwith give unfettered access to the Receiver for the purpose of allowing the Receiver to recover and fully copy all of the information contained therein whether by way of printing the information onto paper or making copies of computer disks or such other manner of retrieving and copying the information as the Receiver in its discretion deems expedient, and shall not alter, erase or destroy any Records without the prior written consent of the Receiver. Further, for the purposes of this paragraph, all Persons shall provide the Receiver with all such assistance in gaining immediate access to the information in the Records as the Receiver may in its discretion require including providing the Receiver with instructions on the use of any computer or other system and providing the Receiver with any and all access codes, account names and account numbers that may be required to gain access to the information.

NO PROCEEDINGS AGAINST THE RECEIVER

7. No proceeding or enforcement process in any court or tribunal (each, a "**Proceeding**"), shall be commenced or continued against the Receiver except with the written consent of the Receiver or with leave of this Court.

NO PROCEEDINGS AGAINST THE DEBTOR OR THE PROPERTY

8. No Proceeding against or in respect of the Debtor or the Property shall be commenced or continued except with the written consent of the Receiver or with leave of this Court and any and all Proceedings currently under way against or in respect of the Debtor or the Property are hereby stayed and suspended pending further Order of this Court, provided, however, that nothing in this Order shall: (i) prevent any Person from commencing a proceeding regarding a claim that might otherwise become barred by statute or an existing agreement if such proceeding is not commenced before the expiration of the stay provided by this paragraph 8; and (ii) affect a Regulatory Body's investigation in respect of the debtor or an action, suit or proceeding that is taken in respect of the debtor by or before the Regulatory Body, other than the enforcement of a payment order by the Regulatory Body

or the Court. "Regulatory Body" means a person or body that has powers, duties or functions relating to the enforcement or administration of an Act of Parliament or of the legislature of a province.

NO EXERCISE OF RIGHTS OF REMEDIES

9. All rights and remedies of any Person, whether judicial or extra-judicial, statutory or non-statutory (including, without limitation, set-off rights) against or in respect of the Debtor or the Receiver or affecting the Property are hereby stayed and suspended and shall not be commenced, proceeded with or continued except with leave of this Court, provided, however, that this stay and suspension does not apply in respect of any "eligible financial contract" (as defined in the BIA), and further provided that nothing in this Order shall:
 - (a) empower the Debtor to carry on any business that the Debtor is not lawfully entitled to carry on;
 - (b) prevent the filing of any registration to preserve or perfect a security interest;
 - (c) prevent the registration of a claim for lien; or
 - (d) exempt the Debtor from compliance with statutory or regulatory provisions relating to health, safety or the environment.
10. Nothing in this Order shall prevent any party from taking an action against the Debtor where such an action must be taken in order to comply with statutory time limitations in order to preserve their rights at law, provided that no further steps shall be taken by such party except in accordance with the other provisions of this Order, and notice in writing of such action be given to the Monitor at the first available opportunity.

NO INTERFERENCE WITH THE RECEIVER

11. No Person shall accelerate, suspend, discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any right, renewal right, contract, agreement, licence or permit in favour of or held by the Debtor, except with the written consent of the Receiver, or leave of this Court. Nothing in this Order shall prohibit any party to an eligible

financial contract (as defined in the BIA) from closing out and terminating such contract in accordance with its terms.

CONTINUATION OF SERVICES

12. All persons having:

- (a) statutory or regulatory mandates for the supply of goods and/or services; or
- (b) oral or written agreements or arrangements with the Debtor, including without limitation all computer software, communication and other data services, centralized banking services, payroll services, insurance, transportation, services, utility or other services to the Debtor

are hereby restrained until further order of this Court from discontinuing, altering, interfering with, suspending or terminating the supply of such goods or services as may be required by the Receiver or exercising any other remedy provided under such agreements or arrangements. The Receiver shall be entitled to the continued use of its current premises, telephone numbers, facsimile numbers, internet addresses and domain names, provided in each case that the usual prices or charges for all such goods or services received after the date of this Order are paid by the Receiver in accordance with the payment practices of the Debtor, or such other practices as may be agreed upon by the supplier or service provider and the Receiver, or as may be ordered by this Court.

RECEIVER TO HOLD FUNDS

13. All funds, monies, cheques, instruments, and other forms of payments received or collected by the Receiver from and after the making of this Order from any source whatsoever, including without limitation the sale of all or any of the Property and the collection of any accounts receivable in whole or in part, whether in existence on the date of this Order or hereafter coming into existence, shall be deposited into one or more new accounts to be opened by the Receiver (the "Post Receivership Accounts") and the monies standing to the credit of such Post Receivership Accounts from time to time, net of any disbursements provided for herein, shall be held by the Receiver to be paid in accordance with the terms of this Order or any further order of this Court.

EMPLOYEES

14. Subject to employees' rights to terminate their employment, all employees of the Debtor shall remain the employees of the Debtor until such time as the Receiver, on the Debtor's behalf, may terminate the employment of such employees. The Receiver shall not be liable for any employee-related liabilities, including any successor employer liabilities as provided for in section 14.06(1.2) of the BIA, other than such amounts as the Receiver may specifically agree in writing to pay, or in respect of its obligations under sections 81.4(5) or 81.6(3) of the BIA or under the *Wage Earner Protection Program Act*, S.C. 2005, c.47 ("WEPPA").
15. Pursuant to clause 7(3)(c) of the *Personal Information Protection and Electronic Documents Act*, S.C. 2000, c. 5, the Receiver shall disclose personal information of identifiable individuals to prospective purchasers or bidders for the Property and to their advisors, but only to the extent desirable or required to negotiate and attempt to complete one or more sales of the Property (each, a "Sale"). Each prospective purchaser or bidder to whom such personal information is disclosed shall maintain and protect the privacy of such information and limit the use of such information to its evaluation of the Sale, and if it does not complete a Sale, shall return all such information to the Receiver, or in the alternative destroy all such information. The purchaser of any Property shall be entitled to continue to use the personal information provided to it, and related to the Property purchased, in a manner which is in all material respects identical to the prior use of such information by the Debtor, and shall return all other personal information to the Receiver, or ensure that all other personal information is destroyed.

LIMITATION ON ENVIRONMENTAL LIABILITIES

16. (a) Notwithstanding anything in any federal or provincial law, the Receiver is not personally liable in that position for any environmental condition that arose or environmental damage that occurred:
 - (i) before the Receiver's appointment; or
 - (ii) after the Receiver's appointment unless it is established that the condition arose or the damage occurred as a result of the Receiver's gross negligence or wilful misconduct.

- (b) Nothing in sub-paragraph (a) exempts a Receiver from any duty to report or make disclosure imposed by a law referred to in that sub-paragraph.
- (c) Notwithstanding anything in any federal or provincial law, but subject to sub-paragraph (a) hereof, where an order is made which has the effect of requiring the Receiver to remedy any environmental condition or environmental damage affecting the Property, the Receiver is not personally liable for failure to comply with the order, and is not personally liable for any costs that are or would be incurred by any person in carrying out the terms of the order,
 - (i) if, within such time as is specified in the order, within 10 days after the order is made if no time is so specified, within 10 days after the appointment of the Receiver, if the order is in effect when the Receiver is appointed, or during the period of the stay referred to in clause (ii) below, the Receiver:
 - A. complies with the order, or
 - B. on notice to the person who issued the order, abandons, disposes of or otherwise releases any interest in any real property affected by the condition or damage;
 - (ii) during the period of a stay of the order granted, on application made within the time specified in the order referred to in clause (i) above, within 10 days after the order is made or within 10 days after the appointment of the Receiver, if the order is in effect when the Receiver is appointed, by,
 - A. the court or body having jurisdiction under the law pursuant to which the order was made to enable the Receiver to contest the order; or
 - B. the court having jurisdiction in bankruptcy for the purposes of assessing the economic viability of complying with the order; or
 - (iii) if the Receiver had, before the order was made, abandoned or renounced or been divested of any interest in any real property affected by the condition or damage.

LIMITATION ON THE RECEIVER'S LIABILITY

17. Except for gross negligence or wilful misconduct, as a result of its appointment or carrying out the provisions of this Order the Receiver shall incur no liability or obligation that exceeds an amount for which it may obtain full indemnity from the Property. Nothing in this Order shall derogate from any limitation on liability or other protection afforded to the Receiver under any applicable law, including, without limitation, section 14.06, 81.4(5) or 81.6(3) of the BIA.

RECEIVER'S ACCOUNTS

18. The Receiver and counsel to the Receiver shall be paid their reasonable fees and disbursements, in each case, incurred at their standard rates and charges. The Receiver and counsel to the Receiver shall be entitled to the benefit of and are hereby granted a charge (the "**Receiver's Charge**") on the Property, as security for such fees and disbursements, incurred at the normal rates and charges of the Receiver and such counsel, both before and after the making of this Order in respect of these proceedings, and the Receiver's Charge shall form a first charge on the Property in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, in favour of any Person but subject to section 14.06(7), 81.4(4) and 81.6(2) of the BIA.
19. The Receiver and its legal counsel shall pass their accounts from time to time.
20. Prior to the passing of its accounts, the Receiver shall be at liberty from time to time to apply reasonable amounts, out of the monies in its hands, against its fees and disbursements, including the legal fees and disbursements, incurred at the normal rates and charges of the Receiver or its counsel, and such amounts shall constitute advances against its remuneration and disbursements when and as approved by this Court.

FUNDING OF THE RECEIVERSHIP

21. The Receiver be at liberty and it is hereby empowered to borrow by way of a revolving credit or otherwise, such monies from time to time as it may consider necessary or desirable, provided that the outstanding principal amount does not exceed \$500,000 (or such greater amount as this Court may by further Order authorize) at any time, at such rate or rates of interest as it deems advisable for such period or periods of time as it may arrange,

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

22. Neither the Receiver's Borrowings Charge nor any other security granted by the Receiver in connection with its borrowings under this Order shall be enforced without leave of this Court.
23. The Receiver is at liberty and authorized to issue certificates substantially in the form annexed as Schedule "A" hereto (the "Receiver's Certificates") for any amount borrowed by it pursuant to this Order.
24. The monies from time to time borrowed by the Receiver pursuant to this Order or any further order of this Court and any and all Receiver's Certificates evidencing the same or any part thereof shall rank on a *pari passu* basis, unless otherwise agreed to by the holders of any prior issued Receiver's Certificates.
25. The Receiver shall be allowed to repay any amounts borrowed by way of Receiver's Certificates out of the Property or any proceeds, including any proceeds from the sale of any assets without further approval of this Court.

ALLOCATION

26. Any interested party may apply to this Court on notice to any other party likely to be affected, for an order allocating the Receiver's Charge and Receiver's Borrowings Charge amongst the various assets comprising the Property.

GENERAL

27. The Receiver may from time to time apply to this Court for advice and directions in the discharge of its powers and duties hereunder.

28. Notwithstanding Rule 6.11 of the *Alberta Rules of Court*, unless otherwise ordered by this Court, the Receiver will report to the Court from time to time, which reporting is not required to be in affidavit form and shall be considered by this Court as evidence. The Receiver's reports shall be filed by the Court Clerk notwithstanding that they do not include an original signature.
29. Nothing in this Order shall prevent the Receiver from acting as a trustee in bankruptcy of the Debtor.
30. This Court hereby requests the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in any foreign jurisdiction to give effect to this Order and to assist the Receiver and its agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Receiver, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Receiver in any foreign proceeding, or to assist the Receiver and its agents in carrying out the terms of this Order.
31. The Receiver be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order and that the Receiver is authorized and empowered to act as a representative in respect of the within proceedings for the purpose of having these proceedings recognized in a jurisdiction outside Canada.
32. The Plaintiff shall have its costs of this application, up to and including entry and service of this Order, provided for by the terms of the Plaintiff's security or, if not so provided by the Plaintiff's security, then on a substantial indemnity basis, including legal costs on a solicitor-client full indemnity basis, to be paid by the Receiver from the Debtor's estate with such priority and at such time as this Court may determine.
33. Any interested party may apply to this Court to vary or amend this Order on not less than 7 days' notice to the Receiver and to any other party likely to be affected by the order sought or upon such other notice, if any, as this Court may order.

FILING

34. The Receiver shall establish and maintain a website in respect of these proceedings at www.alvarezandmarsal.com/voiceconstruction and shall post there as soon as practicable:
- (a) all materials prescribed by statute or regulation to be made publically available; and
 - (b) all applications, reports, affidavits, orders and other materials filed in these proceedings by or on behalf of the Receiver, or served upon it, except such

materials as are confidential and the subject of a sealing order or pending application for a sealing order.

35. Service of this Order shall be deemed good and sufficient by:

(a) serving the same on:

- (i) the persons listed on the service list created in these proceedings or otherwise served with notice of these proceedings;
 - (ii) any other person served with notice of the application for this Order;
 - (iii) any other parties attending or represented at the application for this Order;
- and

(b) posting a copy of this Order on the Receiver's Website

and service on any other person is hereby dispensed with.

36. Service of this Order may be effected by facsimile, electronic mail, personal delivery or courier.

"K.G. Nielsen"

Justice of the Court of Queen's Bench of Alberta

**CONSENTED TO ON JUNE 24, 2019
OSLER, HOSKIN & HARCOURT LLP**



Marc Wasserman/Martino Calvaruso
Counsel for the Defendants

SCHEDULE "A"

RECEIVER CERTIFICATE

CERTIFICATE NO. _____

AMOUNT \$ _____

1. THIS IS TO CERTIFY that Alvarez & Marsal Canada Inc., the receiver and receiver and manager (the "Receiver") of all of the assets, undertakings and properties of Voice Construction OPCO ULC, Voice Management Ltd., Voice Construction Ltd., Earth & Energy Construction Ltd., Voice Holdings Ltd. and 2012442 Alberta Ltd. appointed by Order of the Court of Queen's Bench of Alberta (the "Court") dated the ____ day of June, 2019 (the "Order") made in action number _____, has received as such Receiver from the holder of this certificate (the "Lender") the principal sum of \$_____, being part of the total principal sum of [\$] which the Receiver is authorized to borrow under and pursuant to the Order.
2. The principal sum evidenced by this certificate is payable on demand by the Lender with interest thereon calculated and compounded [daily] [monthly not in advance on the ____ day of each month] after the date hereof at a notional rate per annum equal to the rate of ____ per cent above the prime commercial lending rate of the Bank of ____ from time to time.
3. Such principal sum with interest thereon is, by the terms of the Order, together with the principal sums and interest thereon of all other certificates issued by the Receiver pursuant to the Order or to any further order of the Court, a charge upon the whole of the Property (as defined in the Order), in priority to the security interests of any other person, but subject to the priority of the charges set out in the Order, and the right of the Receiver to indemnify itself out of such Property in respect of its remuneration and expenses.
4. All sums payable in respect of principal and interest under this certificate are payable at the main office of the Lender at ●.
5. Until all liability in respect of this certificate has been terminated, no certificates creating charges ranking or purporting to rank in priority to this certificate shall be issued by the Receiver to any person other than the holder of this certificate without the prior written consent of the holder of this certificate.
6. The charge securing this certificate shall operate so as to permit the Receiver to deal with the Property (as defined in the Order) as authorized by the Order and as authorized by any further or other order of the Court.

7. The Receiver does not undertake, and it is not under any personal liability, to pay any sum in respect of which it may issue certificates under the terms of the Order.

DATED the _____ day of _____, 2019

ALVAREZ & MARSAL CANADA INC.,
solely in its capacity as Receiver of the
Property (as defined in the Order), and not in
its personal capacity

Per: _____
Name:
Title:

2012 ABQB 59
Alberta Court of Queen's Bench

Royal Bank v. Cow Harbour Construction Ltd.

2012 CarswellAlta 198, 2012 ABQB 59, [2012] 8 W.W.R. 209, [2012] A.W.L.D.
1380, [2012] A.W.L.D. 1381, 19 P.P.S.A.C. (3d) 31, 211 A.C.W.S. (3d) 265,
529 A.R. 147, 59 Alta. L.R. (5th) 215, 75 C.B.R. (5th) 99, 98 B.L.R. (4th) 236

**Royal Bank of Canada (Plaintiff) and Cow Harbour
Construction Ltd. and 1134252 Alberta Ltd. (Defendants)**

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended

In the Matter of the Companies' Creditors Arrangement Act, RSC 1985, c C-36, as amended

In the Matter of a Plan of Arrangement of Cow Harbour Construction Ltd.

K.D. Yamauchi J.

Heard: November 2-3, 2011

Judgment: January 23, 2012

Docket: Edmonton 1003-11241, 1003-05560, BKCY 24-115359

Counsel: Walker W. MacLeod for GE

Joseph J. Bellissimo for Scott Capital

Kentigern A. Rowan, Q.C., Stephanie A. Wanke for Wajax

Ryan Zahara, for Caterpillar Financial

Jeremy H. Hockin for Kempenfelt Vehicle Leasing (a Division of Equirex Vehicle Leasing 2007 Inc.), Alter Moneta Corporation,
Concentra Financial, Key Equipment

Subject: Insolvency; Estates and Trusts; Civil Practice and Procedure; Contracts; Corporate and Commercial
Related Abridgment Classifications

Bankruptcy and insolvency

XIV Administration of estate

XIV.3 Trustee's possession of assets

XIV.3.c Particular assets

XIV.3.c.i Leasehold assets

Bankruptcy and insolvency

XVII Practice and procedure in courts

XVII.4 Stay of proceedings

Headnote

Bankruptcy and insolvency --- Administration of estate --- Trustee's possession of assets --- Particular assets --- Leasehold assets
True leases and financing leases --- Debtor entered protection under of Companies' Creditors Arrangement Act, and was later
subject of asset sale --- Company was lessee of several pieces of equipment --- Funds regarding leases were transferred to
receiver --- Lessor's brought application regarding entitlement to funds --- Certain lessors had entered into agreements subject
to true lease, and could claim recovery --- True leases but not financing leases are subject to s. 11.01(a) of Companies' Creditors
Arrangement Act, which allows for payment for leased property --- SC Inc. leased eight pieces of equipment under five leases
--- SC Inc. leases were true leases --- Option to purchase reflected fair purchase price --- Lease did not grant lessee interest
in equipment --- Debtor paid taxes related to equipment and was responsible for insurance, license fees and risk of loss ---
Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated

damages — Equipment was selected by lessee and purchased by lessor for specific lease — Substantial security deposit required — Aggregate rentals approximated purchase price — Lease had warranties of fitness — Lease was reflective of financing transaction as true lease — Parties intent was to have option to buy at full market value, based on knowledge and experience of SC Inc. — End of lease was not end of equipment's useful life, and SC Inc. retained surplus value unless purchased by debtor — Debtor was paying for use of equipment, although hypothetical situations could exist where equity could be built up and only residual amount paid, as if financing agreement were in effect — Equipment lease for C Ltd. was true lease — Option to purchase reflected fair purchase price — Lease did not grant lessee interest in equipment — C Ltd. acted as financing agency and leasing company — Debtor paid taxes related to equipment, and was responsible for insurance, license fees and risk of loss — Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated damages — Equipment selected by lessee and purchased by lessor for specific lease — Debtor not required to pay substantial security deposit — Aggregate rental payments approximated value of purchase price, if interest considered — If purchase option exercised amount would be significant — Equipment lease for W was true lease — Option to purchase reflected fair purchase price — W did not act as financing agency — Debtor was responsible for insurance, license fees and risk of loss — Security deposit not paid but payment was required before equipment delivered — Agreement had liquidated damages clause but default provisions were not inordinately favourable to lessee — Default clause was only for portion of rental charges on unexpired period — Purchase option had expired — K Inc. leases were financing leases — Lease referred to security deposit but deposit was not identified unless amount was first payment, which was five times normal monthly payment and approximately 10 percent of value of equipment — Aggregate rental payments were more than cost of equipment and purchase option available at 60 months was approximately same as remaining monthly payments — Equipment lease for CF was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar, and could be exercised well before useful life of equipment expired — AM Corp. lease was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar — KEFC Ltd. lease was financing lease — Purchase option was for ten percent of value, which was not nominal — However, debtor was required to exercise option.

Bankruptcy and insolvency --- Practice and procedure in courts — Stay of proceedings

True leases and financing leases — Debtor entered protection under Companies' Creditors Arrangement Act, and was later subject of asset sale — Company was lessee of several pieces of equipment — Funds regarding leases were transferred to receiver — Lessor's brought application regarding entitlement to funds — Certain lessors had entered into agreements subject to true lease, and could claim recovery — True leases but not financing leases are subject to s. 11.01(a) of Companies' Creditors Arrangement Act, which allows for payment for leased property — SC Inc. leased eight pieces of equipment under five leases — SC Inc. leases were true leases — Option to purchase reflected fair purchase price — Lease did not grant lessee interest in equipment — Debtor paid taxes related to equipment and was responsible for insurance, license fees and risk of loss — Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated damages — Equipment was selected by lessee and purchased by lessor for specific lease — Substantial security deposit required — Aggregate rentals approximated purchase price — Lease had warranties of fitness — Lease was reflective of financing transaction as true lease — Parties intent was to have option to buy at full market value, based on knowledge and experience of SC Inc. — End of lease was not end of equipment's useful life, and SC Inc. retained surplus value unless purchased by debtor — Debtor was paying for use of equipment, although hypothetical situations could exist where equity could be built up and only residual amount paid, as if financing agreement were in effect — Equipment lease for C Ltd. was true lease — Option to purchase reflected fair purchase price — Lease did not grant lessee interest in equipment — C Ltd. acted as financing agency and leasing company — Debtor paid taxes related to equipment, and was responsible for insurance, license fees and risk of loss — Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated damages — Equipment selected by lessee and purchased by lessor for specific lease — Debtor not required to pay substantial security deposit — Aggregate rental payments approximated value of purchase price, if interest considered — If purchase option exercised amount would be significant — Equipment lease for W was true lease — Option to purchase reflected fair purchase price — W did not act as financing agency — Debtor was responsible for insurance, license fees and risk of loss — Security deposit not paid but payment was required before equipment delivered — Agreement had liquidated damages clause but default provisions were not inordinately favourable to lessee — Default clause was only for portion of rental charges on unexpired period — Purchase option had expired — K Inc. leases were financing leases — Lease referred to security deposit but deposit was not identified unless amount was first payment, which was five times normal monthly payment and approximately 10

percent of value of equipment — Aggregate rental payments were more than cost of equipment and purchase option available at 60 months was approximately same as remaining monthly payments — Equipment lease for CF was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar, and could be exercised well before useful life of equipment expired — AM Corp. lease was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar — KEFC Ltd. lease was financing lease — Purchase option was for ten percent of value, which was not nominal — However, debtor was required to exercise option.

APPLICATION by lessors regarding disposition of funds held by receiver of debtor.

K.D. Yamauchi J.:

I. Nature of the Matter

1 Various equipment lessors (collectively, the Applicants) have applied for what they claim to be their proportionate share of funds that PricewaterhouseCoopers Inc. (PWC) currently holds, pending this Court's determination of whether their leases were subject to section 11.01(a) of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (*CCAA*). PWC is the court-appointed receiver and manager of the assets, property and undertaking of Cow Harbour Construction Ltd. (Cow Harbour).

II. Procedural History

2 On April 7, 2010, Cow Harbour obtained a stay of proceedings against it (Initial Order) under *CCAA* s. 11.02. This Court extended the Initial Order from time to time by a number of subsequent court orders. Pursuant to the Initial Order, this Court appointed Deloitte LLP as monitor under the *CCAA* (Monitor).

3 Cow Harbour's primary business consisted of overburden removal and general contracting services for oil extraction companies in Fort McMurray, Alberta. Its assets consisted mainly of earth moving and hauling equipment. Much of the equipment that Cow Harbour used in its operations was leased from various parties.

4 On May 21, 2010, this Court directed the Monitor to provide all interested parties with a list of those leases which it had classified as ones entitling the respective lessors to receive ongoing monthly payments pursuant to *CCAA* s. 11.01. This Court gave any party who claimed to have such a lease, but whose claim was not included in the Monitor's list, until June 2, 2010 to advise the Monitor that it was disputing the classification, failing which it was barred from subsequently asserting that its lease entitled it to those ongoing monthly payments.

5 Disputes were registered in relation to a total of 58 leases (Disputed Leases).

6 Also on May 21, 2010, this Court directed Cow Harbour to pay over to the Monitor's counsel monies representing all monthly payments from April 1, 2010, that Cow Harbour would have paid to lessors under the Disputed Leases, or leases which had not yet been categorized (Disputed Lease Funds). This Court directed the Monitor's counsel to hold the Disputed Lease Funds pending resolution of disputes pertaining to categorization of the Disputed Leases.

7 It became clear as matters progressed that Cow Harbour was not going to be able to restructure its affairs through refinancing, compromise or an equity restructuring. Rather, the proceedings evolved into a liquidation. PWC was appointed as transaction facilitator to assist the various parties in their negotiations. Acting in that capacity, PWC negotiated a potential sale of certain of Cow Harbour's assets to Aecon Group Inc. (Aecon). On August 10, 2010, PWC's acceptance of Aecon's letter of intent received this Court's endorsement, subject to the parties later applying for court approval of an asset purchase agreement and vesting order.

8 On August 25, 2010, the Royal Bank of Canada (RBC) successfully applied for a receivership order, pursuant to which this Court appointed PWC as receiver and manager of the assets, property and undertaking of Cow Harbour (Receiver). This Court then approved the asset purchase agreement and granted a vesting order in Aecon's favour. The transaction contemplated by the asset purchase agreement closed on August 26, 2010.

9 The Disputed Lease Funds were transferred to the Receiver pending resolution of the disputes over classification of the Disputed Leases.

10 RBC was paid out in full through the *CCAA* and receivership proceedings. The secured creditor holding the next general security over Cow Harbour's assets, property and undertaking is GE Capital Equipment Financing G.P. (GE).

11 The Receiver has settled many of the issues between Cow Harbour and various third parties, including many of the lessors under the Disputed Leases. However, it continues to hold back a portion of the Disputed Lease Funds until this Court's determination of entitlement to those funds.

III. Issue

12 The Applicants ask this Court to determine which of the remaining Disputed Leases fall within *CCAA* s. 11.01(a). This, in turn, will determine which party or parties are entitled to a portion of the Disputed Lease Funds.

IV. Law

A. Legislation

13 Section 11.01(a) of the *CCAA* provides:

11.01 No order made under section 11 or 11.02 has the effect of

(A) prohibiting a person from requiring immediate payment for ... use of leased ... property or other valuable consideration provided after the order is made.

14 Section 11.02 of the *CCAA* provides for a stay of proceedings. It states:

11.02(1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

B. General Legal Principles

15 Section 11.02 of the *CCAA* allows a court to order a stay of proceedings on an initial application under the *CCAA* in respect of a debtor company. This is in keeping with the general policy underlying the *CCAA*, which is to allow a debtor corporation to restructure its corporate or financial affairs in a way that will permit it to continue on as a going concern, without being hampered by those who wish to enforce their previously bargained for rights. As the Ontario Court of Appeal commented in *Nortel Networks Corp., Re*, 2009 ONCA 833 (Ont. C.A.) at para 16, (2009), 59 C.B.R. (5th) 23 (Ont. C.A.) [*Nortel*], "[t]he primary instrument provided by the *CCAA* to achieve its purpose is the power of the court to issue a broad stay of proceedings under s. 11. That power includes the power to stay the *debt obligations* of the company" (emphasis added). Courts have given the *CCAA* a wide and liberal construction to facilitate this policy objective (see e.g. *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.)).

16 While a debtor corporation is proceeding through the *CCAA* restructuring process, it must still carry on its business. It hardly seems fair to require a person to continue to supply the debtor corporation with goods or services, or to allow the debtor corporation to continue to use leased property, without that person being compensated for those goods, services or use. Section 11.01(a) of the *CCAA* allows for that compensation.

17 As noted in *Smith Brothers Contracting Ltd., Re* (1998), 53 B.C.L.R. (3d) 264 (B.C. S.C.) at para 3 (SC) [*Smith Brothers*], Parliament added what is now s. 11.01 to the *CCAA* as part of a set of amendments proclaimed in force on September 30, 1997. Suche J. in *Winnipeg Motor Express Inc., Re*, 2009 MBQB 204, 243 Man. R. (2d) 31 (Man. Q.B.) [*Re Winnipeg*], leave to appeal to CA refused, 2009 MBCA 110, [2009] 12 W.W.R. 224 (Man. C.A. [In Chambers]), suggested that Parliament may have added this provision to clarify the point made in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (B.C. C.A.) [*Quintette*], that a stay would never be used to enforce the continuous supply of goods or services without payment for current deliveries. She also commented that the amendment brought the *CCAA* in line with the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*], which contains a similar provision relating to proposals.

18 To further facilitate the policy objective of the *CCAA*, courts have given *CCAA* s. 11.01(a), which is an exception to the stay provision, a narrow construction (*Nortel* at para 17). They have differentiated between a "true lease," in which the debtors' corporation is paying for use of the property, and a debt obligation clothed in the guise of a lease, i.e., a financing lease in which the debtors' corporation is "earning equity" in the property. Courts and writers have used the term "financing lease," "security lease," "financial leasing arrangement" or similar terms to describe the latter type of arrangement (referred to here as a financing lease). It is only the debtor corporation's obligations under a true lease that courts have excepted from the stay of proceedings, not its obligations under a financing lease (*Smith Brothers* at para 61).

19 Canadian courts have accepted the conclusion of Bauman J. (as he then was) in *Smith Brothers* that a true lease, being a bailment of property, falls within the *CCAA* s. 11.01(a) exception, while a financing lease does not. They also have endorsed his approach to distinguishing between the two types of arrangements (see e.g. *International Wallcoverings Ltd., Re* (1999), 28 C.B.R. (4th) 48 (Ont. Gen. Div. [Commercial List])) [*International Wallcoverings*]; *Sharp-Rite Technologies Ltd., Re*, 2000 BCSC 122 (B.C. S.C.). In *PSINET Ltd., Re* (2001), 26 C.B.R. (4th) 288 (Ont. S.C.J.) at para 19 [*PSINET*], Swinton J. stated:

In my view, *Smith Brothers Contracting Ltd.* was correct in determining that [*CCAA* s. 11.01(a)] is to apply to payments for the use of property provided after the stay order — that is, where a party provides new credit to the debtor following the stay. The payments under the leases here are not that type of payment. These leases are clearly financing arrangements, whose purpose is to secure a loan which was provided before the stay order was made, and the payments owing are repayments for that loan. Therefore, the leases here do not fall within [*CCAA* s. 11.01(a)] of the Act, and the order of Farley J. which prohibits the company from making payments under them is consistent with the purpose of the Act. Any other determination would give the RBC an unfair advantage when compared to other creditors of the applicants, who are bound by the stay.

20 While initially having questioned in oral reasons on August 25, 2010, whether it might be worthwhile to re-examine the approach that Bauman J. took in *Smith Brothers*, this Court concluded the approach was sound, given that *CCAA* s. 11.01(a) is to be narrowly construed. The substance and not the form of the arrangement between the debtor corporation and the other contracting party is of importance and, unless there is a sound policy reason for doing so, the court should not give an advantage to one creditor over another.

21 Why did this Court initially question the reasoning in *Smith Brothers*?

22 Bauman J. relied heavily on Professor Ronald CC Cuming's article, "True Leases and Security Leases Under Canadian Personal Property Security Acts" (1983) 7 Can Bus LJ 251, in arriving at his conclusions. As is apparent from the title, Professor Cuming's article dealt with differentiating leases for purposes of personal property security legislation, not insolvency legislation.

23 The *CCAA* does not expressly incorporate personal property security legislation concepts. Unlike such legislation, the *CCAA* does not distinguish between a true lease and a financing lease.

24 The way in which courts have used personal property security legislation concepts when they are dealing with *CCAA* proceedings, and the tension that this approach creates, was discussed by Professor Roderick J. Wood in his article, "The Definition of Secured Creditor in Insolvency Law" (2010) 25 BFLR 341.

25 Professor Wood recognized that the *CCAA* does not expressly deem a lessor in a financing lease transaction to be a "secured creditor" rather than an owner of the goods. He remarked that the definitions of "secured creditor" and "security interest" in insolvency law (the *CCAA* and *BIA*) do not adopt personal property security legislation terminology (at p 347). He noted that courts have held that the broader definition of the term "secured creditor" in the *Income Tax Act*, RSC 1985, c one (5th Supp.) (*ITA*) does not encompass lessors under a financing lease. Professor Wood recognized the difficulty in interpreting the definition of "a secured creditor" in the *CCAA* as including a lessor under a title retention device such as a financing lease, given that courts have not done so in the context of the broader definition in the *ITA*. He expressed the view that the best way to resolve this tension would be for Parliament to clarify federal insolvency legislation, suggesting at p. 356 that:

It would also produce a proper dovetailing of the federal insolvency provisions. For example, the insolvency statutes provide that a stay of proceedings does not prevent a lessor from requiring immediate payment for use of the leased property. This gives the lessor the ability to collect post-commencement lease payments. Courts have held that this provision only applies to true leases and not to security leases. The latter are treated in the same manner as other security interests and the debtor is able to retain possession of the goods without the need to satisfy the post commencement payments. This further demonstrates that the division between true leases and security leases that is produced by the application of the substance test of the *PPSA* is being recognized in insolvency law, and that an amendment of the definition of secured creditor to reflect this fact is the most sensible solution.

26 When examining *Smith Brothers* closely, it appears that Bauman J. was simply saying that the logic that Professor Cumming applied when differentiating between true leases and financing leases in the context of personal property security legislation applies equally to *CCAA* proceedings. Said differently, *CCAA* s. 11.01(a) protects parties who provide goods and services to the debtor corporation after a court grants an initial order, but not "creditors" to whom the debtor corporation has "debt obligations." This would put the latter in a better position *vis-a-vis* the debtor corporation than the debtor corporation's other creditors.

27 As previously stated, this Court is of the view that Bauman J's decision with respect to this issue is in keeping with the *CCAA*'s underlying policy objectives.

28 It is arguable, however, that Blair J. in *International Wallcoverings* left the door open for a court to find that a financing lease could fall within *CCAA* s. 11.01(a), when he said at para 4:

While I would not go so far as to say, [*CCAA* s. 11.01(a)] requires payment under all leasing arrangements, or (on the other hand) that it could never encompass a financial leasing arrangement, I am satisfied that in the particular circumstances of this case the reasoning of *Smith Brothers* is applicable and that the arrangements in question are more akin to equipment purchase financing arrangements ...

29 He used the *Smith Brothers* true lease/financing lease analysis in reaching his conclusion. He did not speculate as to the type of situation where *CCAA* s. 11.01(a) might encompass a financing lease arrangement.

30 *Winnipeg Motor* could be considered one such case, and, as the result, is contrary to what might be expected when using the *Smith Brothers* analysis.

31 *Winnipeg Motor* dealt with the proper distribution of interim financing and administrative charges incurred after the court granted an initial order under the *CCAA*. The monitor recommended that the charges be distributed among the secured creditors based on a *pro rata* recovery. Two parties claimed to be true lessors. The court referred to the distinction made in *Smith Brothers*

between true leases and financing leases. It commented that the exclusion of financing leases from *CCAA* s. 11.01(a) makes perfect sense based on the notion of ownership, as a financing lessor cannot seek the benefits of ownership when it has given it away (assuming the lessee has been acquiring equity in the leased goods). It also suggested that the narrow construction of *CCAA* s. 11.01(a) as limiting the obligation of the debtor to make payments for "use" is consistent with the idea that a supplier cannot be expected to continue to provide its product without payment.

32 The court in *Winnipeg Motor* noted the financing lessors' complaint that they had been unduly prejudiced by the stay of proceedings. They argued that not only were they not being paid while the debtor corporation was using their assets for the benefit of the other stakeholders, but the debtor corporation was deteriorating their underlying security in the process. They maintained that this violated one of the fundamental objectives of the stay of proceedings: preventing one creditor from obtaining an advantage over other creditors during the stay period. The court at paras 60-62 suggested that the fact true lessors were entitled to be paid aggravated the problem, stating:

It is difficult to know how this situation can be remedied, given that the whole point of the *CCAA* is to relieve a company of ongoing financial burden to allow it the opportunity to restructure. In this case, for example, [the debtor corporation] would not have succeeded had it been obliged to pay for its equipment during the entirety of the restructuring.

On the particular facts of this case, this issue became somewhat easier to address given the nature of [the debtor corporation's] business. Equipment to a transportation company is akin to raw goods to a manufacturer, and I was of the opinion that if [the debtor corporation] was going to be viable, at a certain point it would have to demonstrate it could pay for the essential means of production.

Otherwise, there would be no purpose to continue the stay. Accordingly, I ordered that financing leases would be paid as of August 1, 2008.

I say all this not to justify or revisit the basis for my earlier decision, but to get to the point that in considering what is equitable, undue prejudice is a reason to adjust what would otherwise be a uniform approach. I am satisfied that equipment lessors in a business operation such as [the debtor corporation's] do suffer undue prejudice. In this case, however, the equipment lessors were paid as of August 1. Being financing leases, those payments were not just for use, but included some amount on account of equity. I conclude, then, that the undue prejudice suffered has been recognized, *albeit* not totally, perfectly or precisely, but, in my view, in an amount sufficient amount to justify the uniform application of the methodology proposed by the monitor.

33 Of interest, the court in *Winnipeg Motor* required one of the debtor corporation's true lessors to contribute to the court-ordered charges, as it had derived the same benefit from the *CCAA* proceedings as the financing lessors.

34 In *Clayton Construction Co., Re*, 2009 SKQB 397, 59 C.B.R. (5th) 213 (Sask. Q.B.) [*Clayton Construction*], the debtor corporation sought an extension of a *CCAA* stay of proceedings. Rothery J. granted the extension, but also allowed the payment of interest that the debtor corporation owed to nine of its equipment lessors as a means of compensating them for the use and depreciation of their equipment. The debtor corporation required the equipment to complete its contracts. The court determined that the monthly interest payments to the equipment lessors would not prejudice the other creditors. The major secured creditor had benefited from the accounts receivable generated by the debtor's use of the equipment and the unsecured creditors likely would not have received any benefit, had the equipment lessors withdrawn their support for the restructuring process.

35 *Winnipeg Motor* and *Clayton Construction* might be responses to the non-peer reviewed journal articles that criticize the *Smith Brothers* approach that courts have taken to the issue before this Court (see *e.g.* Steven J. Weisz, Linc A. Rogers & Stacy McLean, "Striking an Imbalance: The Treatment of Equipment Lessors Under Section 11.3 of the *CCAA*" (2003) 20:5 Nat'l Insolv Rev 45 at 48-49; Jeffrey C. Cahart, "Should There be Special Rules in Commercial Reorganizations for Equipment Lessors?" (2002) 15:2 Comm Insolv R 13; Harvey G. Chaiton and John R. Hutchins, "Equipment Lessors in Restructurings: Hostage Lenders" (2009) 21 Comm Insolv R 3).

36 One of the themes that runs through these articles is that it is unfair for courts to allow creditors that hold general security to gain a benefit from the debtor corporation's use of the leased equipment during the stay period. Cahart commented at p. 15:

... it is simply unfair to allow a debtor to continue to use (and to depreciate) a piece of (perhaps essential) equipment which the debtor only has because of the equipment lessor's financing while the debtor pursues a reorganization and/or a sale as a going concern (as has happened in so many *CCAA* cases) possibly over a very extended period. Again, unlike lenders with more general security, equipment lessors (usually) only have recourse to a specific asset. Is it fair to allow, for instance, a mining company under *CCAA* protection to continue to use a specialized leased truck, continue to wear it down and to diminish its value, for 11 months for free, while the company pursues sale as a going concern and/or reorganization based on the company's going concern value? Among other things, the availability of the truck to the company over time: (i) contributes to the going concern value of the company (and the preservation of which is at the heart of what the *CCAA* is trying to achieve); and (ii) allows the company to produce product which is turned into cash and which goes to pay down an operating lender. Yet under the current jurisprudence, the relevant equipment lessor probably receives nothing during the stay period — not even its regular monthly payments, let alone any kind of "premium" for its contribution to the going concern value or to the ability of the company to generate cash.

37 The problem, however, is that one creditor should not receive "an unfair advantage when compared to other creditors of the applicants, who are bound by the stay" (*PSINET* at para 19). If some creditors are to be bound by the stay of proceedings, all creditors must be bound. Any contrary approach invariably would lead to every creditor attempting to argue that its interests are being prejudiced by the stay of proceedings in one way or another, with the end result that the stay of proceedings would prove meaningless.

38 *Smith Brothers* concluded that courts must differentiate between true leases and financing leases. Is this what the legislation says?

39 If certain portions of *CCAA* s. 11.01(a) are emphasized, the legislation could be read differently. For example, *CCAA* s. 11.01(a) might be read as stating that: "No order made under section 11 or 11.02 has the effect of prohibiting a person from requiring immediate payment for ... use of leased ... property ... provided after the order is made" (emphasis added). In other words, the phrase "provided after the order is made" might refer to "leased property." In that case, lessors of pre-stay leases, whether true or financing, would be subject to the stay of proceedings. Only lessors of property leased post-stay could demand that the debtor corporation make its lease payments. This would be in keeping with judicial interpretation of the balance of *CCAA* s. 11.01(a). For example, a supplier may provide goods or services to the debtor corporation post-stay on the basis of "cash on delivery."

40 This type of interpretation would not be unusual, as Canadian courts, including the Alberta Court of Appeal, have taken such a grammatical-interpretative approach when they have considered, for example, *BIA* s. 178(1)(d). That section provides:

178(1) An order of discharge does not release the bankrupt from ...

(d) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity ...

41 The question has arisen whether the words "while acting in a fiduciary capacity" qualify only the word "defalcation" or whether they qualify all of the listed factors, including fraud, embezzlement, misappropriation and defalcation. Courts have held that the latter is the proper interpretation (see e.g. *Confederation Life Insurance Co. v. Waselenak* (1997), [1998] 5 W.W.R. 712, 57 Alta. L.R. (3d) 38 (Alta. Q.B.), aff'd 2000 ABCA 136 (Alta. C.A.); *166404 Canada Inc. v. Coulter* (1998), 4 C.B.R. (4th) 1 (Ont. C.A.), leave to appeal to SCC refused (1998), 233 N.R. 395 (note) (S.C.C.); *Ross & Associates v. Palmer*, 2001 MBCA 17, 22 C.B.R. (4th) 140 (Man. C.A.); *Brant, Re* (1984), 52 C.B.R. (N.S.) 317 (Ont. S.C.)).

42 Including all pre-stay leases in the stay of proceedings would be in keeping with the broad and liberal interpretation that courts have given to the *CCAA*, which is to provide the debtor corporation with "breathing space" in which to determine

whether it is in a position to restructure its affairs and to facilitate its survival. Including only post-stay leases under CCAA s. 11.01(a) also would be in keeping with the narrow interpretation of transactions that are excepted from the stay of proceedings. It would simplify CCAA proceedings involving equipment leases.

43 This interpretation, however, does not give weight to the word "use" in CCAA s. 11.01(a). In making the true lease/financing lease distinction, Bauman J. in *Smith Brothers* and courts in subsequent cases have sought to do just that. They have read the section as stating, "No order made under section 11 or 11.02 has the effect of prohibiting a person from requiring immediate payment for ... use of leased ... property ... provided after the order is made" (emphasis added). In other words, it is "use" of the leased property which is provided after a court makes the initial order.

44 A true lease, in essence, is a bailment contract such that ownership of the leased goods remains with the bailor/lessor and the bailee/lessee pays for "use" of those goods. In *Punch v. Savoy's Jewellers Ltd.* (1986), 54 O.R. (2d) 383 (Ont. C.A.) at para 17, the court defined bailment as follows:

... Bailment has been defined as the delivery of personal chattels on trust, usually on a contract, express or implied, that the trust shall be executed and the chattels be delivered in either their original or an altered form as soon as the time for which they were bailed has elapsed. It is to be noted that the legal relationship of bailor and bailee can exist independently of a contract. It is created by the voluntary taking into custody of goods which are the property of another.

(See also *Visscher v. Triple Broek Holdings Ltd.*, 2006 ABQB 259, 399 A.R. 184 (Alta. Q.B.) at paras 27-28; *Letourneau v. Otto Mobiles Edmonton (1984) Ltd.*, 2002 ABQB 609, 315 A.R. 232 (Alta. Q.B.) at para 23).

45 The central character of a true lease is "payment for use." Bauman J. in *Smith Brothers* at para 48 adopted the following statement in Professor Cumming's above-referenced article to expand on this principle:

Under a true lease, the lessor surrenders his possessory right in chattels to the lessee in return for an undertaking by the lessee to perform certain acts which usually involve the payment of money to the lessor. The lessee has obligations, but the transaction cannot be characterized as a security agreement because the interest of the lessor is not related to those obligations. In other words, the lessor does not remain owner merely to ensure or to induce performance of the lessee's obligations. He remains owner because a bailment contract does not involve the transfer of ownership to the bailee.

46 Bauman J. concluded in *Smith Brothers* at para 61:

It is only payments for the use of leased property that are excepted from a s. 11 stay order under [CCAA s. 11.01(a)]. Payments for use and equity are not. Similarly payments for use and equity and an option to purchase are not. This is another reason to conclude ... [CCAA s. 11.01(a)] is not inclusive of all forms of lease.

47 This is a curious statement inasmuch as it might be seen as suggesting that a court should identify what portion of the lease payments made under the instrument is for use rather than for acquisition of equity (and, perhaps, of the option to purchase). This approach is not in keeping with other statements that Bauman J. made in *Smith Brothers*. In this Court's view, the instrument is either a financing lease or a true lease. There is no room for finding the instrument to be a hybrid of the two, as this unnecessarily confuses the issue.

48 As acknowledged by Suche J. in *Winnipeg Motor* at para 31, "... the true nature of arrangements involving the supply of equipment can be very difficult to peg." There can be a fine line between what is considered a true lease and a financing lease.

49 The determination of whether an arrangement is a true lease for purposes of CCAA s. 11.01(a) involves a functional analysis of the relationship between the parties based on substance as opposed to form (*Smith Brothers* at para 26; *Philip Services Corp., Re* (1999), 15 C.B.R. (4th) 107 (Ont. S.C.J. [Commercial List]) at para 2 [*Philip Services*])).

50 Professors Ronald CC Cumming and Roderick J. Wood in their *Alberta Personal Property Security Act Handbook*, 4th ed (Toronto: Carswell, 1998) at 53 [*Handbook*] emphasized the need to examine the relationship between the lessor and lessee to determine if it reflects indicia of a financing arrangement. They noted, however, that they were not referring to the traditional

indicia prescribed by the common law, but rather those which would be relevant to someone examining the economic realities of the transaction.

51 In *Smith Brothers* at para 67, Bauman J. referred to the following non-exhaustive list of considerations mentioned by Master Powers sitting as a Registrar in Bankruptcy in *Bronson, Re* (1995), 34 C.B.R. (3d) 255 (B.C. Master) [*Bronson*], aff'd (1996), 39 C.B.R. (3d) 33 (B.C. S.C.). This list includes factors considered by American courts in determining whether a document is a true lease or a security agreement, as summarized in *Teaching Material for Personal Property Security Transactions Governed by Personal Property Security Acts* by Professor Cuming in September 1991:

1. Whether there was an option to purchase for a nominal sum;
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment;
3. Whether the nature of the lessor's business was to act as a financing agency;
4. Whether the lessee paid a sales tax incident to acquisition of the equipment;
5. Whether the lessee paid all other taxes incident to ownership of the equipment;
6. Whether the lessee was responsible for comprehensive insurance on the equipment;
7. Whether the lessee was required to pay any and all licence fees for operation of the equipment and to maintain the equipment at his expense;
8. Whether the agreement placed the entire risk of loss upon the lessee;
9. Whether the agreement included a clause permitting the lessor to accelerate the payment of rent upon default of the lessee and granted remedies similar to those of a mortgagee;
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease;
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment;
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement;
13. Whether there was a default provision in the lease inordinately favourable to the lessor;
14. Whether there was a provision in the lease for liquidated damages;
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor;
16. Whether the aggregate rental approximated the value of purchase price of the equipment. [See also *PSINET* at para 12.]

52 Other courts have added that the right of the lessee to an "option to purchase" can be established through the course of conduct between the parties, if not expressly provided for in the document itself (*Philip Services* at paras 4-5). As well, leases that are "bundled together" for financing purposes may be construed as financing transactions and not as true leases, because the transactions really involve payment for financing the acquisition of the assets rather than payment for use (*Philip Services* at para 9).

53 Neither Professor Cuming nor the court in *Smith Brothers* said that a lease must contain all of the foregoing indicia to be classified as a financing lease. Indeed, the main factor on which Bauman J. relied in deciding that the arrangement before him was a financing lease was the default clause.

54 A court may use some or all of the *Smith Brothers* factors when assessing whether a particular transaction is a true lease or a financing arrangement. It is the substance of the transaction that is determinative.

55 Michael E Burke, in his article "Ontario *Personal Property Security Act* Reform: Significant Policy Changes" (2009) 48 Can Bus LJ 289 at 291-97, undertook an empirical review of the authorities and discussed the relative weight courts have placed on these factors. He stated at 291-92:

First, from the universe of factors or indicia that have been mentioned in the jurisprudence, some factors or indicia (referred to in this paper as "primary factors") are clearly more important than other factors or indicia (referred to in this paper as "secondary factors"). Second, the presence of a primary factor in a lease will often be determinative of the characterization of the agreement. Third, secondary factors generally have a corroborative value and are not in and of themselves determinative of the characterization. Accordingly, the presence of a number of secondary factors that are indicative of a characterization that is contrary to the characterization indicated by the primary factor will not be sufficient to overturn the weighting given by a court to the primary factor. Fourth, in those situations where the primary factor is ambiguous or absent, then the relative weighting given by a court to the secondary factors will be relevant in determining the characterization of the lease in question.

56 Topolniski J. in *843504 Alberta Ltd., Re*, 2011 ABQB 448, 80 C.B.R. (5th) 177 (Alta. Q.B.) [843504] identified what Burke at 292-94 referred to as "primary factors":

(a) Relevance of the purchase option price - whether the purchase option price is nominal or reflective of fair market value.

(b) Mandatory purchase options - whether there is a mandatory purchase option that obligates the lessee to purchase the equipment at the end of the term.

(c) Open-end leases/guaranteed residual clauses - whether the lessee is liable for any deficiency in the sale of the equipment at the end of the term.

(d) Sale-leaseback transactions - whether the transaction is structured as a sale and leaseback.

57 Topolniski J. then identified (at para 65) what Burke (at 295-98) referred to as "secondary factors":

(a) The ability to replace/exchange leased equipment is indicative of a true lease.

(b) The lessor's ability to accelerate payments and the residual value are generally inconsistent with a true lease. However, it is equally consistent with a true lease if the acceleration clause limits the lessor's damages to the present value of the remaining rents, plus the present value of the residual value at the end of the term, minus the value of net proceeds from a sale of the assets. If the acceleration clause is more narrowly crafted, it favours a security lease.

(c) A full payment lease may be indicative of either form of lease, depending on the language of the provision.

(d) A security deposit is indicative of a security lease.

(e) A substantial down payment is indicative of a security lease.

(f) Covenants relating to maintenance, insurance and risk of loss can be indicators of either type of lease. They are weak evidence of a security lease.

(g) Whether the lessor uses different forms for different types of transactions may be some evidence of intention.

58 Burke also identified (at 297) some factors, such as the exclusion of warranties on the lessor's part, as "red herrings" because their presence (or lack of presence) in a lease is equivocal: see also Weisz, Rogers & McLean at 48-49.

59 On an application for leave to appeal this Court's assessment that a particular agreement at issue in these proceedings was a financing lease, the Alberta Court of Appeal in *De Lage Landen Financial Services Canada Inc. v. Royal Bank*, 2010 ABCA 394 (Alta. C.A.) at para 60 [*De Lage Landen (CA)*], refusing leave to appeal 2010 ABQB 637, 37 Alta. L.R. (5th) 82 (Alta. Q.B.) [*De Lage Landen (QB)*] expressly rejected the suggestion that there should be a hierarchy of factors that a court should use to determine if a lease is a true lease or a financing lease. In denying the leave application, Ritter J.A. stated at para 15:

The applicant points to a British Columbia decision which suggests in *obiter* that there should be a hierarchy of factors used to determine if a lease is a true lease or a financing lease. In my view, this *obiter* runs contrary to current trends about how to weigh the factors in a legal test and about the deference afforded to courts of first instance in this respect. If one factor trumps the others, there is simply no point in including the others in the test. [Emphasis added].

60 During the present hearing before this Court, counsel spent a significant amount of time attempting to rationalize 843504 and *De Lage Landen (CA)*. In this Court's view, there is no conflict between the two. Topolniski J. in 843504 cited the Court of Appeal's decision in *De Lage Landen (CA)* and quoted (at para 60) this Court's observation in *De Lage Landen (QB)* at para 32 that:

... no one factor "is the *sine qua non* for determining whether a document is a true lease or a financing lease. One must look at the whole document to get a flavour of the [parties'] intentions ..."

While Topolniski J. referred to Burke's discussion of how courts weigh certain factors and outlined the results in her case of applying his "primary" and "secondary" factors, she did not necessarily endorse the view that there is a "hierarchy" of factors in every case.

61 Topolniski J. considered (at para 64) a provision in the lease before her which provided that:

- the lessee could return the vehicle at the end of the six-month minimum lease term;
- once the lessee returned the vehicle, the lessor would sell the vehicle;
- the lessee would keep the surplus if the sale proceeds exceeded the termination book value; and
- if the sale proceeds did not exceed the termination book value, the lessee would be liable for the shortfall.

She found this provision was indicative of a security lease since it rendered the lessee liable for a deficiency on the vehicle's sale at the end of the term.

62 Topolniski J. also applied Burke's "secondary" factors to the lease that was before her. There would have been no point in her doing so had she accepted that the lessee's liability for the deficiency trumped any and all secondary factors. She concluded that the secondary factors were not determinative of the proper characterization of the lease (at para 67). The presence of some secondary factors was insufficient to outweigh the clear effect of the primary factors in her case.

63 GE suggests that Topolniski J. acknowledged that the presence of a primary factor often can be determinative of the characterization, while absence or ambiguity in respect of the primary factors can make weighing of the secondary factors more relevant. In fact, Topolniski J. did not make such a statement. She simply quoted the Burke article where Burke made that argument.

64 GE argues that while the presence of one of Burke's "primary" factors is significant, absence or ambiguity in respect of a primary factor is not determinative. It simply means that other factors will be more important in the analysis. For example,

GE submits that the presence of an option to purchase at nominal value is a primary factor, and while its presence likely will result in the agreement being characterized as a financing lease, the absence of such an option or, indeed, the presence of an option to purchase at fair market value, means that focus must be directed to the other factors. GE suggests that this approach is consistent with authorities which hold that agreements without an option to purchase may still be classified as financing leases when the other indicia of financing leases are present.

65 The proper approach is more holistic than the one advocated by GE. While the presence or absence of one or more factors may loom larger than others, in all instances the inquiry remains focussed on determining the intention of the parties and is based on an interpretation of the entire agreement. As stated by the Alberta Court of Appeal in *De Lage Landen (CA)*, one factor cannot trump others in terms of the legal test. Courts must review the entire agreement and they must consider all factors. That is not to say, however, that certain factors may not have greater probative value than others in terms of the particular agreement before the court. In such a case, the court might give those factors greater weight. In all cases, the court must examine the various *Smith Brothers* factors and any other factors it considers material and relevant, balance those factors in the context of the entire agreement, and make a determination as to whether the agreement before it as a financing lease or a true lease. This is not a scientific exercise.

66 Counsel for several of the Applicants argue that payments that Cow Harbour made under leases containing an option to purchase were payments for "use," as the "purchase price" was not due and payable until Cow Harbour exercised the option to purchase or the lease came to an end and the lessee chose to pay the purchase price at a nominal sum. They cite *Ed Miller Sales & Rentals Ltd. v. R.* (1982), 42 A.R. 350 (Alta. Q.B.) [*Ed Miller*] in support of this position. Purvis J, in that case, relied in turn on *Ramsay v. Pioneer Machinery Co.* (1981), 28 A.R. 429 (Alta. C.A.) [*Ramsay*].

67 The issues in *Ramsay* were whether a transaction fell within the *Conditional Sales Act*, RSA 1970, c 61 and, if it did, whether the conditional seller could recover the purchase price through the sale of the equipment or by suing the conditional buyer. This was called the "seize or sue" provision. The Alberta Court of Appeal stated at para 20:

... Until the option is exercised the lessor is not pursuing his "right to recover the purchase price". If he chooses to recover the chattel he is exercising his right of possession on default, which is a right independent of any money claim. I have no hesitation in saying that [the seize or sue provision] is not applicable unless the lessor is seeking to recover the purchase money and he cannot seek to recover the purchase money until the option is exercised. It may be that a "lessor" who is found to be, in substance, a "conditional sales vendor" should be treated as a vendor claiming his purchase price within the section, but that is not this case.

68 In *Ed Miller*, the court considered whether lessors holding leases with options to purchase could maintain a priority claim to a builders' lien fund. The court applied the analysis in *Ramsay* in finding that until the lessees exercised the options to purchase, the lessors were not "sellers" under the *Conditional Sales Act* and, "... [t]hey are not attempting to recover a purchase price, but are attempting to establish priority against a lien fund for rental for equipment" (at para 49). As a result, the court held that the lessors' claims were not for payment of purchase moneys but for rental and, as a result, they were entitled to advance a claim for a lien for a reasonable and just rental of the equipment while used on the contract site (at para 50).

69 The now repealed *Conditional Sales Act* contained specific provisions concerning registration and remedies available to conditional sellers. The courts, when considering that statute, were more interested in the structure of the transaction than the parties' intention. In fact, the court in *Ed Miller* commented, "Stevenson J.A. [in *Ramsay*] found that it was sufficient to bring the transaction within the relevant sections of the *Conditional Sales Act* if it was established that the lessee merely had it within his power to acquire ownership. It was not necessary to establish intention" (at para 43).

70 When a court undertakes the true lease/financing lease analysis under the *CCAA*, substance, including the parties' intention, is one of the paramount considerations. The form the transaction takes is not. The "all or nothing" argument advanced by certain of the Applicants could just as easily result in all lessors of true and financing leases being precluded from receiving anything during the stay of proceedings.

71 Accordingly, it is of the utmost importance that this Court examine each lease individually to determine whether it falls within the category of a true lease or a financing lease.

72 Finally, it is a fundamental principle of contractual interpretation that a court must interpret an agreement as at the date it was made, as the exercise is intended to discern the intention of the parties at the time the contract was formed (*McDonald Crawford v. Morrow*, 2004 ABCA 150, 348 A.R. 118 (Alta. C.A.)).

V. Specific Leases

A. Scott Capital Group Inc. (Scott Capital) Leases

1. The leases

73 Five of the Disputed Leases are between Cow Harbour and Scott Capital. The lease details are as follows:

<i>Lease number</i>	<i>Date day/month/year</i>	<i>Term (months)</i>	<i>Capital Cost of Items</i>	<i>Monthly Rental</i>	<i>Option Price</i>	<i>Security Deposit</i>
6049520 Schedule 001	1/10/2009	60	\$559,951	\$10,469	25% of original capital cost	\$55,995 = 10% of original capital cost
6049520 Schedule 002	30/10/2009	48	\$801,250	\$18,184	20% of original capital cost	\$160,250 = 20% of original capital cost
6049520 Schedule 003	18/12/2009	48	\$234,000	\$5,295	Fair market value	\$46,800 = 20% of original capital cost
6049520 Schedule 004	4/2/2010	48	\$664,832	\$16,717	Fair market value	\$132,966 = 20% of original capital cost
6049520 Schedule 005	5/2/2010	48	\$286,020	\$7,190	Fair market value	\$57,204 = 20% of original capital cost

74 All of the Scott Capital leases are subject to the terms of the Scott Capital Master Equipment Lease that the parties entered into on October 1, 2009 (Scott Master Lease). Scott Capital's affiant deposed that the Scott Master Lease had been in effect for 30 years, with the last revision having been made about ten years ago. He confirmed that Scott Capital used the same form for what Scott Capital intended to be true leases and financing leases. The number 6049520 refers to the Scott Master Lease to which all of the Scott Capital leases being considered are subject. This Court will refer to each lease by its Schedule number.

75 Scott Capital leased eight pieces of heavy equipment or vehicles to Cow Harbour under these five leases. It entered into all of these leases with Cow Harbour within six months prior to Cow Harbour's CCAA filing. In the case of the Schedule 001 lease, the equipment was only commissioned for use by Cow Harbour in July 2010, which was well into the CCAA proceedings.

76 The evidence of Scott Capital's affiant was that Cow Harbour sourced the equipment, negotiated the sale price and approached a broker to seek assistance with acquisition of the assets. The broker then contacted Scott Capital and the equipment went straight from the third party vendor to Cow Harbour.

77 Scott Capital's affiant deposed that Scott Capital generally structured its leases as true leases. His due diligence on Cow Harbour suggested that Cow Harbour might be in a precarious financial position. As a result, Scott Capital had no intention of providing "financing leases" to Cow Harbour. He deposed that Scott Capital made it clear to Cow Harbour, and Cow Harbour accepted and acknowledged at the time they negotiated the leases, that the lease options to purchase were to be at fair market value.

78 All of the leases identify the option price as being fair market value. In three of the leases, that value is not specified. In the other two, the fair market value of the equipment is pre-estimated and agreed by the parties to be a particular percentage of the original capital cost of the equipment (25 percent in the Schedule 001 lease and 20 percent in the Schedule 002 lease).

79 The security deposits that Scott Capital required Cow Harbour to pay under the leases amounted to 10 percent of the capital cost of the equipment in the case of the Schedule 001 lease and 20 percent of the capital cost of the equipment in the other four leases.

2. Lease-specific arguments of the parties

(a) Scott Capital

80 Scott Capital asserts that it did not structure its leases in such a way that Cow Harbour was financing its purchase of the equipment or accruing equity in the equipment over the lease term. Rather, Scott Capital structured the leases to ensure that the use, condition and value of the equipment were being controlled and maintained, as Scott Capital expected that Cow Harbour would return the equipment to it at the end of the lease terms. As the affiant stated on cross-examination:

A. You will see that the terms on these leases are different. And part of that is because we feel that certain equipment may be perhaps more abused. Certain equipment naturally has a different life than other equipment.

But that type of an analysis is factored into whether or not we will enter into a 48-month lease or perhaps a 60-month lease. If we think that equipment will be used gingerly, then we will perhaps enter into a longer-term lease. If we think that equipment will be used harshly in harsh conditions, we want to put it on a shorter-term lease. There always has to be value on that equipment in the event that it's returned.

[Transcript of the cross-examination of Brian Jagt, 26 October 2010, p. 20, ll 21-34.]

81 The Schedule 003, Schedule 004 and Schedule 005 leases, in addition to other detailed terms concerning the maintenance and condition of the equipment, specified usage maximums in the return provisions of the lease. Scott Capital did this with specific care and concern for the equipment's condition, having regard to how Cow Harbour intended to use the equipment. The affiant explained that Scott Capital was concerned about the number of hours that Cow Harbour intended to use the equipment, rather than the number of kilometres of recorded use, as Scott Capital anticipated that the buses and trucks would be running constantly but not travelling great distances.

82 The purchase option prices set out in the Schedule 001 and the Schedule 002 leases (25 and 20 percent, respectively, of the original capital cost of the equipment) were not arbitrary figures. Rather, Scott Capital determined those prices and Cow Harbour agreed to those prices as a reasonable pre-estimate of the equipment's fair market value at the end of the lease term, based on Cow Harbour's anticipated use and the nature of the use.

83 Scott Capital points out that the present value of the rentals under each lease was less than 90 percent of the original equipment cost.

(b) Monitor

84 The Monitor suggests that the Schedule 001 and Schedule 002 leases are best characterized as financing leases because, among other factors, the end of term purchase option price appears to be arbitrary and bears no direct connection to the actual value of the leased equipment at the time Cow Harbour was to exercise the option. In other words, Cow Harbour appears to have acquired equity in the leased equipment because the fair market value of the leased equipment at the time Cow Harbour was to exercise the option may exceed the purchase option price.

85 In addition, the Schedule 001 and Schedule 002 leases overwhelmingly exhibit other indicia of a financing lease, as discussed in *Smith Brothers*, which militates against them being considered true leases. Specifically, the leases contain the *Smith Brothers* financing lease factors 3 to 10 and 13 to 16.

86 The Monitor points out that the aggregate rental under the Schedule 001 and Schedule 002 leases approximated the value of the purchase price of the equipment, factoring in interest and carrying costs (*Smith Brothers* factor 16), as the equipment in the Schedule 001 lease originally was valued at \$559,951 plus applicable tax, while the total amount to be paid by Cow Harbour during the course of the term was \$628,140 plus applicable tax. In the Schedule 002 lease, the equipment originally was valued at \$801,249.96 plus applicable tax, while the total amount to be paid by Cow Harbour over the course of the term was \$1,033,079.83 plus applicable tax.

87 In the Schedule 003, Schedule 004 and Schedule 005 leases, the end of term purchase option was referred to as "fair market value" (with no approximated value of what that value might be). While this factor militates in favour of each such lease being characterized as a true lease, the Monitor notes that, as in *Bronson*, these leases contained default provisions which guaranteed to Scott Capital the residual value of the equipment. These three leases contained financing lease *Smith Brothers* factors 3 to 10 and 13 to 15.

(c) GE

88 GE takes the position that the Scott Master Lease bears the indicia of a financing lease as *Smith Brothers* factors 4 to 11 and 13 to 15 are present.

89 It says the present value of the rental payments is irrelevant. The more important factor is that the aggregate cost of the rental payments exceeded the value of the equipment at the commencement of the lease.

90 GE points to the evidence of Scott Capital's affiant that the amount of the security deposit that Cow Harbour paid at the outset of the Schedule 002 lease was equal to the amount of the purchase option at the conclusion of the term. It contends this was equivalent to a nominal purchase option price and suggestive of a financing lease as Cow Harbour, at the outset of the lease, paid the amount of the purchase price due at the conclusion of the lease.

91 GE maintains that, if this Court accepts Scott Capital's assertion that the purchase price options in the Schedule 003, Schedule 004 and Schedule 005 leases were for fair market value, it would be accepting form over substance. Scott Capital's affiant confirmed that the amount of the security deposit that Cow Harbour paid in respect of each of these three leases at the outset of the leases was equal to Scott Capital's internal estimate of the remaining value of the equipment at the conclusion of the leases. Said differently, Cow Harbour, at the outset of the lease, paid what was estimated to be the equipment's remaining value at the conclusion of the lease, leaving Cow Harbour with a nominal purchase option.

3. Decision

92 Applying the *Smith Brothers* criteria to the five Scott Capital leases reveals the following:

1. Whether there was an option to purchase for a nominal sum - No, the purchase price was reflective of fair market value (see discussion below).
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.
3. Whether the nature of the lessor's business was to act as a financing agency - The affiant acknowledged financing leases are a small portion of its business.
4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.
5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.
7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.
9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - Yes.
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.
14. Whether there was a provision in the lease for liquidated damages - Yes.
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

93 What do these results establish?

94 Scott Capital's affiant conceded that Cow Harbour sourced the equipment and then approached a broker to seek assistance with acquisition of the assets. The broker would then contact Scott Capital. The way in which the leases came about is more reflective of a financing lease transaction than a true lease situation. However, it is important for this Court to examine the structure of each transaction to characterize properly the agreement.

95 All of the leases had purchase options. This Court must attempt to value the purchase price option as at the date Cow Harbour and Scott Capital executed the lease agreements. As stated in the *Handbook* at 55:

A clause in a lease giving the option to purchase the goods at less than their expected market value (as determined at the date of execution) indicates that the lessee has acquired an equity in the goods not unlike that which he would have acquired under an instalment purchase contract.

[Emphasis added.]

96 In *Ontario Equipment (1976) Ltd., Re* (1981), 33 O.R. (2d) 648 (Ont. Bkcty.) at para 9, aff'd (1982), 35 O.R. (2d) 194 (Ont. C.A.), Henry J. considered the nature of the option to purchase to be a critical factor in distinguishing between true leases and financing leases in personal property security legislation cases, stating:

The test in determining whether an agreement is a true lease or a conditional sale is whether the option to purchase at the end of the lease term is for a substantial sum or a nominal amount ... If the purchase price bears a resemblance to the fair market price of the property, then the rental payments were in fact designated to be in compensation for the use of the property and the option is recognized as a real one. On the other hand, where the price of the option to purchase is substantially less than the fair market value of the leased equipment, the lease will be construed as a mere cover for an agreement of conditional sale.

97 Whether a purchase option price is nominal is fact-specific. A purchase option for a nominal sum is indicative of a financing lease. On the other hand, a purchase option at fair market value is highly suggestive of a true lease. The rationale, according to Burke, is that, "[i]f the lessee is required to pay the actual value of the property at the end of the lease at a time when the property still has value, then the lease payments cannot reasonably be said to have been payments towards an equity interest in the property" (at 293).

98 However, as noted by the Master in *Bronson* at para 55 and confirmed by the British Columbia Supreme Court in that case (at para 7), the mere existence of a fair market value purchase option price in the agreement is not necessarily determinative of whether the agreement is a true lease or a financing transaction.

99 In *Smith Brothers*, Bauman J. commented that simply because the lessee can purchase the equipment at its fair market value at the end of the lease does not prevent a court from characterizing the transaction as a financing transaction if the end of the lease term is roughly equivalent to the end of the equipment's useful life (at para 76).

100 Professors Cuming and Wood explained in their *Handbook* at 55 that:

A clause in a lease giving the lessee the option to purchase the goods at less than their expected market value (as determined at the date of execution) indicates that the lessee has acquired an equity in the goods not unlike that which he would have acquired under an instalment purchase contract. The economic reality is that it is quite predictable the lessee will pay this amount to the lessor. Consequently, the transaction is likely to be characterized as a security agreement. However, the fact that at the end of a lease term roughly equivalent to the useful life of the goods the lessee can purchase the goods at their then market value does not prevent characterization of the transaction as a security agreement. If one or more of the major indicia of a security agreement are present, the transaction may be a security agreement. Accordingly, if the lease is for all or the greater part of the useful life of the leased equipment and the lessee is obligated to pay rental equivalent to the capital cost of the goods and an appropriate credit charge, the fact that the lessee is given the right to buy the goods at the end of the term for their then small market price should play no role in the characterization process. A consideration of the option price is relevant to the characterization of the transaction only if the option can be exercised at a time when the goods have significant commercial value. It may be possible to show that the option price was not designed to ensure that the lessor is fairly compensated for his interest in the goods, but was included for some other purpose (such as satisfying income tax authorities). This provides strong evidence that the parties recognize that by the time the option is exercised the lessor has been fully compensated through rental payments and that it matters little to either the lessor or the lessee that the option is or is not exercised.

101 In the Schedule 001 and Schedule 002 leases, the purchase option price was expressed to be the "fair market value" of the equipment, pre-estimated and agreed by the parties to be 25 percent and 20 percent, respectively, of its original capital cost. These percentages equated to purchase prices of \$139,987.75 (Schedule 001 lease) and \$160,249.99 (Schedule 002 lease). These are not nominal amounts.

102 Scott Capital's affiant deposed that Scott Capital used a "combination of past experience, extensive equipment knowledge, market knowledge and the application or intended use of the equipment to determine the value of any purchase option at lease end such that it is a reasonable estimate of fair market value."

103 The Schedule 003, Schedule 004 and Schedule 005 leases all stated that the purchase option price was "fair market value." There is no evidence to suggest that the parties meant or intended otherwise.

104 This Court finds that the options were for fair market value or a reasonable pre-estimate of such.

105 There was no evidence that 60 months in the case of the Schedule 001 lease or 48 months in the case of the Schedule 002, Schedule 003, Schedule 004 and Schedule 005 leases was roughly equivalent to the end of the useful life of the equipment involved in those leases. In fact, Scott Capital's affiant stated that Scott Capital structured the leases to ensure there was value in the equipment at the end of the lease term.

106 These leases did not contain any mechanism, either in a default situation or at full term, whereby the surplus value of the equipment would go to Cow Harbour. If, at the end of the term of each lease, Cow Harbour did not exercise the purchase option to acquire the equipment, Cow Harbour had to return the equipment to Scott Capital. Scott Capital could then deal with the equipment as it saw fit for its own benefit and account. Cow Harbour was not responsible under any of these leases for any deficiency or shortfall on the sale of the equipment at the end of the term.

107 The Scott Master Lease s 13(f) contained a default clause allowing for liquidated damages to consist of the present value of rents owing to the end of the term, plus the present value of the residual value of the equipment "which Lessor expected to receive at the expiry of the term of the lease, which is equal to the Fair Market Value of the Equipment as set out in the Equipment Schedule ...," minus the net proceeds from a sale or lease of the equipment. The lease schedules stated that if Cow Harbour defaulted in its obligations under the lease, Scott Capital would retain the security deposit as liquidated damages.

108 The default provisions in *Daimler Chrysler Services Canada Inc. v. Cameron*, 2007 BCCA 144 (B.C. C.A.) [*DaimlerChrysler*], rev'g 2006 BCSC 1992, 32 C.B.R. (5th) 188 (B.C. S.C.) were similar (other than retention of the security deposit). The court found that the lease secured the payment of the residual value by the lessee in the contingency of default (at para 28). The court went on at para 37 to say:

... the basis for calculating damages does not distinguish a true lease from a security lease. The ability to claim accelerated damages in *Langille* was not a consequence of the character of the lease, i.e., a true lease or a security lease. Rather, it was simply the proper measure of damages for breach of a chattel lease. Generally, the basis for calculating damages can provide only some insight as to whether an impugned lease secures payment or performance of an obligation. I emphasize that it cannot serve as a decisive factor.

109 The Chambers Judge had concluded in *Daimler Chrysler* that the transaction was a security lease, following *Bronson*, which found that the default clause secured payment of both the lease payments and the option price. On appeal, the court determined that the chambers judge had placed undue weight on the default provision as it can have only corroborative effect (at para 46).

110 According to Burke at 294:

If, however, the lessee's residual value guarantee only applies in the case of an early termination of the lease, whether voluntarily by the lessee or by the lessor as a result of the occurrence of a default, but not at the end of the scheduled lease term, then such a residual value guarantee will not constitute a primary factor that is indicative of a security lease.

111 In the case before this Court, the default provisions contained in the Scott Capital leases are equivocal.

112 The aggregate of rental payments for each of these leases is greater than the original capital cost of the equipment. Professors Cuming and Wood expressed their view in the *Handbook* that if the lessee must pay the equivalent of the lessor's capital investment plus a credit charge at the rate existing at the date of the agreement, there is strong but not conclusive evidence of a secured sale (at 54). However, Burke commented at 296:

If a lessee is required to pay what is the equivalent of the original cost of the leased property (i.e., the lessor's capital investment), plus a finance charge based on the rate existing at the date of the lease agreement, it does not necessarily follow that such an agreement is a security lease, especially if the lease contains a true fair market value purchase option.

In such a lease, it is possible that the lessee has simply agreed to pay a premium for the use of the leased property.

113 The Schedule 003, Schedule 004 and Schedule 005 leases contain specific use limitations with corresponding excess use charges. In *Daimler Chrysler*, the Chambers Judge found that excess kilometre charges and maintenance obligations were indicative of a true lease as they protected the lessor against reduction of market value on expiry of the lease term due to excess "wear and tear" (at para 25). Burke, however, considered such provisions equally consistent with a financing lease, as they

suggest that the lessee bears some risks of ownership (at 296). This Court finds that those provisions are equivocal in the case of the Scott Capital leases.

114 All five Scott Capital leases required substantial security deposits. The evidence of Scott Capital's affiant on cross-examination was that for four of the five Scott Capital leases, the amount of the security deposit was equivalent to the purchase option price in the lease or the anticipated purchase option price (transcript of the cross-examination of Brian Jagt, 26 October 2010, pp 43-45). He explained that in terms of the Schedule 003, Schedule 004 and Schedule 005 leases (which have purchase options simply stated to be at "fair market value"), the security deposit was based on the "estimated" fair market value of the equipment, but that this was just Scott Capital's internal estimate (transcript of the cross-examination of Brian Jagt, 26 October 2010, pp 39-42). Scott Capital did not provide this information to Cow Harbour. Cow Harbour had the ability to purchase the equipment at the end of the term of the lease for the "fair market value," irrespective of whether that amount turned out to be less than, equal to, or greater than the amount of the security deposit.

115 During cross-examination, the Scott Capital affiant gave the following evidence:

Q. And would I be correct in stating as well that typically if a purchaser or if a lessee does exercise an option to purchase the equipment at the end of the lease, the deposit will be utilized in some fashion to acquire the equipment?

A. It depends on the customer. Some customers want us to reimburse in the form of a cheque their security deposit, and then they pay us a separate cheque for the full amount if they purchase it. And other customers just tell us to net it against their purchase option, making sure that the bill of sale records the correct gross purchase price and then with the reflection that the other amount has been applied.

Q. And was there any discussion with Cow Harbour at any point in time with respect to how the deposit, whether the deposit would be utilized for the purchase price of the asset if Cow Harbour did exercise an option to purchase?

A. There was no discussion with Cow Harbour.

[Transcripts of the cross-examination of Brian Jagt, 26 October 2010, p 25, ll 8-26.]

116 This Court finds that Scott Capital's estimated fair market value at the end of the lease term was a reasonable "security deposit" amount to protect against its risk that Cow Harbour might not return the equipment to it when the lease ended because of some total loss event or that Cow Harbour would return the equipment to Scott Capital in such poor condition that the equipment no longer had value. In such cases, the security deposit would have served its stated purpose of being a recourse for Scott Capital's damages under the lease.

117 There are certainly indicia of a financing arrangement. There are hypothetical situations under which Cow Harbour could indeed have built up equity and paid only the residual amount of the equipment's capital cost plus a financing charge; e.g. if it defaulted in its obligations under the leases. Those hypothetical situations did not occur, however, and based on the wording of the leases, Cow Harbour was paying for use of the equipment.

118 Although the security deposits are relatively substantial, there was no obligation on Cow Harbour's part to forfeit the security deposits at the end of the lease term. It could simply return the equipment and demand the security deposits (less any additional charges that it had incurred in the meantime). This is especially so with respect to the Schedule 001 lease, where the purchase option price was 25 percent of the equipment's original capital cost, while the security deposit was ten percent. Although Burke suggested (at 296) that a substantial security deposit is indicative of a financing lease in that the lessee is required to post collateral to obtain the equipment, considering the whole of the Scott Capital lease agreements, this factor is not determinative and, in fact, it assists Scott Capital in its position.

119 For the foregoing reasons, this Court concludes that the Scott Capital leases are true leases.

B. Caterpillar Financial Services Limited (CFSL) Lease

1. The Lease

120 Cow Harbour leased a Caterpillar off-highway truck from CFSL pursuant to a lease dated March 27, 2006. According to CFSL's affiant, the original cost of the truck was \$2,235,456. The amount shown in the floating rate addendum was \$500 more, which CFSL's affiant explained was a fee payable by Cow Harbour (transcript of the cross examination of Renee Bertha Fournier, 21 October 2011, p. 7, ll 32-41). The lease term was 60 months. The lease required Cow Harbour to pay irregular monthly payments pursuant to the terms of the irregular payment schedule attached to the CFSL lease (6 months at \$100,000 and 54 months at \$28,397.86). The aggregate amount of those rents was about \$2,133,485.

121 If Cow Harbour exceeded the maximum hours of use of the equipment, it was to pay an excess hour charge.

122 The CFSL lease contained an end of term purchase option price of \$524,535.

2. Lease-specific arguments of the parties

(a) CFSL

123 CFSL argues that the most probative factor is that the purchase option price was neither a nominal sum nor arbitrarily selected. Rather, it calculated the purchase option price after considering factors such as depreciation, historic resale market for like equipment, application, exchange rate and annual hours of usage. The purchase option price represented 102 percent of the standard residual amount, which CFSL calculated to be \$514,250, and was more than 15 percent of the value of the truck at the commencement of the term.

124 According to CFSL, the purchase option price was an amount intended to represent a reasonable pre-estimate of the fair market value of the truck at the end of the lease term. It relies on the statement by Burke (at 293) that, "[i]f the lessee is required to pay the actual value of the property at the end of the lease at a time when the property still has value, then the lease payments cannot reasonably be said to have been payments towards an equity interest in the property." CFSL says that the term of the lease did not exceed 75 percent of the economic useful life of the truck, which it estimated to be 120 months.

125 The net present value of the rental payments is \$1,865,621.73, which is less than 90 percent of the equipment's value at the beginning of the term. CFSL points out that the rental payments could not be applied in satisfaction of the purchase option price.

126 CFSL maintains that other factors point to this being a true lease, including:

- the lack of any requirement for a security deposit or down payment
- Cow Harbour was not required to pay the equivalent of the original cost of the truck, plus a financing charge based on a rate existing at the date of the CFSL lease
- Cow Harbour was required to maintain certain minimum standards of repair with respect to the truck.

CFSL submits that the latter factor is consistent with it attempting to protect its interest in the residual value of the truck on its return at the end of the lease.

127 Cow Harbour was not required to make a residual payment at the end of the lease term or to guarantee residual value. Cow Harbour could exercise the option or return the truck to CFSL.

128 CFSL asserts that the presence of other factors, such as the inability of Cow Harbour to exchange or replace the truck; a default provision favourable to CFSL; and the inclusion of the floating rate addendum, should be given less weight in comparison with the fair market value option to purchase. Equipment lessors are in the business of making money and the floating rate addendum simply reflects its cost of capital or a return of investment.

129 CFSL relies on *Daimler Chrysler* in arguing that the acceleration of rent on default is equivocal.

130 CFSL submits that given Cow Harbour's operations, the specialized equipment it was leasing and the relatively remote location of the oil sands site where it was working, it was only logical that CFSL would impose the obligation for insurance, maintenance and the risk of loss on Cow Harbour. Accordingly, these are neutral factors.

(b) Monitor

131 The Monitor contends that the CFSL lease is best characterized as a financing lease because, among other factors, the end of term purchase option price (approximately 23 percent of the original value of the equipment) appears to be arbitrary and bears no direct connection to the actual value of the leased equipment at the time Cow Harbour exercises the option. In other words, Cow Harbour appears to have acquired equity in the leased equipment because the fair market value of the leased equipment at the time when the option could be exercised might exceed the purchase option price. This leads to the conclusion that the lease is a financing agreement and/or a lease pursuant to which payments are made for "use and equity."

132 The Monitor suggests that the CFSL lease exhibits other indicia of a financing lease, as discussed in *Smith Brothers*, which militates against it being considered a true lease. Specifically, *Smith Brothers* factors 4 to 6, 8, 9 and 13 to 16 are present in the CFSL lease. The Monitor notes that the equipment originally was valued at \$2,235,956 plus applicable tax, while the total amount that Cow Harbour was to pay during the course of the term was \$2,658,019.44 plus applicable tax. Therefore, the aggregate rentals approximated the value of the purchase price of the equipment factoring in interest and carrying costs.

