CITATION: Growthworks Canadian Fund Ltd. v. Growthworks WV Management Ltd. 2023 ONSC 517
COURT FILE NO.: CV-13-00010279-00CL
DATE: 20230131

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

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 WITH RESPECT TO GROWTHWORKS CANADIAN FUND LTD.

RE: GROWTHWORKS CANADIAN FUND LTD.

AND:

GROWTHWORKS WV MANAGMENT LTD.et al

BEFORE: Penny J.

COUNSEL: *Geoff R. Hall* and *Trevor Courtis* for the Applicant

Melvyn Solmon and *Cameron Wetmore* for the Respondent

Caitlin Fell for the Monitor, FTI Consulting Canada Inc.

HEARD: January 19, 2023

ENDORSEMENT

Overview

[1] On January 19, 2023, I granted an order for various relief sought by the applicant (the Fund) in these CCAA proceedings. I took under reserve one issue in dispute between the Fund and its former manager, the respondent, Growthworks WV Management Ltd. (the former manager). These are my reasons dealing with that dispute.

[2] The issue in dispute involves the Fund's request for an order that the Class C shareholder is not entitled to receive any further dividends or payments on account of the Class C shares. The sole Class C shareholder is the former manager.

[3] The order which I granted on January 19, 2023 provides for the dissolution of the Fund by December 31, 2024 (or earlier if the applicant, in consultation with the Monitor, determines that further realization efforts are no longer desirable in light of the estimated cost).

[4] The respondent says that, upon dissolution of the Fund, it will become entitled to a payment of $672,390.61 on account of its Class C shares. Thus, it opposes the order sought by the Fund that the Class C shareholder is not entitled to any further dividends or payments.

[5] As I will explain in the reasons below, the former manager has demonstrated no entitlement to any payment upon dissolution of the Fund. The order sought by the Fund is granted.

Background

[6] The applicant was incorporated under the *Canada Business Corporations Act*. It carried on the business of a mutual fund as a labour sponsored venture capital corporation. It was formed in 1988 with the investment objective of achieving long-term appreciation for its Class A shareholders, which principally consists of retail investors.

[7] The Fund retained the former manager to manage the business of the Fund. The former manager was first engaged by the Fund in 2002, after being selected in a competitive bid process. Their relationship was governed by a management agreement.

[8] By late 2009, the Fund was experiencing a significant reduction in its liquidity and thus, in its ability to fund redemptions of Class A shares. It became, along with the former manager, embroiled in investigations by the Ontario and British Columbia securities commissions. In September 2013, the Fund terminated the management agreement with the former manager. A month later, it obtained an initial order from this Court under the CCAA. In the course of the CCAA proceedings, the former manager asserted a claim against the Fund for damages for wrongful termination and fees and other payments owing under the management agreement. This claim proceeded by way of a trial before Wilton-Siegel J. in 2017. In a decision of May 18, 2018 (2018 ONSC 3108), Justice Wilton-Siegel dismissed the former manager's claim for damages as a result of the alleged wrongful termination of the management agreement except to the extent of certain claims for unpaid management and administration fees accrued to the date of termination. Of particular relevance to the present dispute is that one of the former manager's claims was for $672,390.65 on account of dividends alleged to be payable on its Class C shares. This is referred to as the "IPA payment". These dividends were a form of incentive payment for meeting certain performance metrics pre-termination. Justice Wilton-Siegel dismissed the former manager's claim because a condition precedent to the payment was a Board resolution declaring the dividend. The Board was, in the Fund's insolvent circumstances leading up to and including the CCAA proceedings, prohibited from declaring any dividends by virtue of the solvency provisions of the CBCA.

[9] In today's circumstances, now that a dissolution of the Fund has been approved, the former manager relies on a passage from Justice Wilton-Siegel's reasons, at para. 380, in which he noted that, "the Fund does not dispute that this amount [$672,390.65] was earned in the sense that the Former Manager is entitled to receive dividends in such amount pursuant to the provisions of section 4.2(d)(i) of the share conditions of the IPA Shares". The former manager maintains that what was expressly not determined in the trial before Justice Wilton-Siegel was whether the former manager might be entitled to the IPA payment on a "Dissolution Event" which would be determined by different contractual language than the

payment triggered on "Termination". Further, the former manager also relies on para. 2 of Justice Wilton-Siegel's Judgment, which states:

> THIS COURT ORDERS that the claim of the Former Manager for $672,390.61 for unpaid incentive payments amounts ("IPA") as a result of the termination of the Management Agreement, but not any potential claim for IPA based on a Dissolution Event as defined in the Article of Amendment for Class C Shares (which potential claim was not before the court on this trial), is dismissed.

[10] Thus, issue is joined on whether the $672,390.65 becomes payable on the Fund's dissolution. The former manager says it does. The Fund says it does not. The answer to this question largely turns on an interpretation of the relevant provisions of the articles which govern the Class C shares.

Analysis

[11] There are three issues:

(1) Was the quantum of the IPA payment sought in the trial before Justice Wilton-Siegel determined to be $672,390.65?

