Court File No. CV-14-10518-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
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 PLAN OF COMPROMISE OR ARRANGEMENT OF THE CASH STORE FINANCIAL SERVICES INC., THE CASH STORE INC., TCS CASH STORE INC., INSTALOANS INC., 7252331 CANADA INC., 5515433 MANITOBA INC., 1693926 ALBERTA LTD. DOING BUSINESS AS "THE TITLE STORE"

Applicants

BOOK OF AUTHORITIES OF COLISEUM CAPITAL PARTNERS, LP, COLISEUM CAPITAL PARTNERS II, LP, BLACKWELL PARTNERS, LLC, ALTA FUNDAMENTAL ADVISORS MASTER LP, AND THE AD HOC COMMITTEE OF CASH STORE NOTEHOLDERS IN THEIR RESPECTIVE CAPACITIES AS DIP LENDERS, FIRST LIEN NOTEHOLDERS AND HOLDERS OF SENIOR SECURED NOTES

June 3, 2014

Norton Rose Fulbright Canada LLP
Royal Bank Plaza, South Tower, Suite 3800
200 Bay Street, P.O. Box 84
Toronto, Ontario M5J 2Z4 CANADA

Orestes Pasparakis
Tel: 1.416.216.4815
orestes.pasparakis@nortonrosefulbright.com

Alan B. Merskey
Tel: 1.416.216.4805
alan.merskey@nortonrosefulbright.com
Fax:1.416.216.3930

Lawyers for Coliseum Capital Partners, LP, Coliseum Capital Partners II, LP, Blackwell Partners, LLC, Alta Fundamental Advisors Master LP and the Ad Hoc Committee of Cash Store Noteholders in their respective capacities as DIP Lenders, First Lien Noteholders and Holders of Senior Secured Notes

TO: The Service List

INDEX

INDEX

1 Donovan Waters, Mark Gillen & Lionel Smith, *Waters' Law of Trusts in Canada*, 4th ed (Toronto: Thomson Reuters Canada Limited, 2012).

2 A.H. Oosterhoff et al, *Oosterhoff on Trusts: Texts, Commentary and Materials*, 6th ed (Toronto: Thomson Canada Limited, 2004).

3 *Outset Media Corp. v. Stewart House Publishing Inc.*, [2003] O.J. No. 2558

4 *Salo v. Royal Bank of Canada*, 1998 BCJ No 999 (BCCA).

5 *Barclays Bank PLC v. Devonshire Trust (Trustee of)*, 2011 ONSC 5008.

6 *Fitkid (York) Inc. v. 1277633 Ontario Ltd.*, [2002] O.J. No. 3959 (SCJ).

7 *Shelanu Inc v. Print Three Franchising Corporation* (2003), 64 O.R. (3d) 533 (CA).

8 *Falk Bros. Industries Ltd. v. Elance Steel Fabricating Co.*, [1989] S.C.J. No. 97.

9 *Canada (Superintendent of Bankruptcy) v 407 ETR Concession Company Limited*, 2013 ONCA 769.

10 *Re Van der Liek*, [1970] O.J. No. 1053 (H. Ct. J.).

11 *Orion Industries Ltd. (Trustee Of) v. Weir's General Contracting Ltd.* (2013), 7 C.B.R. (6th) 329.

12 *Eland Distributors Ltd. (Re),* [1998] B.C.J. No. 1761.

13 *St. Anne Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.,* (2005) 255 D.L.R. (4th) 137.

14 *Conte Estate v. Alessandro* (2002), 119 A.C.W.S. (3d) 951 (Ont. S.C.J.).

15 *Canwest Global Communications Corp. (Re)*, 2011 ONSC 2215.

16 *Canwest Global Communications Corp (Re)*, [2009] O.J. No 5379 (SCJ).

17 *Timminco Ltd. (Re)*, 2012 ONSC 2515.

18 *Canwest Global Communications Corp. (Re)*, [2009] O.J. No. 4286 (SCJ)

19 *Steels Industrial Products Ltd. (Re)*, 2012 BCSC 1501

TAB 1

OOSTERHOFF ON TRUSTS:
TEXT, COMMENTARY AND MATERIALS

Sixth Edition
by

A.H. OOSTERHOFF
B.A., LL.B., LL.M.
of the Ontario Bar
Professor, Faculty of Law
The University of Western Ontario

ROBERT CHAMBERS
B.Ed., LL.B., D.Phil. (Oxon.)
of the Alberta Bar
Professor, Faculty of Law
University of Alberta

MITCHELL MCINNES
B.A., LL.B., LL.M., Ph.D. (Cantab.)
of the Alberta Bar
Professor, Faculty of Law
The University of Western Ontario

LIONEL SMITH
B.Sc., LL.B., LL.M. (Cantab.),
D.Phil, M.A. (Oxon.)
of the Alberta Bar
James McGill Professor of Law
Faculty of Law
McGill University

Madame Justice Eileen E. Gillese co-authored the
3rd through 5th editions of this book.

THOMSON
CARSWELL

©2004 Thomson Canada Limited

NOTICE AND DISCLAIMER: All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the publisher (Carswell).

Carswell and all persons involved in the preparation and sale of this publication disclaim any warranty as to accuracy or currency of the publication. This publication is provided on the understanding and basis that none of Carswell, the author/s or other persons involved in the creation of this publication shall be responsible for the accuracy or currency of the contents, or for the results of any action taken on the basis of the information contained in this publication, or for any errors or omissions contained herein. No one involved in this publication is attempting herein to render legal, accounting, or other professional advice.

Library and Archives Canada Cataloguing in Publication

Oosterhoff on trusts : text, commentary and cases on trusts / Robert Chambers ... [et al.].—6th ed.

First-2nd eds. published under title: Cases and materials on the law of trusts; 3rd-4th: A.H. Oosterhoff : text, commentary and cases on trusts; 5th ed.: Oosterhoff & Gillese : text, commentary and cases on trusts.

Includes bibliographical references and index.

ISBN 0-459-24142-7 (bound).—ISBN 0-459-24141-9 (pbk.)

1. Trusts and trustees—Canada—Cases. I. Chambers, Robert, 1957-
II. Oosterhoff, A.H. Oosterhoff & Gillese.

KE787.A7O68 2004 346.7105'9 C2004-903067-1
KF729.O68 2004

Composition: Computer Composition of Canada Inc.

THOMSON
CARSWELL

One Corporate Plaza
2075 Kennedy Road
Toronto, Ontario
M1T 3V4

Customer Service:
Toronto 1-416-609-3800
Elsewhere in Canada/U.S. 1-800-387-5164
Fax 1-416-298-5082

6. The court disapproved of *Jackson* in *Woodar Investment Development Ltd. v. Wimpey Construction.*[127] *Woodar* held that vendors under a contract for the sale of land which requires the purchaser to pay part of the purchase price to a third party cannot recover damages for non-payment of that amount unless they can show that they themselves have suffered a loss or were agents or trustees for the third party.

7. The problem of third party beneficiaries suing on a contract also arises under performance bonds entered into for the protection of suppliers of labour and material on construction projects. In these cases the rule that such third parties cannot succeed in the absence of a trust in their favour is maintained.[128]

However, in *Johns-Manville Canada Inc. v. John Carlo Ltd.*[129] a labour and material bond entitled a claimant to sue on it "as a beneficiary of the trust herein provided for." The court held that this showed a sufficient intention to create a trust in favour of unpaid claimants.

Similarly, in *Truro v. McCulloch*[130] the third party was successful under a construction performance bond because the owner had expressly contracted with the surety as a trustee. This judgment was reversed by the Nova Scotia Court of Appeal[131] but reinstated by the Supreme Court of Canada.[132]

8. In *Re Miller's Agreement*; *Uniacke v. A.-G.*[133] the court held that, in the absence of a trust, an annuitant has no right to sue a party to a contract who has undertaken to pay him periodic annuities.

9. X sold his share in a partnership to his two partners, who covenanted to pay X's daughter an annuity each year after X's death. X died and the partners refused to pay. The daughter sued. What is her cause of action? Will she succeed?

10. Z made a gift of $10,000 to the Society for the Prevention of Cruelty to Cats. Does the Society get the funds in trust or as an accretion to its existing funds and subject to the contractual obligations of its members?[134]

11. The third party beneficiary rule has been abolished in New Brunswick.[135]

5. TRUST AND DEBT

It is often difficult to determine whether a trust or a debt exists in any given situation, but once again they differ conceptually and the consequences of finding one or the other are significant. The test to determine whether a trust or debt was created is simply: what did the parties intend? *Air Canada v. M & L Travel*,[136] below, illustrates the difficulties in applying this test.

127 [1980] 1 W.L.R. 277, [1980] 1 All E.R. 571 (H.L.).

128 See *R. v. Canadian Indemnity* (1963), 43 W.W.R. 641, 5 C.B.R. (N.S.) 293, 41 D.L.R. (2d) 617 (Man. Q.B.) and *Tobin Tractor (1957) Ltd. v. Western Surety Co.* (1963), 42 W.W.R. 532, 40 D.L.R. (2d) 231 (Sask. Q.B.).

129 (1980), 29 O.R. (2d) 592, 12 B.L.R. 80, 113 D.L.R. (3d) 686 (H.C.).

130 (1971), 4 N.S.R. (2d) 480, 22 D.L.R. (3d) 293, [1972] I.L.R. 1 457 (S.C.).

131 (1973), 4 N.S.R. (2d) 459, 30 D.L.R. (2d) 242, [1973] I.L.R. 1-522 (C.A.).

132 (sub nom. *Truro v. Toronto Gen. Ins. Co.*), [1974] S.C.R. 1129, 6 N.S.R. (2d) 163, 38 D.L.R. (3d) 1, [1973] I.L.R. 1-556.

133 [1947] Ch. 615, [1947] 2 All E.R. 78.

134 A full discussion of the ways in which unincorporated associations are treated in law as having received funds is undertaken in Chapter 15, part 4, *infra*.

135 See *Law Reform Act*, S.N.B. 1993, c. L-1.2, s. 4 (proclaimed and in force on June 1, 1994).

136 [1993] 3 S.C.R. 787, 108 D.L.R. (4th) 592, 50 E.T.R. 225, 159 N.R. 1.

There are five major distinctions between the role of a debtor and that of a trustee. First, the debtor is not a fiduciary whereas the trustee is a fiduciary in the highest sense.

Second, a creditor has no interest, legal or equitable, in the property of the debtor. There is simply a personal obligation upon the debtor to repay the debt when it is due. The trust beneficiary, on the other hand, has a beneficial proprietary interest in the trust property.

Third, a debt is created by agreement and the parties may compromise, alter, or extinguish the debt by further agreement. In contrast, there need be no agreement to create a trust. Further, there can be no bargaining between the trustee and the beneficiaries as the trustee must act strictly in the interest of the beneficiaries and not permit his or her own interest to conflict.

Fourth, the debtor always remains liable to the creditor until the debt is paid. The trustee, however, is not personally obligated to compensate the beneficiaries if the trust property is lost other than through the trustee's own fault.[137]

Fifth, the debtor has no duty to invest or deal with the subject property in any particular manner, while the trustee must administer the trust property in accordance with his or her trust duties, which ordinarily include a duty to invest.

The consequences that follow a finding of debt or a trust can be critical in cases of lost or stolen property and in cases of insolvency. If the subject property is lost or stolen, a debtor remains liable to the creditor until the debt is paid, even if the property is lost through no fault of the debtor's own. The trustee, however, does not bear the loss of the trust property unless he or she is at fault.

If the debtor is insolvent, the creditor has no special interest in the subject property and will rank as a general creditor. The trust beneficiary, however, has a proprietary right to the trust property which entitles him or her to rank above all creditors *vis-à-vis* the trust property. It is, therefore, an advantage to be a trust beneficiary rather than a creditor in cases of insolvency.

AIR CANADA v. M & L TRAVEL LTD.