(c) GE

133 GE focuses on the floating rate addendum, which provided that the rental payments were subject to an interest rate adjustment. It says this resulted in the lease operating like a credit or loan agreement. GE notes that:

- CFSL charged interest to Cow Harbour equivalent to its cost of acquiring the truck;
- the interest rate that CFSL charged fluctuated over the term of the lease, according to the cross-examination of CFSL's affiant (transcript of the cross-examination of Renee Bertha Fournier, 21 October 2011, p.6, ll 5-8);
- Cow Harbour had the option, at any time over the term of the lease, to lock into a fixed interest rate equal to the rate of interest charged to CFSL on fixed rate loans (transcript of the cross-examination of Renee Bertha Fournier, 21 October 2011, p.8, ll 30-41; p.9, ll 1-4);
- at the end of the lease, Cow Harbour's final rent payment was subject to a credit or debit adjustment on the interest rate fluctuation over the term of the lease.

GE suggests that this is the most significant evidence the lease was a financing arrangement.

3. Decision

134 The following results from applying the *Smith Brothers* criteria to the CFSL lease:

1. Whether there was an option to purchase for a nominal sum - No, the purchase price was reflective of fair market value.
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.
3. Whether the nature of the lessor's business was to act as a financing agency - It acted as both a financing and a leasing company, according to its affiant.
4. Whether the lessee paid sales tax incidental to acquisition of the equipment - The lessee was to pay any taxes due on its exercise of the sale option.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.
6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.
7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Not specifically in the lease agreement
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.
9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - No.
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.
14. Whether there was a provision in the lease for liquidated damages - Yes
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes, if interest payments are added to the rent.

135 Cow Harbour selected the truck and CFSL acquired the truck to lease to Cow Harbour.

136 This Court finds that the purchase option price for the CFSL equipment was a reasonable pre-estimate of the truck's fair market value at the end of the 60-month lease term. It was approximately 23 percent of the truck's original price. Based on CFSL's estimate that the truck had an economic useful life of 120 months, it was reasonable for CFSL to believe that the truck would still have value at the end of the lease term. No evidence was led which would suggest otherwise.

137 The lease did not require Cow Harbour to pay a security deposit or down payment. While CFSL was entitled to accelerate rental payments on default, Cow Harbour was not responsible for the residual value, if any, of the truck.

138 The aggregate rent was about five percent less than the truck's original value. However, as is apparent from the floating rate amortization schedule attached to the lease, the rent payments and option purchase price together amounted to the capital cost of the truck, plus a seven percent interest rate (Toronto Dominion prime plus 1.50 percent).

139 GE argues that a "payment for use" contract will not impose an obligation on the lessee to pay interest on the funds that the lessor uses to acquire the leased equipment. However, in this Court's view, it is just as likely that such a charge will be included in a true lease, *albeit* it may be incorporated in the overall rental amount rather than being identified as interest or a financing charge.

140 Some of the terminology that CFSL used in the floating rate addendum suggests that it is an addendum to a financing lease agreement. The terminology includes "principal balance," which is defined as "equal to the amount of *credit extended* of \$2,235,956.00, as adjusted by amortization during the term of the Contract" (emphasis added). Also, "gross lease" was defined

as meaning "the total *Amount of Credit Extended and Aggregate Finance Charge(s)* payable hereunder" (emphasis added). These definitions, however, are not definitive and this Court must look at the lease as a whole.

141 Cow Harbour was not obliged to exercise the purchase option. If it did, the purchase option price was a significant amount and CFSL was not guaranteed the residual value of the truck unless Cow Harbour exercised the option. This Court finds that Cow Harbour simply agreed to pay a premium for the use of the leased property.

142 In looking at the CFSL lease as a whole, this Court holds that it was a true lease.

C. Wajax Industries (Wajax) Leases

1. The Leases

143 Wajax had three leases with Cow Harbour, as set out below:

<i>Lease number (Monitor's Report)</i>	<i>Date day/ month /year</i>	<i>Initial Term (months)</i>	<i>Original Cost of Equipment</i>	<i>Monthly Rental</i>	<i>Option Price</i>	<i>Assessed Value June 2010</i>
196	12/11/2008	6	\$439,810	\$16,500	\$439,810, less a % of rent payments	\$130,000
198	8/4/2009	6	\$1,681,500	\$40,000	\$1,681,500, less a % rent payments	\$450,000
197	8/4/2009	6	\$991,860	\$30,000	\$991,860, less a % of rent payments	\$175,000

144 The leases were for a maximum six-month initial term, with month-to-month extensions allowed after the initial term. Cow Harbour could exercise the option to purchase at any time during the initial term of the lease, or within 6 months after that, if CFSL extended the term of the lease.

145 Cow Harbour was responsible to pay the specified monthly rental, unless it used the equipment for more than 200 hours in a month, in which case it was required to pay overtime charges.

146 The option to purchase was for the original cost of the equipment, but if Cow Harbour exercised it during the initial six-month term, 85 percent of the rental payments that Cow Harbour had made was to be credited towards the purchase price. Wajax had the sole option to extend the option to purchase for a further six-month term. If Cow Harbour exercised the option during the second six-month term, Wajax was to credit towards the purchase price 85 percent of the rental payments that Cow Harbour had made during the first six month term and 50 percent of the rental payments that Cow Harbour had made during the second six-month term.

147 Cow Harbour did not exercise the option to purchase during the initial six-month term and Wajax did not extend the option to purchase beyond that term. At the date this Court granted the Initial Order, Cow Harbour no longer had an option to purchase the equipment.

2. Lease specific arguments of the parties

(a) Wajax

148 Wajax's affiant deposed that Wajax is not in the business of providing equipment financing. He stated that, in this case, Wajax entered into short-term rental agreements with Cow Harbour to accommodate Cow Harbour's need for the equipment and to permit Cow Harbour time to find third party financing for payment of the purchase price.

149 The affiant stated that Wajax set the rental rate with a view to covering the equipment's depreciation during the rental period, as Cow Harbour could have returned the equipment after the initial six-month term without incurring any further obligation to Wajax.

150 Wajax emphasizes that the focus on this application should be on whether the lease agreements secured payment of the purchase price for the equipment. Wajax suggests that this Court should bear in mind the distinctions between leasing consumer goods to an individual versus leasing a large piece of equipment that generates revenue for a business.

151 Wajax submits that the percentage of the rental payments credit that Cow Harbour would have received had it elected to exercise the option to purchase the equipment was minimal when compared to the purchase price for the equipment. It asserts this credit was not "equity" given the equipment's depreciation, as demonstrated by the Ritchie Brothers valuations that were undertaken in these proceedings and the evidence of Wajax's affiant.

152 Wajax notes that there was no mandatory purchase option and no liability for any deficiency on the sale of the equipment following the expiry of the lease. It says these were not sale-leaseback transactions. Under the leases, Wajax could replace the equipment with a comparable piece of equipment if Cow Harbour did not exercise the purchase option during the first six months. Further, if Cow Harbour defaulted, Wajax was entitled only to the amounts that Cow Harbour owed to it under the agreement plus 30 percent of the aggregate rental charges for the unexpired portion of the term as a pre-estimate of liquidated damages. Wajax maintains this was a weak default clause.

153 Wajax points out that the assessed fair market value of the equipment in June of 2010 was significantly less than the purchase option price, even after the second term. As a result, Cow Harbour had not built up equity in the equipment through the lease agreements.

(b) Monitor

154 The Monitor acknowledges that the Wajax leases could be characterized as financing leases or true leases, depending on the approach used in performing the characterization analysis.

155 The Monitor says the Wajax leases were not security agreements under a personal property security analysis. However, it maintains that Cow Harbour made payments for use of and earned equity in the equipment during the first six months of the leases. This militates in favour of the leases being considered financing leases.

156 The Monitor notes that the six-month purchase option period had expired under each of the leases, and Wajax had not given any indication of its election to extend the purchase option period. Therefore, it would appear that Cow Harbour no longer had any equity in the leased equipment, which would militate in favour of each lease being considered a true lease.

(c) GE

157 GE contends that the Wajax leases bear several indicia of financing leases, including Cow Harbour's:

- obligation to pay all taxes incidental to ownership;
- responsibility for insuring the equipment;
- responsibility for payment of license fees for maintenance of the equipment;
- bearing the entire risk of loss

As well, it asserts that the default provisions were inordinately favourable to Wajax, and the leases contained a provision providing for liquidated damages.

158 GE contends that the rental payments earned Cow Harbour a significant equity interest in the equipment over the term of the leases. It says that the most significant factor is that Wajax intended to sell the equipment to Cow Harbour pursuant to the leases, as confirmed by Wajax's affiant. As well, Cow Harbour previously had purchased a number of pieces of the same type of equipment from Wajax.

3. Decision

159 Application of the *Smith Brothers* criteria to the Wajax leases reveals the following:

1. Whether there was an option to purchase for a nominal sum - No, the option purchase price was reflective of fair market value.
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - Yes, but contingent on the option to purchase being exercised.
3. Whether the nature of the lessor's business was to act as a financing agency - No.
4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.
5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes
6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.
7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.
9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes, but only 30 percent of the aggregate rental charges for the unexpired portion of the term, as a pre-estimate of liquidated damages.
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Wajax is the exclusive dealer for Hitachi equipment in Canada. The equipment was new when it provided the equipment to Cow Harbour.
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - No. However, rent for the minimum rental period was payable before delivery of the equipment.
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
13. Whether there was a default provision in the lease inordinately favourable to lessor - No (see discussion below).
14. Whether there was a provision in the lease for liquidated damages - Yes (see discussion below).
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - No.

160 The parties' intent in this case was that Cow Harbour would purchase the equipment, which was the subject of these leases, if it could find a third party to finance its purchase of the equipment.

161 If Cow Harbour exercised the option to purchase within the first six-month term of the leases, it would be credited with 85 percent of the rental payments made. Professors Cuming and Wood commented in the *Handbook* at 56 on this type of situation:

Some leases provide that rental payments made up to the point when the option is exercised are to be "credited" to the lessee and deducted from the amount payable under the option. Under an economic realities test, the amount "credited" to the lessee has little significance; it remains necessary to determine if the amount of new money to be paid by the lessee represents the reasonably expected fair market value of the goods at the time of exercise of the option. If the new money is equal to or near the market value of the goods, the "credit" is of no significance. If the amount of new money is significantly less than the market value of the goods, the term providing for the credit is an overt recognition that the debtor has purchased an "equity" in the goods through his lease payments. It is inevitable that, as a rational person, the lessee will exercise the option in order to realize that equity.

162 This Court finds that the purchase option price or "new money" in this case was a reasonable pre-estimate of what the market value of the equipment would be if and when Cow Harbour exercised the option, taking into account depreciation, which was reflected by the rental "credit." These were relatively short term leases. In any event, the six-month option had expired for each lease and Wajax did not extend them for a second term.

163 While there was a default clause in each case which allowed for acceleration of rents, it was only for 30 percent of the aggregate rental charges for the unexpired portion of the term. Further, Cow Harbour had no liability for deficiency on sale of the leased property at the end of the term.

164 Accordingly, this Court finds that the Wajax leases were true leases.

D. Kempenfelt Vehicle Leasing (a Division of Equirex Vehicle Leasing 2007 Inc.) (Kempenfelt) Leases

1. The Leases

165 Kempenfelt had four leases with Cow Harbour, as described below:

<i>Lease number</i>	<i>Date day/month/ year</i>	<i>Initial Term (months)</i>	<i>Original Cost of Equipment</i>	<i>Monthly Rental</i>	<i>Option Price</i>
ZNCS1001	2/2/2010	66	\$202,738.90	\$4,122.95 (plus one initial payment of \$20,468)	\$20,268 at 60 months, FMV at 66 months
ZNEW1002	10/2/2010	66	\$145,000.00	\$2,979.99 (plus one initial payment of \$14,700)	\$14,500 at 60 months, FMV at 66 months
ZEX1002	2/2/2010	66	\$101,369.00	\$2,061.48 (plus one initial payment of \$10,334)	\$10,134 at 60 months, FMV at 66 months
ZNEY1002	10/2/2010	66	\$101,369.00	\$2,061.48 (plus one initial payment of \$10,334)	\$10,134 at 60 months, FMV at 66 months

166 All the leases required Cow Harbour to make an initial payment, roughly equivalent to 10 percent of the original cost of the equipment, and approximately the same amount as the purchase option price. These payments are not identified as security deposits. However, clause 20 of each lease makes reference to a security deposit, which is refundable at the termination date of the lease, provided Cow Harbour has not defaulted under the lease.

2. Lease-specific arguments of the parties

(a) Kempenfelt

167 Kempenfelt takes the position that all of these leases fall within CCAA s. 11.01(a). In the alternative, Burke's primary/secondary factor approach applies, as the *Smith Brothers* factors are not equally probative of the issue as to whether the leases are true leases or financing leases.

168 Kempenfelt points out that under each lease, Cow Harbour was entitled to purchase the leased equipment for approximately 10 percent of its original value at the end of 60 months, or at fair market value at the end of the 66-month term. Kempenfelt's affiant deposed that the purchase option price was the estimated fair market value of the equipment at the conclusion of the lease term. She did not specify how Kempenfelt arrived at, or calculated, that value.

169 Kempenfelt notes that the leases contained a guaranteed residual clause, but only if Cow Harbour defaulted or on early termination of the leases. Kempenfelt contends that the acceleration of rents on default is typical of both true leases and financing leases. It says the leases were not full payment leases. Cow Harbour was not required to pay a security deposit or down payment. All payments were described in the leases as "rent."

(b) Monitor

170 The Monitor submits that the leases are best characterized as financing leases because the 60-month purchase option price (approximately 10 percent of the original value of the equipment) appears to be arbitrary and bears no direct connection to what the actual value of the leased equipment might be at the time Cow Harbour exercised the option.

171 The Monitor says the leases overwhelmingly exhibit other *Smith Brothers* indicia of a financing lease. Specifically, *Smith Brothers* financing lease factors 3 to 7, 9, 10 and 13 to 15 are present in the Kempenfelt leases. The Monitor asserts that the aggregate rental approximated the value of the purchase price of the equipment, factoring in interest and carrying costs. It points out that under the terms of lease ZNCS1001, the equipment originally was valued at \$202,738 plus applicable tax, while the total amount Cow Harbour was to pay during the lease term, including the initial payment, was \$288,459.95 plus applicable tax. In both leases ZEX1002 and ZNEY1002, the equipment originally was valued at \$101,369 plus applicable tax, while the total amount Cow Harbour was to pay during the lease term of each lease, including the initial payment, was \$144,330.30 plus applicable tax. In lease ZNEW1002, the equipment originally was valued at \$145,000 plus applicable tax, while the total amount Cow Harbour was to pay during the lease term, including the initial payment, was \$208,399.35 plus applicable tax.

(c) GE

172 GE contends that the Kempenfelt leases are full payment leases. GE notes that the aggregate cost of the rental payments exceeded the equipment's original cost in each case.

173 GE notes that the purchase option price exercisable after 60 payments was less than the remaining payments due under the leases. Therefore, the economic reality was that Cow Harbour would be inclined to purchase the equipment for that lower price.

3. Decision

174 The following are the results of applying the *Smith Brothers* criteria to the Kempenfelt leases:

1. Whether there was an option to purchase for a nominal sum - See discussion below.
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.
3. Whether the nature of the lessor's business was to act as a financing agency - Yes.
4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.
5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.
6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.
9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - The leases refer to a security deposit in clause 20.
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
13. Whether there was a default provision in the lease inordinately favourable to lessor - Kempenfelt was permitted to accelerate rent on default.
14. Whether there was a provision in the lease for liquidated damages - Yes.
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

175 Each lease referred to a security deposit and stated that Cow Harbour would not earn any interest on the deposit. Kempenfelt was to return the security deposit to Cow Harbour on the termination of the lease. The leases, however, did not identify any security deposit, unless it was meant to be the first payment, which in each case was approximately 10 percent of the original value of the equipment, or five times the other monthly rental payments.

176 The aggregate of the rental payments, not including the initial payment, was more than the original cost of the equipment in each case. The purchase option price available at 60 months was approximately the same as the remaining five monthly rental payments, less interest.

177 At the end of the term of each lease, the lessee could return the equipment to Kempenfelt or exercise the option to purchase the equipment at fair market value.

178 This Court finds that the option served merely as window dressing. The economic reality was that Cow Harbour would have exercised the 60-month option, whether the first payment was considered a security deposit or actual rent.

179 Considering all of the *Smith Brothers* factors, this Court concludes that the Kempenfelt leases were financing leases.

E. Concentra Financial (Concentra) Lease

1. The Leases

180 Concentra's lease 7958-1, dated February 24, 2006, was for a new off-highway mining truck. The original cost of the truck was \$2,335,456, according to the Monitor's brief. The vendor was shown as Finning (Canada). The initial term of the lease was 60 months. The lease required one payment of \$100,000 and 59 monthly payments of \$35,224.79. The end of term resale value was identified as \$415,000.

181 Under clause 10 of lease 7958-1, Cow Harbour unconditionally guaranteed the end of term minimum resale value of the equipment, on or at expiry of the lease or any renewal term.

182 Attached as part of an appendix to the Monitor's 13th Report was a Concentra lease credit approval relating to this equipment. Concentra approved a "loan" of \$2,075,000, with an "origination fee" of \$21,000 and contract initiation fee of \$5,188. Monthly rental was shown as \$35,224.78, with the term being 60 months. Approval was said to be subject to a "rental" payment in advance of \$100,000. Also attached was a Capital City Savings amortization schedule for a \$2,075,000 loan, at a nominal annual rate of 8.321 percent, compounded monthly, showing the payments noted above in the lease document, plus a \$415,000 payment on February 20, 2011. The copies of these document that this Court reviewed were not signed and Concentra's affiant was not cross-examined on them.

183 The other lease is referred to as "Alter Moneta Equipment Schedule Number 2 to Master Lease No. CCB5314A." It is dated April 18, 2007 and was assigned to Concentra by Alter Moneta Corporation on September 27, 2007. The subject of the lease was a new CAT off-highway truck and accessories, the net price of which was shown as \$2,558,295. The term of the lease was 60 months. The payment schedule addendum provided for an initial payment of \$683,295 and 59 monthly payments of \$40,372.39 each. The lease contained an option to purchase for \$1 at the end of the initial lease term or end of any renewal period

2. Lease-specific arguments of the parties

(a) Concentra

184 Concentra notes that under clause 9 of lease 7958-1, if either party elected not to renew the lease or elected to cancel it during the renewal period, the lessee could return the equipment to Concentra.

185 Concentra suggests the default clause is typical, presumably meaning it is equivocal.

186 Lease 7958-1 did not have an option to purchase. Nor was there a mandatory option requirement. There was no ability for the lessee to exchange equipment. Concentra concedes the \$100,000 payment was a down payment.

187 In terms of the Alter Moneta Corporation assigned lease, Concentra argues that even an option at a nominal purchase price is irrelevant until such time as Cow Harbour exercises the option (*Ed Miller*; see this Court's discussion above). Concentra notes that the option did not state that it was mandatory. As well, there was a guaranteed residual clause. Concentra contends that it is a matter of interpretation whether the termination options or the end of term options make the lease open-ended. The lease was not stated to be a full payment lease and there was no security deposit. The down payment was only about 20 to 25 percent of the equipment's initial acquisition cost.

(b) Monitor

188 The Monitor says that lease 7958-1 is best characterized as a financing lease because, among other things, it contained a "guaranteed residual clause" in clause 10, thereby constituting it a security agreement under a personal property security analysis. The Monitor asserts that because it is a security agreement under a personal property security analysis, it falls outside of the scope of CCAA s. 11.01(a).

189 As well, the Monitor submits that lease 7958-1 overwhelmingly exhibits the *Smith Brothers* indicia of a financing lease. Specifically, *Smith Brothers* factors 3 to 10 and 13 to 16 are present. It notes that the equipment originally was valued at \$2,335,456 plus applicable tax, while the total amount that Cow Harbour was to pay during the course of the lease term was \$2,593,261.84 plus applicable tax. Therefore, the aggregate rental approximated the value of the purchase price of the equipment, factoring in interest and carrying costs.

(c) GE

190 GE takes the position that both leases have indicia of financing leases. Under lease 7958-1, Cow Harbour guaranteed the end of term resale value of the equipment (\$415,000) to Concentra, which suggests this is financing lease.

191 GE says the Alter Moneta Corporation assigned lease was substantively identical to the Alter Moneta Corporation lease (discussed below) in having a mandatory end of term purchase obligation for \$1. This also points to it being a financing lease.

3. Decision

192 The following are the results of applying the *Smith Brothers* criteria to the Concentra leases:

1. Whether there was an option to purchase for a nominal sum - No option to purchase in lease 7958-1, but end of term resale value guaranteed; nominal option price for the Alter Moneta Corporation assigned lease.
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.
3. Whether the nature of the lessor's business was to act as a financing agency - Yes.
4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.
5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.
6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes
7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.
9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There was a down payment for both leases.
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.
14. Whether there was a provision in the lease for liquidated damages - Yes.
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes, in terms of lease 7958-1, but the aggregate would not account for financing charges on the full amount. However, the aggregate was equal to a lesser amount with monthly compounded interest. Yes, in terms of the Alter Moneta Corporation assigned lease.

193 Lease 7958-1 did not contain an option to purchase. At the end of the term, end of any renewal period, or on default, Cow Harbour was required to pay the residual value of the equipment. Cow Harbour, however, also was required to return the equipment to Concentra. If Concentra sold the equipment and the sale yielded an amount less than the end of term minimum resale value, Cow Harbour was responsible for the deficiency (at Concentra's option), but was not entitled to any surplus.

194 Burke stated at 294 that:

Where the lessee is liable under an open-end lease for any deficiency in the sale of the leased property following its return at the end of the scheduled lease term, the current line of authority is to treat such a lease as a security lease, because a lessor is "guaranteed" to receive a minimum return on the transaction.

195 Burke cited *Crop & Soil Service Inc. v. Oxford Leaseway Ltd.* (2000), 48 O.R. (3d) 291 (Ont. C.A.) as authority for this proposition. That case, however, and those referred to in it, involved situations where the lessee was entitled, as well, to any surplus on the sale of the equipment.

196 Burke suggested (at 296) that a substantial down payment is indicative of a financing lease in that the lessee may be viewed as acquiring an equity interest in the leased property.

197 The parties presented no evidence that 60 months was the anticipated useful life of the truck. There was no purchase option. Even though Concentra had a residual value guarantee and Cow Harbour made a substantial down payment, Cow Harbour was required to return the truck at the end of the lease term or renewal period, and it was not entitled to any surplus above the end of term minimum resale value, this Court finds that the Concentra lease was a true lease.

198 The aggregate of rents for the Alter Moneta Corporation assigned lease was approximately \$3,065,266, which was greater than the \$2,558,295 net price. A substantial down payment was required. The assigned lease contained an option to purchase for \$1. The economic reality is that Cow Harbour would have exercised that option. The lease contained other lesser indicia of a financing lease. This Court concludes that the Alter Moneta assigned lease was a financing lease.

F. Alter Moneta Corporation (Alter Moneta) Lease

1. The Lease

199 The lease dated January 21, 2008 between Alter Moneta and Cow Harbour was Equipment Schedule No. 003 to Master Lease No. CCB5314A.

200 The net price of the leased equipment, a new 2008 Caterpillar off-highway truck, was shown as \$2,737,433. The lease term was 60 months. Addendum 4 to the lease called for an initial payment of \$273,743.30 and 59 monthly payments of \$53,116.94.

201 At the end of the initial term or renewal period, Cow Harbour, if not in default, had the option to purchase the lessor's interest and title in the equipment for \$1 or to renew the lease for a further 12 months for the same monthly lease payment.

2. Lease-specific arguments of the parties

(a) Alter Moneta

202 Alter Moneta advanced the same arguments as those advanced in relation to the Alter Moneta lease that Alter Moneta assigned to Concentra. In particular, it argued that the nominal purchase option price was irrelevant until such time as Cow Harbour exercised the option.

203 Alter Moneta notes that the option to purchase was not mandatory, there was no residual guarantee clause and the document did not relate the amount of payments to the purchase price. Alter Moneta says that the document refers to all payments as rent, but the initial payment is different from the others.

(b) GE

204 GE notes that the aggregate value of the rental payments over the term of the lease (\$3,407,643) exceeded the cost of the leased equipment (\$2,737,433).

205 GE asserts that, inasmuch as the option to purchase was for \$1, the economic reality is that Cow Harbour would have bought the leased equipment.

3. Decision

206 The following results from application of the *Smith Brothers* criteria to the Alter Moneta lease:

1. Whether there was an option to purchase for a nominal sum - Yes, the option purchase price was \$1 at the end of the term.
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.
3. Whether the nature of the lessor's business was to act as a financing agency - Yes.
4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.
5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.
6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes
7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.
9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There is a large down payment required, although it is referred to as "rent."
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.
14. Whether there was a provision in the lease for liquidated damages - Yes.
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

207 The aggregate of the lease payments was greater than the net price of the equipment. Cow Harbour was required to make a substantial down payment. The lease contained an option to purchase for \$1. Alter Moneta's affiant deposed that the option was for the estimated fair-market value of the equipment at the end of the lease term. If it is seen as a nominal purchase option price, the economic reality is that Cow Harbour would have exercised that option. If it is a reflection that the equipment was expected to be at the end of its useful life at the conclusion of the lease, Alter Moneta, in essence, was giving credit to Cow Harbour for its purchase of the equipment. The lease contained other *Smith Brothers* indicia of a financing lease.

208 As with the Alter Moneta lease that Alter Moneta assigned to Concentra, this Court concludes that this lease was a financing lease.

G. Key Equipment Finance Canada Ltd. (Key Equipment) Lease

1. The Lease

209 Key Equipment was the assignee of a lease agreement dated November 15, 2006 between Alter Moneta and Cow Harbour (assigned June 27, 2008) relating to a hydraulic excavator. The agreement was described as Equipment Schedule No. 001 to Master Lease No. CCB5314A

210 The equipment's value at the time of the lease agreement was stated to be \$1,484,277.99. The lease term was 60 months. Addendum 4 to the lease agreement called for an initial payment of \$148,429.80, with 59 monthly payments of \$26,777.34.

211 Addendum 3 to the lease provided that if the lease had not been terminated earlier and if the lessee was not in default, the "Lessee *shall*... elect for one of the following options" (emphasis added). The three options were to: (1) purchase the equipment on November 15, 2011 (the option date) for \$148,429.80 plus taxes (the purchase option price), which was said to be the estimated fair market value of the equipment at that date; (2) find a third party to purchase the equipment on the option date for the purchase option price; or (3) rent the equipment for a further period and periodic rent to be established by the lessor acting reasonably.

212 Clause 27 of the Master Lease provided that if there was a substantial adverse change in Cow Harbour's financial circumstances, the lessor could terminate the lease, at the lessor's sole option.

2. Lease-specific arguments of the parties

(a) Key Equipment

213 Key Equipment argues that the purchase option price was not nominal. Instead, it was an amount to which the parties agreed at the outset to be the estimated fair market value of the equipment at the end of the lease term. Key Equipment takes no position on whether the option can be characterized as mandatory.

214 Key Equipment points out that the termination provision in clause 27 of the Master Lease is common to all Alter Moneta leases (including this one and the one Alter Moneta assigned to Concentra). Key Equipment says that the lease agreement did not contain a guaranteed residual clause and it is a matter of interpretation whether the renewal provision made this an open-ended lease. The lease did not state that it is a full payment lease. Key Equipment submits that all payments under the lease were rent.

(b) Monitor

215 The Monitor submits that this lease was a financing lease since the end of term purchase option price (approximately 10 percent of the original value of the equipment) appears to be arbitrary, rather than bearing some connection to what the actual value of the equipment might be at the time Cow Harbour could exercise the option.

216 The Monitor maintains that the lease overwhelmingly exhibits other *Smith Brothers* indicia of a financing lease, which militates against it being considered a true lease. Specifically, *Smith Brothers* factors 3 to 10 and 13 to 16 are present, indicating a financing lease. The Monitor points out that the equipment originally was valued at \$1,484,297.99 plus applicable tax while the total amount Cow Harbour was to pay during the course of the term was \$1,728,292.86 plus applicable tax. Therefore, the aggregate rental approximated the value of the purchase price of the equipment, factoring in interest and carrying costs.

(c) GE

217 GE notes that the aggregate of rental payments exceeded the cost of the equipment, which suggests that this lease agreement was a financing lease. It points out that Cow Harbour was required to purchase the equipment at an option purchase price of \$148,429.80 plus tax, find a purchaser for it at the purchase option price, or renew the lease. Cow Harbour could not return the equipment to Key Equipment.

3. Decision

218 Application of the *Smith Brothers* factors to the Key Equipment lease produces the following results:

1. Whether there was an option to purchase for a nominal sum - There was an option, but it was not for a nominal sum.
2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.
3. Whether the nature of the lessor's business was to act as a financing agency - Yes.
4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.
5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.
6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.
7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.
9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.
10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.
11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There was a substantial down payment.
12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.
14. Whether there was a provision in the lease for liquidated damages - Yes.
15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

219 The purchase option price in this case was approximately 10 percent of the original cost of the equipment, which is not a nominal amount. The parties agreed that this was a pre-estimate of the market value of the equipment at the end of the lease term. Ordinarily, a fair market value option would be highly suggestive of a true lease. In this case, however, Key Equipment was guaranteed the option price, as Cow Harbour was required to exercise the option, find a third party who would pay the option price, or renew the lease for a term and at a rate selected at the sole option of Key Equipment. This was equivalent to a mandatory purchase option. Cow Harbour could not return the equipment to Key Equipment. As Burke stated (at 294):

... leases that do not provide the lessee with the option to return the equipment (i.e., the only available options to a lessee at the end of the scheduled term of the lease are either to purchase the leased property or to renew the lease) can be expected to be construed as conditional sales, because the inability of the lessee to return the leased property at the end of the term will likely be construed as effectively requiring the lessee to acquire the leased property.

220 The Key Equipment lease also contained other indicia of a financing lease. This Court concludes that it was a financing lease.

VI. Conclusions

221 This Court categorizes the Disputed Leases as follows:

- A. Scott Capital's leases were true leases.
- B. CFSL's lease was a true lease.
- C. Wajax's leases were true leases.
- D. Kempenfelt's leases were financing leases.
- E. Concentra's lease was a true lease. The Alter Moneta lease assigned to Concentra was a financing lease.
- F. Alter Moneta lease was a financing lease.
- G. The Alter Moneta lease assigned to Key Equipment was a financing lease.

222 The true leases are subject to *CCAA* s. 11.01(a).

Order accordingly.

2010 ABQB 637
Alberta Court of Queen's Bench

Royal Bank v. Cow Harbour Construction Ltd.

2010 CarswellAlta 2027, 2010 ABQB 637, [2011] A.W.L.D. 7, 193 A.C.W.S.
(3d) 710, 37 Alta. L.R. (5th) 82, 504 A.R. 319, 72 C.B.R. (5th) 261

**Royal Bank of Canada (Plaintiff) and Cow Harbour
Construction Ltd. and 1134252 Alberta Ltd. (Defendants)**

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended

In the Matter of Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

And In the Matter of a Plan of Compromise or Arrangement of Cow Harbour Construction Ltd.

K.D. Yamauchi J.

Heard: September 22, 2010

Judgment: October 5, 2010

Docket: Edmonton 1003-11241, 1003-05560, BKC Y 24-115359

Counsel: Ray Rutman for Royal Bank Canada

Stuart Weatherill, Kyle Kawanami for John Deere Credit Inc., DeLage Landen Financial Services, LiftCapital Corp.

Howard Gorman, Randal Van de Mosselaer for PricewaterHouseCoopers, in its capacity as receiver of Cow Harbour Ltd.

Frances Dearlove for Aecon Group Inc.

Subject: Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act

XIX.5 Miscellaneous

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

Practice and procedure — Construction company entered protection under Companies' Creditors Arrangement Act (CCAA) — Liquidation of assets was deemed best way of proceeding — Buyer sent letter of intent to purchase which was endorsed by court — Lessor claimed that certain equipment in possession of company was covered by true lease, not financing lease — Amount of \$900,000 was paid into court representing payments for equipment under lease term — Court declared that lease was financing lease and not true lease, and approved sale of assets — Lessor brought application for leave to appeal and for stay of proceedings — Application dismissed — Leave to appeal was properly before court, although lessor could also bring matter before court of appeal — CCAA specifically allowed for matter to be brought before court — Nature of lease was fact based matter and was of no importance to practice — Lease was not of significance to proceedings as whole, although it was important to lessor — Deal had been carefully negotiated and each creditor had given up something, while allowing construction company to continue rather than being sold piecemeal — Appeal was not meritorious as error not evident in trial judge's reasons — Appeal would delay proceedings as it would affect amounts to be disbursed from sale — Court required to weigh all relevant factors for determining whether leave to appeal was appropriate, and failure to meet one aspect of test was not fatal for leave.

APPLICATION by lessor for leave to appeal and stay of proceedings under *Companies' Creditors Arrangement Act*.

K.D. Yamauchi J.:

I. Background

1 On April 7, 2010, Cow Harbour Construction Ltd. ("Cow Harbour") applied for a stay of proceedings against it under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA"). This Court granted that order (the "Initial Order") in CCAA action 1003 05560 (the "CCAA Action"). This Court extended the stay of proceedings from time to time by a number of subsequent orders. It should be noted that this Court did not want to extend the stay for a lengthy period at any given time. Accordingly, this Court required the parties to this action, of which there are many, to appear before it often and regularly, so that Cow Harbour and the various professionals involved in this matter could provide this Court with regular updates on the status and progress of the restructuring.

2 It became clear as this matter progressed that Cow Harbour was not going to be able to restructure its affairs through a refinancing, a compromise or an equity restructuring. Rather, this matter evolved into a liquidation. This Court approved a process that would permit Cow Harbour to restructure by way of a sale of its assets. The process involved inviting potential purchasers to present proposals to purchase Cow Harbour's assets and undertaking. The intent behind this process was to effect a sale of Cow Harbour as a going concern. This process resulted in this Court being presented with three proposals to purchase certain of Cow Harbour's assets.

3 Aecon Group Inc. ("Aecon") presented a letter of intent to purchase a significant portion of Cow Harbour's assets (the "Original Aecon Proposal"). The Original Aecon Proposal was subject to a number of terms and conditions. This Court appointed PricewaterhouseCoopers Inc. ("PWC") to act as a transaction facilitator to assist the various parties' in their negotiations. As the transaction facilitator, PWC successfully negotiated a higher purchase price with Aecon. Aecon eventually presented a Letter of Intent to Purchase (the "LOI").

4 On August 5, 2010, this Court endorsed PWC's acceptance of the LOI, with a view that the parties would return to this Court to seek this Court's approval of an asset purchase agreement and vesting order.

5 One of Cow Harbour's assets that Aecon wanted to purchase was a Hitachi EX5500, serial number FF018NQ001008 (the "Equipment"). The Equipment was in Cow Harbour's possession as a result of an agreement dated April 1, 2009, between De Lage Landen Financial Services Canada Inc. ("DLL") and Cow Harbour (the "Agreement"). In the Agreement, DLL agreed to lease the Equipment to Cow Harbour for a 37-month term. The Agreement contained no option in which Cow Harbour could purchase the Equipment at the end of the term of the Agreement or otherwise.

6 After this Court granted the Initial Order, on May 14, 2010, DLL filed a notice of motion, returnable May 21, 2010. In it, DLL sought a declaration that, for the purposes of CCAA s.11.01, the Agreement was a true lease, and not a financing lease.

7 On May 21, 2010, this Court directed that Cow Harbour make certain payments to McLennan Ross LLP, counsel for the monitor this Court appointed pursuant to the Initial Order. Those payments represented all monthly payments from April 1, 2010, that Cow Harbour would have paid to lessors under leases for which there was a dispute as to whether they were true leases or financing leases, or which the monitor's counsel had not been able to categorize as either (the "Disputed Lease Funds"). This Court directed McLennan Ross LLP to hold the Disputed Lease Funds, pending resolution of disputes pertaining to the categorization of the disputed leases.

8 The Agreement was one of the disputed leases. Accordingly, included in the Disputed Lease Funds was approximately \$900,000 representing payments that Cow Harbour should have been making to DLL under the Agreement.

9 As part of the sale process, PWC prepared a proposed allocation of Aecon's purchase price, indicating the portion of the overall purchase price that Aecon allocated among Cow Harbour's assets. This Court received that allocation and placed it under seal. It was of the view that the creditors need not know how much of Aecon's purchase price was going to be allocated to the claims of other creditors.

10 DLL did not agree that the Equipment could be sold to Aecon without DLL's consent. At no time did DLL provide its consent to a sale of the Equipment to Aecon or anyone else.

11 The parties returned to court on August 25, 2010, at which time this Court heard a number of applications, including the following:

(a) DLL's application in the CCAA Action for an order declaring that DLL's interest in the Equipment is that of owner and lessor under a true lease. This application was made by way of a notice of motion in the CCAA Action only and was originally returnable May 21, 2010. It had previously been adjourned;

(b) DLL's application for an adjournment of the pending applications for an approval of the sale of Cow Harbour's assets to Aecon and a vesting order;

(c) RBC's application to appoint a PWC as receiver in action number 1003 11241 (the "Receivership Action"); and

(d) PWC's application for approval of the asset purchase agreement among Aecon, PWC, in its capacity as receiver of Cow Harbour and PWC, in its capacity as transaction facilitator (the "Asset Purchase Agreement") and a vesting order, vesting title of Cow Harbour's assets which formed the subject-matter of the Asset Purchase Agreement into Aecon's name (the "Vesting Order").

12 Counsel made their submissions on the DLL application during the morning of August 25, 2010. This Court took a recess of about 3 hours to consider the positions of the respective parties. This Court rendered its judgment, with oral reasons, that the Agreement constituted a financing lease and not a true lease. This Court then granted RBC's application for a receivership order, and granted an order approving the Asset Purchase Agreement and the Vesting Order. The Vesting Order included the Equipment. This Court granted those orders sequentially, in the sense that:

(a) first, it dealt with DLL's applications in the CCAA Action;

(b) second, it dealt with the receivership application; and

(c) third, it dealt with the applications to approve the Asset Purchase Agreement and the Vesting Order.

The second and third orders were dependent on the Court's determination of the nature of the Agreement.

13 Once this Court granted these orders, the transaction contemplated by the Asset Purchase Agreement closed on August 26, 2010.

14 On August 31, 2010, DLL served all parties to these proceedings with a notice of motion returnable September 3, 2010, for an order staying the provisions of the August 25, 2010 orders, as they related to the Equipment, in the Receivership Action and the CCAA Action. On September 2, 2010, DLL filed a Civil Notice of Appeal relating to issues in the Receivership Action and (notwithstanding the absence of leave to appeal) in the CCAA Action. On September 3, 2010, the parties argued the stay application. This Court denied the application on the basis that the issue was moot and further, that DLL had not met the test for a stay pending its appeal. This Court said:

There was no appeal, there was no seeking of stay of the effect of my orders and this matter has closed. The issue is now moot., Transcript of Proceedings, September 3, 2010, p. 24, ll. 3-6.

II. Nature of the Applications

15 DLL brings two applications, being:

1. An application pursuant to CCAA s. 13, for leave to appeal this Court's August 25, 2010 order, which declared that the Agreement was a financing lease and not a true lease (the "Leave Application"); and

2. An application seeking an order in the nature of a stay pending appeal, holding back the Disputed Lease Funds insofar as they relate to funds payable under the Agreement and an order holding back from distribution a portion of the sale proceeds resulting from the Asset Purchase Agreement, equivalent to the net book value of the Equipment (the "Stay Application").

16 The Royal Bank of Canada ("RBC") and PWC, the court-appointed receiver, oppose these applications.

III. Leave Application

17 DLL seeks leave to appeal pursuant to *CCAA* s.13, which provides:

13. Except in Yukon, any person dissatisfied with an order or a decision made under this Act may appeal from the order or decision on obtaining leave of the judge appealed from or of the court or a judge of the court to which the appeal lies and on such terms as to security and in other respects as the judge or court directs.

18 DLL has the right to seek leave from this Court or from the Court of Appeal or from a judge of the Court of Appeal. The legislation provides for this. If an applicant for leave is not successful at one level, does that preclude the applicant from making a further application to the "next level"? There can be no doubt that if a judge of the court of appeal refuses the applicant's leave to appeal, a judge of the lower court, even the judge who made the original order, could not overturn the court of appeal's decision. The converse, however, was not so clear. In *Westar Mining Ltd., Re*, 1993 CarswellBC 529, 17 C.B.R. (3d) 202 (B.C. C.A.) at para. 7, the majority held that "an application for leave to appeal may be commenced in any one of three ways, and that once that choice is made a party does not have any further right to pursue an application for leave to appeal." McEachern C.J.B.C., at para. 45, dissented and analyzed the issue as follows:

Section 13 of the C.C.A.A. provides for an appeal with leave, and further provides that leave may be obtained from the judge who made the order, from this court, or from a judge of this court. I do not find any support in the language of s. 13 for my colleagues' conclusion that these are exclusive alternatives, so that the refusal of leave at any level precludes an application at another level. Maxwell on *Interpretation of Statutes*, 12th ed. (1969), pp. 232-233, suggests that in some cases "and" and "or" may be substituted for each other. While it is true that the C.C.A.A. must prevail, I see no conflict between it and the *Court of Appeal Act*, or with the practice which is followed in this province to obtain leave from the Court.

19 The Supreme Court of Canada allowed the appeal "for the reasons given by McEachern C.J.B.C.", *Westar Mining Ltd., Re*, 1993 CarswellBC 553, [1993] 2 S.C.R. 448 (S.C.C.). Thus, if DLL is unsuccessful in its application for leave before this Court, there is nothing preventing it from making a further leave application to "the court or a judge of the court to which the appeal lies."

20 Is this matter properly before this Court? In *General Publishing Co., Re*, 2002 CarswellOnt 2215, 34 C.B.R. (4th) 183 (Ont. S.C.J.) at para. 4, Justice Ground said, "the usual and preferred route to appeal an order under the CCAA is to bring the motion for leave before a judge of the Court of Appeal." In fact, in that case, Justice Ground was not prepared to hear the application, "as it would undoubtedly result in a non-productive, additional step in trying to resolve this issue." This Court agrees with the concern Justice Ground expressed for the reasons that follow.

21 Before moving on to consider those reasons, it is worthwhile noting how the Alberta Court of Appeal has dealt with this "concurrent" jurisdiction in another context. In *R. v. Harness*, 2005 CarswellAlta 963, 200 C.C.C. (3d) 431 (Alta. C.A.), the court was considering the effect of the *Criminal Code*, R.S.C. 1985, c. C-46, s. 678(2), which provides:

678(2) The court of appeal or a judge thereof may at any time extend the time within which notice of appeal or notice of an application for leave to appeal may be given.

22 The *Harness* court at para. 23, explained how it would deal with this "concurrent jurisdiction" when it said:

23 Based on the rules of statutory interpretation and the case authorities, it is clear that s. 678(2) provides concurrent jurisdiction to hear applications to extend time, rather than a right of review or right to appeal the decision of a single judge to a full panel of the court. Both a single judge and the court have jurisdiction to grant a time extension, though often the rules of practice established by the court limit the applicant's right to choose which one will hear the application. Once a decision on an application to extend has been made, whether by a single judge or by a full panel of the court, there is no right of appeal within the court. However, a panel or a judge can consider the application afresh when the interests of justice so require, particularly when circumstances or conditions have changed since the last application. No such change is alleged here, nor does Harness suggest that there are new facts that might affect the outcome of his application. [emphasis added]

23 The CCAA permits DLL to apply to this Court to seek leave to appeal this Court's earlier decisions. Accordingly, despite the approach that the *General Publishing* court took in similar circumstances, this Court will consider this application. Whether the Alberta Court of Appeal will apply reasoning similar to that which it applied in *Harness* is not a question that this Court needs to answer.

24 For DLL to obtain leave to appeal under the CCAA, it must meet the test set out by the Alberta Court of Appeal in *Fairmont Resort Properties Ltd., Re*, 2009 ABCA 360 (Alta. C.A.) at para. 10, where the court said:

The test for leave involves a single criterion subsuming four factors. The single criterion is that there must be serious and arguable grounds that are of real and significant interest to the parties. The four factors used to assess whether this criterion is present are (1) whether the point on appeal is of significance to the practice; (2) whether the point raised is of significance to the action itself; (3) whether the appeal is prima facie meritorious or, on the other hand, whether it is frivolous; (4) whether the appeal will unduly hinder the progress of the action.

25 Before this Court considers the factors involved in the "test for leave," it is worthwhile to outline the applicable standard of review that the Court of Appeal will apply if leave were to be granted. In *Canadian Airlines Corp., Re*, 2000 ABCA 149 (Alta. C.A. [In Chambers]) at paras. 28-29, the court held that:

28 The elements of the general criterion cannot be properly considered in a leave application without regard to the standard of review that this Court applies to appeals under the CCAA. If leave to appeal were to be granted, the applicable standard of review is succinctly set forth by Fruman, J.A. in *Royal Bank v. Fracmaster Ltd.* (1999), 244 A.R. 93 (Alta. C.A.) where she stated for the Court at p. 95:

.... this is a court of review. It is not our task to reconsider the merits of the various offers and decide which proposal might be best. The decisions made by the Chambers judge involve a good measure of discretion, and are owed considerable deference. Whether or not we agree, we will only interfere if we conclude that she acted unreasonably, erred in principle or made a manifest error.

26 In *Smoky River Coal Ltd., Re* (1999), 237 A.R. 326 (Alta. C.A.), Hunt, J.A., speaking for the unanimous Court, extensively reviewed the CCAA's history and purpose, and observed at p. 341:

The fact that an appeal lies only with leave of an appellate court (s. 13 CCAA) suggests that Parliament, mindful that CCAA cases often require quick decision-making, intended that most decisions be made by the supervising judge. This supports the view that those decisions should be interfered with only in clear cases.

The standard of review of this Court, in reviewing the CCAA decision of the supervising judge, is therefore one of correctness if there is an error of law. Otherwise, for an appellate court to interfere with the decision of the supervising judge, there must be a palpable and overriding error in the exercise of discretion or in findings of fact.

27 It appears that this is the reason why the *General Publishing* court and this Court has difficulty in analyzing its own decisions. It is awkward, if not difficult, for a court to consider whether it has made a palpable and overriding error in its exercise

of discretion or in findings of fact. These are the foundations on which it built its original decision and it undermines this Court's original decision if it were to second guess itself.

28 Nonetheless, Parliament has given this task to the "judge appealed from" so this Court will undertake that task.

29 *Fairmont Resort* provides us with the "test for leave." The test is but one test, in which "there must be serious and arguable grounds that are of real and significant interest to the parties." To determine whether DLL has met its onus, we must consider the four factors that *Fairmont Resort* outlines. The question then becomes whether DLL must satisfy all the factors. In other words, if it fails on one (or more), does fail to meet the test? The answer to this question lies in the decision of O'Brien J.A. in *Ketch Resources Ltd. v. Gauntlet Energy Corp. (Monitor of)*, 2005 CarswellAlta 1527, 15 C.B.R. (5th) 235 (Alta. C.A. [In Chambers]). In that case, Justice O'Brien went through and applied the four factors to the facts with which he was dealing. The applicant in that case had met some of the factors, but not others. Justice O'Brien at para. 15, made his decision not to grant leave after "weighing all the factors." In other words, success or failure to prove one or more of the factors does not guarantee that the applicant has met the "test for leave." The court must weigh all the factors.

Whether the point on appeal is of significance to the practice

30 DLL argues that the distinction between true leases and financing leases is one of significance to the practice. RBC argues, on the other hand, that the issue is of no significance to the practice. The finding that DLL's Equipment was the subject of a financing lease rather than a true lease is a factual finding that is specific only to that particular lease and does not have any impact on the practice in general.

31 DLL argues that this Court erred in holding that an agreement without a purchase option or any other contractual mechanism of transferring ownership from the purported lessor to the purported lessee, can be characterized as a financing lease. RBC argues that there is no single overriding factor in determining whether a particular lease is a true lease or a financing lease.

32 When characterizing leases pursuant to CCAA s.11.01, the court must have regard to the substance, rather than simply the form of the arrangement, *Smith Brothers Contracting Ltd., Re*, 1998 CarswellBC 678, 53 B.C.L.R. (3d) 264 (B.C. S.C.). In fact, when making its decision, this Court considered the non-exhaustive list of criteria that the *Smith Brothers* court suggested that courts look to when determining whether a document is a true lease or a financing lease. This Court outlined those criteria in its oral reasons, Transcript of Proceedings, August 25, 2010, pp. 57-59, and concluded that:

[T]here is not one factor that is the *sine qua non* for determining whether a document is a true lease or a financing lease. One must look at the whole document to get a flavour of the [parties'] intentions, Transcript of Proceedings, August 25, 2010, p. 59, ll. 11-13.

33 This Court concluded that "When one examines the De Lage Landen Financial Services Canada document as a whole, it is clear that it is a security lease and not a true lease," Transcript of Proceedings, August 25, 2010, p. 59, ll. 23-24.

34 DLL argues that the characterization of a lease without a purchase option or any other mechanism of transferring ownership from the purported lessor to the purported lessee is a novel proposition in law and is an unresolved issue that is of significance to the practice, *Kerr Interior Systems Ltd., Re*, 2008 ABCA 291 (Alta. C.A.) at para. 9. If that were the sole basis on which this Court rendered its decision, it might indeed be novel. However, this Court was guided by the broader principle of examining the whole document, which is an approach that is already well-established in the case law. Thus, there is nothing novel about this approach and this Court's finding that the Agreement was a financing lease, rather than a true lease, has no broad significance to the practice.

35 Furthermore, in *Philip Services Corp., Re*, 1999 CarswellOnt 4495, 15 C.B.R. (4th) 107 (Ont. S.C.J. [Commercial List]) at para. 4, Justice Farley determined that a lease which "does not specifically indicate that there is an option to buy the (hardware) assets at the end of the lease" could indeed be characterized as a capital or financing lease, having regard to the criteria set out in *Smith Brothers*. Notwithstanding the absence of an option to purchase in the agreement, Justice Farley undertook the same analysis set out in *Smith Brothers* to determine the nature of the lease. He said, at para. 3:

That involves a functional analysis of the relationship - based on substance as opposed to form. Unfortunately there are no tags or labels which may be read with ease and "certainty" ("certainty" in the same way that a laboratory is able to conduct a DNA test and give probabilities or odds). Rather the task involves the weighing of the various materials involved. It is not a simple analysis of determining between black and white but rather the shade of grey where all factors are weighed and the balance as to whether the scales would tip towards a true lease relationship - or alternatively against being a true lease relationship.

36 DLL pointed out that the parties in *Philip Services* had a course of conduct that resulted in the lessee purchasing leased assets from the lessor, although Justice Farley, at para. 1, described the course of conduct between the parties as "rather informal, flexible and sloppy." The fact that Justice Farley took care to point out that the leases themselves did not contain an option to buy assets at the end of the lease term indicates that this factor was in his mind when he balanced the various *Smith Brothers* factors. Depending on the circumstances of each case, the presence or absence of an option to purchase may or may not loom large in the court's analysis. In the case with which this Court was dealing, this "tag" or "label" was but one factor it considered.

37 Thus, this Court finds that the issue is of no importance to the practise.

Whether the point on appeal is of significance to the action itself

38 This Court acknowledges that the point on any potential appeal has significance to DLL. Otherwise why would this matter have come before this Court? That, however, is not the nature of this factor. This factor requires this Court to look at the action as a whole.

39 RBC argues that the appeal is of no significance to the action because the appeal is moot and, as such, it would be impossible to "unscramble the egg" even if DLL were successful, *Minister of National Revenue v. Temple City Housing Inc.*, 2008 ABCA 1 (Alta. C.A.) at para. 14. Indeed, DLL acknowledges this fact. However, DLL goes on to argue that while the CCAA Action has been concluded, there still remains the issue of the Disputed Lease Funds. DLL claims entitlement to approximately \$900,000, representing the monthly lease payments to which it would be entitled if classified as a true lessor under CCAA s.11.01. DLL's claim to these funds rests on it being categorized as a true lessor. Additionally, the allocation of restructuring costs against DLL in these proceedings is dependent on whether DLL is classified as a true lessor.

40 It is important, at this stage, to explain the process that resulted in the Vesting Order. This Court appointed PWC to facilitate negotiations with the various parties and finalization of the transaction. From August 5, 2010, when this Court endorsed PWC's acceptance of the LOI, to August 25, 2010, when this Court approved the Agreement of Purchase and Sale and granted the Vesting Order, Aecon and PWC negotiated the allocation of the purchase price among the various creditors. At the beginning of the process, there was not overwhelming support from the general body of creditors for the Aecon transaction. However, through persistent and effective negotiations, PWC secured the support of holders of 92.8 percent of the debt that Cow Harbour owed to its creditors, representing a majority in number of 90.625 percent. As well, Aecon committed to running Cow Harbour's business and employing almost all of Cow Harbour's employees, except for certain management personnel.

41 Because of the circumstances involving certain of Cow Harbour's management, Cow Harbour would not put Aecon's transaction before the creditors as a plan of arrangement. Besides, it would have been impossible to meet the time requirements set forth in the CCAA to allow a plan of arrangement to be considered and approved. Cow Harbour's financial situation was deteriorating with each day. It had to meet payroll and other expenses and it did not have the financial wherewithal to meet those expenses. Aecon advised this Court that for it to facilitate the survival of Cow Harbour's business, this Court had to approve the transaction and allow a closing before the end of August, 2010. Like the parties in *General Publishing*, the parties in this case had a sword of Damocles hanging over their heads, as the failure of this Court to approve this transaction would surely have resulted in Aecon withdrawing its offer or, if it did not, Cow Harbour's continued financial difficulties would have resulted in its demise, whether or not it was in the Aecon's hands.

42 Given the support that the creditors showed, and the fact that Cow Harbour's business would continue to operate, this Court felt it was in the best interests of the stakeholders to approve the sale and grant the Vesting Order. To do otherwise might

have resulted in a piecemeal liquidation of Cow Harbour's assets and a closing-down of its business. In other words, although this transaction was consummated under the Receivership Action, this Court considered the public policy reasons underlying CCAA proceedings, when it approved the Aecon transaction and granted the Vesting Order.

43 The Aecon transaction was carefully negotiated and each of the creditors sacrificed part of their respective claims. No creditor obtained everything it was seeking. Aecon advised this Court on August 25, 2010, that it would not consummate the transaction if it did not receive an order vesting all of the assets it was purchasing into its name, free and clear of all charges, liens and encumbrances. If this Court were to give one creditor, even a creditor that was owed a trifling amount, preferential treatment, the other creditors would not have supported the Aecon transaction.

44 An appeal of this matter might be of significance to DLL specifically. However, this Court's characterization of the Agreement is of no significance to this action generally.

Whether the appeal is prima facie meritorious or, on the other hand, whether it is frivolous

45 RBC argues that DLL has not demonstrated that it has a *prima facie* meritorious case. On September 3, 2010, DLL sought a stay of the various orders this Court granted on August 25, 2010. This Court held that because there was no appeal pending and that DLL did not seek a stay of the effect of the various orders this Court granted on that date after they were granted or at least before the Aecon transaction closed, this Court denied DLL's application on the ground of mootness. In other words, even if the Court of Appeal were to overturn this Court's August 25, 2010 decisions, DLL could not succeed in its claim to have the Equipment returned to it. The Equipment was part of a larger transaction.

46 Does this, of itself, mean that the proposed appeal lacks merit or is otherwise frivolous? The simple answer is no. Allowing the appeal may not provide DLL with a remedy, but that does not make the proposed appeal frivolous or one that lacks merit. Rather, we must analyze the strength of the appeal on the basis of the standard of review that would govern the appeal, *Liberty Oil & Gas Ltd., Re*, 2003 ABCA 158 (Alta. C.A.) at para. 20; *Canadian Airlines Corp., Re*, 2000 ABCA 149 (Alta. C.A. [In Chambers]) at paras. 28-29.

47 As stated earlier in these reasons, it is difficult for this Court to find that it made an overriding and palpable error in its consideration of the issues the parties placed before it. Surely, this is the same awkwardness that Justice Ground faced in *General Publishing*. This Court gave its oral reasons for why it held the Agreement to be a financing lease rather than a true lease. Even taking an objective view of this with the benefit of hindsight, this Court would come to the same conclusion today.

48 This Court acknowledges that it is not necessary for DLL to show that it is guaranteed to win an appeal. It only needs to show that it has an arguable case, *Kerr Interior Systems Ltd., Re*, 2008 ABCA 291 (Alta. C.A.) at para. 11. Given this Court's various findings, it is difficult to see that DLL has an arguable case, in these circumstances. On these bases, this Court finds that any proposed appeal is not on its face meritorious.

Whether the appeal will unduly hinder the progress of the action

49 RBC and PWC argue that an appeal would unduly hinder the CCAA Action and the Receivership Action and create tremendous uncertainty concerning the various transition orders this Court granted in the CCAA Action. It should be noted at this stage that as part of the transition, this Court ordered that Disputed Lease Funds would be transferred from the monitor's counsel to the receiver's counsel, under the same terms as the May 21, 2010 order.

50 DLL, on the other hand argues that an appeal would not unduly hinder the progress of this action. The CCAA Action has been completed. The assets have been sold to Aecon. The hearing at which the other parties with disputed leases will have their agreements categorized has not yet been scheduled. DLL's application for a stay against Aecon has been denied, so there is no issue as to uncertainty surrounding Aecon's use of the Equipment. Accordingly, DLL argues that the progress of neither action would be unduly hindered by an appeal.

51 This Court finds that any appeal would unduly hinder the progress of the actions. Pursuant to the transition orders this Court granted on August 25, 2010, this Court must deal with many issues, including those concerning the remuneration of the chief restructuring advisor, the distribution of the Disputed Lease Funds, and who will be paying the administrative expenses. DLL is correct that Aecon's use of the Equipment is not an issue. However, the creditors seek a distribution of their respective share of the \$180 million purchase price. This cannot happen if there is a pending appeal that could have an effect on the allocation. Thus, the progress of this action would be unduly hindered by the appeal to the prejudice of the creditors who supported the Aecon transaction.

52 More importantly, the transaction that PWC and Aecon negotiated with all the creditors rests on a fine balance. The uncertainty surrounding the finality of these issues unduly hinders the progress of these actions. A more thorough discussion of this fine balance will be undertaken when this Court discusses the Stay Application.

53 As a result of the foregoing, this Court dismisses DLL's application for leave to appeal. This result deals sufficiently with the Stay Application. However, as a courtesy to DLL, this Court will comment briefly on it.

IV. Stay Application

54 Earlier, this Court referred to DLL's application for a stay of this Court's orders approving the Aecon Asset Purchase Agreement and the Vesting Order. On September 3, 2010, the parties argued the stay application. This Court denied the application on the basis that the issue was moot and further, that DLL had not met the test for a stay. DLL argues that the application now before this Court differs from the one it argued on September 3, 2010, as it is not challenging the sale and Vesting Order. Rather, it is seeking to have this Court hold back monies representing DLL's alleged share of the Disputed Lease Funds and the net book value of the Equipment.

55 For DLL to obtain a stay of a stay of proceedings it must satisfy a tripartite test set out in *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311 (S.C.C.), being:

- (a) Is there a serious question to be argued on appeal?
- (b) Will DLL suffer irreparable harm if this Court does not grant a stay?
- (c) Does the balance of convenience weigh in favour of a stay?

56 Unlike the factors that make up the "test for leave," the tripartite test does not require or permit courts to weigh these factors. The applicant must satisfy all three elements before a court will grant the stay. In other words, if the applicant does not establish one of the elements, its application will fail. Because of this, this Court will focus on the third element of the tripartite test; the balance of convenience.

57 On August 25, 2010, the Court heard Aecon's submissions that the Equipment is critical to the work that Aecon will be undertaking under contracts with Syncrude. For its negotiations to be successful, Aecon would have to satisfy Syncrude that it could fulfill the requirements under the Syncrude contracts. For this to occur, Aecon required the Equipment. Without the Equipment, Aecon would not have proceeded with the transaction.

58 As well, this Court heard submissions that outlined many details regarding the negotiations and work of Aecon, PWC and numerous creditors which led to the Asset Purchase Agreement. The negotiations were undertaken by these parties in good faith, which required significant compromise by the creditors, including RBC, Cow Harbour's largest creditor. PWC struck a balance among numerous interests.

59 Creditors representing 90.625 percent of all creditors negotiated in good faith and compromised their claims. Granting a stay in these circumstances would undermine the processes that Aecon, PWC, and the other creditors undertook in good faith. Holding back the net book value of the Equipment seriously upsets the fine balance that resulted from these negotiations. The creditors did not agree to compromise their claims so they could recover "something." They compromised their claims so they

could receive a definite amount, as negotiated. Their receiving something less than that negotiated amount will result in this Court sanctioning an "unscrambling of the egg" and undermines the process that this Court approved and monitored. It should be noted also that DLL will be receiving an allocation of the purchase price representing a substantial portion of its claim.

60 DLL argues that this Court's finding that it holds a financing lease prejudices its right to argue that it should obtain a portion of the Disputed Lease Funds. That may be so, but it chose to have this Court deal with the nature of the Agreement in a summary fashion. Given this Court's finding that the Agreement is a financing lease, in the end, this argument carries little weight. However, this Court has dealt with that issue and it is not now open to DLL to attempt to re-argue it.

61 As a result, the balance of convenience favours this Court denying the stay.

V. Conclusion

62 For the foregoing reasons this Court dismisses DLL's application pursuant to *CCAA* s. 13, for leave to appeal this Court's August 25, 2010 order, which declared that the Agreement was a financing lease and not a true lease. As well, it dismisses DLL's application seeking an order in the nature of a stay pending appeal, holding back the Disputed Lease Funds insofar as they relate to funds payable under the Agreement and an order holding back from distribution a portion of the sale proceeds resulting from the Asset Purchase Agreement, equivalent to the net book value of the Equipment.

Application dismissed.

2016 BCCA 231
British Columbia Court of Appeal

Integris Credit Union v. Mercedes-Benz Financial Services Canada Corp.

2016 CarswellBC 1462, 2016 BCCA 231, [2016] 10 W.W.R. 287, [2016] B.C.W.L.D. 4667, [2016] B.C.W.L.D. 4735, 267 A.C.W.S. (3d) 865, 37 C.B.R. (6th) 1, 387 B.C.A.C. 196, 668 W.A.C. 196, 85 B.C.L.R. (5th) 10

Integris Credit Union, Respondent (Plaintiff) and Mercedes-Benz Financial Services Canada Corporation, Appellant (Defendant) and KPMG Inc., as Court-Appointed Receiver of All-Wood Fibre Ltd., BHL Capital, a division of Berner Holdings Ltd., Respondents (Defendants)

Integris Credit Union, Respondent (Plaintiff) and BHL Capital, a division of Berner Holdings Ltd., Appellant (Defendant) and KPMG Inc., as Court-Appointed Receiver of All-Wood Fibre Ltd. and Mercedes-Benz Financial Services Canada Corporation, Respondents (Defendants)

Neilson, Bennett, Savage JJ.A.

Heard: May 9, 2016

Judgment: June 1, 2016

Docket: Vancouver CA42954. CA42958

Proceedings: reversing *Integris Credit Union v. All-Wood Fibre Ltd.* (2015), 2015 CarswellBC 1850, 2015 BCSC 1146, D.M. Masuhara J. (B.C. S.C.)

Counsel: G.G. Plottel, for Appellant, Mercedes-Benz Financial Services Canada
C.D. Brousson, for Respondent, Integris Credit Union
R.A. Finlay, for Respondent, BHL Capital, a division of Berner Holdings Ltd.
No one for Respondent, KPMG Inc., as Court-Appointed Receiver of All-Wood Fibre Ltd.

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

Related Abridgment Classifications

Debtors and creditors

VII Receivers

VII.7 Actions involving receiver

VII.7.a Actions by receiver

Personal property security

IV Priority of security interest

IV.3 Purchase money security interest

Headnote

Debtors and creditors --- Receivers --- Actions involving receiver --- Actions by receiver

Insolvent company A Ltd. (debtor) financed trucks from financing company M Corp. and from leasing company B Ltd. (together, companies) --- Debtor ceased operations and had total indebtedness exceeding \$8,000,000 --- Creditor I Union, who had general security agreement with debtor, obtained order appointing receiver pursuant to s. 47(1) of Bankruptcy and Insolvency Act and s. 39 of Law and Equity Act --- Chambers judge granted receiver's application for approval of sale of certain property by auction and dismissed companies' applications that their trucks were not subject to receivership order --- Judge held that trucks constituted "property" and were subject to receivership order, but allowed companies to sell trucks on their own, with receiver's consent, on condition that proceeds be held in trust --- Companies appealed judgment dismissing their applications --- Appeals allowed --- Trucks should have been excluded from receivership and should not be subject to receiver's

charges — Issue did not turn on interpretation of "property" in receivership order — Companies' applications were expressly contemplated by receivership order — Companies had priority over creditor with respect to trucks pursuant to their purchase money security interests (PMSI) — To allow trucks to remain under receivership would grant receiver, and indirectly creditor who must indemnify receiver's losses, priority over companies — By virtue of lease or conditional sale agreements, debtor had only possessory interests in trucks, and receiver could not acquire greater interest — As companies' PMSIs took priority over creditor's general security agreement, and companies wanted no part of receivership, trucks should have been released.

Personal property security --- Priority of security interest — Purchase money security interest

Application of receivership order — Insolvent company A Ltd. (debtor) financed trucks from financing company M Corp. and from leasing company B Ltd. (together, companies) — Debtor ceased operations and had total indebtedness exceeding \$8,000,000 — Creditor I Union, who had general security agreement with debtor, obtained order appointing receiver pursuant to s. 47(1) of Bankruptcy and Insolvency Act and s. 39 of Law and Equity Act — Chambers judge granted receiver's application for approval of sale of certain property by auction and dismissed companies' applications that their trucks were not subject to receivership order and should be returned to them — Companies appealed judgment dismissing their applications — Appeals allowed — Trucks should have been excluded from receivership in response to companies' applications and should not be subject to receiver's charges — Companies had priority over creditor with respect to trucks pursuant to their purchase money security interests (PMSI) — To allow trucks to remain under receivership would grant receiver, and indirectly creditor who must indemnify receiver's losses, priority over companies — True lease or financing lease dichotomy was not helpful in this analysis — Even if trucks fell within definition of "property", question of whether companies had superior entitlement under priority rules of Personal Property Security Act (PPSA) was critical to determination of applications — To keep trucks within receivership would circumvent priority rules of PPSA — As companies' PMSIs took priority over creditor's general security agreement, and companies wanted no part of receivership, trucks should have been released at earliest opportunity.

APPEAL by financing company and leasing company from judgment reported at *Integris Credit Union v. All-Wood Fibre Ltd.* (2015), 2015 BCSC 1146, 2015 CarswellBC 1850 (B.C. S.C.), dismissing their applications for orders that their trucks were not subject to receivership order and should be returned to them.

Savage J.A.:

I. Introduction

1 With PD-47 - Model Orders, the Supreme Court has prescribed the use of model forms for certain types of orders. The purpose of the model orders is to encourage parties and the Court to focus on the issues in dispute in a particular proceeding. This appeal concerns an application made under a receivership order based on the Model Receivership Order made pursuant to s. 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 [BIA], and/or s. 39 of the *Law and Equity Act*, R.S.B.C. 1996, c. 253 [LEA].

2 The Appellant Mercedes-Benz Financial Services Canada Corporation ("MBFS") is a company which finances the acquisition of equipment, including vehicles. The Appellant BHL Capital, a division of Berner Holdings Ltd. ("BHL"), is an equipment lessor. All-Wood Fibre Ltd.'s ("All-Wood") principal line of business was fibre supply for the forestry industry. It financed trucks from MBFS and BHL. All-Wood ceased operations March 9, 2015. Integris Credit Union ("Integris") is a lender with a General Security Agreement with All-Wood. Integris sought and obtained a receivership order. KPMG Inc. ("KPMG") is the receiver. The indebtedness of All-Wood to all of its creditors is now estimated to exceed \$8 million.

3 As a result of the size of an unanticipated CRA liability Integris stands to pay for a significant part of KPMG's fees. The Appellants say that their security over the trucks ranks ahead of the General Security Agreement. They say the receivership order should not cover their trucks and, in any event, their trucks should have been excluded upon application in the court below.

4 For the reasons that follow, I would allow these appeals.

II. Background

5 MBFS and BHL supplied four trucks to All-Wood (the "Trucks"):

(a) MBFS provided a 2010 Freightliner CA125DC to All-Wood under a Conditional Sale Contract and Security Agreement dated December 4, 2012. MBFS registered a financing statement for this truck in the British Columbia Personal Property Registry ("PPR") on December 10, 2012.

(b) MBFS provided another 2010 Freightliner CA125DC to All-Wood under a Conditional Sale Contract and Security Agreement dated January 14, 2013. MBFS registered a financing statement for this truck in the PPR on January 16, 2013.

(c) MBFS provided a 2014 Freightliner 122SD to All-Wood under a Lease Agreement dated December 22, 2014. MBFS registered a financing statement for this truck in the PPR on December 29, 2014.

(d) BHL provided a 2015 Freightliner 122SD 48 to All-Wood under a Lease Agreement dated May 23, 2014 (All-Wood was one of several lessees). BHL registered a financing statement for this truck in the PPR on May 23, 2014.

6 By March 9, 2015, All-Wood had ceased operations. On March 17, 2015, Integrus obtained an *ex parte* order appointing KPMG as an interim receiver of All-Wood's "assets, undertakings and properties", pursuant to s. 47(1) of the *BIA* and s. 39 of the *LEA*.

7 On March 25, 2015, Ehrcke J. appointed KPMG as the receiver (the "Receiver") in respect of "all of the assets, undertakings and properties of [All-Wood], including all proceeds thereof", pursuant to s. 243(1) of the *BIA* and s. 39 of the *LEA* (the "Receivership Order"). The Receivership Order was based on the court's Model Receivership Order, and includes the following terms:

- Paragraph 2(a) authorizes the Receiver to "take possession of and exercise control over the Property and any and all proceeds, receipts and disbursements arising out of or from the Property".
- Paragraph 2(j) authorizes the Receiver to "market any or all of the Property ... as the Receiver in its discretion may deem appropriate".
- Paragraph 16 provides for a receiver's charge (the "Receiver's Charge"), which "shall form a first charge on the Property in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, ... but subject to Sections 14.06(7), 81.4(4), and 81.6(2) of the *BIA*".
- Paragraph 19 provides for a charge not to exceed \$100,000 (the "Receiver's Borrowings Charge") as security for funds borrowed by the Receiver, "in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, ... but subordinate in priority to the Receiver's Charge and the charges set out in Sections 14.06(7), 81.4(4), and 81.6(2) of the *BIA*".
- Paragraph 29 provides that "[a]ny interested party may apply to this Court to vary or amend this Order ..., specifically including an application by any Defendant to authorize the Receiver to release to any Defendant any Property in its possession or control, and to exclude such Property from the priorities set out in the paragraphs 16 and 19 herein".

8 I pause to note here that the Receivership Order at issue here differs from the Model Receivership Order by the addition of the phrase, handwritten in the original, "*specifically including an application by any Defendant to authorize the Receiver to release to any Defendant any Property in its possession or control, and to exclude such Property from the priorities set out in the paragraphs 16 and 19 herein*".

9 Notably, the business of All-Wood had ceased. The form of receivership order sought did not empower the Receiver to carry on the business of All-Wood.

10 On May 13, 2015, BHL filed a notice of application seeking the following relief:

1. An order that KPMG Inc., receiver of the assets and undertaking of All-Wood Fibre Ltd. pursuant to an order in these proceedings dated March 25, 2015, forthwith deliver up to BHL the following property:

2015 Freightliner 122SD 48 in. Midroof Tri-Drive Tractor ...

11 On May 25, 2015, MBFS filed a similar notice of application seeking:

1. An order that the Equipment [the three trucks], in the possession or control of the Receiver, be delivered by the Receiver to Mercedes-Benz Financial Services Canada Corporation, or its authorized agent.

2. A declaration that the Equipment is not subject to the Receivership Order made March 25, 2015, herein.

12 By order dated June 8, 2015, the Chambers Judge (the "Judge") approved the Receiver's proposed sale of All-Wood's assets by auction but reserved judgment on the issue of whether the Trucks fell "within the scope of the Receivership Order".

13 By order dated July 3, 2015, the Judge dismissed MBFS and BHL's applications. In addition, he declared that:

1. The truck which is subject to the BHL ... Lease Agreement dated May 23, 2014, ...constitutes "property" within the scope of, and is subject to, the Interim Receivership Order granted March 17, 2015 and the Receivership Order granted March 25, 2015 herein (together the "Receivership Order").

2. The three trucks which are subject to the Mercedes-Benz Financial Services Canada Corporation Conditional Sale Contract and Security Agreement dated December 4, 2012, Conditional Sale Contract and Security Agreement dated January 14, 2013 and Lease Agreement dated December 14, 2014, respectively, ... constitute "property" within the scope of, and are subject to, the Receivership Order.

14 There is some dispute concerning the effect of these orders. The Appellants say that the effect of these orders is that the Trucks are subject to a priority charge in favour of the Receiver's costs by paragraphs 16 and 19 of the order. Integrus says that there needs to be a further hearing at which the court will make an allocation of the Receiver's costs. Conceivably, no allocation or a minor allocation of those costs could result. The Receiver, who filed a factum, but did not appear, made no submission on this issue.

15 By virtue of the nature of the Appellants' interests and the timing of the registrations, it is not disputed that the Appellants had duly registered purchase money security interests (PMSI) in the Trucks and serial-number registrations, which establish the Appellants as the highest ranking secured creditors in respect of the Trucks. Integrus holds a General Security Agreement in favour of All-Wood, which security is subordinate to that of the PMSI's. Accordingly, Integrus is in a subordinate position to the Appellants in respect of the Trucks.

III. Reasons Below

16 The Judge first considered the meaning of "property" in the Receivership Order. He interpreted this term broadly, with reference to s. 243(1) and the definition of "property" in s. 2 of the *BIA*.

17 Next, the Judge considered whether the impugned agreements were "financing leases" or "true leases" (apparently in an effort to address the Appellants' submission that All-Wood did not obtain an interest in the title to the Trucks, and therefore the Trucks did not qualify as "property" under the impugned contracts).

18 At para. 30, he summarized the Receiver's submissions on this issue as follows:

[30] The position of the Receiver ... is that the agreements relating to the subject trucks are "financing leases" as opposed to "true leases". As such, the trucks constitute Property and are subject to the Receivership Order. The Receiver submits that if the agreements are "true leases" then the trucks do not form part of the assets of All-Wood and would not be subject to the Receivership Order.

19 After reviewing the "test" for a financing lease (i.e., security lease) in *Daimler Chrysler Services Canada Inc. v. Cameron*, 2007 BCCA 144 (B.C. C.A.), the Judge concluded that the impugned agreements met this test and were therefore not true leases (paras. 38-39).

20 At para. 40, he summarized his findings as follows:

[40] Given my interpretation of the term Property, the trucks fall within the scope of the Receivership Order. Further, the agreements between All-Wood and BHL and MBFS are financing leases; as a result the trucks fall within the scope of the Receivership Order.

IV. Statutory Provisions

21 Section 243(1) of the *BIA* authorizes a court, upon the application of a secured creditor, to appoint a receiver over an insolvent or bankrupt person's property where it is "just or convenient to do so":

Court may appoint receiver

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.

22 Section 243(6) of the *BIA* also authorizes a court to "make any order respecting the payment of fees and disbursements of the receiver that it considers proper", and order that the receiver's charge has priority ahead of "any or all... secured creditors" although "other secured creditors who would be materially affected by the order" must receive notice and have the opportunity to make representations:

Orders respecting fees and disbursements

(6) If a receiver is appointed under subsection (1), the court may make any order respecting the payment of fees and disbursements of the receiver that it considers proper, including one that gives the receiver a charge, ranking ahead of any or all of the secured creditors, over all or part of the property of the insolvent person or bankrupt in respect of the receiver's claim for fees or disbursements, but the court may not make the order unless it is satisfied that the secured creditors who would be materially affected by the order were given reasonable notice and an opportunity to make representations.

[Emphasis added.]

V. Standard of Review

23 Generally on appeal, questions of law are reviewable on a standard of correctness. Findings of fact may be reversed on a palpable and overriding error. For true questions of mixed fact and law, where a legal principle is not readily extricable, the matter should not be overturned absent palpable and overriding error: *Housen v. Nikolaisen*, 2002 SCC 33 (S.C.C.) at paras. 8-12, 36. Failure to give sufficient weight to relevant considerations may justify appellate review: *Bell v. Bell*, 2001 BCCA 148 (B.C. C.A.) at para. 11.

VI. Interpretation of the Order

24 The arguments here and below focused on the interpretation of the Receivership Order, and in particular the meaning of "property".

25 The principles concerning the interpretation of orders are well settled. In *Yu v. Jordan*, 2012 BCCA 367 (B.C. C.A.), this Court said:

[53] In my view, the interpretation of a court order is not governed by the subjective views of one or more of the parties as to its meaning after the order is made. Rather an order, whether by consent or awarded in an adjudicated disposition, is a decision of the court. As such, it is the court, not the parties, that determines the meaning of its order. In my view, the correct approach to interpreting the provisions of a court order is to examine the pleadings of the action in which it is made, the language of the order itself, and the circumstances in which the order was granted.

[Emphasis added.]

26 In *Sutherland v. Reeves*, 2014 BCCA 222 (B.C. C.A.), it was argued that the interpretation of an order turned on the meaning of the Model Receivership Order. This Court rejected that approach saying:

[30] But I do not accept Mr. Sutherland's underlying premise. This appeal does not turn on an interpretation of the Model Order. It turns on the interpretation of the specific Order made by Mr. Justice Willcock. This is so for two reasons.

[31] First, court orders are not interpreted in a vacuum. This Court has recently described the correct approach to the interpretation of court orders (*Yu v. Jordan*, 2012 BCCA 367 at para. 53, Smith J.A.):

[53] In my view, the interpretation of a court order is not governed by the subjective views of one or more of the parties as to its meaning after the order is made. Rather an order, whether by consent or awarded in an adjudicated disposition, is a decision of the court. As such, it is the court, not the parties, that determines the meaning of its order. In my view, the correct approach to interpreting the provisions of a court order is to examine the pleadings of the action in which it is made, the language of the order itself, and the circumstances in which the order was granted.

[Emphasis added in original.]

As a result, in addition to examining the language of the Order, it is necessary to review the pleadings and surrounding circumstances. It would be an error to have regard to those factors but to then interpret a generic Model Order instead of the specific order Mr. Justice Willcock made in response to the pleadings and the surrounding circumstances before him.

[32] Second, and critically, the Order in this case is not identical to the Model Order. This is most apparent in their divergent definitions of "Property", which was not discussed in Mr. Sutherland's factum. As noted, the Model Order defines "Property" as including all the "assets, undertakings and properties of the Debtor, including all proceeds thereof". In contrast, the Order defines "Property" as "the affairs, business, undertaking and assets" of Tangerine. This is a significantly broader definition than that found in the Model Order.

[Emphasis added.]

27 Those principles were recently applied to the interpretation of a Receivership Order by Fitzpatrick J. in *Credit Suisse AG v. Great Basin Gold Ltd.*, 2015 BCSC 1199 (B.C. S.C.). She found that all of the aspects of the receivership order, based on the factors set out in *Yu*, were interrelated and supported an interpretation of the stay provisions at issue there.

28 As this Court noted in *Sutherland*, the order to be interpreted is a specific order of the court. It is an error to focus on the Model Order rather than the specific order at issue. It is the pleadings, relevant circumstances and specific wording of the order that governs the interpretation of the Receivership Order.

29 The pleadings reveal the nature of the receivership was to liquidate the assets over which Integris held priority for their security. Integris' notice of civil claim sought an order, *inter alia*, giving Integris conduct of sale over All-Wood's assets, or alternatively empowering the Receiver to sell the assets. MBFS's response to civil claim expressly opposed this relief. Further, Integris' notice of application and accompanying affidavit established that All-Wood ceased to carry on business. The draft form of receivership order sought by Integris did not empower the Receiver to carry on the business of All-Wood.

30 Accordingly, realization of Integris' interests, and not operation of All-Wood, was the Receiver's focus. Integris required the Receiver's assistance to realize on the security. Conversely, the Appellants did not want or need the assistance of the Receiver. The pleadings reveal that the Receiver, as Integris' appointee, was intended to be the agency by which Integris would realize on the security it held.

31 The Receivership Order did not incorporate by reference the statutory definition of "property". The reference to "property" provided in the Order was less expansive:

1. Pursuant to Section 243(1) of the BIA and Section 39 of the LEA KPMG Inc. is hereby appointed Receiver, without security, of all of the assets, undertakings and properties of the Debtor, including all proceeds thereof (the "Property").

[Emphasis added.]

32 In *Sutherland*, the receivership order's definition of "property" differed from that of the Model Order. Bauman C.J.B.C. found the definition used to be "significantly broader" than that of the Model Order:

[32] Second, and critically, the Order in this case is not identical to the Model Order. This is most apparent in their divergent definitions of "Property", which was not discussed in Mr. Sutherland's factum. As noted, the Model Order defines "Property" as including all the "assets, undertakings and properties of the Debtor, including all proceeds thereof". In contrast, the Order defines "Property" as "the affairs, business, undertaking and assets" of Tangerine. This is a significantly broader definition than that found in the Model Order.

[33] When the word "Property" is replaced with its definition in the first portion of clause 10 of the Order, that portion provides:

10. No Proceeding against or in respect of Tangerine or the [affairs, business, undertaking and assets of Tangerine] shall be commenced or continued except with the written consent of the Receiver or with leave of this Court ...

33 Integris describes the factual circumstances at the time the Receivership Order was made as chaotic. It says All-Wood's equipment was scattered among various locations, some remote; the landlord had distrained; the company's records had been removed; the employees were laid off; the company's management had walked away; the creditors were seizing assets; and CRA had a lien.

34 Integris submits the definition of "property" should include the Trucks because the Receiver could not have practically considered priorities before needing to step in and take control for the benefit of all creditors. I agree that certain circumstances may justify finding a higher-ranking creditor liable to a receiver appointed by a general creditor. However, such scenarios are an exception to the general rule that a receiver cannot subject secured creditors to liability for disbursements or fees.

35 Although I have reviewed the circumstances of the Receivership Order and the parties' arguments, I do not think the issue before the court properly turns on the interpretation of "property" in the Receivership Order. Here, the applications before the court were to deliver up to MBFS and BHL the Trucks and exclude them from the receivership. That was something expressly contemplated by paragraph 29 of the Receivership Order and is determinative of these appeals.

VII. Application Before the Court

36 The Judge did not find, nor did the Receiver or Integris establish in evidence, that the Receiver expended money necessary for the preservation of the Trucks. The Judge ultimately ordered that the Trucks be excluded from the package of assets auctioned by the Receiver because the Appellants "had the ability and resources to market the trucks on their own".

37 The Appellants could sell the Trucks, with the consent of the Receiver, on the condition that the proceeds be held in trust. The real issue before the court was the Receiver's right to indemnity for the costs of the receivership, and whether the Trucks should be removed from the receivership or be subject to such charges.

38 It is apparent that there are significant differences between a court-appointed receiver and a trustee in bankruptcy. A receiver does not obtain the debtor's proprietary interest in the collateral: *1231640 Ontario Inc., Re*, 2007 ONCA 810 (Ont. C.A.) at para. 22, 27-28. On the other hand, a trustee becomes vested with the property of the bankrupt debtor, which may allow the trustee to assert a claim that the bankrupt cannot: *BIA*, s. 71; *Giffen, Re*, [1998] 1 S.C.R. 91 (S.C.C.).