(2) Does the $672,390.65 IPA payment (said to have been earned pre-termination) become payable on dissolution? and,

(3) If it is payable, must it be paid in priority to distributions to the Class A shareholders?

Was the quantum of the claim for IPA determined?

[12] I agree with the former manager that the quantum of the IPA payment claimed under article 4.2(f) (Manager Termination) at the trial was accepted by the Court to be $672,390.65. Justice Wilton-Siegel was clear, at para. 380, that the Fund did not dispute that this amount was earned in the sense that the former manager was entitled to receive dividends in that amount under article 4.2(d)(i) of the share conditions of the Class C shares if the other conditions were met. He agreed with the Fund, however, that the former manager was not entitled to the IPA payment in the absence of a Board resolution declaring the dividend and that the Board could not do so in view of the solvency provisions of s. 42 of the CBCA. What was left for another day by Justice Wilton-Siegel was not quantification of the former manager's claim but whether the former manager might become entitled to the IPA payment in the event of a future "dissolution".

Is the Incentive Payment Payable on Dissolution?

[13] It is well settled that the relevant principles applicable to contract interpretation (including the interpretation of articles of incorporation) are: (i) the text must be read in conjunction with the surrounding circumstances or factual matrix, without allowing the latter to overwhelm the former and with the language being read in accordance with its ordinary and grammatical sense; (ii) the language of the agreement must be read as a whole; and

(iii) the language must be read in a manner that achieves commercial efficacy: *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53.

[14] Article 4.2(e) provides:

> (e) **Dissolution Amount** - Upon a Dissolution Event, the holder of IPA Shares shall be entitled to receive an amount equal to the sum of:
> (i) all declared but unpaid dividends on the LPA Shares; and
> (ii) an amount equal to the cumulative dividends to which the holder of the IPA Shares would have been entitled pursuant to paragraph (d) above, whether or not dividends were actually declared by the directors, assuming that all Venture Investments had been disposed of as of the date of the Dissolution Event at the estimated fair value of such investments calculated in accordance with the Corporation's usual valuation policies.

[15] There are two bases upon which the former manager says it is entitled to the IPA payment at this time.

[16] First, it argues that the IPA payment is reflected on the financial statements of the Fund, recorded as a debt. As an unsecured debt, the former manager says it should be paid upon dissolution of the Fund in priority to any equity holder, including the Class A shareholders.

[17] Second, the former manager argues it is entitled to the payment because of the language of article 4.2(e). In the event of "dissolution" (it is admitted that the dissolution order of January 19, 2023 contemplates a "dissolution" within the meaning of the articles), the amount payable to the former manager would not be a dividend, but rather "an amount equal to" cumulative dividends, "whether or not dividends were actually declared". Because the "dissolution amount" is not a dividend, the former manager argues, (a) the amount must be paid whether or not dividends were actually declared and, (b) the solvency and "value" tests required by the articles are no longer relevant.

[18] I am unable to accept either of these arguments.

<u>The Alleged "Debt"</u>

[19] It is true that the 2013 financial statements of the Fund record an accrual of about $1.2 million for IPA dividends. The notes make it clear that the accrual is in respect of a dividend, not a debt. The notes also make clear that the three "value" tests set out in the articles (4.2(d)) remain preconditions to any payment.

[20] In any event, accounting treatment does not determine legal status. Justice Wilton-Siegel made this point in the 2017 trial. There is no necessary inference to be derived from the accounting treatment of the former manager's claim (see para. 385). The point is that the former manager's claim is not and was never a debt. The former manager cannot have it both ways. The former manager's only potential entitlement is rooted in the existence of its Class C shares. The only payment available is by way of dividend.

[21] The former manager places great weight on the absence of the word "dividend" in article 4.2(e) and the use of the phrase "an amount equal to" cumulative dividends. As I will explain in greater detail below, however, the difference in language does not mean that the payment ceases to be tied to the Class C shares and to performance of the Fund. The difference in language simply reflects the fact that after a termination, the Fund would presumably continue as an existing entity able to pay dividends, whereas a dissolution of the Fund results in payments to shareholders which are not dividends but a distribution of the remaining property of the corporation.

[22] The dividends that might have been paid in respect of pre-2013 activity could not lawfully be paid because the Fund was insolvent. The time and opportunity for payment of those dividends came and went. The potential for payment by way of those potential dividends is not, and was never, a debt. Nor does the opportunity to earn incentive payments float through the years like a ghost ship coming into harbour just when the Fund is being dissolved. Dissolution is a distinct circumstance and presents a distinct precondition to payment of "an amount equal to" a dividend otherwise earned. The precondition associated with "dissolution", as set out below, precludes payment of the $672,390.65 claimed by the former manager.

The Words of 4.2(e)

[23] The principal problem with the former manager's second argument is that, while laying great emphasis on the opening phrase – "an amount equal to…whether or not dividends were actually declared" – the former manager ignores the two important subsequent phrases – "the cumulative dividends *to which the holder of the IPA Shares would have been entitled pursuant to paragraph (d) above*" and "assuming that all Venture Investments had been *disposed of as of the date of* the Dissolution Event at the estimated fair value of such investments calculated in accordance with the Fund's usual valuation policies"(emphasis added).