[1993] 3 S.C.R. 787, 108 D.L.R. (4th) 592, 50 E.T.R. 225, 159 N.R. 1
Supreme Court of Canada

M & L Travel Ltd. and Air Canada entered into an agreement providing that all moneys, less commissions, collected by the travel agency on the sale of the airline's travel tickets would be held in trust for the airline. The agency set up trust accounts but never used them. It deposited sale proceeds into its general operating account. When the agency failed to repay a demand loan due to its bank, the bank withdrew the amount outstanding from the agency's general operating account. The airline sued the agency and its two directors personally for breach of trust, claiming as damages the amount it was owed for ticket sales.

137 *Ontario Hydro-Electric Power Commission of Ontario v. Brown* (1959), 21 D.L.R. (2d) 551, [1960] O.R. 91 (C.A.).

TAB 2

WATERS' LAW OF TRUSTS IN CANADA

Fourth Edition

By

Editor-in-Chief

Donovan W.M. Waters, Q.C.

M.A., D.C.L. (Oxon.), Ph. D. (London), LL.D. (Hons.) Victoria, McGill, F.R.S.C.
Emeritus Professor, University of Victoria, B.C., of Lincoln's Inn, Barrister at Law, Counsel, Horne Coupar, Barristers & Solicitors, Victoria, B.C.

Contributing Editors

Mark R. Gillen

B.Comm. (Toronto), M.B.A. (York), LL.B. (Osgoode), LL.M. (Toronto),
Faculty of Law, University of Victoria

Lionel D. Smith

B.Sc., LL.M. (Cantab.), D. Phil., M.A. (Oxon.),
James McGill Professor of Law, McGill University,
of the Bar of Alberta

CARSWELL®

© 2012 Thomson Reuters Canada Limited

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the publisher (Carswell).

Carswell and all persons involved in the preparation and sale of this publication disclaim any warranty as to accuracy or currency of the publication. This publication is provided on the understanding and basis that none of Carswell, the author/s or other persons involved in the creation of this publication shall be responsible for the accuracy or currency of the contents, or for the results of any action taken on the basis of the information contained in this publication, or for any errors or omissions contained herein. No one involved in this publication is attempting herein to render legal, accounting, or other professional advice.

Library and Archives Canada Cataloguing in Publication

Waters' law of trusts in Canada / editor-in-chief, Donovan W.M. Waters; contributing editors, Lionel D. Smith, Mark R. Gillen.—4th ed.

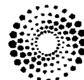
Previously published under title: Law of trusts in Canada / by D.W.M. Waters
Includes bibliographical references and index.
ISBN 978-0-7798-5165-2 (bound).—ISBN 978-0-7798-5166-9 (pbk.)

1. Trusts and trustees—Canada. I. Waters, D. W. M. II. Smith, Lionel D. III. Gillen, Mark R., 1957- IV. Waters, D. W. M. Law of trusts in Canada.

KE787.W38 2005 346.7105'9
C2005-901583-7
KF730.W38 2005

Composition: Computer Composition of Canada Inc.

Printed in the United States by Thomson Reuters



THOMSON REUTERS

CARSWELL, A DIVISION OF THOMSON REUTERS CANADA LIMITED

One Corporate Plaza, 2075 Kennedy Road, Toronto, Ontario M1T 3V4
Customer Relations:
Toronto 1-416-609-3800
Elsewhere in Canada/U.S. 1-800-387-5162
Fax 1-416-298-5094

if title passes in order to allow a range of duties to be discharged by the other, then a trust is created.

Difficulties have always stemmed from the loose employment of the word "trust". It was Blackstone who defined a bailment using the language of trust:[186] "the delivery of goods in trust upon a contract express or implied that the trust shall be duly executed and the goods restored by the bailee as soon as the purpose of the bailment shall be answered." And this inspired later texts to adopt "trust" language. Nor have the authorities been free of a consequent legacy of confusion. But since the beginning of the century it has been clear that the word "trust" means in itself little, even when used in formal documents. Language must be construed in its context. As Riddell J. said in one context:

> The word "trust" has no technical meaning. "Goods held in trust" is a well-known expression in insurance matters, and means "goods held by the insured for which he is responsible to others" – and insurance in this form has always been considered to insure, first, the bailee insuring to the extent of his liens or advances, etc. (if any); and, second, the owner of the goods.[187]

Bailment is essentially "the custody and control" over a thing; "trust" is loosely used as when Blackstone says, "But there are other trusts which are cognizable in a court of law; as deposits and all manner of bailments."[188]

VI. TRUST AND DEBT

As we have seen in distinguishing agency and trusteeship, trust property is always identifiable, either as land, chattels or funds. Specific items must be set aside before it can be said that the trust is ready to take effect. It is the duty of the trustee to administer that specific property for the trust beneficiaries. Most trust property consists of funds, either at the bank or invested in bonds, stocks and shares. But, though it be thus invested, the bank deposit and the other investments are identifiable funds, and remain trust assets, even if they stand in the trustee's name without mention of trust. For this reason trust property is not affected in the event of the trustee's insolvency; the assets of the trust are beyond the reach of the trustee's personal creditors.[189] And if a trustee wrongfully mixes trust assets with his own

---

[186] *Commentaries on the Laws of England*, vol. 2, chapter 30, s. 2.

[187] *Cole v. Merchants Fire Insurance Co.* (1921), 51 O.L.R. 340, 67 D.L.R. 300 (Ont. C.A.) at 348-49 [O.L.R.]. See also *Lesser v. Jones* (1920), 47 N.B.R. 318 (N.B. C.A.) at 322; *Martin v. Town N' Country Delicatessen Ltd.* (1963), 45 W.W.R. 413 (Man. C.A.) at 427.

[188] Quoted and criticized by Moss C.P.O. in *Elgin Loan & Savings Co. v. National Trust Co.*, *supra*, note 181, at 46-47.

[189] E.g., *Prytula v. Prytula* (1980), 30 O.R. (2d) 324, 116 D.L.R. (3d) 474 (Ont. H.C.). The issue of whether the relationship is one of trustee-beneficiary or debtor-creditor may also be significant where an amount is due to B from A but A claims a right to set off amounts owed by B to A. In *Associated Investors of Canada Ltd. (Manager of) v. Principal Savings & Trust Co. (Liquidator of)* (1993), 13 Alta. L.R. (3d) 115, [1994] 1 W.W.R. 750, (sub nom. *Principal Savings & Trust Co. (Liquidation) v. Associated Investors of Canada Ltd. (Receivership)*) 145 A.R. 177 (Alta. C.A.), the trust company,

funds, the trust property remains beyond the creditor's reach until it is no longer "identifiable".

This preference of trust beneficiaries over creditors makes it important to distinguish the trustee-beneficiary relationship from the creditor-debtor relationship. The distinction is clear enough when the trust arises from the intention, express or implied, of the settlor, but when does the law deem a person a constructive trustee of the funds or assets which he holds for another? The answer, as *Ontario Hydro-Electric Power Commission v. Brown*[190] and *Maralta Oil Co. v. Industrial Incomes Ltd.*[191] show, is when the duty of the holder of the funds or assets is to keep that property distinct from his own personal property.[192] For this reason the banker is a debtor *vis-à-vis* its customer; it mixes the customer's money with its own, and is under an

---

being a trustee pursuant to a provision of the trust company legislation, and not a creditor, was not permitted to set off amounts owed to it by the beneficiary.

[190] (1959), [1960] O.R. 91, 21 D.L.R. (2d) 551 (Ont. C.A.). For other cases involving the question of whether the relationship was that of trustee-beneficiary or creditor-debtor see, e.g., *Water Street Pictures Ltd. v. Forefront Releasing Inc.*, 2006 CarswellBC 2476, 26 E.T.R. (3d) 197, 57 B.C.L.R. (4th) 212 (B.C. C.A.), reversing 2005 CarswellBC 596, 14 E.T.R. (3d) 214 (B.C. S.C.); *Giles v. Westminster Savings Credit Union*, 2006 CarswellBC 183, [2006] B.C.J. No. 159 (B.C. S.C.); *Re Kaczmarzyk*, 2006 CarswellOnt 8702 (Ont. S.C.J.); *Stoney Tribal Council v. PanCanadian Petroleum Ltd.* (1998), 218 A.R. 201 (Alta. Q.B.), varied (2000), [2001] 3 C.N.L.R. 347 (Alta. C.A.) at 217 [A.R.]; *Bank of Nova Scotia v. Société Générale (Canada)* (1988), 87 A.R. 133, 58 Alta. L.R. (2d) 193 (Alta. C.A.); *Salo v. Royal Bank* (1988), [1988] B.C.J. No. 999, 1988 CarswellBC 1396 (B.C. C.A.); *Outset Media Corp. v. Stewart House Publishing Inc.* (2003), 34 B.L.R. (3d) 241 (Ont. C.A.), additional reasons at (2003), 34 B.L.R. (3d) 244 (Ont. C.A.); and *Re Blue Range Resource Corp.* (1999), [1999] A.J. No. 929, 1999 CarswellAlta 742 (Alta. Q.B.).

[191] (1964), 49 W.W.R. 175, 46 D.L.R. (2d) 511 (Alta. S.C. (App. Div.)), affirmed [1968] S.C.R. 822 (S.C.C.); *U.A., Local 488 v. J. Neilson & Sons (Mechanical) Ltd.*, [1982] 6 W.W.R. 763, 22 Alta. L.R. (2d) 303 (Alta. Q.B.). It is the obligation to keep the property separate which is important; that it is kept separate as a voluntary act is irrelevant: *Re H.B. Haina & Associates Inc.* (1978), 28 C.B.R. (N.S.) 113, 86 D.L.R. (3d) 262 (B.C. S.C.); *Re Points of Call Holidays Ltd.*, 1991 CarswellBC 471, 41 E.T.R. 56, 54 B.C.L.R. (2d) 384 (B.C. S.C.); and *Bullock v. Key Property Management Inc.*, 1992 CarswellOnt 541, 46 E.T.R. 275 (Ont. Gen. Div.). But *cf. Re Kayford Ltd.* (1974), [1975] 1 W.L.R. 279, [1975] 1 All E.R. 604 (Eng. Ch. Div.). In *Bank of Nova Scotia v. Société Générale (Canada)*, *supra*, note 190, the court noted that a right to commingle funds is a "feature which a court must consider in determining the true relationship created by the agreement between the parties." However, the court concluded that the right to commingle funds was just an "administrative aid" in the implementation of the agreement and did not permit the holder of the funds to put the funds to its own use. The court held the relationship to thus be that of trustee-beneficiary, rather than debtor-creditor, in spite of the right of the holder (trustee) of the funds to commingle the funds. See also *McEachren v. Royal Bank* (1990), 1990 CarswellAlta 234, [1991] 2 W.W.R. 702, 78 Alta. L.R. (2d) 158 (Alta. Q.B.).

[192] *Steffanson v. Jaasma*, [1976] 4 W.W.R. 449 (B.C. S.C.): money was handed to the defendant for one purpose, but was wrongly used for another. There was no constructive trust, because (1) no fiduciary or quasi-fiduciary relationship was intended, i.e., no intention to create a continuing right of property recognized in equity, and (2) the defendant was under no duty to keep the money separate. *Sed quaere* whether after *Becker v. Pettkus*, [1980] 2 S.C.R. 834, 117 D.L.R. (3d) 257 (S.C.C.), number (1), above, is replaced by the requirement of unjust enrichment. Indeed, Meiklem J. came to this conclusion in *Hink v. Saharchuk*, 1999 CarswellBC 2295, [1999] B.C.J. No. 2357 (B.C. S.C. [In Chambers]). For a bank as a constructive trustee, see *infra*, chapter 11.

obligation only to pay out an equivalent sum on demand.[193] The depositor, even if he be an express trustee depositing trust moneys, has only a personal action against the bank; that is the essence of a claim against a debtor. A trustee on the other hand must keep the assets subject to the trust separate, and be ready to hand over those assets when the time comes.[194]

The question which provides the most difficulty is whether the particular holder of title to assets who acknowledges another's interest is trustee or debtor. A trustee must keep the assets of the trust distinct, but in the normal commercial transaction nothing specific is said about this. The duty to keep the assets distinct, if it exists, must be spelled out of the nature of the transaction, the environment in which the parties agree, the type of persons who are the holders of title and the transferor, and whether or not interest payments are to be made by the holder of the assets. If interest is to be paid, the relationship is nearly always that of creditor and debtor.[195]

A good example of the problem is provided by a series of real estate cases concerned with the right of the selling agent to his share of the commission which is held by the listing agent.[196] In *Re Century 21 Brenmore Real Estate Ltd.*, at first instance[197] Anderson J., in a judgment upheld on appeal, readily conceded that trust and contractual debt are not mutually exclusive.