39 A receiver's right to indemnity may exceptionally extend to the security of secured creditors as was discussed in *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.* (1975), 59 D.L.R. (3d) 492 (Ont. C.A.) at 496:

[13] Not only is the receiver's right to indemnity restricted to the assets under his control, but it is also confined to the equity of the partnership in those assets. As a general rule, the receiver of a partnership will have no power to subject the security of secured creditors of the partnership to liability for disbursements made by him. Clark on Receivers, 3rd ed., vol. 2, s. 638, pp. 1070-71, sums up the position regarding general receivers (a general receiver being "a receiver who takes custody of all the property of an individual or corporation for the purpose not only of preserving it and making it available to satisfy a judgment of the plaintiff in the case, but also that the assets and property of the defendant may be collected, administered and distributed to all claimants who may present their claims to the receiver": vol. 1, s. 22, p. 25) in this way:

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

[Emphasis added.]

40 *Kowal* was approved and applied by this Court in *Lochson Holdings Ltd. v. Eaton Mechanical Inc.* (1984), 55 B.C.L.R. 54 (B.C. C.A.). In *Terra Nova Management Ltd. v. Halcyon Health Spa Ltd.*, 2005 BCSC 1017 (B.C. S.C.), aff'd 2006 BCCA 458 (B.C. C.A.), Stromberg-Stein J., as she then was, summarized the exceptions to the general rule provided in *Kowal*:

[30] Although a secured creditor in a priority position may not be bound by a court order granting priority to another party, as held in *Kowal*, a creditor in a superior priority position may nevertheless forgo that priority position by some other means. For example, three exceptions to the general rule that a receiver has no priority for his expenses over a prior secured creditor were recognized by the Ontario Court of Appeal in *Kowal*, and by the British Columbia Court of Appeal in *Lochson*. The three exceptions as provided in *Kowal* at 496, 497, and 499, respectively, are:

1. If a receiver has been appointed at the request, or with the consent or approval, of the holders of security, the receiver will be given priority over the security holders;

2. If a receiver has been appointed to preserve and realize assets for the benefit of all interested parties, including secured creditors, the receiver will be given priority over the secured creditors for charges and expenses properly incurred by him; and

3. If the receiver has expended money for the necessary preservation or improvement of the property he may be given priority for such expenditure over secured creditors.

41 In my view the exceptions provided for in *Kowal* are not engaged here. From the outset of the application, the Appellants took the position that they wanted no part in the receivership. Prior to the court application, BHL engaged in correspondence with KPMG in an attempt to have the Receiver give up the property without a court application. The Receiver also had early notice of MBFS's interest in the Trucks.

42 The most telling circumstance weighing in favour of excluding the Trucks from the receivership is that the Appellants have priority over Integrus with respect to the Trucks pursuant to their PMSI's. To allow the Trucks to remain under the receivership would grant the Receiver, and indirectly Integrus who must indemnify the Receiver's losses, priority over the Appellants.

43 By virtue of the lease or conditional sale agreements, All-Wood had only possessory interests in the Trucks. The Appellants retained the proprietary rights. All-Wood had only the right to possess and use the Trucks, on certain terms and conditions as set out in the agreements. The Receiver could not acquire a greater interest than All-Wood held.

44 The court below focused on a "true lease / financing lease" analysis. The true lease / financing lease dichotomy arises in the context of the *Personal Property and Security Act*, R.S.B.C. 1996, c. 359 [PPSA]. Section 55 of the PPSA exempts Part 5 from transactions referred to in s. 3, which includes a lease for a term of more than one year that does not secure payment or performance of an obligation (i.e., a true lease). However, Part 5 is irrelevant to the application before the court. *DaimlerChrysler*, cited by the Judge, did not involve a receivership but determined whether Part 5 of the PPSA applied to a particular lease.

45 The true lease / financing lease analysis is also relevant in a *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 proceeding in that creditors with a true lease are entitled to continuing payments under s. 11.01(a) while those with a financing lease are not: *Smith Brothers Contracting Ltd., Re* (1998), 53 B.C.L.R. (3d) 264 (B.C. S.C.).

46 In my view the true lease / financing lease dichotomy is not helpful in the analysis here. Section 243(6) of the *BIA* allows a court to direct that a receiver's charges rank ahead of security interests but requires notice to secured creditors. The Appellants applied for orders directing the Receiver to release the Trucks and exclude the property from the Receivership Order (the Receiver's fees and borrowing charges). This type of application was expressly contemplated in paragraph 29 of the Receivership Order, which included these handwritten changes to the Model Receivership Order:

29. Any interested party may apply to this Court to vary or amend this Order on not less than seven (7) clear business days' notice to the Receiver and to any other party likely to be affected by the order sought or upon such other notice, if any, as this Court may order, *specifically including an application by any Defendant to authorize the Receiver to release to any Defendant any Property in its possession or control, and to exclude such Property from the priorities set out in the paragraphs 16 and 19 herein.*

[Italics denote the handwritten addition to the order.]

47 The Judge concluded the Trucks fell within the scope of the Receivership Order because the Trucks were "property" and the agreements between All-Wood and the Appellants were financing leases. However, the Judge did not consider whether, pursuant to paragraph 29 of the Order, the Trucks should be excluded from the priorities set out in paragraphs 16 and 19 despite being "property". Effectively that is what the applications sought.

48 In my opinion, even if the Trucks fell within the definition of "property" in the Receivership Order, the question of whether the Appellants had superior entitlement under the priority rules of the PPSA was critical to the applications before the court.

The priority rules of the *PPSA* are designed to achieve commercial certainty and predictability. To keep the Trucks within the Receivership, and thus subject to the charges of the Receiver, would circumvent the priority rules of the *PPSA*.

49 Groberman J.A. summarized the goal of the *PPSA* and its application to third parties in *KBA Canada Inc. v. 3S Printers Inc.*, 2014 BCCA 117 (B.C. C.A.):

[20] It is well-established that the overriding goal of the *PPSA* is to provide commercial certainty and predictability to personal property financing. The statute includes clear rules for registration of financing statements in respect of security interests and for priorities among secured creditors. Courts have been very reluctant to circumvent or modify the explicit statutory provisions through the use of extra-statutory principles of common law or equity. The general approach to the statute is well-described in the first chapter of Ronald C.C. Cumming, Catherine Walsh & Roderick Wood, *Personal Property Security Law*, 2d ed. (Toronto: Irwin Law, 2012) at 51:

The *PPSA* is founded on certain legislative policies that generally inform its interpretation. The most prominent of these is the advancement of commercial certainty and predictability. This is a primary value in commercial law generally. Its principal application in the *PPSA* context takes the form of an appropriate reluctance to countenance judicial glosses on the statutory rules, especially those dealing with priority.

...

[27] It is difficult to conceive of a situation in which principles of common law, equity, or the law merchant will be applicable to a priorities dispute, because the *PPSA* deals with priorities comprehensively. In discussing similar Saskatchewan legislation in *Bank of Montreal v. Innovation Credit Union*, 2010 SCC 47, the Supreme Court of Canada said this of the priorities scheme:

[22] The *PPSA* provides a detailed set of rules for resolving priority disputes between competing security interests; perfection and various temporal priority rules generally serve as the default priority rules where there is no more specific rule that governs in a particular circumstance; s. 35(1). While having a security interest gives the secured creditor an interest which is enforceable both as against the debtor and against third parties, the *PPSA* recognizes other stakeholders' interests in collateral by subordinating secured creditors' interests to third parties' interests in various circumstances. For example, unperfected secured interests are subordinated to the interests of a trustee in bankruptcy and in certain circumstances to transferees for value without notice: ss. 20(2) and (3) [ss. 20(b) and (c) of the B.C. Act]. Thus, within the domain of application of the Act, the *PPSA* provides a complete set of priority rules for ranking the interests of both creditors and third parties in particular property.

[Emphasis added.]

50 The clear rules of the *PPSA* should not be circumvented by the appointment of a receiver, when the exceptions outlined in *Kowal* are not met.

51 Integris submits that in the appropriate circumstances a court may appoint a receiver and grant it priority over other pre-existing charges, such as occurred in *Caisse Desjardins des Bois-Francs v. River Rock Financial Canada Corp.*, 2013 ONSC 6809 (Ont. S.C.J.).

52 *Caisse* was an application for the appointment of a receiver over the assets of a debtor. Certain mortgagees argued that the real property over which they hold security by way of first and second mortgages respectively should be carved out of any receivership order because "a receiver would do no more than add a layer of expense and procedure to the handling of the real property, resulting in increased expense but adding nothing of convenience" (para. 17). The mortgagees ranked in priority to *Caisse*, the general creditor who sought the appointment. The judge rejected the mortgagees' argument and found that it was just and convenient that a receiver should be appointed over both the receivables of the corporate debtors and the real property of the individual debtors.

53 In my view, *Caisse* does not assist *Integris*. There the judge applied the analytical framework of *Kowal* and found an exception was made out. The particular circumstances of that case justified the order, most notably that (1) the mortgagees would receive a full return on their interests and (2) the realization of the mortgagees' security would not be subjected to the costs arising from the other interests:

[22] I see no injustice or prejudice to the mortgagees under such an arrangement: there is no evidence before me that the real property is worth any less than the \$13.5 million put forth by Hubert Belanger. I cannot conceive of any scenario wherein the receivers' costs or disbursements would compromise a full return on the mortgagees' interest. The proposed order contains a limit on the right of the receiver to borrow in order to fund the receivership (see paragraph 24 of Appendix "A"). To the extent that the receiver conducts itself in a manner similar to a mortgagee in possession, one must assume that some of its costs in that regard would simply be incurred in the stead of the costs that a mortgagee in possession would incur or charge. This assurance can be enhanced by a clause in the order which would serve to ensure that the priority of a receiver's charge or borrowing charge should rank ahead of the three conventional mortgages only to the extent that those charges relate exclusively to the preservation, maintenance, upkeep or condition of the real property. The proposed order put forward by the *Caisse* contains such a clause at paragraph 28. In my view, it is just and convenient that the costs of the receiver as they pertain to the real property be allocated amongst all creditors. Moreover, this arrangement ensures that the realization of the mortgagees' security will not be subjected to the operation of the business, matters which are of no concern to them as mortgagees. On the other hand, it is only reasonable and fair that the receiver be given priority for expenditures incurred for the necessary preservation and improvement of the property. Where a receiver is appointed for the benefit of interested parties to ensure that all creditors are treated fairly and to ensure a fair process to deal with the assets, there is no good reason why the mortgagee should not have to pay its proportionate share of the receivership costs [see: *JP Morgan Chase Bank N.A. v. UTTC United Tri-Tech Corp* (2006), 25 C.B.R. (5th) 156 (ONSC) at para. 45.

[Emphasis added.]

54 In the present case, we are advised that there are insufficient funds from the Receivership to pay the secured creditors and the Receiver's costs and disbursements. The situation described in *Caisse* does not arise.

55 Nor is it appropriate, as *Integris* argues, to reserve the issues here to a future allocation hearing. As the Appellant's PMSIs take priority over *Integris*' GSA, and the Appellants wanted no part of the receivership, in the circumstances here the Trucks should have been released to the secured creditors at the earliest opportunity.

VIII. Conclusion

56 In my opinion the Trucks should have been excluded from the Receivership in response to the Appellants' applications. The Trucks should not be subject to the Receiver's charges. It follows that I would allow the appeals.

Neilson J.A.:

I AGREE.

Bennett J.A.:

I AGREE.

Appeals allowed.

Most Negative Treatment: Distinguished

Most Recent Distinguished: Respec Oilfield Services Ltd., Re | 2010 ABQB 277, 2010 CarswellAlta 830, 17 P.P.S.A.C. (3d) 148, 68 C.B.R. (5th) 189, 28 Alta. L.R. (5th) 239, [2010] A.W.L.D. 2826, 188 A.C.W.S. (3d) 31 | (Alta. Q.B., Apr 28, 2010)

2009 MBQB 204
Manitoba Court of Queen's Bench

Winnipeg Motor Express Inc., Re

2009 CarswellMan 383, 2009 MBQB 204, 15 P.P.S.A.C. (3d) 242,
179 A.C.W.S. (3d) 266, 243 Man. R. (2d) 31, 56 C.B.R. (5th) 265

**IN THE MATTER OF THE COMPANIES' CREDITORS
ARRANGEMENT ACT, R.S.C. 1985, C. c-36, AS AMENDED**

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT OF WINNIPEG
MOTOR EXPRESS INC., 4975813 MANITOBA LTD. and 5273634 MANITOBA LTD. ("the Applicants")

Suche J.

Heard: June 19, 2009
Oral reasons: June 19, 2009
Docket: Winnipeg Centre CI 08-01-56696

Counsel: David R.M. Jackson for Monitor, Ernst & Young Inc.

G. Bruce Taylor, Jennifer J. Burnell for Winnipeg Motor Express ("WME")

Harvey G. Chaiton for Heller Financial Canada Holding Company ("Heller"), GE Canada Leasing Services ("GE"))

Donald G. Douglas for Paccar Financial Services Ltd. ("Paccar"))

Douglas G. Ward, Q.C. for Alterinvest Fund L.P. (BDC)

Robert A. Dewar, Q.C. for Ramwinn Diesel Inc. ("Ramwinn"))

William G. Haight for Key Equipment Finance Canada Ltd.

E. Peter Auvinen for CIT Financial Ltd., Wells Fargo Equipment Finance Company, Capital Underwriters Inc., Stoughton Trailers Canada Corp. ("Stoughton"))

Donald R. Knight, Q.C. for Maxim Transportation Services Inc. ("Maxim"))

Subject: Corporate and Commercial; Insolvency; Estates and Trusts

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act

XIX.2 Initial application

XIX.2.h Miscellaneous

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act

XIX.5 Miscellaneous

Personal property security

I Scope of legislation

I.6 True lease versus sales financing

Headnote

Personal property security --- Scope of legislation --- True lease versus sales financing

W Inc. filed for protection under Companies' Creditors Arrangement Act — M Inc. and S Corp. provided trailers to W Inc. under leases — Monitor recommended that certain charges be allocated among secured creditors on pro rata recovery using actual or estimated recovery — Motion was brought for ruling on appropriate distribution of charges — M Inc. and S Corp. took position that they were true lessors and therefore should not be included in allocation of charges and are entitled to payment for use of property during restructuring under s. 11.3(a) of Act — Agreement between W Inc. and M Inc. was true lease, but agreement with S Corp. was financing lease or sufficiently akin to one to fall outside scope of s. 11.3(a) — Essential bargain between W Inc. and M Inc. was for use of M Inc.'s property — M Inc. undertook all risks associated with ownership of equipment — M Inc.'s agreement did not create security interest — Agreement with S Corp. provided that W Inc. bore entire risk of loss from any cause — W Inc. was required to make payments to S Corp. regardless of loss or any claim against manufacturer of equipment — S Corp. and W Inc. intended that W Inc. purchase vehicle — Ownership was retained by S Corp. solely for purpose of enforcing W Inc.'s obligation.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Miscellaneous

W Inc. filed for protection under Companies' Creditors Arrangement Act — M Inc. and S Corp. provided trailers to W Inc. under leases — Monitor recommended that certain charges be allocated among secured creditors on pro rata recovery using actual or estimated recovery — Motion was brought for ruling on appropriate distribution of charges — M Inc. and S Corp. took position that they were true lessors and therefore should not be included in allocation of charges and are entitled to payment for use of property during restructuring under s. 11.3(a) of Act — Agreement between W Inc. and M Inc. was true lease, but agreement with S Corp. was financing lease or sufficiently akin to one to fall outside scope of s. 11.3(a) — Essential bargain between W Inc. and M Inc. was for use of M Inc.'s property — M Inc. undertook all risks associated with ownership of equipment — M Inc.'s agreement did not create security interest — Agreement with S Corp. provided that W Inc. bore entire risk of loss from any cause — W Inc. was required to make payments to S Corp. regardless of loss or any claim against manufacturer of equipment — S Corp. and W Inc. intended that W Inc. purchase vehicle — Ownership was retained by S Corp. solely for purpose of enforcing W Inc.'s obligation.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

W Inc. filed for protection under Companies' Creditors Arrangement Act — Monitor recommended that certain charges be allocated among secured creditors on pro rata recovery using actual or estimated recovery — Charges consisted of DIP loan and administrative charges incurred since stay of proceedings was granted — Motion was brought for ruling on appropriate distribution of DIP loan and administrative charges — Methodology proposed by monitor on its face was fair, had objective basis and was applied uniformly — Utilizing "outstanding indebtedness approach" would not have been better as it would favour one creditor substantially — Where allocation is prima facie fair, onus is on objecting creditor to demonstrate that proposal was unfair or prejudicial — There was no basis to deviate from proposal — All secured creditors received real and meaningful benefit as result of these proceedings — It would be economically self-defeating to undergo analysis to determine who benefited more — Any equipment recovered by lessors after stay was included in allocation — Undue prejudice suffered by equipment lessors who held financing leases had been recognized by previous court order that they be paid as of August 1, 2008 — True lessor derived same benefit as financing lessors from these proceedings and was to share in charges, but amount of lessor's total recovery was discounted by 6 percent for risk of non-performance.

MOTION for ruling on appropriate distribution of DIP loan and administrative charges incurred since stay of proceedings was granted pursuant to s. 11 of *Companies' Creditors Arrangement Act*.

Suche J. (orally):

1 The issue before me today is the appropriate distribution of the DIP loan and administrative charges (collectively referred to as the "Court Ordered Charges") incurred since May 15, 2008, when I granted a stay of proceedings pursuant to s. 11 of the *CCAA*. The DIP loan represents working capital advanced to WME by Heller during the restructuring period; the administrative charges consist of the monitor's fees, its legal fees, WME's legal fees, and director's charges. The amount of these fees is not in issue and both have been paid by Heller out of receivables collected from WME's operations and sale of assets. Thus, the effect of this order will be to require other parties to reimburse Heller for some portion of the \$1.8525 million in issue.

- 2 The monitor, in its twelfth report dated February 12, 2009, recommends that the Court Ordered Charges be allocated among the secured creditors based on pro rata recovery, using actual or estimated recovery. Total recovery for any creditor includes its direct recovery plus allocated sale proceeds, plus any lease payments recovered, less direct costs, which includes expenditures for such things as repairs or reconditioning.
- 3 In the result, certain secured creditors will be excluded, namely:
- (i) Daimler Chrysler Financial Services, as I ruled its equipment was not subject to the stay, or the Court Ordered Charges;
 - (ii) three secured creditors, Richard Sobey, Frontier Capital Partners, and Shaw Satellite Services, whose security is subordinate to BDC, which itself only recovered a minimal amount of WME's outstanding indebtedness.
- 4 In addition, several office or non-fleet equipment lessors have been excluded on the basis of administrative efficiency because of the very small amount of their respective recoveries.
- 5 In making its recommendations, the monitor indicates it relied on the following principles:
- (i) all secured creditors should contribute to the cost of restructuring;
 - (ii) a strict accounting on a cost benefit basis is impractical and not necessary or desirable for allocation purposes;
 - (iii) security arrangements and priorities should not be readjusted as part of this process;
 - (iv) the proportion each creditor should be allocated need not be equal; and
 - (v) the allocation should be equitable, rather than equal.
- 6 The monitor also recommends that no DIP charge should be allocated to any equipment parked and available for pickup at the date of filing, or for units that have not yet been returned to a lessor/lender.

The Parties and Their Positions

Heller

7 Heller provided a demand operating loan to WME margined against 85% of eligible accounts receivable. At the time of the stay, this loan was at \$5,643,297, which was secured by accounts receivable of \$5,868,630. During the restructuring, Heller continued to allow the operating loan to revolve. It advanced approximately \$8,750,000 (Cdn.) and \$2,800,000 (U.S.) under the operating loan to pay WME's ongoing business expenses. The pay down of the loan was as a result of a combination of the sale of assets and collection of receivables. In the end, Heller is projected to suffer a loss of approximately \$55,000. It makes the point that it would likely have avoided this had its collateral not been used to make lease payments of approximately \$394,000 to financing lessors.

8 Heller supports the monitor's recommendation.

GE

9 GE leased 44 tractors and 204 trailers to WME under financing leases. Despite my order of July 3, 2008 requiring WME to pay equipment lessors as of August 1, 2008, GE did not seek payment under any of its leases. Ultimately, GE's equipment was included in the purchase by Newco, although as part of that transaction, GE wrote off approximately \$250,000 in principal and unpaid interest and renegotiated its leases at an interest rate of 9.25%.

10 In calculating GE's net recovery, the monitor used the average between the liquidation value of its equipment and the present value of the leases assumed, discounted at the rate of 9.25%. It was argued by several creditors that this discount is commercially unreasonable, and seriously understates the value of GE's recovery.

11 GE supports the monitor's proposed allocation.

Paccar

12 as at the date of filing, Paccar leased 83 tractors and 19 trailers to WME, pursuant to financing leases. As a result of my order of July 3, 2008, Paccar received \$279,855 in lease payments between August 1 and the date on which its equipment was returned. Although Newco was amenable to including Paccar's equipment in its purchase, Paccar was not agreeable to this. Accordingly, all its equipment (save one or two units which could not be recovered) was returned.

13 Paccar disputes the monitor's proposed allocation, arguing that GE and Heller have received the lion's share of the benefit from these proceedings and have suffered virtually no loss. It further maintains that it has been unduly prejudiced, as have all equipment lessors, by virtue of the fact that its security has been used to the benefit of WME (and the other secured creditors, particularly Heller) during the restructuring. In contrast, Paccar's security has suffered significant deterioration.

14 Paccar maintains that the appropriate methodology would be to recognize the net losses suffered. It points out that its loss from its dealings with WME is approximately \$2.7 million, compared to Heller's loss of \$55,000, on virtually the same level of debt owed. It maintains that GE should be considered to have effected 100% recovery, given that Newco has assumed the leases for its equipment.

15 It also maintains that the benefit of an orderly return by WME was not all that significant, given that Paccar is in the business of supplying transport equipment, and is experienced in recovering vehicles in such situations.

Cit Financial Ltd., Wells Fargo Equipment Finance Company, Capital Underwriters Inc. and Stoughton

16 These four equipment lessors collectively had 115 trailers under lease to WME at the time of filing. Stoughton maintains that its lease is not a financing lease.

17 Collectively they argue that the monitor's methodology is not appropriate as it does not adequately reflect the relative benefit derived from the proceedings by different secured creditors. They, too, argue that Heller and GE have essentially been paid in full, which stands in contrast to their situation, each of them having incurred substantial losses. They also did not have the opportunity to have their equipment included in the Newco purchase.

18 These creditors ask that I allocate specific expenses to the secured creditors who they say benefitted from various expenses, which they did not.

19 When considering the issue of recovery, they say the only benefit they received from the restructuring was the orderly return of equipment. However, they maintain that several of their units should not be included in the calculation as these were recovered through their efforts, with no help from WME. They also argue that they were well equipped to pick up all units and would have happily done so.

Ramwinn

20 Ramwinn provided mechanical services to WME. At the time of the stay, it had some vehicles in its possession and, thus, possessory lienholder rights. It also had lien claims against a significant number of other vehicles. An arrangement was made among the various equipment lessors to whom equipment was to be returned, to pay Ramwinn for the work performed in order to secure release of the equipment. Ramwinn was also granted leave to commence certain actions where the limitation dates were approaching during the restructuring period. It also recovered \$4,738.12 out of the proceeds of sale of WME's redundant assets.

21 Ramwinn argues that the money it received from the equipment lessors should not be included in its net recovery, as it was recovered from third parties, not WME. It also points out that Ramwinn's garagekeeper security was of a different kind than the other secured creditors and gave it priority ahead of all other creditors. Thus, to include its recovery in the allocation, effectively amounts to altering the security arrangements between WME and its creditors, which is something that should not be done.

22 Finally, Ramwinn has a claim against WME in the amount of \$18,679 for an account incurred subsequent to the stay. The monitor disputes liability on the part of WME and asserts the account payable by Newco. This dispute has yet to be resolved. Ramwinn seeks payment of this account, or, at least an order requiring that this amount ought to be set aside by Heller pending the determination of the matter.

Maxim

23 Maxim provided 15 trailers to WME under a lease which it maintains is an operating lease. It was paid its lease payments of \$5,985 per month during the restructuring period, and its leases have been assumed by Newco. It says its registration in the Personal Property Registry is for purposes of giving notice that WME is in possession of its equipment, and is not a registration of a security interest.

BDC

24 BDC was owed approximately \$2.5 million plus interest as at the date of the stay. It holds security over all of WME's assets. In general terms, it was subordinate only to Heller on accounts receivable but had a first charge on all other assets. It recovered \$78,998.79 plus interest from the redundant asset sale and will recover \$260,000 plus interest from the proceeds of the sale to Newco. BDC supports the monitor's methodology and its recommendation, although it argues that the application was premature given that there may be statutory creditors such as Worker's Compensation who might be entitled to be paid their claims in priority to the secured creditors who are being asked to contribute to the Court Ordered Charges. Since the date of the hearing, I have made an order of bankruptcy against WME.

25 I turn, then, to the legal issues raised on this motion.

True Versus Financing Leases

26 Both Stoughton and Maxim claim to be "true" lessors. The significance of this issue is twofold; s. 11.3(a) of the *CCAA* provides that an owner of property is entitled to require payment for its use during the restructuring. In addition, of course, the recommendation of the monitor is that only the secured lenders be included in the allocation of the Court Ordered Charges.

27 Section 11.3(a) was added to the *CCAA* in 1997, apparently to clarify, or address, the point made by the British Columbia Court of Appeal in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105, [1990] B.C.J. No. 2278 (B.C. C.A.), namely, that a stay under s. 11, presumably would never be used to enforce the continuous supply of goods or services without payment for current deliveries. The amendment, of course, makes good sense and also brings the *CCAA* into line with the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "*BIA*"), which has a similar provision concerning proposals.

28 The leading authority on the proper interpretation of s. 11.3(a) is *Smith Brothers Contracting Ltd., Re* (1998), 53 B.C.L.R. (3d) 264, [1998] B.C.J. No. 728 (B.C. S.C.). There, Bauman J. relied on jurisprudence arising out of personal property security legislation as a starting point in the determination of the circumstances which would bring a party within s. 11.3(a). The distinction between a true lease - that is, a contract of bailment also known as an operating lease - and a financing, or capital lease, is critical, in a variety of situations. Where a supplier of equipment retains ownership solely for the purposes of enforcing the obligations of the debtor/lessee until payment in full has been made, a security interest is created, and ownership is lost.

29 It is worth observing that the precise legal nature of an agreement in these situations has considerable commercial significance, and seems to have generated something of an ongoing legal struggle. Purveyors of equipment, ever concerned with the legitimate business goal of minimizing risk, try to appear as owners engaging in acts of bailment, thus minimizing

the risk of the failure of a debtor/lessee's business, while at the same time passing off the risks of the equipment; that is, loss, damage and defects.

30 At the same time, it is also true that the world of commercial arrangements is increasingly diverse, complex and focused on cost recovery, so it is very difficult to generalize about how any particular type of relationship will be structured.

31 All of this is to say that, with the benefit of sophisticated legal advice and astute business judgment, the true nature of arrangements involving the supply of equipment can be very difficult to peg.

32 In *Smith Brothers*, Bauman J. concluded that s. 11.3(a) should be narrowly construed, given that it is an exception to a s. 11 stay, which in turn is of a remedial nature, and to be interpreted broadly and in a manner which supports the objectives of the *CCAA*. He says:

56 What I take from all of this is that by preserving a limited remedy for lessors, that is, "payment for use", in a field of commercial transactions which, as I have shown with these leases, encompasses a variety of arrangements with much broader remedies on default, s. 11.3(a) can be interpreted as restricting itself to the type of arrangement which is characterized by the narrower bargain. More simply: this analysis suggests that s. 11.3(a) does not cover all leases. Rather, it covers traditional true leases where the essential bargain is payment for use.

33 And further, at para. 61:

61 It is only payments for the use of leased property that are excepted from a s. 11 stay order under s. 11.3(a). Payments for use *and* equity are not. Similarly payments for use *and* equity *and* an option to purchase are not. This is another reason to conclude the s. 11.3(a) is not inclusive of all forms of lease.

34 *Smith Brothers* has been widely accepted and applied by courts across the country. The exclusion of financing leases makes perfect sense, of course, based on the notion of ownership: if the financing lessor has given away ownership, it cannot seek the benefits of ownership. Similarly, the narrow construction of s. 11.3 limiting it to payments for use of equipment only, is consistent with the idea that a supplier could not be expected to continue to provide its product without payment. All this being so, the result has some unintended consequences, which I address later on in these reasons.

35 I turn, then, to the two creditors in this case, Maxim and Stoughton. I have no hesitation in concluding that the agreement between Maxim and WME is a "true" lease. The essential bargain is payment for use of Maxim's property.

36 I say this because a review of Maxim's obligations reveal that it undertakes all the risks associated with ownership of the equipment - it is responsible for providing all parts and supplies, carrying out maintenance and repairs, providing road service for vehicles which suffer mechanical breakdown, supplies substitute vehicles to WME if there has been mechanical failure, and provides and pays for all licencing and taxes. The option to purchase is truly an option, and the purchase price is determined by a formula, which seeks to determine the true market value of the vehicle at the time the option is exercised.

37 It was argued that the "Elective Termination" provision, which allows Maxim to require WME to purchase the equipment in accordance with the Option if a default has not been cured within seven days, changes the nature of the arrangement. I disagree. While on its face it may be an unusual remedy and probably has more bark than bite, it seems that Maxim is letting WME know that it may take tardiness very seriously.

38 The Maxim agreement does not, in my view, create a security interest. In this regard, I prefer the analysis on *Western Express Air Lines Inc., Re*, 2005 BCSC 53, 10 C.B.R. (5th) 154 (B.C. S.C.), over that in *Paccar of Canada Ltd. v. Peterbilt of Ontario Inc.* (2005), 18 C.B.R. (5th) 125 (Ont. S.C.J. [Commercial List]).

39 The agreement between Stoughton and WME is a different matter. When Stoughton's agreement is viewed as a whole, I conclude that it is either a financing lease or sufficiently akin to one to fall outside the scope of s. 11.3(a). In particular, the agreement provides that WME bears the entire risk of loss from any cause and is required to make payments to Stoughton

regardless of loss, or any claim against the manufacturer of the equipment. The warranties by the manufacturers are excluded. All registration, licence fees and taxes are paid by WME, as is any and all maintenance and repair costs.

40 The lease also requires that the vehicle be returned to Stoughton in a condition that would require significant expenditure. This, combined with an option to purchase the vehicle for a stated amount, which appears to be the difference between the initial value of the equipment less payments made over the term of the lease, suggest to me that the parties intended that WME purchase the vehicle, and ownership was retained solely for the purpose of enforcing WME's obligation.

The Law

41 I turn, then, to the question of principles of allocation of Court Ordered Charges under the *CCAA*. This is a matter of discretion for the court. Each case must be judged on its facts, but fundamentally any allocation must be fair and equitable. This does not mean equal, however, as observed by the court in *Hunters Trailer & Marine Ltd., Re*, 2001 ABQB 1094, 305 A.R. 175 (Alta. Q.B.). While it is unfair to ignore the degree of potential benefit that each creditor might derive, it is also accepted that any means of calculating a precise percentage will be arbitrary. The nature of proceedings under the *CCAA* make a strict accounting on a cost benefit basis impractical and ultimately defeating. It is also accepted that the concept of potential benefit versus direct benefit be utilized, otherwise the process would dissolve into a cost benefit analysis.

42 In *Hickman Equipment (1985) Ltd., Re*, 2004 NLSCTD 164 (N.L. T.D.), at para. 17, Hall J. set out the principles to be applied in allocating restructuring costs, as follows:

- (1) The allocation of costs ought to be fair and evenhanded amongst all creditors upon an objective basis of allocation;
- (2) The fairest basis of allocation would be a uniform percentage of the sale price received for the asset over which the paying creditor had a realizable security interest;
- (3) There must be a recognition that the Cost Allocation Plan acknowledges that costs are not limited to the cost of realization alone but relates to all receivership costs whether direct sales cost or indirect cost;
- (4) Exceptions to a uniform application of cost to creditors ought not to be lightly granted. Nonetheless it must be recognized that certain activities of the Receiver in managing the affairs of the receivership may have been less intensive or less advantageous with respect to certain groups of assets as opposed to other groups of assets and that the extent of this intensity or disadvantage may not be immediately or easily determinable. To require the Receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-a-vis another would likely not be cost effective, would drive up the overall receivership cost and would likely be a fool's errand in any event;
- (5) Exceptions to the rule of uniform cost allocation should only be made where the requirement for such variation is reasonably articulable.

43 I also agree with the decision in *Sulphur Corp. of Canada Ltd., Re*, 2002 ABQB 682, 5 Alta. L.R. (4th) 251 (Alta. Q.B.), where LoVecchio J. concluded that the court has jurisdiction to grant a charge for debtor in possession financing which ranks in priority to provincial statutory liens, in that case a builder's lien.

Analysis and Decision

44 I begin with the observation that the s. 11 stay in this case has accomplished exactly what the *CCAA* intends that it do - it allowed a company in desperate financial circumstances the opportunity to restructure so that part of its business which was viable could carry on.

45 Having said that, good news under the *CCAA* is a relative thing. Substantial financial carnage occurred along the way, not just to the secured creditors, almost all of whom have recovered at least something, but more so to a long list of unsecured creditors as well as the investors. The overriding theme of the individual submissions before me was that each of the parties

would have been in a much better position had they been able to simply realize on their security. That may or may not have been so, but of course the point of the *CCAA* is that the collective good and the benefit to all stakeholders governs.

46 The starting point, then, on this motion is the recommendation of the monitor to allocate the Court Ordered Charges among the secured creditors on the basis of a pro rata share using total recovery. This method, in effect, amounts to requiring the secured creditors to pay a fee to collect its outstanding receivables. This certainly is not a novel concept in debt collection.

47 In my view, the methodology proposed by the monitor on its face is fair. It has an objective basis and is being applied uniformly. Utilizing an "outstanding indebtedness approach", which has been applied in other cases, would not be better as it ends up favouring Heller substantially at the expense of most of the secured creditors.

48 I agree with the view expressed in *Hunjan International Inc., Re* (2006), 21 C.B.R. (5th) 276 (Ont. S.C.J.), that where the allocation is *prima facie* fair, the onus is on an objecting creditor to demonstrate that the proposal is unfair or prejudicial. The monitor, after all, is both court appointed and is intimately familiar with the details of the restructuring, including the particular costs incurred and what has transpired within the company's business operations during the restructuring period.

49 So, then, is there a basis to deviate from the proposal? As noted earlier, while exceptions to a uniform application of costs should not be lightly granted, and the basis for any exception must be reasonably articulable, the court can take into account the different nature of the security held by various creditors, and the potential benefit to them when deciding if the allocation is fair and equitable. This was the focus of much of the argument raised by the secured creditors here.

50 As I said, for the most part, each minimized the benefit or potential benefit to them of the restructuring process, and pointed to how certain expenditures or actions taken were detrimental to their interests.

51 My conclusion is that all the secured creditors who the monitor suggests should participate in the allocation received real and meaningful benefit as a result of these proceedings. Heller's success in collecting receivables was increased and made less costly than had the company been placed in receivership. The equipment lessors' effort, cost, delay, and risk in recovering their equipment from various locations across North America was considerably reduced by virtue of WME's organized return of equipment to its yard or other agreed upon locations. Ramwinn's effort, cost and delay in having its accounts paid was substantially less than had it been required to engage in collecting from the equipment lessors, institute court proceedings, and potentially undergo the process of realizing on equipment in its possession. Those creditors, including Heller, BDC and Ramwinn, who shared in the proceeds from the sale of redundant assets or the purchase by Newco, also received real and meaningful benefit from the efforts of WME and the monitor in conducting the sale and the purchase by Newco would not have happened without the restructuring.

52 Who benefitted more? If a meaningful answer could be given to that question, it would require a careful accounting and cost benefit analysis of each party's circumstance. This is exactly what courts repeatedly have said should not be done. It is economically self-defeating and the cost and the time involved in finding such an answer would only serve to benefit the professionals hired to assist in the process. It is antithetical to objectives of the *CCAA*.

53 I am also of the view that the relative loss - the issue raised by Paccar - results more from the nature of the security and the specific business decisions made by the parties. Heller, and Ramwinn, for example, experienced very small relative losses; BDC's and Alterinvest's loss was considerable. The difference in their respective security is substantial. To make adjustments as Paccar requests would, in my view, amount to readjusting priorities among creditors.

54 At the same time, I do not accept Ramwinn's argument that requiring it to pay the allocation recommended by the monitor is also a violation of this principle. The allocation proposed is not at all disproportionate, in my view, to the benefit accrued to Ramwinn.

55 I also conclude that there is no basis on which I can or should direct that the funds be held to pay for the outstanding claim Ramwinn advances against WME.

56 As to equipment obtained directly by lessors, I am of the view that regardless of how lessors recovered equipment, any equipment recovered post stay should be included in the allocation as suggested by the monitor. Self-help is not to be condoned, and a potential benefit not realized due to a creditor's actions, should not be discounted in this analysis, as to do so falls into a detailed cost benefit analysis.

57 There is one adjustment, however, that I do feel is in order. A discount rate of 9.25% on the present value of GE's leases was used by the monitor. I am not persuaded that this is justifiable. I accept what I take to be the monitor's secondary position of 6% as being reasonable.

Equipment Leases

58 Much attention was paid during these proceedings to the situation of equipment lessors who hold financing leases. Paccar, in particular, but also others, advocated forcefully that they were unduly prejudiced by the stay. They maintain that not only are they not being paid while their assets are being used to the benefit of the other stakeholders, but their underlying security is being rapidly and substantially deteriorated in the process. This, they say, violates one of the fundamental objectives of preventing one creditor from obtaining an advantage over other creditors during the stay period.

59 It strikes me that the fact that true lessors are entitled to be paid further aggravates this problem in circumstances such as WME's where it has a variety of arrangements with equipment suppliers, including some true leases. It is clearly in a debtor company's economic interests to use financed rather than leased equipment during restructuring. This is what seems to have occurred here (although I make no criticism of WME for doing so).

60 It is difficult to know how this situation can be remedied, given that the whole point of the *CCAA* is to relieve a company of ongoing financial burden to allow it the opportunity to restructure. In this case, for example, WME would not have succeeded had been obliged to pay for its equipment during the entirety of the restructuring.

61 On the particular facts of this case, this issue became somewhat easier to address given the nature of WME's business. Equipment to a transportation company is akin to raw goods to a manufacturer, and I was of the opinion that if WME was going to be viable, at a certain point it would have to demonstrate it could pay for the essential means of production. Otherwise, there would be no purpose to continue the stay. Accordingly, I ordered that financing leases would be paid as of August 1, 2008.

62 I say all this not to justify or revisit the basis for my earlier decision, but to get to the point that in considering what is equitable, undue prejudice is a reason to adjust what would otherwise be a uniform approach. I am satisfied that equipment lessors in a business operation such as WME's do suffer undue prejudice. In this case, however, the equipment lessors were paid as of August 1. Being financing leases, those payments were not just for use, but included some amount on account of equity. I conclude, then, that the undue prejudice suffered has been recognized, albeit not totally, perfectly or precisely, but, in my view, in an amount sufficient amount to justify the uniform application of the methodology proposed by the monitor.

63 The last issue is one that perhaps is more controversial. Maxim, the only true lessor, has, in my view, derived the same benefit as the financing lessors from these proceedings. Its trailers were part of WME's network which stretched across North America. As a result of WME's continued operations, its equipment was gathered in and ultimately it was able to assign its leases to Newco without any interruption. While s. 11.3(a) specifically allows for payments for use of equipment despite the stay, I do not see that there is any statutory prohibition against requiring a contribution to the Court Ordered Charges against such a party. Taking a broad and purposive approach to the *CCAA*, which I am obliged at law to do in determining an equitable distribution of the costs of the restructuring, I conclude that Maxim should share in these charges on some basis.

64 I do this, recognizing that the only authority on point that was provided to me, *Western Express Air Lines Inc.*, came to a different conclusion. However, I note that there, Brenner C.J.S.C. specifically found that:

20 ... If costs are to be allocated in the basis of the benefit to be derived from a successful restructuring, then the lessors should arguably pay nothing. As ordinary creditors for the outstanding lease payments they will likely receive nothing. ...

.....

22 Accordingly under the general equitable principles of the *CCA* I see no basis for requiring the aircraft lessors to bear a portion of the Existing Charges.

65 Here, I have found the situation to be otherwise. There was a real and meaningful benefit to Maxim.

66 However, just as GE's assumed lease was discounted for the risk of nonperformance by Newco, so, too, should Maxim's. Subject to hearing further submissions on the matter, the amount of Maxim's total recovery should be discounted by the same discount rate, namely, 6%.

Conclusion

67 At the outset of the hearing before me, several disputes remained which concerned the value of various creditors' total recovery.

68 I understand that through a combination of information provided during the hearing and the findings I have made this afternoon, these have all been resolved.

69 I trust that these reasons will allow the monitor to calculate the precise allocation among the parties. However, I recognize that it may be that some aspect of my reasons require either clarification or some addition. Should that be the case, I invite the parties to let me know.

Order accordingly.

Most Negative Treatment: Distinguished

Most Recent Distinguished: Medican Holdings Ltd., Re | 2013 ABQB 224, 2013 CarswellAlta 513, [2013] A.W.L.D. 2731, 16 B.L.R. (5th) 327, 229 A.C.W.S. (3d) 331 | (Alta. Q.B., Apr 23, 2013)

2010 ABQB 277
Alberta Court of Queen's Bench

Respec Oilfield Services Ltd., Re

2010 CarswellAlta 830, 2010 ABQB 277, [2010] A.W.L.D. 2826, 17 P.P.S.A.C.
(3d) 148, 188 A.C.W.S. (3d) 31, 28 Alta. L.R. (5th) 239, 68 C.B.R. (5th) 189

In the Matter of the Bankruptcy of Respec Oilfield Services Ltd.

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended
and the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

And In the Matter of a Plan of Compromise or Arrangement of Respec Oilfield Services Ltd.

Myra B. Bielby J.

Heard: March 25, 2010

Judgment: April 28, 2010

Docket: Edmonton BK03-115337, 0903-06823

Counsel: Richard Reeson, Q.C., Satpal Bhurjee for PricewaterhouseCoopers Inc.

Terrence Warner for National Leasing Group Inc.

Charles Russell, Q.C. for Canadian Western Bank

Kibben Jackson for Business Development Bank

Ryan Zahara, Michael O'Brien for Komatsu International (Canada) Inc.

Sean Collins, Jeffrey Whyte for GE Capital

Stephen Livingstone for Little Red River Cree Nation

Colin Brousson, Eugene Macchi for North Shore Leasing Ltd.

Paul Pidde for Ford Credit Canada

Robert Kennedy for Jim Pattison Leasing

Justice Agyemang for Bank of Nova Scotia

Ed Bresky for Great West Kenworth

Karl Driedger for K & N Contracting

Tara Hamelin for Wells Fargo Equipment Finance Company

Subject: Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency

IV Receivers

IV.2 Fees and expenses

Headnote

Bankruptcy and insolvency --- Receivers --- Fees and expenses

Debtor was placed into receivership — Number of pieces of equipment were sold in auction, monitor applied for approval to apportion its costs among all creditors on pro rata basis — CWB bank was secured lender that held first priority claim and BDC was secured creditor that held second priority claim over much of debtor's assets — Pursuant to court order, any lender

or lessor who wished to remove equipment subject to its security from auction was permitted to do so upon paying monitor deposit on account of any portion of allocated costs it was found liable to pay — Two banks supported proposed distribution, bank CWB was likely to recover entire indebtedness whereas BDC anticipated shortfall — Monitor brought application for approval to deduct allocated costs due from each creditor from sale proceeds of equipment upon which that creditor had charge, where creditor removed equipment deposit paid to monitor would be applied to its share of allocated costs, and where deposit was inadequate to cover its share then judgment against that creditor for shortfall — Application granted — Argument that costs be allocated based on proportion of debt owed to each creditor to total debt owed by debtor was rejected as it would result in creditor who would receive least from auction bearing greatest portion of costs — Monitor granted judgment against GE for amounts owed, court in Companies' Creditors Arrangement Act proceeding has ability to deal with assets, debt and costs incurred in that proceeding including right to grant judgment against party which it determines liable to contribute to those costs — Fairness did not require that two banks bear more than their pro rata share of allocated costs, plan did impose pro rata contribution on CWB but it would ultimately be indemnified because its security gave it first charge for such recovery, however, BDC would bear ultimate cost because it held second-in-line security — Fact that CWB would be indemnified in full was because it had enough security to protect it for its entire exposure while others did not — JPL, true lessor of equipment, was exempted from contributing to allocated costs as there were true leases in sense that parties always intended leased equipment would be returned to JPL — Restructuring attempt did not benefit JPL and JPL did not receive uninterrupted flow of lease payments — Wages payable to debtor's principals were incurred prior to granting of receivership order and on account of work done while monitor was in place, funds ordered to be withheld from distribution of auction proceeds.

APPLICATION by monitor to have its proposed apportionment of allocated costs approved.

Myra B. Bielby J.:

Decision

1 An attempted reorganization of a debtor company under the *Companies' Creditors Arrangement Act* ("CCAA") failed whereupon the debtor was placed into receivership. A number of pieces of heavy equipment were sold in an auction held before the termination of the CCAA stay. The Monitor applied for approval to apportion its costs, the costs of conducting the auction and Debtor-in-Possession financing costs ("the allocated costs") among all creditors on a *pro rata* basis, to deduct those costs from the auction proceeds payable to creditors who had security on the auctioned equipment, and to distribute the balance of the auction proceeds accordingly.

2 The Court approved an apportionment of costs calculated through a comparison of the net funds received on the sale of each secured asset or the estimated value of unsold secured assets against the value of the debt secured on that asset. Where costs of sale could be traced to a specific asset those costs were deducted from the value received on the sale of that asset. Otherwise the costs of sale were attributed on the same *pro rata* basis as other costs.

3 Approval was granted as sought except in relation to a proposed apportionment of allocated costs to a "true" lessor of equipment. That lessor was not obliged to bear any portion of those costs because it received no benefit from the CCAA proceedings. The lease payments it received during the period of the stay were no more than that to which it was entitled as a continuing supplier pursuant to s. 11.01(a) of the CCAA.

4 The auctioneer had provided a guaranteed price for assets placed in the auction. GE Canada Equipment Financing G.P. ("GE") had first-in-priority security on assets for which that guaranteed price was \$1.4 million. It elected to retrieve those assets from the auction rather than allow them to be sold. They remained in GE's possession and unsold as of the date of this application. GE led evidence to show that those assets are worth only \$990,000. It was unsuccessful in its application to reduce its *pro rata* share of the allocated costs through using \$990,000 rather than \$1.4 million as the basis upon which that share should be calculated. It would not be fair and equitable to permit a creditor to avoid the consequences of a poor business decision by foisting them in part on other creditors. The Monitor was granted judgment against GE for its share of the allocated costs in the amount of \$215,688.46, less any portion of the deposit paid by GE which has not been accounted for in the determination of that figure.

5 The charge granted to the Monitor under the initial CCAA order ("the First Day Order") was increased from \$200,000 to \$240,000 to reflect the estimated actual costs to be incurred by the Monitor to complete the distribution and other work remaining from events which occurred during the operation of the stay. This was notwithstanding the fact that the Monitor otherwise did not have any function in relation to the disposition of remaining assets, which were placed in the control of the Receiver shortly after the conclusion of the equipment auction.

Facts

6 On May 8, 2009 Respec Oilfield Services Ltd. ("Respec") applied for and received a First Day Order granted pursuant to s. 11 of the CCAA imposing a stay of proceedings on any actions by its creditors to collect any debts owing to them and appointing PricewaterhouseCoopers ("PWC") as Monitor. The initial stay was to expire May 23, 2009 but was extended by various Court orders up until November 30, 2009 at which time PWC was appointed Receiver of the undertaking upon the collapse of Respec's efforts to devise a plan of compromise of its debts.

7 Canadian Western Bank ("CWB") is the secured lender which holds a first priority claim and the Business Development Bank ("BDC") is the secured creditor which holds a second priority claim over all Respec's assets except for a significant number of pieces of heavy equipment which were subject to personal property security interests ("PMSI"s) held by various lenders and finance companies. CWB and BDC are together referred to as "the two banks".

8 Pursuant to the provisions of orders granted by me on October 8 and 20, 2009, Respec entered into a contract with Ritchie Bros. Auctioneers ("Ritchie Bros.") which provided that many pieces of the heavy equipment were to be auctioned on November 24 and 25, 2009 in Grande Prairie, Alberta. Under that contract Ritchie Bros. undertook to pay Respec a minimum amount of money in respect of each item auctioned irrespective of the net bid price received at the auction.

9 Pursuant to Court order any lender or lessor who wished to remove equipment subject to its security from the auction, and take it away was permitted to do so upon paying the Monitor a deposit on account of any portion of the allocated costs it was ultimately found liable to pay.

10 Certain lenders paid this deposit and removed their equipment including GE, Wells Fargo Equipment Finance Co. ("Wells Fargo") and Jim Patterson Lease ("JPL"). The balance was sold netting \$5,643,858.46, a figure below the guaranteed price offered by Ritchie Bros. of \$6,338,000. Ritchie Bros. has paid the Monitor an additional \$114,048, being the difference between the guaranteed and actual net auction proceeds.

11 The Monitor incurred certain professional and legal fees during the period of the stay, secured by the granting to it of a \$200,000 administration charge in the First Day Order. It anticipates incurring additional fees to a maximum of \$35,000 to conclude its involvement in this matter. In its 15th report dated March 12, 2010 the Monitor has recommended that these costs as well as all the other allocated costs including the Debtor-in-Possession financing ("the DIP funds") and the indirect costs incurred to sell assets in the auction be allocated on a *pro rata* basis among the secured creditors based on their actual or estimated recovery (for those assets not yet liquidated). Any direct costs of sale of a particular asset are proposed to be charged against the sum recovered on the sale of that asset.

12 Then, based on that proposed distribution, the Monitor seeks approval for the following:

- to deduct the allocated costs due from each creditor from the sale proceeds of the equipment upon which that creditor had a PMSI charge and to distribute the net balance to that creditor;
- where a creditor removed the equipment upon which it had security from the auction the deposit it paid to the Monitor would be applied to its share of the allocated costs;
- where the deposit is inadequate to cover its share in full the Monitor would be granted a judgment against that creditor for the shortfall; and

- when the Receiver sells the assets upon which the two banks have security their shares of the allocated costs will be recovered from those sale proceeds.

13 In its 15th report the Monitor sets out its suggested calculation of the allocated costs relating to each piece of equipment or other asset, plus the direct costs of sale for that asset, if any, identifies the auction price received for or estimated value of each and proposes the net difference as the payment to be made to each affected creditor. Each of the two banks and a majority of the PMSI creditors support the Monitor's proposed distribution. GE, Caterpillar Financial Services Ltd. (Cat), Komatsu International (Canada) Inc. (Komatsu), Kingland Ford Sales Ltd. (Kingland), Wells Fargo, and JPL do not. I note that the proposed allocation will require the two banks to contribute to the indirect costs of the auction notwithstanding that it is highly unlikely that either will receive any of the auction proceeds given their status as second-in-priority creditors behind the PMSI holders.

14 The DIP costs represent the amount of monies Respec borrowed to keep its operations afloat during the period of the stay while it was attempting to reorganize. They total \$1.368 million. That money just happened to be borrowed from a company related to GE. The DIP costs have now been repaid in their entirety including interest; the remaining issue is which parties should bear ultimate responsibility for that liability and in what proportion.

15 The two banks each advise that CWB is very likely to recover its entire indebtedness from the liquidation of its security. BDC is left in the unenviable position of anticipating a significant shortfall after the liquidation of all remaining secured property including real estate, accounts receivable and some remaining equipment. The relative security positions of the two banks have the effect of ultimately redistributing to BDC any contribution CWB makes to the allocated costs as a result of this application. It is therefore in BDC's particular interest to ensure that the PMSI creditors bear as many of those costs as possible.

16 Accompanying its application to approve payment of the allocated costs and distribution of the balance of the auction proceeds, the Monitor also seeks an order requiring GE to pay it \$215,688.46 as the balance remaining from its share of the apportioned costs. Unlike other PMSI creditors which removed equipment from the auction, GE did not pay the Monitor a deposit equivalent to its estimated *pro rata* share of the allocated costs but only \$30,000 which apparently represented only its share of the administration costs, which are just a portion of the allocated costs. GE argues that it should not be obliged to pay this additional sum.

17 Wells Fargo objects to the Monitor's proposed distribution because it does not directly apportion the costs of transporting the equipment from Red Earth, Alberta to the auction site, i.e. the cost of transporting each piece of equipment is not charged against that piece. Rather, the entire transportation costs are allocated *pro rata* among the creditors.

18 JPL objects to paying any portion of the allocated costs because it is not a secured creditor but rather a "true lessor" of five pieces of heavy equipment.

19 The Monitor also seeks an order increasing the priority administration charge it has on Respec's assets on account of its professional and legal expenses from the current \$200,000 to \$240,000.

20 It also seeks direction as on whether funds payable to principals of Respec as wages, conditional upon their providing certain information which has yet to be provided, should be accounted for in the distribution of auction proceeds or from the liquidation of other assets in the subsequent receivership.

21 When this application was argued, BDC sought and was granted an order placing Respec in bankruptcy which gives it a strategic advantage in relation to a claim by Canada Revenue Agency in relation to unpaid Goods and Services Tax ("GST").

Issues

1. Should the proposed distribution of auction proceeds be approved?

a. should GE be required to pay a further \$215,688.46 on account of its share of the allocated costs?

- b. does fairness require the two banks to bear more than their *pro rata* share of the allocated costs?
- c. should the costs allocated to Wells Fargo be reduced rather than, as proposed, attributing the direct costs of disassembling the camps upon which it held security to its share of the auction proceeds given the costs of transporting all the equipment to the Ritchie Bros. auction are attributed on a *pro rata* basis among creditors?
- d. should JPL, a "true lessor" of equipment, thus be exempted from contributing to the allocated costs?

- 2. Should the Monitor's administration charge be increased to \$240,000?
- 3. Should the funds payable to Respec's principals as wages be "held back" from the distribution of the auction proceeds or taken from proceeds realized in the receivership? and,
- 4. Should Respec be placed into bankruptcy?

Analysis

1. Should the proposed distribution of auction proceeds be approved?

22 Each application to apportion costs incurred in a failed attempt to reorganize under the CCAA must be decided on its own facts. In cases where a pre-existing Court order prescribes the apportionment method to be used, that method will be used. Where, as here, no such order yet exists, the issue will be decided based on the facts in the case. I note that I have no obligation to attempt to allocate those costs on the basis of a cost-benefit analysis as to which creditor benefited to what degree as a result of the activities of the Monitor; see *Hunjan International Inc., Re*, 2006 CarswellOnt 2718 (Ont. S.C.J.). No such analysis has been undertaken in any case either by counsel or by myself. However, it is fundamental that any allocation of Court-ordered charges be fair and equitable; see *Winnipeg Motor Express Inc., Re*, 2009 MBQB 204 (Man. Q.B.) at para. 41.

23 Hall J. set out the following principles for apportioning costs in *Hickman Equipment (1985) Ltd., Re*, 2004 NLSCTD 164 (N.L. T.D.) at para. 17:

- (1) the allocation of costs ought to be fair and evenhanded amongst all creditors upon an objective basis of allocation;
- (2) the fairest basis of allocation would be a uniform percentage of the sale price received for the asset over which the paying creditor had a realizable security interest;
- (3) there must be a recognition that the Cost Allocation Plan acknowledges that costs are not limited to the cost of realization alone but relate to all receivership costs whether direct sales cost or indirect cost;
- (4) exceptions to a uniform application of cost to creditors ought not to be lightly granted. Nonetheless it must be recognized that certain activities of the Receiver in managing the affairs of the receivership may have been less intensive or less advantageous with respect to certain groups of assets as opposed to other groups of assets and that the extent of this intensity or disadvantage may not be immediately or easily determinable.

To require the Receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-à-vis another would likely not be cost effective, would drive up the overall receivership cost and would likely be a fool's errand in any event;

- (5) exceptions to the rule of uniform cost allocation should only be made where the requirement for such variation is reasonably articulable.

24 Allocating costs on a uniform percentage of the sale price received for the asset in question has been interpreted and applied to mean allocating the costs on the basis of a *pro rata* share using the total recovery as a factor in the calculation; see *Winnipeg Motor Express Inc. (Re)*, *supra*, at paras. 46 and 47. That is the approach the Monitor proposes be used here.

25 While none of the creditors challenging the Monitor's proposed cost allocation has described an alternate method of apportionment which they believe to be more equitable, the following challenges have been raised:

a. Should GE Be Required to Pay a Further \$215,688.46 on Account of Its Share of DIP and the Administrative Charge?

i. Does the Proposed Allocation and Distribution Fail to Attribute a Proper Portion of the Allocated Costs to the Two General Secured Lenders, CWB and BDC?

26 In addition to seeking approval for apportionment of the allocated costs to the PMSI creditors, the Monitor has apportioned part of those costs to each of the two banks based on estimated liquidation values for the assets subject to their charges. GE originally challenged the Monitor's proposed distribution under the mistaken impression that all allocated costs were proposed to be borne by the PMSI creditors. This point has now been clarified.

27 GE did not press the issue of the proposed apportionment to be borne by the two banks being based on estimated values rather than realized values perhaps because its own share of the allocated costs, however calculated, must also be based on estimated values as the equipment it removed from the auction has yet to be sold by it.

28 GE also challenged the distribution on the basis that it was impossible to calculate the proper *pro rata* share of the allocated costs to be borne by the two banks because the total amount of Respec's indebtedness to them was not known. CWB was quick to advise that it is owed \$1,872,000 plus interest to be calculated at prime rate plus 1% from May 21, 2009 to the date of payment. Similarly, BDC advised it was owed \$3,430,000 as of March 22, 2010. The Monitor's calculation of their proposed share of allocated costs is based on these figures.

ii. Method of Determination of Pro Rata Share - the Debt Owed to Any PMSI Creditor as Against Respec's Total Indebtedness Versus the Net Sale Proceeds Recovered on the Sale of a Given Piece of Equipment as Against the Total Amount Owed on That Equipment;

29 The Monitor's calculation of each creditor's *pro rata* share of the allocated costs is based on a comparison of the sale proceeds recovered on the sale of each asset or the estimated value of that asset as against the total amount owed by Respec on that asset. GE argued that its share should be calculated based on a comparison of the debt owed to it against the total debt owed by Respec to all its creditors. While each application for apportionment must be considered in the context of its own facts, no case law was produced in which any court has attributed costs on this basis.

30 BDC vigorously opposed this proposal which would have the effect of offloading most of the allocated costs onto it, reducing its recovery accordingly. That is because it and CWB are together owed much more than the PMSI lenders. However, the two banks will recover little, if anything, from the auction proceeds as they are in a position to recover only any surplus earned after applying the sale proceeds produced from the auction of a given piece of equipment from the debt owed to the PMSI lender holding security on it.

31 In other words, if the allocated costs were to be calculated as suggested by GE they would be borne in large measure by the two banks, and ultimately therefore by BDC which will not receive much, if any, benefit from the Monitor's actions in organizing the auction which produced the sale proceeds which are now to be distributed virtually in their entirety to the PMSI creditors.

32 This is not a situation where BDC or the Monitor must prove that GE and the other PMSI creditors would be unjustly enriched at the cost of BDC before I can take this consideration into account. The laws of unjust enrichment do require that certain prerequisites be met which may or may not have been established on the evidence in this application. However, what is important, and is not disputed is that the approach advocated by GE would result in the creditor who will receive the least from the auction proceeds bearing the greatest portion of them, contrary to the principles in *Hunters Trailer & Marine Ltd., Re*, 2001 ABQB 1094 (Alta. Q.B.) at para. 20 where Chief Justice Wachowich concluded that in allocating costs it is unfair to ignore the differences in the type of security held by various creditors and the degree of potential benefit that each creditor may derive from the proceedings.

33 I therefore reject GE's proposal that the allocated costs be allocated among creditors based on proportion of debt owed to each creditor to total debt owed by Respec.

iii. should GE's pro rata share of allocated expenses be calculated on the basis that its secured assets have a value of \$990,000 or \$1.4 million?

34 In the supplement to the Monitor's 15th report dated March 18, 2010 the Monitor provided evidence that the guaranteed minimum price offered by Ritchie Bros. for the equipment GE removed from the auction was \$1,398,200. There was also some additional equipment removed which was not included in the guarantee which the Monitor values at \$100,000.

35 There is no evidence as to why GE elected to remove the equipment against which it held PMSI security from the auction. GE's counsel advised the Court that it removed the equipment for business reasons, based on a policy that required GE to be responsible for liquidating its own security. That equipment has not yet been liquidated.

36 On October 27, 2009 GE advised the Monitor's staff that it had received an evaluation of \$1.4 million on that equipment from Century Services Inc. However, in support of this application it filed evidence that it had received only an appraisal of \$990,000 "on an orderly liquidation" basis dated November 25, 2009 from that firm. The date of that \$990,000 evaluation is the same as the date upon which Ritchie Bros. made its offer of the \$1.4 million guarantee.

37 GE asks that the \$990,000 value be used to calculate its proportionate share of the allocated costs rather than the \$1.4 million figure used by the Monitor. The Monitor argues that the other creditors should not be penalized as a result of a poor decision made by GE which could have received a minimum of \$1.4 million for its equipment had it been left in the auction. Further, it has not provided evidence to support its earlier advice that it had a higher appraised value for it at the time the decision was made to withdraw it.

38 In furtherance of the principle that costs should be allocated in a fair and equitable manner, it is fair and equitable that one creditor not be permitted to avoid the consequences of a poor business decision by foisting them in part on other creditors. GE should bear the consequences of its decision to walk away from a guaranteed price almost 50% higher than the most recent appraised value for this equipment. GE's share of the allocated costs should be calculated based on those assets being valued at \$1.5 million, being the total of the Ritchie Bros. guaranteed price plus the estimated value of the additional equipment at \$100,000.

iv. Should GE Be Exempt from Contributing to the DIP Financing Costs Because of Its Relationship to the DIP Lender?

39 GE's counsel argued that had GE known it would have had to bear a portion of the DIP financing costs it would not have permitted its related company to advance the DIP financing. There is no evidence which supports this allegation.

40 GE argues that it took a risk in advancing the DIP loan and urges the Court to exercise its discretion to excuse it from responsibility for its *pro rata* share of that obligation on the basis it would be equitable given that only it, and no other creditor, was prepared to advance these operating funds to the debtor company as it attempted to restructure. I recall, however, that another lender was available and willing to advance DIP financing and that I approved the GE source on the basis that it would charge a lower cost for lending than that lender.

41 GE argues that by advancing the DIP financing it assumed a risk attendant with the potential benefit which might ensue had the restructuring of Respec been successful. Had that restructuring been successful presumably all creditors would have secured a benefit beyond that which they will recover through the liquidation of Respec's assets. GE should therefore be compensated for taking that risk on behalf of all creditors in the form of its not being required to bear its share of the DIP financing costs.

42 GE was repaid the entire DIP loan of \$1.138 million within four months of it being borrowed plus an administration fee of \$300,000 plus interest which was charged at 9.72% per annum over the bank's acceptance rate. CWB argued that this had the effect of according a return to the DIP lender equivalent to 100% per annum, an arguably criminal rate of interest. If

it were to be successful in avoiding payment of its *pro rata* contribution to the DIP costs, its rate of recovery would jump, in effect, to almost 200% per annum.

43 Further, had GE truly anticipated it would not have to bear any portion of these costs it could easily have included that provision in the loan agreement through which it advanced the DIP funding.

44 This situation differs from that addressed by Justice Campbell in *Hunjan International Inc. (Re)*, *supra*, in which he found at para. 52 that the DIP lender would not likely have agreed to loan the DIP financing had it believed that in the event of a collapse of the corporate reorganization and ultimate deficiency it would not have a priority claim for the entire amount of the DIP advanced. I make no such finding here. Rather, the advancing of the DIP financing in this case provided a handsome rate of return in and of itself to the lender and the DIP has been repaid in full, with no issue of deficiency arising.

45 I cannot see that it would be equitable to exempt GE from its obligations to contribute to the overall DIP costs given the rate of return on its investment and the fact it was in a position to make an assessment of business risk at the time it made that loan and no doubt did so.

v. Do the Provisions in the First Day Order Exempt GE from Any Obligation to Contribute to the DIP Financing Costs?

46 GE argued that paras. 27, 29 and 35 of the First Day Order should be interpreted to mean that it is not obliged to now contribute to the DIP financing costs. The order contains no express provision to that effect.

47 Paragraph 27 provides that the Monitor and its counsel will be paid their reasonable fees and disbursements. Paragraph 29 provides that as security for same the Monitor is granted a charge on Respec's property in the maximum amount of \$200,000. Paragraph 35 provides that any interested person may apply on notice for an order to allocate this charge amongst various of Respec's assets.

48 GE did not offer an interpretation of any of these three paragraphs which leads to the conclusion that it should not be obliged to pay its share of that portion of the allocated costs which are made up of the DIP financing allocated costs. I cannot see any interpretation which supports that position.

vi. Declaration and Judgment

49 There is no suggestion that GE has an arguable defence to liability for the \$215,688.46. I therefore declare that GE is obligated to pay to the Monitor the sum of \$215,688.46 on account of its *pro rata* share of the allocated costs in the amount of \$215,688.46.

50 GE argues that I am precluded from granting judgment against it for this sum because the Monitor/Receiver should have deducted it from the funds used to repay the DIP. However, timely repayment of the DIP in full avoided ongoing interest costs. In the absence of any express agreement relieving GE from its obligation to share in the DIP costs I conclude that to the extent there was, in effect, an overpayment to GE in an amount of GE's share of the DIP costs, those overpaid funds remain subject to the repayment of those costs.

51 GE also argues that I cannot grant the Monitor judgment in this or any sum against it in the absence of express provisions in the CCAA or other legislation granting that jurisdiction. It argues that the Monitor is obliged to now issue a Statement of Claim against it claiming judgment based on my declaration of liability. If a defence is filed it must then apply for summary judgment or conduct a trial, all pursuant to the provisions of the Alberta Rules of Court.

52 The Monitor urges me to find jurisdiction to grant a direct judgment based on my wide and broad discretion to deal with various matters that are not expressly addressed in the CCAA; see *Skeena Cellulose Inc., Re*, 2003 CarswellBC 1399 (B.C. C.A.).

53 It also argues that the ability to grant a judgment flows from the provisions of my October 8 and 20, 2009 orders in which I:

(a) directed a sale of the equipment of Respec under the supervision of the Monitor;

(b) directed that the PMSI creditors could either let the equipment on which they had security be sold in that auction or remove it from the sale;

(c) ordered that where equipment was removed the creditor removing it must post a deposit with the Monitor as against any eventual finding that it was liable for the payment of a portion of the allocated costs; and

(d) directed that such a deposit was to be paid to legal counsel for the Monitor to be held in trust until further Court order which could be made after taking into account the portion of the allocated costs for which each such creditor was found to be liable.

54 Of course, the fact this order was granted cannot confer any jurisdiction to grant it which does not otherwise exist but these provisions evidence that there was a plan in place to liquidate certain assets and account for the costs incurred to that point. I find that the creation and implementation of such a plan was within my jurisdiction as a part of the overall scheme of the CCAA. A Court in a CCAA proceeding has the ability to deal with assets, debt and costs incurred in that proceeding. I conclude this includes the right to grant judgment against a party which it determines liable to contribute to those costs.

55 I therefore grant the Monitor judgment against it in that amount.

56 If the \$30,000 deposit was not accounted for in the determination of that figure it should now be applied to reduce the judgment accordingly.

b. Does Fairness Require the Two Banks to Bear More Than Their Pro Rata Share of the Allocated Costs?

57 While the majority of the PMSI creditors support the Monitor's proposed allocation of costs, certain of the PMSI creditors, Cat, Kingland Ford and Komatsu, argues that the principles in *Hunters Trailer & Marine Ltd. (Re)*, *supra*, require the two banks to bear more than their *pro rata* share of the allocated costs.

58 First, these PMSI creditors suggest that a cost allocation which requires the PMSI creditors to pay a *pro rata* portion of the Monitor's costs means that CWB will not make any contribution to those costs. The proposed allocation does impose a *pro rata* contribution on CWB based on the estimated value of the assets upon which it holds security. However, it will ultimately be indemnified for that contribution because its security gives it a first charge for such recovery. In the result, BDC will bear the ultimate cost of that indemnity by way of an accordingly reduced recovery from those assets upon which it holds a second-in-line security position after CWB. Therefore the fact CWB is indemnified in full and the PMSI creditors are not is that CWB had enough security to protect it for its entire exposure whereas the PMSI creditors did not.

59 Second, these PMSI creditors argue that the costs incurred by the Monitor to the date of the termination of the stay should be paid for through the collection of the receivables generated by Respec during that period or by application of the \$275,000 in cash in Respec's bank account on the day the stay was terminated. The value of the receivables on the day the stay was granted was not significantly different than their value on the day the stay was terminated. Of course the identity of the individual receivables changed during the stay as old ones were paid and new ones created.

60 Both the receivables and cash on deposit are subject to the first ranking security interest of CWB and the second ranking security interest of BDC. The Monitor allocated \$30,982.58 of the funds in the bank account to be applied to the DIP loan as CWB's proportionate share of that aspect of the allocated costs. These PMSI creditors argue the entire amount of \$275,000 should have been applied to the DIP costs as well as \$513,559.27 of the receivables.

61 The main thrust of this argument is that the receivables and cash were generated during the stay using equipment for which these PMSI creditors were not paid. They were thus prejudiced through the resulting depreciation of their equipment although no evidence was lead to this effect.

62 The result of this argument, if accepted, is that those receivables and the cash against which the two banks had first charge would be entirely used to fund costs incurred on behalf of the PMSI creditors as well as the two banks. In comparison, the proposed allocation would attribute costs in proportion to the recovery made by each creditor.

63 These PMSI creditors argue that they have suffered undue prejudice but in the absence of evidence to show the equipment upon which they held security depreciated more than the assets upon which the two banks held security through the position of the stay, I cannot reach that conclusion.

64 Third, these PMSI creditors argue that it is inequitable for their recovery to be based on the actual sale proceeds of their secured equipment because in May 2009 the Monitor obtained estimates of higher values for that equipment than were received at auction. That assertion is largely factually incorrect.

65 The earlier estimates were obtained prior to moving and placing the equipment for auction. They were contained in a valuation estimate, not an appraisal, obtained at the direction of the Court. Those figures did not reflect the costs of sale which were, naturally, unknown at that time. When comparing the gross auction sale proceeds against the estimated values the Monitor has calculated that those gross sale proceeds were 14.92% higher than the estimate for the Cat secured goods, 18.06% higher than the estimate for the Kingland Ford secured goods and 9.04% less than the estimate for the Komatsu secured goods.

66 Therefore, fairness does not compel an order that the two banks bear more than their *pro rata* share of the allocated costs.

c. should the costs allocated to Wells Fargo be reduced rather than, as proposed, attributing the direct costs of disassembling the camps upon which it held security to its share of the auction proceeds given the costs of transporting all the equipment to the Ritchie Bros. auction are attributed on a pro rata basis among creditors?

67 While the Monitor requested a detailed cost breakdown from the party transporting the equipment to be auctioned to the Ritchie Bros. site in Grande Prairie, such a breakdown was not received. It is not possible, therefore, for it to account for transportation costs as part of the direct costs attributed to each item sold. Rather, the Monitor has apportioned them as part of the indirect costs which make up a portion of the allocated costs. Therefore, each PMSI creditor, including Wells Fargo, will not have the gross sale proceeds received in relation to each piece of equipment reduced by the actual cost of transporting that item to auction but by another amount, a *pro rata* share of all transportation costs.

68 Other costs, which were accounted for in relation to individual pieces of equipment, i.e. direct costs of sale, were offset against the sale proceeds from that piece of equipment. That includes the cost of disassembling various camp equipment subject to a PMSI charge held by Wells Fargo.

69 Wells Fargo complains that this approach requires it to bear the entire actual costs of disassembling these assets but allocates transportation costs on a *pro rata* basis. Somewhat ironically, that includes the costs of transportation to market that Wells Fargo bears in relation to other equipment upon which it had PMSI security. Of course it cannot be determined whether any PMSI creditor, including Wells Fargo, will bear a greater or lesser cost as a result of this *pro rata* attribution than it would had actual costs been recorded as against each item transported.

70 Wells Fargo submits that it has not been treated fairly as a result of having to bear the actual costs of dismantling the camps while other creditors (including itself in relation to other assets) bear only *pro rata* costs of transportation. It asks that those other creditors each be required to bear a *pro rata* share of the disassembly costs as well or that its obligation to contribute to the DIP costs be reduced to account for its proportionately higher costs in the realization of its security. It argues that under the principles outlined in *Hunters Trailer & Marine Ltd. (Re)*, *supra*. I should exercise my discretion to modify the proposed distribution to achieve one of these two possible results on the basis this is necessary to effect equity in relation to the apportionment of costs among creditors.

71 Any finding of inequity would have to be based on a finding that Wells Fargo bore a disproportionately higher portion of the costs than did other creditors. However, the Monitor proposes that each PMSI creditor bear any actual costs related to the

sale of the equipment it charged. The reason Wells Fargo is the only creditor charged camp dismantling costs is because it is the only creditor which had a charge on any of the camp assets which were disassembled.

72 I cannot therefore discern any inequity which requires Wells Fargo to bear the direct costs relating to its charged assets simply because one of those costs is of a type unique to a certain kind of asset. The same approach is followed in relation to all other kinds of asset where the PMSI creditor is asked to bear the direct costs incurred in placing that asset for sale. To find otherwise would be to violate the *Hunters Trailer & Marine Ltd. (Re)* principles and accord Wells Fargo a disproportionate benefit.

d. Should JPL, a "True Lessor" of Equipment, Thus Be Exempted from Contributing to the Allocated Costs?

73 JPL was the lessor of five pieces of equipment leased to Respec. Upon paying the Monitor a deposit of \$20,900 it removed that equipment from the Ritchie Bros. auction. It now seeks recovery of that deposit on the basis that its leases were true leases, it was not therefore a secured creditor of Respec and that it received no benefit from the efforts of the Monitor or the DIP financing other than lease payments which it was entitled to receive pursuant to the provisions of s. 11.01(a) of the CCAA. If successful it will bear no portion of the allocated costs.

74 The Monitor acknowledges that these five leases were true leases in the sense that the parties always intended the leased equipment would be returned to JPL at the end of the lease term. In other words, the leases were not disguised forms of purchase financing.

75 After the granting of the First Day Order, Respec retained and continued to use the leased equipment, paying the monthly lease costs for the May 1, 2009 through October 31, 2009 period in the total sum of \$20,712.36. During that period Respec maintained insurance coverage for these vehicles as well as performing any required maintenance or repairs, as required by the terms of the leases. The Monitor, in its proposed distribution of allocated costs, has attributed \$20,900 to JPL.

76 Section 11 and 11.02 give the Court jurisdiction to order a stay of all proceedings against the debtor company such as was granted here in the May 8, 2009 First Day Order.

77 This stay is subject to the operation of s. 11.01 of the CCAA which provides:

No order made under section 11 or 11.02 has the effect of

(a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made;

78 While it did receive lease payments during the period of the stay, including the benefits of insurance and vehicle maintenance, JPL argues that those payments were made because Respec was obligated to make them pursuant to s. 11.01(a) of the CCAA. It otherwise, arguably, received no benefit from the efforts to reorganize Respec and thus should not be obliged to contribute to the allocated costs.

79 The Monitor responds that had the reorganization been successful JPL would have secured the benefit of an uninterrupted stream of lease payments. It is in essentially the same position as other creditors in that had the reorganization been successful it would have benefitted. The fact that its lease payments were required and not caught by the stay is arguably no reason to exempt JPL from contributing its fair share of the allocated costs.

80 While I required JPL to post a deposit with the Monitor as a condition of the recovery of its leased equipment, my order did not have the effect of determining ultimate responsibility for any portion of the allocated funds. The deposit was simply a deposit, to be applied in the event that JPL was ultimately found liable for a contribution to same.

81 In *Western Express Air Lines Inc., Re*, [2005] B.C.J. No. 72 (B.C. S.C.), Chief Justice Brenner held that an equipment lessor under a "true lease" was not required to contribute to CCAA costs. While the PPSA in British Columbia allowed registration of such leases, the Chief Justice held that mere registration did not make the lessors secured creditors. Registration existed merely

to allow the legislation's provisions in relation to conflicts, perfection and priority to apply with respect to the leased goods. Unlike the situation where a lease is a vehicle used to finance the purchase of goods, registration of a "true lease" does not permit a secured creditor who took a security interest in leased goods to declare a priority over the lessor. As such, the Chief Justice held that the lessors did not become secured creditors of the debtor which was subject to the CCAA reorganization attempt.

82 He stated at paras. 20-21:

20. If costs are to be allocated on the basis of the benefit to be derived from a successful restructuring, then the lessors should arguably pay nothing. ...They continue to own the aircraft. That will not change whether the restructuring succeeds or fails.

21. Post filing they have continued to receive payments for aircraft leases that Westex has chosen not to disclaim. However under the First Day Order they were obligated to continue leasing these aircraft to Westex. They were prevented from relying on the outstanding unpaid pre-filing lease payments and repossessing the aircraft.

83 He went on to conclude that under the general equitable principles of the CCAA there was no basis for requiring the aircraft lessors to bear a part of the restructuring costs.

84 As stated, in *Hunters Trailer & Marine Ltd. (Re)*, Chief Justice Wachowich held only that it was equitable for each major secured creditor to be liable for a portion of the CCAA costs.

85 The Monitor urges me to extend this principle to lessors notwithstanding that they are not secured creditors as was done in *Winnipeg Motor Express Inc. (Re)* at paras. 63-65 where Suche J. held that the true lessor of equipment there would nonetheless be required to bear a portion of the allocated costs. She distinguished *Western Express Air Lines Inc. (Re)* by observing that Chief Justice Brenner there concluded that the lessor received no benefit from the restructuring whereas she found the true lessor in the case before her to have received a real and meaningful benefit from the successful restructuring of the debtor company. The lease was assigned to the new purchaser "without interruption" which presumably means the lease payments continued to be made without interruption. She ordered the true lessor thus to contribute to the allocated costs without finding it to be a secured creditor and notwithstanding its status under s. 11.01(a) of the CCAA.

86 In comparison, in *Western Express Air Lines Inc. (Re)* the ongoing payment of lease costs was not found by Chief Justice Brenner to create a sufficient benefit to the lessor to require it, in equity, to contribute to the allocated costs even though at the time of the making of his judgment it was still possible for that restructuring to succeed.

87 As we now know that the Respec structuring did not succeed and JPL did not receive an uninterrupted flow of lease payments, JPL received less benefit from the unsuccessful efforts to restructure Respec than that which accrued to the lessors in *Western Express Air Lines Inc. (Re)*. Just as Chief Justice Brenner found no basis under the general equitable principles of the CCAA for requiring the lessors to contribute to the allocated costs, that must also be the result on this more egregious set of facts.

88 The Monitor is thus required to return the deposit of \$20,712.36 to JPL in its entirety. JPL has no obligation to contribute to the allocated costs.

2. Should the Monitor's administration charge be increased to \$240,000?

89 Paragraph 27 of the First Day Order provides that the Monitor and its counsel shall be paid their reasonable fees and disbursements. Paragraph 29 provides that as security for same the Monitor is granted a charge on Respec's property in the maximum amount of \$200,000.

90 I find that the Monitor has provided evidence establishing that it has incurred fees to this point of \$196,189.52. Notwithstanding the appointment of the Receiver on November 30, 2009, the Monitor has continued to function to bring to a conclusion those matters arising during the stay. That includes making this application to address distribution of the proceeds of the auction pursuant to an order I granted on December 9, 2009. The Monitor advises that it expects to incur a further \$35,000

in professional fees to conclude its obligations, over and above any fees incurred in the operation of the receivership. It applies to increase the charge to a maximum of \$240,000 as a result.

91 Presumably it is making this application to permit it to, essentially, withhold \$35,000 of the auction proceeds which would otherwise be distributed as a result of my order because there is not likely to be any further funds coming into the hands of the Monitor which it could use to pay these future costs. An increase in the charge created by para. 29 of the First Day Order is not a prerequisite to its entitlement to be paid its actual further professional fees but rather would ensure the continuation of a pool of funds from which they may be paid.

92 GE opposes this application, seeking to have any additional professional fees paid as a cost in the receivership. I note this would result in BDC bearing those costs in their entirety given its position of second-in-line general secured creditor which has as its sole source of recovery of its debt the net funds generated in the receivership.

93 There is nothing in the First Day Order or any subsequent order which expressly limits any subsequent increase in the administration charge. Indeed, para. 42 of the First Day Order expressly permits any interested party "including ... the Monitor" to apply to the Court to vary or amend the order.

94 Refusing the Monitor's application could well have a chilling effect on future CCAA applications as insolvency professionals which might otherwise be willing to take on the role of Monitor could feel disinclined to so act, being unable perhaps to adequately predict their entire future costs and so leaving themselves exposed to the risk of being inadequately secured. Further, it would have the effect of offloading costs which benefitted all secured creditors onto the shoulders of only one of those creditors, BDC, which is not within the equitable principles of overall fair, reasonable cost allocation discussed in *Hunters Trailer & Marine Ltd. (Re)*; see also *Triton Tubular Components Corp., Re* [2006 CarswellOnt 2120 (Ont. S.C.J. [Commercial List])], Ontario Superior Court of Justice, Court File No. 04-CL-5672.

95 GE complains that the Monitor has not led evidence to show what further fees it will actually incur or to show that they are necessary or reasonable. However, that is not a reason to deny this application. The Monitor will have to bring on a future application approving any additional fees or disbursements it wishes to have paid out of the administration costs. At that time GE can challenge the payment if it believes the facts support doing so.

96 The application to increase the administration charge to \$240,000 is hereby granted.

3. Should the funds payable to Respec's principals as wages be "held back" from the distribution of the auction proceeds or taken from proceeds realized in the receivership?

97 The Monitor acknowledges that certain principals of and parties related to Respec are owed approximately \$22,000 for wages in respect to work done for the company while it was subject to the CCAA stay. It has agreed to pay those costs upon receipt of certain information which it requires to justify certain travel expenses charged to Respec and to prove that certain equipment removed from the auction site was not the property of Respec. That information has been promised but not yet been provided.

98 The Monitor seeks direction as to whether funds should be withheld from the distribution of auction proceeds to other creditors on account of these claims or whether the claims should be left to be paid from the further liquidation of assets, now by it in its capacity as Receiver of Respec. BDC objects to the latter proposal noting that it would result in BDC in effect paying that entire sum by way of reduced recovery from liquidation of its secured assets, the only remaining source of funds once CWB is paid in full.

99 As the debt was incurred prior to the granting of the receivership order and on account of work done while the Monitor was in place pursuant to the CCAA orders, I direct that the funds be withheld from that distribution and paid once the required information is provided.