[24] I agree with the applicant's submission that these two phrases create: (i) a condition that must be met for the former manager to be entitled to a payment on dissolution, and (ii) an assumption that must be applied in determining whether the condition has been met. The condition is that the former manager must be entitled to dividends under section 4.2(d). The assumption is that all remaining Venture Investments were disposed of as of the date of dissolution.

[25] Compliance with article 4.2 (d) is the condition. It provides that the former manager may be entitled to dividends if certain conditions are met. Class C dividends were not part of the former manager's ordinary compensation for its services before it was terminated. The former manager received substantial annual management and administration fees for its services. Class C dividends were incentive payments based on the performance of the Fund's portfolio.

[26] 4.2(d)(ii) provides three tests that must be met for the former manager to be eligible to receive incentive payments.[1] These are intended to ensure that the Fund's investments have performed well, both individually and collectively, before the former manager is entitled to an incentive payment. They were to "ensure that the other classes of shareholders of the Fund have received the substantial benefit of investment performance". The three tests are:

> (a) the Portfolio Test, which requires that the annual rate of return on the Fund's entire Portfolio exceed the average annual rate of return on a five-year GIC plus 2%. The purpose of this condition seems to be to ensure that satisfactory returns have been generated on the Fund's portfolio as a whole;
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> (b) the Venture Investment Test, which requires the annual rate of return from the particular Venture Investment to equal or exceed 12%. The purpose of this condition is to ensure that significant returns have been generated on the particular Venture Investment in respect of which the former manager is claiming an incentive payment; and
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> (c) the Principal Test, which requires that the Fund have recovered cash at least equal to the principal investment in the particular Venture Investment. The purpose of this condition is to ensure that adequate cash has been generated to make the incentive payments.

[27] The assumption in article 4.2(e)(ii) requires that, on dissolution, these tests are applied *as of the date of* dissolution. This assumption is, in essence, a deemed disposition on the date of dissolution. The commercial purpose of the deemed disposition is to focus on the former manager's performance at the date of dissolution and to reward that performance if it is otherwise justified as of that date. Article 4.2(ii), therefore, must be read as applying to portfolio holdings at the time of dissolution, not to all portfolio holdings that have ever been.[2] The provision is not (and cannot be, if the underlying purpose is to be served) backward looking so as to permit a retroactive reward to the former manager for events of a decade or more ago. This is particularly the case where the "performance" of the Fund has, since 2013 and even before, been extremely poor.

[28] The unchallenged evidence before the Court is that the Fund's portfolio of Venture Investments will have a negative annualized rate of return as of the date of dissolution. The result is that the Portfolio Test, at the very least, has not been met. In order for incentive dividends to be paid in accordance with paragraph 4.2(d), the total net realized and unrealized gains and income of the Fund from its portfolio of venture investments must have generated an annualized rate of return greater than a cumulative annualized threshold rate of return equal to the average annual rate of return on a five year guaranteed investment certificate ("GIC") offered by a major Canadian chartered bank (which is 2.5%) plus 2%.

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[1] It is common ground that 4.2(d)(i) has no application.

[2] For example, there is no suggestion the former manager could be entitled to any incentive payments as a result of realizations on sales on the Fund's investments during the CCAA proceedings.

[29] The Fund has received a total of $57.0 million in proceeds from realizations on its portfolio investments since the commencement of these CCAA proceedings. The sum of those realizations plus the estimated current fair value of the Fund's remaining portfolio investments is significantly less than the cost of those investments as set out in the most recent audited financial statements of the Fund. Accordingly, the portfolio will have a negative annualized rate of return, which is obviously less than the required Portfolio Test return of 4.25%.

[30] This interpretation is consistent with the commercial purpose of the Class C shares and the three value tests. At this stage, when the Fund is preparing to make distributions to its Class A shareholders, the Fund's portfolio has not generated positive returns that will benefit its Class A shareholders, for over a decade. The performance of the Fund's portfolio has been negative. Any incentive payment that is made to the former manager will only deepen the losses that Class A shareholders have suffered on their investments—a result which is the exact opposite of that intended by the creation of the incentive dividend provisions of the articles.

[31] For these reasons, I conclude that no distribution is payable in respect of the Class C shares.

If Payable, Is It Paid in Priority to Class A Shareholder Distributions?

[32] Had I come to a different conclusion about the former manager's entitlement to a payment in lieu of dividend on dissolution, the former manager would have sought an additional order that its payment ranked ahead of any distribution to the Class A shareholders. Article 4.1(d) governs the Class C share terms. It expressly provides that, on dissolution, the Class C shares "shall rank equally with" the Class A shares. The former manager's claim is not a debt. Any other argument for a priority is simply inconsistent with the express conditions governing the Class C shares. For these reasons, even if I had agreed with the former manager that it was entitled to $672,390.65 as an amount equal to an undeclared dividend, I would have held that the Class C shares rank equally with the Class A shares, such that any distribution would be *pari passu*.

Costs

[33] The parties agreed, this being a CCAA proceeding and this issue needing to be decided as part bringing the process to a close, that there should be no order as to costs.

Penny J.

Date: January 31, 2023