The listing agent contracts with the would-be vendor to find a purchaser of the property, and that contract in its standard form entitles the agent to a commission

---

193 A term deposit is a debt owed by the bank, and is therefore subject to garnishment proceedings: *Bel-Fran Investments Ltd. v. Pantuity Holdings Ltd.*, [1975] 6 W.W.R. 374, 62 D.L.R. (3d) 140 (B.C. S.C.); and *Bank of Montreal v. I.M. Krisp Foods Ltd.* (1996), 1996 CarswellSask 581, [1997] 1 W.W.R. 209, 140 D.L.R. (4th) 33 (Sask. C.A.). Certification of the drawer/debtor's cheque by the bank does not make the bank a trustee of that sum for the payee/creditor. The certification is equivalent to payment by the debtor, but the bank merely becomes the debtor of the creditor. See *Marrs' Marine Ltd. v. Rosetown Chrysler Plymouth Ltd.* (1975), 61 D.L.R. (3d) 497 (Sask. Q.B.).

If by consent the trustee retains the trust fund when the trust is terminated by the settlor, the trustee becomes instead a debtor *vis-à-vis* the settlor. However, if the former (express) trustee agrees to hold the fund in a separate account, does the law of trusts make him a resulting trustee for the former settlor? Obviously it depends upon the terms of the agreement the parties have made as to retention by the former express trustee. See, e.g., *Barclays Bank Ltd. v. Quistclose Investments Ltd.* (1968), [1970] A.C. 567, [1968] 3 All E.R. 651 (U.K. H.L.).

194 The beneficiary has not only a right of action against the trustee personally, and the right to recover trust assets as against the general creditors of the trustee himself, but he can trace the assets into the hands of innocent third party donees, and recover from them.

195 See further, *Restatement, Trusts 3d*, para. 5(k) and the commentary thereon. If interest is to be paid it is almost always a relationship of debtor and creditor, but, even if interest is to be paid, a trust relationship may be found to exist. See, e.g., *Bank of Nova Scotia v. Société Générale (Canada)*, *supra*, note 190; and *McEachren v. Royal Bank of Canada*, *supra*, note 191.

196 *Re Ridout Real Estate Ltd.* (1957), 36 C.B.R. 111 (Ont. S.C.); *Manitoba (Securities Commission) v. Showcase Realty Ltd.* (1978), 28 C.B.R. (N.S.) 24, 84 D.L.R. (3d) 518 (Man. Q.B.), reversed in part (sub nom. *Manitoba (Securities Commission) v. Imperial Bank of Commerce*) [1979] 2 W.W.R. 526, (sub nom. *Re Showcase Realty Ltd.*) 96 D.L.R. (3d) 58 (Man. C.A.), varied on rehearing [1979] 6 W.W.R. 464, (sub nom. *Re Showcase Realty (No. 2)*) 106 D.L.R. (3d) 679 (Man. C.A.); *Re Allan Realty of Guelph Ltd.* (1979), 24 O.R. (2d) 21, 97 D.L.R. (3d) 95 (Ont. Bktcy.); *Re Century 21 Brenmore Real Estate Ltd.* (1979), 100 D.L.R. (3d) 150, 6 E.T.R. 1 (Ont. S.C.), affirmed (1980), 6 E.T.R. 205, 111 D.L.R. (3d) 280 (Ont. C.A.).

197 *Re Century 21 Brenmore Real Estate Ltd.*, *supra*, note 196 (6 E.T.R. 1 at 8).

TAB 3

Case Name:

Outset Media Corp. v. Stewart House Publishing Inc.

Between
Outset Media Corporation, (plaintiff/respondent), and
Stewart House Publishing Inc. and Ken Thomson,
(defendants/appellants)

[2003] O.J. No. 2558

34 B.L.R. (3d) 241

124 A.C.W.S. (3d) 70

Docket No. C39390

Ontario Court of Appeal
Toronto, Ontario

O'Connor A.C.J.O., Morden and Sharpe JJ.A.

Heard: June 18, 2003.
Oral judgment: June 18, 2003. Released: June 26, 2003.

(7 paras.)

Trusts -- Creation of trust -- Transactions not creating trusts -- Surplus from sale.

Appeal by the defendants Stewart House Publishing and Thomson from a decision by a motion judge that Stewart held certain monies in trust. The parties entered into a contract regarding the sale of games to purchasers. The judge held that upon the sale of the games, Stewart acquired a contractual right to appropriate 25 per cent of the sale price as a selling agent's commission. The judge further held that the remaining funds, or the net proceeds of the sale, remained Thomson's property.

HELD: Appeal allowed. The arrangement between the parties was inconsistent with the notion that the proceeds received from the sales were impressed with a trust in favour of Outset. Further, there was no provision in the agreement for the segregation of funds received from the sale of the games.

On appeal from the judgment of Justice Angus D.K. MacKenzie of the Superior Court of Justice dated December 16, 2002.

Counsel:

R. Andrew Biggart and John R. Hart, for the appellants.
Robert C. Taylor, for the respondent.

[Quicklaw note: Supplementary reasons for judgment, which included a correction to the text below, were released July 18, 2003. See [2003] O.J. No. 2934.]

The following judgment was delivered by

1 THE COURT (oral endorsement):-- In our view, the appellant, Ken Thomson, is entitled to raise the argument that the motion judge erred in concluding that Stewart House held the monies in trust even though Stewart House itself has not continued its appeal after its bankruptcy. The conclusion of the motion judge that there was a trust affected the appellant's interest and is a conclusion that is as much against the appellant as it is against Stewart House. The appellant is therefore entitled to appeal that conclusion.

2 In our view, on the record before him, the motion judge erred holding that the amounts owing to the respondent were impressed with a trust. In his reasons, the motion judge misconstrued the legal effect of the provision in the agreement relating to the payments by Stewart House to the respondent.

3 The motion judge said the following:

> Upon sale of the product, Stewart House acquired a contractual right to appropriate to itself 25% of the sale price as a selling agent's commission for the product. Upon appropriating that 25% of the sale price to itself, the remaining funds or net proceeds of sale which represented the product remained the property of the plaintiff.

4 We do not think that the agreement, properly interpreted, means that the net proceeds of sale "remained the property of the respondent". Rather, the agreement provided that Stewart House was contractually obligated to pay to the respondent 75% of the amount invoiced to purchasers. Payments to the respondent did not depend on receipt of payment by Stewart House. The risk of non-payment was assumed by Stewart House not by the respondent. Indeed, there was a specific provision in the agreement to this effect.

5 This arrangement for payment to the respondent is inconsistent with the notion that the proceeds received from sales of the games were impressed with a trust in favour of the respondent.

6 Another factor which points away from the existence of a trust is that the agreement made no provision for the segregation of the funds received by Stewart House from the sale of the games.

7 Accordingly, the appeal is allowed with costs to the appellant, Thomson, the judgment as against the appellant, Thomson, is set aside and the motion for summary judgment is dismissed. The costs of the appeal are fixed on a partial indemnity basis in the amount of $12,000, inclusive of disbursements and G.S.T.

O'CONNOR A.C.J.O.
MORDEN J.A.
SHARPE J.A.

cp/e/nc/qw/qlhcc/qlmjb

TAB 4

Indexed as:

Salo v. Royal Bank of Canada (B.C.C.A.)

Between
John Salo, Peter Swanell, David Weymer and Henry Syrjala, Plaintiffs, (Appellants), and
Royal Bank of Canada and Patrick & Miles Logs Ltd., Defendants, (Respondents)

Vancouver Registry No. CA005921

[1988] B.C.J. No. 999

British Columbia Court of Appeal

Craig, Macfarlane and Wallace JJ.A.

May 5, 1988

G.L. Bisaro, appearing for the Appellants.
D.G. Morrison, appearing for the Respondent Royal Bank of Canada.
L. Kancs, appearing for the Respondent Patrick & Miles Logs Ltd.

CRAIG J.A.:-- Mr. Justice Wallace will give the first judgment.

WALLACE J.A. (for the Court, orally, dismissing the appeal):-- This appeal arises from a transaction in which the plaintiffs (appellants) who were loggers, allege that funds received by their logging broker (the respondent Patrick & Miles Logs Ltd.) from the sale of their logs were subject to an implied trust in their favour. Further, they claimed that the respondent Royal Bank had notice of that trust and that $51,000 of their trust funds could be traced to the Royal Bank since it had received $70,000 by way of reduction of the Patrick & Miles revolving line of credit on the same date that Patrick & Miles had received and deposited a payment of $108,000 for proceeds from logs which it had sold.

The trial Judge, Mr. Justice Toy, concluded that the relationship of the plaintiffs to their logging broker was that of a debtor/creditor and that there was not an implied trust or fiduciary relationship created with respect to the proceeds of the sale of the plaintiffs' logs. Accordingly, he dismissed the plaintiffs' action.

In his carefully reasoned judgment, Mr. Justice Toy reviewed in considerable detail the facts upon which he based his conclusion. It would be redundant to repeat that analysis in these reasons. It is sufficient to note that the findings of fact are well supported by the evidence.

The evidence discloses that Patrick & Miles had been appointed the plaintiffs' broker to sell their logs; that apart from a direction by the plaintiffs that their logs be kept separate from other logs acquired by Patrick & Miles, no direction or control was exercised by the plaintiffs over the manner in which Patrick & Miles performed its function of broker; that apart from expecting and receiving an accounting from Patrick & Miles as to the disposition of the proceeds received and the expenses incurred by it in the sale of the logs, the plaintiffs exercised no direction or control over the manner in which Patrick & Miles dealt with the proceeds received from the sale of the logs; that during the years the plaintiffs dealt with Patrick & Miles they never instructed it to keep the proceeds from the sale of their logs separate from Patrick & Miles' general funds.

Patrick & Miles deposited the proceeds from the sale of the logs of all of their respective clients into a general account from which it made various payments for advances to the clients, payment of disbursements, and payments to the bank on its revolving line of credit.

No interest was paid to the plaintiffs on the proceeds from the sale of their logs by Patrick & Miles, nor was any request made by the plaintiffs for such interest. The bank had no knowledge of the source or ownership of the funds paid into the Patrick & Miles general account - that is, whether they were proceeds from trading accounts or brokerage accounts, or the specific terms of any brokerage arrangement. The payment from Patrick & Miles to the bank on account of its line of credit was made in the normal course of its business practice, and was in accord with the specific arrangements made by Patrick & Miles with the bank.

To this factual background Mr. Justice Toy applied the principles expressed by the Supreme Court of Canada in M.A. Hanna Company v. Provincial Bank of Canada (1935) S.C.R. 144, at pp. 167-168, where Mr. Justice Cannon stated:

> "But, is there evidence of an original trust? Under the agreement, the coal company could and did mix with their own moneys the proceeds of the coal supplied by the appellant and use the proceeds for the purposes of their business, provided they made a payment to the appellant every four weeks. These facts, taken with the provision for the payment of interest on overdue remittances, which was subsequently (Jan. 21, 1932) insisted on by the appellant, and the form of the accounts accompanying the remittances, go far to show that the relation existing after, as well as before, November 11, 1931, was that of debtor

and creditor. See Henry v. Hammond [1913] 2 K.B. 515:

> 'It is clear that if the terms upon which the person receives the money are that he is bound to keep it separate, either in a bank or elsewhere, and to hand that money so kept as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If on the other hand he is not bound to keep the money separate, but is entitled to mix it with his own money and deal with it as he pleases, and when called upon to hand over an equivalent sum of money, then, in my opinion, he is not a trustee of the money, but merely a debtor. All the authorities seem to me to be consistent with that statement of the law.'