4. Should Respec be placed into bankruptcy?

100 Alterinvest II Fund L.P., an entity related to BDC, applied to place Respec into bankruptcy, a move designed to give it priority over a claim by the Canada Revenue Agency for money owed by Respec on account of GST. In its application it stated that Respec is indebted to it in the sum of \$3,434,888 plus interest from March 11, 2010 at a rate of 12.5% per annum and legal costs. BDC holds security for the payment of that indebtedness but its counsel advised that as its security ranks behind the security held by CWB and the PMSI holders, it expects its security to have a maximum value of \$1 million at this time.

101 There is no issue that within the six months prior to the date of the filing of the application on March 16, 2010 Respec committed acts of bankruptcy including ceasing to meet its liabilities generally as they became due and by advising its creditors that it is insolvent thus giving rise to acts of bankruptcy which support the granting of this application.

102 Originally brought on March 19, 2010, the application was adjourned to March 25, 2010 so that BDC could give notice to CRA. That having occurred, with CRA not appearing or otherwise objecting to the making of this order and none of the other parties objecting to same, I thereupon adjudged Respec bankrupt and made a bankruptcy order in respect of its property.

Conclusion

103 The Monitor's application to approve its proposed apportionment of the allocated costs and the resulting distribution of sale proceeds to the creditors of Respec is approved as adjusted to reflect my decision that JPL is not required to contribute to those costs. The Monitor is directed to return the deposit of \$20,712.36 to JPL in its entirety. The Monitor is granted judgment against GE in the sum of \$215,688.46 or that amount less \$30,000 if the deposit has not been accounted for in its calculation.

104 The Monitor's charge for its professional fees and disbursements is increased from the \$200,000 figure set out in the First Day Order to \$240,000.

105 A \$22,000 debt owed to parties related to Respec shall be paid from funds realized while it was operating under the First Day Order rather than those realized in the subsequent receivership.

106 Respec has been adjudicated to be bankrupt.

Application granted.

Most Negative Treatment: Leave to appeal allowed

Most Recent Leave to appeal allowed: Chandos Construction Ltd. v. Deloitte Restructuring Inc. in its capacity as Trustee in Bankruptcy of Capital Steel Inc., a bankrupt | 2019 CarswellAlta 1422, 2019 CarswellAlta 1423 | (S.C.C., Jul 11, 2019)

2019 ABCA 32
Alberta Court of Appeal

Capital Steel Inc v. Chandos Construction Ltd

2019 CarswellAlta 125, 2019 ABCA 32, [2019] A.W.L.D. 1155, [2019]
A.W.L.D. 1170, 301 A.C.W.S. (3d) 64, 70 C.B.R. (6th) 1, 91 B.L.R. (5th) 1

**Deloitte Restructuring Inc. in its Capacity as Trustee in Bankruptcy of
Capital Steel Inc., a Bankrupt (Appellant / Plaintiff / Applicant) and
Chandos Construction Ltd. (Respondent / Defendant / Respondent)**

Patricia Rowbotham, Barbara Lea Veldhuis, Thomas W. Wakeling JJ.A.

Heard: November 28, 2017
Judgment: January 29, 2019
Docket: Edmonton Appeal 1703-0085-AC

Counsel: V.L. Merritt, for Appellant
D.R. Bieganek, Q.C., for Respondent

Subject: Contracts; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency

XX Miscellaneous

Contracts

VI Illegal contracts (substantive validity) -

VI.3 Contrary to public policy

VI.3.f Miscellaneous

Headnote

Contracts --- Illegal contracts (substantive validity) — Contrary to public policy — Miscellaneous

On condominium project, general contractor subcontracted steel-related work to subcontractor, who filed for assignment in bankruptcy prior to completion — Provision in subcontract provided that, in event subcontractor committed any act of insolvency or bankruptcy, it agreed to forfeit 10 per cent of agreement price to contractor as fee for inconvenience of completing and monitoring work — Contractor took position that it was entitled to offset amount it owed to subcontractor against 10 per cent of total contract price, which would effectively eliminate debt owing from contractor and give contractor \$10,511.66 claim provable in bankruptcy proceedings — Trustee in bankruptcy applied for advice and directions on whether contractor was entitled to rely on provision — Chambers judge concluded that contractor could enforce provision — Trustee appealed — Appeal allowed — Common law anti-deprivation rule prevented parties from agreeing to remove property from bankrupt's estate in event of insolvency that would otherwise have vested in trustee — Common law anti-deprivation rule formed part of common law in Canada and had not been ousted by amendments to Bankruptcy and Insolvency Act — Chambers judge erred by applying wrong test for determining whether provision offended anti-deprivation rule — Proper approach was to look at effect of clause and not its purpose — Contractual provision offended common law anti-deprivation rule and was declared invalid. Bankruptcy and insolvency --- Miscellaneous

On condominium project, general contractor subcontracted steel-related work to subcontractor, who filed for assignment in bankruptcy prior to completion — Provision in subcontract provided that, in event subcontractor committed any act of insolvency or bankruptcy, it agreed to forfeit 10 per cent of agreement price to contractor as fee for inconvenience of completing and monitoring work — Contractor took position that it was entitled to offset amount it owed to subcontractor against 10 per cent of total contract price, which would effectively eliminate debt owing from contractor and give contractor \$10,511.66 claim provable in bankruptcy proceedings — Trustee in bankruptcy applied for advice and directions on whether contractor was entitled to rely on provision — Chambers judge concluded that contractor could enforce provision — Trustee appealed — Appeal allowed — Common law anti-deprivation rule prevented parties from agreeing to remove property from bankrupt's estate in event of insolvency that would otherwise have vested in trustee — Common law anti-deprivation rule formed part of common law in Canada and had not been ousted by amendments to Bankruptcy and Insolvency Act — Chambers judge erred by applying wrong test for determining whether provision offended anti-deprivation rule — Proper approach was to look at effect of clause and not its purpose — Contractual provision offended common law anti-deprivation rule and was declared invalid.

The general contractor on a condominium project subcontracted steel-related work to the subcontractor. The subcontractor finished the majority of the required work, but it filed an assignment in bankruptcy prior to finishing and a trustee in bankruptcy (trustee) was appointed. A clause in the subcontract provided that, if the subcontractor committed any act of insolvency or bankruptcy, it agreed to forfeit 10 per cent of the subcontract agreement price as a fee for the inconvenience of completing and monitoring the work during the warranty period. The contractor took the position that it was entitled to offset \$126,818.39 it owed to the subcontractor against 10 per cent of the total contract price or, \$137,330.05, which would effectively eliminate the debt owing from the contractor and give the contractor a \$10,511.66 claim provable in the bankruptcy proceedings.

The trustee applied for advice and directions on whether the contractor was entitled to rely on the clause. The chambers judge recognized that the common law anti-deprivation rule prevented the parties from contracting out of bankruptcy laws, and that if the clause were a liquidated damages provision rather than a penalty it would not violate the rule. The chambers judge found that the clause was a genuine pre-estimate of damages, which imposed liquidated damages. The chambers judge found that the clause represented a bona fide commercial transaction and its primary purpose was not the deprivation of the subcontractor's property. The chambers judge concluded that the contractor could enforce the provision. The trustee appealed.

Held: The appeal was allowed.

Per Rowbotham J.A. (Veldhuis J.A. concurring): The "fraud on the bankruptcy law" principle provided that parties could not arrange their affairs through contract in a way that conflicted with the operation of bankruptcy laws. The fraud on the bankruptcy law principle had two sub-rules, the *pari passu* rule and the anti-deprivation rule. The *pari passu* rule invalidated contractual provisions that would alter the bankruptcy scheme of distribution if enforced during bankruptcy proceedings. Provisions that offended the *pari passu* rule did not affect the total assets available to the creditors, but allowed certain creditors to receive more than their fair share. The anti-deprivation rule prevented parties from agreeing to remove property from a bankrupt's estate in the event of insolvency that would otherwise have vested in the trustee. Provisions that offended the anti-deprivation rule reduced the total assets available to the creditors.

The Bankruptcy and Insolvency Act (BIA) includes provisions that invalidate certain types of contract clauses that take effect on the occurrence of a debtor's insolvency. None of the BIA provisions applies to corporate bankruptcies, and they did not apply in this case. The statutory provisions were intended to expand the common law to provide protection to debtors in situations where the anti-deprivation rule would not have protected them.

The distinctions between the statutory provisions and the common law anti-deprivation rule prohibited the inference that the statutory provisions occupied the field with respect to *ipso facto* clauses. The statutory provisions expanded the common law protecting debtors by prohibiting *ipso facto* clauses that would not be caught by the anti-deprivation rule. The anti-deprivation rule continued to apply to protect creditors by ensuring that the bankrupt's property was distributed according to the BIA's scheme of distribution.

The United Kingdom test that the anti-deprivation rule does not apply to bona fide commercial transactions that do not have as their predominant purpose the deprivation of the property of one of the parties on bankruptcy did not apply. That test looked at the purpose of the provision rather than its effect. The purpose-based test was inconsistent with Canadian cases that applied the anti-deprivation rule and would eliminate the usefulness of the rule. The Canadian cases adopted an effects-based approach to determining the validity of a contractual provision. The purpose of the anti-deprivation rule, to ensure that contracting parties could not opt out of the distribution of assets mandated by the BIA, was best served by invalidating the provisions that operated

in the event of insolvency and had the effect of prejudicing creditors. An effect-based approach would not inappropriately undermine the values of freedom of contract and party autonomy.

The chambers judge erred in adopting the purpose-based approach, as the proper approach was to look at the effect of the clause and not its purpose. The clause here effectively redirected \$126,818.39 to the contractor that would otherwise have formed part of the subcontractor's estate and gave the contractor a further claim for \$10,511.66. The contractor had a commercial interest it sought to protect, but it would conflict with the BIA's scheme of distribution if it could elevate itself to a preferred status through a contractual arrangement. The common law anti-deprivation rule invalidated the clause. It was not necessary to consider whether the clause imposed liquidated damages or a penalty.

Per Wakeling J.A. (dissenting): The classic penalty rule provided no principled basis for assessing the enforceability of stipulated-consequence-on-breach provisions in commercial contracts between parties with sufficient resources to protect their own interests. Only stipulated-consequence-on-breach terms that were oppressive were unenforceable. Oppression should be given a limited meaning as freedom of contract is of paramount importance, and it should only apply in extraordinary circumstances to a commercial contract. A term of a commercial contract is oppressive if it is so manifestly grossly one-sided that its enforcement would bring the administration of justice into disrepute. The parties had the resources necessary to retain legal counsel and secure competent advice and could protect their own interests. The clause was a stipulated-consequence-on-breach term and it was enforceable. It was not so manifestly grossly one-sided that its enforcement would bring the administration of justice into disrepute. The clause in issue was not a penalty provision; it was fair and balanced, and it served a justifiable business purpose. It was not unreasonable, extravagant or unconscionable. The clause may fairly be characterized as a liquidated damages term.

The fraud on the bankruptcy principle was neither now nor likely ever to be part of Canada's law. The BIA's amendments relating to ipso facto terms now constituted the code governing the enforceability of ipso facto clauses, and there was no room for any common law principles. Parliament occupied the field and corporate bankruptcy ipso facto terms were enforceable.

The common law should attach more weight to the value of party autonomy and freedom of contract than the collective interests of creditors favoured by the effects-based test given that bankruptcy is a statutory construct. Parliament had identified circumstances when collective interests trumped party autonomy and freedom of contract. A corporate bankruptcy ipso facto term is enforceable if its most important feature is the advancement of a reasonable and defensible commercial purpose and its enforcement provides a benefit for the non-bankrupt party that is not significantly greater than is necessary to promote the non-bankrupt party's legitimate commercial interest. The clause here met that new common law test. The only purpose of the clause was to declare the amount the contractor was entitled to if the subcontractor went out of business and the contractor had to fund other suppliers to provide the services and material the subcontractor promised to provide, and that was a reasonable and defensible commercial purpose. The benefit the contractor received from enforcing the ipso facto clause was not greater than was necessary to promote its legitimate commercial interests. The clause was not a blatant and egregious attempt to hijack the subcontractor's property and attack the interests of its creditors.

The clause was enforceable because the BIA did not prohibit corporate bankruptcy ipso facto terms. The clause was a corporate ipso facto term. If the BIA did not extinguish the common law on corporate bankruptcy ipso facto terms, the clause met the new party-autonomy-inspired common law test and was valid.

APPEAL by trustee in bankruptcy from judgment holding provision in construction contract under which bankrupt subcontractor agreed to forfeit sum of money on its insolvency was enforceable.

Patricia Rowbotham J.A.:

I. Introduction

I A construction contract between Capital Steel Inc. (Capital Steel) and Chandos Construction Ltd. (Chandos) contained a provision that imposed a monetary consequence on Capital Steel's insolvency. When Capital Steel filed an assignment in bankruptcy, Deloitte Restructuring Inc. (Deloitte) was appointed as the trustee in bankruptcy for Capital Steel's estate. A chambers judge allowed Chandos to rely on the provision with the result that there were less assets in Capital Steel's estate for distribution to creditors. At issue on appeal is whether the provision conflicts with the common law anti-deprivation rule, which prevents parties from contracting out of bankruptcy laws.

- 2 This case is not fundamentally one of contract law but of bankruptcy law. It is insolvency law that determines the outcome. The *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (*BIA*) provides the mechanism for the orderly liquidation of a bankrupt's estate and the distribution of the value of the estate in accordance with the statutory provisions, including the priorities established therein. Its purpose is to codify, for all debtors and creditors, what will transpire in the event of a bankruptcy. This certainty is critical to the operation of commercial entities throughout Canada.
- 3 One of the purposes of the *BIA* is to prevent a premature race to the debtor's assets. The Act is premised on collective action intended to maximize the return to all creditors *pari passu*. The Act specifically gives trustees the power to set aside preferences and other fraudulent transactions whose underlying objective is to circumvent the Act.
- 4 A trustee in bankruptcy has an obligation to take possession of all property of the bankrupt. Section 67(1) of the *BIA* defines property of the bankrupt that is divisible among the creditors. Accounts receivable clearly fall within that definition. In addition, a right of set off that existed at the date of bankruptcy (not as a result of the bankruptcy) is not affected.
- 5 A contractual provision triggered only in the event of insolvency or bankruptcy which would deprive creditors of value otherwise available to them and effectively directs the value to an unsecured creditor is void: *Aircell Communications Inc. (Trustee of) v. Bell Mobility Cellular Inc.*, 2013 ONCA 95 (Ont. C.A.) at paras 10-12, (2013), 14 C.B.R. (6th) 276 (Ont. C.A.).
- 6 The contractual provision at issue in this appeal is such a provision and offends the common law anti-deprivation rule. The rule forms part of the common law of Canada and has not been ousted by amendments to the *BIA*. The chambers judge acknowledged the rule but, in my view, applied the wrong test for determining whether the provision offended the anti-deprivation rule. I allow the appeal.

II. Facts

- 7 Chandos was hired as the general contractor for a condominium project in St. Albert, Alberta. It subcontracted steel-related work on the project to Capital Steel for a price of \$1,373,300.47. Capital Steel completed the majority of the work required under the subcontract, and Chandos made payments to Capital Steel totalling \$1,223,682.08. This left an outstanding balance of \$149,618.39.
- 8 On September 26, 2016, Capital Steel filed an assignment in bankruptcy. Deloitte was appointed as the trustee. Capital Steel had not completed everything required under the subcontract prior to filing the assignment, causing Chandos to incur costs estimated at \$22,800.00 to complete Capital Steel's work on the project.
- 9 Offsetting the \$22,800.00 in completion costs against the outstanding balance of \$149,618.39, Chandos owed a total of \$126,818.39 to Capital Steel. Chandos took the position that it was entitled to further offset this amount against 10 percent of the total contract price, or \$137,330.05, which it alleged Capital Steel had agreed to forfeit in the event of insolvency. This would effectively eliminate the debt owing from Chandos to Capital Steel and give Chandos a \$10,511.66 claim provable in the bankruptcy proceedings. Clause VII Q of the subcontract reads, in part:

In the event the Subcontractor commits any act of insolvency, bankruptcy, winding up or other distribution of assets, or permits a receiver of the Subcontractor's business to be appointed, or ceases to carry on business or closes down its operations, then in any such events:

...

(d) the Subcontractor shall forfeit 10 [percent] of the within Subcontract Agreement price to the Contractor as a fee for the inconvenience of completing the work using alternate means and/or for monitoring the work during the warranty period.

- 10 On March 6, 2017, Deloitte applied to the Court of Queen's Bench seeking advice and directions on whether Chandos was entitled to rely on clause VII Q(d).

III. Decision Below

11 Before the chambers judge, Deloitte argued that clause VII Q(d) had the effect of withdrawing value from Capital Steel's estate that would otherwise flow to creditors. As the clause was triggered by Capital Steel's insolvency, Deloitte argued that it violated the common law anti-deprivation rule. It also argued that clause VII Q(d) was an unenforceable penalty, rather than a liquidated damages provision.

12 The chambers judge recognized that the common law anti-deprivation rule prevents parties from contracting out of bankruptcy laws. He stated that if clause VII Q(d) were a liquidated damages provision rather than a penalty, it would not violate the rule.

13 The chambers judge ultimately found that the clause was a genuine pre-estimate of damages, which imposed liquidated damages and not a penalty. He also held that clause VII Q(d) represented a *bona fide* commercial transaction that did not have as its predominant purpose the deprivation of Capital Steel's property. Consequently, the chambers judge concluded that Chandos could enforce clause VII Q(d) against Deloitte.

IV. Grounds of Appeal and Standard of Review

14 Deloitte's appeal raises two issues:

1. Does clause VII Q(d) violate the common law anti-deprivation rule?
2. Does clause VII Q(d) impose liquidated damages or a penalty?

15 The content of the common law anti-deprivation rule and the proper test for invalidating penalty provisions are pure questions of law reviewable for correctness: *Housen v. Nikolaisen*, 2002 SCC 33 (S.C.C.) at para 8, [2002] 2 S.C.R. 235 (S.C.C.). Absent an extricable legal error, the chambers judge's application of the proper tests is reviewable on a standard of palpable and overriding error: *Housen* at para 36.

V. Analysis

16 The common law anti-deprivation rule and the rule against penalties are two distinct concepts that must be assessed separately. Clause VII Q(d) may be found unenforceable under either of the two rules. I conclude that clause VII Q(d) conflicts with the anti-deprivation rule, and it is therefore unnecessary for me to consider whether clause VII Q(d) imposes liquidated damages or a penalty.

A. The Common Law Anti-Deprivation Rule

17 The anti-deprivation rule forms a part of what is referred to as the "fraud on the bankruptcy law" principle. The essence of the fraud on the bankruptcy principle is that parties cannot arrange their affairs through contract in a way that conflicts with the operation of bankruptcy laws: Roderick J Wood, "Direct Payment Clauses and the Fraud Upon the Bankruptcy Law Principle: Re Horizon Earthworks Ltd. (Bankrupt)" (2014) 52:1 Alta LR 171 [Wood, "Fraud Upon the Bankruptcy"]; Anthony Duggan et al, *Canadian Bankruptcy and Insolvency Law*, 3rd ed (Toronto: Emond, 2015) at 297.

18 The chambers judge commented that there was some debate about whether the anti-deprivation rule applied in Canada and the extent of its application. He ultimately concluded that it was clear that there was a common law rule, based on public policy, that prevented parties from contracting out of bankruptcy law and that given the rule, he would determine whether clause VII Q(d) was an attempt to contract out of bankruptcy law. Deloitte submits that Canadian jurisprudence recognizes the common law anti-deprivation rule. Chandos does not deny the existence of the rule, but contends it has not enjoyed significant application in Canada. My colleague, Wakeling JA, goes further and concludes that the common law anti-deprivation rule is not part of Canadian law. I disagree with his conclusion.

19 The fraud on the bankruptcy law principle traces its origins from England; by the 19th century, the principle's adoption was certain enough to warrant commentary that "the law is too clearly settled to admit of a shadow of doubt" about its application: *Whitmore v. Mason* (1861), 70 E.R. 1031 (Eng. K.B.) at 1034, (1861), 2 John. & H. 204 (Eng. K.B.).

20 The fraud on the bankruptcy law principle can be divided into two distinct sub-rules: Roderick J Wood, *Bankruptcy and Insolvency Law*, 2nd ed (Toronto: Irwin, 2015) at 88 [Wood, "Bankruptcy and Insolvency"]. The first is the *pari passu* rule. This rule invalidates contractual provisions that, if enforced during bankruptcy proceedings, would alter the bankruptcy scheme of distribution. Provisions that offend the *pari passu* rule do not affect the size of the total pot of assets available to creditors but allow certain creditors to receive more than their fair share: Duggan et al at 444; Wood, "Fraud Upon the Bankruptcy" at 177. Under the *pari passu* rule, it is irrelevant whether the contractual provision is triggered by insolvency; arrangements that would have been enforceable against the debtor outside of bankruptcy proceedings, but would alter the scheme of distribution after proceedings begin, are unenforceable against the trustee: Wood, "Fraud Upon the Bankruptcy" at 177.

21 The second rule of the fraud on the bankruptcy law principle is the anti-deprivation rule. The anti-deprivation rule prevents parties from agreeing to remove property from a bankrupt's estate in the event of insolvency that would have otherwise vested in the trustee: Duggan et al at 297; Wood, "Fraud Upon the Bankruptcy" at 176. Provisions that offend the anti-deprivation rule reduce the total pot of assets available to the bankrupt's creditors. As stated in *Whitmore* at 1034:

[N]o person possessed of property can reserve that property to himself until he shall become bankrupt, and then provide that, in the event of his becoming bankrupt, it shall pass to another and not to his creditors.

22 In my view, the fraud on the bankruptcy law principle, including the anti-deprivation rule, has a clear jurisprudential and policy basis that supports its application. The anti-deprivation rule was adopted from England and continues to apply in Canada.

23 There is no doubt that the *pari passu* rule applies in Canada. In *A.N. Bail Co. v. Gingras*, [1982] 2 S.C.R. 475, 54 N.R. 280 (S.C.C.), the Supreme Court dealt with a direct payment clause in a construction contract. The clause allowed the property owner to pay any amounts owing to the general contractor directly to subcontractors to satisfy the general contractor's obligations. When the general contractor entered bankruptcy, the trustee argued that this provision was no longer effective. While the provision would not reduce the total amount available to creditors, the subcontractors receiving a direct payment would have received more than what they would have under the applicable legislative scheme. The Supreme Court stated at 487 that:

It would be to disregard the *Bankruptcy Act* and deprive it of all meaning if the debtor of a bankrupt, instead of paying the trustee, were authorized, by contract or some other means, to pay one or other of the creditors of the bankrupt as he saw fit.

24 Notably, the contractual arrangement in *Bail* would have been enforceable against the debtor outside of bankruptcy proceedings. And even though, as a general rule, the trustee in bankruptcy enjoys no greater rights than the debtor, it would have been inequitable to enforce the provision against the trustee to alter the legislated scheme of distribution.

25 This Court applied *Bail* to invalidate a similar provision in *Horizon Earthworks Ltd., Re*, 2013 ABCA 302, 556 A.R. 344 (Alta. C.A.) [hereinafter *Greenview*], as offending the *pari passu* rule.

26 Canadian courts have also adopted the anti-deprivation rule: *Hoskins, Re*, [1877] O.J. No. 16, 1 O.A.R. 379 (Ont. C.A.); *Wetmore, Re*, [1924] N.B.J. No. 6, [1924] 4 D.L.R. 66 (N.B. C.A.); *Westerman, Re*, 1998 ABQB 946, 234 A.R. 371 (Alta. Q.B.), rev'd on other grounds 1999 ABQB 708, 275 A.R. 114 (Alta. Q.B.); *Knechtel Furniture Ltd., Re*, [1985] O.J. No. 1265, 56 C.B.R. (N.S.) 258 (Ont. S.C.); *Daoust c. Cie de gestion Gar-Vin Inc.* (1982), 138 D.L.R. (3d) 61, 42 C.B.R. (N.S.) 50 (C.S. Que.). *Canadian Imperial Bank of Commerce v. Bramalea Inc.* (1995), 33 O.R. (3d) 692, [1995] O.J. No. 4884 (Ont. Gen. Div. [Commercial List]), is often cited as the leading authority. The provision at issue in *Bramalea* would have allowed one party to purchase their insolvent partner's partnership interest at the lesser of book value or fair market value. Blair J accepted the respondent's argument, at 694, that:

A provision in an agreement which provides that upon an insolvency, value is removed from the reach of the insolvent person's creditors to which would otherwise have been available to them, and places that value in the hands of others ... is void on the basis that it violates the public policy of equitable and fair distribution amongst unsecured creditors in insolvency situations.

27 The Ontario Court of Appeal recently adopted Blair J's formulation of the rule: *Aircell* at paras 10-12. The rule was again recently recognized by the Ontario Superior Court: *HGC v. IESO*, 2019 ONSC 259 (Ont. S.C.J.) at para 100.

28 A judge of this Court has also recognized the anti-deprivation rule. At issue in *1183882 Alberta Ltd. v. Valin Industrial Mill Installations Ltd.*, 2012 ABCA 62, 522 A.R. 285 (Alta. C.A.), leave to appeal to SCC refused, [2012] S.C.C.A. No. 180 (S.C.C.), was a contractual provision that conveyed an option that had the effect of depriving creditors of one of the debtor's assets. McDonald JA concluded that the provision offended the common law anti-deprivation rule and was therefore invalid. While McDonald JA was in dissent, the majority did not comment on the provision or the anti-deprivation rule.

29 There does not appear to be any decision that expressly rejects the anti-deprivation rule's application in Canada. Chandos argues, however, that the Supreme Court of Canada's decision in *Coopérants, Société mutuelle d'assurance-vie c. Raymond, Chabot, Fafard, Gagnon Inc.*, [1996] 1 S.C.R. 900, 133 D.L.R. (4th) 643 (S.C.C.) implicitly abandons the rule. This argument is premised on the basis that the reasoning in *Bramalea* relied, in part, on the Quebec Court of Appeal decision that was overturned by the Supreme Court of Canada in *Coopérants*. In my view, *Coopérants* does not reject the anti-deprivation rule's application in Canada. The outcome in *Coopérants* turned on the fact that there was no evidence the contractual provision at issue prejudiced creditors: Adrienne Ho, "The Treatment of Ipso Facto Clauses in Canada" (2015) 61:1 McGill LJ 139 at 169.

30 The provision at issue in *Coopérants* allowed the debtor's co-owners, in the event of the debtor's insolvency, to purchase the debtor's interest in certain immovable property at 75 percent of the property's fair market value. Though this type of provision could potentially prejudice creditors, the Supreme Court determined that no prejudicial effect was apparent in the circumstances. The property's fair market value was calculated without considering ownership restrictions that would affect the price obtained through liquidation: *Coopérants* at para 42. The evidentiary record also lacked information about the property's appraisal value, which prevented the Court from identifying any prejudice: *Coopérants* at para 44. The Supreme Court stated at para 40 that:

The assets available for distribution to the other creditors are not diminished. Even if this may mean that the appellant's claim is satisfied while unsecured monetary claims are not, the other unsecured creditors cannot complain because they will not be suffering any harm.

31 The Supreme Court's reasoning in *Coopérants* is consistent with the anti-deprivation rule described in *Bramalea*. The anti-deprivation rule is concerned with provisions that have a prejudicial impact on creditors. The rule has no application where the prejudicial effect is not immediately apparent and the party seeking to have the contractual arrangement deemed unenforceable has not established any prejudice.

32 In summary, the principle that parties cannot contract out of bankruptcy laws has a lengthy common law history, dating back at least to the 18th century in England: Wood, "Fraud Upon the Bankruptcy" at 171. The anti-deprivation rule in particular has received positive treatment from Canadian courts. Contracting parties cannot rely on provisions that are engaged by a debtor's insolvency and remove value from the debtor's estate to the prejudice of creditors. Much like the *pari passu* rule, I accept that it would disregard the *BIA* and deprive it of all meaning if a bankrupt could agree that assets would be diverted out of its estate in the event of insolvency: *Bail* at 487.

B. Effect of the Statutory Ipso Facto Provisions

33 The *BIA* includes provisions invalidating certain types of contract clauses that take effect upon the occurrence of a debtor's insolvency. However, the statutory provisions apply only to corporate restructuring, consumer proposals, and consumer bankruptcies. None of the *BIA* provisions applies to corporate bankruptcies, meaning that they do not apply in this case. Chandos contends and my colleague concludes that the *BIA* provisions codify and, in the present context, supplant the common law

anti-deprivation rule. In my view, a more appropriate conclusion is that the statutory provisions were intended to expand the common law to provide protection to debtors in situations where the anti-deprivation rule would not have protected them.

34 Provisions that offend the anti-deprivation rule are also referred to as *ipso facto* clauses, a term which encompasses any provision that sets out the consequences of a debtor's insolvency: *Black's Law Dictionary*, 10th ed, *sub verbo* "*ipso facto* clause"; Duggan et al at 296. However, not all *ipso facto* clauses offend the anti-deprivation rule. For example, some *ipso facto* clauses operate to terminate executory agreements between an insolvent debtor and another contracting party: Duggan et al at 296; Wood, "Bankruptcy and Insolvency" at 178. Eliminating a debtor's opportunity to perform a contract does not necessarily result in a deprivation of value that would prejudice creditors.

35 The United States Code expressly prohibits *ipso facto* provisions regardless of whether they offend the anti-deprivation rule: 11 USC § 365(e); 11 USC § 541(c). The provisions read, in part:

365(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on —

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

...

541(c)(1) ... an interest of the debtor in property becomes property of the estate ... notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law —

...

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

36 In contrast, section 65.1 of the *BIA*, which applies when a commercial debtor has filed a notice of intention or proposal, is representative of the *BIA*'s *ipso facto* provisions. The provision reads, in part:

65.1 (1) If a notice of intention or a proposal has been filed in respect of an insolvent person, no person may terminate or amend any agreement, including a security agreement, with the insolvent person, or claim an accelerated payment, or a forfeiture of the term, under any agreement, including a security agreement, with the insolvent person, by reason only that

(a) the insolvent person is insolvent; or

(b) a notice of intention or a proposal has been filed in respect of the insolvent person.

37 Sections 66.34 and 84.2 of the *BIA* are similarly worded and invalidate *ipso facto* clauses in the context of consumer proposals and consumer bankruptcies, respectively. Notably, all of these sections mirror 11 USC § 365(e) but make no mention of the property deprivation targeted by 11 USC § 541(c). In my view, this is because the *BIA* provisions were primarily intended to prohibit *ipso facto* clauses that terminate or modify executory agreements.

38 The prohibition on *ipso facto* clauses initially applied only to commercial restructuring and consumer proposals, as sections 65.1 and 66.34 of the *BIA* were enacted prior to section 84.2. In other words, Parliament first saw fit to prohibit the use of certain *ipso facto* provisions in contexts where debtors are attempting to reach a compromise with their creditors. In those contexts, it is important to maintain the *status quo* by allowing debtors to continue to rely on existing contractual relationships: Ho at 146. Preserving such relationships helps provide debtors with the opportunity to successfully restructure their liabilities: *Crystalline Investments Ltd. v. Domgroup Ltd.* (2002), 58 O.R. (3d) 549 (Ont. C.A.) at paras 6-8, (2002), 210 D.L.R. (4th) 659 (Ont. C.A.), aff'd 2004 SCC 3, [2004] 1 S.C.R. 60 (S.C.C.). The same concern is not as pressing with respect to a corporate bankruptcy, as the corporate entity is destined for liquidation: Ho at 182.

39 For consumers, the *ipso facto* provisions provide further protection, preventing creditors from terminating basic services even where the debtor has failed to make required payments: *BIA*, ss 66.34(3), 84.2(3).

40 For example, section 66.34(3) provides:

66.34 (3) Where a consumer proposal has been filed in respect of a consumer debtor, no public utility may discontinue service to that consumer debtor by reason only that

(a) the consumer debtor is insolvent,

(b) a consumer proposal has been filed in respect of the consumer debtor, or

(c) the consumer debtor has not paid for services rendered, or material provided, before the filing of the consumer proposal

until the consumer proposal has been withdrawn, refused by the creditors or the court, annulled or deemed annulled.

41 In the 2009 amendments to the *BIA*, the *ipso facto* prohibitions were extended to consumer bankruptcies. This was motivated by the "fresh start" principle that stems from the discharge available to consumer bankrupts. Prohibiting *ipso facto* termination clauses ensures that a debtor seeking a fresh start cannot be "unreasonably evicted from their home, denied basic and essential services or denied other benefits to which they would otherwise be entitled": Duggan et al at 296, citing Industry Canada, *Bill C-55 Clause-by-Clause Analysis* (6 September 2011). The Senate Standing Committee on Banking, Trade and Commerce, which recommended the reform, similarly stated that *ipso facto* clauses "should be unenforceable in order to ensure that debtors continue to have access to the basic services that they and their families need": Senate, Standing 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* (November 2003) at 75 (Chair: Hon Richard H. Kroft). This concern has no bearing on corporate bankruptcies.

42 The statutory provisions exhibit a debtor-protection purpose with two facets. First, they ensure that consumer and corporate debtors seeking to restructure their affairs have the time and resources to do so by maintaining the *status quo*. Second, the provisions extend protection to all consumer debtors to prevent the termination of basic services and executory agreements. This protection recognizes the impact such terminations would have on individuals and their families. These purposes are either less pressing or completely inapplicable to corporate bankruptcies, which may explain why the statutory provisions were not extended to those situations. Moreover, the debtor-protection purpose of the statutory provisions stands in contrast to the anti-deprivation rule, which protects creditors by ensuring a fair and equitable distribution of the debtor's estate: *Bramalea* at 694. In my view, this difference in purpose suggests that the statutory provisions expanded the common law. It does not lead to the inference that the common law rule was replaced.

43 Furthermore, the *BIA* provisions represent only a partial codification of the anti-deprivation rule: Wood, "Bankruptcy and Insolvency" at 90. None of the statutory provisions mentions a deprivation of assets from the debtor's estate — the sole concern of the anti-deprivation rule. In my view, there are at least some deprivations of property that would not be considered a termination, amendment, acceleration, or forfeiture of a term caught by the language of the statutory provisions. Professor

Wood also notes that "there may be instances where the transaction arises out of a grant rather than an agreement or involves a transfer of an asset to a third party so as to take it outside the ambit of the statutory provision[s]": Wood, "Bankruptcy and Insolvency" at 90.

44 Even if the *BIA* provisions do fully capture the common law rule, their scope is certainly much broader. The anti-deprivation rule is not generally concerned with the termination of agreements unless value is removed from the debtor's estate. The anti-deprivation rule also differentiates between the defeasance of an absolute interest and grants that create limited interests from the outset, holding that the latter are enforceable: *Belmont Park Investments Pty Ltd. v. BNY Corporate Trustee Services Ltd.*, [2011] UKSC 38 (U.K. S.C.) at paras 84-87, (2011), [2012] 1 All E.R. 505 (U.K. S.C.); *Knechtel*. The *BIA* provisions do not have the same limitation, extending their application to interests such as leases and licenses: Wood, "Bankruptcy and Insolvency" at 90. I conclude that expansion of the common law in the restructuring and consumer bankruptcy contexts does not mean that the anti-deprivation rule was eliminated for corporate bankruptcies.

45 In my view, the distinctions between the statutory provisions and the common law anti-deprivation rule prohibit the inference that the statutory provisions have occupied the field with respect to *ipso facto* clauses. As the *BIA* provisions and the anti-deprivation rule serve different purposes, and the overlap between them is not extensive, Parliament's legislative prohibition of one type of clause does not invite the inference that it condones the other. The statutory provisions expand the common law, protecting debtors by prohibiting *ipso facto* clauses that would not have been caught by the anti-deprivation rule. The anti-deprivation rule continues to apply, protecting creditors by ensuring that a bankrupt's property is distributed in accordance with the *BIA*'s scheme of distribution.

C. The Test for Applying the Anti-Deprivation Rule

46 Even if the anti-deprivation rule applies in Canada, Chandos contends that it does not invalidate good faith commercial transactions and urges this Court to adopt the test enunciated by the United Kingdom Supreme Court in *Belmont*. The court concluded that the anti-deprivation rule does not apply to "bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy": *Belmont* at para 104. This test looks at the purpose of the provision rather than its effect. I decline to adopt *Belmont*. The purpose-based test articulated in *Belmont* is inconsistent with Canadian cases applying the anti-deprivation rule and would eliminate virtually all of the rule's utility.

47 Canadian cases applying the anti-deprivation rule adopt an effects-based approach to determining the validity of a contractual provision: Wood, "Bankruptcy and Insolvency" at 89-90. Blair J in *Bramalea*, stated that the fraud on the bankruptcy law principle targets "not necessarily 'fraud' in the sense of dishonesty or impropriety, but fraud in the effect": *Bramalea* at 694. And while the Supreme Court of Canada did not address the issue directly in *Coopérants*, an effects-based approach is implicit in the court's determination that no prejudicial effect was evident in the circumstances: *Coopérants* at para 44.

48 Cases dealing with the *pari passu* rule similarly apply an effects-based approach. *Bail* and *Greenview* both dealt with contractual provisions allowing payments to be made directly to subcontractors to satisfy the obligations of a general contractor. Such provisions are generally motivated by the inability of subcontractors to acquire liens over public lands: *Greenview* at para 31; *Bail* at 483-484. The provisions clearly served a legitimate commercial purpose. Nevertheless, applying them after the general contractor had entered bankruptcy proceedings would have operated to disrupt the bankruptcy scheme of distribution. Both this Court and the Supreme Court of Canada refused to allow such a result.

49 In *Belmont* at paras 78-79, the court distinguished between the anti-deprivation rule and the *pari passu* rule, holding that a purpose-based approach applies only to the former. However, both rules stem from the basis that it would be inequitable to creditors if parties could contract out of the bankruptcy scheme. I see no principled basis to adopt differing standards for the two rules.

50 Furthermore, adoption of a purpose-based approach in the United Kingdom has received criticism for defeating the purpose of the anti-deprivation rule. Professor Worthington notes that "insisting that breach of the [anti-deprivation] rule depends on a

deliberate intention to evade the insolvency law effectively emasculates this limb of the [fraud on the bankruptcy principle]": Sarah Worthington, "Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule" (2012) 75:1 Mod L Rev 112 at 117. Professor Wood similarly concludes that Canadian courts should not adopt a purpose-based test: Wood, "Fraud Upon the Bankruptcy" at 184. The purpose of the anti-deprivation rule is to ensure that contracting parties cannot opt out of the distribution of assets mandated by the *BIA*. This purpose is best served by invalidating provisions that operate in the event of insolvency and have the effect of prejudicing creditors.

51 Finally, I do not accept that an effects-based approach would inappropriately undermine the values of freedom of contract and party autonomy, given the creditor-protection purpose of the fraud on the bankruptcy principle. The Supreme Court recognized this in *Coopérants* at para 41, stating that contracts signed in good faith should be respected, "unless the obligations contained therein are prejudicial to the other creditors and give rise to an unjust preference in light of all the circumstances" [emphasis added]. Freedom of contract is a much more central consideration when enforcing provisions that have been negotiated by the parties they affect. A party who might become insolvent has no motivation to negotiate a clause that directs property out of its estate upon insolvency. At the moment the clause becomes operative, the insolvent party is set to lose the property regardless of the contractual provision. The creditors who are impacted by the clause do not have a seat at the negotiating table.

52 For all of these reasons, I decline to adopt the purpose-based approach espoused in *Belmont*. Canadian authorities on the anti-deprivation rule support an effects-based approach to determining whether a provision is enforceable against the trustee in bankruptcy. Moreover, I agree with the conclusion that considering the purpose of a contractual provision would all but sterilize the anti-deprivation rule. The anti-deprivation rule applies to provisions that operate in the event of insolvency and, in effect, remove value from a bankrupt's estate to the prejudice of the bankrupt's creditors. It follows that I do not endorse the new test proposed by my colleague.

VI. Application

53 The chambers judge correctly identified the existence and application of the fraud on the bankruptcy principle in Canada. In outlining the scope of the anti-deprivation rule, however, the chambers judge erred. The chambers judge adopted the purpose-based approach set out by the Supreme Court of the United Kingdom in *Belmont*. He stated that if the clause were a genuine pre-estimate of damages, or a *bona fide* commercial transaction not premised on the avoidance of bankruptcy laws, it would have to be upheld.

54 As I have indicated, the proper approach is to look at the effect of clause VII Q(d), rather than its purpose. Whether the provision is a liquidated damages or penalty clause is a separate analysis.

55 Looking at the effect of clause VII Q(d), this case is not comparable to *Coopérants*, where there was no established prejudice to creditors. Clause VII Q(d) effectively redirects \$126,818.39 to Chandos that would have otherwise formed part of Capital Steel's estate and gives Chandos a further claim for \$10,511.66. Other provisions of Clause Q address the ability of Chandos to complete the work, to recover the cost to complete the work, and to withhold a percentage of the contract price until all warranties have expired. It is only Clause VII Q(d) which is at issue. While Chandos undoubtedly has legitimate commercial interests it was seeking to protect, it would conflict with the *BIA*'s scheme of distribution if Chandos could elevate itself to a preferred status through such a contractual arrangement. The common law anti-deprivation rule invalidates clause VII Q(d) and Chandos cannot rely on the provision in defence of a claim for payment by the trustee.

56 Given that clause VII Q(d) contravenes the common law anti-deprivation rule, it is unnecessary to address whether it also would constitute an unenforceable penalty.

VII. Conclusion

57 The appeal is allowed. Chandos is not entitled to rely on clause VII Q(d) of the subcontract against Deloitte, the trustee in bankruptcy.

2017 ABQB 805
Alberta Court of Queen's Bench

Super Save Disposal (Alberta) Ltd v. Shenwei Enterprises Ltd

2017 CarswellAlta 2814, 2017 ABQB 805, [2018] A.W.L.D. 228,
[2018] A.W.L.D. 229, 286 A.C.W.S. (3d) 466, 69 Alta. L.R. (6th) 409

**Super Save Disposal (Alberta) Ltd. (Appellant)
and Shenwei Enterprises Ltd. (Respondent)**

K.P. Feehan J.

Heard: November 10, 2017
Judgment: December 22, 2017
Docket: Edmonton 1603-19236

Proceedings: affirming *Super Save Disposal (Alberta) Ltd. v. Shenwei Enterprises Ltd.* (2016), 2016 ABPC 224, 2016 CarswellAlta 2143, D.G. Ingram Prov. J. (Alta. Prov. Ct.)

Counsel: James R. Kitsul, for Appellant
David L. Schwartz, for Respondent

Subject: Contracts

Related Abridgment Classifications

Contracts

IX Performance or breach

IX.8 Breach

IX.8.d Miscellaneous

Contracts

XIV Remedies for breach

XIV.2 Contractual remedies

XIV.2.c Penalty or liquidated damages

Headnote

Contracts --- Remedies for breach --- Contractual remedies --- Penalty or liquidated damages

Contract between plaintiff and defendant granted plaintiff exclusive right to provide waste disposal services to defendant's restaurant for five years — Contract included liquidated damages clause that provided defendant could be required to pay full amount owing under remaining term of contract in event that defendant unlawfully terminated contract — Plaintiff was supposed to pick up garbage twice per week but only showed up once per week on five occasions within six-month time period — Plaintiff failed to provide credit as promised so defendant terminated contract — Plaintiff brought action against defendant for liquidated damages in accordance with contract — Action dismissed — Trial judge held that liquidated damages clause could not be upheld as bona fide liquidated damages — Plaintiff appealed — Appeal dismissed — Clause in contract claimed as liquidated damages amount equal to amount of monthly charges plus applicable sales taxes that would ordinarily become due to contractor for balance of term — This was measurement of gross income and not genuine pre-estimate of loss of net profit in context of contract between parties — It was unreasonable and oppressive response to repudiation of contract, and therefore penalty, not genuine pre-estimate of damages — It was unfair and inequitable to charge gross income amount when loss suffered by plaintiff was loss of net profit liquidated damages provision in contract.

Contracts --- Performance or breach --- Breach --- Miscellaneous

Contract between plaintiff and defendant granted plaintiff exclusive right to provide waste disposal services to defendant's restaurant for five years — Contract included liquidated damages clause that provided defendant could be required to pay

full amount owing under remaining term of contract in event that defendant unlawfully terminated contract — Plaintiff was supposed to pick up garbage twice per week but only showed up once per week on five occasions within six-month time period — Plaintiff failed to provide credit as promised so defendant terminated contract — Plaintiff brought action against defendant for liquidated damages in accordance with contract — Action dismissed on other grounds — Trial judge held that breaches of contract by plaintiff did not amount to sufficient breach so as to entitle defendant to cancel contract and avoid its obligations under it — Defendant had complained but then backed off and continued to accept and pay for plaintiff's services for several months — Defendant could not wait several months to elect to end contract and rely on breaches that occurred several months before — Plaintiff appealed — Appeal dismissed.

APPEAL from judgment reported at *Super Save Disposal (Alberta) Ltd. v. Shenwei Enterprises Ltd.* (2016), 2016 ABPC 224, 2016 CarswellAlta 2143 (Alta. Prov. Ct.), dismissing action for breach of contract.

K.P. Feehan J.:

I. Overview

1 Super Save appeals a Provincial Court of Alberta Small Claims decision of Judge D.G. Ingram in which he found that a clause in a waste disposal service contract was unenforceable as being a penalty rather than a liquidated, fair pre-estimate of probable damage. The clause purported to set out as liquidated damages, in the event that Shenwei unlawfully terminated the agreement, an amount equal to the amount of monthly charges plus applicable sales taxes that would ordinarily become due to Super Save for the balance of the term of the contract. He found he had equitable jurisdiction to relieve against a penalty and therefore dismissed Super Save's civil claim for liquidated damages.

2 I agree with Judge Ingram's conclusion that the clause in question was "extravagant and unconscionable", that in a contract for the provision of continuing services the loss of income stream, gross income, does not on its face represent a close approximation of the maximum damages recoverable at common law, net profit, and the clause cannot be upheld as a *bona fide* liquidated damages clause. This conclusion is correct at law regardless of whether the financial calculation of the difference between gross income and net profit is not extreme; it is the quality and not solely the quantity of the difference that is determinative in a contract for the provision of continuing services.

II. Standard of Review

3 The standard of review when the Court of Queen's Bench sits as a civil appellant court was summarized in *Kieller v. John Doe*, 2008 ABQB 783 (Alta. Q.B.) at para 39, (2008), 1 Alta. L.R. (5th) 130 (Alta. Q.B.), a decision of Justice Moen of this Court:

The standard of review to be applied by a civil appeal court is correctness in relation to questions of law (*Housen v. Nikolaisen*, 2002 SCC 33 (CanLII), [2002] 2 SCR 235; *R v. Sehn*, 2005 ABCA 203 (CanLII), 371 AR 14) and palpable and overriding error in terms of findings of fact (*Stein v. The Ship "Kathy K"*, 1975 CanLII 146 (SCC), [1976] 2 SCR 802; *527353 Alberta Ltd v. Stedelbauer Chevrolet Oldsmobile (1975) Ltd* (2001), 2001 ABQB 909 (CanLII), 302 AR 316 at 321 (QB)) and factual inferences (*Housen* at para 25). A palpable and overriding error occurs where the trial judge makes a manifest error, ignores conclusive or relevant evidence, misunderstands the evidence or draws erroneous conclusions from it (*Toneguzzo-Novell (Guardian ad litem of) v. Burnaby Hospital*, 1994 CanLII 106 (SCC), [1994] 1 SCR 114 at para 13, 110 DLR (4th) 289, cited in *MacCabe v. Westlock Roman Catholic Separate School District*, 2001 ABCA 257 (CanLII) at para 21, 293 AR 41). In terms of findings of mixed fact and law where the issue is the application of a legal standard to a set of facts, the standard of review is palpable and overriding error. However, if the trial judge made an extricable error in principle with respect to the characterization of the standard or its application, the error may amount to an error of law, which is subject to the standard of correctness: *Housen* at paras 26-36.

See also *McCallum v. Edmonton Frame and Suspension (2000) Ltd.*, 2016 ABQB 271 (Alta. Q.B.) at para 50, a decision of Justice Graesser of this Court.

III. Legal History

4 The original Provincial Court Civil Claim of Super Save was filed August 7, 2014 and amended April 21, 2016. It claimed \$20,605.65 and costs, of which \$19,401.47 was claimed as liquidated damages. At trial, the officer of Super Save said the amount was 48 months times \$363.16 plus GST: \$18,303.26. The remainder, which comprised a debt claim, was later withdrawn, as being double counting.

5 The original Dispute Note of Shenwei was filed October 24, 2014 and amended May 3, 2016. It acknowledged the waste disposal service contract and its termination of that contract on the basis that Super Save had failed to provide the services for which it had contracted, and had failed to pay promised credits to Shenwei for work not done. It defended on the basis of fundamental breach of contract or breach of a fundamental term, the right to repudiate the contract, the assertion that the liquidated damages clause was in fact a penalty at law, and that Super Save had failed to mitigate its damages.

6 The matter proceeded to small claims trial on September 6, 2016 and Reasons for Decision were issued by Judge Ingram on September 27, 2016. The Notice of Appeal was filed in the Provincial Court on October 17, 2016 and in the Court of Queen's Bench on November 1, 2016.

IV. Grounds of Appeal

7 Super Save says the trial judge erred in law and in fact in finding the liquidated damages claimed amounted to a penalty and was not a genuine pre-estimate of damages. It says the trial judge was wrong in not finding that a loss of the entire income stream resulting from the breach of contract was a close approximation of the maximum damages recoverable at common law such that it was a *bona fide* liquidated damages clause. Super Save also says the trial judge made findings of fact not supported by the evidence, if there was evidence to support his findings he erred in law in admitting that evidence, and he erred in law in finding that the onus was on Super Save to prove the liquidated damages claim was a genuine pre-estimate of damages rather than on Shenwei to prove that the liquidated damages claim was a penalty.

V. The Contract

8 The waste disposal services contract in dispute was effective March 1, 2013 to March 1, 2018 and provided for twice weekly removal of six yards of waste at an initial monthly charge of \$328.65 plus tax which was to increase over time to \$381.32 per month plus tax.

9 The disputed term in the contract was paragraph 11: Failure to Perform. It provided that if Shenwei unlawfully repudiated the agreement prior to its expiration and if Super Save accepted the repudiation, Shenwei would be required to pay "as liquidated damages, an amount equal to the amount of the monthly charges plus applicable sales taxes that would ordinarily become due to the contractor for the balance of the term". Paragraph 11 also provided that "the foregoing liquidated damages are an accurate calculation of the anticipated lost income stream to the contractor for the balance of the term of the agreement" and were not "imposed as penalty".

10 There was no argument before me, nor in the Court below, as to whether the termination of the contract by Shenwei for failure to perform by Super Save was an "unlawful repudiation", and that seminal issue is therefore not before me for determination on this appeal. Additionally, although the defence of fundamental breach of contract or breach of a fundamental term of the contract was argued before the Court of first instance, it was not before me on appeal.

11 Judge Ingram found that Super Save had failed to pick up garbage on May 7, 14 and 17, July 22 and October 5, 2013 as contracted. He found that Shenwei had provided advice to Super Save that it wished to terminate the agreement on both August 29 and September 5, 2013, and that in response, Super Save had promised credits for the missed services but those credits were never paid. He also found that Shenwei stopped the service on January 4, 2014 and made an agreement with a competitor to pick up their waste effective January 1, 2014. On January 13, 2014, Super Save advised Shenwei that it was entitled to accept repudiation of the agreement, in which case Shenwei would be responsible for payment of liquidated damages in the sum of

\$18,684.68. Again, there was no allegation that the repudiation was unlawful. On March 18, 2014, Super Save issued a formal termination and demand for payment.

12 Shenwei said that due to the failure of Super Save to pick up garbage when agreed, its restaurant business was put at risk. The garbage in question consisted of thrown out left-over foods of various kinds and failure to dispose of the garbage promptly resulted in the garbage becoming smelly, infected with bacteria and vermin, and left the restaurant in an unclean and unhealthy condition which brought complaints from neighbours and concern over City health fines.

VI. The Liquidated Damages vs. Penalty Determination

13 Judge Ingram found as a matter of judicial notice that the waste disposal to be provided by Super Save required the incurring of operation and service costs by Super Save. He said:

It is apparent the plaintiff would have had to operate trucks to remove the waste which would involve the expenditure of money, to hire persons to operate the trucks, and equipment used in connection with them. The plaintiff would have had to pay wages, buy gasoline, have insurance, pay waste disposal fees at the landfill or other place where the waste was disposed of, and would have had other operating costs which would have been incurred in the event that the service would have continued.

14 He concluded that what Super Save had actually lost was in reality not the gross "anticipated lost income stream to the contractor for the balance of the term" but the net profit they should reasonably have expected from the contract. He said although there was no evidence before him on the cost of the provision of continuing services, there was no doubt a significant difference between the gross income and the net profit. He said the attempt to claim gross income, when all that had been lost was anticipated net profit, would have been a windfall of unspecified amount to Super Save. He said this term of the contract was "extravagant and unconscionable, and therefore a penalty".

15 During argument, counsel for Super Save represented, although this was not in evidence before me or the Court below, that the quantitative difference between Super Save's gross income and net profit was very small because of what he called the synergies in this business. He said that a typical garbage pickup route would have between 80 and 100 customers, and perhaps up to 120 customers, per day such that a loss of one customer would not considerably reduce the cost incurred by Super Save to provide the service. It still would have to pay the driver, pay for gasoline, waste disposal fees and general administration costs, maintain and insure the trucks, and continue to incur virtually every other ongoing cost to do business. He said in some contracts there may be a significant quantitative difference between gross income and net profit, such as in a pure service contract, while in other contracts, such as "sign contracts", there would be little or no difference between those figures.

16 Judge Ingram was entitled to take judicial notice of the commercial distinction between the concepts of gross income and net profit as being clearly non-controversial or beyond reasonable dispute, so notorious or generally accepted as not to be the subject of debate among reasonable persons, and capable of immediate and accurate demonstration by resort to readily accessible sources of indisputable accuracy: *R. v. Potts* (1982), 66 C.C.C. (2d) 219 (Ont. C.A.); Sopinka, Lederman & Bryant, *The Law of Evidence in Canada* (2nd) at 1055.

17 Judge Ingram reviewed and relied upon *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* (1914), [1915] A.C. 79 (U.K. H.L.), 32262 *B.C. Ltd. v. See-Rite Optical Ltd.*, [1998] 9 W.W.R. 442 (Alta. C.A.), *Langille v. Keneric Tractor Sales Ltd.* (1987), 19 D.L.R. (4th) 652 (S.C.C.), and *Super Save Disposal Inc. v. Tristar Cap & Garment Ltd.*, 2014 BCSC 690 (B.C. S.C.), in concluding that it is the duty of the Court in equity to determine whether accreted payments set out in a contract are "in truth a penalty or liquidated damages".

18 Quoting at para 21 from *Dunlop Tyre*, he said:

It will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

19 Quoting at para 22 from *32262 B.C. Ltd.*, he said it was a concern of the courts to seek fairness and reasonableness, and that judicial interference would be justified if the contractual result would otherwise be a grossly punitive response to the problem which it addressed. This case relied upon the decision in *H.F. Clarke Ltd. v. Thermidaire Corp.* (1974), 54 D.L.R. (3d) 385 (S.C.C.) where Chief Justice Laskin commented on the role of the courts in interpreting contractual provisions as damages or penalty clauses and said that the concern of the courts is one of fairness and reasonableness in the surrounding circumstances (at p 392).

20 Quoting at para 23 from *Langille*, he relied upon the general contract principle that an award should put the plaintiff in the position he would have been had the defendant fully performed his contractual obligations.

21 Quoting at para 24 from *TriStar Cap*, he said it was settled law that the enforceability of a liquidated damages clause turns on whether it is a genuine pre-estimate of a party's expected loss in the event of a breach of contract or a penalty that is so oppressive or unreasonable that equitable intervention is justified to prevent injustice.

22 In defining what constitutes a penalty, Pitch & Snyder in their text *Damages for Breach of Contract* say at p 6-3:

A penalty clause is not a genuine pre-estimate of damages. Instead it is inserted for the purpose of compelling performance of contractual obligations. It is classically called an *in terrorem* clause and the alleged estimate is so unreasonable that it justifies the equitable intervention of the court to prevent oppression or injustice.

See also *Bodkin Leasing Corp. v. Mighty Moose Holdings Ltd.*, [2014] A.J. No. 546 (Alta. Q.B.), a decision of Master Prowse of this Court; *Ashland Scurlock Permian Canada Ltd. v. Nesi Energy Marketing Canada Ltd. (Trustee of)*, [1998] A.J. No. 678 (Alta. Q.B.), a decision of Justice Forsyth of this Court; and *Xerox Canada Ltd. v. Accurate Data Services Inc.*, [2013] A.J. No. 1395 (Alta. Q.B.), a decision of Master Robertson of this Court.

23 A fresh view of the law in this area was recently had by the British House of Lords in *Cavendish Square Holding B.V. v. Talal El Makdessi*, [2015] UKSC 67 (U.K. S.C.). It said as a foundational statement of law at para 9:

The distinction between a clause providing for a genuine pre-estimate of damages and a penalty clause has remained fundamental to the modern law, as it is currently understood. The question whether a damages clause is a penalty falls to be decided as a matter of construction therefore as at the time that it is agreed [authorities deleted]. This is because it depends on the character of the provision, not on the circumstances in which it falls to be enforced.

24 Clearly, at the time of the signing of the contract, the quantum of the difference between future gross income and net profit is not calculable, but the qualitative difference is obvious. This importance of the qualitative aspect of the distinction is consistent with the qualitative requirement for proof of irreparable harm as the second criteria for an interlocutory injunction or stay of proceedings; see *Metropolitan Stores (MTS) Ltd. v. Manitoba Food & Commercial Workers, Local 832*, [1987] 1 S.C.R. 110 (S.C.C.) and *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311 (S.C.C.).

25 The British House of Lords in *Cavendish* went on to say at para 31:

The real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss. These are not natural opposites or mutually exclusive categories. A damages clause may be neither or both.

26 It analyzed the three leading cases in England, *Clydebank Engineering & Shipbuilding Co. v. Yzquierdo* (1904), [1905] A.C. 6 (U.K. H.L.), *Public Works Commissioner v. Hills*, [1906] A.C. 368 (South Africa P.C.), and *Dunlop Tyre*, it concluded that the legal issue is not quantum but the penal nature or quality of the contract (see paras 131-138).

27 A similar conclusion was reached in the decision of *Dial Mortgage Corp. v. Baines* (1980), 15 Alta. L.R. (2d) 211 (Alta. Q.B.), a decision of Justice J.B. Feehan where he concluded at p 220:

Reasonableness of the sum or formula adopted seems to be the key consideration, and if it is concluded that the sum or formula in question is not set properly in regards to the estimated loss, it will be seen as a penalty clause even though, on some occasions, the loss that could be estimated would equal or surpass the sum or formula agreed upon.

28 Judge Ingram determined that the clause in question before him was not a genuine, covenanted pre-estimate of damage recoverable at common law but was extravagant and unconscionable. Relying upon the equitable jurisdiction of the Court, and the duty of the Court to strive for fairness and reasonableness, he determined that judicial interference was justified as the contractual result would be oppressive and a grossly and punitive response to the repudiation of the contract.

29 He said cases for the supply of goods where there is no ongoing provision of services to be performed by the party accepting the repudiation of the contract are to be distinguished from cases for continuing supply of services with ongoing costs of doing business, on the basis that in the former there is no appreciable difference between gross income and net profit after the supply of the goods under the contract: see *Alwest Neon Signs Ltd. v. Henze* (1989), 105 A.R. 343 (Alta. C.A.); *32262 B.C. Ltd. v. Besler*, [2000] A.J. No. 141 (Alta. Q.B.), a decision of Justice Acton of this Court; *32262 B.C. Ltd. v. G. Pataki Enterprises Ltd.*, [1998] A.J. No. 313 (Alta. C.A.); and *DirectCash ATM Processing Partnership v. 564024 Alberta Inc.*, 2006 ABPC 112 (Alta. Prov. Ct.), a decision of Judge O'Ferrall, now a member of our Court of Appeal.

VII. Conclusion

30 I agree with Judge Ingram. The clause as set out in paragraph 11 of the contract which claims as liquidated damages an amount equal to the amount of the monthly charges plus applicable sales taxes that would ordinarily become due to the contractor for the balance of the term is a measurement of gross income and not a genuine pre-estimate of loss of net profit in the context of the contract between the parties. It is an unreasonable and oppressive response to the repudiation of the contract, and therefore a penalty, not a genuine pre-estimate of damages. This is not because there was any proof before the trial judge of the quantitative difference between the gross income and net profit figures, but because qualitatively it is unfair and inequitable to charge a gross income amount, whatever it is, when the loss suffered by Super Save was loss of net profit, whatever it is, on a liquidated damages provision in a contract.

31 I uphold the decision of Judge Ingram in dismissing Super Save's civil claim.

VIII. Costs

32 Shenwei is awarded taxable costs on a party and party basis in this Court and in the Court below.

Appeal dismissed.

Most Negative Treatment: Distinguished

Most Recent Distinguished: Williams-Sonoma Inc. v. Oxford Properties Group Inc. | 2013 ONCA 441, 2013 CarswellOnt 8646, 22 C.L.R. (4th) 199, [2013] O.J. No. 2980, 307 O.A.C. 314, 229 A.C.W.S. (3d) 865 | (Ont. C.A., Jun 26, 2013)

1999 CarswellBC 1927
Supreme Court of Canada

Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.

1999 A.M.C. 2840, 1999 CarswellBC 1927, 1999 CarswellBC 1928, [1999] 3 S.C.R. 108, [1999] 9 W.W.R. 380, [1999] I.L.R. I-3717, [1999] S.C.J. No. 48, [2000] 1 Lloyd's Rep. 199, 11 C.C.L.I. (3d) 1, 127 B.C.A.C. 287, 176 D.L.R. (4th) 257, 207 W.A.C. 287, 245 N.R. 88, 47 C.C.L.T. (2d) 1, 50 B.L.R. (2d) 169, 67 B.C.L.R. (3d) 213

Fraser River Pile & Dredge Ltd., Appellant v. Can-Dive Services Ltd., Respondent

Gonthier, Cory, McLachlin, Iacobucci, Major, Bastarache, Binnie JJ.

Heard: February 25, 1999
Judgment: September 10, 1999
Docket: 26415

Proceedings: affirming (1997), 39 B.C.L.R. (3d) 187 (C.A.); reversing (1995), 9 B.C.L.R. (3d) 260 (S.C.); additional reasons at (1995), 33 C.C.L.I (2d) 71 (B.C. S.C.)

Counsel: *David F. McEwen*, for the appellant.

D. Barry Kirkham, Q.C., and *Gregory J. Tucker*, for the respondent.

Subject: Contracts; Insurance

Related Abridgment Classifications

Civil practice and procedure

XXIV Costs

XXIV.8 Scale and quantum of costs

XXIV.8.d Quantum of costs

XXIV.8.d.ii Allowance of increased costs

Commercial law

I Agency

I.4 Ratification

I.4.c Necessity for full knowledge by principal

Contracts

II Parties to contract

II.4 Privity

II.4.b Third party beneficiary

II.4.b.i General principles

Contracts

VII Construction and interpretation

VII.8 Implied terms

VII.8.c Warranty

VII.8.c.iii Fitness

Insurance

VI Contract of indemnity

VI.2 Subrogation

VI.2.f Defences to subrogated action

VI.2.f.i Waiver of subrogation rights

Insurance

VI Contract of indemnity

VI.2 Subrogation

VI.2.f Defences to subrogated action

VI.2.f.iv Miscellaneous

Torts

XVI Negligence

XVI.2 Duty and standard of care

XVI.2.b Standard of care

Headnote

Insurance --- Contract of indemnity — Subrogation — Defences to subrogated action — Waiver of subrogation rights
Insurance policy covered owner for loss of vessels — Policy contained waiver of subrogation clause stating that insurer waived right of subrogation against charterers — Owner lost vessel as result of charterer's negligence — Owner received payment under insurance policy and then brought successful action against charterer for damages — Appeal by charterer was allowed — Court of Appeal held that waiver of subrogation clause was established exception to doctrine of privity of contract and that charterer could rely on clause as defence to action — Appeal by owner dismissed — Two requirements for relaxing doctrine of privity of contract were clearly met in circumstances.

Contracts --- Parties to contract — Privity — Third party beneficiary — General

Insurance policy covered owner for loss of vessels — Policy contained waiver of subrogation clause stating that insurer waived right of subrogation against charterers — Owner lost vessel as result of charterer's negligence — Owner received payment under insurance policy and then brought successful action against charterer for damages — Appeal by charterer was allowed — Court of Appeal held that waiver of subrogation clause was established exception to doctrine of privity of contract and that charterer could rely on clause as defence to action — Appeal by owner dismissed — Two requirements for relaxing doctrine of privity of contract were clearly met in circumstances.

Assurance --- Contrat d'indemnisation — Subrogation — Moyens de défense à une action subrogatoire — Renonciation au droit à la subrogation

Police d'assurance couvrant le propriétaire contre la perte de navires — Police comprenait une clause de renonciation à la subrogation énonçant que l'assureur renonce à son droit à la subrogation à l'encontre des affrêteurs — Propriétaire a perdu un navire en raison de la négligence de l'affrêteur — Propriétaire a obtenu un paiement en vertu de sa police d'assurance et a ensuite obtenu gain de cause contre l'affrêteur dans une action en dommages et intérêts — Pourvoi de l'affrêteur a été accueilli — Cour d'appel a conclu que la clause de renonciation à la subrogation constituait une exception fondée sur des principes à la règle du lien contractuel et que l'affrêteur pouvait invoquer cette clause pour se défendre contre l'action — Pourvoi du propriétaire a été rejeté — Deux exigences permettant l'assouplissement de la règle du lien contractuel ont été clairement satisfaites dans les circonstances.

Contrats --- Parties au contrat — Lien contractuel — Tiers partie bénéficiaire — En général

Police d'assurance couvrant le propriétaire contre la perte de navires — Police comprenait une clause de renonciation à la subrogation énonçant que l'assureur renonce à son droit à la subrogation à l'encontre des affrêteurs — Propriétaire a perdu un navire en raison de la négligence de l'affrêteur — Propriétaire a obtenu un paiement en vertu de sa police d'assurance et a ensuite obtenu gain de cause contre l'affrêteur dans une action en dommages et intérêts — Pourvoi de l'affrêteur a été accueilli — Cour d'appel a conclu que la clause de renonciation à la subrogation constituait une exception fondée sur des principes à la règle du lien contractuel et que l'affrêteur pouvait invoquer cette clause pour se défendre contre l'action — Pourvoi du propriétaire a été rejeté — Deux exigences permettant l'assouplissement de la règle du lien contractuel ont été clairement satisfaites dans les circonstances.

The owner carried on business as a provider of dredging, pile-driving and related services. Occasionally the owner chartered vessels to third parties. The charterer chartered a derrick barge to carry out work on a natural gas pipeline. The barge was insured by the owner under a Hull Subscription Policy. The policy contained a waiver of subrogation clause which stated that

the insurers waived any right of subrogation against any charterer. The charterer contracted with the owner for the owner's personnel to operate the crane and winches on board the barge. The charterer assumed full responsibility for towing the barge to and from the work site and for maintaining the safety and condition of the barge. The barge sunk at the work site in stormy weather, two weeks after being towed to the site. The owner recovered the sum of \$1,128,365.57 from the insurers, and entered into an agreement with the insurers to pursue a legal action against the charterer in negligence.

The owner brought an action for damages against the charterer, and was awarded judgment in the amount of \$949,503. The trial judge held that the loss was owing to the charterer's negligence. The trial judge concluded that there was insufficient clear and cogent evidence to enable him to conclude that the owner agreed to extend its own insurance to cover any risk of loss by the charterer during the charter period. The trial judge further concluded that the insurers were not precluded from bringing a subrogated action against the charterer on the basis that the charterer was an "additional insured" under the policy. The trial judge held that the charterer could not rely on a contractual term in the policy, as it was not a party to the policy. The trial judge held that for the same reason, the charterer could not rely on the waiver of subrogation clause in the policy, as no sufficient reason existed to relax the doctrine of privity of contract in the circumstances. The trial judge awarded the owner costs, and held that the owner was entitled to increased costs. The charterer's appeal to the Court of Appeal was allowed. The Court of Appeal agreed that the claim was wholly subrogated, and held that the charterer could rely on the waiver of subrogation clause in the policy in the circumstances. The Court of Appeal held that "waiver of subrogation" clauses in contracts of insurance constituted an exception to the doctrine of privity of contract in circumstances where the third-party beneficiary is not a party to the policy, but nonetheless falls within the contractual definition of those to whom coverage is extended. The Court of Appeal awarded the charterer its costs there and at the court below. The owner brought an appeal.

Held: The appeal was dismissed.

Generally, the doctrine of privity provides that a contract can neither confer rights nor impose obligations on third parties. The charterer was a third-party beneficiary who normally would be precluded from enforcing or relying on the terms of the policy in effect between the owner and its insurers. A principled exception to the common law doctrine of privity of contract has been introduced by recent caselaw. The threshold requirement for the exception is that the parties to the contract must have intended the relevant provision to confer a benefit on the third party. Secondly, the activities performed by the third party seeking to rely on the contractual provision must be the very activities contemplated as coming within the scope of the contract in general, or the provision in particular. There was no question that the parties intended to extend the benefit under the waiver of subrogation clause to a class of third-party beneficiaries whose membership included the charterer. A plain reading of the provision did not support the owner's claim that the provision could only be enforced by the owner on the charterer's behalf and not by the charterer acting independently. The owner and the insurers could not unilaterally revoke the charterer's rights under the provision once they had developed into an actual benefit. The charterer became for all intents and purposes a party to the initial contract for the limited purpose of relying on the waiver of subrogation clause, at the point at which its rights crystallized. The activities of the charterer in issue arose in the context of the relationship of the charterer to the owner as a charterer, the very activity anticipated in the insurance policy pursuant to the waiver of subrogation clause. The two requirements for relaxing the doctrine of privity were clearly met in the circumstances. In addition, there were also sound policy reasons for relaxing the doctrine in the circumstances. No commercial reason existed for failing to enforce a bargain entered into by sophisticated commercial actors. Relaxing the doctrine of privity in the circumstances most closely corresponded to commercial reality.

Le propriétaire exploitait une entreprise de services de dragage et de battage de pieux, et de services connexes. Il frétait occasionnellement des navires nolisés à des tiers. L'affrètement a loué une barge-grue pour effectuer des travaux sur un gazoduc. Le propriétaire était titulaire d'une police de coassurance sur corps de navire, laquelle police couvrait la barge. La police d'assurance contenait une clause de renonciation à la subrogation qui stipulait que les assureurs renonçaient à tous droits de subrogation à l'égard des frétauteurs. L'affrètement a convenu avec le propriétaire que les employés de ce dernier feraient fonctionner la grue et les treuils qui se trouvaient sur la barge. L'affrètement a assumé l'entière responsabilité du remorquage de la barge pour l'amener au chantier et pour l'en ramener, ainsi que de la sécurité et du maintien en bon état de celle-ci. Deux semaines après avoir été remorquée jusqu'au chantier, la barge y a fait naufrage lors d'une tempête. Les assureurs ont versé la somme de 1 128 365,57 \$ au propriétaire et ce dernier a conclu une entente avec les assureurs dans laquelle ils ont convenu d'intenter une action fondée sur la négligence contre l'affrètement.

Le propriétaire a intenté une action en dommages-intérêts contre l'affrètement et a obtenu un jugement pour la somme de 949 503 \$. Le juge de première instance a estimé que la perte avait été causée par la négligence de l'affrètement et a conclu qu'il n'existait pas

suffisamment d'éléments de preuve clairs et convaincants pour qu'il puisse conclure que le propriétaire avait accepté d'étendre sa propre assurance à tout risque de perte par l'affrètement au cours de la période d'affrètement. Le juge de première instance a par ailleurs conclu que les assureurs avaient le droit d'intenter une action subrogatoire contre l'affrètement au motif que ce dernier était un « assuré additionnel » aux termes de la police. Il a par ailleurs estimé que l'affrètement ne pouvait invoquer la clause de renonciation à la subrogation prévue dans la police puisqu'il n'était pas partie à celle-ci. Il a conclu, pour les mêmes motifs, que l'affrètement ne pouvait invoquer la clause de renonciation à la subrogation parce qu'il n'avait pas de raisons suffisantes pour justifier l'assouplissement de la règle du lien contractuel dans les circonstances. Le juge de première instance a accordé les dépens au propriétaire et jugé que ce dernier avait le droit à des dépens majorés. La Cour d'appel a accueilli le pourvoi de l'affrètement. Elle a estimé que l'action était entièrement subrogatoire et que l'affrètement pouvait, dans les circonstances, invoquer la clause de renonciation à la subrogation stipulée dans la police. La Cour d'appel était d'avis que les clauses de « renonciation à la subrogation » stipulées dans les contrats d'assurance constituaient une exception à la règle du lien contractuel dans le cas où le tiers bénéficiaire n'est pas partie à la police, mais est néanmoins visé par la définition contractuelle des personnes à l'égard desquelles la protection est accordée. Elle a accordé à l'affrètement les dépens relatifs à l'appel et au tribunal de première instance. Le propriétaire a formé un pourvoi.

Arrêt: Le pourvoi a été rejeté.

De façon générale, la règle du lien contractuel veut qu'un contrat ne puisse conférer de droits, ni imposer d'obligations à un tiers. L'affrètement était un tiers bénéficiaire à qui il n'aurait normalement pas été permis de faire exécuter ou d'invoquer les conditions de la police en vigueur entre le propriétaire et ses assureurs. Une exception fondée sur des principes à la règle du lien contractuel de common law a toutefois été reconnue par la jurisprudence récente. Pour donner ouverture à l'exception, la condition préliminaire selon laquelle les parties au contrat doivent avoir voulu que la disposition pertinente confère un avantage au tiers doit être satisfaite. Deuxièmement, les activités auxquelles se livrait le tiers qui entend invoquer la clause du contrat doivent correspondre aux activités mêmes qui sont censées être visées par le contrat en général ou par la disposition particulière. Il n'y avait aucun doute que les parties avaient l'intention d'accorder le bénéfice de la clause de renonciation à la subrogation à une catégorie de tiers bénéficiaires comprenant l'affrètement. Le sens clair de la disposition n'était pas la prétention du propriétaire selon laquelle seul le propriétaire pouvait faire exécuter la disposition pour le bénéfice de l'affrètement, et non ce dernier de façon indépendante. Le propriétaire et les assureurs ne pouvaient pas supprimer de façon unilatérale les droits de l'affrètement une fois qu'ils s'étaient cristallisés sous la forme d'un avantage réel. Au moment où les droits de l'affrètement se sont cristallisés, ce dernier était devenu à toutes fins pratiques une partie au contrat initial en ce qui concernait uniquement le droit d'invoquer la clause de renonciation à la subrogation. Les activités pertinentes de l'affrètement s'inscrivaient dans le contexte de sa relation avec le propriétaire, soit l'activité même qui était prévue par la police aux termes de la clause de renonciation à la subrogation. Il était manifeste que les deux conditions requises pour l'assouplissement de la règle du lien contractuel avaient été satisfaites. Il existait également des raisons de principe valables en faveur de l'assouplissement de cette règle dans les circonstances. Il n'y avait aucune raison commerciale de ne pas faire exécuter un marché conclu par des acteurs commerciaux avertis. L'assouplissement de la règle du lien contractuel dans ces circonstances correspondait très étroitement à la réalité commerciale.

APPEAL by owner from judgment reported at (1997), 39 B.C.L.R. (3d) 187, [1998] 3 W.W.R. 177, 98 B.C.A.C. 138, 161 W.A.C. 138, 47 C.C.L.I. (2d) 111 (B.C. C.A.) allowing charterer's appeal from judgment reported at [1995] 9 W.W.R. 376, 33 C.C.L.I. (2d) 9, 9 B.C.L.R. (3d) 260 (B.C. S.C.) allowing owner's action for damages arising from negligence.

POURVOI formé par le propriétaire à l'encontre de l'arrêt publié à (1997), 39 B.C.L.R. (3d) 187, [1998] 3 W.W.R. 177, 98 B.C.A.C. 138, 161 W.A.C. 138, 47 C.C.L.I. (2d) 111 (C.A. C.-B.) accueillant le pourvoi de l'affrètement contre le jugement publié à [1995] 9 W.W.R. 376, 33 C.C.L.I. (2d) 9, 9 B.C.L.R. (3d) 260 (C.S. C.-B.) accueillant l'action du propriétaire en dommages-intérêts résultant de la négligence.

The judgment of the court was delivered by Iacobucci J.:

1 This appeal concerns the application of the doctrine of privity of contract to a waiver of subrogation clause in a contract of insurance.

I. Facts

2 This action arose subsequent to the sinking of the derrick barge "Sceptre Squamish," owned by the appellant, Fraser River Pile & Dredge Ltd. ("Fraser River") and, at the time of loss, under charter to the respondent, Can-Dive Services Ltd. ("Can-Dive"). Can-Dive was held liable at trial for damages in the amount of \$949,503. In appealing the trial decision, Can-Dive does not dispute that the loss resulted from its negligence, but contends that it cannot be held liable in what is in effect a subrogated action by the underwriters of Fraser River's insurance policy.

3 Fraser River carries on business as a provider of dredging, pile-driving and related services. It owns approximately 50 vessels which it uses for these purposes. Occasionally, Fraser River charters vessels for which it has no immediate use to others. In 1990, Can-Dive undertook work as a sub-contractor on a natural gas pipeline under construction between Vancouver Island and the mainland of British Columbia. In order to carry out the work required, Can-Dive contracted with Fraser River to charter the "Sceptre Squamish," and arranged for Fraser River's personnel to operate the crane and winches on board. The charter contract also included a flat scow. Can-Dive assumed full responsibility for towing the barge to and from the work site, and for maintaining the safety and condition of the barge. The "Sceptre Squamish" was towed to the work site on October 30, 1990, where it remained until sinking in stormy weather on the night of November 16, 1990.

4 At all material times during the charter of the "Sceptre Squamish" and its subsequent loss, Fraser River was insured under a Hull Subscription Policy (the "policy"), dated June 28, 1990. Following the loss of the vessel and its equipment, Fraser River recovered from the insurers the sum of \$1,128,365.57, being the fixed amount stipulated in the policy to cover such loss. On June 4, 1991, Fraser River and the insurers entered into a further agreement, setting out their joint intention to pursue a legal action against Can-Dive in negligence for the sinking of the "Sceptre Squamish." The preamble of the agreement included the following terms:

C) The Underwriters have agreed to pay the claims (the claims) of F.R.P.D. for the loss of the barge and crane and the Underwriters wish to proceed with legal action against Can-Dive Services Ltd. and possibly others to recover part or all of their payments;

D) F.R.P.D. has agreed to waive any right it may have pursuant to the waiver of subrogation clause in the aforesaid policy with respect to Can-Dive Services Ltd. ...

5 Fraser River subsequently commenced this action in June, 1991 to recover damages for its losses arising from the sinking of the derrick barge. Can-Dive not only denied that it was negligent, but argued as well that the action was a subrogated action conducted by and for the sole benefit of the insurers, i.e., that as Fraser River had received payment from the insurers in the amount specified in the policy (which exceeded the actual value of the loss by a little over \$300,000), the claim was wholly subrogated, notwithstanding that it was initiated by Fraser River. Accordingly, the insurers were precluded from proceeding against Can-Dive on the basis that the company was included within the category of "Additional Insureds" as defined in the terms of the policy as follows:

General Conditions

1. Additional Insureds Clause

It is agreed that this policy also covers the Insured, associated and affiliated companies of the Insured, be they owners, subsidiaries or interrelated companies and as bareboat charterers and/or charterers and/or sub-charterers and/or operators and/or in whatever capacity and shall so continue to cover notwithstanding any provisions of this policy with respect to change of ownership or management. Provided, however, that in the event of any claim being made by associated, affiliated, subsidiary or interrelated companies under this clause, it shall not be entitled to recover in respect of any liability to which it would be subject if it were the owner, nor to a greater extent than an owner would be entitled in such event to recover.

Notwithstanding anything contained in the Additional Insureds Clause above, it is hereby understood and agreed that permission is hereby granted for these vessels to be chartered and the charterer to be considered an Additional Insured hereunder.

.....
Trustee Clause

It is understood and agreed that the Named Insured who obtained this Policy did so on his own behalf and as agent for the others insured hereby including those referred to by general description.

6 In the alternative, Can-Dive claimed that, assuming it was not included in the policy under the category of "Additional Insureds," the insurers had nonetheless expressly waived any right of subrogation it may have held against the defendant, pursuant to the waiver of subrogation clause which read as follows:

17. Subrogation and Waiver of Subrogation Clause

In the event of any payment under this Policy, the Insurers shall be subrogated to all of the Insured's rights of recovery therefor, and the Insured shall execute all papers required and shall do everything that may be necessary to secure such rights, but it is agreed that the Insurers waive any right of subrogation against:

.....
(b) any charterer(s) and/or operator(s) and/or lessee(s) and/or mortgagee(s).

II. Judgments Below

A. Supreme Court of British Columbia (1995), 9 B.C.L.R. (3d) 260 (B.C. S.C.)

Warren J.

7 Having found that Fraser River's loss was owing to Can-Dive's negligence, Warren J. nonetheless agreed with Can-Dive that the action amounted to a subrogated claim, and went on to consider Can-Dive's defences based on the provisions of the policy. Can-Dive raised three defences: (a) that in agreeing to charter the "Sceptre Squamish" to Can-Dive, Fraser River agreed as well to extend its own insurance coverage under the policy to cover Can-Dive for the duration of the charter agreement; (b) that it came within the class of "Additional Insureds" as specified in the terms of the policy, thereby precluding the insurers from proceeding in a subrogated action against their own insured; and (c) that the insurers expressly waived a right of subrogation against Can-Dive as a "charterer" pursuant to a waiver of subrogation clause contained in the policy.

8 As to Can-Dive's claim that insurance coverage under Fraser River's policy was a term of the charter agreement, Warren J. held that there was insufficient clear and cogent evidence to enable him to conclude on a balance of probabilities that Fraser River agreed to extend its own insurance to cover any risk of loss by Can-Dive during the charter period. Warren J. also rejected Can-Dive's claim that the insurers were precluded from bringing a subrogated action against the company on the basis that Can-Dive, as a "charterer," came within the contractual definition of "Additional Insureds." Warren J. noted that, for this argument to succeed, Can-Dive would have to rely on a contractual term in the policy, and therefore must first overcome the doctrine of privity of contract which generally provides that a stranger to a contract may neither enforce nor rely on its terms.

9 Warren J. next considered Can-Dive's submission that, notwithstanding its status as a third party to the contract, the insurers were bound by the waiver of subrogation clause contained therein as the doctrine of privity of contract does not apply in circumstances where a third-party beneficiary relies on the waiver to defend against an action initiated by the insurers. Having reviewed the existing jurisprudence purporting to deal with privity of contract in this context, and relying in particular on the decision of the Privy Council in *Vandepitte v. Preferred Accident Insurance Co. of New York* (1932), [1933] A.C. 70 (British Columbia P.C.), Warren J. concluded that the doctrine was still applicable except to the extent it was incrementally abrogated through the creation of specific judicial exceptions, or more substantively, through legislative reform, as has generally been the case with automobile insurance legislation. He held that the Court's decision in *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299 (S.C.C.), was controlling on this issue; a waiver of subrogation clause, as with any other contractual provision, is subject to the doctrine of privity unless a traditional exception applies, or sufficient reason exists to relax the doctrine in the given circumstances. Warren J. held that relaxing the doctrine of privity of contract in the present circumstances would alter the doctrine in excess of the incremental changes contemplated by the reasoning in *London Drugs*.