Halsbury's Laws of England (2nd Ed.), Vol. 1, p. 247, s. 420, says:

> 'Where money is intrusted to an agent by his principal or received by him on his principal's behalf, it depends upon the terms of the agency whether the agent is bound to keep the money separate or is entitled to mix it with his own. In the former case the agent will be a trustee, in the latter a debtor.'"

Further, Mr. Justice Rinfret at p. 156, stated:

> "I, therefore, come to the conclusion that the agreement of November 11th allowed the Docks Company to deposit the proceeds of the sale of the appellant's coal in the Docks Company's general account and to use the proceeds thereof between the settlement dates, subject only to the obligation of remitting to the appellant a sum of money equivalent to the collections at the end of the remittance period agreed upon between the parties.
>
> As a consequence, the relation of the Docks Company towards the appellant in respect of the funds collected was not that of agent or trustee, but the relation between them was that of debtor and creditor (Henry v. Hammond [1913] 2 K.B. 515). The Docks Company had the use of the funds and could dispose of them as its own; and, in that aspect of the question, it is, of course, immaterial whether they disposed of it in favour of the bank respondent or in favour of other persons."

Both these passages are particularly pertinent to the case at bar where the factual circumstances are unusually similar.

Despite the very able submissions of counsel for the appellants, I am of the view that the findings of fact of Mr. Justice Toy were well supported by the evidence and he correctly applied the appropriate principles. Accordingly, I would dismiss the appeal.

WALLACE J.A.
CRAIG J.A.:-- I agree.
MACFARLANE J.A.:-- I agree.
CRAIG J.A.:-- The appeal is dismissed.

TAB 5

Case Name:

Barclays Bank PLC v. Devonshire Trust (Trustee of)

Between
Barclays Bank PLC, Plaintiff, and
Metcalfe & Mansfield Alternative Investments VII Corp., in its capacity as Trustee of Devonshire Trust, The Bank of New York as Custodian, and CIBC Mellon Trust Company, in its capacity as Indenture Trustee, Defendants

[2011] O.J. No. 3988

2011 ONSC 5008

82 C.B.R. (5th) 159

93 B.L.R. (4th) 205

2011 CarswellOnt 9183

Court File No. CV-09-0370103

Ontario Superior Court of Justice
Commercial List

F.J.C. Newbould J.

Heard: September 21, 27, October 1, 4, 6, 12-15, 18-22, 25-29, November 2-5, December 6-10, 13-17, 2010; April 18-21, 26-29, May 2-4, 9-10, and June 6-9, 2011.
Judgment: September 7, 2011.

(482 paras.)

Contracts -- Performance and discharge -- Termination -- By notice -- Action for breach of contract dismissed ---- Devonshire held income-producing assets financed through asset backed commercial paper -- Plaintiff was asset and liquidity provider to Devonshire -- Under Master Agreement between parties, Devonshire acquired two credit default swap transactions from plaintiff -- Plaintiff failed to pay liquidity funds to Devonshire in 2007 -- Plaintiff paid funds in 2009 and purported to

terminate Agreement based on defendant's insolvency -- Plaintiff could not terminate agreements early -- Plaintiff failed to make timely payment to Devonshire in 2009 before delivering notice of termination -- Plaintiff breached its good faith obligations under Master Agreement.

Contracts -- Breach of contract -- Action for breach of contract dismissed ---- Devonshire held income-producing assets financed through asset backed commercial paper -- Plaintiff was asset and liquidity provider to Devonshire -- Under Master Agreement between parties, Devonshire acquired two credit default swap transactions from plaintiff -- Plaintiff failed to pay liquidity funds to Devonshire in 2007 -- Plaintiff paid funds in 2009 and purported to terminate Agreement based on defendant's insolvency -- Plaintiff could not terminate agreements early -- Plaintiff failed to make timely payment to Devonshire in 2009 before delivering notice of termination -- Plaintiff breached its good faith obligations under Master Agreement.

Action for breach of contract. The plaintiff was the asset and liquidity provider to the defendant Devonshire Trust. Devonshire was established as the special purpose trust for the purpose of acquiring and holding income-producing assets financed through the issuance of asset backed commercial paper. In 2006, the plaintiff and Devonshire entered into several agreements, including an International Swap Dealers Association Master Agreement. Under the agreements, Devonshire acquired two credit default swap transactions from the plaintiff. Under these transactions, Devonshire sold the plaintiff protection against the possibility of credit defaults in a portfolio of debt obligations not owned by the plaintiff. The plaintiff paid a monthly premium to Devonshire for this protection. When the market froze in August 2007, Devonshire, like other independent conduits, was unable to roll its Class A notes. The plaintiff then entered into a Consortium Agreement which contained a long-term proposal under which all outstanding asset backed commercial paper would be converted into term floating rate notes maturing no earlier than their scheduled termination dates and the signatories, including the plaintiff, agreed in principle to the long-term proposal and to work in good faith to bring about its timely implementation. Devonshire sent market disruption notices to the plaintiff in 2007 requesting payments under the liquidity facility it had with the plaintiff to be used to pay the noteholders whose notes had become due. The plaintiff took the position that no market disruption event as defined in the relevant agreement had occurred and refused to provide any liquidity payments to Devonshire. Devonshire delivered a default notice to the plaintiff. Suspension Notices suspended the notice of default sent by Devonshire until the end of the Standstill Period to allow the plaintiff to implement the Consortium Agreement. In 2009, the plaintiff wired to Devonshire's bank the liquidity payments demanded by Devonshire in 2007. The plaintiff then delivered its notice of termination of the Master Agreement based on an alleged insolvency of Devonshire. On the same day, Devonshire delivered a notice purporting to terminate the Master Agreement for the plaintiff's failure to pay the liquidity calls made in 2007. Devonshire argued that the plaintiff's failure to make the liquidity payments was the proximate cause of its insolvency and that the plaintiff should not be able to take advantage of its breach by relying on Devonshire's insolvency.

HELD: Action dismissed. The plaintiff could not rely on its notice of early termination of 2009. The plaintiff failed to make timely payment to Devonshire in 2009 before delivering its notice of early termination and could not rely on the conditional payment it made by reason of its breach of its good faith obligations under the Master Agreement. The plaintiff obtained the last two extensions of the Standstill Period misrepresenting to Devonshire that its negotiations with the Caisse under the Consortium Agreement were progressing. The misrepresentations influenced the decision of Devonshire to accept those extensions and were reasonably relied on by Devonshire to its detriment. Devonshire was entitled to rescission of the last two extensions. Although Devonshire was insolvent when the liquidity payments were made by the plaintiff in 2009, the plaintiff elected not to terminate swap contracts on the basis of the insolvency of Devonshire. Its notice of early termination on the ground of Devonshire's insolvency was thus ineffective. It was only after the liquidity funds were transferred into Devonshire's account that the funds were made available to Devonshire. Based on the timing of the fund transfer, the plaintiff failed to pay the outstanding liquidity amount before purporting to terminate the swap contracts. As the plaintiff was not a non-defaulting party, it had no right under the Master Agreement to deliver its notice of early termination when it did. The plaintiff's conduct leading up to its purported termination of the swap contracts in 2009 breached its good faith obligations. Devonshire was entitled to terminate the agreement. Any amounts payable to the plaintiff on the termination were subordinated to amounts payable to Devonshire. By reason of the Intercreditor Agreement, Devonshire was entitled to receive $532,668,082 as the Base Calculation Amount as well as the Unpaid Amounts claimed, together with interest.

Counsel:

Peter F.C. Howard, Eliot N. Kolers, Samaneh Hosseini and Lindsey Love-Forester, for the plaintiff.

J. Thomas Curry, Monique J. Jilesen, Kate McGrann and Brendan Gray, for the defendant Metcalfe & Mansfield Alternative Investments VII Corp., in its capacity as Trustee of Devonshire Trust.

Jeffery S. Leon, for the defendant, CIBC Mellon Trust.

[Editor's note: An amended judgment was released by the Court May 18, 2012. The changes were not indicated. This document contains the amended text.]

REASONS FOR JUDGMENT

1 F.J.C. NEWBOULD J.:-- This judgment is lengthy and an index at the outset will assist in making headway through what is by any account a complex matter.

Index

1. Prelude
2. Asset Backed Commercial Paper market
3. The Barclays and Devonshire swap transactions
4. The Montreal Accord
5. Interim suspension of rights
6. Events of January 13, 2009 and litigation
7. Bifurcation order
8. Credibility of witnesses
9. Which law governs the Montreal Accord, the Suspension Notice and Extension Agreements?

(a) Principles of interpretation

10. Did Barclays waive its right to remedy its default?
11. Effect of the Suspension Notice
12. Misrepresentation claim

(a) Nature of claim
(b) Relevant facts
(c) Analysis
(d) Result of misrepresentation

13. Can Barclays rely on the insolvency of Devonshire to terminate the swaps?

(a) Was Devonshire insolvent on January 13, 2009?
(b) Did Barclays elect to abandon its right to rely on the insolvency of Devonshire?
(c) Is Barclays prevented by its own wrongdoing from relying on Devonshire's insolvency?
(d) Should a term be implied preventing Barclays from relying on the insolvency of Devonshire?
(e) Could Barclays cure its failure to make the liquidity payments?
(f) Did Barclays make the liquidity payments on time to enable it to terminate the swaps?

14. Did Barclays act in breach of a duty of good faith?
15. Did Barclays have the right to terminate the ISDA Master Agreement?

16. Did Devonshire have the right to terminate the ISDA Master Agreement?
17. Settlement on Barclays default
18. Settlement on Devonshire default

(a) Evidence of Leslie Rahl
(b) Valuation date
(c) Loss as of January 13, 2009
(d) Mitigation issues
(e) Barclays' recourse

19. Conclusion

1. Prelude

2 This action arises from the events in 2007 and 2008 surrounding the liquidity crisis in the asset backed commercial paper (ABCP) market in Canada that led to a portion of the ABCP market referred to as the third party or independently sponsored ABCP market being compromised and restructured under the CCAA in 2008-9. The Devonshire Trust was the only trust, or in the jargon of the market, the only "conduit" in the independently sponsored Canadian ABCP market that was not a party to the CCAA restructuring.

3 The plaintiff Barclays Bank PLC was counterparty to Devonshire by virtue of it being the asset and liquidity provider to Devonshire, as will be explained. It was only through the Devonshire Trust that Barclays participated in the Canadian ABCP market.

4 Barclays and Devonshire each claim that the other breached the relevant agreements. The rights of Barclays and Devonshire in this action depend in part on the interpretation of the legal documentation that governs their relationship. The deal between them took nine months to negotiate. Each side had businessmen who were legally trained and who were advised by teams of outside lawyers. The legal documentation is byzantine in its complexity and would make the work of the most Philadelphian of lawyers look like mere child's play. The financial product involved was relatively new and complex, with many acronyms being used by the players as short form descriptions.

5 There is collateral of $600 million plus interest held in trust. There is a further amount of approximately $183 million plus interest held by Devonshire. Barclays claims to have suffered a loss of $1.2 billion and claims entitlement to all of the funds. Devonshire claims to be entitled to all of the funds in order to pay the outstanding noteholders of Devonshire.

2. Asset Backed Commercial Paper market

6 Commercial paper is a term used to refer to promissory notes, or bonds, issued in the commercial world. Asset backed commercial paper (ABCP) is a term used that refers to commercial paper secured, or backed, by some asset. A secured note is a shorter description of ABCP.

7 In the market involved in this case, securitization is a method of raising financing. It involves the use of a special-purpose entity such as a trust that repackages the cash flow from income-producing financial assets into securities, or notes, that are purchased by investors in the debt capital markets. In a securitization transaction, financial assets are purchased by the trust from operating or finance companies that sell or "originate" those assets. Examples of so-called traditional assets that are securitized are mortgages, loans, leases, and credit card receivables. Other assets are called "structured financial assets", including "synthetic" assets such as credit default swaps (CDS), which were used in the transactions between Barclays and Devonshire.

8 In securitizations, the trust (or conduit) acquires assets and earns a return from the income produced by those assets. To pay for the assets, the conduit issues ABCP. The ABCP is sold and interest is paid by the trust to the investors holding the notes at a spread over the Canadian Dealer Offered Rate ("CDOR"). The trust earns revenue on the spread between its return on the underlying asset and the cost of interest it must pay its investors on its ABCP.

9 The ABCP market in Canada at the relevant times was described by Purdy Crawford, Q.C., who was the chairman of an investor's committee that spearheaded the restructuring of the independent conduits in the Canadian ABCP market. In his affidavit filed in CCAA proceedings, Mr. Crawford described the market and the problems that arose as follows:

> [7] Before the week of August 13, 2007, there was an operating market in ABCP. Various corporations (referred to below as "Sponsors") arranged for the Conduits to make ABCP available as an investment vehicle bearing interest at rates slightly higher than might be available on government or bank short-term paper.
>
> [8] The ABCP represents debts owing by the trustees of the Conduits. Most of the ABCP is short-term commercial paper (usually 30 to 90 days). The balance of the ABCP is made up of commercial paper that is extendible for up to 364 days and longer-term floating rate notes. The money paid by investors to acquire ABCP was used to purchase a portfolio of financial assets to be held, directly or through subsidiary trusts, by the trustees of the Conduits. Repayment of each series of ABCP is supported by the assets held for that series, which serves as collateral for the payment obligations. ABCP is therefore said to be "asset-backed."
>
> [9] Some of these supporting assets were mid-term, but most were long-term, such as pools of residential mortgages, credit card receivables or credit default

swaps (which are sophisticated derivative products). Because of the generally long-term nature of the assets backing the ABCP, the cash flow they generated did not match the cash flow required to repay maturing ABCP. Before mid-August 2007, this timing mismatch was not a problem because many investors did not require repayment of ABCP on maturity; instead they reinvested or "rolled" their existing ABCP at maturity. As well, new ABCP was continually being sold, generating funds to repay maturing ABCP where investors required payment. Many of the trustees of the Conduits also entered into back-up liquidity arrangements with third-party lenders ("Liquidity Providers") who agreed to provide funds to repay maturing ABCP in certain circumstances.

[10] In the week of August 13, 2007, the ABCP market froze. The crisis was largely triggered by market sentiment, as news spread of significant defaults on U.S. sub-prime mortgages. In large part, investors in Canadian ABCP lost confidence because they did not know what assets or mix of assets backed their ABCP. Because of this lack of transparency, existing holders and potential new investors feared that the assets backing the ABCP might include sub-prime mortgages or other overvalued assets. Investors stopped buying new ABCP, and holders stopped "rolling" their existing ABCP. As ABCP became due, Conduits were unable to fund repayments through new issuances or replacement notes. Trustees of some Conduits made requests for advances under the back-up arrangements that were intended to provide liquidity; however, most Liquidity Providers took the position that the conditions to funding had not been met. With no new investment, no reinvestment, and no liquidity funding available, and with long-term underlying assets whose cash flows did not match maturing short-term ABCP, payments due on the ABCP could not be made -- and no payments have been made since mid-August.

3. The Barclays and Devonshire swap transactions

10 Quanto Financial Corporation, the sponsor and financial services agent of Devonshire, was formed in October, 2005 by Mr. Lafleur-Ayotte and Mr. Alain Pelchat, both of whom had been with National Bank. Mr. Lafleur-Ayotte and Mr. Pelchat had started up the conduit business while at National Bank, setting up three conduits. They left National Bank to establish Quanto, at which time National Bank transferred the conduit business to Quanto. Each of Mr. Lafleur-Ayotte and Mr. Pelchat owned 20% of Quanto at the outset, the other shareholders being National Bank and Deutsche Bank, each as to 15% and the balance of 30% being owned by key employees.

11 In the fall of 2005 Mr. Lafleur-Ayotte and Mr. Pelchat began discussions with Barclays regarding a conduit business. They knew Mr. Lovisolo of Barclays from earlier days when all three

worked at Deutsche Bank and they knew Mr. Neville of Barclays whom they had met while working for National Bank. The transaction with Barclays was negotiated and eventually agreed in August, 2006 and amended in December, 2006.

12 Devonshire and Barclays entered into an ISDA[1] Master Agreement dated as of July 6, 2006, an Amended and Restated Master Credit Derivatives Confirmation Agreement dated December 1, 2006, two Amended and Restated Transaction Supplements dated August 16, 2006 and August 25, 2006 and two Amended and Restated Seller Credit Support Annexes (CSAs) also dated August 16, 2006 and August 25, 2006, a Trust Indenture dated August 2, 2006 and a Series A Supplemental Indenture made as of August 2, 2006, which, along with detailed Schedules and Annexes to these agreements, governed the credit derivative transaction between the parties.

13 Devonshire was established as the special purpose trust for the purpose of acquiring and holding income-producing assets financed through the issuance of ABCP. Under the terms of the agreements between the parties, Devonshire was only permitted to acquire assets from Barclays. The two transactions in dispute were intended to be only the first of several transactions between the parties, but they became the only transactions.

14 Barclays was the "asset provider" to Devonshire. The assets acquired by Devonshire from Barclays were two credit default swap transactions, or contracts, between Barclays and Devonshire called "synthetic leveraged super senior credit default swaps". Synthetic leveraged super senior credit default swap transactions came into the market in Canada in the fall of 2004 and were made by the independent conduits. The bank sponsored conduits did not enter into leveraged super senior contracts.

15 Under these transactions, Barclays was a "credit protection buyer" and Devonshire was a "credit protection seller". That is, Devonshire sold Barclays protection against the possibility of credit defaults in a portfolio of debt obligations not owned by Barclays. Barclays paid a monthly premium to Devonshire for this protection and Devonshire agreed that if the level of losses in the portfolio reached a certain point, Devonshire would pay an amount to Barclays.

16 The term of the two swaps was to run until 2016. The monthly premium paid to Devonshire by Barclays for this protection was the source of the payments to the noteholders who purchased their ABCP from Devonshire.

17 The portfolio of underlying debt obligations consisted of 130 corporate bonds issued by various corporations in the first swap and 100 in the second swap, as well as various asset backed and mortgaged backed securities. The contents of the portfolio were negotiated between Barclays and Devonshire. Thus the transactions were called "bespoke" transactions. Because Barclays did not have any ownership interest in the pool of assets for which it was buying credit protection, the swaps were called "synthetic".[2]

18 In order to secure the contingent obligation of Devonshire to Barclays if there were credit

defaults in the underlying portfolio, Devonshire was required to, and did, pay $300 million to Barclays for each transaction, or $600 million in total, at the outset of the transactions. Under the relevant agreements, if there were no defaults in the underlying portfolio of obligations at the end of the agreements in 2016 that required Devonshire to pay Barclays, Barclays was obliged to repay Devonshire the $600 million. In order to secure this obligation to repay Devonshire, Barclays was required to, and did, post $600 million of its own assets or funds as collateral, and it is held by Bank of New York under a custodian agreement.

19 The swaps were called "leveraged" because while the amount that Devonshire could be called upon to pay under each swap was $3 billion, Devonshire was required to post collateral for this obligation of only $300 million for each swap. Thus the swaps were initially leveraged on a 10 to 1 basis, which allowed Devonshire to be paid premiums on $6 billion worth of protection for initial collateral of one-tenth that amount. However, to protect Barclays in the event that the value of the swaps to Barclays increased beyond certain trigger points based on a mark to market[3] valuation of the underlying portfolio for which credit protection was being purchased, Devonshire agreed to post further collateral to Barclays on certain conditions. This was to protect Barclays against its "gap risk", being the risk that the collateral held by Barclays was less than the loss to Barclays in the event that there was early termination of the swaps.

20 The credit risk of the bond portfolio was broken into "tranches" and Devonshire was responsible only for losses in the tranche referred to as the "super senior" tranche. If aggregate losses in the bond portfolio exceeded 15% in the case of one of the swaps and 16% for the other the ("attachment point") Devonshire became liable for a portion of those losses.[4] The super senior tranche went up to 62.5% ("detachment point") for one swap and 60% for the other. Because of the quality of the corporate bonds which made up the underlying portfolio on which Barclays bought credit protection,[5] it was thought by both Barclays and Devonshire that it would be highly unlikely that any losses would occur during the term of the swaps that would reach the attachment point, and thus highly unlikely that Devonshire would ever be called upon to pay anything to Barclays for losses in the super senior tranche.

21 There were three classes of notes of one series issued by Devonshire, being short term notes (Class A), extendible notes (Class E) and floating rate term notes (Class FRN). The Class A notes were short term notes that matured within 30 to 90 days and were either rolled over on maturity by the holders or cashed in with new notes being issued by Devonshire to other investors. In order to ensure that there would be funds available to Devonshire to buy up maturing Class A notes in the event notes could not roll over, Barclays agreed to be a "liquidity provider' to Devonshire. This means that Barclays agreed to supply funds to repay Devonshire's maturing Class A notes upon the occurrence of a "Market Disruption" event. Barclays' maximum obligation as liquidity provider was to provide $205 million in liquidity payments for one year, later extended to two years. Devonshire paid a monthly fee to Barclays for this liquidity protection.

22 Whether there was a "Market Disruption" in August 2007 became a hotly contested issue.

23 There were other features of the transactions that have taken on an importance in this litigation. One was what was described by Barclays in internal trade approval documentation as a non-standard non-recourse feature that did not permit any claim against Devonshire if upon the "unwind" or termination of the transactions, the collateral posted by Devonshire was not sufficient to cover Barclays loss. What collateral is available to Barclays in the event of a default by Devonshire is contested.

24 Another is what Devonshire describes as a stop-loss provision, under which Devonshire had the right upon being called to post more collateral during the life of the swaps to terminate the swaps rather than post more collateral. The effect of this provision plays a role in the debate in the case as to the losses claimed by Barclays to have been suffered upon the termination of the swaps.

4. The Montreal Accord

25 It was on August 13, 2007 that the independent ABCP market froze in Canada. Because of the uncertainty in the marketplace and the increased lack of liquidity, the spreads on ABCP notes quickly widened, which raised the likelihood of collateral calls being made on the conduits by the asset providers to provide more collateral to secure the asset providers. Because noteholders were not rolling their notes, liquidity calls were being made by conduits for cash to pay out these noteholders on their ABCP that became due.

26 A meeting of the major players in the independent ABCP market was held in Montreal on August 15 and into the early hours of August 16. It was organized in large part by the Caisse, a very large investor in ABCP, and by National Bank, a large dealer of ABCP. It was attended by ABCP noteholders, dealers, and asset and liquidity providers. Barclays attended the meeting. The conduits were not represented. The idea was to get the asset providers to agree on a moratorium against any collateral calls being made for more security and a moratorium on the conduits from making liquidity calls for funds to pay noteholders who were not rolling their notes. As Mr. Davis of National Bank testified, the purpose was to prevent a blow-up of the market and to have everyone put their weapons down and take a pause.

27 On August 16, 2007, before the opening of the markets, an agreement known as the Montreal Accord was made. It contained an interim agreement for 60 days called the Standstill Period that precluded calls by the conduits for liquidity payments and calls by the asset providers for collateral to be posted by the conduits. The Montreal Accord also contained a proposal with a framework of principles to be used in restructuring each of the conduits. It was later extended to March 14, 2008.

28 Barclays, the asset and liquidity provider to Devonshire, was a signatory to the Montreal Accord. Major note holders of Devonshire who signed the Montreal Accord were the Caisse, National Bank and Desjardins Group. There were 22 conduits in the independent ABCP market at the time of the Montreal Accord. They initially were not signatories to it. However on October 15, 2007 Devonshire and all other affected conduits signed it.