10 Finally, Warren J. considered whether Can-Dive could avail itself of the principles of either trust or agency, established in the case law as potential exceptions to the doctrine of privity of contract. He quickly dismissed the application of trust principles, concluding that the policy did not reveal any intention that Fraser River was acting as trustee on Can-Dive's behalf in contracting for insurance coverage. As to the agency exception, Warren J. first noted that Fraser River, as the purported agent for Can-Dive, must have intended to act on behalf of Can-Dive as the principal or as a member of an ascertainable class of principals. As he was of the opinion that the case could be decided on other grounds, Warren J. was prepared to assume for the purposes of argument that the requisite intention was present.

11 The more significant obstacle in applying principles of agency, however, was the requirement of ratification. Warren J. held that to gain the benefit of the policy, Can-Dive as principal would have to ratify the actions taken by Fraser River in acting on its behalf to arrange for the policy to cover Can-Dive as within the class of "Additional Insureds." Subsequent ratification involves three initial requirements: (a) the purported agent must have represented to the third party that he or she was acting on behalf of the purported principal; (b) the purported principal must have been competent at the time the act was done; and (c) the purported principal must be legally capable of completing the act at the time of ratification. Warren J. concluded that the three initial requirements were met in these circumstances. The first criterion was satisfied by the inclusion of the "Trustee Clause," indicating to the insurers that Fraser River may be acting as agent on behalf of certain unnamed parties who might later ratify the act and become "Additional Insureds" under the policy. Both the second and third criteria were satisfied by the status of Fraser River and Can-Dive as capable, juridical persons at all material times.

12 Assuming that these initial hurdles were overcome, there still remained, however, as a final requirement an actual act of ratification, whether express or by implication. Warren J. concluded that Can-Dive's only act of ratification was amending its Statement of Defence upon learning of the existence of the policy and its potential scope of coverage. While Warren J. did not find that Can-Dive was precluded from ratifying its inclusion as an "Additional Insureds" under the terms of the policy subsequent to the time at which the loss occurred, he held that the opportunity for ratification was extinguished when Fraser River and the insurers entered into an agreement in June, 1991, to pursue a claim against Can-Dive for damages. The effect of this agreement was to change the terms of the policy, given that an action against Can-Dive would have been fundamentally incompatible with the existing scope of the "Additional Insureds" clause. Accordingly, no effective ratification of the policy could have occurred subsequent to this date.

13 Also fatal to Can-Dive's claim was Warren J.'s finding that, even assuming that the requirements of ratification had been met, no consideration flowed from Can-Dive to the insurers; the mere act of chartering Fraser River's vessel was insufficient to amount to consideration for the purposes of concluding that agency principles applied to deem Can-Dive a legal party to the contract between Fraser River and the insurers. In the result, Fraser River's action in negligence was allowed.

B. Court of Appeal for British Columbia (1996), 39 B.C.L.R. (3d) 187 (B.C. C.A.)

Esson, Huddart and Proudfoot J.J.A.

14 Esson J.A., writing for the court, agreed that the claim was wholly subrogated, noting that Fraser River had already received from the insurers the amount fixed in the policy, a sum which exceeded Fraser River's actual losses by over \$300,000. He rejected Can-Dive's submission, however, that the trial judge was in error in finding that Fraser River did not covenant to insure Can-Dive as a term of the charter agreement. Instead, Esson J.A. chose to decide the appeal on the basis of the waiver of subrogation clause contained in the policy and the principles of the doctrine of privity of contract.

15 Esson J.A. first considered whether Can-Dive, as a stranger to the contract of insurance between Fraser River and the insurers, could rely on the waiver of subrogation clause to defend against the subrogated action. He disagreed with the trial judge's conclusion on this point, holding instead that *Vandepitte, supra*, had been impliedly overruled by the Supreme Court of Canada on the basis that the precedent had been ignored in cases where it might well have applied: see, for example, *Scott v. Wavanesa Mutual Insurance Co.*, [1989] 1 S.C.R. 1445 (S.C.C.), where the Court held, without any reference to the doctrine of privity of contract, that the named insured's son came within the class of "Insureds" as defined in the homeowner's policy.

Esson J.A. also noted that soon after *Vandepitte* had been decided, its potential impact on contracts for automobile insurance was abrogated in every relevant jurisdiction. In his opinion, the decision was not good law, as it had either been overtaken by legislation, as in the case of automobile insurance, or largely ignored in favour of reasoning which better reflected commercial reality.

16 Apart from referring to the implicit overruling of *Vandepitte*, *supra*, Esson J.A. also concluded that judicial authority supported Can-Dive's submission that "waiver of subrogation" clauses in contracts of insurance constituted an exception to the doctrine of privity of contract in circumstances where the third-party beneficiary is not a party to the policy, but nonetheless falls within the contractual definition of those to whom coverage is extended. In *Commonwealth Construction Co. v. Imperial Oil Ltd.* (1976), [1978] 1 S.C.R. 317 (S.C.C.), for example, subcontractors who were not parties to a builder's risk policy, but who met the definition of a "Contractor" for the purposes of coverage, were able to overcome the doctrine of privity of contract. In holding that subrogation was not available against the subcontractor, de Grandpré J. relied upon the nature of the relationship amongst the various contractors on a construction site, i.e., that the parties were involved in a joint effort towards a common goal. To give effect to the doctrine of privity of contract would be commercially unreasonable in these circumstances, in that any loss on the construction site caused by one of the parties would necessarily lead to litigation between the parties, contrary to the interest of the common enterprise. In addition to the builder's risk cases, Esson J.A. also identified an existing exception to the doctrine of privity of contract in insurance law more generally, originating in a line of authority dating back to a decision of Mathew J. in *Thomas & Co. v. Brown* (1899), 4 Com. Cas. 186.

17 Esson J.A. next considered whether this established exception, available in circumstances where a purported third-party beneficiary comes within the class of those to whom insurance coverage is extended, has nonetheless been overtaken by the Court's decision in *London Drugs*, *supra*. In other words, the exception in favour of waiver of subrogation clauses remains good law only to the extent that it does not contradict the legal principles or analytical framework set out in *London Drugs*. Esson J.A. held that an exception of this nature was entirely consistent on the basis that, if an insurer were to seek to avoid liability on the same grounds as were relied upon in *Vandepitte*, *supra*, under the more recent *London Drugs* analysis, it would fail. Many of the same considerations relevant to the disposition of *London Drugs* were applicable in the instant case, e.g., the third party or stranger to the contract was seeking to rely on a contractual provision to defend against an action, rather than seeking to enforce the terms of the contract on its own initiative against one of the original parties. Furthermore, it was expressly stated in *London Drugs* that nothing in the reasons should be taken as affecting in any way existing exceptions to the doctrine of privity of contract such as principles of trust or agency. Accordingly, as the jurisprudence in support of an exception to privity in favour of third-party beneficiaries falling within the contractual definition of the insured class for the purposes of the insurance policy had not been overtaken by the Court's decision in *London Drugs*, *supra*, Esson J.A. concluded that Can-Dive could rely on the waiver of subrogation clause in the policy.

18 Esson J.A. was also of the view that Can-Dive could succeed on the basis of the agency exception. He found that the trial judge erred in failing to find a clear act of ratification by Can-Dive. Specifically, he did not agree with the trial judge's conclusion that Can-Dive's amendment to the pleadings in February, 1994 could not amount to ratification on the basis that Fraser River and its insurers, by virtue of their agreement in June, 1991 to proceed against Can-Dive, had effectively revised the terms of the policy so as to delete the provision granting third-party rights to Can-Dive. Esson J.A. held that while parties to a contract may subsequently delete provisions in favour of third-party beneficiaries, contractual terms providing protection against loss to third parties cannot be varied to the detriment of the third party after the occurrence of the very loss contemplated in the policy.

19 Accordingly, Esson J.A. allowed the appeal and dismissed the action against Can-Dive.

III. Issues

20 As noted above, this appeal concerns the question of whether a third-party beneficiary can rely on a waiver of subrogation clause contained in a contract of insurance to defend against a subrogated action initiated by the insurer. In the context of this appeal, this question raises the following issues:

a. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the agency exception to the doctrine of privity of contract?

b. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the principled exception to the privity of contract doctrine established by the Court's decision in *London Drugs*?

IV. Analysis

A. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the agency exception to the doctrine of privity of contract?

21 The entirety of the dispute between the parties concerns the legal effect to be given to the waiver of subrogation contained in Clause 17 of the appellant Fraser River's contract of insurance, which reads as follows:

17. Subrogation and Waiver of Subrogation Clause

In the event of any payment under this Policy, the Insurers shall be subrogated to all of the Insured's rights of recovery therefor, and the Insured shall execute all papers required and shall do everything that may be necessary to secure such rights, but it is agreed that the Insurers waive any right of subrogation against:

.....
(b) any charterer(s) and/or operator(s) and/or lessee(s) and/or mortgagee(s).

22 The respondent Can-Dive is seeking to rely on the waiver of subrogation clause contained in the policy to defend against this subrogated action in negligence. As a general rule, however, the doctrine of privity provides that a contract can neither confer rights nor impose obligations on third parties. This appeal is concerned only with the former situation, namely, circumstances in which a third party is seeking to obtain a benefit or right established in its favour pursuant to the terms of the contract. The Court is not called on to address the situation in which a contract imposes obligations on a third party, and I stress that nothing in these reasons should be taken as applicable to the law in this area.

23 Although the doctrine of privity would normally be fatal to its case, Can-Dive submits that the principle of agency applies to deem Can-Dive a party to the contract in law, if not in fact, such that privity is no longer a concern. Because of the approach I intend to take to this case, I do not find it necessary to deal with the argument that Can-Dive may rely on the waiver of subrogation clause on this basis. In so stating, I do not wish to be taken as either agreeing or disagreeing with Esson J.A.'s conclusions on this issue. Instead, I prefer to adopt the approach set out in *London Drugs, supra*, and consider whether the doctrine of privity should be relaxed in these circumstances.

B. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the principled exception to the privity of contract doctrine established by the Court's decision in *London Drugs*?

1. *London Drugs* and a Principled Exception to the Doctrine of Privity of Contract

24 As stated above, Can-Dive's position is that of a third-party beneficiary who normally would be precluded from enforcing or relying on the terms of the policy in effect between Fraser River and its insurers. Accordingly, it is necessary to consider the legal status of the waiver of subrogation clause in light of the Court's decision in *London Drugs, supra*. In that case, the Court introduced what was intended as a principled exception to the common law doctrine of privity of contract.

25 At issue was the status of a limitation of liability clause in the standard form contract between the appellant and the respondent for storage of the appellant's transformer. The clause limited a "warehouseman's" liability on any one package to \$40.

While in storage, a transformer was damaged owing to negligence on the part of the respondent's employees. The appellant sued both the warehouse company and its employees, and the trial judge found the employees personally liable for the full amount of the damages. On appeal, the majority allowed the employees to rely on the limitation of liability clause in the employer's contract with the appellant, notwithstanding that the employees were not parties to this contract. The majority of the Court upheld the result on appeal, concluding that in circumstances where the traditional exceptions to privity of contract such as agency or trust do not apply, courts may nonetheless undertake the appropriate analysis, bounded by both common sense and commercial reality, in order to determine whether the doctrine of privity with respect to third-party beneficiaries should be relaxed in the given circumstances.

26 The Court devoted a great deal of attention to the judicial history and application of the doctrine of privity of contract as it relates to third-party beneficiaries, noting the extent of judicial discontent, legislative override, and a significant body of academic criticism. While acknowledging that privity of contract is an established doctrine of contract law, the Court concluded, at p. 423, that the concerns expressed regarding the application of the doctrine to third-party beneficiaries indicated that the time for judicial consideration in this particular context had arrived:

These comments and others reveal many concerns about the doctrine of privity as it relates to third party beneficiaries. For our purposes, I think it sufficient to make the following observations. Many have noted that an application of the doctrine so as to prevent a third party from relying on a limitation of liability clause which was intended to benefit him or her frustrates sound commercial practice and justice. It does not respect allocations and assumptions of risk made by the parties to the contract and it ignores the practical realities of insurance coverage. In essence, it permits one party to make a unilateral modification to the contract by circumventing its provisions and the express or implied intention of the parties. In addition, it is inconsistent with the reasonable expectations of all the parties to the transaction, including the third party beneficiary who is made to support the entire burden of liability. The doctrine has also been criticized for creating uncertainty in the law. While most commentators welcome, at least in principle, the various judicial exceptions to privity of contract, concerns about the predictability of their use have been raised. Moreover, it is said, in cases where the recognized exceptions do not appear to apply, the underlying concerns of commercial reality and justice still militate for the recognition of a third party beneficiary right.

27 The respondent employees in *London Drugs* were unable to rely on existing principles of trust or agency. Rather than adapting these established principles to accommodate yet another *ad hoc* exception to the doctrine of privity, it was decided to adopt a more direct approach as a matter of principle. The Court held that, in circumstances where the traditional exceptions do not apply, the relevant functional inquiry is whether the doctrine should be relaxed in the given circumstances.

28 In order to distinguish mere strangers to a contract from those in the position of third-party beneficiaries, the Court first established a threshold requirement whereby the parties to the contract must have intended the relevant provision to confer a benefit on the third party. In other words, an employer and its customer may agree to extend, either expressly or by implication, the benefit of any limitation of liability clause to the employees. In the circumstances of *London Drugs*, the customer had full knowledge that the storage services contemplated by the contract would be provided not only by the employer, but by the employees as well. In the absence of any clear indication to the contrary, the Court held that the necessary intention to include coverage for the employees was implied in the terms of the agreement. The employees, therefore, as third-party beneficiaries, could seek to rely on the limitation clause to avoid liability for the loss to the customer's property.

29 The Court further held, however, that the intention to extend the benefit of a contractual provision to the actions of a third-party beneficiary was irrelevant unless the actions in question came within the scope of agreement between the initial parties. Accordingly, the second aspect of the functional inquiry was whether the employees were acting in the course of their employment when the loss occurred, and whether in so acting they were performing the very services specified in the contract between their employer and its customer. Based on uncontested findings of fact, it was clear that the damage to the customer's transformer occurred when the employees were acting in the course of their employment to provide the very storage services specified in the contract.

30 Taking all of these circumstances into account, the Court interpreted the term "warehouseman" in the limitation of liability clause to include coverage for the employees, thereby absolving them of any liability in excess of \$40 for the loss that occurred. The Court concluded that the departure from the traditional doctrine of privity was well within its jurisdiction representing, as it did, an incremental change to the common law rather than a wholesale abdication of existing principles. Given that the exception was dependent on the intention stipulated in the contract, relaxing the doctrine of privity in the given circumstances did not frustrate the expectations of the parties.

2. Application of the Principled Exception to the Circumstances of this Appeal

31 As a preliminary matter, I note that it was not our intention in *London Drugs*, *supra*, to limit application of the principled approach to situations involving only an employer-employee relationship. That the discussion focussed on the nature of this relationship simply reflects the prudent jurisprudential principle that a case should not be decided beyond the scope of its immediate facts.

32 In terms of extending the principled approach to establishing a new exception to the doctrine of privity of contract relevant to the circumstances of the appeal, regard must be had to the emphasis in *London Drugs* that a new exception first and foremost must be dependent upon the intention of the contracting parties. Accordingly, extrapolating from the specific requirements as set out in *London Drugs*, the determination in general terms is made on the basis of two critical and cumulative factors: (a) did the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision; and (b) are the activities performed by the third party seeking to rely on the contractual provision the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, again as determined by reference to the intentions of the parties?

Intentions of the Parties

33 As to the first inquiry, Can-Dive has a very compelling case in favour of relaxing the doctrine of privity in these circumstances, given the express reference in the waiver of subrogation clause to "charterer(s)," a class of intended third-party beneficiaries that, on a plain reading of the contract, includes Can-Dive within the scope of the term. Indeed, there is no dispute between the parties as to the meaning of the term within the waiver of subrogation clause; disagreement exists only as to whether the clause has legal effect. Accordingly, there can be no question that the parties intended to extend the benefit in question to a class of third-party beneficiaries whose membership includes Can-Dive. Given the lack of ambiguity on the face of the provision, there is no need to resort to extrinsic evidence for the purposes of determining otherwise. If the parties did not intend the waiver of subrogation clause to be extended to third-party beneficiaries, they need not have included such language in their agreement.

34 In essence, Fraser River's argument in terms of the intention of the parties is not that the scope of the waiver of subrogation clause does not extend to third parties such as Can-Dive, but that the provision can only be enforced by Fraser River on Can-Dive's behalf, and not by Can-Dive acting independently. A plain reading of the provision, however, does not support this conclusion. There is no language in the clause indicating that the waiver of subrogation is intended to be conditional upon Fraser River's initiative in favour of any particular third-party beneficiary. It appears to me that Fraser River has conflated arguments concerning the intentions of the parties in drafting the provision and the legal effect to be given to the provision. In no uncertain terms, the waiver of subrogation clause indicates that the insurers are precluded from proceeding with an action against third-party beneficiaries coming within the class of "charterer(s)," and the relevant inquiry is whether to give effect to these intentions by enforcing the contractual term, notwithstanding the doctrine of privity of contract.

35 In my opinion, the case in favour of relaxing the doctrine of privity is even stronger in the circumstances of this appeal than was the case in *London Drugs*, *supra*, wherein the parties did not expressly extend the benefit of a limitation of liability clause covering a "warehouseman" to employees. Instead, it was necessary to support an implicit extension of the benefit on the basis of the relationship between the employers and its employees, that is to say, the identity of interest between the employer and its employees in terms of performing the contractual obligations. In contrast, given the express reference to "charterer(s)"

in the waiver of subrogation clause in the policy, there is no need to look for any additional factors to justify characterizing Can-Dive as a third-party beneficiary rather than a mere stranger to the contract.

36 Having concluded that the parties intended to extend the benefit of the waiver of subrogation clause to third parties such as Can-Dive, it is necessary to address Fraser River's argument that its agreement with the insurers to pursue legal action against Can-Dive nonetheless effectively deleted the third-party benefit from the contract. A significant concern with relaxing the doctrine of privity is the potential restrictions on freedom of contract which could result if the interests of a third-party beneficiary must be taken into account by the parties to the initial agreement before any adjustment to the contract could occur. It is important to note, however, that the agreement in question was concluded subsequent to the point at which what might be termed Can-Dive's inchoate right under the contract crystallized into an actual benefit in the form of a defence against an action in negligence by Fraser River's insurers. Having contracted in favour of Can-Dive as within the class of potential third-party beneficiaries, Fraser River and the insurers cannot revoke unilaterally Can-Dive's rights once they have developed into an actual benefit. At the point at which Can-Dive's rights crystallized, it became for all intents and purposes a party to the initial contract for the limited purposes of relying on the waiver of subrogation clause. Any subsequent alteration of the waiver provision is subject to further negotiation and agreement among all of the parties involved, including Can-Dive.

37 I am mindful, however, that the principle of freedom of contract must not be dismissed lightly. Accordingly, nothing in these reasons concerning the ability of the initial parties to amend contractual provisions subsequently should be taken as applying other than to the limited situation of a third-party's seeking to rely on a benefit conferred by the contract to defend against an action initiated by one of the parties, and only then in circumstances where the inchoate contractual right has crystallized prior to any purported amendment. Within this narrow exception, however, the doctrine of privity presents no obstacle to contractual rights conferred on third-party beneficiaries.

Third-Party Beneficiary is Performing the Activities Contemplated in the Contract

38 As to the second requirement that the intended third-party beneficiary must rely on a contractual provision in connection with the very activities contemplated by the contract in general, or by the relevant clause in particular, Fraser River has argued that a significant distinction exists between the situation in *London Drugs*, *supra*, and the circumstances of the present appeal. In *London Drugs*, the relationship between the contracting parties and the third-party beneficiary involved a single contract for the provision of services, whereas in the present circumstances, such a "contractual nexus," to use Fraser River's phrase, does not exist. In other words, the waiver of subrogation clause upon which Can-Dive seeks to rely is contained in an unrelated contract that does not pertain to the charter contract in effect between Fraser River and Can-Dive.

39 With respect, I do not find this argument compelling, given that a similar contractual relationship could be said to exist in *London Drugs*, in terms of the service contract between the parties and a contract of employment which presumably existed between the employer and employees. At issue is whether the purported third-party beneficiary is involved in the very activity contemplated by the contract containing the provision upon which he or she seeks to rely. In this case, the relevant activities arose in the context of the relationship of Can-Dive to Fraser River as a charterer, the very activity anticipated in the policy pursuant to the waiver of subrogation clause. Accordingly, I conclude that the second requirement for relaxing the doctrine of privity has been met.

Policy Reasons in Favour of an Exception in these Circumstances

40 Having found that Can-Dive has satisfied both of the cumulative threshold requirements for the purposes of introducing a new, principled exception to the doctrine of privity of contract as it applies to third-party beneficiaries, I nonetheless wish to add that there are also sound policy reasons for relaxing the doctrine in these circumstances. In this respect, it is time to put to rest the unreasonable application of the doctrine of privity to contracts of insurance established by the Privy Council in *Vandepitte*, *supra*, a decision characterized since its inception by both legislatures and the judiciary as out of touch with commercial reality. As Esson J.A. noted, the decision in *Vandepitte* received little attention outside the field of automobile insurance, where it had been promptly overruled by legislative amendment in British Columbia and other provinces. In addition, Esson J.A. was correct in holding that *Vandepitte* has been impliedly overruled in the course of decisions by the Court, given that in cases where the

rule of privity might have been applied, the decision was ignored: *Scott, supra*. Of particular interest is the Court's decision in *Commonwealth Construction Co., supra*. The case concerned a general contractor's "builder's risk" policy that purported to extend coverage to sub-contractors who were not parties to the original contract. In holding that subrogation was not available against the sub-contractors, de Grandpré J., writing for the Court, made the following comments regarding the "Additional Insureds" and "Trustee" clauses, at p. 324:

While these conditions may have been inserted to avoid the pitfalls that were the lot of the unnamed insured in *Vandepitte v. Preferred Accident Ins. Co.* [citations omitted] a precaution that in my view was not needed, they without doubt cover additional ground.

41 When considered in light of the Court's discussion of the necessary interdependence of various contractors involved in a common construction enterprise, the comment reflects the Court's acknowledgment that the rule of privity set out in *Vandepitte, supra*, was inconsistent with commercial reality. In a similar fashion, Fraser River in the course of this appeal has been unable to provide any commercial reason for failing to enforce a bargain entered into by sophisticated commercial actors. In the absence of any indication to the contrary, I must conclude that relaxing the doctrine of privity in these circumstances establishes a default rule that most closely corresponds to commercial reality as is evidenced by the inclusion of the waiver of subrogation clause within the contract itself.

42 A plain reading of the waiver of subrogation clause indicates that the benefit accruing in favour of third parties is not subject to any qualifying language or limiting conditions. When sophisticated commercial parties enter into a contract of insurance which expressly extends the benefit of a waiver of subrogation clause to an ascertainable class of third-party beneficiary, any conditions purporting to limit the extent of the benefit or the terms under which the benefit is to be available must be clearly expressed. The rationale for this requirement is that the obligation to contract for exceptional terms most logically rests with those parties whose intentions do not accord with what I assume to be standard commercial practice. Otherwise, notwithstanding the doctrine of privity of contract, courts will enforce the bargain agreed to by the parties and will not undertake to rewrite the terms of the agreement.

43 Fraser River has also argued that to relax the doctrine of privity of contract in the circumstances of this appeal would be to introduce a significant change to the law that is better left to the legislature. As was noted in *London Drugs, supra*, privity of contract is an established doctrine of contract law, and should not be lightly discarded through the process of judicial decree. Wholesale abolition of the doctrine would result in complex repercussions that exceed the ability of the courts to anticipate and address. It is by now a well-established principle that courts will not undertake judicial reform of this magnitude, recognizing instead that the legislature is better placed to appreciate and accommodate the economic and policy issues involved in introducing sweeping legal reforms.

44 That being said, the corollary principle is equally compelling, which is that in appropriate circumstances, courts must not abdicate their judicial duty to decide on incremental changes to the common law necessary to address emerging needs and values in society: *Watkins v. Olafson*, [1989] 2 S.C.R. 750 (S.C.C.) at pp. 760-61, and *R. v. Salituro*, [1991] 3 S.C.R. 654 (S.C.C.) at pp. 665-70. In this case, I do not accept Fraser River's submission that permitting third-party beneficiaries to rely on a waiver of subrogation clause represents other than an incremental development. To the contrary, the factors present in *London Drugs, supra*, in support of the incremental nature of the exception are present as well in the circumstances of this appeal. As in *London Drugs*, a third-party beneficiary is seeking to rely on a contractual provision in order to defend against an action initiated by one of the contracting parties. Fraser River's concerns regarding the potential for double recovery are unfounded, as relaxing the doctrine to the extent contemplated by these reasons does not permit Can-Dive to rely on any provision in the policy to establish a separate claim. In addition, the exception is dependent upon the express intentions of the parties, evident in the language of the waiver of subrogation clause, to extend the benefit of the provision to certain named classes of third-party beneficiaries.

V. Conclusion and Disposition

45 I conclude that the circumstances of this appeal nonetheless meet the requirements established in *London Drugs, supra*, for a third-party beneficiary to rely on the terms of a contract to defend against a claim initiated by one of the parties to the contract.

As a third-party beneficiary to the policy, Can-Dive is entitled to rely on the waiver of subrogation clause whereby the insurers expressly waived any right of subrogation against Can-Dive as a "charterer" of a vessel included within the policy's coverage.

46 Accordingly, I would dismiss the appeal with costs.

Appeal dismissed.

Pourvoi rejeté.

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CANADA

CONSOLIDATION

CODIFICATION

Bankruptcy and Insolvency Act

Loi sur la faillite et l'insolvabilité

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Audit of proceedings

241 The accounts of every clerk that relate to proceedings under this Part are subject to audit in the same manner as if the accounts were the accounts of a provincial officer.

R.S., c. B-3, s. 212.

Application of this Part

242 (1) The Governor in Council shall, at the request of the lieutenant governor in council of a province, declare, by order, that this Part applies or ceases to apply, as the case may be, in respect of the province.

Automatic application

(2) Subject to an order being made under subsection (1) declaring that this Part ceases to apply in respect of a province, if this Part is in force in the province immediately before that subsection comes into force, this Part applies in respect of the province.

R.S., 1985, c. B-3, s. 242; 2002, c. 7, s. 85; 2007, c. 36, s. 57.

PART XI

Secured Creditors and Receivers

Court may appoint receiver

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.

Restriction on appointment of receiver

(1.1) In the case of an insolvent person in respect of whose property a notice is to be sent under subsection 244(1), the court may not appoint a receiver under subsection (1) before the expiry of 10 days after the day on which the secured creditor sends the notice unless

Vérification des comptes

241 Les comptes de chaque greffier, relatifs aux procédures prévues par la présente partie, sont sujets à vérification de la même manière que s'ils étaient les comptes d'un fonctionnaire provincial.

S.R., ch. B-3, art. 212.

Application

242 (1) À la demande du lieutenant-gouverneur en conseil d'une province, le gouverneur en conseil déclare par décret que la présente partie commence à s'appliquer ou cesse de s'appliquer, selon le cas, dans la province en question.

Application automatique

(2) Sous réserve d'une éventuelle déclaration faite en vertu du paragraphe (1) indiquant qu'elle cesse de s'appliquer à la province en cause, la présente partie s'applique à toute province dans laquelle elle était en vigueur à l'entrée en vigueur de ce paragraphe.

L.R. (1985), ch. B-3, art. 242; 2002, ch. 7, art. 85; 2007, ch. 36, art. 57.

PARTIE XI

Créanciers garantis et séquestres

Nomination d'un séquestre

243 (1) Sous réserve du paragraphe (1.1), sur demande d'un créancier garanti, le tribunal peut, s'il est convaincu que cela est juste ou opportun, nommer un séquestre qu'il habilite :

a) à prendre possession de la totalité ou de la quasi-totalité des biens — notamment des stocks et comptes à recevoir — qu'une personne insolvable ou un failli a acquis ou utilisés dans le cadre de ses affaires;

b) à exercer sur ces biens ainsi que sur les affaires de la personne insolvable ou du failli le degré de prise en charge qu'il estime indiqué;

c) à prendre toute autre mesure qu'il estime indiquée.

Restriction relative à la nomination d'un séquestre

(1.1) Dans le cas d'une personne insolvable dont les biens sont visés par le préavis qui doit être donné par le créancier garanti aux termes du paragraphe 244(1), le tribunal ne peut faire la nomination avant l'expiration d'un délai de dix jours après l'envoi de ce préavis, à moins :

(a) the insolvent person consents to an earlier enforcement under subsection 244(2); or

(b) the court considers it appropriate to appoint a receiver before then.

Definition of receiver

(2) Subject to subsections (3) and (4), in 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 receiver-manager.

Definition of receiver — subsection 248(2)

(3) For the purposes of subsection 248(2), the definition **receiver** in subsection (2) is to be read without reference to paragraph (a) or subparagraph (b)(ii).

Trustee to be appointed

(4) Only a trustee may be appointed under subsection (1) or under an agreement or order referred to in paragraph (2)(b).

Place of filing

(5) The application is to be filed in a court having jurisdiction in the judicial district of the locality of the debtor.

Orders respecting fees and disbursements

(6) If a receiver is appointed under subsection (1), the court may make any order respecting the payment of fees and disbursements of the receiver that it considers proper, including one that gives the receiver a charge, ranking ahead of any or all of the secured creditors, over all or part of the property of the insolvent person or bankrupt in respect of the receiver's claim for fees or

a) que la personne insolvable ne consente, aux termes du paragraphe 244(2), à l'exécution de la garantie à une date plus rapprochée;

b) qu'il soit indiqué, selon lui, de nommer un séquestre à une date plus rapprochée.

Définition de séquestre

(2) Dans la présente partie, mais sous réserve des paragraphes (3) et (4), **séquestre** s'entend de toute personne qui :

a) soit est nommée en vertu du paragraphe (1);

b) soit est nommément habilitée à prendre — ou a pris — en sa possession ou sous sa responsabilité, aux termes d'un contrat créant une garantie sur des biens, appelé « contrat de garantie » dans la présente partie, ou aux termes d'une ordonnance rendue sous le régime de toute autre loi fédérale ou provinciale prévoyant ou autorisant la nomination d'un séquestre ou d'un séquestre-gérant, la totalité ou la quasi-totalité des biens — notamment des stocks et comptes à recevoir — qu'une personne insolvable ou un failli a acquis ou utilisés dans le cadre de ses affaires.

Définition de séquestre — paragraphe 248(2)

(3) Pour l'application du paragraphe 248(2), la définition de **séquestre**, au paragraphe (2), s'interprète sans égard à l'alinéa a) et aux mots « ou aux termes d'une ordonnance rendue sous le régime de toute autre loi fédérale ou provinciale prévoyant ou autorisant la nomination d'un séquestre ou d'un séquestre-gérant ».

Syndic

(4) Seul un syndic peut être nommé en vertu du paragraphe (1) ou être habilité aux termes d'un contrat ou d'une ordonnance mentionné à l'alinéa (2)b).

Lieu du dépôt

(5) La demande de nomination est déposée auprès du tribunal compétent dans le district judiciaire de la localité du débiteur.

Ordonnances relatives aux honoraires et débours

(6) Le tribunal peut, relativement au paiement des honoraires et débours du séquestre nommé en vertu du paragraphe (1), rendre toute ordonnance qu'il estime indiquée, y compris une ordonnance portant que la réclamation de celui-ci à l'égard de ses honoraires et débours est garantie par une sûreté de premier rang sur tout ou partie des biens de la personne insolvable ou du

disbursements, but the court may not make the order unless it is satisfied that the secured creditors who would be materially affected by the order were given reasonable notice and an opportunity to make representations.

Meaning of disbursements

(7) In subsection (6), *disbursements* does not include payments made in the operation of a business of the insolvent person or bankrupt.

1992, c. 27, s. 89; 2005, c. 47, s. 115; 2007, c. 36, s. 58.

Advance notice

244 (1) A secured creditor who intends to enforce a security on all or substantially all of

- (a) the inventory,
- (b) the accounts receivable, or
- (c) the other property

of an insolvent person that was acquired for, or is used in relation to, a business carried on by the insolvent person shall send to that insolvent person, in the prescribed form and manner, a notice of that intention.

Period of notice

(2) Where a notice is required to be sent under subsection (1), the secured creditor shall not enforce the security in respect of which the notice is required until the expiry of ten days after sending that notice, unless the insolvent person consents to an earlier enforcement of the security.

No advance consent

(2.1) For the purposes of subsection (2), consent to earlier enforcement of a security may not be obtained by a secured creditor prior to the sending of the notice referred to in subsection (1).

Exception

(3) This section does not apply, or ceases to apply, in respect of a secured creditor

- (a) whose right to realize or otherwise deal with his security is protected by subsection 69.1(5) or (6); or
- (b) in respect of whom a stay under sections 69 to 69.2 has been lifted pursuant to section 69.4.

failli, avec préséance sur les réclamations de tout créancier garanti; le tribunal ne peut toutefois déclarer que la réclamation du séquestre est ainsi garantie que s'il est convaincu que tous les créanciers garantis auxquels l'ordonnance pourrait sérieusement porter atteinte ont été avisés à cet égard suffisamment à l'avance et se sont vu accorder l'occasion de se faire entendre.

Sens de débours

(7) Pour l'application du paragraphe (6), ne sont pas comptés comme débours les paiements effectués dans le cadre des opérations propres aux affaires de la personne insolvable ou du failli.

1992, ch. 27, art. 89; 2005, ch. 47, art. 115; 2007, ch. 36, art. 58.

Préavis

244 (1) Le créancier garanti qui se propose de mettre à exécution une garantie portant sur la totalité ou la quasi-totalité du stock, des comptes recevables ou des autres biens d'une personne insolvable acquis ou utilisés dans le cadre des affaires de cette dernière doit lui en donner préavis en la forme et de la manière prescrites.

Délai

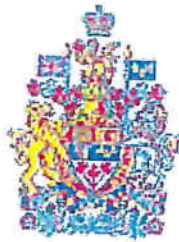
(2) Dans les cas où un préavis est requis aux termes du paragraphe (1), le créancier garanti ne peut, avant l'expiration d'un délai de dix jours suivant l'envoi du préavis, mettre à exécution la garantie visée par le préavis, à moins que la personne insolvable ne consente à une exécution à une date plus rapprochée.

Préavis

(2.1) Pour l'application du paragraphe (2), le créancier garanti ne peut obtenir le consentement visé par le paragraphe avant l'envoi du préavis visé au paragraphe (1).

Non-application du présent article

(3) Le présent article ne s'applique pas, ou cesse de s'appliquer, au créancier garanti dont le droit de réaliser sa garantie ou d'effectuer toute autre opération, relativement à celle-ci est protégé aux termes du paragraphe 69.1(5) ou (6), ou à l'égard de qui a été levée, aux termes de l'article 69.4, la suspension prévue aux articles 69 à 69.2.



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Receiver's interim reports

(2) A receiver shall, in accordance with the General Rules, prepare further interim reports relating to the receivership, and shall provide copies thereof to the Superintendent and

(a) to the insolvent person or the trustee (in the case of a bankrupt); and

(b) to any creditor of the insolvent person or the bankrupt who requests a copy at any time up to six months after the end of the receivership.

Receiver's final report and statement of accounts

(3) A receiver shall, forthwith after completion of duties as receiver, prepare a final report and a statement of accounts, in the prescribed form and containing the prescribed information relating to the receivership, and shall forthwith provide a copy thereof to the Superintendent and

(a) to the insolvent person or the trustee (in the case of a bankrupt); and

(b) to any creditor of the insolvent person or the bankrupt who requests a copy at any time up to six months after the end of the receivership.

1992, c. 27, s. 89.

Good faith, etc.

247 A receiver shall

(a) act honestly and in good faith; and

(b) deal with the property of the insolvent person or the bankrupt in a commercially reasonable manner.

1992, c. 27, s. 89.

Powers of court

248 (1) Where the court, on the application of the Superintendent, the insolvent person, the trustee (in the case of a bankrupt), a receiver or a creditor, is satisfied that the secured creditor, the receiver or the insolvent person is failing or has failed to carry out any duty imposed by sections 244 to 247, the court may make an order, on such terms as it considers proper,

(a) directing the secured creditor, receiver or insolvent person, as the case may be, to carry out that duty, or

(b) restraining the secured creditor or receiver, as the case may be, from realizing or otherwise dealing with the property of the insolvent person or bankrupt until that duty has been carried out,

Rapports provisoires

(2) Le séquestre doit, conformément aux Règles générales, établir des rapports provisoires supplémentaires portant sur son mandat et en fournir un exemplaire au surintendant, à la personne insolvable ou, dans le cas d'un failli, au syndic et à tout créancier de la personne insolvable ou du failli qui en demande un exemplaire dans les six mois suivant la fin du mandat du séquestre.

Rapport définitif et état de comptes

(3) Dès qu'il cesse d'occuper ses fonctions, le séquestre établit, en la forme prescrite, un rapport définitif et un état de comptes contenant les renseignements prescrits relativement à l'exercice de ses attributions; il en transmet sans délai une copie au surintendant et :

a) à la personne insolvable ou, en cas de faillite, au syndic;

b) à tout créancier de la personne insolvable ou du failli qui en fait la demande au plus tard six mois après que le séquestre a complété l'exercice de ses attributions en l'espèce.

1992, ch. 27, art. 89.

Obligation de diligence

247 Le séquestre doit gérer les biens de la personne insolvable ou du failli en toute honnêteté et de bonne foi, et selon des pratiques commerciales raisonnables.

1992, ch. 27, art. 89.

Pouvoirs du tribunal

248 (1) S'il est convaincu, à la suite d'une demande du surintendant, de la personne insolvable, du syndic — en cas de faillite —, du séquestre ou d'un créancier que le créancier garanti, le séquestre ou la personne insolvable ne se conforme pas ou ne s'est pas conformé à l'une ou l'autre des obligations que lui imposent les articles 244 à 247, le tribunal peut, aux conditions qu'il estime indiquées :

a) ordonner au créancier garanti, au séquestre ou à la personne insolvable de se conformer à ses obligations;

b) interdire au créancier garanti ou au séquestre de réaliser les biens de la personne insolvable ou du failli, ou de faire toutes autres opérations à leur égard, jusqu'à ce qu'il se soit conformé à ses obligations.

1991 CarswellOnt 205
Ontario Court of Appeal

Royal Bank of Canada v. Soundair Corporation

1991 CarswellOnt 205, [1991] O.J. No. 1137, 27 A.C.W.S. (3d) 1178,
46 O.A.C. 321, 4 O.R. (3d) 1, 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76

**ROYAL BANK OF CANADA (plaintiff/respondent) v. SOUNDAIR CORPORATION
(respondent), CANADIAN PENSION CAPITAL LIMITED (appellant)
and CANADIAN INSURERS' CAPITAL CORPORATION (appellant)**

Goodman, McKinlay and Galligan JJ.A.

Heard: June 11, 12, 13 and 14, 1991

Judgment: July 3, 1991

Docket: Doc. CA 318/91

Counsel: *J. B. Berkow* and *S. H. Goldman*, for appellants Canadian Pension Capital Limited and Canadian Insurers' Capital Corporation.

J. T. Morin, Q.C., for Air Canada.

L.A.J. Barnes and *L.E. Ritchie*, for plaintiff/respondent Royal Bank of Canada.

S.F. Dunphy and *G.K. Ketcheson*, for Ernst & Young Inc., receiver of respondent Soundair Corporation.

W.G. Horton, for Ontario Express Limited.

N.J. Spies, for Frontier Air Limited.

Subject: Corporate and Commercial: Insolvency

Headnote

Receivers --- Conduct and liability of receiver - General conduct of receiver

Court considering its position when approving sale recommended by receiver. S Corp., which engaged in the air transport business, had a division known as AT. When S Corp. experienced financial difficulties, one of the secured creditors, who had an interest in the assets of AT, brought a motion for the appointment of a receiver. The receiver was ordered to operate AT and to sell it as a going concern. The receiver had two offers. It accepted the offer made by OEL and rejected an offer by 922 which contained an unacceptable condition. Subsequently, 922 obtained an order allowing it to make a second offer removing the condition. The secured creditors supported acceptance of the 922 offer. The court approved the sale to OEL and dismissed the motion to approve the 922 offer. An appeal was brought from this order.

Held:

The appeal was dismissed.

Per Galligan J.A.: When a court appoints a receiver to use its commercial expertise to sell an airline, it is inescapable that it intends to rely upon the receiver's expertise and not upon its own. The court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions made by its receiver. The conduct of the receiver should be reviewed in the light of the specific mandate given to him by the court. The order appointing the receiver did not say how the receiver was to negotiate the sale. The order obviously intended, because of the unusual nature of the asset being sold, to leave the method of sale substantially to the discretion of the receiver. To determine whether a receiver has acted providently, the conduct of the receiver should be examined in light of the information the receiver had when it agreed to accept an offer. On the date the receiver accepted the OEL offer, it had only two offers: that of OEL, which was acceptable, and that of 922, which contained an unacceptable condition. The decision made was a sound one in the circumstances. The receiver made a sufficient effort to obtain the best price, and did not act improvidently.

The court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the assets to them.

Per McKinlay J.A. (concurring in the result): It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers. In all cases, the court should carefully scrutinize the procedure followed by the receiver. While the procedure carried out by the receiver in this case was appropriate, given the unfolding of events and the unique nature of the asset involved, it may not be a procedure that is likely to be appropriate in many receivership sales. Per Goodman J.A. (dissenting): It was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to the receiver. The offer accepted by the receiver was improvident and unfair insofar as two creditors were concerned.

Appeal from order approving sale of assets by receiver.

Galligan J.A. :

1 This is an appeal from the order of Rosenberg J. made on May 1, 1991. By that order, he approved the sale of Air Toronto to Ontario Express Limited and Frontier Air Limited, and he dismissed a motion to approve an offer to purchase Air Toronto by 922246 Ontario Limited.

2 It is necessary at the outset to give some background to the dispute. Soundair Corporation ("Soundair") is a corporation engaged in the air transport business. It has three divisions. One of them is Air Toronto. Air Toronto operates a scheduled airline from Toronto to a number of mid-sized cities in the United States of America. Its routes serve as feeders to several of Air Canada's routes. Pursuant to a connector agreement, Air Canada provides some services to Air Toronto and benefits from the feeder traffic provided by it. The operational relationship between Air Canada and Air Toronto is a close one.

3 In the latter part of 1989 and the early part of 1990, Soundair was in financial difficulty. Soundair has two secured creditors who have an interest in the assets of Air Toronto. The Royal Bank of Canada (the "Royal Bank") is owed at least \$65 million dollars. The appellants Canadian Pension Capital Limited and Canadian Insurers' Capital Corporation (collectively called "CCFL") are owed approximately \$9,500,000. Those creditors will have a deficiency expected to be in excess of \$50 million on the winding up of Soundair.

4 On April 26, 1990, upon the motion of the Royal Bank, O'Brien J. appointed Ernst & Young Inc. (the "receiver") as receiver of all of the assets, property and undertakings of Soundair. The order required the receiver to operate Air Toronto and sell it as a going concern. Because of the close relationship between Air Toronto and Air Canada, it was contemplated that the receiver would obtain the assistance of Air Canada to operate Air Toronto. The order authorized the receiver:

(b) to enter into contractual arrangements with Air Canada to retain a manager or operator, including Air Canada, to manage and operate Air Toronto under the supervision of Ernst & Young Inc. until the completion of the sale of Air Toronto to Air Canada or other person.

Also because of the close relationship, it was expected that Air Canada would purchase Air Toronto. To that end, the order of O'Brien J. authorized the Receiver,

(c) to negotiate and do all things necessary or desirable to complete a sale of Air Toronto to Air Canada and, if a sale to Air Canada cannot be completed, to negotiate and sell Air Toronto to another person, subject to terms and conditions approved by this Court.

6 Those negotiations came to an end when an offer made by Air Canada on June 19, 1990, was considered unsatisfactory by the receiver. The offer was not accepted and lapsed. Having regard to the tenor of Air Canada's negotiating stance and a letter sent by its solicitors on July 20, 1990, I think that the receiver was eminently reasonable when it decided that there was no realistic possibility of selling Air Toronto to Air Canada.

8 It was well known in the air transport industry that Air Toronto was for sale. During the months following the collapse of the negotiations with Air Canada, the receiver tried unsuccessfully to find viable purchasers. In late 1990, the receiver turned to Canadian Airlines International, the only realistic alternative. Negotiations began between them. Those negotiations led to a letter of intent dated February 11, 1990. On March 6, 1991, the receiver received an offer from Ontario Express Limited and Frontier Airlines Limited, who are subsidiaries of Canadian Airlines International. This offer is called the OEL offer.

10 The first 922 offer contained a condition which was unacceptable to the receiver. I will refer to that condition in more detail later. The receiver declined the 922 offer and on March 8, 1991, accepted the OEI offer. Subsequently, 922 obtained an order allowing it to make a second offer. It then submitted an offer which was virtually identical to that of March 7, 1991, except that the unacceptable condition had been removed.

12 There are only two issues which must be resolved in this appeal. They are:

(2) What effect does the support of the 922 offer by the secured creditors have on the result?

1. Did the Receiver Act Properly in Agreeing to Sell to OEL?

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also assume that the receiver is acting properly unless the contrary is clearly shown. The second observation is that the court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions made by its receiver. The third observation which I wish to make is that the conduct of the receiver should be reviewed in the light of the specific mandate given to him by the court.

15 The order of O'Brien J. provided that if the receiver could not complete the sale to Air Canada that it was "to negotiate and sell Air Toronto to another person." The court did not say how the receiver was to negotiate the sale. It did not say it was to call for bids or conduct an auction. It told the receiver to negotiate and sell. It obviously intended, because of the unusual nature of the asset being sold, to leave the method of sale substantially in the discretion of the receiver. I think, therefore, that the court should not review minutely the process of the sale when, broadly speaking, it appears to the court to be a just process.

16 As did Rosenberg J., I adopt as correct the statement made by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 67 C.B.R. (N.S.) 320n, 22 C.P.C. (2d) 131, 39 D.T.R. (4th) 526 (H.C.), at pp. 92-94 [O.R.], of the duties which a court must perform when deciding whether a receiver who has sold a property acted properly. When he set out the court's duties, he did not put them in any order of priority, nor do I. I summarize those duties as follows:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
2. It should consider the interests of all parties.
3. It should consider the efficacy and integrity of the process by which offers are obtained.
4. It should consider whether there has been unfairness in the working out of the process.

17 I intend to discuss the performance of those duties separately.

1. Did the Receiver make a sufficient effort to get the best price and did it act providently?

18 Having regard to the fact that it was highly unlikely that a commercially viable sale could be made to anyone but the two national airlines, or to someone supported by either of them, it is my view that the receiver acted wisely and reasonably when it negotiated only with Air Canada and Canadian Airlines International. Furthermore, when Air Canada said that it would submit no further offers and gave the impression that it would not participate further in the receiver's efforts to sell, the only course reasonably open to the receiver was to negotiate with Canadian Airlines International. Realistically, there was nowhere else to go but to Canadian Airlines International. In doing so, it is my opinion that the receiver made sufficient efforts to sell the airline.

19 When the receiver got the OEL offer on March 6, 1991, it was over 10 months since it had been charged with the responsibility of selling Air Toronto. Until then, the receiver had not received one offer which it thought was acceptable. After substantial efforts to sell the airline over that period, I find it difficult to think that the receiver acted improvidently in accepting the only acceptable offer which it had.

20 On March 8, 1991, the date when the receiver accepted the OEL offer, it had only two offers, the OEL offer, which was acceptable, and the 922 offer, which contained an unacceptable condition. I cannot see how the receiver, assuming for the moment that the price was reasonable, could have done anything but accept the OEL offer.

21 When deciding whether a receiver had acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer. In this case, the court should look at the receiver's conduct in the light of the information it had when it made its decision on March 8, 1991. The court should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. To do so, in my view, would derogate from the mandate to sell given to the receiver by

the order of O'Brien J. I agree with and adopt what was said by Anderson J. in *Crown Trust Co. v. Rosenberg*, supra, at p. 112 [O.R.].

Its decision was made as a matter of business judgment *on the elements then available to it*. It is of the very essence of a receiver's function to make such judgments and in the making of them to act seriously and responsibly so as to be prepared to stand behind them.

If the court were to reject the recommendation of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

[Emphasis added.]

22 I also agree with and adopt what was said by Macdonald J.A. in *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), at p. 11 [C.B.R.].

In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances *at the time existing* it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement.

[Emphasis added.]

23 On March 8, 1991, the receiver had two offers. One was the OEL offer, which it considered satisfactory but which could be withdrawn by OEL at any time before it was accepted. The receiver also had the 922 offer, which contained a condition that was totally unacceptable. It had no other offers. It was faced with the dilemma of whether it should decline to accept the OEL offer and run the risk of it being withdrawn, in the hope that an acceptable offer would be forthcoming from 922. An affidavit filed by the president of the receiver describes the dilemma which the receiver faced, and the judgment made in the light of that dilemma:

24. An asset purchase agreement was received by Ernst & Young on March 7, 1991 which was dated March 6, 1991. This agreement was received from CCFE in respect of their offer to purchase the assets and undertaking of Air Toronto. Apart from financial considerations, which will be considered in a subsequent affidavit, the Receiver determined that it would not be prudent to delay acceptance of the OEL agreement to negotiate a highly uncertain arrangement with Air Canada and CCFE. Air Canada had the benefit of an 'exclusive' in negotiations for Air Toronto and had clearly indicated its intention take itself out of the running while ensuring that no other party could seek to purchase Air Toronto and maintain the Air Canada connector arrangement vital to its survival. The CCFE offer represented a radical reversal of this position by Air Canada at the eleventh hour. However, it contained a significant number of conditions to closing which were entirely beyond the control of the Receiver. As well, the CCFE offer came less than 24 hours before signing of the agreement with OEL which had been negotiated over a period of months, at great time and expense.

[Emphasis added.] I am convinced that the decision made was a sound one in the circumstances faced by the receiver on March 8, 1991.

24 I now turn to consider whether the price contained in the OEL offer was one which it was provident to accept. At the outset, I think that the fact that the OEL offer was the only acceptable one available to the receiver on March 8, 1991, after 10 months of trying to sell the airline, is strong evidence that the price in it was reasonable. In a deteriorating economy, I doubt that it would have been wise to wait any longer.

25 I mentioned earlier that, pursuant to an order, 922 was permitted to present a second offer. During the hearing of the appeal, counsel compared at great length the price contained in the second 922 offer with the price contained in the OEL offer. Counsel put forth various hypotheses supporting their contentions that one offer was better than the other.

26 It is my opinion that the price contained in the 922 offer is relevant only if it shows that the price obtained by the receiver in the OEL offer was not a reasonable one. In *Crown Trust Co. v. Rosenberg*, supra, Anderson J., at p. 113 [O.R.], discussed the comparison of offers in the following way:

No doubt, as the cases have indicated, situations might arise where the disparity was so great as to call in question the adequacy of the mechanism which had produced the offers. It is not so here, and in my view that is substantially an end of the matter.

27 In two judgments, Saunders J. considered the circumstances in which an offer submitted after the receiver had agreed to a sale should be considered by the court. The first is *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. S.C.), at p. 247:

If, for example, in this case there had been a second offer of a substantially higher amount, then the court would have to take that offer into consideration in assessing whether the receiver had properly carried out his function of endeavouring to obtain the best price for the property.

28 The second is *Re Beauty Counsellors of Canada Ltd.* (1986), 58 C.B.R. (N.S.) 237 (Ont. S.C.), at p. 243:

If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate.

29 In *Re Selkirk* (1987), 64 C.B.R. (N.S.) 140 (Ont. S.C.), at p. 142, McRae J. expressed a similar view:

The court will not lightly withhold approval of a sale by the receiver, particularly in a case such as this where the receiver is given rather wide discretionary authority as per the order of Mr. Justice Trainor and, of course, where the receiver is an officer of this court. Only in a case where there seems to be some unfairness in the process of the sale or where there are substantially higher offers which would tend to show that the sale was improvident will the court withhold approval. It is important that the court recognize the commercial exigencies that would flow if prospective purchasers are allowed to wait until the sale is in court for approval before submitting their final offer. This is something that must be discouraged.

[Emphasis added.]

30 What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to show that the receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered bona fide into an agreement with the receiver, can only lead to chaos, and must be discouraged.

31 If, however, the subsequent offer is so substantially higher than the sale recommended by the receiver, then it may be that the receiver has not conducted the sale properly. In such circumstances, the court would be justified itself in entering into the sale process by considering competitive bids. However, I think that that process should be entered into only if the court is satisfied that the receiver has not properly conducted the sale which it has recommended to the court.

32 It is necessary to consider the two offers. Rosenberg J. held that the 922 offer was slightly better or marginally better than the OEL offer. He concluded that the difference in the two offers did not show that the sale process adopted by the receiver was inadequate or improvident.

33 Counsel for the appellants complained about the manner in which Rosenberg J. conducted the hearing of the motion to confirm the OEL sale. The complaint was that when they began to discuss a comparison of the two offers, Rosenberg J. said that he considered the 922 offer to be better than the OEL offer. Counsel said that when that comment was made, they did not think it necessary to argue further the question of the difference in value between the two offers. They complain that the finding that the 922 offer was only marginally better or slightly better than the OEL offer was made without them having had the opportunity to argue that the 922 offer was substantially better or significantly better than the OEL offer. I cannot understand how counsel could have thought that by expressing the opinion that the 922 offer was better, Rosenberg J. was saying that it was a significantly or substantially better one. Nor can I comprehend how counsel took the comment to mean that they were foreclosed from arguing that the offer was significantly or substantially better. If there was some misunderstanding on the part of counsel, it should have been raised before Rosenberg J. at the time. I am sure that if it had been, the misunderstanding would have been cleared up quickly. Nevertheless, this court permitted extensive argument dealing with the comparison of the two offers.

34 The 922 offer provided for \$6 million cash to be paid on closing with a royalty based upon a percentage of Air Toronto profits over a period of 5 years up to a maximum of \$3 million. The OEL offer provided for a payment of \$2 million on closing with a royalty paid on gross revenues over a 5-year period. In the short term, the 922 offer is obviously better because there is substantially more cash up front. The chances of future returns are substantially greater in the OEL offer because royalties are paid on gross revenues, while the royalties under the 922 offer are paid only on profits. There is an element of risk involved in each offer.

35 The receiver studied the two offers. It compared them and took into account the risks, the advantages and the disadvantages of each. It considered the appropriate contingencies. It is not necessary to outline the factors which were taken into account by the receiver because the manager of its insolvency practice filed an affidavit outlining the considerations which were weighed in its evaluation of the two offers. They seem to me to be reasonable ones. That affidavit concluded with the following paragraph:

24. On the basis of these considerations the Receiver has approved the OEL offer and has concluded that it represents the achievement of the highest possible value at this time for the Air Toronto division of SoundAir.

36 The court appointed the receiver to conduct the sale of Air Toronto, and entrusted it with the responsibility of deciding what is the best offer. I put great weight upon the opinion of the receiver. It swore to the court which appointed it that the OEL offer represents the achievement of the highest possible value at this time for Air Toronto. I have not been convinced that the receiver was wrong when he made that assessment. I am, therefore, of the opinion that the 922 offer does not demonstrate any failure upon the part of the receiver to act properly and providently.

37 It follows that if Rosenberg J. was correct when he found that the 922 offer was in fact better, I agree with him that it could only have been slightly or marginally better. The 922 offer does not lead to an inference that the disposition strategy of the receiver was inadequate, unsuccessful or improvident, nor that the price was unreasonable.

38 I am, therefore, of the opinion the the receiver made a sufficient effort to get the best price, and has not acted improvidently.

2. Consideration of the Interests of all Parties

39 It is well established that the primary interest is that of the creditors of the debtor; see *Crown Trust Co. v. Rosenberg*, supra, and *Re Selkirk*, supra (Saunders J.). However, as Saunders J. pointed out in *Re Beauty Counsellors*, supra at p. 244 [C.B.R.], "it is not the only or overriding consideration."

40 In my opinion, there are other persons whose interests require consideration. In an appropriate case, the interests of the debtor must be taken into account. I think also, in a case such as this, where a purchaser has bargained at some length and doubtless at considerable expense with the receiver, the interests of the purchaser ought to be taken into account.

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While it is not explicitly stated in such cases as *Crown Trust Co. v. Rosenberg*, supra, *Re Selkirk* (1986), supra, *Re Beauty Counsellors*, supra, *Re Selkirk* (1987), supra, and *Cameron*, supra, I think they clearly imply that the interests of a person who has negotiated an agreement with a court-appointed receiver are very important.

41 In this case, the interests of all parties who would have an interest in the process were considered by the receiver and by Rosenberg J.

3. Consideration of the Efficacy and Integrity of the Process by which the Offer was Obtained

42 While it is accepted that the primary concern of a receiver is the protecting of the interests of the creditors, there is a secondary but very important consideration, and that is the integrity of the process by which the sale is effected. This is particularly so in the case of a sale of such a unique asset as an airline as a going concern.

43 The importance of a court protecting the integrity of the process has been stated in a number of cases. First, I refer to *Re Selkirk*, supra, where Saunders J. said at p. 246 [C.B.R.]:

In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.

In that connection I adopt the principles stated by Macdonald J.A. of the Nova Scotia Supreme Court (Appeal Division) in *Cameron v. Bank of N.S.* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), where he said at p. 11:

In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard — this would be an intolerable situation.

While those remarks may have been made in the context of a bidding situation rather than a private sale, I consider them to be equally applicable to a negotiation process leading to a private sale. Where the court is concerned with the disposition of property, the purpose of appointing a receiver is to have the receiver do the work that the court would otherwise have to do.

44 In *Salima Investments Ltd. v. Bank of Montreal* (1985), 59 C.B.R. (N.S.) 242, 41 Alta. L.R. (2d) 58, 65 A.R. 372, 21 D.L.R. (4th) 473 at p. 476 [D.L.R.], the Alberta Court of Appeal said that sale by tender is not necessarily the best way to sell a business as an ongoing concern. It went on to say that when some other method is used which is provident, the court should not undermine the process by refusing to confirm the sale.

45 Finally, I refer to the reasoning of Anderson J. in *Crown Trust Co. v. Rosenberg*, supra, at p. 124 [O.R.]:

While every proper effort must always be made to assure maximum recovery consistent with the limitations inherent in the process, no method has yet been devised to entirely eliminate those limitations or to avoid their consequences. Certainly it is not to be found in basing the entire foundation of the system. This to compare the results of the process in this case with what might have been recovered in some other set of circumstances is neither logical nor practical.

[Emphasis added.]

46 It is my opinion that the court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith,

bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

47 Before this court, counsel for those opposing the confirmation of the sale to OEL suggested many different ways in which the receiver could have conducted the process other than the way which he did. However, the evidence does not convince me that the receiver used an improper method of attempting to sell the airline. The answer to those submissions is found in the comment of Anderson J. in *Crown Trust Co. v. Rosenberg*, supra, at p. 109 [O.R.].

The court ought not to sit as on appeal from the decision of the Receiver, reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise.

48 It would be a futile and duplicitous exercise for this court to examine in minute detail all of circumstances leading up to the acceptance of the OEL offer. Having considered the process adopted by the receiver, it is my opinion that the process adopted was a reasonable and prudent one.

4. Was there unfairness in the process?

49 As a general rule, I do not think it appropriate for the court to go into the minutia of the process or of the selling strategy adopted by the receiver. However, the court has a responsibility to decide whether the process was fair. The only part of this process which I could find that might give even a superficial impression of unfairness is the failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto.

50 I will outline the circumstances which relate to the allegation that the receiver was unfair in failing to provide an offering memorandum. In the latter part of 1990, as part of its selling strategy, the receiver was in the process of preparing an offering memorandum to give to persons who expressed an interest in the purchase of Air Toronto. The offering memorandum got as far as draft form, but was never released to anyone, although a copy of the draft eventually got into the hands of CCFL before it submitted the first 922 offer on March 7, 1991. A copy of the offering memorandum forms part of the record, and it seems to me to be little more than puffery, without any hard information which a sophisticated purchaser would require in order to make a serious bid.

51 The offering memorandum had not been completed by February 11, 1991. On that date, the receiver entered into the letter of intent to negotiate with OEL. The letter of intent contained a provision that during its currency the receiver would not negotiate with any other party. The letter of intent was renewed from time to time until the OEL offer was received on March 6, 1991.

52 The receiver did not proceed with the offering memorandum because to do so would violate the spirit, if not the letter, of its letter of intent with OEL.

53 I do not think that the conduct of the receiver shows any unfairness towards 922. When I speak of 922, I do so in the context that Air Canada and CCFL are identified with it. I start by saying that the receiver acted reasonably when it entered into exclusive negotiations with OEL. I find it strange that a company, with which Air Canada is closely and intimately involved, would say that it was unfair for the receiver to enter into a time-limited agreement to negotiate exclusively with OEL. That is precisely the arrangement which Air Canada insisted upon when it negotiated with the receiver in the spring and summer of 1990. If it was not unfair for Air Canada to have such an agreement, I do not understand why it was unfair for OEL to have a similar one. In fact, both Air Canada and OEL in its turn were acting reasonably when they required exclusive negotiating rights to prevent their negotiations from being used as a bargaining lever with other potential purchasers. The fact that Air Canada insisted upon an exclusive negotiating right while it was negotiating with the receiver demonstrates the commercial efficacy of OEL being given the same right during its negotiations with the receiver. I see no unfairness on the part of the receiver when it honoured its letter of intent with OEL by not releasing the offering memorandum during the negotiations with OEL.

54 Moreover, I am not prepared to find that 922 was in any way prejudiced by the fact that it did not have an offering memorandum. It made an offer on March 7, 1991, which it contends to this day was a better offer than that of OEL. 922 has not convinced me that if it had an offering memorandum, its offer would have been any different or any better than it actually was. The fatal problem with the first 922 offer was that it contained a condition which was completely unacceptable to the receiver. The receiver, properly, in my opinion, rejected the offer out of hand because of that condition. That condition did not relate to any information which could have conceivably been in an offering memorandum prepared by the receiver. It was about the resolution of a dispute between CCFL and the Royal Bank, something the receiver knew nothing about.

55 Further evidence of the lack of prejudice which the absence of an offering memorandum has caused 922 is found in CCFL's stance before this court. During argument, its counsel suggested as a possible resolution of this appeal that this court should call for new bids, evaluate them and then order a sale to the party who put in the better bid. In such a case, counsel for CCFL said that 922 would be prepared to bid within 7 days of the court's decision. I would have thought that, if there were anything to CCFL's suggestion that the failure to provide an offering memorandum was unfair to 922, that it would have told the court that it needed more information before it would be able to make a bid.

56 I am satisfied that Air Canada and CCFL have, and at all times had, all of the information which they would have needed to make what to them would be a commercially viable offer to the receiver. I think that an offering memorandum was of no commercial consequence to them, but the absence of one has since become a valuable tactical weapon.

57 It is my opinion that there is no convincing proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL. Therefore, the failure to provide an offering memorandum was neither unfair, nor did it prejudice the obtaining of a better price on March 8, 1991, than that contained in the OEL offer. I would not give effect to the contention that the process adopted by the receiver was an unfair one.

58 There are two statements by Anderson J. contained in *Crown Trust Co. v. Rosenberg*, supra, which I adopt as my own. The first is at p. 109 [O.R.]:

The court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

The second is at p. 111 [O.R.]:

It is equally clear, in my view, though perhaps not so clearly enunciated, that it is only in an exceptional case that the court will intervene and proceed contrary to the Receiver's recommendations if satisfied, as I am, that the Receiver has acted reasonably, prudently and fairly and not arbitrarily.

In this case the receiver acted reasonably, prudently, fairly and not arbitrarily. I am of the opinion, therefore, that the process adopted by the receiver in reaching an agreement was a just one.

59 In his reasons for judgment, after discussing the circumstances leading to the 922 offer, Rosenberg J. said this:

They created a situation as of March 8th, where the Receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The Receiver acted appropriately in accepting the OEL offer.

I agree

60 The receiver made proper and sufficient efforts to get the best price that it could for the assets of Air Toronto. It adopted a reasonable and effective process to sell the airline which was fair to all persons who might be interested in purchasing it. It is my opinion, therefore, that the receiver properly carried out the mandate which was given to it by the order of O'Brien J. It follows that Rosenberg J. was correct when he confirmed the sale to OEL.

II. The effect of the support of the 922 offer by the two secured creditors.

61 As I noted earlier, the 922 offer was supported before Rosenberg J., and in this court, by CCFL and by the Royal Bank, the two secured creditors. It was argued that, because the interests of the creditors are primary, the court ought to give effect to their wish that the 922 offer be accepted. I would not accede to that suggestion for two reasons.

62 The first reason is related to the fact that the creditors chose to have a receiver appointed by the court. It was open to them to appoint a private receiver pursuant to the authority of their security documents. Had they done so, then they would have had control of the process and could have sold Air Toronto to whom they wished. However, acting privately and controlling the process involves some risks. The appointment of a receiver by the court insulates the creditors from those risks. But, insulation from those risks carries with it the loss of control over the process of disposition of the assets. As I have attempted to explain in these reasons, when a receiver's sale is before the court for confirmation, the only issues are the propriety of the conduct of the receiver and whether it acted providently. The function of the court at that stage is not to step in and do the receiver's work, or change the sale strategy adopted by the receiver. Creditors who asked the court to appoint a receiver to dispose of assets should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale made by the receiver. That would take away all respect for the process of sale by a court-appointed receiver.

63 There can be no doubt that the interests of the creditor are an important consideration in determining whether the receiver has properly conducted a sale. The opinion of the creditors as to which offer ought to be accepted is something to be taken into account. But if the court decides that the receiver has acted properly and providently, those views are not necessarily determinative. Because, in this case, the receiver acted properly and providently, I do not think that the views of the creditors should override the considered judgment of the receiver.

64 The second reason is that, in the particular circumstances of this case, I do not think the support of CCFL and the Royal Bank of the 922 offer is entitled to any weight. The support given by CCFL can be dealt with summarily. It is a co-owner of 922. It is hardly surprising and not very impressive to hear that it supports the offer which it is making for the debtor's assets.

65 The support by the Royal Bank requires more consideration and involves some reference to the circumstances. On March 6, 1991, when the first 922 offer was made, there was in existence an inter-lender agreement between the Royal Bank and CCFL. That agreement dealt with the share of the proceeds of the sale of Air Toronto which each creditor would receive. At the time, a dispute between the Royal Bank and CCFL about the interpretation of that agreement was pending in the courts. The unacceptable condition in the first 922 offer related to the settlement of the inter-lender dispute. The condition required that the dispute be resolved in a way which would substantially favour CCFL. It required that CCFL receive \$3,375,000 of the \$6 million cash payment and the balance, including the royalties, if any, be paid to the Royal Bank. The Royal Bank did not agree with that split of the sale proceeds.

66 On April 5, 1991, the Royal Bank and CCFL agreed to settle the inter-lender dispute. The settlement was that if the 922 offer was accepted by the court, CCFL would receive only \$1 million, and the Royal Bank would receive \$5 million plus any royalties which might be paid. It was only in consideration of that settlement that the Royal Bank agreed to support the 922 offer.

67 The Royal Bank's support of the 922 offer is so affected by the very substantial benefit which it wanted to obtain from the settlement of the inter-lender dispute that, in my opinion, its support is devoid of any objectivity. I think it has no weight.

68 While there may be circumstances where the unanimous support by the creditors of a particular offer could conceivably override the proper and provident conduct of a sale by a receiver, I do not think that this is such a case. This is a case where the receiver has acted properly and in a provident way. It would make a mockery out of the judicial process, under which a mandate was given to this receiver to sell this airline if the support by these creditors of the 922 offer were permitted to carry the day. I give no weight to the support which they give to the 922 offer.

69 In its factum, the receiver pointed out that, because of greater liabilities imposed upon private receivers by various statutes such as the *Employment Standards Act*, R.S.O. 1980, c. 137, and the *Environmental Protection Act*, R.S.O. 1980, c. 141, it is likely that more and more the courts will be asked to appoint receivers in insolvencies. In those circumstances, I think that creditors who ask for court-appointed receivers and business people who choose to deal with those receivers should know that if those receivers act properly and providently, their decisions and judgments will be given great weight by the courts who appoint them. I have decided this appeal in the way I have in order to assure business people who deal with court-appointed receivers that they can have confidence that an agreement which they make with a court-appointed receiver will be far more than a platform upon which others may bargain at the court approval stage. I think that persons who enter into agreements with court-appointed receivers, following a disposition procedure that is appropriate given the nature of the assets involved, should expect that their bargain will be confirmed by the court.

70 The process is very important. It should be carefully protected so that the ability of court-appointed receivers to negotiate the best price possible is strengthened and supported. Because this receiver acted properly and providently in entering into the OEL agreement, I am of the opinion that Rosenberg J. was right when he approved the sale to OEL and dismissed the motion to approve the 922 offer.

71 I would, accordingly, dismiss the appeal. I would award the receiver, OEL and Frontier Airlines Limited their costs out of the Soundair estate, those of the receiver on a solicitor-client scale. I would make no order as to the costs of any of the other parties or intervenors.

McKinlay J.A. :

72 I agree with Galligan J.A. in result, but wish to emphasize that I do so on the basis that the undertaking being sold in this case was of a very special and unusual nature. It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers. Consequently, in all cases, the court should carefully scrutinize the procedure followed by the receiver to determine whether it satisfies the tests set out by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 67 C.B.R. (N.S.) 320n, 60 O.R. (2d) 87, 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526 (H.C.). While the procedure carried out by the receiver in this case, as described by Galligan J.A., was appropriate, given the unfolding of events and the unique nature of the assets involved, it is not a procedure that is likely to be appropriate in many receivership sales.

73 I should like to add that where there is a small number of creditors who are the only parties with a real interest in the proceeds of the sale (i.e., where it is clear that the highest price attainable would result in recovery so low that no other creditors, shareholders, guarantors, etc., could possibly benefit therefore), the wishes of the interested creditors should be very seriously considered by the receiver. It is true, as Galligan J.A. points out, that in seeking the court appointment of a receiver, the moving parties also seek the protection of the court in carrying out the receiver's functions. However, it is also true that in utilizing the court process, the moving parties have opened the whole process to detailed scrutiny by all involved, and have probably added significantly to their costs and consequent shortfall as a result of so doing. The adoption of the court process should in no way diminish the rights of any party, and most certainly not the rights of the only parties with a real interest. Where a receiver asks for court approval of a sale which is opposed by the only parties in interest, the court should scrutinize with great care the procedure followed by the receiver. I agree with Galligan J.A. that in this case that was done. I am satisfied that the rights of all parties were properly considered by the receiver, by the learned motions court judge, and by Galligan J.A.

Goodman J. 1. (dissenting):

⁷⁴ I have had the opportunity of reading the reasons for judgment herein of Galligan and McKimlay JJ. A. Respectfully, I am unable to agree with their conclusion.

⁷⁵ The case at bar is an exceptional one in the sense that upon the application made for approval of the sale of the assets of Air Toronto, two competing offers were placed before Rosenberg J. Those two offers were that of OFI and that of 922, a company incorporated for the purpose of acquiring Air Toronto. Its shares were owned equally by CCFL and Air Canada. It was conceded by all parties to these proceedings that the only persons who had any interest in the proceeds of the sale were two secured creditors, viz., CCFL and the Royal Bank of Canada. Those two creditors were unanimous in their position that they desired the court to approve the sale to 922. We were not referred to, nor am I aware of, any case where a court has refused to abide by the unanimous wishes of the only interested creditors for the approval of a specific offer made in receivership proceedings.

⁷⁶ In *British Columbia Developments Corp. v. Spin Cast Industries Ltd.* (1977), 26 C.B.R. (N.S.) 28, 5 B.C.L.R. 94 (S.C.), Berger J. said at p. 30 [C.B.R.]:

Here all of those with a financial stake in the plant have joined in seeking the court's approval of the sale to Fincas. This court does not have a roving commission to decide what is best for investors and businessmen when they have agreed among themselves what course of action they should follow. It is their money.

⁷⁷ I agree with that statement. It is particularly apt to this case. The two secured creditors will suffer a shortfall of approximately \$50 million. They have a tremendous interest in the sale of assets which form part of their security. I agree with the finding of Rosenberg J. that the offer of 922 is superior to that of OEL. He concluded that the 922 offer is marginally superior. If by that he meant that mathematically it was likely to provide slightly more in the way of proceeds, it is difficult to take issue with that finding. If, on the other hand, he meant that having regard to all considerations it was only marginally superior, I cannot agree. He said in his reasons:

I have come to the conclusion that knowledgeable creditors such as the Royal Bank would prefer the 922 offer even if the other factors influencing their decision were not present. No matter what adjustments had to be made, the 922 offer results in more cash immediately. Creditors facing the type of loss the Royal Bank is taking in this case would not be anxious to rely on contingencies especially in the present circumstances surrounding the airline industry.

⁷⁸ I agree with that statement completely. It is apparent that the difference between the two offers insofar as cash on closing is concerned amounts to approximately \$3 million to \$4 million. The bank submitted that it did not wish to gamble any further with respect to its investment, and that the acceptance and court approval of the OEL offer in effect supplanted its position as a secured creditor with respect to the amount owing over and above the down payment and placed it in the position of a joint entrepreneur, but one with no control. This results from the fact that the OEL offer did not provide for any security for any funds which might be forthcoming over and above the initial down payment on closing.

⁷⁹ In *Cambridge Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), Hart J.A., speaking for the majority of the court, said at p. 10 [C.B.R.]:

Here we are dealing with a receiver appointed at the instance of one major creditor, who chose to insert in the contract of sale a provision making it subject to the approval of the court. This, in my opinion, shows an intention on behalf of the parties to invoke the normal equitable doctrines which place the court in the position of looking to the interests of all persons concerned before giving its blessing to a particular transaction submitted for approval. In these circumstances the court would not consider itself bound by the contract entered into in good faith by the receiver but would have to look to the broader picture to see that that contract was for the benefit of the creditors as a whole. When there was evidence that a higher price was readily available for the property the chambers judge

was, in my opinion, justified in exercising his discretion as he did. Otherwise he could have deprived the creditors of a substantial sum of money.

80 This statement is apposite to the circumstances of the case at bar. I hasten to add that in my opinion it is not only price which is to be considered in the exercise of the judge's discretion. It may very well be, as I believe to be so in this case, that the amount of cash is the most important element in determining which of the two offers is for the benefit and in the best interest of the creditors.

81 It is my view, and the statement of Hart J.A. is consistent therewith, that the fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. I agree completely with the views expressed by McKinlay J.A. in that regard in her reasons.

82 It is my further view that any negotiations which took place between the only two interested creditors in deciding to support the approval of the 922 offer were not relevant to the determination by the presiding judge of the issues involved in the motion for approval of either one of the two offers, nor are they relevant in determining the outcome of this appeal. It is sufficient that the two creditors have decided unanimously what is in their best interest, and the appeal must be considered in the light of that decision. It so happens, however, that there is ample evidence to support their conclusion that the approval of the 922 offer is in their best interests.

83 I am satisfied that the interests of the creditors are the prime consideration for both the receiver and the court. In *Re Beauty Counsellors of Canada Ltd.* (1986), 58 C.B.R. (N.S.) 237 (Ont. S.C.), Saunders J. said at p. 243:

This does not mean that a court should ignore a new and higher bid made after acceptance where there has been no unfairness in the process. The interests of the creditors, while not the only consideration, are the prime consideration.

84 I agree with that statement of the law. In *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. S.C.), Saunders J. heard an application for court approval of the sale by the sheriff of real property in bankruptcy proceedings. The sheriff had been previously ordered to list the property for sale subject to approval of the court. Saunders J. said at p. 246:

In dealing with the request for approval, the court has to be concerned primarily with protecting the interests of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.

85 I am in agreement with that statement as a matter of general principle. Saunders J. further stated that he adopted the principles stated by Macdonald J.A. in *Cameron*, supra, quoted by Galligan J.A. in his reasons. In *Cameron*, the remarks of Macdonald J.A. related to situations involving the calling of bids and fixing a time limit for the making of such bids. In those circumstances the process is so clear as a matter of commercial practice that an interference by the court in such process might have a deleterious effect on the efficacy of receivership proceedings in other cases. But Macdonald J.A. recognized that even in bid or tender cases where the offeror for whose bid approval is sought has complied with all requirements, a court might not approve the agreement of purchase and sale entered into by the receiver. He said at pp. 11-12 [C.B.R.]:

There are, of course, many reasons why a court might not approve an agreement of purchase and sale, viz., where the offer accepted is so low in relation to the appraised value as to be unrealistic, or, where the circumstances indicate that insufficient time was allowed for the making of bids or that inadequate notice of sale by bid was given (where the receiver sells property by the bid method), or, where it can be said that the proposed sale is not in the best interest of either the creditors or the owner. Court approval must involve the delicate balancing of competing interests and not simply a consideration of the interests of the creditors.

86 The deficiency in the present case is so large that there has been no suggestion of a competing interest between the owner and the creditors.

87 I agree that the same reasoning may apply to a negotiation process leading to a private sale, but the procedure and process applicable to private sales of a wide variety of businesses and undertakings with the multiplicity of individual considerations applicable and perhaps peculiar to the particular business is not so clearly established that a departure by the court from the process adopted by the receiver in a particular case will result in commercial chaos to the detriment of future receivership proceedings. Each case must be decided on its own merits, and it is necessary to consider the process used by the receiver in the present proceedings and to determine whether it was unfair, improvident or inadequate.

88 It is important to note at the outset that Rosenberg J. made the following statement in his reasons:

On March 8, 1991 the trustee accepted the OEL offer subject to court approval. The Receiver at that time had no other offer before it that was in final form or could possibly be accepted. The Receiver had at the time the knowledge that Air Canada with CCFL had not bargained in good faith and had not fulfilled the promise of its letter of March 1st. The Receiver was justified in assuming that Air Canada and CCFL's offer was a long way from being in an acceptable form and that Air Canada and CCFL's objective was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada.

89 In my opinion there was no evidence before him or before this court to indicate that Air Canada, with CCFL, had not bargained in good faith, and that the receiver had knowledge of such lack of good faith. Indeed, on his appeal, counsel for the receiver stated that he was not alleging Air Canada and CCFL had not bargained in good faith. Air Canada had frankly stated at the time that it had made its offer to purchase, which was eventually refused by the receiver, that it would not become involved in an "auction" to purchase the undertaking of Air Canada and that, although it would fulfil its contractual obligations to provide connecting services to Air Toronto, it would do no more than it was legally required to do insofar as facilitating the purchase of Air Toronto by any other person. In so doing, Air Canada may have been playing "hardball," as its behaviour was characterized by some of the counsel for opposing parties. It was nevertheless merely openly asserting its legal position, as it was entitled to do.

90 Furthermore, there was no evidence before Rosenberg J. or this court that the receiver had assumed that Air Canada and CCFL's objective in making an offer was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada. Indeed, there was no evidence to support such an assumption in any event, although it is clear that 922, and through it CCFL and Air Canada, were endeavouring to present an offer to purchase which would be accepted and/or approved by the court in preference to the offer made by OEL.

91 To the extent that approval of the OEL agreement by Rosenberg J. was based on the alleged lack of good faith in bargaining and improper motivation with respect to connector traffic on the part of Air Canada and CCFL, it cannot be supported.

92 I would also point out that rather than saying there was no other offer before it that was final in form, it would have been more accurate to have said that there was *no unconditional* offer before it.

93 In considering the material and evidence placed before the court, I am satisfied that the receiver was at all times acting in good faith. I have reached the conclusion, however, that the process which he used was unfair insofar as 922 is concerned, and improvident insofar as the two secured creditors are concerned.

94 Air Canada had been negotiating with Soundair Corporation for the purchase from it of Air Toronto for a considerable period of time prior to the appointment of a receiver by the court. It had given a letter of intent indicating a prospective sale price of \$18 million. After the appointment of the receiver, by agreement dated April 30, 1990, Air Canada continued its negotiations for the purchase of Air Toronto with the receiver. Although this agreement contained a clause which provided that the receiver "shall not negotiate for the sale of Air Toronto with any person except Air Canada," it further provided that the receiver would not be in breach of that provision merely by receiving unsolicited offers for all or any of the assets of Air Toronto. In addition, the agreement, which had a term commencing on April

30, 1990, could be terminated on the fifth business day following the delivery of a written notice of termination by one party to the other. I point out this provision merely to indicate that the exclusivity privilege extended by the receiver to Air Canada was of short duration at the receiver's option.

95 As a result of due diligence investigations carried out by Air Canada during the months of April, May and June of 1990, Air Canada reduced its offer to \$8.1 million conditional upon there being \$4 million in tangible assets. The offer was made on June 14, 1990, and was open for acceptance until June 29, 1990.

96 By amending agreement dated June 19, 1990, the receiver was released from its covenant to refrain from negotiating for the sale of the Air Toronto business and assets to any person other than Air Canada. By virtue of this amending agreement, the receiver had put itself in the position of having a firm offer in hand, with the right to negotiate and accept offers from other persons. Air Canada, in these circumstances, was in the subservient position. The receiver, in the exercise of its judgment and discretion, allowed the Air Canada offer to lapse. On July 20, 1990, Air Canada served a notice of termination of the April 30, 1990 agreement.

97 Apparently as a result of advice received from the receiver to the effect that the receiver intended to conduct an auction for the sale of the assets and business of the Air Toronto division of Soundair Corporation, the solicitors for Air Canada advised the receiver by letter dated July 20, 1990, in part as follows:

Air Canada has instructed us to advise you that it does not intend to submit a further offer in the auction process.

98 This statement, together with other statements set forth in the letter, was sufficient to indicate that Air Canada was not interested in purchasing Air Toronto in the process apparently contemplated by the receiver at that time. It did not form a proper foundation for the receiver to conclude that there was no realistic possibility of selling Air Toronto [to] Air Canada, either alone or in conjunction with some other person, in different circumstances. In June 1990, the receiver was of the opinion that the fair value of Air Toronto was between \$10 million and \$12 million.

99 In August 1990, the receiver contacted a number of interested parties. A number of offers were received which were not deemed to be satisfactory. One such offer, received on August 20, 1990, came as a joint offer from OEL and Air Ontario (an Air Canada connector). It was for the sum of \$3 million for the good will relating to certain Air Toronto routes, but did not include the purchase of any tangible assets or leasehold interests.

100 In December 1990, the receiver was approached by the management of Canadian Partner (operated by OEL) for the purpose of evaluating the benefits of an amalgamated Air Toronto/Air Partner operation. The negotiations continued from December of 1990 to February of 1991, culminating in the OEL agreement dated March 8, 1991.

101 On or before December 1990, CCFL advised the receiver that it intended to make a bid for the Air Toronto assets. The receiver, in August of 1990, for the purpose of facilitating the sale of Air Toronto assets, commenced the preparation of an operating memorandum. He prepared no less than six draft operating memoranda with dates from October 1990 through March 1, 1991. None of these were distributed to any prospective bidder despite requests having been received therefor, with the exception of an early draft provided to CCFL without the receiver's knowledge.