29 Following the Montreal Accord, a "Pan-Canadian Third Party Asset-Backed Commercial Paper Investors Committee" was formed by investors of ABCP notes to negotiate for investors in the restructuring of the ABCP market. Purdy Crawford Q.C. was appointed its chairman. It was the Investors Committee and its advisors, including Goodmans and JPMorgan, who spearheaded the negotiations on behalf of the conduits, including Devonshire.

30 On December 23, 2007 a "Framework Agreement" was made covering 20 of the trusts[6]. This was an agreement in principle as to how those conduits were to be restructured and it eventually led to a restructuring under the CCAA. Barclays was not a signatory to the Framework Agreement as it was not prepared to make the kind of concessions required by that agreement.

31 From then on the attempts to restructure Devonshire were carried on outside the provisions of the Montreal Accord. The discussions for the most part did not involve Devonshire. They were carried on by the major note holders of Devonshire, together with the Investors Committee, directly with Barclays.

32 A CCAA filing took place in March, 2008 covering the restructuring of the 20 conduits that were parties to the Framework Agreement of December 23, 2007. The CCAA plan was later approved by Campbell J. and then by the Court of Appeal in August, 2008. After that, because of dramatic market changes that took place in the fall of 2008 following large financial failures, including Lehman Brothers, the plan was twice renegotiated in December, 2008 at the insistence of the Investors Committee led by Purdy Crawford. This larger restructuring closed in January, 2009.[7]

5. Interim suspension of rights

33 When the market froze on August 13, 2007, Devonshire, like other independent conduits, was unable to roll its Class A notes, meaning noteholders whose notes became due on those days were unwilling to roll them over for new notes and Devonshire was unable to sell other notes to obtain funds to pay the noteholders whose notes had become due. Devonshire sent market disruption notices to Barclays on August 13, 14 and 15 requesting payments from Barclays under the liquidity facility it had with Barclays to be used to pay the noteholders whose notes had become due. Barclays took the position that no market disruption event as defined in the relevant agreement had occurred and refused to provide any liquidity payments to Devonshire. On August 14, 2007 Devonshire delivered a default notice to Barclays, the effect of which was to give Barclays three days to cure the default.

34 Because of the Montreal Accord, and in order to allow negotiations to take place with a view to restructuring Devonshire, Devonshire delivered a Suspension Notice to Barclays on August 16, 2007 in which it suspended without prejudice the effect of the default notice it had sent to Barclays and agreed not to take any further steps to enforce its rights under that notice until the end of the Standstill Period. Barclays wanted Devonshire to simply rescind the default notice, but Devonshire refused unless further assurances were provided, which did not occur. This Suspension Notice was extended for fixed periods of time until February 22, 2008, then daily until March 14, 2008, then for

a fixed period until April 16, 2008, and thereafter on a daily basis until January 12, 2009.

35 The effect of the Suspension Notice is contested. Further, Devonshire claims that the daily extensions of January 8 and 9, 2009 contained misrepresentations of fact by Barclays entitling Devonshire to set aside those extensions.

6. Events of January 13, 2009 and litigation

36 The last daily extension between Barclays and Devonshire was made on Friday, January 9, 2009 effective through the close of business on Monday. January 12, 2009.

37 Shortly after 9 a.m. on January 13, 2009 Barclays delivered a notice to Devonshire purporting to terminate the ISDA Master Agreement based on an alleged insolvency of Devonshire. Just moments before that, Barclays had given notice that it would pay to Devonshire under protest the past due liquidity amount under the market disruption notices given by Devonshire on August 13, 14 and 15, 2007, plus interest, and these funds, some $71,000, were sent by Barclays just before 9 a.m. and received in Devonshire's bank account around 11 a.m. that morning. Barclays also issued and served its statement of claim that morning commencing this action.

38 Devonshire did not accept that Barclays had grounds to terminate the ISDA Master Agreement. On the same day, at 2:22 p.m., Devonshire delivered a notice to Barclays purporting to terminate the ISDA Master Agreement for failure of Barclays to pay the liquidity calls made by Devonshire on August 13, 14 and 15, 2007.

7. Bifurcation order

39 Prior to this trial, a bifurcation order was made by Campbell J. on consent, in which it was agreed that a number of issues would be bifurcated. The bifurcated issues were (i) whether there was a market disruption event in August 2007, (ii) whether Devonshire's market disruption notices and notice of default were valid, (iii) whether Barclays was in default under the notices sent by Devonshire up to August 16, 2007, (iv) whether Devonshire was precluded from asserting the occurrence of a market disruption event. It was agreed that for the purposes of this "first trial", these issues would be determined in favour of Devonshire without prejudice to the position of Barclays that its payment on January 13, 2009 cured any default.

40 On October 15, 2010 I made a ruling as to what evidence could be led in this first stage of the trial as a result of the bifurcation order. In particular, I ruled that the only evidence pertaining to the alleged default of Devonshire that could be led at this stage was evidence relating to the claim that Devonshire was insolvent at some time after August 16, 2009.

8. Credibility of witnesses

41 This case is one of extreme complexity involving a market unknown to all but those who have

practised in it. I was fortunate to have counsel who recognized the need to make things intelligible, no doubt born from their need to understand the market from the time they first became involved many years ago. The witnesses all did their best to simplify matters to the extent that they could be simplified, and to explain the myriad of concepts. As might be expected, the witnesses without exception were highly educated and intelligent.

42 Much of what happened in this case took place by e-mail. There were a large number of telephone conversations amongst the various participants, most of which were recorded because they were made on traders' lines that are automatically recorded, and transcripts of these calls were made exhibits. This was not a case, however, which could be decided on the basis of only such evidence. Issues were raised which required consideration of the credibility and reliability of the evidence of some witnesses. In making credibility and reliability assessments, the statement of O'Halloran J.A. in *Faryna v. Chorny* [1952] 2 D.L.R. 354 (B.C.C.A.), is helpful:

> The credibility of interested witnesses...cannot be gauged solely by the test of whether the personal demeanour of the particular witness carried conviction of the truth. The test must reasonably subject his story to an examination of its consistency with the probabilities that surround the currently existing conditions. In short, the real test of the truth of the story of a witness in such a case must be its harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions. ... Again a witness may testify what he sincerely believes to be true, but he may be quite honestly mistaken.

43 While I found the evidence of the fact witnesses of Barclays extremely helpful, I must say that I found some of them too engaged in trying to sell their case regarding the state of negotiations between Barclays and the Caisse and the state of the market, and as will be discussed, I have not been able to accept all of their evidence as reliable or credible. Regarding the fact witnesses called by Devonshire, I did not have the same concerns. Some had better recollection than others, as is not unusual, but they all attempted to give their evidence according to their recollection of things. Regarding Mr. Lafleur-Ayotte, I found him to be loquacious, and one of those persons who, when asked a question, hears more in the question than asked and drifts off into areas not directly responsive to the question. I did not find him purposely doing so, however, and did not find him trying to argue the case any more than most witnesses are prone to do. I found his evidence generally to be credible and reliable.

44 Regarding the expert witnesses and their valuation evidence, a trial judge is entitled to accept or reject the evidence of an expert witness in whole or in part. The fact that the evidence of a witness is accepted or rejected in any part does not mean that the whole of the evidence of that witness must be accepted or rejected. A trial judge need not accept the valuation of the experts, and is entitled to make his own calculations to arrive at a valuation. See *R. v. Towne Cinema*, [1985] 1 S.C.R. 494 and *Connor v. The Queen*, [1979] C.T.C. 365, 79 D.T.C. 5256 (F.C.A.). In *Connor*,

Urie, J., referred to the trial judge's reasons, [1978] F.C.J. No. 905, and stated:

> ... In this case he accepted some of the evidence but he rejected in all cases the methods, at least in part, whereby the experts arrived at their valuations. He was entitled to do so and unless it can be said that thereafter he proceeded on a wrong principle or that he made a palpable error in reaching his own conclusions as to value, we ought not to interfere with his findings. We have not been persuaded by the arguments of counsel that he proceeded on a wrong principle or made any such error. Certainly he appears to have adopted parts of the methods used by the witnesses in making their calculations but in using only parts and not the whole of their respective methods we do not believe that he erred in law.

See also generally the decision of Greenberg J. in re *Domglas Inc; Domglas Inc. v. Jarislovsky* et al (1981) 13 B.L.R. 135; aff'd (1982) 138 D.L.R. (3d) 521, as to the role of a judge in setting value. In that case, Greenberg J. fixed value guided by, but not slavish to, the values and factors chosen by the various experts. See also my comments in *Consulate Ventures Inc. v. Amico Contracting & Engineering (1992) Ltd.* (2010), 318 D.L.R. (4th) 513; aff'd [2011] O.J. No. 2476 (C.A.).

9. Which law governs the Montreal Accord, the Suspension Notice and Extension Agreements?

45 Devonshire contends that the contractual relations between Devonshire and Barclays embodied in the Montreal Accord, the Suspension Notice and extension agreements are governed by Quebec law and subject to an obligation to act in good faith, among other things. None of these agreements state what law governs them.

46 Where an agreement does not stipulate the governing law, a court will, if possible, infer the parties' choice of law from the circumstances of the case. If it is not possible to infer the parties' intention in this manner, then the proper law is determined by the application of the "closest and most real (or substantial) connection" test. See J. Walker, *Castel & Walker Canadian Conflict of Laws*, loose-leaf, 6th ed. (Markham, Ontario: LexisNexis, 2005) at s.31.2c and d.

47 With respect to determining the proper law of the contract by considering the system of law that has the closest and most substantial connection with the transaction, Ritchie J. stated in *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R. 443 at p 4:

> [T]he problem of determining the proper law of the contract is to be solved by considering the contract as a whole in light of all the circumstances which surround it and applying the law with which it appears to have the closest and most substantial connection.

48 The Suspension Notice recited the ISDA Master Agreement, the market disruption notices delivered by Devonshire under the Special Provisions Annex of that agreement and the default

notice delivered by Devonshire under the ISDA Master Agreement. The ISDA Master Agreement expressly provides that it is to be governed by and construed in accordance with the laws of Ontario and the laws of Canada applicable in Ontario.

49 The Suspension Notice provides that in light of the Montreal Accord and at the request of the consortium that signed it, Devonshire "hereby suspends without prejudice the effect of the Default Notice and agrees not to take any further steps or proceedings to enforce its rights thereunder until the end of the Standstill Period..." Thus the central issue as to the meaning of the Suspension Notice involves the effect of suspending the default notice and agreeing not to take steps to enforce Devonshire's rights under it. That is, it involves the extent to which the suspension of the default notice affected or amended the rights of the parties under the ISDA Master Agreement. The inescapable inference, in my view, is that as the Suspension Notice did not expressly provide what law was to govern it, the law governing the ISDA Master Agreement and the default notice, i.e. Ontario law, would be the applicable law involved in interpreting its meaning.

50 Devonshire contends that as the meeting which led to the Montreal Accord was held in Quebec, and called by the Caisse and National Bank personnel from Montreal, Quebec law governs its interpretation. As the Suspension Notice was given at the request of the participants to the Montreal Accord and incorporated by reference the Standstill Period contained in the Montreal Accord, Devonshire contends that the Suspension Notice should also be governed by Quebec law.

51 I cannot accept these contentions of Devonshire. The Montreal Accord did not have a governing law clause. That may be due to the fact that the participants chosen to attend purposely excluded legal counsel for the participants. It is highly likely that the participants never discussed the issue of what law was to govern. However, the evidence of Brian Davis of National Bank who was instrumental in calling the meeting, was that the concerns that were dealt with involved liquidity calls that had been made by a number of trusts, including Devonshire, and collateral calls that asset providers had or could make. He testified that the purpose of the Montreal Accord at that time was to have the players in the market put their weapons down and take a pause in order to prevent the market from blowing up. Those weapons arose from the ISDA Master Agreements applicable to all of the trusts, which were governed by Ontario law.