102 During the period December 1990 to the end of January 1991, the receiver advised CCFL that the offering memorandum was in the process of being prepared and would be ready soon for distribution. He further advised CCFL that it should await the receipt of the memorandum before submitting a formal offer to purchase the Air Toronto assets.

103 By late January, CCFL had become aware that the receiver was negotiating with OEL for the sale of Air Toronto. In fact, on February 11, 1991, the receiver signed a letter of intent with OEL wherein it had specifically agreed not to negotiate with any other potential bidders or solicit any offers from others.

104 By letter dated February 25, 1991, the solicitors for CCFL made a written request to the receiver for the offering memorandum. The receiver did not reply to the letter because he felt he was precluded from so doing by the provisions

of the letter of intent dated February 11, 1991. Other prospective purchasers were also unsuccessful in obtaining the promised memorandum to assist them in preparing their bids. It should be noted that, exclusivity provision of the letter of intent expired on February 20, 1991. This provision was extended on three occasions, viz., February 19, 22 and March 5, 1991. It is clear that from a legal standpoint the receiver, by refusing to extend the time, could have dealt with other prospective purchasers, and specifically with 922.

105 It was not until March 1, 1991, that CCFL had obtained sufficient information to enable it to make a bid through 922. It succeeded in so doing through its own efforts through sources other than the receiver. By that time the receiver had already entered into the letter of intent with OEL. Notwithstanding the fact that the receiver knew since December of 1990 that CCFL wished to make a bid for the assets of Air Toronto (and there is no evidence to suggest that at that time such a bid would be in conjunction with Air Canada or that Air Canada was in any way connected with CCFL), it took no steps to provide CCFL with information necessary to enable it to make an intelligent bid, and indeed suggested delaying the making of the bid until an offering memorandum had been prepared and provided. In the meantime, by entering into the letter of intent with OEL, it put itself in a position where it could not negotiate with CCFL or provide the information requested.

106 On February 28, 1991, the solicitors for CCFL telephoned the receiver and were advised for the first time that the receiver had made a business decision to negotiate solely with OEL and would not negotiate with anyone else in the interim.

107 By letter dated March 1, 1991, CCFL advised the receiver that it intended to submit a bid. It set forth the essential terms of the bid and stated that it would be subject to customary commercial provisions. On March 7, 1991 CCFL and Air Canada, jointly through 922, submitted an offer to purchase Air Toronto upon the terms set forth in the letter dated March 1, 1991. It included a provision that the offer was conditional upon the interpretation of an inter-lender agreement which set out the relative distribution of proceeds as between CCFL and the Royal Bank. It is common ground that it was a condition over which the receiver had no control, and accordingly would not have been acceptable on that ground alone. The receiver did not, however, contact CCFL in order to negotiate or request the removal of the condition, although it appears that its agreement with OEL not to negotiate with any person other than OEL expired on March 6, 1991.

108 The fact of the matter is that by March 7, 1991, the receiver had received the offer from OEL which was subsequently approved by Rosenberg J. That offer was accepted by the receiver on March 8, 1991. Notwithstanding the fact that OEL had been negotiating the purchase for a period of approximately 3 months, the offer contained a provision for the sole benefit of the purchaser that it was subject to the purchaser obtaining "a financing commitment within 45 days of the date hereof in an amount not less than the Purchase Price from the Royal Bank of Canada or other financial institution upon terms and conditions acceptable to them. In the event that such a financing commitment is not obtained within such 45 day period, the purchaser or OEL shall have the right to terminate this agreement upon giving written notice of termination to the vendor on the first Business Day following the expiry of the said period." The purchaser was also given the right to waive the condition.

109 In effect, the agreement was tantamount to a 45-day option to purchase, excluding the right of any other person to purchase Air Toronto during that period of time and thereafter if the condition was fulfilled or waived. The agreement was, of course, stated to be subject to court approval.

110 In my opinion, the process and procedure adopted by the receiver was unfair to CCFL. Although it was aware from December 1990 that CCFL was interested in making an offer, it effectively delayed the making of such offer by continually referring to the preparation of the offering memorandum. It did not endeavour during the period December 1990 to March 7, 1991, to negotiate with CCFL in any way the possible terms of purchase and sale agreement. In the result, no offer was sought from CCFL by the receiver prior to February 11, 1991, and thereafter it put itself in the position of being unable to negotiate with anyone other than OEL. The receiver then, on March 8, 1991, chose to accept

an offer which was conditional in nature without prior consultation with CCFL (922) to see whether it was prepared to remove the condition in its offer.

111 I do not doubt that the receiver felt that it was more likely that the condition in the OEL offer would be fulfilled than the condition in the 922 offer. It may be that the receiver, having negotiated for a period of 3 months with OEL, was fearful that it might lose the offer if OEL discovered that it was negotiating with another person. Nevertheless, it seems to me that it was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to it. The potential loss was that of an agreement which amounted to little more than an option in favour of the offeror.

112 In my opinion the procedure adopted by the receiver was unfair to CCFL in that, in effect, it gave OEL the opportunity of engaging in exclusive negotiations for a period of 3 months, notwithstanding the fact that it knew CCFL was interested in making an offer. The receiver did not indicate a deadline by which offers were to be submitted, and it did not at any time indicate the structure or nature of an offer which might be acceptable to it.

113 In his reasons, Rosenberg J. stated that as of March 1, CCFL and Air Canada had all the information that they needed, and any allegations of unfairness in the negotiating process by the receiver had disappeared. He said:

They created a situation as of March 8, where the receiver was faced with two offers, one of which was acceptable in form and one of which could not possibly be accepted in its present form. The Receiver acted appropriately in accepting the OEL offer.

If he meant by "acceptable in form" that it was acceptable to the receiver, then obviously OEL had the unfair advantage of its lengthy negotiations with the receiver to ascertain what kind of an offer would be acceptable to the receiver. If, on the other hand, he meant that the 922 offer was unacceptable in its form because it was conditional, it can hardly be said that the OEL offer was more acceptable in this regard, as it contained a condition with respect to financing terms and conditions "acceptable to them."

114 It should be noted that on March 13, 1991, the representatives of 922 first met with the receiver to review its offer of March 7, 1991, and at the request of the receiver, withdrew the inter-lender condition from its offer. On March 14, 1991, OEL removed the financing condition from its offer. By order of Rosenberg J. dated March 26, 1991, CCFL was given until April 5, 1991, to submit a bid, and on April 5, 1991, 922 submitted its offer with the inter-lender condition removed.

115 In my opinion, the offer accepted by the receiver is improvident and unfair insofar as the two creditors are concerned. It is not improvident in the sense that the price offered by 922 greatly exceeded that offered by OEL. In the final analysis it may not be greater at all. The salient fact is that the cash down payment in the 922 offer constitutes approximately two thirds of the contemplated sale price, whereas the cash down payment in the OEL transaction constitutes approximately 20 to 25 per cent of the contemplated sale price. In terms of absolute dollars, the down payment in the 922 offer would likely exceed that provided for in the OEL agreement by approximately \$3 million to \$4 million.

116 In *Re Beauty Counsellors of Canada Ltd.*, supra, Saunders J. said at p. 243 [C.B.R.]:

If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate. In such a case the proper course might be to refuse approval and to ask the trustee to recommence the process.

117 I accept that statement as being an accurate statement of the law. I would add, however, as previously indicated, that in determining what is the best price for the estate, the receiver or court should not limit its consideration to which offer provides for the greater sale price. The amount of down payment and the provision or lack thereof to secure payment of the balance of the purchase price over and above the down payment may be the most important factor to

be considered, and I am of the view that is so in the present case. It is clear that that was the view of the only creditors who can benefit from the sale of Air Toronto.

118 I note that in the case at bar the 922 offer in conditional form was presented to the receiver before it accepted the OEL offer. The receiver, in good faith, although I believe mistakenly, decided that the OEL offer was the better offer. At that time the receiver did not have the benefit of the views of the two secured creditors in that regard. At the time of the application for approval before Rosenberg J., the stated preference of the two interested creditors was made quite clear. He found as fact that knowledgeable creditors would not be anxious to rely on contingencies in the present circumstances surrounding the airline industry. It is reasonable to expect that a receiver would be no less knowledgeable in that regard, and it is his primary duty to protect the interests of the creditors. In my view, it was an improvident act on the part of the receiver to have accepted the conditional offer made by OEL, and Rosenberg J. erred in failing to dismiss the application of the receiver for approval of the OEL offer. It would be most inequitable to foist upon the two creditors, who have already been seriously hurt, more unnecessary contingencies.

119 Although in other circumstances it might be appropriate to ask the receiver to recommence the process, in my opinion, it would not be appropriate to do so in this case. The only two interested creditors support the acceptance of the 922 offer, and the court should so order.

120 Although I would be prepared to dispose of the case on the grounds stated above, some comment should be addressed to the question of interference by the court with the process and procedure adopted by the receiver.

121 I am in agreement with the view expressed by McKinlay J.A. in her reasons that the undertaking being sold in this case was of a very special and unusual nature. As a result, the procedure adopted by the receiver was somewhat unusual. At the outset, in accordance with the terms of the receiving order, it dealt solely with Air Canada. It then appears that the receiver contemplated a sale of the assets by way of auction, and still later contemplated the preparation and distribution of an offering memorandum inviting bids. At some point, without advice to CCFL, it abandoned that idea and reverted to exclusive negotiations with one interested party. This entire process is not one which is customary or widely accepted as a general practice in the commercial world. It was somewhat unique, having regard to the circumstances of this case. In my opinion, the refusal of the court to approve the offer accepted by the receiver would not reflect on the integrity of procedures followed by court-appointed receivers, and is not the type of refusal which will have a tendency to undermine the future confidence of business persons in dealing with receivers.

122 Rosenberg J. stated that the Royal Bank was aware of the process used and tacitly approved it. He said it knew the terms of the letter of intent in February 1991, and made no comment. The Royal Bank did, however, indicate to the receiver that it was not satisfied with the contemplated price, nor the amount of the down payment. It did not, however, tell the receiver to adopt a different process in endeavouring to sell the Air Toronto assets. It is not clear from the material filed that at the time it became aware of the letter of intent that it knew that CCFL was interested in purchasing Air Toronto.

123 I am further of the opinion that a prospective purchaser who has been given an opportunity to engage in exclusive negotiations with a receiver for relatively short periods of time which are extended from time to time by the receiver, and who then makes a conditional offer, the condition of which is for his sole benefit and must be fulfilled to his satisfaction unless waived by him, and which he knows is to be subject to court approval, cannot legitimately claim to have been unfairly dealt with if the court refuses to approve the offer and approves a substantially better one.

124 In conclusion, I feel that I must comment on the statement made by Galligan J.A. in his reasons to the effect that the suggestion made by counsel for 922 constitutes evidence of lack of prejudice resulting from the absence of an offering memorandum. It should be pointed out that the court invited counsel to indicate the manner in which the problem should be resolved in the event that the court concluded that the order approving the OEL offer should be set aside. There was no evidence before the court with respect to what additional information may have been acquired by CCFL since March

8, 1991, and no inquiry was made in that regard. Accordingly, I am of the view that no adverse inference should be drawn from the proposal made as a result of the court's invitation.

125 For the above reasons I would allow the appeal one set of costs to CCF-L-922, set aside the order of Rosenberg J., dismiss the receiver's motion with one set of costs to CCF-L-922 and order that the assets of Air Toronto be sold to numbered corporation 922246 on the terms set forth in its offer with appropriate adjustments to provide for the delay in its execution. Costs awarded shall be payable out of the estate of Soundair Corporation. The costs incurred by the receiver in making the application and responding to the appeal shall be paid to him out of the assets of the estate of Soundair Corporation on a solicitor-client basis. I would make no order as to costs of any of the other parties or intervenors.

Appeal dismissed.

2011 ABQB 726
Alberta Court of Queen's Bench

Computershare Trust Co. of Canada v. Venti Investments Corp.

2011 CarswellAlta 2304, 2011 ABQB 726, 213 A.C.W.S. (3d) 203, 86 C.B.R. (5th) 71

Computershare Trust Company of Canada (Plaintiff) and Venti Investments Corporation, Shariff Chandran and Qualia Real Estate Investment Fund VI Limited Partnership (Defendants)

B.E. Romaine J.

Judgment: November 25, 2011

Docket: Calgary 1101-03154

Counsel: Kevin E. Barr for MNP Ltd. in its capacity as Court-appointed Receiver
Ryan P. Pelletier, Richard Billington, Q.C. for Venti Investment Corporation
David Wood, Jared Spindel for Computershare Trust Company of Canada
Terry L. Czechowskyj for Proposed Purchaser
Michael B. Niven, Q.C. for Durum Real Estate Holdings Inc.

Subject: Corporate and Commercial; Insolvency

Headnote

Debtors and creditors --- Receivers --- Conduct and liability of receiver --- General conduct of receiver
Receiver brought application to approve sale of property --- V Corp. brought cross-application for order rejecting any agreement of sale, directing that it was entitled to redeem arrears on mortgage on property in question or make such payments as were necessary to bring mortgage back into good standing, directing hearing to set amount of arrears, and discharging receiver --- Application granted; cross-application dismissed --- Receiver made more than sufficient effort to get best price for property and had not acted improvidently --- Sale price was not low in relation to appraised value, there was plenty of time for bids and adequate notice of sale process --- As to interests of parties, sale was supported by major creditor --- It was also important and appropriate to note interests of proposed purchaser, which tendered its bid in good faith and presumably at some expense and which opposed V Corp.'s cross-application --- No issue with respect to efficacy and integrity of process by which offers were obtained --- Certain objection of V Corp. concerning possibility of unfairness in working out of process had to be viewed in context --- There was nothing in history in issue that cast doubt on fairness of process or role of receiver --- To accept V Corp.'s proposal would be unfair to parties who participated in bidding process in good faith, and proposed purchaser who entered bona fide into agreement with receiver --- It would lead to kind of chaos referred to in certain case law and would be unwarranted interference with properly-run process conducted by receiver --- V Corp. had plenty of time in last 21 months to bring arrears up to date and avoid sale, and what it offered now was too little and too late --- Submission that there was no urgency about application was not accepted.

APPLICATION by receiver to approve sale of property; CROSS-APPLICATION by company for order rejecting any agreement of sale, directing that it was entitled to redeem arrears on mortgage on property in question or make such payments as were necessary to bring mortgage back into good standing, directing hearing to set amount of arrears, and discharging receiver.

B.E. Romaine J.:

1 This was an application to approve a sale of property brought by the Receiver of the assets and property of Venti Investment Corporation and Qualia Real Estate Investment Fund VI Limited Partnership. Venti cross-applied for an order rejecting any agreement of sale, directing that it is entitled to redeem the arrears on a mortgage on the property in question or make such

payments as are necessary to bring the mortgage back into good standing, directing a hearing to set the amount of the arrears and discharging the Receiver

2 Despite efforts to characterize the application as a sale in foreclosure proceedings, this was a sale within a receivership that resulted from a consent order granted on March 4, 2011. I find that the consent order is correctly characterized as a liquidating order. This order first appointed MNP Ltd. as a Monitor to oversee the sale of the property under an existing agreement of sale and purchase. When the proposed sale terminated in April, 2011, MNP became the Receiver under the order, authorized by its terms to complete the sale of the property and to enter into a replacement agreement of purchase and sale. It has now done so.

3 The criteria to be applied when considering the approval of a sale recommended by a receiver were first set out by the Ontario Court of Appeal in *Royal Bank v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (Ont. C.A.). The *Soundair* principles have been applied many times by this Court.

4 When deciding whether a receiver who has sold a property has acted properly, a court is to consider and determine:

(a) whether the receiver has made a sufficient effort to get the best price and has not acted improvidently;

(b) the interests of all parties;

(c) the efficacy and integrity of the process by which offers were obtained; and

(d) whether there has been unfairness in the working out of the process.

5 In considering whether the Receiver has made a sufficient effort to get the best price, I note that there has been a thorough and extensive process undertaken to sell the property, and the agreement of purchase and sale finally executed by the Receiver represents a sale at or above fair market value. However, Venti submits in essence that the Receiver acted improvidently on the basis of information Mr. Chandran, the principle of Venti, says was obtained from the sale and leasing agent retained by the Receiver that the Receiver's report in support of the application failed to include material information. Mr. Chandran submits through his counsel that there have been two undisclosed written offers to lease the property in question that would affect approximately half of the vacant space in the building and that could dramatically affect its appraised value.

6 Given the nature of the application, its urgency and the allegations made, I took the unusual step of inviting counsel for the Receiver to respond to this allegation by having the Receiver testify and be subject to cross-examination on this limited issue. I accept the Receiver's testimony, corroborated by that of the Receiver's leasing agent, that he was informed the morning of the application that an existing tenant was expressing some unwritten, informal interest in leasing approximately 2,000 to 4,000 additional square feet. This is not material information that either should have been disclosed in the report or that would affect fair market value. At any rate, the Receiver's conduct is to be examined in light of the information the Receiver had at the time it agreed to accept the offer, which was November 8, 2011. I find that the Receiver made more than a sufficient effort to get the best price for the property and has not acted improvidently. The sale price is not low in relation to the appraised value, there was plenty of time for bids and adequate notice of the sale process.

7 With respect to the interests of the parties, the sale is supported by the major creditor, Computershare Trust Company of Canada. Venti submits that it should not matter to Computershare if a sale of the property is the result of this application or if Venti is able to bring the mortgage into good standing, but Computershare has made it clear that it has lost faith in Venti and that it has a reasonable and valid preference for a sale rather than merely allowing Venti to extinguish the arrears. It points out that the cash flow from the property is insufficient to cover the monthly mortgage payments, and Venti has offered no more than to bring the arrears up to date and cover future mortgage payments for an indeterminate period.

8 It is also important and appropriate to note the interests of the proposed purchaser of the property, which tendered its bid in good faith and presumably at some expense and which opposes Venti's cross-application: *Soundair* at para. 40.

9 There is no issue with respect to the efficacy and integrity of the process by which offers were obtained.

- 10 With respect to the possibility of unfairness in the working out of the process, Venti suggests that the Receiver was deficient in failing to control or intervene with respect to what it characterizes as unfair behaviour by Computershare in communicating to Venti the amount it would cost to bring the arrears up to date.
- 11 This objection must be viewed in context. This became a receivership on April 12, 2011. On August 31, 2011, Venti enquired of the Receiver through counsel as to amount necessary to bring the mortgage back into good standing, and "in theory" discharge the Receiver.
- 12 On September 2, 2011, the Receiver's counsel advised of a figure of about \$850,000, subject to adjustment, additional interest, additional legal and other expenses, implementation of a realty tax reserve and payment of all receivership costs.
- 13 On September 29, 2011, in anticipation of a meeting requested by Venti to discuss a possible reorganization, Computershare notified Venti that the amount required to bring the mortgage into good standing would be \$1.07 million, plus certain processing and assumption fees, plus additional costs with respect to the receivership, the listing of the property, the property manager and the lender's counsel and subject to additional interest, the implementation of a monthly tax escrow amount and payment of the Silvercrest lease obligation.
- 14 It was only on October 24, 2011, having received the September 29, 2011 estimate (which was clearly characterized as an estimate) and advice from the Receiver on that date that the Receiver was dealing with interested parties and expected a binding agreement of sale shortly, that Venti's counsel expressed the intention of bringing the mortgage up to date "this week". This email from Venti's counsel repeats the September 29, 2011 estimate, with its references to additional costs.
- 15 On October 26, 2011, Computershare provided its revised estimate, which incorporated the items that had previously been referenced, including the costs of the receivership, the Silvercrest lease obligation, the costs of the listing and leasing agent, the immediate amount of tax escrow and updated payments due.
- 16 Computershare advised that Venti should confirm that it would pay these amounts that week. Instead, on October 27, 2011, Venti disputed the amount payable. On November 3, 2011, Computershare provided its explanation of the amounts owing, and reduced the previous amount said to be immediately owing by \$65,000.
- 17 On November 7, 2011, the Receiver received a reorganization proposal from a third party which included the concept of bringing the mortgage into good standing, and considered this proposal together with the two other proposals it had received. On November 8, 2011, the Receiver executed a purchase and sale agreement with the proposed Purchaser.
- 18 It was not until November 10, 2011 that Venti sent Computershare's counsel \$1 million towards the arrears, and then only under unacceptable trust conditions. While another \$700,000 was promised to be available during the course of the hearing, it did not materialize.
- 19 There is nothing in this history that casts doubt on the fairness of the process or the role of the Receiver. The first estimate of payout cost was clearly subject to upward adjustment, and subsequent estimates identified why the payout figure increased over time. Venti had the opportunity to payout the mortgage prior to the Receiver entering into a binding offer subject only to court approval on November 8, 2011, and plenty of warning that the sales process was unfolding and nearing completion.
- 20 At page 19 of *Sundair*, McKinlay J.A. emphasized the importance of protecting the integrity of the procedures followed by a court-appointed receiver "in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers". That concern for the integrity of the process has been expressed in many cases in Alberta, including by our Court of Appeal: *Bank of Montreal v. River Rentals Group Ltd.*, [2010] A.J. No. 12 (Alta. C.A.) at para. 18.
- 21 While the concern for the integrity of the process is often expressed in terms of whether it is appropriate to consider a last-minute higher offer to purchase, it is equally important here, where the debtor is not offering a higher amount for the property, nor even to redeem the entire debt, but only to bring the arrears up to date. Venti does not even accept the amount of arrears set by the mortgagee, but asks that there be a subsequent hearing to establish that amount. To accept Venti's proposal would be

unfair to the parties who participated in the bidding process in good faith, and the Proposed Purchaser who entered *bona fide* into an agreement with the Receiver. It would lead to the kind of chaos referred to in *Somclair* at para. 30 and would be an unwarranted interference with a properly-run process conducted by the Receiver. Venti had plenty of time in the last 21 months to bring the arrears up to date and avoid the sale, and what it offers now is too little and too late.

22 Venti submits that there is no urgency about this application. I must disagree. As I indicated when I refused an adjournment, I agree with Computershare that there is no reason to delay the application, and considerable prejudice in terms of mounting arrears, a limited recourse loan and little or no equity.

23 Given the decision I have reached, it is not necessary that I consider whether Venti is in effect seeking relief from forfeiture, and if so, whether it is entitled to such relief.

24 The Receiver's application is granted and Venti's cross-application is dismissed.

25 This decision was originally scheduled to be delivered orally the day after the application was heard. At that time, counsel for Venti indicated that his client had changed his position and was prepared to consent to the application. I advised the parties that I would grant an order of sale and would issue subsequent written reasons.

26 If the parties are unable to agree on costs, they may make submissions on that issue.

Application granted, cross-application dismissed

2000 ABQB 766
Alberta Court of Queen's Bench

Cobrico Developments Inc. v. Tucker Industries Inc.

2000 CarswellAlta 1211, 2000 ABQB 766, [2000] A.J. No. 1295, [2001] A.W.L.D. 349, 273 A.R. 297

**Cobrico Developments Inc., Plaintiff and Tucker
Industries Inc. and Tucker Enterprises Corp., Defendants**

Lee J.

Heard: October 25, 2000
Judgment: November 1, 2000
Docket: Edmonton 0003-17053

Proceedings: additional reasons at 2000 ABQB 817 (Alta. Q.B.)

Counsel: *Richard N. Billington*, for Receiver/Manager.

Barry M. King and Kevin Ozubko, for Unnamed party, Ritchie Bros. Auctioneers (Canada) Ltd.

Thomas R. Benson, for Unnamed party, All Peace Auctions Ltd.

Subject: Corporate and Commercial; Insolvency

Headnote

Personal property security --- Remedies — Sale or realization — Miscellaneous issues

Receiver was appointed with respect to property and assets of T Inc. and T Corp. — Receiver approached three auction houses to submit proposals for public sale of assets — R Ltd. was unsuccessful and A Ltd. was chosen — Receiver brought application for order permitting disposition of T Inc. and T Corp.'s assets by way of public sale — R Ltd. objected to bid process and receiver's conclusions — Application granted — Receiver's discretion should not be lightly interfered with without strong evidence — R. Ltd. did not bring forward anything that would vitiate or interfere with wide powers granted to receiver — Receiver acted in good faith and in commercially reasonable manner — Creditor who held General Security Agreement and PMSI holders supported auction and receiver's recommendation of A Ltd. — A Ltd. guaranteed that it would recover amount at least sufficient to pay out PMSI indebtedness and R Ltd. did not — R Ltd. was not creditor of T Inc. or T Corp. and did not have standing to object to receiver's exercise of discretion.

Receivers --- Conduct and liability of receiver — General conduct of receiver

Receiver was appointed with respect to property and assets of T Inc. and T Corp. — Receiver approached three auction houses to submit proposals for public sale of assets — R Ltd. was unsuccessful and A Ltd. was chosen — Receiver brought application for order permitting disposition of T Inc. and T Corp.'s assets by way of public sale — R Ltd. objected to bid process and receiver's conclusions — Application granted — Receiver's discretion should not be lightly interfered with without strong evidence — R. Ltd. did not bring forward anything that would vitiate or interfere with wide powers granted to receiver — Receiver acted in good faith and in commercially reasonable manner — Creditor who held General Security Agreement and PMSI holders supported auction and receiver's recommendation of A Ltd. — A Ltd. guaranteed that it would recover amount at least sufficient to pay out PMSI indebtedness and R Ltd. did not — R Ltd. was not creditor of T Inc. or T Corp. and did not have standing to object to receiver's exercise of discretion.

APPLICATION by receiver for order permitting disposition of assets by public sale.

Lee J.:

1 On September 7, 2000, my colleague, Lefsrud, J., appointed Myers Norris & Penny Limited (hereinafter referred to as the "Receiver") to be the Receiver and Manager with respect to the property and assets of the Defendants Tucker Industries Inc. and Tucker Enterprises Corp. (hereinafter referred to as ("Tucker")).

2 On Wednesday, October 25, 2000, the Receiver made an Application before me for an Order pursuant to s. 60 of the *Personal Property Security Act* (hereinafter referred to as the "PPSA") permitting the disposition by public sale of assets of the Defendants, and for an Order pursuant to s. 60(15) of the *Act* permitting the disposition of collaterals secured by a charge under the *Act* without notice to the debtor, or to any person with an interest in the collateral.

3 Cobrico Developments Inc. ("Cobrico") was the petitioning creditor in this matter

4 Ritchie Bros. Auctioneers (Canada) Ltd. [hereinafter referred to as "Ritchie Bros."] was one of the three auction houses that had been approached by the Receiver/Manager to submit a proposal with respect to Tucker on approximately October 13, 2000. Their proposal with respect to Tucker, dated October 17, 2000, provides for a gross guarantee of two million dollars, a 12% commission of \$240,000.00, for a net of \$1.76 million dollars. With respect to proceeds over two million dollars, 88% would go to the debtor's estate, and 12% would be retained by Ritchie Bros.

5 Ritchie Bros. and Century Sales Inc. were the unsuccessful public auction houses not chosen to dispose of the debtor's estate. All Peace Auctions Ltd. [hereinafter referred to as "All Peace"] based in Grande Prairie was the successful auction house chosen by the Receiver/Manager.

6 Ritchie Bros. now comes before this Court and objects to both the bid process used by the Receiver/Manager and to the conclusions it reached, and wishes to submit a revised bid based on a fair process that it submits was not present in the first place.

7 Ritchie Bros. alleges that certain material information was not supplied to it (that was supplied to All Peace), and submits that as a result of this, the creditors of Tucker will not benefit as much as they could if the present proposed Order sought by the Receiver/Manager is granted. Ritchie Bros. also argues that the Receiver's Grande Prairie office provides accounting and audit services over many years to All Peace constituting a real or apparent conflict of interest on the part of the Receiver/Manager.

8 The Receiver/Manager strongly objects to Ritchie Bros.'s intervention, describing it as nothing more than "vexatious intermeddler", for the purposes which include determining essentially what the competing auction house bids were. The Receiver/Manager submits that Ritchie Bros. has absolutely no standing in this matter and should not be heard.

9 The General Manager of All Peace, Kevin Tink, disputed many of Ritchie Bros.'s claims with respect to the bidding process, and described their state of preparedness for the proposed mid-November, 2000 public auction in an Affidavit filed October 27, 2000. Further, Mr. Tink claimed that Ritchie Bros. was also involved in a similar last-minute intervention, or inter-meddling, with respect to a Calgary matter that was similar to the present Application before me, in the matter of Serval Corporation.

10 The Receiver/Manager argues that any delay in this matter would be very prejudicial to all parties involved (with the possible exception of Ritchie Bros.) because of the fact that the equipment of Tucker essentially is oil and gas drilling equipment for which there is primarily a market before drilling season commences. Therefore, the mid-November auction of this equipment is essential. It is estimated that approximately ten million dollars will be received from this auction.

The Law

11 Ritchie Bros. submits *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1 (N.S. C.A.) to support its argument that it has standing before me. At paragraph 18, Hart JA indicates that there is no merit to the suggestion that the unsuccessful bidders have no standing:-

A preliminary question was raised as to whether Mr. Treby or Mr. Cameron had any right to appear at the original hearing before Burchell, J., or any status which would enable them to appeal from his decision, but, in my opinion, there is no merit

in such a suggestion. Both parties were persons to be affected directly by the decision of the court and, in my opinion, were proper parties to the proceedings.

12 *Cameron*, supra, was followed by the Alberta Court of Appeal in *Salima Investments Ltd. v. Bank of Montreal* (1985), 21 D.L.R. (4th) 473 (Alta. C.A.). *Salima* involved an appeal of an Order approving the sale of property by a receiver. The appellant had submitted the highest tender and, subject to court approval, the receiver had agreed to convey the property to the appellant. A higher offer was submitted; by another party prior to the motion for approval. The motion was adjourned and the appellant and two other parties submitted bids. The chambers judge directed the receiver to complete the sale to the party that submitted the highest offer.

13 Kerans, J.A. concluded that the Court had jurisdiction to consider other offers on the motion to approve the sale, and could conduct what was, in essence, a judicial auction. No issue was raised as to the standing of *Salima Investments Ltd.*, as an unsuccessful bidder, to appeal.

14 Ritchie Bros. submits that the *Salima* case makes it clear that the Court has jurisdiction to exercise judicial discretion and consider other offers as well as to direct an alternative process. In *Salima*, Kerans J.A. states the following at pages 466-467:-

We think that the proper exercise of judicial discretion in these circumstances should be limited, in the first instance, to an inquiry whether the receiver has made a sufficient effort to get the best price and not acted improvidently. In examining that question, there are many factors which the court may consider. As Macdonald J.A. said in the *Cameron* case at pp. 11-2:

There are, of course, many reasons why a court might not approve an agreement of purchase and sale, viz., where the offer accepted is so low in relation to the appraised value as to be unrealistic; or, where the circumstances indicate that insufficient time was allowed for the making of bids or that inadequate notice of sale by bid was given (where the receiver sells property by the bid method); or, where it can be said that the proposed sale is not in the best interest of either the creditors or the owner.

15 It is submitted that this is not a total catalogue of those factors which might lead a court to refuse to approve a sale. In *Salima*, supra, the Court concluded the following at page 477:-

We do not have the benefit of the recorded reasons by the learned chambers judge. We assume that he came to the conclusion that the efforts of the receiver - while always in good faith - had not been adequate. In our view, there was evidence before him to support that finding, and we cannot say that this conclusion is so unreasonable as to warrant interference. Nor can we criticize his decision to conduct a summary court-supervised sale in the urgent circumstances which then arose.

16 The factors in the case at bar that Ritchie Bros. object to as against the Receiver/Manager include:-

- (a) The longstanding accountant/client relationship between the Receiver/Manager and All Peace raises an appearance or potential of conflict on the part of the Receiver;
- (b) All Peace had an advantage in terms of access to information, the assets and to the Receiver/Manager;
- (c) The Receiver/Manager may have made the decision to engage All Peace prior to receipt of the proposal of Ritchie Bros.;
- (d) The asset and equipment list used by the Receiver/Manager to request proposals appears to have varied from case to case and has not yet been finalized; and
- (e) The instructions by the Receiver/Manager to All Peace and Ritchie Bros. with respect to preparation of proposals appear to have been inconsistent and were capable of multiple interpretations which effected the integrity of the proposals and the process.

17 The Receiver/Manager rely on the case of *Skyepharma PLC v. Hyal Pharmaceutical Corp.* (1999), 12 C.B.R. (4th) 87 (Ont. S.C.J. [Commercial List]), a decision of Farley, J. of the Commercial List of the Ontario Superior Court of Justice which deals with a fact situation that is somewhat similar to the case at bar.

18 In *Skyepharma*, supra PWC as Court appointed receiver of Hyal made a motion on October 15, 1999 for an Order approving and authorizing the Receiver's acceptance of an Agreement of Purchase and Sale with Skye designated as Plan C. Ground, J. expressed some doubt in Oral Reasons as to the activity of the Receiver.

19 Certain confidential information was not available to Ground, J., as it is not available to me in the case at bar.

20 In *Skyepharma*, Farley, J. concluded that as a result of that confidential information and the complexity of what was available for sale by the receiver, there were various other potentially important considerations surrounding the asset sale and/or sale of shares.

21 Eventually the confidential lists were distributed, and one of the arguments for re-opening the bid auction process would be to put all potential bidders on an equal footing, knowing what everyone else's present position was. It was argued in *Skyepharma* that the best offer would, therefore, be improved, and whatever procedural defects existed would be remedied.

22 Farley, J. concluded as follows:-

3 Through its activities as authorized by the court, the Receiver has significantly increased the initial indications from the various interested persons. In a motion to approve a sale by a receiver, the court should place a great deal of confidence in the receiver's expert business judgement particularly where the assets (as here) are "unusual" and the process used to sell these is complex. In order to support the role of any receiver and to avoid commercial chaos in receivership sales, it is extremely desirable that perspective participants in the sale process know that a court will not likely interfere with a receiver's dealings to sell to the selected participant and that the selected participant have the confidence that it will not be back doored in some way. See *Soundair* at pp. 5, 9-10, 12 and *Crown Trust Co. v. Rosenberg et al.* (1986), 60 O.R. (2d) 87 (H.C.J.). The court should assume that the receiver has acted properly unless the contrary is clearly demonstrated; see *Soundair* of pp. 5 and 11. Specifically the court's duty is to consider as per *Soundair* at p. 6:

- (a) whether the receiver made a sufficient effort to obtain the best price and did not act improvidently;
- (b) the interests of all parties;
- (c) the efficacy and integrity of the process by which the receiver obtained offers; and
- (d) whether the working out of the process was unfair.

4 As to the providence of the sale, a receiver's conduct is to be reviewed in light of the (objective) information a receiver had and not with the benefit of hindsight: *Soundair* at p. 7. A receiver's duty is not to obtain the best possible price but to do everything reasonable possible in the circumstances with a view to obtaining the best price: see *Greyvest Leasing Inc. v. Merkur*, [1994] O.J. No. 2465 (Gen. Div.) at para. 45. Other offers are irrelevant unless they demonstrate that the price in the proposed sale was so unreasonable low that it shows the receiver as acting improvidently in accepting it. It is the receiver's sale not the sale by the court: *Soundair* at pp. 9-10.

5 In deciding to accept an offer, a receiver is entitled to prefer a bird in the hand to two in the bush. The receiver, after a reasonable analysis of the risks, advantages and disadvantages of each offer (or indication of interest if only advanced that far) may accept an unconditional offer rather than risk delay or jeopardize closing due to conditions which are beyond the receiver's control. Furthermore, the receiver is obviously reasonable in preferring any unconditional offer to a conditional offer: See *Crown Trust* at p. 107 where Anderson, J. stated:

The proposition that conditional offers would be considered equally with unconditional offers is so palpably ridiculous commercially that it is difficult to credit that any sensible businessman would say it, or if said, that any sensible businessman would accept it.

See also *Soundair* at p. 8. Obviously if there are conditions in offers, they must be analysed by the receiver to determine whether they are within the receiver's control or if they appear to be in the circumstances as minor or very likely to be fulfilled. This involves the game theory known as mini-max where the alternatives are gridded with a view to maximizing the reward at the same time as minimizing the risk. Size and certainty does matter.

6 Although the interests of the debtor and purchaser are also relevant, on a sale of assets, the receiver's primary concern is to protect the interests of the debtor's creditors. Where the debtor cannot meet statutory solvency requirements, then in accord with the Plimsoll line philosophy, the shareholders are not entitled to receive payments in priority or partial priority to the creditors. Shareholders are not creditors and in a liquidation, shareholders rank below the creditors. See *Soundair* at p. 12 and *Re Central Capital Corporation* (1996), 38 C.B.R. (3d) 1 at pp. 31-41 (per Weiler, JA) and pp. 50-53 (Laskin, JA).

7 Provided a receiver has acted reasonably, prudently and not arbitrarily, a court should not sit as in an appeal from a receiver's decision, reviewed in detail every element of the procedure by which the receiver made the decision (so long as that procedure fits with the authorized process specified by the court if a specific order to that effect has been issued). To do so would be futile and duplicative. It would emasculate the role of the receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval. See *Soundair* at p. 14 and *Crown Trust* at p. 109.

8 Unsuccessful bidders have no standing to challenge a receiver's motion to approve the sale to another candidate. They have no legal or proprietary right as technically they are not affected by the order. They have no interest in the fundamental question of whether the court's approval is in the best interest of the parties directly involved. See *Crown Trust* at pp. 114-119 and *British Columbia Development Corporation v. Spun Cast Industries Ltd.* (1977), 26 C.B.R. (N.S.) 28 (B.C.S.C.) at p. 30-31. The corollary of this is that no weight should be given to the support offered by a creditor qua creditor as to its offer to purchase the assets. [Emphasis Added]

23 *Skyepharm* was taken to the Ontario Court of Appeal and their Reasons are reported at (2000), 47 O.R. (3d) 234 (Ont. C.A.). The Ontario Court of Appeal's Reasons, issued on February 18, 2000, dealt with the appeal by BP plc with respect to the Approved Sale Order made by Farley, J., which appeal the Receiver moved to have quashed on the ground that the Court did not have jurisdiction. The Receiver submitted that a potential purchaser does not have any legal or any proprietary right that is affected by the Court's approval of a sale and accordingly the potential purchaser does not have standing to challenge the Order approving the sale.

24 The Ontario Court of Appeal held:-

...the question raised by the receiver's motion to quash was whether BP plc had a right that was finally disposed of by the sale approval order.

25 The Ontario Court of Appeal held that there was no such right for two reasons:-

First, a prospective purchaser has no legal or proprietary right in the property being sold. There is no right in a party who submits an offer to have the offer, even if the highest, accepted by either the receiver or the court. Second, the fundamental purpose of the sale approval motion is to consider the best interests of the parties with a direct interest in the proceeds of the sale, primarily the creditors, and an unsuccessful purchaser has no interest in that issue.

26 Continuing on, the Ontario Court of Appeal then stated as follows:

[8] On October 13, the receiver reported to the court on the results of the negotiations with Skyepharma and Cangene. The parties had been unable to structure the transaction to take advantage of Hal's tax loss positions. Nevertheless, the receiver recommended approval for an agreement to sell the assets of Hal to Skyepharma. In its report, the receiver pointed out that the agreement it was recommending did not necessarily maximize the realization for the assets but that it did minimize the risk of not closing and also the risk of liabilities increasing in the interim period up to closing, which risks arose from the provisions and time-frames contained in other offers. The receiver said that these risks were not immaterial.

[9] At the same time that the receiver filed its report it brought a motion for approval of the agreement with Skyepharma. The motion was heard by Farley J. on October 20, 1999. Counsel for Skyepharma, Cangene and Bioglan appeared and were permitted to make submissions. Skyepharma, which was both a creditor of Hal and the purchaser under the agreement for which approval was being sought, supported the motion. Cangene and Bioglan, which in addition to being unsuccessful prospective purchasers, were also creditors of the company, opposed the motion.

[10] It is apparent that the motions judge heard the submissions of Cangene and Bioglan in their capacities as creditors of Hal and not in their role as unsuccessful bidders for the assets being sold. In his endorsement made on October 24 he said:

Unsuccessful bidders have no standing to challenge a receiver's motion to approve the sale to another candidate. They have no legal or proprietary right as technically they are not affected by the order. They have no interest in the fundamental question of whether the court's approval is in the best interests of the parties directly involved.

The motions judge continued by saying that he would "take into account the objections of Bioglan and Cangene as they have shoehorned into the approval motion". This latter comment, as it applied to Bioglan, appears to refer to the fact that Bioglan only became a creditor after the receiver was appointed and then only by acquiring a small debt of Hal in the amount of \$40,000.

[11] The motions judge approved the agreement for the sale of the assets to Skyepharma. In his endorsement, he noted that the assets involved were "unusual" and that the process to sell these assets was complex. He attached significant weight to the recommendation of the receiver who, he pointed out, had the expertise to deal with matters of this nature. The motions judge noted that the receiver's primary concern was to protect the interests of the creditors of Hal. He recognized the advantages of avoiding risks that may result from the delay or uncertainty inherent in offers containing conditional provisions. The certainty and timeliness of the Skyepharma agreement were important factors in both the recommendation of the receiver and in the reasons of the court for approving the sale.

[22] I adopt both his reasoning and his conclusion. At p. 118, he said:

The motion brought by Clarkson to approve the sales is one upon which the fundamental question for consideration is whether that approval is in the best interests of the parties to the action as being the approval of sales which will be most beneficial to them. In that fundamental question Larco has no interest at all. Its' only interest is in seeking to have its offer accepted with whatever advantages will accrue to it as a result. That interest is purely incidental and collateral to the central issue in the substantive motion and, in my view, would not justify an exercise of the discretion given by the rule.

Nor, in my view, can Larco resort successfully to cl. (b) of rule 13.01(1)-which raises the question whether it may be adversely affected by a judgment in the proceeding. For these purposes I leave aside the technical difficulties with respect to the word "judgment". In my view, Larco will not be adversely affected in respect of any legal or proprietary right. It has no such right to be adversely affected. The most it will lose as a result of an order approving the sales as recommended, thereby excluding it, is a potential economic advantage only.

Conclusion

27 The *Skyepharm* case was cited with approval in *Sonoma, Re*, decided by Lovecchio, J. on October 6, 2000 in Calgary (Action No. 0001-06953).

28 Further, the Alberta Court of Appeal has favoured preserving the integrity of the process and allowing the Receiver to exercise its discretion without fetter from the Court in the case of *Royal Bank v. Fracmaster Ltd.* (1999), 209 W.A.C. 93 (Alta. C.A.) approving (1999), 245 A.R. 138 (Alta. Q.B.). Paperny J. wrote at paragraph 58:-

This court appointed the Receiver based on its experience and expertise. It is the Receiver's function to do the business analysis necessary to develop a disposition strategy, to analyse the proposed offers and to make a recommendation to the Court. As Anderson, J. stated in *Crown Trustco v. Rosenberg* (Supra) the Court ought not: "enter into the marketplace" ... the Court out not to sit as on appeal from the decision of the Receiver, reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise... The Court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

29 Paperny J.'s decision was expressly upheld by the Court of Appeal. At paragraph 32 the Alberta Court of Appeal considered the *Salima* decision, but reiterated the provisions of the *Soundair* [*Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1 (Ont. C.A.)] decision which were quoted by Farley, J., in the *Skyepharm* case, supra at page 4. At paragraph 33 they deferred to the recommendation of the Receiver/Manager.

30 The *Salima* case specifically did not deal with the standing issue of Salima Investments, as an unsuccessful bidder, to appeal.

31 The *Cameron* decision referred to in *Salima* dealt with a Nova Scotia rule which permits intervenor status [paragraph 12 of *Cameron*] which does not exist here.

32 Based on the Reasons as discussed in the two *Skyepharm* [*Skyepharm*, *Skyepharm*] decisions and *Royal Bank v. Fracmaster Ltd.*, I conclude that:-

- (a) wide latitude is afforded to the Receiver;
- (b) disappointed bidders generally have no standing; and
- (c) the Court does not wish to sanction a process that will result in chaos and confusion at the approval motion.

33 The Receiver/Manager set out a bid process in this matter, and its discretion should not be lightly interfered with without strong evidence. Here the allegations by Ritchie Bros. are disputed, and some of the allegations do not appear to be that serious in any event.

34 If there was strong evidence of serious problems in the bid process the Court would exercise its inherent jurisdiction and discretion. I would be been prepared to allow Ritchie Bros. to put forward another proposal for the potential benefit of the creditors. The Court's supervisory jurisdiction requires this in the appropriate clear-cut case otherwise it would just be a rubber stamp for the Receiver/Manager.

35 The Court also must ensure generally that the Receiver/Manager acts in accordance with its enabling Order, and carries out these functions properly under the provision of S. 66(1) of the *PPSA* which reads:-

66(1) All rights, duties or obligations arising under a security agreement, under this Act or under any other applicable law shall be exercised or discharged **in good faith and in a commercially reasonable manner.**

[Emphasis added]

36 In the result however, I conclude that Ritchie Bros. has not brought forward anything that would vitiate or interfere with the wide powers that were granted by this Court to the Receiver/Manager on September 7, 2000 which include:-

At paragraph 1

The Receiver is given authority to "manage and operate the businesses and undertakings";

At paragraph 2

It is hereby acknowledged and declared that the Receiver is an officer of this Honourable Court and is assisting in the preservation and, as appropriate, the orderly sale and realization of the property, undertaking and assets of the Defendant for the benefit of all creditors and claimants, including the Plaintiff, as a secured creditor.

At paragraph 7

The Receiver shall be at liberty to employ such assistants, agents, employees, auditors, advisers and counsel, including legal counsel as it may consider necessary for the purpose ... of realizing the undertaking, property and assets of the Defendants...

At paragraph 8

The Receiver be and is hereby granted leave to take such steps as in its judgement are necessary or desirable for the preservation, protection and realization of the business...

At paragraph 9

The Receiver is authorized to sell, on credit or otherwise, the undertaking, assets and property of each of the Defendants ... or any part or parts thereof out of the ordinary course of business, at public auction, by public tender or by private sale on such terms and conditions as it deems appropriate, provided any such sales over \$100,000.00 shall be subject to approval of this Court.

37 While Ritchie Bros. submits that the Receiver/Manager made some errors in its process and procedures, I conclude that it has acted "in good faith and in a commercially reasonable manner."

38 In the initial Order appointing the Receiver/Manager, Lefsrud J. gave Meyers Norris & Penny Limited wide latitude to dispose of the assets of the Defendants, on behalf of the creditors of the Defendants. That latitude provides the Receiver/Manager with a variety of options, including that the Receiver/Manager may choose to sell some or all of the assets by public auction. The Receiver/Manager may choose to sell none by auction, and proceed with other methods of realization.

39 In this case, Cobrico holds General Security Agreements over the Defendants, who are both insolvent. The Defendants will be unable to fully pay the indebtedness owed to the Plaintiff. It is therefore clear that there will be no recovery for unsecured creditors.

40 Certain secured parties hold purchase money security interests ("PMSI") which afford them with priority security over certain of the chattels of the Defendants. Of those chattels, some have an equity sufficient to fully redeem the PMSI secured indebtedness, while other chattels will have insufficient value to fully repay the indebtedness owed to the PMSI holder. In the latter case, it is the desire of the Receiver/Manager to recognize that the decision to be made as to how best to realize on that particular chattel should be left to the PMSI holder, and the Receiver/Manager has no-wish to engage in the sale of that chattel, unless specifically instructed to do so by the holder of the PMSI.

41 The Receiver/Manager knows that certain of the chattels have sufficient equity to fully pay out the secured party who holds a PMSI with respect to each such chattel. The Receiver/Manager, however, is not qualified to assess the value of the chattels, or to determine if they have such equity. For that reason the Receiver/Manager submitted the same list of equipment

to three auction houses and asked them to appraise each item so that a determination could then be made of the value of that equipment, and if that value exceeded the indebtedness owed to the respective PMSI holder for each such chattel.

42 Three auction houses were requested to submit proposals and valuations. All Peace Auctions and Century Sales Inc. did so. Ritchie Bros. did not submit valuations on each individual piece.

43 With respect to the alleged conflict of interest, the commercial reality of receiverships is that trustees in bankruptcy, who will act as receivers, receiver/managers, monitors, trustees or as privately appointed receivers, are often affiliated with chartered accountancy practices which engage in accounting, audit, consulting, tax planning and a variety of other functions. Trustees in bankruptcy are regulated professionals who in the course of the realization on assets may be employing the services of experts, or who may be selling assets to persons, any of whom may have affiliation with the receiver.

44 However, generally that does not constitute a conflict of interest, nor generally does the marketplace of potential advisers or of potential purchasers have any legal standing to interfere with the performance of the receiver. That standing is generally reserved by law to those persons whose indebtedness is being protected by the receivership.

45 In the case at bar, those persons are the secured parties, being the PMSI holders and the Plaintiff. Indeed it is the Plaintiff whose interest is most immediately affected by the realization process. Any act which increases the value of the assets (at least those assets whose value is sufficient to satisfy the PMSI indebtedness) will be to the benefit of the Plaintiff. Any act which decreases the value of the assets will be at the Plaintiff's cost.

46 In this case the Plaintiff and the PMSI holders have been given notice of the list of assets which the Receiver/Manager proposes to sell by public auction. They support that auction and the recommendation of the Receiver/Manager to sell the chattels at the November 15, 2000 All Peace auction because of its strategic advantages of size and timing. They support it because All Peace complied with the request to provide an appraisal of each asset, and has guaranteed that it will pay to the Receiver/Manager an amount sufficient to pay off the PMSI indebtedness on each asset which eliminates risk and uncertainty. They support the decision to not select Century Sales Inc. which complied with the Receiver/Manager's stated requirements, and they support the decision to not select Ritchie Bros. which did not comply with the Receiver/Manager's stated requirements.

47 Ritchie Bros. now complains that it has not received the same "Final List" of assets from the Receiver/Manager as did the other auction houses. The "Final List" of assets never existed in the form contemplated by Ritchie Bros.. The Receiver/Manager gave the three auction houses the same inventory list of assets which was compiled by the Receiver/Manager, which exceeds 100 pages, and asked them to provide an appraisal for each of the assets, and a bid amount for the assets which each auction house *in their own discretion and judgement* considered to have an equity sufficient to pay off the PMSI indebtedness. The same statement of pay out amounts (the "Master List") was given to each auction house, and that has not changed. It listed the items secured by PMSI. It was up to the auction houses to each assess how successful they could be at recovering equity on each item. Any items which increase the total bid submitted by All Peace over the total bid submitted by Ritchie Bros. are not significant because they increase the total bid. Rather, they are significant because All Peace has guaranteed the Receiver that it will recover at least an amount sufficient to pay out the PMSI indebtedness secured by that chattel, whereas Ritchie Bros. have been unable or unwilling to do so.

48 The auction houses were each given access to the equipment to inspect the same. The Receiver/Manager's decision to proceed in this fashion is commercially reasonable and prudent (unlike the sale in *Salima*) and is supported by the creditors.

49 Further Ritchie Bros. have given no notice to the secured creditors, most particularly the Plaintiff, and are not supported by any of the secured creditors. They engage in a move to effectively enjoin the sale at the APA auction by the Receiver/Manager, but have not complied with any of the tripartite test for an injunction, nor have they posted an undertaking in damages.

50 The motion by the Receiver/Manager is to permit it to dispose of the assets listed in the proposed Order by public auction. Even by granting Ritchie Bros. status and standing, there is no serious reason to upset the Receiver/Manager's discretion, which is supported by the various secured creditors whose interests are of greater importance.

51 Further, there are certain procedural requirements imposed upon a person wishing to take action against the companies or by extension, the Receiver/Manager which Ritchie Bros. has not complied with Paragraph 6 of the initial Order states:-

That no legal actions, administrative proceedings, self-help remedies or other acts or proceedings shall be taken or continued against the Receiver of either of the Defendants' assets without leave of this Court first had and obtained upon 2 days prior notice to the Receiver....

52 The Receiver/Manager may therefore exercise its authority in any way it considers to be commercially reasonable, subject only to the requirement imposed by paragraph 9 to obtain Court approval for sales over \$100,000.00.

53 Ritchie Brothers are not creditors of either Tucker Industries Inc. or Tucker Enterprises Corp.. While the Receiver/Manager has extended contractually the time in which Ritchie Brothers was entitled to make its bid for auction rights, Ritchie Brothers has no standing to object to the exercise of discretion by the Receiver/Manager. Ritchie Bros. has also not established conclusively that anyone, other than themselves would benefit from the Court's intervention in this case.

54 The Receiver/Manager is authorized to dispose of the assets by public auction conducted by All Peace. Notice of Intention to dispose of the assets as required by the *PPSA* is dispensed with upon the debtor since there will be no remaining assets left for its benefit in any event.

Application granted.

2014 ABQB 350
Alberta Court of Queen's Bench

Alberta Treasury Branches v. Elaborate Homes Ltd.

2014 CarswellAlta 921, 2014 ABQB 350, [2014] A.W.L.D. 3322, [2014]
A.W.L.D. 3353, 14 C.B.R. (6th) 199, 243 A.C.W.S. (3d) 80, 590 A.R. 156

**In the Matter of the Insolvency of Elaborate
Homes Ltd. and Elaborate Developments Inc.**

Alberta Treasury Branches, Plaintiff and Elaborate Homes Ltd., Elaborate
Developments Inc., Manjit (John) Nagra, Jaswinder Nagra, Defendants

K.G. Nielsen J.

Heard: May 14, 2014

Judgment: June 11, 2014 *

Docket: Edmonton 1103-02937

Counsel: Robert M. Curtis, Q.C. for Alco Industrial Inc.
Michael J. McCabe, Q.C. for PriceWaterhouseCoopers Inc.

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

Headnote

Bankruptcy and insolvency --- Effect of bankruptcy on other proceedings --- Proceedings against bankrupt --- Before discharge of trustee --- Granting of leave

Company E went into receivership, with P being appointed as receiver --- Corporation A held second mortgage on condominium property owned by E, before bankruptcy --- Secured creditor held first mortgage on this property --- P accepted bid from numbered company, to purchase assets of E --- P submitted this bid for court approval, as they were required to do --- Approval was given by court --- However, A claimed they were not properly notified of this proceeding --- A claimed that had they known, they would have raised issue that property was being sold for less than market value, against their interests --- A brought motion for leave to file action against P --- Motion dismissed --- Threshold was low to allow for leave --- However, A did not demonstrate that service was improper --- Service by e-mail was proper and should have come to attention of A and its principal --- It was principal's actions that caused A to be unaware of proceeding, not any misconduct on part of P --- P followed necessary steps in sale of assets --- P made best efforts to obtain best price, and did not act improvidently --- A did not have evidence to show that P acted against its interests in sale of assets --- Action would not have sufficient merit to proceed, so not granting leave was appropriate remedy.

Debtors and creditors --- Receivers --- Conduct and liability of receiver --- Duties --- General principles

Company E went into receivership, with P being appointed as receiver --- Corporation A held second mortgage on condominium property owned by E, before bankruptcy --- Secured creditor held first mortgage on this property --- P accepted bid from numbered company, to purchase assets of E --- P submitted this bid for court approval, as they were required to do --- Approval was given by court --- However, A claimed they were not properly notified of this proceeding --- A claimed that had they known, they would have raised issue that property was being sold for less than market value, against their interests --- A brought motion for leave to file action against P --- Motion dismissed --- Threshold was low to allow for leave --- However, A did not demonstrate that service was improper --- Service by e-mail was proper and should have come to attention of A and its principal --- It was principal's actions that caused A to be unaware of proceeding, not any misconduct on part of P --- P followed necessary steps in sale of assets --- P made best efforts to obtain best price, and did not act improvidently --- A did not have evidence to show that P acted against its interests in sale of assets --- Action would not have sufficient merit to proceed, so not granting leave was appropriate remedy.

MOTION by corporation for leave to file action against receiver, in bankruptcy matter.

K.G. Nielsen J.:

I. Introduction

1 PriceWaterhouseCoopers Inc. (PWC) was appointed as receiver of all current and future assets and property of Elaborate Homes Ltd. and Elaborate Developments Inc. (collectively referred to as Elaborate).

2 Alco Industrial Inc. (Alco) seeks leave to commence proceedings against PWC in relation to matters arising in the receivership.

II. Background

3 Alco held a second mortgage (the Mortgage) in the amount of \$1,075,000 on, *inter alia*, property (the Condo) owned by Elaborate Homes Ltd., legally described as:

Condominium Plan 0520263 Unit 4 and 905 undivided 1/10,000 shares in the common property Excepting thereout all mines and minerals.

4 Alberta Treasury Branches was a secured creditor of Elaborate. It held, *inter alia*, a first mortgage on the Condo.

5 PWC was appointed as the receiver of Elaborate Homes Ltd. pursuant to a Consent Receivership Order dated February 22, 2011 (the Receivership Order). Pursuant to a separate Receivership Order, also dated February 22, 2011, PWC was named as receiver of Elaborate Developments Inc., a company related to Elaborate Homes Ltd.

6 On March 3, 2011, PWC sent notice to Alco, pursuant to ss. 245 and 246 of the *Bankruptcy and Insolvency Act*, RSC, 1985, c B-3 (*BIA*) of the receivership of Elaborate. This was sent by regular mail to the address indicated on the registration of the Mortgage on the Certificate of Title to the Condo. In the Brief filed in this application on behalf of Alco, it is acknowledged that Alco was served with a copy of the Receivership Order.

7 On or about April 5, 2011, an assistant with legal counsel for PWC (not the counsel for PWC on this application) obtained certain contact information with respect to Alco. While the assistant could not recall with whom she spoke at Alco or the exact conversation, she deposed that she believed she followed her typical practice when speaking to creditors which was as follows:

(a) she identified herself to the creditor and advised that she was calling from counsel for the receiver with respect to the receivership of the debtor company;

(b) she advised the creditor that the receiver required certain information from the creditor with respect to the receivership; and

(c) she requested contact information for the individual within the creditor's organization who would be best suited to receive correspondence with respect to the receivership.

8 In the discussions that ensued with the individual at Alco following this typical practice, she was advised that the owner of Alco was Bob Taubner and she was given his email address. This information is confirmed in a handwritten note made by the assistant. At all material times, Mr. Taubner was the President of Alco.

9 PWC took steps to market Elaborate's assets and property pursuant to the provisions of the Receivership Order. As a result of the marketing efforts, a number of offers were received for individual assets of Elaborate. PWC also received a number of "*en bloc*" offers to purchase all of Elaborate's assets. One of those *en bloc* offers was received from 1601812 Alberta Ltd. (the 160 Offer).

10 In accordance with its obligations, PWC reported to the Court with respect to the offers received in its Second Report, filed May 26, 2011. The Second Report contained a Bid Summary of all of the offers. PWC wished to keep the information in the Bid Summary confidential, and to release it to the public only after the Court had approved a sale. However, parties could obtain a copy of the Bid Summary on signing and sending to PWC a Confidentiality Letter, which provided that anyone signing it would be provided with the Bid Summary, but would be barred from acting as a purchaser in any way in respect of Elaborate's assets.

11 As outlined in the Second Report, PWC was of the opinion that the 160 Offer would lead to the highest net recovery for the creditors of Elaborate, as opposed to accepting other offers for specified or individual assets. PWC formed this view based on the combined value of the cash and assumption of liabilities components of the 160 Offer.

12 PWC accepted the 160 Offer subject to Court approval. PWC recommended to the Court that the 160 Offer be approved on the basis that it was higher than other offers and was preferable from the perspective of all of the creditors of Elaborate as a whole. Compared to all of the other *en bloc* offers, the 160 Offer would produce the highest net recovery on the Condo. Based on its analysis of the 160 Offer, PWC concluded that accepting the 160 Offer would allow for recovery of all of the indebtedness of Elaborate to Alberta Treasury Branches, but would not allow for the full recovery of the indebtedness of Elaborate to another secured creditor, Servus Credit Union. Following discussions with PWC, Servus Credit Union agreed with PWC's recommendation to accept the 160 Offer. PWC had no discussions with Alco with respect to the offers received.

13 The 160 Offer required Court approval by June 3, 2011. By an email dated May 26, 2011, counsel for PWC forwarded to Elaborate's creditors, including Alco, copies of the following:

- (a) the Application for an Order Approving Sale and Vesting Order returnable June 3, 2011 (the Application);
- (b) the Second Report;
- (c) a copy of a letter directed to the Court; and
- (d) a copy of the Confidentiality Letter.

14 On June 3, 2011, Belzil J. heard the application for approval of the sale of Elaborate's assets and property pursuant to the 160 Offer. Belzil J. granted a Sale Approval and Vesting Order approving the acceptance of the 160 Offer by PWC (the Sale Order). Belzil J. also granted a Sealing Order which sealed the Bid Summary until such time as the sale transaction had closed and a letter had been filed with the Clerk of the Court confirming that fact (the Sealing Order).

15 On June 3, 2011, counsel for PWC served the Sale Order and the Sealing Order by email on the listed creditors, including Alco.

16 Mr. Taubner, the President of Alco, has deposed that while he received the email of May 26, 2011 enclosing the Application, and 19 other emails with respect to this receivership, he did not use the email address which had been given to counsel for PWC or any other email address at the material time. He deposed that he was unfamiliar with computers and he did not anticipate that he might receive communications from PWC in such a fashion.

17 On cross-examination on his Affidavit, Mr. Taubner testified that he would occasionally request email communications, some of his employees would communicate with him by email, he would read such emails, and the group accountant for Alco had access to his emails. There is no evidence that any of the emails forwarded to Alco with respect to the Elaborate receivership at the address given, were rejected or returned as undeliverable.

18 The sale of Elaborate's assets and property proceeded pursuant to the 160 Offer, and Alco ultimately received the sum of \$90,553.09 net of costs in relation to the security which it held on the Condo. This recovery was insufficient to pay out the Mortgage.

19 PWC reported in its First Report, filed April 20, 2011, that an appraisal of the Condo had been conducted in August 2010, reflecting a market value of \$785,000. The Bid Summary indicated that the appraised value of the Condo on a forced liquidation was \$505,750. The value assigned to the Condo pursuant to the 160 Offer was \$432,000. This was the highest value assigned to the Condo in any of the *en bloc* offers. An offer had been received on the Condo only. This offer was in the amount of \$529,444.

20 The value assigned to the Condo in the 160 Offer represented 85% of the forced liquidation valuation. Only two other assets had higher returns compared to their valuations. The lowest allocation to an asset in the offers received was 24% of that asset's valuation.

21 Andrew Burnett, Vice President of PWC, was involved in this receivership. He filed an Affidavit in response to Alco's Application and was examined on it. With respect to the 160 Offer, Mr. Burnett deposed as follows:

Page 30, lines 17 to 22:

Q Was there ever any conversation with the offeror about modifying its offer in respect of the office condo [the Condo] because of the position of Alco?

A No, there was never discussion with them about changing their position on any of the other pieces of property other than the Althen One [unrelated to the Condo].

Page 33, lines 25 to 27 and Page 34, lines 1 to 11:

Q One of the bids that PWC did receive for the office condo alone was over \$500,000, correct?

A Correct.

Q When that bid came in, do I take it that the sole consideration was that it was a standalone bid whereas you wanted to have *en bloc* bids?

A No.

Q What consideration was given to possibly accepting that bid?

A We went back to all the purchasers that had more than one item on there and asked them whether we could carve out pieces, saying okay, you're the highest on this, but you're lower on this, can we just take that?

Page 36, lines 15 to 20:

Q What did Studio Homes [formerly 1601812 Alberta Ltd.] specifically advise with respect to their position on the office condo at the time, not in January of 2014, but at the time?

A At the time, and I won't say it's just on the office condo, we asked whether they would pull any of their other parcels out and they advised no.

III. Terms of the Orders

A. Receivership Order

22 The following provisions of the Receivership Order are relevant to this application:

...2. Pursuant to sections 243(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c. B-03 (the "BIA"), 13(2) of the *Judicature Act*, RSA 2000, c. J-2, 99(a) of the *Business Corporations Act*, RSA 2000, c. B-9 and 65(7) of the *Personal Property Security Act*, RSA 2000, c. P-7, PriceWaterhouseCoopers Inc. is hereby appointed Receiver (the

"Receiver"), without security, of all of the Debtor current and future assets, undertakings and properties real and personal of every nature and kind whatsoever, and wherever situate, including all proceeds thereof ("the Property").

3. The Receiver is hereby empowered and authorized, but not obligated, to act at once in respect of the property and, without in any way limiting the generality of the foregoing, the Receiver is hereby expressly empowered and authorized to do any of the following where the Receiver considers it necessary or desirable:

...(k) to market any or all of the Property, including advertising and soliciting offers in respect of the Property or any part or parts thereof and negotiating such terms and conditions of sale as the Receiver in its discretion may deem appropriate.

(l) To sell, convey, transfer, lease or assign the Property (the "Disposition") or any part or parts thereof: ...

7. No proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against the Receiver except with the written consent of the Receiver or with leave of this Court.

...

16. The Receiver shall incur no liability or obligation as a result of its appointment or carrying out the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part, or in respect of its obligations under sections 81.4(5) or 81.6(3) of the BIA or under the WEPPA. Nothing in this order shall derogate from the protection afforded to the Receiver by s. 14.06 of the BIA or any other applicable legislation.

B. Sale Order

23 The following provisions of the Sale Order are relevant to this application:

1. Service of the notice of this application and supporting materials is hereby declared to be good and sufficient, and no other person is required to have been served with notice of this application, and time for service is abridged to that actually given.

2. The Receiver's acceptance of the Purchaser's offer to purchase the Lands and Personal Property dated May 6th, 2011 as clarified and extended by the letter from the Receiver dated May 13, 2011, the e-mail from the Purchaser's legal counsel to the Receiver's legal counsel dated May 19, 2011, the letter from legal counsel for the Receiver to legal counsel for the Purchaser dated May 20, 2011, the letter from legal counsel for the Purchaser to legal counsel for the Receiver dated May 24, 2011, the letter from legal counsel for the Purchaser to legal counsel for the Receiver dated May 25, 2011, and the letter from the Receiver to the Purchaser dated May 26, 2011 (the "Offer"), which Offer is summarized at paragraphs 20 to 32 of the Receiver's Second Report, and [sic] is hereby approved and ratified.

...

15. Service of this Order may be effected upon those persons (directly or through legal counsel) on the Service List by facsimile or electronic mail, and such service shall constitute good and sufficient service. Service on any person other than as specified in the Service List is hereby dispensed with.

C. Sealing Order

24 The following provision of the Sealing Order is relevant to this application:

1. ... the Clerk of the Court is hereby directed to seal the Bid Summary (the "Confidential Documents") on the Court file until the sale of the Lands and Personal Property to 1601812 Alberta Ltd. has been closed in accordance with the Offer Terms and the filing of a letter with the Clerk of the Court from PriceWaterhouseCoopers Inc. confirming the sale of the Lands and Personal Property has been closed. ...

IV. Positions of the Parties

25 Alco argues that leave should be granted to file the Statement of Claim appended to its Application. Alco submits that it has a claim against PWC for gross negligence or wilful misconduct in serving the Application by email on May 26, 2011, and selling the Condo for less than its appraised value, thereby preferring the interests of other creditors to those of Alco.

26 PWC argues that there is no basis for a claim against it, as all documents were properly served on Alco by email, and all steps taken by it were in accordance with its obligations to act in the best interests of the creditors of Elaborate as a whole. Therefore, it was neither grossly negligent, nor did it wilfully misconduct itself.

V. Issue

27 The sole issue before the Court is whether Alco should be granted leave to file the Statement of Claim against PWC.

VI. Applicable Rules

A. Alberta Rules of Court, Alta Reg 124/2010

28 The following Rules of the *Alberta Rules of Court* are relevant to this application:

9.15(1) On application, the Court may set aside, vary or discharge a judgment or an order, whether final or interlocutory, that was made

(a) without notice to one or more affected persons, or

(b) following a trial or hearing at which an affected person did not appear because of an accident or mistake or because of insufficient notice of the trial or hearing.

(2) Unless the Court otherwise orders, the application must be made within 20 days after the earlier of

(a) the service of the judgment or order on the applicant, and

(b) the date the judgment or order first came to the applicant's attention.

11.21(1) A document, other than a commencement document, may be served by electronic method on a person who has specifically provided an address to which information or data in respect of an action may be transmitted, if the document is sent to the person at the specified address, and

(a) the electronic agent receiving the document at that address receives the document in a form that is usable for subsequent reference, and

(b) the sending electronic agent obtains or receives a confirmation that the transmission to the address of the person to be served was successfully completed.

(2) Service is effected under subrule (1) when the sending electronic agent obtains or receives confirmation of the successfully completed transmission.

(3) In this rule, "electronic" and "electronic agent" have the same meanings as they have in the *Electronic Transactions Act*.

B. Bankruptcy and Insolvency General Rules, CRC, c 368

29 The following *BIA* Rules are relevant to this application:

3. In cases not provided for in the Act or these Rules, the courts shall apply, within their respective jurisdictions, their ordinary procedure to the extent that that procedure is not inconsistent with the Act or these Rules.

...

6.(1) Unless otherwise provided in the Act or these Rules, every notice or other document given or sent pursuant to the Act or these Rules must be served, delivered personally, or sent by mail, courier, facsimile or electronic transmission.

VII. Law

A. Threshold Test for Leave

30 The Supreme Court of Canada in *GMAC Commercial Credit Corp. - Canada v. TCT Logistics Inc.*, 2006 SCC 35, [2006] 2 S.C.R. 123 (S.C.C.) confirmed that the threshold is low on an application for leave to commence an action against a receiver or trustee:

55 For almost 150 years, courts and commentators have been universally of the view that the threshold for granting leave to commence an action against a receiver or trustee is not a high one, and is designed to protect the receiver or trustee against only frivolous or vexatious actions, or actions which have no basis in fact...

...

57 In the leading case of *Mancini*, the Court of Appeal summarized the accepted principles as being the following:

1. Leave to sue a trustee should not be granted if the action is frivolous or vexatious. Manifestly unmeritorious claims should not be permitted to proceed.

2. An action should not be allowed to proceed if the evidence filed in support of the motion, including the intended action as pleaded in draft form, does not disclose a cause of action against the trustee. The evidence typically will be presented by way of affidavit and must supply facts to support the claim sought to be asserted.

3. The court is not required to make a final assessment of the merits of the claim before granting leave. [Citations omitted; para. 7.]

31 Conrad J. (as she then was) considered this issue in her decision in *RoyNat Inc. v. Omni Drilling Rig Partnership No. 1 (Receiver of)* (1988), 90 A.R. 173 (Alta. Q.B.), at 177-78, [1988] 6 W.W.R. 156 (Alta. Q.B.):

...In *Royal Bank of Canada v. Vista Homes Ltd. et al* (1985) 63 B.C.L.R. 366 (B.C.S.C.), Mr. Justice MacDonald stated at p. 374:

...the obtaining of an order to sue should not be a perfunctory process... The court should examine with some care the foundation of the alleged claim with a bias against exposing its appointed officer to unnecessary or unwarranted litigation. On the other hand, there is not an onus on the applicant to prove its case against the receiver-manager at this stage.

...

I am satisfied the test to be applied by this court is to determine whether it is perfectly clear that there is no foundation for the claim or whether the action is frivolous or vexatious. It is not for this court to deal with the merits of either party's position or to gauge the probability of success should the action proceed to trial. Leave should be granted if

the evidence presented discloses that there is some foundation for the claim and that the claim is not merely frivolous nor vexatious.

Indeed, while the Court may by its order want to protect its appointed officer from unnecessary and unwarranted litigation, I do not take that to mean they are entitled to protection against proper actions simply because they are court appointed.

32 Therefore, the proposed plaintiff must have supplied "facts to support the claim sought to be asserted", or "some foundation for the claim". Both of these cases make it clear that there must be some factual basis for the claim, a court should not grant leave for frivolous, vexatious or unmeritorious claims, and it is not appropriate at the leave stage for the court to make a final assessment of the merits of the claim or possible defences to the claim.

33 While the threshold for granting leave is low, the process of reviewing the proposed claim is not to be perfunctory. Therefore, I will analyze in some detail the basis for the claims alleged by Alco against PWC.

B. Gross Negligence and Willful Misconduct

34 Clause 16 of the Receivership Order provides that PWC will incur liability only in circumstances of "gross negligence or wilful misconduct on its part". The starting point, therefore, is to consider what constitutes gross negligence or willful misconduct.

35 *Black's Law Dictionary*, 9th ed (St Paul, MN: West, 2009) defines gross negligence as, *inter alia*:

A conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party, who may typically recover exemplary damages.

...As it originally appeared, this was very great negligence, or the want of even slight or scant care. It has been described as a failure to exercise even that care which a careless person would use. Several courts, however, dissatisfied with a term so nebulous...have construed gross negligence as requiring willful, wanton, or reckless misconduct, or such utter lack of all care as will be evidence thereof...But it is still true that most courts consider that 'gross negligence' falls short of a reckless disregard of the consequences, and differs from ordinary negligence only in degree, and not in kind...

36 The *Dictionary of Canadian Law*, 4th ed (Scarborough, Ont: Thomson Carswell, 2011) provides the following definition:

Conduct in which if there is not conscious wrongdoing, there is a very marked departure from the standard by which responsible and competent people...habitually govern themselves...a high or serious degree of negligence...

37 The Supreme Court of Canada has considered these terms in the context of tort litigation. In *McCulloch v. Murray*, [1942] S.C.R. 141 (S.C.C.), at 145, [1942] S.C.J. No. 7 (S.C.C.), Duff C.J. observed:

... All these phrases, gross negligence, wilful misconduct, wanton misconduct, imply conduct in which, if there is not conscious wrong doing, there is a very marked departure from the standards by which responsible and competent people in charge of motor cars habitually govern themselves. ...

38 In *Société Telus Communications v. Peracom Inc.*, 2014 SCC 29, [2014] S.C.J. No. 29 (S.C.C.), Cromwell J. for the majority commented on "wilful misconduct":

57 In other contexts, "wilful misconduct" has been defined as "doing something which is wrong knowing it to be wrong or with reckless indifference"; "recklessness" in this context means "an awareness of the duty to act or a subjective recklessness as to the existence of the duty": *R. v. Boulanger*, 2006 SCC 32, [2006] 2 S.C.R. 49, at para. 27, citing *Attorney General's Reference (No. 3 of 2003)*, 2004 EWCA Crim 868, [2005] Q.B. 73. Similarly, in an

insightful article, Peter Cane states that "[a] person is reckless in relation to a particular consequence of their conduct if they realize that their conduct may have that consequence, but go ahead anyway. The risk must have been an unreasonable one to take": *"Mens Rea in Tort Law"* (2000), 20 *Oxford J. Legal Stud.* 533, at p. 535.

58 These formulations capture the essence of wilful misconduct as including not only intentional wrongdoing but also conduct exhibiting reckless indifference in the face of a duty to know...

39 Therefore, in order for Alco to establish PWC's liability arising from the receivership at an eventual trial, it must show that PWC demonstrated a very marked departure from the standards by which responsible and competent people in such circumstances would have acted or conducted themselves, or in a manner such that it knew what it was doing was wrong or was recklessly indifferent in its conduct.

40 Against this backdrop, I will consider Alco's complaints regarding PWC's conduct.

VIII. Analysis

A. Email Service

41 Alco argues that service of the Application was not effective, as Alco had not specifically provided an address to which information or data in respect of the receivership action might be transmitted to it.

42 Nothing in the material before the Court supports this allegation. Clearly, the assistant for counsel at PWC contacted a representative of Alco who provided an email address for the president of Alco. It is reasonable to infer that whoever provided the email address to the assistant for counsel at PWC was not aware that Mr. Taubner would not access his email account. PWC cannot be deemed to have known this. Indeed, it appears from Mr. Taubner's testimony that he did access the email account when he wished to do so. It is also reasonable to infer that Mr. Taubner would not have had an email account if he been totally computer illiterate, and if he was, that fact, presumably, would have been well known within the company.

43 PWC derived its authority from the Receivership Order which specifically references the *BIA*. Rule 6(1) of the *BIA Rules* requires that every notice or other document pursuant to the *BIA* or the *BIA Rules* be "served, delivered personally or sent by mail, courier, facsimile or electronic transmission". Both the Application and the Sale Order were sent by electronic transmission to an email address provided by Alco. There is nothing in the material before the Court to suggest that service was not effected in compliance with Rule 6(1) of the *BIA Rules*.

44 In contrast, *BIA* Rule 124 provides that a notice pursuant to s. 244(1) of the *BIA* by a secured creditor who intends to enforce a security on all or substantially all property of an insolvent may be "sent, if agreed to by the parties, by electronic transmission". Neither s. 245 regarding the initial notice of the receiver, nor general Rule 6(1) imposes a similar requirement.

45 The *Alberta Rules of Court* supplement the *BIA Rules* to the extent that they are not inconsistent with the *BIA* or the *BIA Rules*. Rule 11.21 requires that the recipient has specifically provided an address. Arguably, this is more onerous than Rule 6(1), and therefore inconsistent with it. However, even if Rule 11.21 of the *Alberta Rules of Court* applies, there is nothing in the material before the Court to suggest that the requirements of Rule 11.21 were not met in this case.

46 I also note that if Alco wished to pursue the position that the Sale Order had been obtained without notice to it, it could have availed itself of Rule 9.15 of the *Alberta Rules of Court* which provides a mechanism to seek to vary or discharge a judgment or order on that basis. Such an application must be made within 20 days after the earlier of service of the order on the applicant, or the date the order first came to the applicant's attention.

47 The Sale Order was, of course, also served by email on Alco. Therefore, Alco would argue that the Sale Order was not properly served upon it. However, on the record before me it is clear that Alco was aware of the Sale Order by

January 11, 2012 at the latest, when it resisted the apportionment of receivership costs as against the proceeds from the sale of the Condo. Alco took no timely steps to set aside the Sale Order for lack of service upon becoming aware of it.

48 Further, the Sale Order makes it clear that service of the Application was declared to be good and sufficient and that service of the Sale Order could be effected upon all affected persons by way of facsimile or electronic mail, and such service was constituted to be good and sufficient. Therefore, it appears that Belzil J. considered the matter of both service of the Application and the Sale Order. Again, Alco could have either appealed the Sale Order, or sought to set it aside on the basis of a lack of notice. It took neither of these steps.

49 I would add that in today's world, electronic service is a reflection of practical realities. The *Alberta Rules of Court* and the *BIA Rules* recognize this reality. Perhaps there is no area of practice where electronic service of documents is more appropriate than the bankruptcy and insolvency area. I say this because of the volume of documents that are often produced in such matters, and the need for receivers, trustees, monitors and counsel to act expeditiously and often in the face of very short deadlines. Given the commercial and legal realities of bankruptcy and insolvency matters, there is an obvious need to exchange documents electronically. In my view, a party involved in such matters cannot ignore these realities by refusing to move effectively into the electronic age.

50 In summary, I find nothing in the material before the Court to suggest that PWC through its counsel did not properly effect service of both the Application and the Sale Order on Alco by emailing those documents to Mr. Taubner at Alco. There is no factual basis to suggest that PWC was either grossly negligent, or that it wilfully misconducted itself, in effecting service of the documents by email.

B. Sale Transaction

51 Alco also alleges that PWC breached its duties to Alco in the manner in which it conducted the sale of Elaborate's assets. Specifically, Alco alleges that PWC concealed the Bid Summary, and sold the Condo for an amount which was below its appraised value.

52 The Second Report indicated that PWC preferred that the Bid Summary remain confidential until such time as the sale transaction had closed. Upon signing the Confidentiality Letter, the Bid Summary would be disclosed to the signatory on the basis that the information disclosed in the Bid Summary would not later be used by the signatory as a potential purchaser of Elaborate assets.

53 Alco argues that PWC should not have required it to give up any right to make an offer on the Condo. Alco submits that its rights "ought not to have been extorted away under threat that otherwise the information necessary for it to respond to a court application would be kept hidden from view".

54 It is common practice in the insolvency context for information in relation to the sale of the assets of an insolvent corporation to be kept confidential until after the sale is completed pursuant to a Court order. In *Look Communications Inc. v. Look Mobile Corp.*, 2009 CarswellOnt 7952, [2009] O.J. No. 5440 (Ont. S.C.J. [Commercial List]), Newbould J. explained the reasons for such confidentiality:

17 It is common when assets are being sold pursuant to a court process to seal the Monitor's report disclosing all of the various bids in case a further bidding process is required if the transaction being approved falls through. Invariably, no one comes back asking that the sealing order be set aside. That is because ordinarily all of the assets that were bid on during the court sale process end up being sold and approved by court order, and so long as the sale transaction or transactions closed, no one has any further interest in the information. In *8857574 Ontario Inc. v. Pizza Pizza Ltd.*, (1994), 23 B.L.R. (2nd) 239, Farley J. discussed the fact that valuations submitted by a Receiver for the purpose of obtaining court approval are normally sealed. He pointed out that the purpose of that was to maintain fair play so that competitors or potential bidders do not obtain an unfair advantage by obtaining such information while others have to rely on their own resources. In that context, he stated that he thought the most

appropriate sealing order in a court approval sale situation would be that the supporting valuation materials remain sealed until such time as the sale transaction had closed.

55 Alco alleges that PWC and its counsel ignored Alco, hid the Bid Summary and cloaked their activities in the receivership with secrecy. However, there is nothing in the material before the Court to suggest that PWC's preference to keep the Bid Summary confidential until the sale transaction had been approved and closed was for any purpose other than to ensure the integrity of the marketing process, and to avoid misuse of the information in the Bid Summary by a subsequent bidder to obtain an unfair advantage in the event it was necessary to remarket Elaborate's assets. Further, there is nothing to suggest that Belzil J. granted the Sealing Order for any other reason.

56 Alco may have been in a unique position given that it held a second mortgage on the Condo. Given that unique position, it may very well have been entitled to receive information with respect to the offers received in relation to the Condo and, therefore, could have suggested revised terms to any required confidentiality agreement. However, Alco's position does not render PWC's actions inappropriate. There is nothing to suggest that PWC's actions in this regard were not in accordance with common, prudent and reasonable practice in receiverships, or that they reflect or resulted from gross negligence or wilful misconduct on the part of PWC.

57 With respect to the manner in which the sale of the Condo was conducted, Alco submits that PWC breached a "fundamental duty of Receivers" in that it failed to act with an even hand towards classes of creditors and in accordance with recognised lawful priorities. Again, the law and the material before the Court do not support this contention.

58 The obligations of a receiver in carrying out a sales transaction have been considered in numerous cases. In *Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1, [1991] O.J. No. 1137 (Ont. C.A.) at paras 27-29, Galligan J.A. cited with approval case law for the proposition that if a receiver's decision to enter into an agreement of sale, subject to court approval, is reasonable and sound under the circumstances at the time, it should not be set aside simply because a later and higher bid is made. Otherwise, chaos would result in the commercial world, and receivers and purchasers would never be sure they had a binding agreement. Galligan J.A. concluded:

30 What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to show that the receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered *bona fide* into an agreement with the receiver, can only lead to chaos, and must be discouraged.

59 Galligan J.A. recognized that in considering a sale by a receiver, a court must place a great deal of confidence in the actions taken and in the opinions formed by the receiver, and should assume that the receiver is acting properly unless the contrary is clearly shown. He summarized the duties of the court when deciding whether a receiver who has sold property acted properly as follows (at para 17):

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently;
2. It should consider the interests of all parties;
3. It should consider the efficacy and integrity of the process by which offers are obtained;
4. It should consider whether there has been unfairness in the working out of the process.