52 The Support Agreement made as of March 14, 2008 by the participants to the large Crawford restructuring, following on the Montreal Accord and the Framework Agreement, does provide that the agreement is governed by Ontario law and the laws of Canada applicable in Ontario. That is some indication that the parties to the Montreal Accord did not intend Quebec law to govern it.

53 In the circumstances, I would not infer that the parties to the Montreal Accord intended Quebec law to govern it or the Suspension Notice of Devonshire that was made following the Montreal Accord. The same is applicable to the extensions that followed. They extended "the Montreal Accord standstills and the related suspension of default notices".

54 In the circumstances, I conclude that Ontario law applies to the interpretation of the Montreal

Accord, the Suspension Notice and extension agreements and to a consideration of any rights flowing from these documents, including a consideration of any obligation to act in good faith.

(a) Principles of interpretation

55 The ISDA Master Agreement and its annexes and the several other related agreements are commercial contracts. In interpreting a contract, the goal is to determine the intent of the parties by reference to the words that they chose. The plain meaning of the words is to be given effect, read harmoniously and in the context of other provisions of the contract, and in light of the factual matrix as a whole. Interpretations that give effect to all the terms of a contract should be preferred over interpretations that render one or more terms superfluous or ineffective. A commercial contract should be interpreted in a manner that accords with sound commercial principles, good business sense and that does not result in absurdities. While evidence of the factual matrix is generally admissible and relevant to the construction of a contract, extrinsic evidence as to the meaning of a contract is inadmissible unless there is an ambiguity. See generally *Toronto-Dominion Bank v. Leigh Instruments Ltd.* (1998), 40 B.L.R. (2d) 1, aff'd (1999) 45 O.R. (3d) 417 (C.A.) and *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust,* (2007), 85 O.R. (3d) 254 (C.A.).

56 With respect to what may be considered to be the factual matrix, Goudge J.A. in *Kentucky Fried Chicken v. Scott's Food Services Inc.*, (1998), 41 B.L.R. (2d) 42 stated:

> While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its "factual matrix" will also provide the court with useful assistance. In his famous passage in *Reardon Smith Line v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-996 (H.L.) Lord Wilberforce said this:
>
>> No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of a contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.

57 In *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, Estey J. stated the following regarding avoidance of interpretations that produced commercially unfair and reasonable results:

> ... the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the

> true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intention of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation ... which promotes a sensible commercial result.

10. Did Barclays waive its right to remedy its default?

58 On January 13, 2009 Barclays took steps to make a payment to Devonshire purporting to pay the outstanding liquidity payments that had been demanded on August 13, 14 and 15, 2007 by wiring $71,196,072.58, the amount of the liquidity calls made plus interest. Barclays also sent to Devonshire a document headed Liquidity Demand Notice. That document included the following statement:

> It has been and remains the position of Barclays that the Liquidity Call Notices were not proper and the Barclays was not and is not under any contractual obligation to pay the Liquidity Call Notices. Equally, Barclays takes the position that the Event of Default notice was not proper or justified as a matter of contract (collectively, the Barclays' Position).
>
> Notwithstanding the Barclays' Position, Barclays has arranged for payment of the Liquidity Amount which is being made within the contractual period for payment, as extended from time to time. Such payment is being made without any admission or inference that it is due or that any demand therefore was valid, and, accordingly, Barclays reserves all of its rights and remedies under the Master Agreement, including the right to demand the return of all such funds, subject to resolution of dispute, together with interest thereon.

59 Section 5(a)(i) of the ISDA Master Agreement provides that a failure to make any required payment is an Event of Default if not remedied within 3 days:

> 5. Events of Default and Termination Events
>
> (i) Failure to Pay or deliver. Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business

Day after notice of such failure is given to the party.

60 Devonshire takes the position that Barclays unequivocally waived its right to remedy its default in failing to pay the liquidity demands when made.

61 The evidence makes clear, in my view, that Barclays never had an intention to pay the liquidity demands made on August 13, 14 and 15, 2007. On each of those days Barclays decided not to pay the demands. Barclays' position was that there was no market disruption event because the notes of bank sponsored conduits were rolling on each of those days. It is clear from internal Barclays documents prior to the signing of the contractual documents with Devonshire in the first place that Barclays intended to take the position that there would never be a market disruption event within the meaning of the contractual documents if the notes of bank sponsored conduits were rolling on days on which the notes of independent sponsored conduits such as Devonshire were not rolling. Barclays determined on each of August 13, 14 and 15, 2007 that notes of bank sponsored conduits in Canada were rolling and never after those days made any investigation on the matter. Barclays' notice of January 13, 2009 to Devonshire reiterated its position that it had no obligation to pay the liquidity demands of Devonshire.

62 There is also no question on the evidence that Barclays made clear to Devonshire that it did not intend to make payment on the liquidity calls that had been made because on its view there had been no market disruption event. The question is whether on the evidence it can be inferred that Barclays waived its right to remedy its default by later making liquidity payments.

63 In *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 S.C.R. 490 Major J. described the law of waiver as follows:

> 19. Waiver occurs where one party to a contract or to proceedings takes steps which amount to foregoing reliance on some known right or defect in the performance of the other party... The elements of waiver were described in *Federal Business Development Bank v. Steinbock Development Corp.* (1983), 42 A.R. 231 (C.A.), cited by both parties to the present appeal (Laycraft J.A. for the court, at p. 236):
>
> > The essentials of waiver are thus full knowledge of the deficiency which might be relied upon and the unequivocal intention to relinquish the right to rely on it. That intention may be expressed in a formal legal document, it may be expressed in some informal fashion or it may be inferred from conduct. In whatever fashion the intention to relinquish the right is communicated, however, the conscious intention to do so is what must be ascertained.
>
> 20. Waiver will be found only where the evidence demonstrates that the party

> waiving had (1) a full knowledge of rights; and (2) an unequivocal and conscious intention to abandon them. The creation of such a stringent test is justified since no consideration moves from the party in whose favour a waiver operates. An overly broad interpretation of waiver would undermine the requirement of contractual consideration.
>
> 24 ... The nature of waiver is such that hard and fast rules for what can and cannot constitute waiver should not be proposed. The overriding consideration in each case is whether one party communicated a clear intention to waive a right to the other party.

64 One difficulty in concluding that Barclays waived its right to cure is that Barclays had taken the position from August 13, 2007 onwards up to January 13, 2009 that it had no obligation to cure. Intentionally waving a right to cure presupposes knowledge of an obligation to cure. It can be taken, however, that Barclays knew that if its position regarding no obligation to cure was incorrect, it had an obligation to cure.

65 I am not able to conclude on the evidence that Barclays communicated a clear intention to waive its right to cure in the event that it was incorrect in refusing to pay the liquidity demands made by Devonshire. Barclays certainly communicated to Devonshire its intention not to pay, but did not go further and communicate any intention to waive a right to later remedy its default.

66 Had I found that there was a communication by Barclays of an intention to waive its right to cure, I do not think that sections 9(b) or (f) of the ISDA Master Agreement would preclude a finding of waiver. Section 9(f) provides that a failure or delay in exercising any right will not be presumed to operate as a waiver. This section does not state that such a failure or delay could be deemed to be a waiver, but merely that a waiver will not be presumed. Section 9(b) provides that no waiver will be effective unless in writing and executed by each of the parties. However, there is authority that variation of a contract is effective even if the contract purports to exclude subsequent oral variations and also that oral statements may operate as a waiver of rights evidenced by an earlier written document or may set up an estoppel. See Waddams, *The Law of Contracts*, 6th Edition at para. 329 and *Shelanu Inc. v. Print Three Franchising Corp* (2003), 64 O.R. (3d) 533 at para. 50.

11. Effect of the Suspension Notice

67 Once Barclays had signed the Montreal Accord, it asked Devonshire to rescind the notice of default that Devonshire had sent on August 14, 2007. Devonshire did not want to do that for fear of liability to its noteholders in the event that a restructuring was not reached. It proposed a suspension rather than a rescission. Eventually that was settled on by Devonshire in the form of the Suspension Notice. Barclays was unhappy about it but was prepared to live with it and in its pleadings admitted that it accepted the terms.

68 The Suspension Notice recited the ISDA Master Agreement, the market disruption notices and the default notice. It then provided:

> In light of the agreement reached on August 16, 2007 (the "Consortium Agreement") between the Bank and a number of investors and financial institutions (the "Consortium"), and at the request of the members of such Consortium.

69 The Consortium Agreement referred to was the Montreal Accord. The operative part of the Suspension Notice provided:

> The Trust hereby suspends without prejudice the effect of the Default Notice and agrees not to take any further steps or proceedings to enforce its rights thereunder until the end of the Standstill Period (or any extension thereof consented to by the Trust), provided that the Bank complies with its obligations under the Agreement and as a Signatory under the Consortium Agreement.
>
> ...
>
> The Trust otherwise reserves all of its rights under the Agreement and Default Notice.

70 Devonshire contends that the language of the Suspension Notice "suspends without prejudice the effect of the Default Notice" suspended Devonshire's right to take steps to enforce its rights under the ISDA Master Agreement but did not suspend the obligation of Barclays to make the liquidity payments needed to remedy its default. It says this is made clear by the next part of the sentence "and agrees not to take any further steps or proceedings to enforce its rights thereunder" and by the last sentence which provides the Devonshire otherwise reserves all of its rights under the ISDA Master Agreement and default notice. Devonshire further says that the words "without prejudice" means that the Suspension Notice was without prejudice to Devonshire's rights under the agreements including its right to have the liquidity payments made during the three business days following the Default Notice.

71 Barclays contends that one of the effects of the Default Notice was that it had three days to pay the liquidity payments, a failure of which would result in an event of default permitting Devonshire to terminate the swaps and that by suspending the effect of the Default Notice, Devonshire suspended the three day period which Barclays had to cure its failure to make the liquidity payments. Devonshire counters by contending that if Barclays were correct, the further provision that Devonshire agrees not to take any further steps to enforce its rights would not be needed and would be surplus.

72 The Default Notice delivered by Devonshire to Barclays on the evening of August 14, 2007 notified Barclays of an Event of Default provided for under section 5(a)(i) of the ISDA Master Agreement, which provides as follows:

> **5. Events of Default and Termination Events**
>
> **(a) Events of Default.** The occurrence at any time with respect to a party or, if applicable, any Credit Support Provider of such party or any Specified Entity of such party of any of the following events constitutes an event of default (an "Event of Default") with respect to such party: --
>
>> **(i) Failure to Pay or deliver.** Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party.

73 Absent the Suspension Notice, on the expiry of the three day period on August 17, 2007, Devonshire would have had the right to designate an Early Termination Date under paragraph 6(a) of the ISDA Master Agreement, which provides as follows:

> **6. Early Termination**
>
> **(a) Right to Terminate Following an Event of Default.** If any time an Event of Default with respect to a party (the "Defaulting Party") has occurred and is then continuing, the other party (the "Non-Defaulting Party") may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all outstanding Transactions.

74 One of the effects, therefore, of the Default Notice was that if Barclays failed to make the liquidity payments within three business days after the Default Notice was given, an event of default would have occurred permitting Devonshire to terminate the swaps. By suspending the effect of the Default Notice, Devonshire in my view suspended whatever part of the three day cure period remained. Whatever the meaning of the words "without prejudice" in the Suspension Notice, they cannot make meaningless the suspension of the effect of the Default Notice.

75 It is agreed that the Suspension Notice and its extensions constitute a contract. Part of the factual matrix surrounding the Suspension Notice is the Montreal Accord, which is recited in it. The Montreal Accord contained a framework for a long term restructuring. It also contained an interim agreement which provided, amongst other things,

3. Signatories who are counterparties of the Third Party ABCP conduits [Barclays was a signatory] will not pursue any existing margin calls or make any further margin calls during the Standstill Period.
4. The Third Party ABCP conduits [Devonshire was one] will agree not to pursue any existing liquidity calls during the Standstill Period or make any further liquidity calls for 150 days after the Standstill Period.