60 In *Skyepharma PLC v. Hyal Pharmaceutical Corp.* (1999), 12 C.B.R. (4th) 87, [1999] O.J. No. 4300 (Ont. S.C.J. [Commercial List]) at para 4, Farley J. cited *Soundair* with approval, holding that a receiver's conduct is to be reviewed

in light of the objective information the receiver had and not with the benefit of hindsight. Other offers are irrelevant unless they demonstrate that the price in the proposed sale was so unreasonably low that it shows the receiver acted improvidently in accepting it.

61 In *Scamwood Canada Ltd., Re*, 2011 NSSC 189, 305 N.S.R. (2d) 34 (N.S. S.C.), the receiver was of the view that the best realization of the assets in question would come from a sale *en bloc*. Hood J. held that the receiver's duty to act in the interests of the general body of creditors does not necessarily mean that the majority rules. Rather, the receiver must consider the interests of all creditors and then act for the benefit of the general body.

62 PWC accepted the 160 Offer and recommended that the acceptance be approved by the Court on the basis that it was higher than other *en bloc* offers and was preferable from the overall perspective of Elaborate's creditors. The 160 Offer provided for the highest net recovery on the Condo of all of the *en bloc* offers and represented a recovery of 85% of the forced liquidation valuation of the Condo. Only one other offer in the marketing process undertaken by PWC assigned a purchase price for the Condo which was higher than the price assigned in the 160 Offer. This was an offer with respect to the Condo only.

63 The law is clear to the effect that the receiver must not consider the interests of only one creditor, but must act for the benefit of the general body of creditors. PWC was under a duty to act in the interests of the general body of creditors and to conduct a fair and efficient marketing process.

64 The excerpts from the cross-examination of Mr. Burnett on his Affidavit indicate that PWC did attempt to maximize the recovery on all of Elaborate's assets as it conducted negotiations with the various bidders in this regard.

65 There is nothing before the Court to suggest that PWC did not make sufficient efforts to obtain the best price for the assets, nor that it acted improvidently. Alco has not put forward any factual foundation to support an inference that PWC did not act for the benefit of the general body of creditors.

66 Alco submits that had it attended the hearing on June 3, 2011 before Belzil J., it would have been successful in arguing that Alco was deprived of a statutory right to recover its secured debt against the Condo. However, the contents of the Second Report undermine the argument that PWC's acceptance of the 160 Offer would not have been approved in the circumstances as known when the matter proceeded before Belzil J. Further, given my findings on the email service issue, PWC cannot be blamed for Alco's non-attendance at the hearing on June 3, 2011.

67 Therefore, I conclude that Alco has not established a factual basis for the claim that PWC was either grossly negligent or wilfully misconducted itself in the manner that it marketed Elaborate's assets or in its reporting to the Court.

IX. Conclusion

68 The threshold test for leave in this case is low. However, PWC would only be liable if it acted with gross negligence or wilful misconduct. I have found no factual basis to suggest that PWC was either grossly negligent or wilfully misconducted itself as alleged by Alco.

69 PWC is not entitled to protection against proper actions simply because it was court appointed. However, I am mindful of the bias against exposing a court appointed officer to unnecessary or unwarranted litigation. In my view, granting leave to Alco to proceed with the claim against PWC would expose it to a manifestly unmeritorious action.

70 Therefore, Alco's application for leave to file the Statement of Claim against PWC is dismissed.

X. Costs

71 If the parties cannot otherwise agree on costs, they may appear before me within 60 days of the filing of these Reasons for Judgment.

Motion dismissed.

Footnotes

- * A corrigendum issued by the court on June 23, 2014 has been incorporated herein.

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Ontario Supreme Court, High Court of Justice

1986 CarswellOnt 235, 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526, 60 O.R. (2d) 87, 67 C.B.R. (N.S.) 320 (note)

**CROWN TRUST COMPANY, SEAWAY TRUST COMPANY
and GREYMAC TRUST COMPANY v. ROSENBERG et al.**

Anderson J.

Judgment: November 6, 1986

Docket: No. 1380/83

Subject: Corporate and Commercial; Insolvency

Headnote

Receivers — Sale of debtor's assets — Approval by court — Court discussing obligations in determining whether to approve sale.

On a motion by a court appointed receiver and manager to approve the sale of certain properties, the duties of the court are to consider: whether the receiver has made a sufficient effort to get the best price and ensure he has not acted improvidently; the interests of all parties; the efficacy and integrity of the process by which offers have been obtained; and whether there has been unfairness in the working out of the process.

The court has the power and responsibility to disregard the recommendation of the receiver and to approve another offer or offers. On the other hand, the court ought not to enter into the market place or sit as on appeal from the decision of the receiver, reviewing in minute detail every element of the process by which his decision has been reached. Furthermore, the court ought not to embark on a process analogous to the trial of a claim by an unsuccessful bidder for something in the nature of specific performance or proceed against the recommendations of its receiver except in special circumstances or where the necessity and propriety of doing so are plain. It is only in exceptional circumstances that a court will intervene and proceed contrary to the receiver's recommendations if satisfied that the receiver has acted reasonably, prudently and fairly, and not arbitrarily.

It is necessary to keep in mind not only the function of the court but the function of the receiver. The receiver is selected and appointed having regard for experience and expertise in the duties which are involved. It is the function of the receiver to conduct negotiations and to assess the practical business aspects of the problems involved in the disposition of the assets. However, the court is not to apply an automatic stamp of approval to the decision of the receiver. The court has power to come to a different decision and a discretion to exercise which must be exercised judicially.

The courts have recognized that they are not making a decision in a vacuum: that they are concerned with the process not only as it affects the case at bar, but as it stands to affect situations of a similar nature in the future. The delicate balance of competing interests is relevant and material.

Anderson J., (orally):

I This is a motion to approve the sale of certain properties, the subject-matter of the action in which the motion is brought. The moving party is the receiver and manager appointed by the court. The respondents are parties to the action. The properties are of considerable value and the motion, therefore, is one of some importance to the receiver and to the parties. The events giving rise to the action have a measure of local notoriety, but those colourful happenings have no direct bearing on the matters which I must resolve. The disposition of the motion may be of some general interest of a legal nature, involving as it does a consideration of the nature of the function to be discharged by the court upon such a motion, and also of the nature and extent of the duties of a court-appointed receiver.

2 A brief chronological narrative of facts which are not in dispute and of the history of the proceedings will be useful background. In February of 1983 an order was made by the Associate Chief Justice of the High Court appointing Clarkson Gordon Inc. as interim receiver and manager of the Cadillac Fairview Properties. Where throughout these reasons I say "Clarkson", I mean Clarkson in its capacity as receiver and manager, and when I say "Receiver", I refer to Clarkson in that capacity.

3 In July of 1983 an order was made by Catzman J. with respect to marketing the properties pursuant to a process which has been designated the "Disposition Strategy". Clarkson implemented the strategy report and the details of that implementation are in the motion record at pp. 10-15 and from pp. 23-6.

4 In many cases where portions of the record are painfully familiar to the counsel and participants I propose not to read them during the course of my reasons, although they will form part of the reasons should they be transcribed.

5 On September 3, 1986, Larco Enterprises submitted four draft letters. The Receiver pursuant to the Disposition Strategy had received some 200 offers from some 70 odd offerors and after the deadline fixed for such offers an additional 60 odd. On September 8, 1986, the Larco offers were acknowledged and certain comments made by the Receiver with respect to them.

6 On September 10th, Larco submitted four sealed bids. Clarkson received in all some 230 odd bids from 76 offerors.

7 On September 25th, Clarkson selected certain offers, 26 in all by some 14 offerors, and it is those offers that are recommended for the approval of the court.

8 This motion was launched and the material served on October 10, 1986. The motion was returnable on October 20th, October 20th and 21st were taken up with some preliminary or interlocutory matters and evidence and argument were heard for the balance of two weeks.

9 Of the offers submitted by Larco, three were rejected and a fourth was extended and held open pending the hearing and disposition of this motion. Clarkson does not recommend the acceptance of that offer despite the fact that it produces a higher return to the Receiver than the aggregate amount of the offers recommended. To over-simplify somewhat, Larco is the highest bidder. The extent of the difference I will discuss in a moment and I will also discuss the reasons advanced by Clarkson for not recommending it.

10 On the return of the motion Larco moved to be added as an intervenor under rule 13.01. I dismissed that application on the following day. The reasons for that ruling are an appendix to these reasons. (See App. I [not reproduced]).

11 On Wednesday, October 27th, Larco presented during the hearing of the motion an entirely new offer in a still higher amount. On Thursday, October 28th, I made a ruling that I would not consider that offer. My reasons for that ruling are likewise an appendix to these reasons. (See App. II [not reproduced]). On the argument of the motion no criticism was advanced of any of the offers recommended by the Receiver. The only criticism that was advanced on behalf of some defendants was that the Larco bid should have been recommended and in any event should be approved by the court. The plaintiffs in the action supported the recommendation of the Receiver.

12 Before dealing with the elements of the ensuing dispute, I turn to a consideration of the nature of the motion which is before me and of the duty of the court in the disposition of such a motion. The duties of the court I conceive to be the following, and I do not put them in any order of priority.

1. It is to consider whether the Receiver has made a sufficient effort to get the best price and has not acted improvidently. Authority for that proposition is to be found in a judgment of the Alberta Court of Appeal, *Salima Investments Ltd. v. Bank of Montreal et al.* (1985), 21 D.L.R. (4th) 473, 65 A.R. 372, 41 Alta. L.R. (2d) 58. The [D.L.R.] headnote is of assistance, as is the judgment delivered by Kerans J.A. and particularly that portion which appears at p. 476. The questions with which the court was dealing were similar to those with which I am now concerned.

The real issue, in our view, is the appropriate exercise of the admitted discretion of the court when "looking to the interests of all persons concerned". It certainly does not follow, for example, that the court in an application for approval of a sale is bound to conduct a judicial auction or even to accept a higher last-minute bid. There are, however, binding policy considerations. In *Canada Permanent Trust Co. v. King Art Developments Ltd. et al.* (1984), 12 D.L.R. (4th) 161, [1984] 4 W.W.R. 587, 32 Alta. L.R. (2d) 1, we said that receivers (and masters on foreclosure) should look for new and imaginative ways to get the highest possible price in these cases. Sale by tender is not necessarily the best method for a commercial property which involves also the sale of an ongoing business. The receiver here accepted the challenge offered by this court, and combined a call for tenders with subsequent negotiations. In order to encourage this technique, which we understand has met with some success, the court should not undermine it. It is undermined by a judicial auction, because all negotiators must then keep something in reserve. Worse, the person who successfully negotiates with the receiver will suffer a disadvantage because his bargain will become known to others.

We think that the proper exercise of judicial discretion in these circumstances should be limited, in the first instance, to an inquiry whether the receiver has made a sufficient effort to get the best price and not acted improvidently.

II. The court should consider the interests of all parties, plaintiffs and defendants alike.

That is made apparent by the judgment of this court in *Ostrander v. Niagara Helicopters Ltd. et al.* (1973), 1 O.R. (2d) 281, 40 D.L.R. (3d) 161, 19 C.B.R. (N.S.) 5, although the conclusion appears rather by indirection and as a statement *obiter* to judgment.

III. The court must consider the efficacy and integrity of the process by which the offers are obtained.

The first authority which is of assistance in that regard is the judgment of Saunders J. in *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. S.C. Bkcy.). There, in dealing with the question of approval, he has this to say in his reasons at p. 246:

In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity:

In that connection I adopt the principles stated by Macdonald J.A. of the Nova Scotia Supreme Court (Appeal Division) in *Cameron v. Bank of Nova Scotia et al.* (1981), 45 N.S.R. (2d) 303 at p. 314, 86 A.P.R. 303, 38 C.B.R. (N.S.) 1 at p. 11 (C.A.), where he said:

In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard - this would be an intolerable situation.

While those remarks may have been made in the context of a bidding situation rather than a private sale, I consider them to be equally applicable to a negotiation process leading to a private sale. Where the court is concerned with the disposition of property, the purpose of appointing a receiver is to have the receiver do the work that the court would otherwise have to do.

The submissions on behalf of Leung and the creditors who are opposing approval boil down to this: that if, subsequent to a court-appointed receiver making a contract subject to court approval, a higher and better offer is submitted, the court should not approve what the receiver has done. There may be circumstances where the court would give effect to such a submission. If, for example, in this case there had been a second offer of a substantially higher amount, then the court would have to take that offer into consideration in assessing whether the receiver had properly carried out his function of endeavouring to obtain the best price for the property. Also, if there were circumstances which indicated a defect in the

sale process as ordered by the court, such as unfairness to a potential purchaser, that might be a reason for withholding approval of the sale.

A further authority for that proposition is to be found in *Bank of Montreal v. Maitland Seafoods Ltd. et al.* (1983), 57 N.S.R. (2d) 20 at p. 23, 46 C.B.R. (N.S.) 75 (N.S.S.C.).

If any efficacy is to be given to the tender system, then it requires that ... a person, whether insider or guarantor, who obtains full information of the amounts of the tender ought not, at the last moment, be entitled to make a somewhat higher offer and obtain the property. To permit this would create "chaos in the commercial world". Not only would there be uncertainty ... but it could lead to the situation where there might be no bidders.

IV. The court should consider whether there has been unfairness in the working out of the process.

The authority for that is the case to which reference was made by Saunders J., *Cameron v. Bank of Nova Scotia et al.* (1981), 45 N.S.R. (2d) 303, 86 A.P.R. 303, 38 C.B.R. (N.S.) 1. The [C.B.R.] headnote again is useful as is, in this connection, the language at the concluding portion of the judgment where this is said:

Misleading a bidder, even unintentionally, by a receiver must always be a sufficient ground for a court to refuse to approve an agreement of purchase and sale.

That case is also authority, if authority were needed for the proposition that in a proper case the court has the power to disregard the recommendation of the Receiver and to approve another offer.

13 It is with those areas of responsibility in mind that I proceed to deal with the motion. I have already said that no criticism is made of the offers which are recommended. Likewise no criticism has been made of the process by which the offers were obtained.

14 Attention has focused on the different economic returns which it is anticipated would flow from the recommended offers on the one hand and the Larco offer on the other. Depending upon whose data and calculations are accepted, that difference may be as high as \$7 million odd, or as low as \$1 million odd. I do not propose to analyze the data or the calculations which have been advanced, because in the view which I take of the matter they are not material.

15 The central issue is whether the court should disregard the recommendations of the Receiver and approve the higher bid. Indeed at the end of the day that is the only real issue. This requires first some review of the reasons advanced by the Receiver for rejecting or at any rate not recommending the Larco bid. This is dealt with in the motion record in the Receiver's report in para. 38, at pp 51-67 of the record.

38 Clarkson did not accept Enterprises' Offer, and does not recommend its acceptance and approval by this Court, for the following reasons:

(a) Clarkson's concern to maintain the integrity and fairness of the tender process embodied in the Invitation to Tender, and Clarkson's conviction that the evident success of the marketing and tender process as reflected both in the quantity and quality of the offers which were received was due in large measure to the faith and trust of prospective purchasers that they would each be afforded a fair and equal opportunity to purchase, have been discussed at length above. Clarkson and Cogan were advised on August 14, 1986 by representatives of Enterprises that Enterprises shared those concerns as a result of an unsuccessful tender recently made by Enterprises in respect of certain other properties, and particular emphasis was placed by the said representatives of Enterprises on their need to understand the tender rules, that the rules not be changed, and that they expected everyone to adhere to such rules.

Nevertheless, Clarkson does not believe that Enterprises' Offer as supplemented by the letters delivered after the Bid Deadline was in acceptable form or in accordance with the rules of the tender process established by and embodied in the Invitation to Tender in that, inter alia,

(i) the above-mentioned mechanism for determining the price at which Clarkson would be required to sell the Note might be said to have afforded Enterprises the opportunity to change the cash purchase price offered for the subject Properties, after the Bid Deadline, although no objection could be raised to a change in such cash purchase price if the percentage to be stipulated by one of the designated financial institutions was determined by such financial institution solely on the basis of objective market interest rate criteria; Clarkson and Fraser & Beatty, following the Bid Deadline, therefore repeatedly requested confirmation from The Royal Bank of Canada that the percentage set out in its said letter dated September 15, 1986 was determined by such bank based upon objective market interest rate criteria alone, but no such confirmation was received by Clarkson;

(ii) Enterprises or persons acting on its behalf changed or attempted to change or might have changed, after the Bid Deadline, material terms and conditions of Enterprises' Offer; namely

(A) price by means of the Note purchase mechanism;

(B) the financing condition in Enterprises' Sealed Bid referred to in paragraph 34 above was included in such sealed bid despite repeated statements by Clarkson, Cogan and Fraser & Beatty to representatives of and to the solicitors for Enterprises prior to the Bid Deadline that this would represent a serious negative feature of any offer submitted; by letter dated September 18, 1986 from Enterprises' solicitors addressed to Clarkson (a copy of which is annexed hereto as Schedule H (Appendix III [not reproduced]) and received by Clarkson the following day, nine days after the Bid Deadline, this condition was purportedly waived;

(C) as mentioned in paragraph 36 above, Clarkson did not receive, on or before September 17, 1986, the purchase undertaking from one of the designated financial institutions in accordance with Enterprises' Sealed Bid, and in lieu thereof the solicitors for Enterprises, by means of the aforesaid letter dated September 18, 1986, a copy of which is annexed hereto as Schedule H, purported to amend Enterprises' Offer to provide that Enterprises would cause the Note to be purchased on closing "on the same terms and conditions as contemplated in [Sealed Bid Schedule 3] paragraph 8";

(D) Clarkson and Fraser & Beatty had indicated to Enterprises and its solicitors following the Bid Deadline that Clarkson had difficulty in properly evaluating Enterprises' Offer until it knew what mortgages Enterprises intended to require be discharged. While the amount payable by Enterprises would increase dollar for dollar for each dollar spent to obtain a mortgage discharge, the effect of the aforesaid Note purchase mechanism would be to satisfy such amount (including dollars expended to obtain mortgage discharges) at 81.2 cents per dollar. Fraser & Beatty therefore asked Enterprises' solicitors to confirm in writing to Clarkson what mortgages Enterprises' solicitors believed Enterprises was entitled to request a discharge of under the terms of Enterprises' Offer, it being a fair assumption that a request for a discharge of as many mortgages as possible would be received by Clarkson given the aforesaid discount achieved by means of the Note purchase mechanism. Instead, by letter dated September 21, 1986, a copy of which is annexed hereto as Schedule I, (Appendix IV [not reproduced]) Enterprises' solicitors purported to further amend Enterprises' Offer in this regard; and

(E) notwithstanding the clear provisions of the Invitation to Tender, as late as September 17, 1986 and again on September 18, 1986 a representative of Enterprises requested that Clarkson agree to negotiate a reduction in the amount of the required deposits, which request was denied, and then requested that Clarkson agree to a reduction in the amount of the further deposit to be provided within 5 days of acceptance of any offer, which further request was also denied by Clarkson;

(b) despite repeated requests by Clarkson and Fraser & Beatty for an explanation of the commercial reason for the use of the Note purchase mechanism (which on its face only serves to reduce the purchase price for the subject Properties from a high nominal value to a lower real value), in the view of Clarkson and Fraser & Beatty no clear and consistent

reasons were given. Accordingly, a written explanation was requested and a reason was cited in the letter annexed hereto as Schedule I, but Clarkson did not and does not regard the explanations received as satisfactory:

(c) Clarkson was concerned and remains concerned, particularly given the history of the subject Properties and the attention they have attracted in federal, provincial and municipal political circles and with the tenants thereof and those representing such tenants, with the appearance of the proposed transaction in the minds of the tenants, the media, the politicians and the public at large, some of whom might be expected to question seriously whether the inflated nominal purchase price was being used to raise mortgage money without adequate security, or to lay the groundwork for an application for an excessive rent increase. In the absence of definitive evidence to the contrary, Clarkson believes that this aspect raises perceptible risks of intervention of some kind which might imperil a successful closing of the proposed transaction with Enterprises:

(d) as was mentioned above, Enterprises failed to cause the Note purchase undertaking from Citibank to be delivered to Clarkson on or before September 17, 1986 as provided in Enterprises' Sealed Bid, and Clarkson was concerned and remains concerned with the acceptance of any offer in respect of which the offeror, before Clarkson has even had a reasonable opportunity to accept the same, has already failed to perform a material term thereof; and

(e) Clarkson was not satisfied, notwithstanding all of the foregoing, that Enterprises' Offer was capable of acceptance, and believed that certain aspects thereof would have to be successfully negotiated prior to any such acceptance, including in particular:

(i) the waiver of the financing condition which, as noted above, was purportedly effected by letter dated September 18, 1986 from Enterprises' solicitors addressed to Clarkson despite the relevant provisions of Enterprises' Offer in respect of amendments and despite the statement of Enterprises' solicitors, with which Fraser & Beatty agreed, in a telephone conversation between such solicitors that this and any other matter pertaining to the terms of Enterprises' Offer should be in the name of and executed by Enterprises;

(ii) the substitution of Enterprises' agreement to cause the Note to be purchased on closing "on the same terms and conditions as contemplated in paragraph 8", which again was purportedly effected by the letter dated September 18, 1986 and therefore suffered from the same difficulties as the purported waiver plus the additional difficulty that it is unclear what such "same terms and conditions" are; in Clarkson's view, it is totally unsatisfactory for a transaction of this magnitude, which contemplates an unsecured note in the order of \$375,000,000, to hinge on such vague and uncertain wording;

(iii) in connection with the aforesaid purchase of the Note on closing, reference was made in paragraph 34 above to the provision in Enterprises' Sealed Bid that the Note was to be purchased "at the closing at the said [price] as part of the escrow arrangements herein provided", but in view of the uncertainty as to the intent and effect of these words, clarification would be required to ensure that there was no misunderstanding in this respect; and

(iv) the amendment to Enterprises' Offer purportedly effected by the aforesaid letter dated September 21, 1986 from Enterprises' solicitors addressed to Clarkson in respect of the mortgages to be discharged on closing and the effect thereof on the ultimate purchase price realized by Clarkson, which at the very least suffers from the same difficulties as the aforesaid purported waiver.

Apart altogether from its concern to maintain the integrity and fairness of the tender process, Clarkson concluded that, even if it were prepared to attempt such negotiations in an effort to put Enterprises' Offer into acceptable form, the time constraints imposed by the tender rules and the fact that all offers would expire on September 25, 1986 and the difficulties encountered in resolving outstanding questions to date raised a serious question as to the successful outcome of such negotiations. In view of the risks to the entire sales process if that had happened, Clarkson decided not to attempt such negotiations but to accept the offers in hand that were capable of acceptance as they stood.

16 The motion was brought on in the usual way on a written report of the Receiver signed by Mr. S.R. Shaver, a vice-president of Clarkson, and unsworn.

17 Counsel for the Receiver submitted at the opening of the motion that for reasons pertaining to the importance of the matter and its public interest, he proposed to lead the evidence of Mr. Shaver *viva voce* although it is something of an exception in the disposition of a motion of this kind. I acceded to that submission. I confess to having had moments during the subsequent proceedings when I doubted the wisdom of that decision. The inevitable result was that evidence was called by the defendants who were advancing a different position, and a considerable amount of time was spent. Notwithstanding my doubts, I think that for the reasons advanced by the Receiver, and because an element of catharsis is involved, perhaps the hearing of *viva voce* evidence was appropriate in all the circumstances.

18 I have made references to the Disposition Strategy Report which lay behind the negotiations which produced the offers which are now before the court for consideration. It is a voluminous and detailed document comprising, without its various appendices and schedules, some 98 pages. It was pursuant to that strategy report that the order of Catzman J. in July of this year set in motion the sequence of events leading to the report and motion which are now before me.

19 Throughout that sequence of events, the Receiver has had the benefit and assistance of the advice of eminent solicitors and counsel and of an eminent real estate consultant appointed for the purpose.

20 In the motion which is before me some 15 counsel appeared at various times, eight for most of the time, representing various interests. The evidence consumed seven full days and final argument a further day. Most of the principal participants in the sequence of events made their appearance in the witness-box. The ponderous chain of happenings which followed the order of Catzman J. and culminating in the motion and the nature and extent of that motion are both matters of consequence to which I will refer subsequently.

21 Events were set in train by a letter written by Clarkson to potential purchasers which is dated July 28, 1986. It is found in the motion record at p. 124:

On July 25, 1986 Mr. Justice Catzman approved the final stages of the disposition process which include the following:

1. A negotiation stage culminating on September 3, 1986 with an offer as between the Interim Receiver and Manager and prospective purchasers wherein all terms and conditions respecting the transaction, exclusive of the final offering price, are settled ("Approved Offers").
2. After the Approved Offers are settled prospective purchasers wishing to bid on individual Properties, groups of Properties or all of the Properties are directed to forward Sealed Bids to the Office of the Registrar of the Supreme Court of Ontario addressed to the Interim Receiver and Manager. The Sealed Bids must be submitted to the Registrar on or by 3.00 p.m. September 10, 1986 (Bid Deadline Date).
3. After reviewing and analyzing the Sealed Bids, in context with the Approved Offers, bidders will be notified whether or not their offers are accepted within 15 days of the Bid Deadline Date.
4. The Standard Form of Offer and the Invitation to Tender stipulate that offerors must submit with their Sealed Bids deposits amounting to the greater of \$100,000 or 2 1/2% of the price offered in the Sealed Bid in the form of a certified cheque or bank draft.

For greater certainty and clarity we request that you carefully review the Invitation to Tender, Sealed Bid form and Standard Form of Offer in order that all aspects of the above outlined disposition process are understood and, more importantly, closely adhered to so that no one is disadvantaged throughout this process.

We urge each of you to convene meetings with us at the earliest possible date to ensure that all of your queries and concerns are adequately addressed. These meetings should assist you in preparing and submitting an Approved Offer on or by September 3, 1986. To this end, we have prepared all of the schedule for each Property to be affixed to the offer(s) including financial information and rent rolls as of June 30 and July 1, 1986 respectively.

There will be one and only one opportunity to bid. Because of the nature of the process, prospective purchasers will be automatically encouraged to submit their highest and best offers. Please be cognizant of the fact that all offers will be evaluated on a "cash equivalent" basis to ensure a fair and equitable evaluation process.

A prospective purchaser's chance to be the successful bidder will be enhanced relative to another purchaser, assuming equal "cash equivalent" offers are received, if:

1. the Approved Offer contains fewer onerous and time consuming conditions.
2. the prospective purchaser establishes his "credit worthiness". This aspect can best be established if conclusive third party evidence of the purchaser's ability to arrange the necessary financing to close the transaction is provided; and
3. Property inspections are completed in advance of the final Bid Deadline Date, September 10, 1986.

22 The invitation to tender is an exhibit on these proceedings. Again, its contents are material. I do not intend to read them but they will be included in the reasons. (See App. V [not reproduced])

23 I said when referring to the portion of the report which set out the reasons by the Receiver for not recommending the Larco offer that I did not propose to deal in detail with each of the points raised. The objections upon which emphasis was particularly placed were the following:

1. the use of the promissory note and the related problems of the discount rate and the sale and purchase of that note;
2. the inclusion in the sealed bid of a financing condition which had not been provided in Larco's formal offer;
3. the identification and amount of the mortgages which Larco would require to be discharged upon closing, and
4. relating to the financing condition, the ultimate waiver of that condition.

24 The uncontentious history of the Larco offer is that prior to its being made there was a meeting in August of 1986 attended by representatives of Larco and representatives of Clarkson when the prospective offering and bidding procedure were discussed.

25 On September 3rd offers were submitted. On September 8th Clarkson replied in writing with certain comments. Between September 3rd and September 9th there were meetings and telephone conversations between the representatives of Larco and representatives of the Receiver. On September 10th there were consultations and there was a subsequent exchange of correspondence. When the final decision of the Receiver was announced September 25th the Larco offers were not recommended.

26 I have already indicated that the difference between the competing offers figured largely in the hearing and blow-by-blow accounts were given by the various participants of the exchanges between representatives of Larco and representatives of the Receiver. These exchanges must be explored to some extent, though not with the attention to detail which they received during the hearing.

27 I do not intend to deal *seriatim* with each of the Receiver's objections as was done by counsel for the defendants, Green Door and Walton, and I trust that he will not feel that his argument was slighted or not considered because I do not do so. I do intend to mention some of the major points.

28 The first of those was the note mechanism. In the preliminary discussions between representatives of Larco and the Receiver there had been some mention of the use of a note or debenture to finance a portion of the price. I think nothing turns on the contents of those precise discussions. The actual mechanism was not fully disclosed until the bid deadline and the submission of the sealed bid.

29 It is appropriate I think to consider that, in the offer which was submitted on September 3rd, para. 3 dealing with payment, after setting out provisions with respect to deposit and the taking back of mortgages, concluded with the following subparagraph:

30 And the balance of the price for the Properties shall be paid subject to adjustments to the Interim Receiver on the Escrow Closing by certified cheque or bank draft payable to the Interim Receiver drawn on or by a Canadian chartered bank or by another Canadian financial institution acceptable to the Interim Receiver.

31 When the sealed bid was submitted the note mechanism, a phrase which I shall adopt although it is not in all respects a happy one, was in the form which appears at p. 136 of the record, this by way of amendment to the offer to which I have just referred:

8. Paragraph 3 of the Form of Offer shall be amended by adding thereto the following paragraphs:

The balance of the price referred to in paragraph 3 of the Form of Offer shall be paid by Offeror to the Interim Receiver by Offeror's delivering to the Interim Receiver a promissory note ("Citibank Guaranteed Note") in that amount, which note shall be unsecured by any charge against the Properties, but which shall be absolutely and unconditionally guaranteed by one of Citibank Canada, Royal Bank of Canada or another financial institution reasonably acceptable to the Interim Receiver (which financial institution is herein referred to as "Citibank"). The said promissory note shall require equal monthly payments of principal and interest sufficient to fully amortize the said sum at the rate of 8.222% per annum over a term of thirty (30) years. Offeror shall arrange a conventional mortgage loan with Citibank or its designee (which party is herein called ("Lender")) which shall be secured by a charge against the Properties which shall be subject and subordinate in all respects to the existing loans which are assumed by Offeror on the date of Closing.

The Interim Receiver shall sell the Citibank Guaranteed Note on the date of Closing to Lender for cash purchase price determined as follows:

on or before Monday, September 15th Citibank shall report in writing to the Interim Receiver stating the cash price (the "Cash Purchase Price") for the Citibank Guaranteed Note as of Wednesday, September 10, 1986. On or before Wednesday, September 17, 1986 the Interim Receiver shall have received in form satisfactory to Interim Receiver acting reasonably an undertaking from Citibank to purchase or cause to be purchased the Citibank Guaranteed Note at the Closing at the said Cash Purchase Price as part of the escrow arrangements herein provided, subject only to the acceptance of this Offer and such reasonable warranties and representations from the Interim Receiver that he has not encumbered or accepted payment on the said note as Citibank may require. Any such sale of the Citibank Guaranteed Note by the Interim Receiver will be on a nonrecourse basis.

Any Court approval of this Agreement to be effective and acceptable to the Offeror shall also include approval of the sale by the Interim Receiver of the Citibank Guaranteed Note as herein provided.

32 The concerns of the Receiver to which this aspect of the transaction gave rise are set out, as I have indicated, in para 38 of the report. It was, I think it is fair to say, a complicated mechanism and had some elements of novelty. In its very nature it gave rise to questions, particularly perhaps having regard for the history of these properties in the recent past. It gave rise to questions as to the reasons for its use and also as to its possible effect on the price. In my view, the questions raised by the Receiver were reasonable questions and they were not answered promptly, frankly or fully.

33 The position of Larco, in part made explicit and in part to be inferred from conduct and from the evidence, was that this was largely none of the Receiver's business. Larco was perfectly entitled to take that position. I should say by way of

digression that if in any previous ruling or in these reasons I appear to be critical of what was done by Larco, it is within the limited framework of the process with which I am concerned and not otherwise. Larco is not a charitable organization. It is a commercial corporation entitled, within the limits of the law, to carry on its commercial affairs as those having the charge of those affairs deem appropriate. But if in some respects it produced adverse reactions in the Receiver, and adverse consequences for the reception of its offer, it cannot be heard to complain.

34 The next contentious item to which I propose to make reference was what has been called in the evidence the "Financing Condition". This was not part of the draft offer but was contained in the sealed bid and was set out in the following terms by way of amendment to that offer:

Notwithstanding any other provision of this Offer, the obligation of the Offeror to proceed with this transaction shall be conditional upon the Offeror's obtaining written commitments, reasonably acceptable to Offeror, for the Citibank Guaranteed Note and the conventional mortgage loan from the Lender no later than twenty (20) days after Acceptance of this Offer. If Offeror does not obtain the written commitments from Citibank and the Lender within the time period of twenty (20) days, Offeror may terminate this Agreement, in which case, the Interim Receiver shall return the deposits and interest thereon to Offeror promptly following demand.

35 In my view, such a provision given the mechanism and procedure, the process which was being followed, ought to have been part of the Larco offer and subject to negotiation at the proper time and not at the 11th hour.

36 The evidence of Mr. Shiraz Lalji was to the effect that he considered the offer as merely a format for the transaction and that the real substance was to be in the sealed bid. He also testified that he had been led to believe that conditional offers would be at no disadvantage. I find it difficult to accept that evidence. The financing condition was a provision so material and of such obvious advantage to the purchaser and a commensurate disadvantage to the vendor that it went to the very root of the transaction. Indeed, as the apprehension of the Receiver indicated, it converted what purported to be an offer into what was in substance an option. I shall have to discuss further in a moment the reasons that I cannot accept Mr. Lalji's evidence in that regard. I can only say for the present that if he entertained the view which he expressed with respect to the form of offer it was a mistaken view and should have been recognized as mistaken having regard particularly for the form of the invitation to tender and of the converting letter with which that invitation went out. Whether this deferral of a term so critical was deliberate or inadvertent, I need express no conclusion. It operated, however, to the detriment of Larco in the consideration of its offer by the Receiver.

37 Eventually it was recognised by Larco that the financing condition was likely to be seriously prejudicial, if not fatal. Steps were set in train to address its removal. That removal entailed a financial cost and risk to Larco which it had sought to avoid. Approval of its board of directors was required and that approval was obtained early on the morning of September 18th, 10 days after the bid deadline. Written confirmation of that waiver is found in sch. 8 to the report, at p. 179, in a letter from Messrs. Weir & Foulds, Solicitors to Clarkson Gordon Inc. which says after some reference of a preliminary nature to the sealed bids: "Our client has instructed us to waive, and we hereby waive, the benefit of paragraph 10 to Schedule 3."

38 The evidence indicated that Mr. Carthy apparently wanted some assurances from Larco before writing that letter, an apprehension which is not difficult to understand. The Receiver has taken the position that the waiver should have come direct from Larco and not from its solicitors. I do not propose to determine as a matter of law whether the purported waiver was effectual or not, although invited in argument to do so. I do not consider it any necessary part of my function on this motion. What is to be considered is the reaction of the Receiver.

39 In a transaction of such magnitude and pertaining to a condition so material, I do not consider it in any way unreasonable that the Receiver looked upon it as one of the unfavourable elements which ultimately tipped the scales against the Larco bid. Solicitors, of course, have certain general and accepted authority to bind their clients. But the annals of law are not wanting in cases where the authority and its exercise have become a topic of litigation. And there is a maxim well-known among businessmen that no one wants to buy a lawsuit. All of this dealing with the form of the waiver I say, without any reflection upon or lack of respect for the eminently capable and reliable firm of solicitors who offered it.

40 I turn now to the question of the mortgages to be discharged which proved to be a bone of contention. In view of the mechanism of the promissory note, which was to be sold at a discount, it was essential for the Receiver to know the mortgages to be discharged in order to know the real price. The final position of Larco in this regard is contained in a letter dated September 21st from Weir & Foulds which is contained at p. 181 of the record.

4. Assumed Mortgages

By letter dated September 16, 1986, provided you with a letter explaining the "Estimated Assumed Loans" in connection with 's bids. As you may know, we have not had the opportunity to fully review all of the existing mortgages which affect the properties and make a final decision as to which existing mortgages will be assumed at closing by hereby agrees that the "Reconciled Contract Price" set forth in 's letter for each of 's bids shall be the exact cash equivalent price which the Receiver shall receive at closing from . For example, if the actual assumed mortgages are less than the amount stated by in his letter, the shortfall shall be paid by in cash at closing in order to maintain the "Reconciled Contract Price" as stated in 's letter. On the other hand, if the actual assumed mortgages are more than the amount stated by in his letter, the "Face Value of Vendor Note at Closing" will be adjusted downward in such a manner as to maintain the stated "Reconciled Contract Price" as stated by in his letter.

If further clarifications of the offers are required, please advise the undersigned.

41 It does not respond in exactly the terms in which the Receiver had put its inquiries but instead provided a mechanism for possible adjustment with respect to the mortgages assumed. Again, I do not propose to consider whether this was a satisfactory response or not. It was another complication, another blemish on the Larco offer, another factor which the Receiver not unreasonably considered to be adverse and to weigh against approval.

42 There is a further matter dealing with the utilization of the note. As I have indicated, the precise mechanism made its appearance in the sealed bid and I have already read the relevant paragraph. I do not propose to review all of the evidence, which was considerable, bearing on this topic. It is sufficient to say that the final solution unilaterally proposed by Larco is as found in the record at p. 179 in the letter from Weir & Foulds of September 18th to which I have already referred in another context. The concluding paragraph of that letter reads:

Enterprises Inc. hereby agrees to cause the Citibank Guaranteed Note to be purchased on closing on the same terms and conditions as contemplated in paragraph 8.

No reference is made to the Royal Bank who at one time had been proposed as a potential purchaser or to any other purchaser. The covenant of Larco has been substituted for that of Citibank, and as I have indicated, no purchaser has been provided or even proposed.

43 It is the position of Larco, as put in argument and in evidence, that from a commercial standpoint the purchase of the note became irrelevant once Larco had demonstrated credit capacity adequate for the transaction, as it did by a letter from Citibank dated September 9th. Larco was then, it is said, in the same position as other tenderers, obliged to pay on closing or otherwise make good. Ignoring any frailties which may be inherent in that argument, it is undeniable that it did not put the Receiver in the position which it had originally been proposed of having a bank liable to make good.

44 It has been submitted by counsel supporting the Larco offer that the requirement for a purchaser of the note had been waived by the Receiver. Again, I do not propose to dispose of waiver or estoppel as matters of law. I refer to the episode as yet another problem for the Receiver and its counsel and a problem which militated against the Larco offer.

45 In outlining initially the obligations of the court on a motion of this kind, I adverted to the question of whether the Receiver has in any way misled a bidder. It is clear that if a bidder has been misled that may constitute a circumstance upon which the court will intervene upon the motion for approval. Though it was not passed in argument, there was clear indication

in the evidence, particularly that of Mr. Shiraz Lalji, that Larco had been misled as to the acceptability of a conditional offer. This was relevant to the much discussed financing condition.

46 Any suggestion that Larco was misled in this respect must be approached with a measure of skepticism. Larco is apparently a large sophisticated enterprise and those charged with its affairs appear expert in matters of contract negotiation and finance. It was advised in and about this transaction not only by members of its own board of directors but by an attorney of Seattle, Washington, Mr. Thaddas Alston. Mr. Alston testified and was quite evidently an able and experienced lawyer with a connection of some duration with the affairs of Larco. Larco was also advised by eminently capable solicitors in Toronto. It had every advantage to review and consider every aspect of the transaction.

47 Mr. Lalji testified that early in the discussions Shaver indicated that conditional offers would be considered on a par with unconditional offers. This Shaver denies and says that all he ever said was to the effect that: "We will look at all offers." The evidence of other representatives of the Receiver was that Larco was repeatedly told that a condition would be to its disadvantage.

48 It is always difficult and distasteful to a judge to have to resolve a direct conflict of evidence between what are apparently respectable and reliable witnesses. But sometimes the duty is one which cannot be avoided, and in this instance I find myself compelled to accept the evidence of Shaver and to reject that of Lalji. I do so chiefly on what is most probable. The proposition that conditional offers would be considered equally with unconditional offers is so palpably ridiculous commercially that it is difficult to credit that any sensible businessman would say it, or if said, that any sensible businessman would accept it. Indeed it is a clear inference from Mr. Lalji's evidence that he recognized that it was bizarre and had it been said I doubt very much that he would have taken it seriously.

49 It was also suggested that Larco was misled into concluding at the last stages that the Receiver was not insisting on the undertaking of the bank to purchase the note. I have already made brief reference to this. It was said that Mr. Cogan, a representative of the real estate consultant advising the Receiver, had either said so or had plainly inferred it. This Cogan denies. Cogan was responsible for the real estate aspects of the transaction and not for the legal or financial ones. If Larco received such an impression from Cogan, prudence would have dictated that the matter be verified either with Mr. Shaver or with the solicitors advising the Receiver. So much Mr. Alston conceded in his evidence. It would appear that Mr. Carthy of Weir & Foulds recognized that there was a deficiency in that regard.

50 The evidence of Mr. Zimmerman, a member of the firm of solicitors advising the Receiver, confirmed by the uncontradicted evidence of Shaver, was that on September 16th Carthy and Alston were advised during a telephone conversation that the note purchase undertaking was expected by the Receiver on the following day. It was never received.

51 Taking the evidence as a whole, I am not at all persuaded that Larco was misled in any material respect.

52 In criticism of the conduct of the Receiver, criticism which I may say has been very limited in extent, it was submitted that the Receiver negotiated with other parties after the bid deadline. Specifically reference was made to the Ivordale-Maisonettes property where a discrepancy had appeared between the words and the numerals in the offer. I am not persuaded that the resolution of the problem involved negotiation, nor that if it did it offended the process or was prejudicial to Larco.

53 There was likewise some criticism upon the undertaking of the recommended bidders to improve the offer in one respect made during the hearing. That was in respect of the equity participation. That is a matter which I must have in mind when I make my final disposition.

54 A special and somewhat peculiar position in the matter was put on behalf of the defendant Maysfield Property Management Inc. Maysfield is a corporation whose shares are effectively held by receivers appointed for two other corporations. Maysfield managed and operated the subject properties before Clarkson was appointed Receiver, and by arrangement with Clarkson continued to perform that function after the receivership commenced. It employs something over 200 persons. It has substantial worth and it has substantial revenues.

55 By letter dated October 16, 1986, Larco offered to purchase the outstanding shares in Maysfield for net book value, an offer conditional upon approval of the Larco offer by the court. If the offers recommended by the Receiver are approved, there appears to be no certainty and perhaps not even any probability of the continued viability of Maysfield.

56 In a secondary submission counsel for Maysfield asked that if an order were made as sought by the Receiver, that that order should be stayed for some period of time to enable Maysfield to negotiate with the purchaser.

57 I observe by looking at the clock that I have been going for something well over an hour at the moment, and I regret to tell everyone that I am not finished yet. I propose to take 10 minutes for my benefit and perhaps for yours as well.

58 [Court recessed 11.07 a.m. and resumed 11.19 a.m.]

59 I propose now to express some factual conclusions with respect to the matter.

60 The Larco offer is the highest bid. The difference between it and the recommended offers is substantial in absolute amount but not material in proportion or relation to the over-all amounts involved in the transaction. The difference is not such as to create any inference that the Disposition Strategy and its application by the Receiver was inadequate or unsuccessful. Indeed my conclusion would be quite to the contrary. Larco was not misled or unfairly treated by the Receiver in any material regard. The Larco offer was presented in a form and negotiated in a manner which gave the Receiver legitimate and reasonable cause for concern as to the advisability of accepting it.

61 Mr. Zimmerman very fairly conceded in his evidence that probably none of those causes was in itself fatal. I think that probably is so. They were, however, considered cumulatively by the Receiver and it was in my view legitimate and reasonable to do so.

62 In essence the position of the Receiver was this: having before it the Larco offer with the concerns about it which it entertained, having before it the offers which it now recommends which occasioned no such concerns, considering that in relative terms the difference in return was not material, the Receiver elected to recommend the somewhat lower offers which were not attended by troublesome concerns against the higher one which was. In my view the Receiver acted reasonably in doing so.

63 Unfortunately, that is not the end of the matter. The question remains in the light of the factual conclusions which I have reached and expressed, how should my discretion be exercised in the final result? Perhaps it is useful to review very briefly the propositions governing the duties of the court which I outlined earlier in my reasons. I must consider whether the Receiver has made a sufficient effort to get the best price and has not acted improperly. I must consider the interests of all parties to the action, plaintiffs and defendants alike. I must consider the efficacy and the integrity of the process by which the offers were obtained. I should consider whether there has been any unfairness in the working out of the process and in a proper case I have the power and the responsibility to disregard the recommendation of the Receiver and to approve another offer or offers.

64 Those propositions I have put in positive terms. I think some help in measuring the ambit of the court's discretion is to be had from putting certain negative propositions which are not so explicit in the cases but which I think are fairly to be inferred from them.

65 The court ought not to enter into the market-place. In this case it ought not to become involved in the implementation of the Disposition Strategy and the attendant negotiations. The court ought not to sit as on appeal from the decision of the Receiver, reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise. The court ought not to embark on a process analogous to the trial of a claim by an unsuccessful bidder for something in the nature of specific performance. The court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

66 In all of this it is necessary to keep in mind not only the function of the court but the function of the Receiver. The Receiver is selected and appointed having regard for experience and expertise in the duties which are involved. It is the function of the Receiver to conduct negotiations and to assess the practical business aspects of the problems involved in the disposition of the assets.

67 To put the alternative positions briefly they are these. The submission on behalf of the Receiver is that if the conclusion is that it has acted reasonably and fairly, and I would add not arbitrarily, in the best interests of the parties, I should make the order asked.

68 The submission of the objecting defendants reduced to its narrowest compass is along these lines. The Larco offer is or could by terms of the court's order be made legally susceptible of acceptance. It will produce the most money and it should be approved.

69 It is clear that to accede to the Receiver's submission will probably result in a lower return to the estate. I say "probably" because there are no certainties in this life except the classic ones often referred to. The approval of the recommended offer will clearly and plainly be detrimental to the position of Maysfield.

70 Reviewing these positions I have concluded that to accede to the position advanced by the defendants involves ignoring or at any rate acting contrary to the recommendation of the Receiver appointed by the court. It would involve me in making what is essentially a business decision, though one with some legal components. A decision of which the consequences are not in all respects predictable.

71 I am not, as I said earlier, deciding an action for breach of contract or trying a claim for specific performance. It is because of that view that I have not responded in these reasons to all of the legal arguments advanced with much force and clarity by Mr. Falby. In my view of the function which I must discharge the decision of such technical legal matters is not involved.

72 Reference was made in argument to *The Queen in right of Ontario et al v Ron Engineering & Construction Eastern Ltd.* (1981), 119 D.L.R. (3d) 267, [1981] 1 S.C.R. 111, 13 B.L.R. 72 (S.C.C.). In that case there were contractual rights at issue as is made clear by the reasons of Estey J. referred to at p. 274 of the report. No such contractual issues arise here. At most there are some legal questions raised as being among the concerns that led to rejection of the Larco bid.

73 The decision made by the Receiver was one to which it brought its experience and expertise for the position to which it was appointed. It was a decision upon which the Receiver had the advice of solicitors and counsel and of an expert real estate consultant retained for the purpose. It was a decision from which the Receiver did not renege at the conclusion of two weeks of hearing.

74 It is clear on the one hand that the court is not to apply an automatic stamp of approval to the decision of the Receiver. Plainly, the court has power to decide differently and a discretion to exercise which must be exercised judicially.

75 The court no doubt has power to enter into the process to any extent which appears proper in the circumstances. In *Salima Investments Ltd. v. Bank of Montreal et al.* (1985), 21 D.L.R. (4th) 473, 65 A.R. 372, 41 Alta. L.R. (2d) 58, to which I have referred, the judge in chambers actually received bids.

76 In this case it was suggested by counsel for some of the objecting defendants that the court conduct a run-off or direct the Receiver to do so between the Larco and the recommended offerors. I have no doubt that I have the power to do so. To exercise it would, in my view, exhibit very little judgment. It would be to open a Pandora's box, the contents of which might be more unruly and unpredictable than the consequences which followed my decision to hear *in vacuo* evidence in this case.

77 It is equally clear, in my view, though perhaps not so clearly enunciated, that it is only in an exceptional case that the court will intervene and proceed contrary to the Receiver's recommendations if satisfied, as I am, that the Receiver has acted reasonably, prudently and fairly and not arbitrarily.

78 Much was said during the hearing about the integrity of the process, that is, the process carried through by the Receiver pursuant to the July order made by Catzman J., and whether Larco had abused or evaded or sought to abuse or evade it. The Receiver perceived, not unreasonably in my view, that that was so. Certainly it must be said that Larco fell somewhat short of coming forward promptly, openly, forthrightly and unequivocally with its best offer, an objective at which the process was directed.

79 In the arguments of counsel for the objecting defendants, particularly for the defendant Prousky, the process was very narrowly defined, virtually confined to the precise provisions of the plan approved by the court. I do not consider it appropriate to view it so narrowly or that the ambit of the Receiver's discretion should be so narrowly limited.

80 In addition to the regard which must be had for the process in this case, there is another similar factor for which I must have regard. It was adverted to by Saunders J. in the two cases of *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245, and *Re Beauty Counsellors of Canada Ltd.* (1986), 58 C.B.R. (N.S.) 237, which have been referred to in the argument. It was also reflected in the Nova Scotia Court of Appeal decision in *Cameron*. In all of those cases the courts have recognized that they are not making a decision in a vacuum; that they were concerned with the process not only as it affected the case at bar, but as it stood to be effected in situations of a similar nature in the future. In what was called by MacDonald J. A. in *Cameron v. Bank of Nova Scotia et al.* (1981), 45 N.S.R. (2d) 303, 38 C.B.R. (N.S.) 1, 86 A.P.R. 303, "the delicate balance of competing interests", that is a relevant and material one.

81 In this case I am reviewing the recommendations of the Receiver. I have had the benefit of two weeks of hearing and the assistance of a dozen learned counsel, advantages which were denied to the Receiver.

82 If I were persuaded, and I am not, to conclude that as a result of this hearing the objections of the Receiver had been fully and satisfactorily met, I should still have much hesitation in rejecting the Receiver's recommendation.

83 Its decision was made as a matter of business judgment on the elements then available to it. It is of the very essence of a receiver's function to make such judgments and in the making of them to act seriously and responsibly so as to be prepared to stand behind them.

84 If the court were to reject the recommendation of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

85 Plainly, each case must be decided upon its own facts, and with a view to producing a proper result within the legal framework to which I have made reference. Such policy considerations as I have just enunciated are, as they were said to be by Saunders J., secondary, but they are none the less relevant and material.

86 During the time which I have spent considering this matter, I have asked myself many times what the situation would have been had we been dealing with hundreds of thousands of dollars, rather than hundreds of millions, and a potential difference in the result potentially reduced accordingly. I have asked myself whether I would have had any difficulty in arriving at a conclusion, and have found myself forced to answer that question in the negative. It is a well-worn adage among lawyers and judges that hard cases make bad law. Perhaps there is a corollary proposition that large cases have a tendency to do the same sort of thing.

87 The actual difference between the offers under consideration, I am repeating myself, is substantial. It is that alone which has really created the issue before me. While the actual difference is a factor of much weight, it must also be viewed in its relative relation to the size of the transaction. No doubt, as the cases have indicated, situations might arise where the disparity was so great as to call in question the adequacy of the mechanism which had produced the offers. It is not so here, and in my view that is substantially an end of the matter.

88 The importance of this motion, and the measure of interest which it has for the parties and for the public, might have made desirable a period under reserve of sufficient duration to permit the writing of formal reasons for judgment. The circumstances related to the prospective sales were such that prompt disposition of the motion seemed more important than elegance of expression. The worst grammatical solecisms will be massaged out in the editorial process. As to the substance of the reasons, I feel as much confidence as is possible when one is dealing with matters of difficulty, of importance and of some notoriety.

89 There will be orders as asked upon the motion approving the sales. I presume that there will be some mechanical matters to be dealt with before we all part and I invite counsel. I guess first of all Mr. Lamek, to suggest whether it would be appropriate that I adjourn for a few moments while those matters be considered and discussed, or whether I should proceed to deal with them immediately.

MR. LAMEK: I suggest a short adjournment might be useful, My Lord. On the possibility that your lordship would take the view of this matter that you have expressed this morning a revised draft order was prepared to take into account the matters that occurred during the course of the hearing. We have not been so bold as to distribute that to other counsel in advance. Having not seen the revised draft, and of course neither has your lordship, it might be helpful if we do and until your lordship has a good look at the draft.

HIS LORDSHIP: Does it make any disposition as to costs, Mr. Lamek.

MR. LAMEK: I did not, my lord.

HIS LORDSHIP: If you will be kind enough to send my copy of it through the Registrar, I will recess now for what, 15 minutes?

MR. LAMEK: I think that should be sufficient, my lord, yes. If it is not perhaps ...

HIS LORDSHIP: You can let me know?

MR. LAMEK: Thank you, my lord.

90 [Court recessed 11.45 a.m. and resumed 12.07 p.m. Counsel made submissions as to costs.]

HIS LORDSHIP: There will be no order as to costs. Mr. Strosberg's argument, as usual, makes good sense and I would be hard put to disagree that a measure of benefit has flowed from the proceedings.

91 At the same time, I think it fair to observe that the objecting defendants were not proceeding *pro bono publico*, and I see no sufficient reason that their participation should be other than at their own expense.

92 Before I depart from the matter I should, which I normally do at the outset before anybody knows whether they have won or lost, record my gratitude to counsel for their assistance in dealing with the matter and for the orderly conduct of the proceedings throughout.

93 *Motion granted*

Footnotes

1 Interprises was the initial name used for Interprises Inc.



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RULES OF COURT

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Division 4

Restriction on Media Reporting and Public Access to Court Proceedings

Application of this Division

6.28 Unless an enactment otherwise provides or the Court otherwise orders, this Division applies to an application for an order

- (a) to ban publication of court proceedings,
- (b) to seal or partially seal a court file,
- (c) permitting a person to give evidence in a way that prevents that person or another person from being identified,
- (d) for a hearing from which the public is excluded, or
- (e) for use of a pseudonym.

Restricted court access applications and orders

6.29 An application under this Division is to be known as a restricted court access application and an order made under this Division is to be known as a restricted court access order.

When restricted court access application may be filed

6.30 A person may file a restricted court access application only if a judge has authority to make a restricted court access order under an enactment or at common law.

Timing of application and service

6.31 An applicant for a restricted court access order must, 5 days or more before the date scheduled for the hearing, trial or proceeding in respect of which the order is sought,

- (a) file the application in Form 32, and
- (b) unless the Court otherwise orders, serve every party and any other person named or described by the Court.

Notice to media

6.32 When a restricted court access application is filed, a copy of it must be served on the court clerk, who must, in accordance with the direction of the Chief Justice, give notice of the application to

- (a) the electronic and print media identified or described by the Chief Justice, and
- (b) any other person named by the Court.

AR 124/2010 s6.32;163/2010

2002 SCC 41, 2002 CSC 41
Supreme Court of Canada

Sierra Club of Canada (Inc.) v. Canada (Minister of Finance)

2002 CarswellNat 822, 2002 CarswellNat 823, 2002 SCC 41, 2002 CSC 41, [2002] 2 S.C.R. 522, [2002] S.C.J. No. 42, 113 A.C.W.S. (3d) 36, 18 C.P.R. (4th) 1, 20 C.P.C. (5th) 1, 211 D.L.R. (4th) 193, 223 F.T.R. 137 (note), 287 N.R. 203, 40 Admin. L.R. (3d) 1, 44 C.E.L.R. (N.S.) 161, 93 C.R.R. (2d) 219, J.E. 2002-803, REJB 2002-30902

Atomic Energy of Canada Limited, Appellant v. Sierra Club of Canada, Respondent and The Minister of Finance of Canada, the Minister of Foreign Affairs of Canada, the Minister of International Trade of Canada and the Attorney General of Canada, Respondents

McLachlin C.J.C., Gonthier, Iacobucci, Bastarache, Binnie, Arbour, LeBel JJ.

Heard: November 6, 2001
Judgment: April 26, 2002
Docket: 28020

Proceedings: reversing (2000), 2000 CarswellNat 970, (sub nom. Atomic Energy of Canada Ltd. v. Sierra Club of Canada) 187 D.L.R. (4th) 231, 256 N.R. 1, 24 Admin. L.R. (3d) 1, [2000] 4 F.C. 426, 182 F.T.R. 284 (note), 2000 CarswellNat 3271, [2000] F.C.J. No. 732 (Fed. C.A.); affirming (1999), 1999 CarswellNat 2187, [2000] 2 F.C. 400, 1999 CarswellNat 3038, 179 F.T.R. 283, [1999] F.C.J. No. 1633 (Fed. T.D.)

Counsel: J. Brett Ledger and Peter Chapin, for appellant
Timothy J. Howard and Franklin S. Gertler, for respondent Sierra Club of Canada
Graham Garton, Q.C., and J. Sanderson Graham, for respondents Minister of Finance of Canada, Minister of Foreign Affairs of Canada, Minister of International Trade of Canada, and Attorney General of Canada

Subject: Intellectual Property: Property: Civil Practice and Procedure, Evidence: Environmental
Headnote

Evidence --- Documentary evidence Privilege as to documents Miscellaneous documents
Confidentiality order was necessary in this case because disclosure of confidential documents would impose serious risk on important commercial interest of Crown corporation and there were no reasonable alternative measures to granting of order Confidentiality order would have substantial salutary effects on Crown corporation's right to fair trial and on freedom of expression Deleterious effects of confidentiality order on open court principle and freedom of expression would be minimal -- Salutary effects of order outweighed deleterious effects -- Canadian Environmental Assessment Act, S.C. 1992, c. 37, s. 51(1b) Federal Court Rules, 1998, SOR/98-106, R. 151, 312

Practice --- Discovery Discovery of documents Privileged document Miscellaneous privileges
Confidentiality order was necessary in this case because disclosure of confidential documents would impose serious risk on important commercial interest of Crown corporation and there were no reasonable alternative measures to granting of order Confidentiality order would have substantial salutary effects on Crown corporation's right to fair trial and on freedom of expression Deleterious effects of confidentiality order on open court principle and freedom of expression would be minimal -- Salutary effects of order outweighed deleterious effects -- Canadian Environmental Assessment Act, S.C. 1992, c. 37, s. 51(1b) Federal Court Rules, 1998, SOR/98-106, R. 151, 312.

Practice --- Discovery Examination for discovery Range of examination Privilege Miscellaneous privileges
Confidentiality order was necessary in this case because disclosure of confidential documents would impose serious risk on important commercial interest of Crown corporation and there were no reasonable alternative measures to granting of order Confidentiality order would have substantial salutary effects on Crown corporation's right to fair trial and on

freedom of expression — Deleterious effects of confidentiality order on open court principle and freedom of expression would be minimal — Salutary effects of order outweighed deleterious effects — *Canadian Environmental Assessment Act*, S.C. 1992, c. 37, s. 5(1)(b) — *Federal Court Rules*, 1998, SOR/98-106, R. 151, 312

Preuve --- Preuve documentaire — Confidentialité en ce qui concerne les documents — Documents divers

Ordonnance de confidentialité était nécessaire parce que la divulgation des documents confidentiels menacerait gravement l'intérêt commercial important de la société d'État et parce qu'il n'y avait aucune autre option raisonnable que celle d'accorder l'ordonnance — Ordonnance de confidentialité aurait des effets bénéfiques considérables sur le droit de la société d'État à un procès équitable et à la liberté d'expression — Ordonnance de confidentialité n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression — Effets bénéfiques de l'ordonnance l'emportaient sur ses effets préjudiciables — **Loi canadienne sur l'évaluation environnementale, L.C. 1992, c. 37, art. 5(1)(b)** — Règles de la Cour fédérale, 1998, DORS/98-106, r. 151, 312

Procédure --- Communication de la preuve — Communication des documents — Documents confidentiels — Divers types de confidentialité

Ordonnance de confidentialité était nécessaire parce que la divulgation des documents confidentiels menacerait gravement l'intérêt commercial important de la société d'État et parce qu'il n'y avait aucune autre option raisonnable que celle d'accorder l'ordonnance — Ordonnance de confidentialité aurait des effets bénéfiques considérables sur le droit de la société d'État à un procès équitable et à la liberté d'expression — Ordonnance de confidentialité n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression — Effets bénéfiques de l'ordonnance l'emportaient sur ses effets préjudiciables — **Loi canadienne sur l'évaluation environnementale, L.C. 1992, c. 37, art. 5(1)(b)** — Règles de la Cour fédérale, 1998, DORS/98-106, r. 151, 312

Procédure --- Communication de la preuve — Interrogatoire préalable — Étendue de l'interrogatoire — Confidentialité — Divers types de confidentialité

Ordonnance de confidentialité était nécessaire parce que la divulgation des documents confidentiels menacerait gravement l'intérêt commercial important de la société d'État et parce qu'il n'y avait aucune autre option raisonnable que celle d'accorder l'ordonnance — Ordonnance de confidentialité aurait des effets bénéfiques considérables sur le droit de la société d'État à un procès équitable et à la liberté d'expression — Ordonnance de confidentialité n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression — Effets bénéfiques de l'ordonnance l'emportaient sur ses effets préjudiciables — **Loi canadienne sur l'évaluation environnementale, L.C. 1992, c. 37, art. 5(1)(b)** — Règles de la Cour fédérale, 1998, DORS/98-106, r. 151, 312

The federal government provided a Crown corporation with a \$1.5 billion loan for the construction and sale of two CANDU nuclear reactors to China. An environmental organization sought judicial review of that decision, maintaining that the authorization of financial assistance triggered s. 5(1)(b) of the *Canadian Environmental Assessment Act*. The Crown corporation was an intervenor with the rights of a party in the application for judicial review. The Crown corporation filed an affidavit by a senior manager referring to and summarizing confidential documents. Before cross-examining the senior manager, the environmental organization applied for production of the documents. After receiving authorization from the Chinese authorities to disclose the documents on the condition that they be protected by a confidentiality order, the Crown corporation sought to introduce the documents under R. 312 of the *Federal Court Rules*, 1998 and requested a confidentiality order. The confidentiality order would make the documents available only to the parties and the court but would not restrict public access to the proceedings.

The trial judge refused to grant the order and ordered the Crown corporation to file the documents in their current form, or in an edited version if it chose to do so. The Crown corporation appealed under R. 151 of the *Federal Court Rules*, 1998 and the environmental organization cross-appealed under R. 312. The majority of the Federal Court of Appeal dismissed the appeal and the cross-appeal. The confidentiality order would have been granted by the dissenting judge. The Crown corporation appealed.

Held: The appeal was allowed.

Publication bans and confidentiality orders, in the context of judicial proceedings, are similar. The analytical approach to the exercise of discretion under R. 151 should echo the underlying principles set out in ***Dagenais v. Canadian Broadcasting Corp.*, [1994] 3 S.C.R. 835 (S.C.C.)**. A confidentiality order under R. 151 should be granted in only two circumstances, when an order is needed to prevent serious risk to an important interest, including a commercial interest, in the

context of litigation because reasonable alternative measures will not prevent the risk, and when the salutary effects of the confidentiality order, including the effects on the right of civil litigants to a fair trial, outweigh its deleterious effects, including the effects on the right to free expression, which includes public interest in open and accessible court proceedings.

The alternatives to the confidentiality order suggested by the Trial Division and Court of Appeal were problematic. Expunging the documents would be a virtually unworkable and ineffective solution. Providing summaries was not a reasonable alternative measure to having the underlying documents available to the parties. The confidentiality order was necessary in that disclosure of the documents would impose a serious risk on an important commercial interest of the Crown corporation, and there were no reasonable alternative measures to granting the order.

The confidentiality order would have substantial salutary effects on the Crown corporation's right to a fair trial and on freedom of expression. The deleterious effects of the confidentiality order on the open court principle and freedom of expression would be minimal. If the order was not granted and in the course of the judicial review application the Crown corporation was not required to mount a defence under the *Canadian Environmental Assessment Act*, it was possible that the Crown corporation would suffer the harm of having disclosed confidential information in breach of its obligations with no corresponding benefit to the right of the public to freedom of expression. The salutary effects of the order outweighed the deleterious effects.

Le gouvernement fédéral a fait un prêt de l'ordre de 1,5 milliards de dollar en rapport avec la construction et la vente par une société d'État de deux réacteurs nucléaires CANDU à la Chine. Un organisme environnemental a sollicité le contrôle judiciaire de cette décision, soutenant que cette autorisation d'aide financière avait déclenché l'application de l'art. 5(1)b) de la *Loi canadienne sur l'évaluation environnementale*. La société d'État était intervenante au débat et elle avait reçu les droits de partie dans la demande de contrôle judiciaire. Elle a déposé l'affidavit d'un cadre supérieur dans lequel ce dernier faisait référence à certains documents confidentiels et en faisait le résumé. L'organisme environnemental a demandé la production des documents avant de procéder au contre-interrogatoire du cadre supérieur. Après avoir obtenu l'autorisation des autorités chinoises de communiquer les documents à la condition qu'ils soient protégés par une ordonnance de confidentialité, la société d'État a cherché à les introduire en invoquant la r. 312 des *Règles de la Cour fédérale, 1998*, et elle a aussi demandé une ordonnance de confidentialité. Selon les termes de l'ordonnance de confidentialité, les documents seraient uniquement mis à la disposition des parties et du tribunal, mais l'accès du public aux débats ne serait pas interdit.

Le juge de première instance a refusé l'ordonnance de confidentialité et a ordonné à la société d'État de déposer les documents sous leur forme actuelle ou sous une forme révisée, à son gré. La société d'État a interjeté appel en vertu de la r. 151 des *Règles de la Cour fédérale, 1998*, et l'organisme environnemental a formé un appel incident en vertu de la r. 312. Les juges majoritaires de la Cour d'appel ont rejeté le pourvoi et le pourvoi incident. Le juge dissident aurait accordé l'ordonnance de confidentialité. La société d'État a interjeté appel.

Arrêt: Le pourvoi a été accueilli.

Il y a de grandes ressemblances entre l'ordonnance de non-publication et l'ordonnance de confidentialité dans le contexte des procédures judiciaires. L'analyse de l'exercice du pouvoir discrétionnaire sous le régime de la r. 151 devrait refléter les principes sous-jacents énoncés dans l'arrêt *Dagenais c. Société Radio-Canada, [1994] 3 R.C.S. 835*. Une ordonnance de confidentialité rendue en vertu de la r. 151 ne devrait l'être que lorsque : 1) une telle ordonnance est nécessaire pour écarter un risque sérieux pour un intérêt important, y compris un intérêt commercial, dans le cadre d'un litige, en l'absence d'autres solutions raisonnables pour écarter ce risque; et 2) les effets bénéfiques de l'ordonnance de confidentialité, y compris les effets sur les droits des justiciables civils à un procès équitable, l'emportent sur ses effets préjudiciables, y compris les effets sur le droit à la liberté d'expression, lequel droit comprend l'intérêt du public à l'accès aux débats judiciaires.

Les solutions proposées par la Division de première instance et par la Cour d'appel comportaient toutes deux des problèmes. Épurer les documents serait virtuellement impraticable et inefficace. Fournir des résumés des documents ne constituant pas une « autre option raisonnable » à la communication aux parties des documents de base. L'ordonnance de confidentialité était nécessaire parce que la communication des documents menacerait gravement un intérêt commercial important de la société d'État et parce qu'il n'existait aucune autre option raisonnable que celle d'accorder l'ordonnance.

L'ordonnance de confidentialité aurait d'importants effets bénéfiques sur le droit de la société d'État à un procès équitable et à la liberté d'expression. Elle n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression. Advenant que l'ordonnance ne soit pas accordée et que, dans le cadre de la demande de contrôle judiciaire, la société d'État n'ait pas l'obligation de présenter une défense en vertu de la *Loi canadienne sur l'évaluation environnementale*, il se pourrait que la société d'État subisse un préjudice du fait d'avoir communiqué cette information confidentielle en violation de ses obligations, sans avoir pu profiter d'un avantage similaire à celui du droit du public à la liberté d'expression. Les effets bénéfiques de l'ordonnance l'emportent sur ses effets préjudiciables.

APPEAL from judgment reported at 2000 CarswellNat 970, 2000 CarswellNat 3271, [2000] F.C.J. No. 732. (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada*) 187 D.L.R. (4th) 231, 256 N.R. 1, 24 Admin. L.R. (3d) 1. [2000] 4 F.C. 426, 182 F.T.R. 284 (note) (Fed. C.A.), dismissing appeal from judgment reported at 1999 CarswellNat 2187, [2000] 2 F.C. 400, 1999 CarswellNat 3038, 179 F.T.R. 283 (Fed. T.D.), granting application in part.

POURVOI à l'encontre de l'arrêt publié à 2000 CarswellNat 970, 2000 CarswellNat 3271, [2000] F.C.J. No. 732. (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada*) 187 D.L.R. (4th) 231, 256 N.R. 1, 24 Admin. L.R. (3d) 1. [2000] 4 F.C. 426, 182 F.T.R. 284 (note) (C.A. Féd.), qui a rejeté le pourvoi à l'encontre du jugement publié à 1999 CarswellNat 2187, [2000] 2 F.C. 400, 1999 CarswellNat 3038, 179 F.T.R. 283 (C.F. (1^{re} inst.)), qui avait accueilli en partie la demande.

The judgment of the court was delivered by *Iacobucci J.*:

I. Introduction

1 In our country, courts are the institutions generally chosen to resolve legal disputes as best they can through the application of legal principles to the facts of the case involved. One of the underlying principles of the judicial process is public openness, both in the proceedings of the dispute, and in the material that is relevant to its resolution. However, some material can be made the subject of a confidentiality order. This appeal raises the important issues of when, and under what circumstances, a confidentiality order should be granted.

2 For the following reasons, I would issue the confidentiality order sought and, accordingly, would allow the appeal.

II. Facts

3 The appellant, Atomic Energy of Canada Ltd. ("AECL"), is a Crown corporation that owns and markets CANDU nuclear technology, and is an intervenor with the rights of a party in the application for judicial review by the respondent, the Sierra Club of Canada ("Sierra Club"). Sierra Club is an environmental organization seeking judicial review of the federal government's decision to provide financial assistance in the form of a \$1.5 billion guaranteed loan relating to the construction and sale of two CANDU nuclear reactors to China by the appellant. The reactors are currently under construction in China, where the appellant is the main contractor and project manager.

4 The respondent maintains that the authorization of financial assistance by the government triggered s. 5(1)(b) of the *Canadian Environmental Assessment Act*, S.C. 1992, c. 37 ("CEAA"), which requires that an environmental assessment be undertaken before a federal authority grants financial assistance to a project. Failure to undertake such an assessment compels cancellation of the financial arrangements.

5 The appellant and the respondent Ministers argue that the CEAA does not apply to the loan transaction, and that if it does, the statutory defences available under ss. 8 and 54 apply. Section 8 describes the circumstances where Crown corporations are required to conduct environmental assessments. Section 54(2)(b) recognizes the validity of an environmental assessment carried out by a foreign authority provided that it is consistent with the provisions of the CEAA.

6 In the course of the application by Sierra Club to set aside the funding arrangements, the appellant filed an affidavit of Dr. Simon Pang, a senior manager of the appellant. In the affidavit, Dr. Pang referred to and summarized certain documents (the "Confidential Documents"). The Confidential Documents are also referred to in an affidavit prepared by Dr. Feng, one of AFCL's experts. Prior to cross-examining Dr. Pang on his affidavit, Sierra Club made an application for the production of the Confidential Documents, arguing that it could not test Dr. Pang's evidence without access to the underlying documents. The appellant resisted production on various grounds, including the fact that the documents were the property of the Chinese authorities and that it did not have authority to disclose them. After receiving authorization by the Chinese authorities to disclose the documents on the condition that they be protected by a confidentiality order, the appellant sought to introduce the Confidential Documents under R. 312 of the *Federal Court Rules, 1998*, SOR/98-106, and requested a confidentiality order in respect of the documents.

7 Under the terms of the order requested, the Confidential Documents would only be made available to the parties and the court; however, there would be no restriction on public access to the proceedings. In essence, what is being sought is an order preventing the dissemination of the Confidential Documents to the public.

8 The Confidential Documents comprise two Environmental Impact Reports on Siting and Construction Design (the "EIRs"), a Preliminary Safety Analysis Report (the "PSAR"), and the supplementary affidavit of Dr. Pang, which summarizes the contents of the EIRs and the PSAR. If admitted, the EIRs and the PSAR would be attached as exhibits to the supplementary affidavit of Dr. Pang. The EIRs were prepared by the Chinese authorities in the Chinese language, and the PSAR was prepared by the appellant with assistance from the Chinese participants in the project. The documents contain a mass of technical information and comprise thousands of pages. They describe the ongoing environmental assessment of the construction site by the Chinese authorities under Chinese law.

9 As noted, the appellant argues that it cannot introduce the Confidential Documents into evidence without a confidentiality order; otherwise, it would be in breach of its obligations to the Chinese authorities. The respondent's position is that its right to cross-examine Dr. Pang and Dr. Feng on their affidavits would be effectively rendered nugatory in the absence of the supporting documents to which the affidavits referred. Sierra Club proposes to take the position that the affidavits should therefore be afforded very little weight by the judge hearing the application for judicial review.

10 The Federal Court of Canada, Trial Division, refused to grant the confidentiality order and the majority of the Federal Court of Appeal dismissed the appeal. In his dissenting opinion, Robertson J.A. would have granted the confidentiality order.

III. Relevant Statutory Provisions

11 *Federal Court Rules, 1998*, SOR/98-106

151(1) On motion, the Court may order that material to be filed shall be treated as confidential.

(2) Before making an order under subsection (1), the Court must be satisfied that the material should be treated as confidential, notwithstanding the public interest in open and accessible court proceedings.

IV. Judgments below

A. *Federal Court of Canada, Trial Division, [2000] 2 F.C. 400*

12 Pelletier J. first considered whether leave should be granted pursuant to R. 312 to introduce the supplementary affidavit of Dr. Pang to which the Confidential Documents were filed as exhibits. In his view, the underlying question was that of relevance, and he concluded that the documents were relevant to the issue of the appropriate remedy. Thus, in the absence of prejudice to the respondent, the affidavit should be permitted to be served and filed. He noted that the respondents would be prejudiced by delay, but since both parties had brought interlocutory motions which had

contributed to the delay, the desirability of having the entire record before the court outweighed the prejudice arising from the delay associated with the introduction of the documents.

13 On the issue of confidentiality, Pelletier J. concluded that he must be satisfied that the need for confidentiality was greater than the public interest in open court proceedings, and observed that the argument for open proceedings in this case was significant given the public interest in Canada's role as a vendor of nuclear technology. As well, he noted that a confidentiality order was an exception to the rule of open access to the courts, and that such an order should be granted only where absolutely necessary.

14 Pelletier J. applied the same test as that used in patent litigation for the issue of a protective order, which is essentially a confidentiality order. The granting of such an order requires the appellant to show a subjective belief that the information is confidential and that its interests would be harmed by disclosure. In addition, if the order is challenged, then the person claiming the benefit of the order must demonstrate objectively that the order is required. This objective element requires the party to show that the information has been treated as confidential, and that it is reasonable to believe that its proprietary, commercial and scientific interests could be harmed by the disclosure of the information.

15 Concluding that both the subjective part and both elements of the objective part of the test had been satisfied, he nevertheless stated: "However, I am also of the view that in public law cases, the objective test has, or should have, a third component which is whether the public interest in disclosure exceeds the risk of harm to a party arising from disclosure" (para. 23).

16 A very significant factor, in his view, was the fact that mandatory production of documents was not in issue here. The fact that the application involved a voluntary tendering of documents to advance the appellant's own cause as opposed to mandatory production weighed against granting the confidentiality order.

17 In weighing the public interest in disclosure against the risk of harm to AECL arising from disclosure, Pelletier J. noted that the documents the appellant wished to put before the court were prepared by others for other purposes, and recognized that the appellant was bound to protect the confidentiality of the information. At this stage, he again considered the issue of materiality. If the documents were shown to be very material to a critical issue, "the requirements of justice militate in favour of a confidentiality order. If the documents are marginally relevant, then the voluntary nature of the production argues against a confidentiality order" (para. 29). He then decided that the documents were material to a question of the appropriate remedy, a significant issue in the event that the appellant failed on the main issue.

18 Pelletier J. also considered the context of the case and held that since the issue of Canada's role as a vendor of nuclear technology was one of significant public interest, the burden of justifying a confidentiality order was very onerous. He found that AECL could expunge the sensitive material from the documents, or put the evidence before the court in some other form, and thus maintain its full right of defence while preserving the open access to court proceedings.

19 Pelletier J. observed that his order was being made without having perused the Confidential Documents because they had not been put before him. Although he noted the line of cases which holds that a judge ought not to deal with the issue of a confidentiality order without reviewing the documents themselves, in his view, given their voluminous nature and technical content as well as his lack of information as to what information was already in the public domain, he found that an examination of these documents would not have been useful.

20 Pelletier J. ordered that the appellant could file the documents in current form, or in an edited version if it chose to do so. He also granted leave to file material dealing with the Chinese regulatory process in general and as applied to this project, provided it did so within 60 days.

B. Federal Court of Appeal, [2000] 4 F.C. 426

I. Evans J.A. Sharlow J.A. concurring

21 At the Federal Court of Appeal, AECL appealed the ruling under R. 151 of the *Federal Court Rules, 1998*, and Sierra Club cross-appealed the ruling under R. 312.

22 With respect to R. 312, Evans J.A. held that the documents were clearly relevant to a defence under s. 54(2)(b), which the appellant proposed to raise if s. 5(1)(b) of the CEAA was held to apply, and were also potentially relevant to the exercise of the court's discretion to refuse a remedy even if the Ministers were in breach of the CEAA. Evans J.A. agreed with Pelletier J. that the benefit to the appellant and the court of being granted leave to file the documents outweighed any prejudice to the respondent owing to delay and thus concluded that the motions judge was correct in granting leave under R. 312.

23 On the issue of the confidentiality order, Evans J.A. considered R. 151, and all the factors that the motions judge had weighed, including the commercial sensitivity of the documents, the fact that the appellant had received them in confidence from the Chinese authorities, and the appellant's argument that without the documents it could not mount a full answer and defence to the application. These factors had to be weighed against the principle of open access to court documents. Evans J.A. agreed with Pelletier J. that the weight to be attached to the public interest in open proceedings varied with context and held that, where a case raises issues of public significance, the principle of openness of judicial process carries greater weight as a factor in the balancing process. Evans J.A. noted the public interest in the subject matter of the litigation, as well as the considerable media attention it had attracted.

24 In support of his conclusion that the weight assigned to the principle of openness may vary with context, Evans J.A. relied upon the decisions in *AB Hassle v. Canada (Minister of National Health & Welfare)*, [2000] 3 F.C. 360 (Fed. C.A.), where the court took into consideration the relatively small public interest at stake, and *Ethyl Canada Inc. v. Canada (Attorney General)* (1998), 17 C.P.C. (4th) 278 (Ont. Gen. Div.), at p. 283, where the court ordered disclosure after determining that the case was a significant constitutional case where it was important for the public to understand the issues at stake. Evans J.A. observed that openness and public participation in the assessment process are fundamental to the CEAA, and concluded that the motions judge could not be said to have given the principle of openness undue weight even though confidentiality was claimed for a relatively small number of highly technical documents.

25 Evans J.A. held that the motions judge had placed undue emphasis on the fact that the introduction of the documents was voluntary; however, it did not follow that his decision on the confidentiality order must therefore be set aside. Evans J.A. was of the view that this error did not affect the ultimate conclusion for three reasons. First, like the motions judge, he attached great weight to the principle of openness. Secondly, he held that the inclusion in the affidavits of a summary of the reports could go a long way to compensate for the absence of the originals, should the appellant choose not to put them in without a confidentiality order. Finally, if AECL submitted the documents in an expunged fashion, the claim for confidentiality would rest upon a relatively unimportant factor, i.e., the appellant's claim that it would suffer a loss of business if it breached its undertaking with the Chinese authorities.

26 Evans J.A. rejected the argument that the motions judge had erred in deciding the motion without reference to the actual documents, stating that it was not necessary for him to inspect them, given that summaries were available and that the documents were highly technical and incompletely translated. Thus, the appeal and cross-appeal were both dismissed.

2 Robertson J.A. dissenting

27 Robertson J.A. disagreed with the majority for three reasons. First, in his view, the level of public interest in the case, the degree of media coverage, and the identities of the parties should not be taken into consideration in assessing an application for a confidentiality order. Instead, he held that it was the nature of the evidence for which the order is sought that must be examined.

28 In addition, he found that without a confidentiality order, the appellant had to choose between two unacceptable options: either suffering irreparable financial harm if the confidential information was introduced into evidence or being denied the right to a fair trial because it could not mount a full defence if the evidence was not introduced.

29 Finally, he stated that the analytical framework employed by the majority in reaching its decision was fundamentally flawed as it was based largely on the subjective views of the motions judge. He rejected the contextual approach to the question of whether a confidentiality order should issue, emphasizing the need for an objective framework to combat the perception that justice is a relative concept, and to promote consistency and certainty in the law.

30 To establish this more objective framework for regulating the issuance of confidentiality orders pertaining to commercial and scientific information, he turned to the legal rationale underlying the commitment to the principle of open justice, referring to *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326 (S.C.C.). There, the Supreme Court of Canada held that open proceedings foster the search for the truth, and reflect the importance of public scrutiny of the courts.

31 Robertson J.A. stated that, although the principle of open justice is a reflection of the basic democratic value of accountability in the exercise of judicial power, in his view, the principle that justice itself must be secured is paramount. He concluded that justice as an overarching principle means that exceptions occasionally must be made to rules or principles.

32 He observed that, in the area of commercial law, when the information sought to be protected concerns "trade secrets," this information will not be disclosed during a trial if to do so would destroy the owner's proprietary rights and expose him or her to irreparable harm in the form of financial loss. Although the case before him did not involve a trade secret, he nevertheless held that the same treatment could be extended to commercial or scientific information which was acquired on a confidential basis and attached the following criteria as conditions precedent to the issuance of a confidentiality order (at para. 13):

(1) the information is of a confidential nature as opposed to facts which one would like to keep confidential; (2) the information for which confidentiality is sought is not already in the public domain; (3) on a balance of probabilities the party seeking the confidentiality order would suffer irreparable harm if the information were made public; (4) the information is relevant to the legal issues raised in the case; (5) correlatively, the information is "necessary" to the resolution of those issues; (6) the granting of a confidentiality order does not unduly prejudice the opposing party; and (7) the public interest in open court proceedings does not override the private interests of the party seeking the confidentiality order. The onus in establishing that criteria one to six are met is on the party seeking the confidentiality order. Under the seventh criterion, it is for the opposing party to show that a *prima facie* right to a protective order has been overtaken by the need to preserve the openness of the court proceedings. In addressing these criteria one must bear in mind two of the threads woven into the fabric of the principle of open justice: the search for truth and the preservation of the rule of law. As stated at the outset, I do not believe that the perceived degree of public importance of a case is a relevant consideration.

33 In applying these criteria to the circumstances of the case, Robertson J.A. concluded that the confidentiality order should be granted. In his view, the public interest in open court proceedings did not override the interests of AECL in maintaining the confidentiality of these highly technical documents.

34 Robertson J.A. also considered the public interest in the need to ensure that site-plans for nuclear installations were not, for example, posted on a web-site. He concluded that a confidentiality order would not undermine the two primary objectives underlying the principle of open justice: truth and the rule of law. As such, he would have allowed the appeal and dismissed the cross-appeal.

V. Issues

35

A What is the proper analytical approach to be applied to the exercise of judicial discretion where a litigant seeks a confidentiality order under R. 151 of the *Federal Court Rules*, 1998?

B. Should the confidentiality order be granted in this case?

VI. Analysis

A. The Analytical Approach to the Granting of a Confidentiality Order

(1) The General Framework: Herein the *Dagenais* Principles

36 The link between openness in judicial proceedings and freedom of expression has been firmly established by this Court. In *Canadian Broadcasting Corp. v. New Brunswick Attorney General*, [1996] 3 S.C.R. 480 (S.C.C.) [hereinafter *New Brunswick*], at para. 23, La Forest J. expressed the relationship as follows:

The principle of open courts is inextricably tied to the rights guaranteed by s. 2(b). Openness permits public access to information about the courts, which in turn permits the public to discuss and put forward opinions and criticisms of court practices and proceedings. While the freedom to express ideas and opinions about the operation of the courts is clearly within the ambit of the freedom guaranteed by s. 2(b), so too is the right of members of the public to obtain information about the courts in the first place.

Under the order sought, public access and public scrutiny of the Confidential Documents would be restricted; this would clearly infringe the public's freedom of expression guarantee.

37 A discussion of the general approach to be taken in the exercise of judicial discretion to grant a confidentiality order should begin with the principles set out by this Court in *Dagenais v. Canadian Broadcasting Corp.*, [1994] 3 S.C.R. 835 (S.C.C.). Although that case dealt with the common law jurisdiction of the court to order a publication ban in the criminal law context, there are strong similarities between publication bans and confidentiality orders in the context of judicial proceedings. In both cases a restriction on freedom of expression is sought in order to preserve or promote an interest engaged by those proceedings. As such, the fundamental question for a court to consider in an application for a publication ban or a confidentiality order is whether, in the circumstances, the right to freedom of expression should be compromised.

38 Although in each case freedom of expression will be engaged in a different context, the *Dagenais* framework utilizes overarching *Canadian Charter of Rights and Freedoms* principles in order to balance freedom of expression with other rights and interests, and thus can be adapted and applied to various circumstances. As a result, the analytical approach to the exercise of discretion under R. 151 should echo the underlying principles laid out in *Dagenais*, *supra*, although it must be tailored to the specific rights and interests engaged in this case.

39 *Dagenais*, *supra*, dealt with an application by four accused persons under the court's common law jurisdiction requesting an order prohibiting the broadcast of a television programme dealing with the physical and sexual abuse of young boys at religious institutions. The applicants argued that because the factual circumstances of the programme were very similar to the facts at issue in their trials, the ban was necessary to preserve the accused's right to a fair trial.

40 Lamer C.J. found that the common law discretion to order a publication ban must be exercised within the boundaries set by the principles of the *Charter*. Since publication bans necessarily curtail the freedom of expression of third parties, he adapted the pre-*Charter* common law rule such that it balanced the right to freedom of expression with the right to a fair trial of the accused in a way which reflected the substance of the test from *R. v. Oakes*, [1986] 1 S.C.R. 103 (S.C.C.). At p. 878 of *Dagenais*, Lamer C.J. set out his reformulated test.

A publication ban should only be ordered when:

(a) Such a ban is *necessary* in order to prevent a real and substantial risk to the fairness of the trial, because reasonably available alternative measures will not prevent the risk, and

(b) The salutary effects of the publication ban outweigh the deleterious effects to the free expression of those affected by the ban. [Emphasis in original.]

41 In *New Brunswick*, *supra*, this Court modified the *Dagenais* test in the context of the related issue of how the discretionary power under s. 486(1) of the *Criminal Code* to exclude the public from a trial should be exercised. That case dealt with an appeal from the trial judge's order excluding the public from the portion of a sentencing proceeding for sexual assault and sexual interference dealing with the specific acts committed by the accused on the basis that it would avoid "undue hardship" to both the victims and the accused.

42 La Forest J. found that s. 486(1) was a restriction on the s. 2(b) right to freedom of expression in that it provided a "discretionary bar on public and media access to the courts": *New Brunswick*, *supra*, at para. 33; however, he found this infringement to be justified under s. 1 provided that the discretion was exercised in accordance with the *Charter*. Thus, the approach taken by La Forest J. at para. 69 to the exercise of discretion under s. 486(1) of the *Criminal Code*, closely mirrors the *Dagenais* common law test:

(a) the judge must consider the available options and consider whether there are any other reasonable and effective alternatives available;

(b) the judge must consider whether the order is limited as much as possible; and

(c) the judge must weigh the importance of the objectives of the particular order and its probable effects against the importance of openness and the particular expression that will be limited in order to ensure that the positive and negative effects of the order are proportionate.

In applying this test to the facts of the case, La Forest J. found that the evidence of the potential undue hardship consisted mainly in the Crown's submission that the evidence was of a "delicate nature" and that this was insufficient to override the infringement on freedom of expression.

43 This Court has recently revisited the granting of a publication ban under the court's common law jurisdiction in *R. v. Mentuck*, 2001 SCC 76 (S.C.C.), and its companion case *R. v. E. (O.N.)*, 2001 SCC 77 (S.C.C.). In *Mentuck*, the Crown moved for a publication ban to protect the identity of undercover police officers and operational methods employed by the officers in their investigation of the accused. The accused opposed the motion as an infringement of his right to a fair and public hearing under s. 11(d) of the *Charter*. The order was also opposed by two intervening newspapers as an infringement of their right to freedom of expression.

44 The Court noted that, while *Dagenais* dealt with the balancing of freedom of expression on the one hand, and the right to a fair trial of the accused on the other, in the case before it, both the right of the accused to a fair and public hearing, and freedom of expression weighed in favour of denying the publication ban. These rights were balanced against interests relating to the proper administration of justice, in particular, protecting the safety of police officers and preserving the efficacy of undercover police operations.

45 In spite of this distinction, the Court noted that underlying the approach taken in both *Dagenais* and *New Brunswick* was the goal of ensuring that the judicial discretion to order publication bans is subject to no lower a standard of compliance with the *Charter* than legislative enactment. This goal is furthered by incorporating the essence of s. 1 of the *Charter* and the *Oakes* test into the publication ban test. Since this same goal applied in the case before it, the Court adopted a similar approach to that taken in *Dagenais*, but broadened the *Dagenais* test (which dealt specifically with the right of an accused to a fair trial) such that it could guide the exercise of judicial discretion where a publication ban is requested in order to preserve any important aspect of the proper administration of justice. At para. 32, the Court reformulated the test as follows:

A publication ban should only be ordered when:

(a) such an order is necessary in order to prevent a serious risk to the proper administration of justice because reasonably alternative measures will not prevent the risk; and

(b) the salutary effects of the publication ban outweigh the deleterious effects on the rights and interests of the parties and the public, including the effects on the right to free expression, the right of the accused to a fair and public trial, and the efficacy of the administration of justice

46 The Court emphasized that under the first branch of the test, three important elements were subsumed under the "necessity" branch. First, the risk in question must be a serious risk well-grounded in the evidence. Second, the phrase "proper administration of justice" must be carefully interpreted so as not to allow the concealment of an excessive amount of information. Third, the test requires the judge ordering the ban to consider not only whether reasonable alternatives are available, but also to restrict the ban as far as possible without sacrificing the prevention of the risk.

47 At para. 31, the Court also made the important observation that the proper administration of justice will not necessarily involve *Charter* rights, and that the ability to invoke the *Charter* is not a necessary condition for a publication ban to be granted:

The [common law publication ban] rule can accommodate orders that must occasionally be made in the interests of the administration of justice, which encompass more than fair trial rights. As the test is intended to "reflect . . . the substance of the *Oakes* test", we cannot require that *Charter* rights be the only legitimate objective of such orders any more than we require that government action or legislation in violation of the *Charter* be justified exclusively by the pursuit of another *Charter* right. [Emphasis added.]

The Court also anticipated that, in appropriate circumstances, the *Dagenais* framework could be expanded even further in order to address requests for publication bans where interests other than the administration of justice were involved.

48 *Mentuck* is illustrative of the flexibility of the *Dagenais* approach. Since its basic purpose is to ensure that the judicial discretion to deny public access to the courts is exercised in accordance with *Charter* principles, in my view, the *Dagenais* model can and should be adapted to the situation in the case at bar where the central issue is whether judicial discretion should be exercised so as to exclude confidential information from a public proceeding. As in *Dagenais*, *New Brunswick* and *Mentuck*, granting the confidentiality order will have a negative effect on the *Charter* right to freedom of expression, as well as the principle of open and accessible court proceedings, and, as in those cases, courts must ensure that the discretion to grant the order is exercised in accordance with *Charter* principles. However, in order to adapt the test to the context of this case, it is first necessary to determine the particular rights and interests engaged by this application.

(2) The Rights and Interests of the Parties

49 The immediate purpose for AECL's confidentiality request relates to its commercial interests. The information in question is the property of the Chinese authorities. If the appellant were to disclose the Confidential Documents, it would be in breach of its contractual obligations and suffer a risk of harm to its competitive position. This is clear from the findings of fact of the motions judge that AECL was bound by its commercial interests and its customer's property rights not to disclose the information (para. 27), and that such disclosure could harm the appellant's commercial interests (para. 23).

50 Aside from this direct commercial interest, if the confidentiality order is denied, then in order to protect its commercial interests, the appellant will have to withhold the documents. This raises the important matter of the litigation context in which the order is sought. As both the motions judge and the Federal Court of Appeal found that the information contained in the Confidential Documents was relevant to defences available under the CEAA, the inability to present this information hinders the appellant's capacity to make full answer and defence or, expressed more generally, the appellant's right, as a civil litigant, to present its case. In that sense, preventing the appellant from disclosing these documents on a confidential basis infringes its right to a fair trial. Although in the context of a civil proceeding this does

not engage a *Charter* right, the right to a fair trial generally can be viewed as a fundamental principle of justice. *Meiorin v. Roy*, [1997] 1 S.C.R. 157 (S.C.C.), at para. 84, per L'Heureux-Dubé J. (dissenting, but not on that point). Although this fair trial right is directly relevant to the appellant, there is also a general public interest in protecting the right to a fair trial. Indeed, as a general proposition, all disputes in the courts should be decided under a fair trial standard. The legitimacy of the judicial process alone demands as much. Similarly, courts have an interest in having all relevant evidence before them in order to ensure that justice is done.

51 Thus, the interests which would be promoted by a confidentiality order are the preservation of commercial and contractual relations, as well as the right of civil litigants to a fair trial. Related to the latter are the public and judicial interests in seeking the truth and achieving a just result in civil proceedings.

52 In opposition to the confidentiality order lies the fundamental principle of open and accessible court proceedings. This principle is inextricably tied to freedom of expression enshrined in s. 2(b) of the *Charter*; *New Brunswick*, *supra*, at para. 23. The importance of public and media access to the courts cannot be understated, as this access is the method by which the judicial process is scrutinized and criticized. Because it is essential to the administration of justice that justice is done and is *seen* to be done, such public scrutiny is fundamental. The open court principle has been described as "the very soul of justice," guaranteeing that justice is administered in a non-arbitrary manner; *New Brunswick*, *supra*, at para. 22.

(3) Adapting the *Dagenais* Test to the Rights and Interests of the Parties

53 Applying the rights and interests engaged in this case to the analytical framework of *Dagenais* and subsequent cases discussed above, the test for whether a confidentiality order ought to be granted in a case such as this one should be framed as follows:

A confidentiality order under R. 151 should only be granted when:

- (a) such an order is necessary in order to prevent a serious risk to an important interest, including a commercial interest, in the context of litigation because reasonably alternative measures will not prevent the risk; and
- (b) the salutary effects of the confidentiality order, including the effects on the right of civil litigants to a fair trial, outweigh its deleterious effects, including the effects on the right to free expression, which in this context includes the public interest in open and accessible court proceedings.

54 As in *Mentuck*, *supra*, I would add that three important elements are subsumed under the first branch of this test. First, the risk in question must be real and substantial, in that the risk is well-grounded in the evidence and poses a serious threat to the commercial interest in question.

55 In addition, the phrase "important commercial interest" is in need of some clarification. In order to qualify as an "important commercial interest," the interest in question cannot merely be specific to the party requesting the order; the interest must be one which can be expressed in terms of a public interest in confidentiality. For example, a private company could not argue simply that the existence of a particular contract should not be made public because to do so would cause the company to lose business, thus harming its commercial interests. However, if, as in this case, exposure of information would cause a breach of a confidentiality agreement, then the commercial interest affected can be characterized more broadly as the general commercial interest of preserving confidential information. Simply put, if there is no general principle at stake, there can be no "important commercial interest" for the purposes of this test. Or, in the words of Binnie J. in *Re A - F*, [2000] 1 S.C.R. 880, 2000 SCC 35 (S.C.C.), at para. 10, the open court rule only yields "where the public interest in confidentiality outweighs the public interest in openness" (emphasis added).

56 In addition to the above requirement, courts must be cautious in determining what constitutes an "important commercial interest." It must be remembered that a confidentiality order involves an infringement on freedom of expression. Although the balancing of the commercial interest with freedom of expression takes place under the second

branch of the test, courts must be alive to the fundamental importance of the open court rule. See generally Muldoon J. in *Eli Lilly & Co. v. Novopharm Ltd.* (1994), 56 C.P.R. (3d) 437 (Fed. T.D.), at p. 439.

57 Finally, the phrase "reasonably alternative measures" requires the judge to consider not only whether reasonable alternatives to a confidentiality order are available, but also to restrict the order as much as is reasonably possible while preserving the commercial interest in question.

B. Application of the Test to this Appeal

(1) Necessity

58 At this stage, it must be determined whether disclosure of the Confidential Documents would impose a serious risk on an important commercial interest of the appellant, and whether there are reasonable alternatives, either to the order itself or to its terms.

59 The commercial interest at stake here relates to the objective of preserving contractual obligations of confidentiality. The appellant argues that it will suffer irreparable harm to its commercial interests if the confidential documents are disclosed. In my view, the preservation of confidential information constitutes a sufficiently important commercial interest to pass the first branch of the test as long as certain criteria relating to the information are met.

60 Pelletier J. noted that the order sought in this case was similar in nature to an application for a protective order which arises in the context of patent litigation. Such an order requires the applicant to demonstrate that the information in question has been treated at all relevant times as confidential and that on a balance of probabilities its proprietary, commercial and scientific interests could reasonably be harmed by the disclosure of the information: *AB Hassle v. Canada (Minister of National Health & Welfare)* (1998), 83 C.P.R. (3d) 428 (Fed. T.D.), at p. 434. To this I would add the requirement proposed by Robertson J.A. that the information in question must be of a "confidential nature" in that it has been "accumulated with a reasonable expectation of it being kept confidential" (para. 14) as opposed to "facts which a litigant would like to keep confidential by having the courtroom doors closed" (para. 14).

61 Pelletier J. found as a fact that the *AB Hassle* test had been satisfied in that the information had clearly been treated as confidential both by the appellant and by the Chinese authorities, and that, on a balance of probabilities, disclosure of the information could harm the appellant's commercial interests (para. 23). As well, Robertson J.A. found that the information in question was clearly of a confidential nature as it was commercial information, consistently treated and regarded as confidential, that would be of interest to AECL's competitors (para. 16). Thus, the order is sought to prevent a serious risk to an important commercial interest.

62 The first branch of the test also requires the consideration of alternative measures to the confidentiality order, as well as an examination of the scope of the order to ensure that it is not overly broad. Both courts below found that the information contained in the Confidential Documents was relevant to potential defences available to the appellant under the CEAA and this finding was not appealed at this Court. Further, I agree with the Court of Appeal's assertion (para. 99) that, given the importance of the documents to the right to make full answer and defence, the appellant is, practically speaking, compelled to produce the documents. Given that the information is necessary to the appellant's case, it remains only to determine whether there are reasonably alternative means by which the necessary information can be adduced without disclosing the confidential information.

63 Two alternatives to the confidentiality order were put forward by the courts below. The motions judge suggested that the Confidential Documents could be expunged of their commercially sensitive contents, and edited versions of the documents could be filed. As well, the majority of the Court of Appeal, in addition to accepting the possibility of expungement, was of the opinion that the summaries of the Confidential Documents included in the affidavits could go a long way to compensate for the absence of the originals. If either of these options is a reasonable alternative to submitting the Confidential Documents under a confidentiality order, then the order is not necessary, and the application does not pass the first branch of the test.

64 There are two possible options with respect to expungement, and, in my view, there are problems with both of these. The first option would be for AECL to expunge the confidential information without disclosing the expunged material to the parties and the court. However, in this situation the filed material would still differ from the material used by the affiants. It must not be forgotten that this motion arose as a result of Sierra Club's position that the summaries contained in the affidavits should be accorded little or no weight without the presence of the underlying documents. Even if the relevant information and the confidential information were mutually exclusive, which would allow for the disclosure of all the information relied on in the affidavits, this relevancy determination could not be tested on cross-examination because the expunged material would not be available. Thus, even in the best case scenario, where only irrelevant information needed to be expunged, the parties would be put in essentially the same position as that which initially generated this appeal in the sense that at least some of the material relied on to prepare the affidavits in question would not be available to Sierra Club.

65 Further, I agree with Robertson J.A. that this best case scenario, where the relevant and the confidential information do not overlap, is an untested assumption (para. 28). Although the documents themselves were not put before the courts on this motion, given that they comprise thousands of pages of detailed information, this assumption is at best optimistic. The expungement alternative would be further complicated by the fact that the Chinese authorities require prior approval for any request by AECL to disclose information.

66 The second option is that the expunged material be made available to the Court and the parties under a more narrowly drawn confidentiality order. Although this option would allow for slightly broader public access than the current confidentiality request, in my view, this minor restriction to the current confidentiality request is not a viable alternative given the difficulties associated with expungement in these circumstances. The test asks whether there are *reasonably* alternative measures; it does not require the adoption of the absolutely least restrictive option. With respect, in my view, expungement of the Confidential Documents would be a virtually unworkable and ineffective solution that is not reasonable in the circumstances.

67 A second alternative to a confidentiality order was Evans J.A.'s suggestion that the summaries of the Confidential Documents included in the affidavits "may well go a long way to compensate for the absence of the originals" (para. 103). However, he appeared to take this fact into account merely as a factor to be considered when balancing the various interests at stake. I would agree that at this threshold stage to rely on the summaries alone, in light of the intention of Sierra Club to argue that they should be accorded little or no weight, does not appear to be a "reasonably alternative measure" to having the underlying documents available to the parties.

68 With the above considerations in mind, I find the confidentiality order necessary in that disclosure of the Confidential Documents would impose a serious risk on an important commercial interest of the appellant, and that there are no reasonably alternative measures to granting the order.

(2) The Proportionality Stage

69 As stated above, at this stage, the salutary effects of the confidentiality order, including the effects on the appellant's right to a fair trial, must be weighed against the deleterious effects of the confidentiality order, including the effects on the right to free expression, which, in turn, is connected to the principle of open and accessible court proceedings. This balancing will ultimately determine whether the confidentiality order ought to be granted.

a. Salutary Effects of the Confidentiality Order

70 As discussed above, the primary interest that would be promoted by the confidentiality order is the public interest in the right of a civil litigant to present its case or, more generally, the fair trial right. Because the fair trial right is being invoked in this case in order to protect commercial, not liberty, interests of the appellant, the right to a fair trial in this context is not a *Charter* right; however, a fair trial for all litigants has been recognized as a fundamental principle of justice: *Ryan, supra*, at para. 84. It bears repeating that there are circumstances where, in the absence of an affected

Charter right, the proper administration of justice calls for a confidentiality order. *Mentuck*, *supra*, at para. 31. In this case, the salutary effects that such an order would have on the administration of justice relate to the ability of the appellant to present its case, as encompassed by the broader fair trial right.

71 The Confidential Documents have been found to be relevant to defences that will be available to the appellant in the event that the CFAA is found to apply to the impugned transaction and, as discussed above, the appellant cannot disclose the documents without putting its commercial interests at serious risk of harm. As such, there is a very real risk that, without the confidentiality order, the ability of the appellant to mount a successful defence will be seriously curtailed. I conclude, therefore, that the confidentiality order would have significant salutary effects on the appellant's right to a fair trial.

72 Aside from the salutary effects on the fair trial interest, the confidentiality order would also have a beneficial impact on other important rights and interests. First, as I discuss in more detail below, the confidentiality order would allow all parties and the court access to the Confidential Documents, and permit cross-examination based on their contents. By facilitating access to relevant documents in a judicial proceeding, the order sought would assist in the search for truth, a core value underlying freedom of expression.

73 Second, I agree with the observation of Robertson J.A. that, as the Confidential Documents contain detailed technical information pertaining to the construction and design of a nuclear installation, it may be in keeping with the public interest to prevent this information from entering the public domain (para. 44). Although the exact contents of the documents remain a mystery, it is apparent that they contain technical details of a nuclear installation, and there may well be a substantial public security interest in maintaining the confidentiality of such information.

(b) Deleterious Effects of the Confidentiality Order

74 Granting the confidentiality order would have a negative effect on the open court principle, as the public would be denied access to the contents of the Confidential Documents. As stated above, the principle of open courts is inextricably tied to the s. 2(b) *Charter* right to freedom of expression, and public scrutiny of the courts is a fundamental aspect of the administration of justice: *New Brunswick*, *supra*, at paras. 22-23. Although as a general principle, the importance of open courts cannot be overstated, it is necessary to examine, in the context of this case, the particular deleterious effects on freedom of expression that the confidentiality order would have.

75 Underlying freedom of expression are the core values of (1) seeking the truth and the common good, (2) promoting self-fulfilment of individuals by allowing them to develop thoughts and ideas as they see fit, and (3) ensuring that participation in the political process is open to all persons: *Irwin Toy Ltd. v. Québec (Procureur général)*, [1989] 1 S.C.R. 927 (S.C.C.), at p. 976; *R. v. Keegstra*, [1990] 3 S.C.R. 697 (S.C.C.), per Dickson C.J., at pp. 762-764. *Charter* jurisprudence has established that the closer the speech in question lies to these core values, the harder it will be to justify a s. 2(b) infringement of that speech under s. 1 of the *Charter*. *Keegstra*, *supra*, at pp. 760-761. Since the main goal in this case is to exercise judicial discretion in a way which conforms to *Charter* principles, a discussion of the deleterious effects of the confidentiality order on freedom of expression should include an assessment of the effects such an order would have on the three core values. The more detrimental the order would be to these values, the more difficult it will be to justify the confidentiality order. Similarly, minor effects of the order on the core values will make the confidentiality order easier to justify.

76 Seeking the truth is not only at the core of freedom of expression, but it has also been recognized as a fundamental purpose behind the open court rule, as the open examination of witnesses promotes an effective evidentiary process: *Edmonton Journal*, *supra*, per Wilson J., at pp. 1357-1358. Clearly, the confidentiality order, by denying public and media access to documents relied on in the proceedings, would impede the search for truth to some extent. Although the order would not exclude the public from the courtroom, the public and the media would be denied access to documents relevant to the evidentiary process.

-- However, as mentioned above, to some extent the search for truth may actually be *promoted* by the confidentiality order. This motion arises as a result of Sierra Club's argument that it must have access to the Confidential Documents in order to test the accuracy of Dr. Pang's evidence. If the order is denied, then the most likely scenario is that the appellant will not submit the documents, with the unfortunate result that evidence which may be relevant to the proceedings will not be available to Sierra Club or the court. As a result, Sierra Club will not be able to fully test the accuracy of Dr. Pang's evidence on cross-examination. In addition, the court will not have the benefit of this cross-examination or documentary evidence, and will be required to draw conclusions based on an incomplete evidentiary record. This would clearly impede the search for truth in this case.

78 As well, it is important to remember that the confidentiality order would restrict access to a relatively small number of highly technical documents. The nature of these documents is such that the general public would be unlikely to understand their contents, and thus they would contribute little to the public interest in the search for truth in this case. However, in the hands of the parties and their respective experts, the documents may be of great assistance in probing the truth of the Chinese environmental assessment process, which would, in turn, assist the court in reaching accurate factual conclusions. Given the nature of the documents, in my view, the important value of the search for truth which underlies both freedom of expression and open justice would be promoted to a greater extent by submitting the Confidential Documents under the order sought than it would by denying the order, and thereby preventing the parties and the court from relying on the documents in the course of the litigation.

79 In addition, under the terms of the order sought, the only restrictions on these documents relate to their public distribution. The Confidential Documents would be available to the court and the parties, and public access to the proceedings would not be impeded. As such, the order represents a fairly minimal intrusion into the open court rule, and thus would not have significant deleterious effects on this principle.

80 The second core value underlying freedom of speech, namely, the promotion of individual self-fulfilment by allowing open development of thoughts and ideas, focuses on individual expression, and thus does not closely relate to the open court principle which involves institutional expression. Although the confidentiality order would restrict individual access to certain information which may be of interest to that individual, I find that this value would not be significantly affected by the confidentiality order.

81 The third core value, open participation in the political process, figures prominently in this appeal, as open justice is a fundamental aspect of a democratic society. This connection was pointed out by Cory J. in *Edmonton Journal*, *supra*, at p. 1339:

It can be seen that freedom of expression is of fundamental importance to a democratic society. It is also essential to a democracy and crucial to the rule of law that the courts are seen to function openly. The press must be free to comment upon court proceedings to ensure that the courts are, in fact, seen by all to operate openly in the penetrating light of public scrutiny.

Although there is no doubt as to the importance of open judicial proceedings to a democratic society, there was disagreement in the courts below as to whether the weight to be assigned to the open court principle should vary depending on the nature of the proceeding.

82 On this issue, Robertson J.A. was of the view that the nature of the case and the level of media interest were irrelevant considerations. On the other hand, Evans J.A. held that the motions judge was correct in taking into account that this judicial review application was one of significant public and media interest. In my view, although the public nature of the case may be a factor which strengthens the importance of open justice in a particular case, the level of media interest should not be taken into account as an independent consideration.

83 Since cases involving public institutions will generally relate more closely to the core value of public participation in the political process, the public nature of a proceeding should be taken into consideration when assessing the merits of

a confidentiality order. It is important to note that this core value will *always* be engaged where the open court principle is engaged owing to the importance of open justice to a democratic society. However, where the political process is also engaged by the *substance* of the proceedings, the connection between open proceedings and public participation in the political process will increase. As such, I agree with Evans J.A. in the court below, where he stated, at para. 87:

While all litigation is important to the parties, and there is a public interest in ensuring the fair and appropriate adjudication of all litigation that comes before the courts, some cases raise issues that transcend the immediate interests of the parties and the general public interest in the due administration of justice, and have a much wider public interest significance.

84 This motion relates to an application for judicial review of a decision by the government to fund a nuclear energy project. Such an application is clearly of a public nature, as it relates to the distribution of public funds in relation to an issue of demonstrated public interest. Moreover, as pointed out by Evans J.A., openness and public participation are of fundamental importance under the CEAA. Indeed, by their very nature, environmental matters carry significant public import, and openness in judicial proceedings involving environmental issues will generally attract a high degree of protection. In this regard, I agree with Evans J.A. that the public interest is engaged here more than it would be if this were an action between private parties relating to purely private interests.

85 However, with respect, to the extent that Evans J.A. relied on media interest as an indicium of public interest, this was an error. In my view, it is important to distinguish *public* interest from *media* interest, and I agree with Robertson J.A. that media exposure cannot be viewed as an impartial measure of public interest. It is the *public nature* of the proceedings which increases the need for openness, and this public nature is not necessarily reflected by the media desire to probe the facts of the case. I reiterate the caution given by Dickson C.J. in *Keegstra, supra*, at p. 760, where he stated that, while the speech in question must be examined in light of its relation to the core values, "we must guard carefully against judging expression according to its popularity."

86 Although the public interest in open access to the judicial review application *as a whole* is substantial, in my view, it is also important to bear in mind the nature and scope of the information for which the order is sought in assigning weight to the public interest. With respect, the motions judge erred in failing to consider the narrow scope of the order when he considered the public interest in disclosure, and consequently attached excessive weight to this factor. In this connection, I respectfully disagree with the following conclusion of Evans J.A., at para. 97:

Thus, having considered the nature of this litigation, and having assessed the extent of public interest in the openness of the proceedings in the case before him, the Motions Judge cannot be said in all the circumstances to have given this factor undue weight, even though confidentiality is claimed for only three documents among the small mountain of paper filed in this case, and their content is likely to be beyond the comprehension of all but those equipped with the necessary technical expertise

Open justice is a fundamentally important principle, particularly when the substance of the proceedings is public in nature. However, this does not detract from the duty to attach weight to this principle in accordance with the specific limitations on openness that the confidentiality order would have. As Wilson J. observed in *Edmonton Journal, supra*, at pp. 1353-1354:

One thing seems clear and that is that one should not balance one value at large and the conflicting value in its context. To do so could well be to pre-judge the issue by placing more weight on the value developed at large than is appropriate in the context of the case.

87 In my view, it is important that, although there is significant public interest in these proceedings, open access to the judicial review application would be only slightly impeded by the order sought. The narrow scope of the order coupled with the highly technical nature of the Confidential Documents significantly temper the deleterious effects the confidentiality order would have on the public interest in open courts.

88 In addressing the effects that the confidentiality order would have on freedom of expression, it should also be borne in mind that the appellant may not have to raise defences under the CEAA, in which case the Confidential Documents would be irrelevant to the proceedings, with the result that freedom of expression would be unaffected by the order. However, since the necessity of the Confidential Documents will not be determined for some time, in the absence of a confidentiality order, the appellant would be left with the choice of either submitting the documents in breach of its obligations or withholding the documents in the hopes that either it will not have to present a defence under the CEAA or that it will be able to mount a successful defence in the absence of these relevant documents. If it chooses the former option, and the defences under the CEAA are later found not to apply, then the appellant will have suffered the prejudice of having its confidential and sensitive information released into the public domain with no corresponding benefit to the public. Although this scenario is far from certain, the possibility of such an occurrence also weighs in favour of granting the order sought.

89 In coming to this conclusion, I note that if the appellant is not required to invoke the relevant defences under the CEAA, it is also true that the appellant's fair trial right will not be impeded, even if the confidentiality order is not granted. However, I do not take this into account as a factor which weighs in favour of denying the order because, if the order is granted and the Confidential Documents are not required, there will be no deleterious effects on *either* the public interest in freedom of expression *or* the appellant's commercial interests or fair trial right. This neutral result is in contrast with the scenario discussed above where the order is denied and the possibility arises that the appellant's commercial interests will be prejudiced with no corresponding public benefit. As a result, the fact that the Confidential Documents may not be required is a factor which weighs in favour of granting the confidentiality order.

90 In summary, the core freedom of expression values of seeking the truth and promoting an open political process are most closely linked to the principle of open courts, and most affected by an order restricting that openness. However, in the context of this case, the confidentiality order would only marginally impede, and in some respects would even promote, the pursuit of these values. As such, the order would not have significant deleterious effects on freedom of expression.

VII. Conclusion

91 In balancing the various rights and interests engaged, I note that the confidentiality order would have substantial salutary effects on the appellant's right to a fair trial, and freedom of expression. On the other hand, the deleterious effects of the confidentiality order on the principle of open courts and freedom of expression would be minimal. In addition, if the order is not granted and in the course of the judicial review application the appellant is not required to mount a defence under the CEAA, there is a possibility that the appellant will have suffered the harm of having disclosed confidential information in breach of its obligations with no corresponding benefit to the right of the public to freedom of expression. As a result, I find that the salutary effects of the order outweigh its deleterious effects, and the order should be granted.

92 Consequently, I would allow the appeal with costs throughout, set aside the judgment of the Federal Court of Appeal, and grant the confidentiality order on the terms requested by the appellant under R. 151 of the *Federal Court Rules, 1998*.

Appeal allowed

Promoted as a result

2009 CarswellOnt 7952
Ontario Superior Court of Justice [Commercial List]

Look Communications Inc. v. Inukshuk Wireless Partnership

2009 CarswellOnt 7952, [2009] O.J. No. 5440, 183 A.C.W.S. (3d) 736

**IN THE MATTER OF LOOK COMMUNICATIONS INC. (Applicant) and LOOK
MOBILE CORPORATION AND LOOK COMMUNICATIONS L.P. (Respondent)**

AND IN THE MATTER OF AN APPLICATION BY LOOK COMMUNICATIONS INC. UNDER
SECTION 192 OF THE BUSINESS CORPORATIONS ACT, R.S.C. 1985, c. C.44, AS AMENDED

Newbould J.

Heard: December 17, 2009
Judgment: December 18, 2009
Docket: 08-CL-7877

Counsel: John T. Porter for Look Communications Inc.
Aubrey E. Kauffman for Inukshuk Wireless Partnership

Subject: Corporate and Commercial, Civil Practice and Procedure

Headnote

Business associations --- Changes to corporate status --- Arrangements and compromises --- Under general corporate legislation

Corporation made plan of arrangement under Canada Business Corporations Act --- Court approved sale of most of corporation's assets to joint venture --- Monitor's first report was ordered sealed until sale was completed --- Completion occurred much earlier than expected --- Corporation meanwhile was attempting to sell remaining assets and wished to keep earlier bids confidential --- Joint venture wanted information to gain advantage in bidding for remaining assets --- Corporation brought motion to extend sealing order for six months --- Motion granted --- Court had jurisdiction under s. 137 of Courts of Justice Act to extend order notwithstanding that plan of arrangement was finalized --- Corporation had commercial interest in selling its remaining assets --- Extending order would not have substantial detrimental effect on core values of freedom of expression.

MOTION by corporation for order extending sealing order made in court approved sale of assets

Newbould J.:

1 Look Communications Inc. (Look) moves for an order extending a sealing order under which bids made in a court approved sales process were sealed. The order is opposed by Inukshuk Wireless Partnership which is a joint venture between Rogers Communications Inc. and Bell Canada.

Circumstances of Sealing Order

2 On December 1, 2008, Look was authorized by Pepall J. to conduct a special shareholder's meeting to pass resolutions (i) authorizing Look to establish a sales process for the sale of all or substantially all of its assets and to seek an order approving the sales process, and (ii) authorizing a plan of arrangement under section 192 of the CBCA which contemplated the sale of all or substantially all of Look's assets. The shareholders voted in favour of both a sales process and the arrangement.

3 On January 21, 2009, Look obtained an order approving the sales process and Grant Thornton Limited was appointed as Monitor to manage and conduct the sales process with Look. The sales process provided for bids from interested persons for five assets of Look, which were substantially all of its assets, being (i) Spectrum, being approximately 100MHz of License Spectrum in Ontario and Quebec, (ii) a CRTC Broadcast License, (iii) Subscribers, (iv) a Network consisting of two network operating centers and (v) approximately \$300 million in "tax attributes" or losses. Court approval was required for any sale.

4 Under the sales process, a bidder was entitled to bid for any or all of the assets that were being sold, or a combination thereof. Pursuant to the sales process, four bids were received and Look and the Monitor engaged in discussions with each bidder. Look eventually accepted an offer from Inukshuk for the Spectrum and Broadcast License. It is agreed that while not all of the assets of Look were sold, what was sold to Inukshuk were substantially all of the assets of Look.

5 The parties obtained a consent order on May 14, 2009 from Marrocco J. in which the sale of the Spectrum and Broadcast License to Inukshuk was approved. The order provided that the assets would vest in Inukshuk upon the Monitor filing a certificate with the court certifying as to the completion of the transaction. The sale contemplated a staged closing, with the first taking place immediately following the order of Marrocco J., the second being December 31, 2009 and the final taking place as late as what the sale agreement defined as the Outside Date, being the third anniversary of the date of the final order approving the transaction, i.e., May 14, 2012. I am told that the reason for the staged dates was that it was anticipated that the necessary regulatory approvals for the sale of the Spectrum and License could take some time.

6 As it turned out, the final closing took place much earlier than the Outside Date within a few months of the order of Marrocco J. On September 11, 2009, the Monitor filed its certificate with the Court certifying that the purchase price had been paid in full and that the conditions of closing had been satisfied. Thus the sold assets vested in Inukshuk. Under the terms of the plan of arrangement that was approved by the order of Marrocco J., once the certificate of the Monitor as to the completion of the transaction was delivered, the articles of arrangement became effective.

7 In connection with the application to Marrocco J. to approve the arrangement and the sale to Inukshuk, the Monitor filed a redacted version of its First Report, as is usual in the Commercial List for sales carried out under a court process, redacting the information about the bids received in the sales process. The order of Marrocco J. provided that an unredacted version of the First Report was to be sealed and not form part of the public record until the Monitor's Certificate after the sale was completed was filed with the Court. That certificate, as I have said, was filed with the Court on September 11, 2009. Therefore under the order of Marrocco J. the unredacted First Report of the Monitor was no longer to be sealed.

8 Look is now attempting to sell its remaining assets, which include a corporation which had been approved by the CRTC to hold a license and has \$350 million of tax losses. Look is presently in discussions for the sale of its remaining assets with some of the same parties with whom discussions were held and bids were received under the previous sales process, including Rogers.

9 In early November 2009 Inukshuk asked the Monitor for the information contained in the Monitor's First Report that was sealed under the order of Marrocco J. Look immediately obtained an *ex parte* order from Campbell J. on November 4, 2009 extending the sealing of the Monitor's First Report pending a determination of this motion.

Analysis

10 Look seeks to extend the sealing order for six months while it completes the sale of its remaining assets. It has a concern that publication of the information could impede the sale process now underway and affect the amount received. Look is concerned that if the bids were disclosed, and with Rogers being one of the parties in discussions with Look for the purchase of Look's tax losses, other players in the telecommunications industry would not bid for the remaining assets.

11 Inukshuk has filed no affidavit material as to why it is interested in the sealed information in the Monitor's First Report dealing with all of the bids that were received for all assets. Inukshuk's position in a nutshell is that the sales process previously approved by the Court is over and that the public interest in seeing an open court process should prevent any further sealing of the Monitor's First Report. Mr. Kauffman said that his clients are here in this motion "in their own interest as two members of the public" seeking access to the documents that were filed in the court process.

12 It is understandable why Rogers would want the information. It has been negotiating with Look for the purchase of one or more of Look's remaining assets. Having access to prior bids in the prior sales process in which one or more of those remaining assets may have been the subject of a bid would obviously be of benefit to Rogers in considering what price it is prepared to offer for the company with the tax loss benefits. While Mr. Kauffman pointed out that it is Inukshuk Wireless Partnership that is opposing the order sought, and that includes Bell as well as Rogers, the fact remains that the partnership does include Rogers which is in negotiations with Look. In any event, it is unrealistic to think that Bell, through its interest in Inukshuk, is funding at least in part the opposition to the extension of the sealing order out of altruistic or public purposes.

13 Section 137 of the *Courts of Justice Act* provides that a court may order any document filed in a civil proceeding to be treated as confidential, sealed and not form part of the public record. The fact that the plan of arrangement consummated under the court proceedings under s. 192 of the CBCA has now been finalized does not in itself mean that the court does not have jurisdiction to continue with the sealing order if it is otherwise appropriate to do so. There is no limitation in section 137 limiting a sealing order to the time during which the litigation in question is ongoing.

14 In *MacIntyre v. Nova Scotia (Attorney General)*, [1982] 1 S.C.R. 175 (S.C.C.), it was held that sworn information to obtain a search warrant could not be made available to the public until the search warrant had been executed. In that case, Dixon J. (as he then was) for the majority noted that the case law did not distinguish between judicial proceedings which are part of a trial and those which are not, and that subject to a few well-recognized exceptions, all judicial proceedings should be in public. He held that the presumption was in favour of public access and the burden of contrary proof lay upon the person contending otherwise.

15 In *Sierra Club of Canada v. Canada (Minister of Finance)*, [2002] 2 S.C.R. 522 (S.C.C.), the court authorized a confidentiality order. It stated that an order should be granted in only two circumstances, being (i) when an order is needed to prevent serious risk to an important interest, including a commercial interest, in the context of litigation because reasonable alternative measures will not prevent the risk, and (ii) when the salutary effects of the confidentiality order, including the effects on the right civil litigants to a fair trial, outweighs its deleterious effects, including the effects on the right of free expression, which includes public interest in open and accessible court proceedings. In dealing with the notion of an important commercial interest, Iacobucci J. stated:

In addition, the phrase "important commercial interest" is in need of some clarification. In order to qualify as an "important commercial interest", the interest in question cannot merely be specific to the party requesting the order; the interest must be one which can be expressed in terms of a public interest in confidentiality. For example, a private company could not argue simply that the existence of a particular contract should not be made public because to do so would cause the company to lose business, thus harming its commercial interests. However, if, as in this case, exposure of information would cause a breach of a confidentiality agreement, then the commercial interest affected can be characterized more broadly as the general commercial interest of preserving confidential information. Simply put, if there is no general principle at stake, there can be no "important commercial interest" for the purposes of this test. Or, in the words of Binnie J. in *Re N. (F.)* [2000] 1 S.C.R. 880, 2000 SCC 35, at para. 10, the open court rule only yields "where the public interest in confidentiality outweighs the public interest in openness".

16 Look points out that it is not a private company. It is a public company with stakeholders, being public shareholders. It is not the kind of private corporation that Iacobucci J. was discussing in *Sierra*.

17 It is common when assets are being sold pursuant to a court process to seal the Monitor's report disclosing all of the various bids in case a further bidding process is required if the transaction being approved falls through. Invariably, no one comes back asking that the sealing order be set aside. That is because ordinarily all of the assets that were bid on during the court sale process end up being sold and approved by court order, and so long as the sale transaction or transactions closed, no one has any further interest in the information. In *88-7574 Ontario Inc. v. Pizza Pizza Ltd.* (1994), 23 B.I.R. (2d) 239 (Ont. Gen. Div. [Commercial List]), Farley J. discussed the fact that valuations submitted by a Receiver for the purpose of obtaining court approval are normally sealed. He pointed out that the purpose of that was to maintain fair play so that competitors or potential bidders do not obtain an unfair advantage by obtaining such information while others have to rely on their own resources. In that context, he stated that he thought the most appropriate sealing order in a court approval sale situation would be that the supporting valuation materials remain sealed until such time as the sale transaction had closed.

18 This case is a little different from the ordinary. Some of the assets that were bid on during the sales process were not sold. However, because the assets that were sold constituted substantially all of the assets of Look, the arrangement under section 192 of the CBCA was completed. Those assets that were not sold remained, however, to be sold and it is in the context of that process that Rogers has been discussing purchasing one or more of these assets from Look.

19 In this case, had the closing of the sale of the Spectrum and the License been drawn out to the maximum three year period provided for in the sale agreement, these remaining assets in all likelihood would have been sold before the maximum period ran out and during a period of time in which the Receiver's First Report remaining sealed. In those circumstances the effect of the sealing order would have been to protect the later sale process, a process which originally involved a sale of all of the assets of Look. While the remaining sales will not take place under the original sale process that was conducted by Look and the Monitor, the commercial interest in seeing that the remaining assets are sold to the benefit of all stakeholders, including the public shareholders of Look, remains now as it did before.

20 The advantage to Rogers in seeing what other bidders may have bid on the assets that have remained unsold is obvious. Rogers is in negotiations with Look regarding the acquisition of one or more of those assets. If other bidders previously bid on one or more of those assets, that information would be beneficial to Rogers. If the other bidders did not bid on any of those remaining assets, that too would be of interest to Rogers. As well, Look's concern that the disclosure of the sealed information could impede other bidders from coming forward is not without some merit.

21 In *Sierra*, Iacobucci J. said there were core values that should be considered in a motion such as this. *Sierra* involved an application by the Government of Canada for a confidentiality order protecting documents from public disclosure in litigation between the *Sierra* and the Government. Iacobucci J. stated that under the order sought, public access to the documents in question would be restricted, which would infringe the public's freedom of expression guarantees contained in section 2(b) of the *Charter*. He discussed the core values of freedom of expression and how they should be considered in a motion seeking confidentiality of documents. He stated

Underlying freedom of expression are the core values of (1) seeking the truth and the common good; (2) promoting self-fulfilment of individuals by allowing them to develop thoughts and ideas as they see fit; and (3) ensuring that participation in the political process is open to all persons. *Irwin Toy Ltd. v. Quebec (Attorney General)*, [1989] 1 S.C.R. 927, [page 551] at p. 976. *R. v. Keegstra*, [1990] 3 S.C.R. 697, at pp. 762-64, per Dickson C.J. Charter jurisprudence has established that the closer the speech in question lies to these core values, the harder it will be to justify a s. 2(b) infringement of that speech under s. 1 of the *Charter*. *Keegstra*, at pp. 760-61. Since the main goal in this case is to exercise judicial discretion in a way which conforms to *Charter* principles, a discussion of the deleterious effects of the confidentiality order on freedom of expression should include an assessment of the effects such an order would have on the three core values. The more detrimental the order would be to these values, the more difficult it will be to justify the confidentiality order. Similarly, minor effects of the order on the core values will make the confidentiality order easier to justify. (underlining added)

22 Rogers, or Inukshuk, cannot, in my view, claim that there will be a substantial detrimental effect on these core values by a continuation of the sealing order for a further six months. What Rogers will lose will be access to information that it could use against the interests of Look and its stakeholders. In my view, the salutary effects of extending the sealing order for six months to permit the sale of the remaining assets of Look outweighs the deleterious effects of such order in this case.

23 Inukshuk asks that if the extension order is made, there is no reason to seal the prior bids for the Spectrum that Inukshuk purchased and thus the order should permit that information to be made public. It is said by Mr. Kauffman that such information is of historical interest. I would not make this exception as requested by Inukshuk. Bidders under the prior sales process were entitled to bid on all of the assets either individually or together, and Mr. Porter points out that it may well be difficult to separate out the portion of any prior bid dealing with the Spectrum from a bid for other assets that are now sought to be sold. If the interest sought is only for historical purposes, a six month delay will not be of much or any consequence.

24 In the circumstances, the order sought by Look shall go. Look is entitled to its costs of the motion against Inukshuk. If costs cannot be agreed, short submissions may be made within ten days by Look and reply submissions may be made within a further ten days by Inukshuk.

Motion granted.

1994 CarswellOnt 1214

Ontario Court of Justice (General Division), Commercial List

887574 Ontario Inc. v. Pizza Pizza Ltd.

1994 CarswellOnt 1214, [1994] O.J. No. 3112, 23 B.L.R. (2d) 239, 35 C.P.C. (3d) 323, 52 A.C.W.S. (3d) 516

RE ARBITRATION BEFORE THE HONOURABLE R.E. HOLLAND, Q.C.

887574 ONTARIO INC., 863644 ONTARIO INC., 801409 ONTARIO INC., WESTBRIDGE FOODS LTD., 830542 ONTARIO INC., 779975 ONTARIO LIMITED, 783129 ONTARIO INC., 284055 ONTARIO INC., 946171 ONTARIO INC., 768027 ONTARIO INC., 841875 ONTARIO INC., 660840 ONTARIO LTD., BULE ENTERPRISES LIMITED, 900766 ONTARIO INC., 755950 ONTARIO LIMITED, 554135 ONTARIO INC., 769049 ONTARIO INC., 781380 ONTARIO INC., 892922 ONTARIO INC., 814591 ONTARIO INC., 925446 ONTARIO LTD., 876310 ONTARIO INC., 812138 ONTARIO INC., 880602 ONTARIO INC., 697339 ONTARIO INC., 863008 ONTARIO INC., 898201 ONTARIO INC., 989897 ONTARIO INC., 857387 ONTARIO INC., 828659 ONTARIO INC., 750242 ONTARIO LIMITED, 803767 ONTARIO INC., 910874 ONTARIO INC., 805837 ONTARIO INC., GOLD LION GROUP OF COMPANIES, 697246 ONTARIO LIMITED, 827532 ONTARIO INC., 914470 ONTARIO LIMITED, 804631 ONTARIO INC., 954270 ONTARIO INC., 686603 ONTARIO LIMITED, 741897 ONTARIO LIMITED, 675367 ONTARIO LIMITED, 809692 ONTARIO LIMITED, 681630 ONTARIO INC., 763012 ONTARIO LTD., 905933 ONTARIO INC., 945671 ONTARIO INC., 807352 ONTARIO INC. and 909206 ONTARIO INC. v. PIZZA PIZZA LIMITED

Farley J.

Oral reasons: December 14, 1994 *

Written reasons: December 27, 1994

Docket: Doc. 93-CQ-33541; Commercial Court File Doc. B85/93

Counsel: *Peter Griffin, Gavin MacKenzie and Daniel Vukovich*, for moving party (defendant).

Nancy Spies and Timothy Mitchell, for responding parties (plaintiffs) except 828659 Ontario Inc., 805837 Ontario Inc., 807353 Ontario Inc., and Drag Eleven Pizza Inc.

P. Waldmann, for other responding parties (plaintiffs).

B. Bruser, for Toronto Star.

Subject: Civil Practice and Procedure; Corporate and Commercial

Headnote

Judges and Courts --- Jurisdiction — Jurisdiction of court over own process

Arbitration — Commercial arbitration — Large group of franchisees and their franchisor agreeing to discontinue litigation and settle their differences through arbitration — Arbitration agreed to be subject to appeal — Franchisor appealing arbitration award and franchisees cross-appealing — Application by franchisor for order directing material filed on appeal be sealed because arbitration to be kept confidential.

Practice — Practice on appeal — Record on appeal — Application by appellant from arbitration award for order directing record to be sealed denied — No evidence adduced to support any public policy grounds to depart from rule of public accessibility to court proceedings.

In 1993, 50 franchisees commenced legal proceedings against their franchisor, PP Ltd. Later, the parties entered into minutes of settlement whereby the dispute would be mediated and/or arbitrated by H, a retired judge and highly respected private arbitrator. The minutes of settlement also provided that the parties would have a right to appeal any binding decision by H. Arbitration proceedings ensued over many months and interim awards and a final award were issued by H.

He issued a confidentiality award with respect to the arbitration proceedings. This was followed by a consent order made by the judge before whom the present motion was argued confirming that the interim and final awards were to remain confidential until the final Award was filed in court.

PP Ltd. appealed four components of H's award. Six of the franchisees cross-appealed one component of the award. PP Ltd. then brought a motion seeking an order that the appeal material be sealed on the grounds that, (i) the arbitration proceedings were confidential by agreement, (ii) the parties would not have entered into the arbitration process without the condition of confidentiality, and (iii) the disclosure of the arbitration proceedings to the public could affect the competitive position of PP Ltd.

Held:

The motion was dismissed.

When a matter comes to court, the philosophy of the court system is openness. There are established exceptions to this general rule, such as actions involving infants or mentally disturbed people and actions involving matters of secrecy; however, this sealing application did not fit within any of those exceptions.

If the dispute settlement process had involved other types of alternative dispute resolution such as mediation, conciliation or neutral evaluation where the focus is on the parties' coming to a consensual arrangement, then other considerations could be brought to bear.

Curtailment of public accessibility can be justified only where there is present the need to protect social values of great importance. This test is not met by wishing to keep secret the material involved in an arbitration appeal which of necessity takes the parties back into the court system with its insistence on openness, an aspect which one must assume the parties fully recognized before proceeding to appeal the award.

Motion for an order that material relating to appeal from commercial arbitration be sealed on grounds of confidentiality.

Editor's Note

This judgment, taken together with the arbitration award immediately preceding and the two reasons for judgment immediately following, forms an interesting quartet. It provides a basis for comment on several aspects of commercial arbitration in a general business setting. See the Case Comment at p. 277 post.

Farley J.:

1 At the hearing I dismissed the confidentiality/sealing motion, promising formal reasons at a later date. These are those reasons.

2 The defendant Pizza Pizza Limited ("P²") moved for an order:

(a) pursuant to Section 137(2) of the *Courts of Justice Act*, R.S.O. 1990, c. C43 directing that the appeal materials upon the appeal to be heard on February 20, 1995 in this Honourable Court be sealed pending further order;

(b) continuing the order of the Honourable Mr. Justice Farley dated July 20, 1994.

P² submitted that the grounds for such a motion were:

1. The parties were originally before this Honourable Court by way of injunction proceedings (and extensive materials) in the spring of 1993;

2. The parties entered into Minutes of Settlement by which they submitted these issues to arbitration/mediation before the Honourable R.E. Holland;

3. Those proceedings were, by agreement and by order of the Honourable R.E. Holland, confidential;

4. The arbitration proceedings were conducted over many months involving at least 20 days of hearing time, during which a wide range of issues were canvassed;
5. The parties would not have entered into the arbitration process without the condition of confidentiality;
6. The parties have expended significant amounts of money upon the arbitration proceedings;
7. Only a handful of the myriad issues before the Honourable R.E. Holland are the subject of the appeal herein;
8. The disclosure of the arbitration proceedings to the public may affect the competitive position of the defendant and its franchisees in releasing the details of its operations to the public and competitors;
9. To fail to continue the order of the Honourable Mr. Justice Farley would discourage the attempts (and success) of the arbitration/mediation process which these parties underwent in confidence.

The aspect of item 8 was not in substance pursued. This is not in essence a situation involving trade secrets or confidential proprietary information. Further it was acknowledged that the proceedings resolved into an arbitration (versus other forms of alternative dispute resolution ("ADR")).

3 On Wednesday, June 22, 1994, the Honourable R.E. Holland, Q.C. ("Arbitrator") issued a confidentiality order. This was followed by a consent order issued by myself on July 20, 1994. Its terms provided (and clearly contemplated not only that there could be an adjustment or amendment to or cancellation of the sealing order, but also that the award would be made public when the matter was in court):

It is hereby ordered that:

1. The Interim Award of the Honourable R.E. Holland dated April 8, 1994 and the Cost Award dated May 19, 1994 (the "Awards") are, as all of the proceedings in this matter, confidential and may not be released to any party other than the parties to this proceeding and their professional advisors in this proceeding.
2. Until such time as it is filed in court, the Final Award arising from the Awards (the "Final Award") is also confidential and may only be released to those parties identified above.

4 The award has been appealed by P² and cross-appealed by the plaintiffs. Thus the matter is "re-entering" the court system after functionally having been in the private confidential sector before the Arbitrator. When the matter went out to the arbitration, it may have been that the parties contemplated some form of arbitration, but it was also conceivable that another form of ADR could have been employed. I think it fair to observe that a binding arbitration is a non-court equivalent to a court trial. In either case a neutral third party hears the case and makes his decision which (subject to appeal) is binding upon the parties. This differs from other forms of ADR in which the parties themselves are part of the decision-making mechanism and the neutral third party's involvement is of a facilitative nature: e.g. mediation, conciliation, neutral evaluation, non-binding opinion, non-binding arbitration. Of course, the simplest method — often overlooked — is that of non-involvement by a neutral: a negotiation between the parties. It is not unusual that ADR resolutions are conducted privately; more to the point, I suspect it would be unusual to see a public ADR session especially where the focus is on coming to a consensual arrangement. The parties need to have the opportunity of discussion and natural give and take with brainstorming and conditional concession giving without the concern of being under a microscope. If the parties were under constant surveillance, one could well imagine that they would be severely inhibited in the frank and open discussions with the result that settlement ratios would tend to dry up. The litigation system depends on a couple of percent of new cases only going to trial. If this were doubled to several percent the system would collapse. Therefore in my view public policy supports the non-trial resolution of disputes. I note the observation of Oliver Tickell, "Shogun's Beginnings" *Oxford Today*, vol. 7, no. 1 Michaelmas Issue 1994 at p. 20 where he observed as to Professor Jeffrey Mass' view of the benefits of the first Shogunate in Japan:

... finding to [Professor Mass] surprise that its rule was based far more on efficient administration than on military heroics. "Although a warrior government, it was devoted not to the battlefield but to maintaining the peace ... It developed laws, institutions of justice, and an adversarial legal system that even today seems extraordinarily ingenious and sophisticated. Written evidence always took precedence over oral testimony, and women enjoyed their full day in court. The vendetta was illegal, as the objective was to keep people ensnared in litigation".

I also note that perhaps the legal sector in Canada has progressed a little too far in the ensnarement direction.

5 Section 137(2) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 (CJA) provides:

A court may order that any document filed in a civil proceeding before it be treated as confidential, sealed and not form part of the public record.

However when a matter comes to court the philosophy of the court system is openness: See *MDS Health Group Ltd. v. Canada (Attorney General)* (1993), 15 O.R. (3d) 630 (Gen. Div.) at p. 633. The present sealing application would not fit within any of the exceptions to the general rule of public justice as discussed in *A. (J.) v. Canada Life Assurance Co.* (1989), 70 O.R. (2d) 27 (H.C.) at p. 34: "... actions involving infants, or mentally disturbed people and actions involving matters of secrecy '... secret processes, inventions, documents or the like ...' " The broader principle of confidentiality possibly being "warranted where confidentiality is precisely what is at stake" was also discussed at the same page but would not appear applicable.

6 Mr. Griffin raised the question of reorganization material under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 or the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 or valuations submitted by a receiver for the purpose of obtaining court approval on a sale arrangement having been sealed. The purpose of that, of course, is to maintain fair play so that competitors or potential bidders do not obtain an unfair advantage by obtaining such information whilst others have to rely on their own resources. I would think the most appropriate sealing order in a court approval sale situation would be that the supporting valuation material remain sealed until such time as the sale transaction has closed.

7 I believe that it is obvious that if the ADR process entered into is along the mediation philosophy structure that it will be appreciated that the best and most productive results re dispute resolution will be achieved generally if such process involves a degree of confidentiality. This of course is subject to some exceptions such as when the parties agree that in a mediation of public policy issues there is a positive requirement for public exposure: see Brown and Marriott, *ADR Principles and Practice* (1993, London), Sweet & Maxwell, at p. 356. In other instances public exposure may induce a very negative reaction — e.g. if outsiders can be observers, then some (depending on their relationship to the parties involved) may become "cheerleaders", "advisors without the benefit of the facts" or "advisors without the discipline of having to live with the end result of the mediation" (which may be a non-resolution of the issues which may otherwise have been resolved). Unwanted pressure may thus be applied to one or more of the participants. Similarly a volunteer advisor-type may give "free" advice (e.g. "Don't settle; take him to court; you've got an absolute winner!") when the hidden agenda of this officious intermeddler is to foment disruption, harass the other side or pursue his own self interests. Allow me to observe that it would be unusual for anyone to feel obliged to conduct all of his negotiations (including those to settle disputes) in a fishbowl: Consider for instance one having a mild disagreement with one's mother as to where the two of you should have lunch — or a debate between a customer and a supplier over whether an order was short-shipped and, if so, what adjustment should be made (all without resort to the *Sale of Goods Act* and/or the courts).

8 While it is true that it appears in this case that the parties went private in a dispute which they could have litigated openly in the courts with a trial rather than an arbitration, I do not see that this choice would oblige the parties to make their arbitration public in and of itself. As for the confidentiality order of July 20, 1994 referring to two types of awards, an interim and a final, I now understand from counsel that the thrust of the interim award was the legal principles and of the final the damage calculation or other results flowing as opposed to the interim being a draft for comment and possible

adjustment. If the latter were the case then one would appreciate the practicality/necessity of maintaining confidentiality so as to avoid the types of unwarranted pressures aforesaid in achieving the end result. If of the other nature, I believe the same result prevails. Similarly if the process were something other than non-binding arbitration, one would also see the same type of necessity. In the instant case, the parties could have, if they had so chosen (i.e. either side), decided not to appeal the Arbitration's award. In such case, the result would have been the same as the two sides entering into settlement negotiations to end their dispute and coming to an agreement. In effect that is what they did by entering the arbitration process except that in doing so, they at the start of the piece delegated the resolution determination function to the Arbitrator for him to do so by applying legal principles to the facts as he found them. If the parties had not made the detour from the main channel of court proceedings leading to trial by going to arbitration but had merely negotiated a settlement, then with a settlement achieved they would customarily merely proceed to put on the public court record that the claim had been dismissed on consent. Details of the settlement would remain with the parties; they would be free to disclose or agree not to disclose, subject to some legal obligation to make disclosure (e.g. timely disclosure requirements under securities legislation).

9 However in this case, it appears that both sides were dissatisfied to some degree by the decision of the Arbitrator for various reasons. Perhaps counsel would be of assistance to their clients if they were able to reflect upon what may have been attempted to be communicated by the other side at the hearing before me. I state the obvious: sometimes signals are obliquely broadcast; sometimes what might be perceived as a signal is nothing more than a false hope by the recipient. However if there is truly a signal intended, it would be very unfortunate if the recipient did not pick it up because it was too oblique or worse still because the mind was closed (possibly because the mouth was open so as to block the ear passage).

10 The onus is upon P² as moving party to demonstrate sound reason for departing from the openness rule: See *MDS*, supra, at p. 633. As the factum of P² put it:

There is an overriding public interest in the 1990's especially in fostering effective Alternative Dispute Resolution ("ADR") in such a way that parties will willingly submit to it in a manner which fosters its use and development and reduces the demands for scarce court resources.

The authority for this was given as *Brown and Marriott*, supra, at p. 356; *London & Leeds Estates Ltd. v. Paribas Ltd.*, unreported decision of Mance, J. (Q.B.) of July 28, 1994 and *Hassnah Insurance Co. of Israel v. Mew*, [1993] 2 Lloyd's Rep. 243 (Q.B. [Com. Ct.]). In citing *Hassnah*, Mance, J. at p. 8 of *London* merely stated:

There is no doubt that the parties to such a previous arbitration owed each other a duty of confidence and privacy in respect of the course of and evidence given during it.

He went on to say at p. 9:

None of those authorities deals with the need to consider the rights of a witness which could arise if duties of confidentiality or privacy were owed to him or her. Despite this I see some force in the submission that it is implicit in the nature of private consensual arbitration that witnesses who give evidence, even paid and professional experts, will within certain limits be accorded the benefits of the privacy which overall attaches to this type of arbitration. The privacy of arbitration is likely to be a factor in persuading many witnesses to give evidence and a factor in encouraging them to speak, or in the case of experts, enabling them to obtain permission from other principals to speak, about matters within their experience about which otherwise they might be hesitant or unable to speak.

London of course involved a question of whether a subpoena to an expert witness should be set aside where the confidential or private documents of the expert were sought to be obtained by the subpoena. It is even clearer in *Hassnah* what the limits of confidentiality would be concerning an arbitration and the award issuing therefrom. In that case there was an arbitration between the defendant who was reinsured by the plaintiff under various reinsurance contracts which had been placed by brokers. The defendant pursued arbitration to recover under the policies; the arbitration went mainly

against the defendant which now wished to proceed in court against the placing brokers for negligence in breach of duty. Coleman, J. found as stated in the headnote: "that if it was reasonably necessary for the establishment or protection of an arbitrating party's legal rights vis-a-vis a third party that the award should be disclosed to that third party in order to found a defence or as the basis for a cause of action, so to disclose it including its reasons would not be a breach of the duty of confidence (See p. 249, col. 2)".

11 However as discussed above the parties clearly contemplated the possibility of appeal pursuant to the *Arbitration Act, 1991*, S.O. 1991, c. 17. Both have availed themselves of that opportunity; the court files for whatever is filed pursuant to that appeal (and cross-appeal) will be open for inspection in the same way any other appeal of whatever nature or kind would be (assuming no valid sealing order obtained on the basis of the reasons set out above). This is not a case such as *Hassnah* where witness statements, documents and transcripts of a confidential arbitration were not to be made public for the purpose of a court action against a third person—*Hassnah* being a completely "separate" proceeding. In this case (the P² case) the court proceedings are merely the continuation of the fight between P² and the plaintiff franchisees (and not between one of them and a third person in separate proceedings), a fight which they took private but which they have now returned to the open arena of the court.

12 As Dickson, J. said at p. 186 (S.C.R.) of *MacIntyre v. Nova Scotia (Attorney General)*, [1982] 1 S.C.R. 175, 49 N.S.R. (2d) 609 (and cited in *MDS*, supra, at p. 635):

In my view, curtailment of public accessibility can only be justified where there is present the need to protect social values of superordinate importance. One of these is the protection of the innocent.

In my view "one of these" is not to keep secret the material involved in an arbitration appeal which of its necessity takes the parties back into the court system with its insistence on openness for court proceedings, an aspect which one must assume each side fully recognized before proceeding to appeal the award.

13 I believe it well expressed by Smith, J. in *S. (P.) v. C. (D.)* (1987), 22 C.P.C. (2d) 225 (Ont. H.C.) at p. 229 and p. 231:

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14 P² has not adduced any evidence to support a sealing order pursuant to s. 137(2) CJA but rather it has relied on the court to fashion an order so as to extend the confidentiality which the parties had in their arbitration to the material in that arbitration which would otherwise be public pursuant to the appeal. I see no public policy grounds for doing so.

15 Mr. Griffin with his usual candour immediately agreed with Mr. Waldmann's proposition that if the sealing motion were dismissed then Mr. Waldmann's two clients outside the arbitration would be allowed access to the arbitration material.

16 The sealing order motion of P² is dismissed. P² is to pay \$1,000 in costs forthwith to the plaintiffs represented by Ms. Spies and Mr. Mitchell; no other costs awarded.

Motion dismissed.

Footnotes

- * Leave to appeal to the Ontario Court of Appeal was refused with costs on June 7, 1995, Doc. CA M15773, McKinlay, Griffiths and Doherty J.J.A. (Ont. C.A.).

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1994 CarswellOnt 1214
Ontario Court of Justice (General Division), Commercial List

887574 Ontario Inc. v. Pizza Pizza Ltd.

1994 CarswellOnt 1214, [1994] O.J. No. 3112, 23 B.L.R. (2d) 239, 35 C.P.C. (3d) 323, 52 A.C.W.S. (3d) 516

RE ARBITRATION BEFORE THE HONOURABLE R.E. HOLLAND, Q.C.

887574 ONTARIO INC., 863644 ONTARIO INC., 801409 ONTARIO INC., WESTBRIDGE FOODS LTD., 830542 ONTARIO INC., 779975 ONTARIO LIMITED, 783129 ONTARIO INC., 284055 ONTARIO INC., 946171 ONTARIO INC., 768027 ONTARIO INC., 841875 ONTARIO INC., 660840 ONTARIO LTD., BULE ENTERPRISES LIMITED, 900766 ONTARIO INC., 755950 ONTARIO LIMITED, 554135 ONTARIO INC., 769049 ONTARIO INC., 781380 ONTARIO INC., 892922 ONTARIO INC., 814591 ONTARIO INC., 925446 ONTARIO LTD., 876310 ONTARIO INC., 812138 ONTARIO INC., 880602 ONTARIO INC., 697339 ONTARIO INC., 863008 ONTARIO INC., 898201 ONTARIO INC., 989897 ONTARIO INC., 857387 ONTARIO INC., 828659 ONTARIO INC., 750242 ONTARIO LIMITED, 803767 ONTARIO INC., 910874 ONTARIO INC., 805837 ONTARIO INC., GOLD LION GROUP OF COMPANIES, 697246 ONTARIO LIMITED, 827532 ONTARIO INC., 914470 ONTARIO LIMITED, 804631 ONTARIO INC., 954270 ONTARIO INC., 686603 ONTARIO LIMITED, 741897 ONTARIO LIMITED, 675367 ONTARIO LIMITED, 809692 ONTARIO LIMITED, 681630 ONTARIO INC., 763012 ONTARIO LTD., 905933 ONTARIO INC., 945671 ONTARIO INC., 807352 ONTARIO INC. and 909206 ONTARIO INC. v. PIZZA PIZZA LIMITED

Farley J.

Oral reasons: December 14, 1994 *

Written reasons: December 27, 1994

Docket: Doc. 93-CQ-33541; Commercial Court File Doc. B85/93

Counsel: *Peter Griffin, Gavin MacKenzie and Daniel Vukovich*, for moving party (defendant).

Nancy Spies and Timothy Mitchell, for responding parties (plaintiffs) except 828659 Ontario Inc., 805837 Ontario Inc., 807353 Ontario Inc., and Drag Eleven Pizza Inc.

P. Waldmann, for other responding parties (plaintiffs).

B. Bruser, for Toronto Star.

Subject: Civil Practice and Procedure; Corporate and Commercial

Headnote

Judges and Courts --- Jurisdiction — Jurisdiction of court over own process

Arbitration — Commercial arbitration — Large group of franchisees and their franchisor agreeing to discontinue litigation and settle their differences through arbitration — Arbitration agreed to be subject to appeal — Franchisor appealing arbitration award and franchisees cross-appealing — Application by franchisor for order directing material filed on appeal be sealed because arbitration to be kept confidential.

Practice — Practice on appeal — Record on appeal — Application by appellant from arbitration award for order directing record to be sealed denied — No evidence adduced to support any public policy grounds to depart from rule of public accessibility to court proceedings.

In 1993, 50 franchisees commenced legal proceedings against their franchisor, PP Ltd. Later, the parties entered into minutes of settlement whereby the dispute would be mediated and/or arbitrated by H, a retired judge and highly respected private arbitrator. The minutes of settlement also provided that the parties would have a right to appeal any binding decision by H. Arbitration proceedings ensued over many months and interim awards and a final award were issued by H.

He issued a confidentiality award with respect to the arbitration proceedings. This was followed by a consent order made by the judge before whom the present motion was argued confirming that the interim and final awards were to remain confidential until the final Award was filed in court.

PP Ltd. appealed four components of H's award. Six of the franchisees cross-appealed one component of the award. PP Ltd. then brought a motion seeking an order that the appeal material be sealed on the grounds that, (i) the arbitration proceedings were confidential by agreement, (ii) the parties would not have entered into the arbitration process without the condition of confidentiality, and (iii) the disclosure of the arbitration proceedings to the public could affect the competitive position of PP Ltd.

Held:

The motion was dismissed.

When a matter comes to court, the philosophy of the court system is openness. There are established exceptions to this general rule, such as actions involving infants or mentally disturbed people and actions involving matters of secrecy; however, this sealing application did not fit within any of those exceptions.

If the dispute settlement process had involved other types of alternative dispute resolution such as mediation, conciliation or neutral evaluation where the focus is on the parties' coming to a consensual arrangement, then other considerations could be brought to bear.

Curtailment of public accessibility can be justified only where there is present the need to protect social values of great importance. This test is not met by wishing to keep secret the material involved in an arbitration appeal which of necessity takes the parties back into the court system with its insistence on openness, an aspect which one must assume the parties fully recognized before proceeding to appeal the award.

Motion for an order that material relating to appeal from commercial arbitration be sealed on grounds of confidentiality.

Editor's Note

This judgment, taken together with the arbitration award immediately preceding and the two reasons for judgment immediately following, forms an interesting quartet. It provides a basis for comment on several aspects of commercial arbitration in a general business setting. See the Case Comment at p. 277 post.

Farley J.:

1 At the hearing I dismissed the confidentiality/sealing motion, promising formal reasons at a later date. These are those reasons.

2 The defendant Pizza Pizza Limited ("P²") moved for an order:

(a) pursuant to Section 137(2) of the *Courts of Justice Act*, R.S.O. 1990, c. C43 directing that the appeal materials upon the appeal to be heard on February 20, 1995 in this Honourable Court be sealed pending further order;

(b) continuing the order of the Honourable Mr. Justice Farley dated July 20, 1994.

P² submitted that the grounds for such a motion were:

1. The parties were originally before this Honourable Court by way of injunction proceedings (and extensive materials) in the spring of 1993;

2. The parties entered into Minutes of Settlement by which they submitted these issues to arbitration/mediation before the Honourable R.E. Holland;

3. Those proceedings were, by agreement and by order of the Honourable R.E. Holland, confidential;

4. The arbitration proceedings were conducted over many months involving at least 20 days of hearing time, during which a wide range of issues were canvassed;
5. The parties would not have entered into the arbitration process without the condition of confidentiality;
6. The parties have expended significant amounts of money upon the arbitration proceedings;
7. Only a handful of the myriad issues before the Honourable R.E. Holland are the subject of the appeal herein;
8. The disclosure of the arbitration proceedings to the public may affect the competitive position of the defendant and its franchisees in releasing the details of its operations to the public and competitors;
9. To fail to continue the order of the Honourable Mr. Justice Farley would discourage the attempts (and success) of the arbitration/mediation process which these parties underwent in confidence.

The aspect of item 8 was not in substance pursued. This is not in essence a situation involving trade secrets or confidential proprietary information. Further it was acknowledged that the proceedings resolved into an arbitration (versus other forms of alternative dispute resolution ("ADR")).

3 On Wednesday, June 22, 1994, the Honourable R.E. Holland, Q.C. ("Arbitrator") issued a confidentiality order. This was followed by a consent order issued by myself on July 20, 1994. Its terms provided (and clearly contemplated not only that there could be an adjustment or amendment to or cancellation of the sealing order, but also that the award would be made public when the matter was in court):

It is hereby ordered that:

1. The Interim Award of the Honourable R.E. Holland dated April 8, 1994 and the Cost Award dated May 19, 1994 (the "Awards") are, as all of the proceedings in this matter, confidential and may not be released to any party other than the parties to this proceeding and their professional advisors in this proceeding.
2. Until such time as it is filed in court, the Final Award arising from the Awards (the "Final Award") is also confidential and may only be released to those parties identified above.

4 The award has been appealed by P² and cross-appealed by the plaintiffs. Thus the matter is "re-entering" the court system after functionally having been in the private confidential sector before the Arbitrator. When the matter went out to the arbitration, it may have been that the parties contemplated some form of arbitration, but it was also conceivable that another form of ADR could have been employed. I think it fair to observe that a binding arbitration is a non-court equivalent to a court trial. In either case a neutral third party hears the case and makes his decision which (subject to appeal) is binding upon the parties. This differs from other forms of ADR in which the parties themselves are part of the decision-making mechanism and the neutral third party's involvement is of a facilitative nature: e.g. mediation, conciliation, neutral evaluation, non-binding opinion, non-binding arbitration. Of course, the simplest method — often overlooked — is that of non-involvement by a neutral: a negotiation between the parties. It is not unusual that ADR resolutions are conducted privately; more to the point, I suspect it would be unusual to see a public ADR session especially where the focus is on coming to a consensual arrangement. The parties need to have the opportunity of discussion and natural give and take with brainstorming and conditional concession giving without the concern of being under a microscope. If the parties were under constant surveillance, one could well imagine that they would be severely inhibited in the frank and open discussions with the result that settlement ratios would tend to dry up. The litigation system depends on a couple of percent of new cases only going to trial. If this were doubled to several percent the system would collapse. Therefore in my view public policy supports the non-trial resolution of disputes. I note the observation of Oliver Tickell, "Shogun's Beginnings" *Oxford Today*, vol. 7, no. 1 Michaelmas Issue 1994 at p. 20 where he observed as to Professor Jeffrey Mass' view of the benefits of the first Shogunate in Japan:

... finding to [Professor Mass'] surprise that its rule was based far more on efficient administration than on military heroics. "Although a warrior government, it was devoted not to the battlefield but to maintaining the peace ... It developed laws, institutions of justice, and an adversarial legal system that even today seems extraordinarily ingenious and sophisticated. Written evidence always took precedence over oral testimony, and women enjoyed their full day in court. The vendetta was illegal, as the objective was to keep people ensnared in litigation".

I also note that perhaps the legal sector in Canada has progressed a little too far in the ensnarement direction.

5 Section 137(2) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 (CJA) provides:

A court may order that any document filed in a civil proceeding before it be treated as confidential, sealed and not form part of the public record.

However when a matter comes to court the philosophy of the court system is openness: See *MDS Health Group Ltd. v. Canada (Attorney General)* (1993), 15 O.R. (3d) 630 (Gen. Div.) at p. 633. The present sealing application would not fit within any of the exceptions to the general rule of public justice as discussed in *A. (J.) v. Canada Life Assurance Co.* (1989), 70 O.R. (2d) 27 (H.C.) at p. 34: "... actions involving infants, or mentally disturbed people and actions involving matters of secrecy '... secret processes, inventions, documents or the like ...' " The broader principle of confidentiality possibly being "warranted where confidentiality is precisely what is at stake" was also discussed at the same page but would not appear applicable.

6 Mr. Griffin raised the question of reorganization material under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 or the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 or valuations submitted by a receiver for the purpose of obtaining court approval on a sale arrangement having been sealed. The purpose of that, of course, is to maintain fair play so that competitors or potential bidders do not obtain an unfair advantage by obtaining such information whilst others have to rely on their own resources. I would think the most appropriate sealing order in a court approval sale situation would be that the supporting valuation material remain sealed until such time as the sale transaction has closed.

7 I believe that it is obvious that if the ADR process entered into is along the mediation philosophy structure that it will be appreciated that the best and most productive results re dispute resolution will be achieved generally if such process involves a degree of confidentiality. This of course is subject to some exceptions such as when the parties agree that in a mediation of public policy issues there is a positive requirement for public exposure: see Brown and Marriott, *ADR Principles and Practice* (1993, London), Sweet & Maxwell, at p. 356. In other instances public exposure may induce a very negative reaction — e.g. if outsiders can be observers, then some (depending on their relationship to the parties involved) may become "cheerleaders", "advisors without the benefit of the facts" or "advisors without the discipline of having to live with the end result of the mediation" (which may be a non-resolution of the issues which may otherwise have been resolved). Unwanted pressure may thus be applied to one or more of the participants. Similarly a volunteer advisor-type may give "free" advice (e.g. "Don't settle; take him to court; you've got an absolute winner!") when the hidden agenda of this officious intermeddler is to foment disruption, harass the other side or pursue his own self interests. Allow me to observe that it would be unusual for anyone to feel obliged to conduct all of his negotiations (including those to settle disputes) in a fishbowl: Consider for instance one having a mild disagreement with one's mother as to where the two of you should have lunch — or a debate between a customer and a supplier over whether an order was short-shipped and, if so, what adjustment should be made (all without resort to the *Sale of Goods Act* and/or the courts).

8 While it is true that it appears in this case that the parties went private in a dispute which they could have litigated openly in the courts with a trial rather than an arbitration, I do not see that this choice would oblige the parties to make their arbitration public in and of itself. As for the confidentiality order of July 20, 1994 referring to two types of awards, an interim and a final, I now understand from counsel that the thrust of the interim award was the legal principles and of the final the damage calculation or other results flowing as opposed to the interim being a draft for comment and possible

adjustment. If the latter were the case then one would appreciate the practicality/necessity of maintaining confidentiality so as to avoid the types of unwarranted pressures aforesaid in achieving the end result. If of the other nature, I believe the same result prevails. Similarly if the process were something other than non-binding arbitration, one would also see the same type of necessity. In the instant case, the parties could have, if they had so chosen (i.e. either side), decided not to appeal the Arbitration's award. In such case, the result would have been the same as the two sides entering into settlement negotiations to end their dispute and coming to an agreement. In effect that is what they did by entering the arbitration process except that in doing so, they at the start of the piece delegated the resolution determination function to the Arbitrator for him to do so by applying legal principles to the facts as he found them. If the parties had not made the detour from the main channel of court proceedings leading to trial by going to arbitration but had merely negotiated a settlement, then with a settlement achieved they would customarily merely proceed to put on the public court record that the claim had been dismissed on consent. Details of the settlement would remain with the parties; they would be free to disclose or agree not to disclose, subject to some legal obligation to make disclosure (e.g. timely disclosure requirements under securities legislation).

9 However in this case, it appears that both sides were dissatisfied to some degree by the decision of the Arbitrator for various reasons. Perhaps counsel would be of assistance to their clients if they were able to reflect upon what may have been attempted to be communicated by the other side at the hearing before me. I state the obvious: sometimes signals are obliquely broadcast; sometimes what might be perceived as a signal is nothing more than a false hope by the recipient. However if there is truly a signal intended, it would be very unfortunate if the recipient did not pick it up because it was too oblique or worse still because the mind was closed (possibly because the mouth was open so as to block the ear passage).

10 The onus is upon P² as moving party to demonstrate sound reason for departing from the openness rule: See *MDS*, supra, at p. 633. As the factum of P² put it:

There is an overriding public interest in the 1990's especially in fostering effective Alternative Dispute Resolution ("ADR") in such a way that parties will willingly submit to it in a manner which fosters its use and development and reduces the demands for scarce court resources.

The authority for this was given as *Brown and Marriott*, supra, at p. 356; *London & Leeds Estates Ltd. v. Paribas Ltd.*, unreported decision of Mance, J. (Q.B.) of July 28, 1994 and *Hassnah Insurance Co. of Israel v. Mew*, [1993] 2 Lloyd's Rep. 243 (Q.B. [Com. Ct.]). In citing *Hassnah*, Mance, J. at p. 8 of *London* merely stated:

There is no doubt that the parties to such a previous arbitration owed each other a duty of confidence and privacy in respect of the course of and evidence given during it.

He went on to say at p. 9:

None of those authorities deals with the need to consider the rights of a witness which could arise if duties of confidentiality or privacy were owed to him or her. Despite this I see some force in the submission that it is implicit in the nature of private consensual arbitration that witnesses who give evidence, even paid and professional experts, will within certain limits be accorded the benefits of the privacy which overall attaches to this type of arbitration. The privacy of arbitration is likely to be a factor in persuading many witnesses to give evidence and a factor in encouraging them to speak, or in the case of experts, enabling them to obtain permission from other principals to speak, about matters within their experience about which otherwise they might be hesitant or unable to speak.

London of course involved a question of whether a subpoena to an expert witness should be set aside where the confidential or private documents of the expert were sought to be obtained by the subpoena. It is even clearer in *Hassnah* what the limits of confidentiality would be concerning an arbitration and the award issuing therefrom. In that case there was an arbitration between the defendant who was reinsured by the plaintiff under various reinsurance contracts which had been placed by brokers. The defendant pursued arbitration to recover under the policies; the arbitration went mainly

against the defendant which now wished to proceed in court against the placing brokers for negligence in breach of duty. Coleman, J. found as stated in the headnote: "that if it was reasonably necessary for the establishment or protection of an arbitrating party's legal rights vis-a-vis a third party that the award should be disclosed to that third party in order to found a defence or as the basis for a cause of action, so to disclose it including its reasons would not be a breach of the duty of confidence (See p. 249, col. 2)".

11 However as discussed above the parties clearly contemplated the possibility of appeal pursuant to the *Arbitration Act, 1991*, S.O. 1991, c. 17. Both have availed themselves of that opportunity; the court files for whatever is filed pursuant to that appeal (and cross-appeal) will be open for inspection in the same way any other appeal of whatever nature or kind would be (assuming no valid sealing order obtained on the basis of the reasons set out above). This is not a case such as *Hassnah* where witness statements, documents and transcripts of a confidential arbitration were not to be made public for the purpose of a court action against a third person—*Hassnah* being a completely "separate" proceeding. In this case (the P² case) the court proceedings are merely the continuation of the fight between P² and the plaintiff franchisees (and not between one of them and a third person in separate proceedings), a fight which they took private but which they have now returned to the open arena of the court.

12 As Dickson, J. said at p. 186 (S.C.R.) of *MacIntyre v. Nova Scotia (Attorney General)*, [1982] 1 S.C.R. 175, 49 N.S.R. (2d) 609 (and cited in *MDS*, supra, at p. 635):

In my view, curtailment of public accessibility can only be justified where there is present the need to protect social values of superordinate importance. One of these is the protection of the innocent.

In my view "one of these" is not to keep secret the material involved in an arbitration appeal which of its necessity takes the parties back into the court system with its insistence on openness for court proceedings, an aspect which one must assume each side fully recognized before proceeding to appeal the award.

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Footnotes

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