76 The purpose in clause 3 of agreeing not to pursue any existing margin calls was to prevent the necessity of a conduit having to post collateral resulting from a margin call i.e. preventing the conduit from having to pay cash to meet a margin call. Likewise, the purpose of an ABCP conduit agreeing not to pursue any existing liquidity call was to prevent the counterparty on whom the liquidity call had been made from having to pay cash to the conduit required by the liquidity call.

77 The operative paragraph in the Suspension Notice begins by providing that the suspension is given in light of the Montreal Accord and at the request of the members of the consortium who signed it. This is an indication that what was being sought in the Suspension Notice was an agreement by Devonshire consistent with clause 4 of the interim agreement contained in the Montreal Accord, i.e. an agreement "not to pursue" any existing liquidity calls, the meaning of which could only be not to require the payment by Barclays of the existing liquidity calls. Otherwise agreeing "not to pursue" the liquidity calls would be meaningless. The provision in the Suspension Notice that Devonshire agreed not to take any steps to enforce its rights until the end of the standstill period was consistent with that position.

78 There was much argument as to the meaning of the words "without prejudice" in the Suspension Notice. The words are puzzling and there was no evidence of any discussion between the parties regarding them at the time the Suspension Notice was prepared and signed. Devonshire contends that the words mean that the granting of the Suspension Notice could not be detrimental or prejudicial to Devonshire, in the sense that it could not be harmful to Devonshire, and thus the obligation on Barclays to make the payment within three business days was not suspended. In answer to a question as to whether the words meant "apart from what we are doing here it is without prejudice to our other rights", the response was that it had to mean more as the last sentence in the Suspension Notice already provided that Devonshire otherwise reserved all of its rights under the ISDA Master Agreement and Default Notice.

79 I confess to being unsure what was intended by the words "without prejudice". The best I can make of them is that Devonshire was saying that the effect of the Default Notice was suspended without prejudice to the rights of Devonshire under that Default Notice at the end of the standstill period.

80 Barclays contended that in the event of any ambiguity in the meaning of the Suspension Notice, regard could be had to discussions between Mr. Lafleur-Ayotte and representatives of Barclays prior to Barclays agreeing to operate under the terms of the Suspension Notice. It is not

necessary in my view to consider that evidence. However, if I were to do so, I would not put much if any weight on it. Two things from the evidence appear clear. One is that people at Barclays had little regard for Mr. Lafleur-Ayotte and I doubt very much if they paid any attention to his views. It is also clear from the conversation in question that they wanted to look at the document before considering their position.

81 In my view by construing the language of the Suspension Notice and considering its factual matrix, the time during which Barclays had to pay the existing liquidity calls in order to remedy its failure was suspended during the period of the Suspension Notice as extended from time to time.

82 The default notice was given at 8:07 p.m. on Tuesday, August 14, 2007, after the close of business that day, and so is taken to have been given on August 15, 2007. The Suspension Notice was given at 7:44 p.m. on August 16, 2007, after the close of business that day, and so is taken to be effective on August 17, 2007. Therefore one of the three days to remedy Barclays' failure to pay the liquidity calls expired before the Suspension Notice.

12. Misrepresentation claim

(a) Nature of claim

83 Devonshire claims that in extending the Standstill Period on January 8 and 9, 2009, Barclays misrepresented the state of negotiations that were going on between Barclays and the Caisse. This was just days prior to the purported termination of the ISDA Master Agreement by Barclays on January 13, 2009. The parties agree that the daily extensions of the Standstill Period were each separate contracts. Devonshire claims that the extensions that took place on January 8 and 9, 2009 should be rescinded because of the misrepresentations. Devonshire claims that even if the three day cure period for Barclays to cure the default did stop running on August 16, 2007 during the Standstill Period, it started running again at the latest on January 9, 2009 and expired before January 13, 2009.

(b) Relevant facts

84 Following the Montreal Accord and the suspension by Devonshire of its notice of default, the Standstill Period between Barclays and Devonshire was extended by various agreements to April 18, 2008. Following the expiry of the extension agreement on April 18, 2008, the Standstill Period and the Suspension Notice served by Devonshire were extended by daily e-mails sent on each business day from Barclays to Mr. Lafleur-Ayotte of Quanto. These e-mails contained the same language each day as follows:

> "<u>There are still a number of issues being worked out regarding the proposed restructuring of Devonshire Trust</u>. Accordingly, for the sake of good order we are confirming that, as between Barclays and Devonshire, the Montreal Accord standstills and the related suspension of default notices have and will continue

> through [the next business day] to allow for these negotiations to continue. If anyone takes a different position, please let us know ASAP." (underlining added)

85 The second last e-mail was sent on January 8, 2009 and the last was sent on January 9, 2009. The last one extended the standstill and suspension of Devonshire's default notice to January 12, 2009, which was the next business day, a Monday. Devonshire takes the position that the underlined words misrepresented the situation in that the restructuring negotiations being held by Barclays had reached an impasse and that Barclays did not at that stage expect the negotiations to be successful and planned instead to terminate the Devonshire swaps. In order to understand the issue, it is necessary to review what the discussions were by this time.

86 Following the Montreal Accord, discussions were held amongst all of the major parties in the ABCP market with a view to restructuring the entire market. These included discussions by Barclays with the major Devonshire noteholders with a view to a restructuring of Devonshire. No one on behalf of Devonshire or Quanto participated in these negotiations. Legal and financial representatives of the Investors Committee participated from time to time.

87 As early as August, 2007 Barclays was of the view that Devonshire was a good trust to be restructured individually with the noteholders, and it proposed to the Caisse as well as other large noteholders the idea of taking some or all of the leveraged super senior trades out of Devonshire and creating a super senior swap directly between Barclays and the Caisse and other note holders. The effect of such a transaction would be to remove from Devonshire that portion of the swap between Barclays and Devonshire represented by the notes held by each note holder and transferring that swap to a new swap between Barclays and each particular note holder who agreed to do it. If the new swap were on economically identical terms as the swap between Barclays and Devonshire, Barclays would effectively be made whole for that portion of the swap transferred to the note holder. The first of such proposals was sent to the Caisse, National Bank and Desjardins on August 31, 2007. Later iterations of the proposal were sent to them and to Citibank as well.

88 Although Barclays wanted to achieve a restructuring by the end of 2007, that was not possible, and discussions continued. Barclays was concerned with delays and in early April, 2008 was considering terminating the Devonshire swaps if the latest term sheet sent by Barclays was not signed by the Caisse, National Bank and Desjardins within a week.

89 On April 8, 2008 a meeting took place in New York amongst representatives of Barclays, the Caisse, National Bank and the Investors Committee. Attending the meeting for Barclays were a number of executives, the most senior of whom was Mr. Jerry del Missier, the co-CEO of Barclays Capital. There were a number of representatives from the Caisse, the most senior of whom was Mr. Henri-Paul Rousseau, the CEO of the Caisse. National Bank was represented by Mr. Ricardo Pascoe.

90 A power point presentation was made by the Caisse in which a number of concerns of the Caisse with the Barclays term sheet were set out. The concerns had to do with accounting issues

that the Caisse said would be very unfavourable to it. At the end of the power point presentation there was a counter-proposal by the Caisse and National Bank which contained terms, including terms regarding how to deal with the small noteholders who held $75 million of Devonshire notes. During the presentation, the Caisse stated that neither Citibank nor Desjardins wanted to participate in a swap proposal.

91 Gregory Neville of Barclays attended the meeting. He testified that after the power point presentation, the Barclays representatives went into a side meeting to discuss the proposal of the Caisse and concluded that while they were concerned about Desjardins and Citibank, they could work with the Caisse's proposal and agreed to go back into the meeting and accept the proposal and then later work on Desjardins and Citibank. Mr. Neville testified that they went back into the meeting and told the Caisse that they accepted the proposal of the Caisse and would work toward a revised term sheet to reflect the terms. He said that Mr. del Missier spoke on behalf of Barclays and Mr. Rousseau spoke on behalf of the Caisse. He said that the meeting ended with a handshake deal.

92 Mr. Bergeron of the Caisse and Mr. Pascoe of National Bank both testified that no agreement was reached on all necessary terms for a restructuring and that further work was required.

93 On April 9, 2008, the day following the meeting in New York, Mr. Neville sent a revised term sheet to the Caisse, National Bank, Desjardins and Citibank. Desjardins and Citibank did not want to participate and that month Barclays acquired the notes held by Desjardins and Citibank at only a fraction of their face value.

94 From mid-April to mid-September, 2008, there were ongoing discussion amongst lawyers for Barclays, the Caisse and National Bank regarding the term sheet. Matters proceeded slowly.

95 On October 10, 2008 Barclays and National Bank signed a framework agreement under which Barclays acquired the National Bank notes with a face value of $59.2 million for one dollar. National Bank agreed to assist Barclays in obtaining MAV II notes that would become available upon the successful larger restructuring of the ABCP market. These MAV II notes would then be offered by Barclays to the small noteholders[8] holding notes with a total face value of $75 million. While the offer to be made to the small noteholders pursuant to this framework agreement was not conditional upon a successful agreement between Barclays and the Caisse, Barclays did not proceed with the offer after it failed to reach an agreement with the Caisse.

96 After the agreement was made between Barclays and National Bank, the only remaining Devonshire note holder with whom there was no agreement, apart from the small noteholders holding about $75 million of notes, was the Caisse which held Devonshire notes with a face value of $385 million. Once Barclays had made its deal with National Bank, Barclays pushed to settle terms with the Caisse. By this time, the senior officers of the Caisse at the time of the meeting in New York in April, 2008, including Mr. Rousseau and Mr. Guay, were no longer at the Caisse and Barclays had to deal with other personnel, and in particular Mr. Claude Bergeron, a vice-president of the Caisse.

97 Another thing that had changed was the market for ABCP. From September to December 2008 there were large financial failures, including Fannie Mae and Freddie Mac being put into conservatorship, the bankruptcy of Lehman Brothers and the failures of Washington Mutual and three Icelandic banks. World markets reacted and became extremely illiquid. Appetite for risk dried up. Continued deterioration of the credit market caused credit spreads to widen to unprecedented levels and investment grade debt was trading at junk debt spreads. The mark to market values of swaps moved severely against the position of investors in the ABCP market. Although a framework agreement in principle had been reached by the Investors Committee led by Purdy Crawford on December 23, 2007 with the asset and liquidity providers for the large restructuring involving 20 conduits, new rounds of negotiations twice led to modifications in December 2008 to give investors more protection required by them as a result of the market changes.

98 For Devonshire, the spreads increased from August, 2007 to January 2009 by an unprecedented 228%. In early November, 2008 the Caisse began asking for revised terms to reflect the market changes, and made clear during the remainder of 2008 that it was looking for changes of the kind agreed to in the larger Crawford restructuring. While Barclays was not happy with the requested changes, it began to negotiate with the Caisse on the Caisse's requests and during those negotiations made a number of concessions.

99 On November 4, 2008 Mr. Bergeron told Barclays that a mark to market valuation was no longer a good indication of value and he suggested some cap on the collateral requirements that the Caisse might be called on to deposit with Barclays. Barclays interpreted this as the Caisse wanting to change the trigger for collateral calls from a mark to market valuation of the swaps to a spread and loss trigger, which Barclays did not want. As Mr. Neville explained, Barclays lived in a mark to market world and if the trade with the Caisse was to have triggers on a different spread/loss basis, it could create a very significant gap risk for Barclays, which is a notional risk from Barclays's point of view if the mark to market value of the swaps is less than the value of the assets in Devonshire which is the collateral available to Barclays if the swaps are terminated early.

100 On November 18, 2008, in anticipation of a meeting with the Caisse the following day, Barclays proposed as a compromise a partial spread/loss trigger mechanism once the mark to market reached 50%, with concessions on other points being made by the Caisse. At a meeting in New York the next day, Mr. Bergeron said they would discuss the Barclays proposal with his board the next week but said that they had problems with a spread trigger and preferred a loss-only trigger.

101 On November 20, 2008, in anticipation of the Caisse board meeting to be held on Monday, November 24, 2008, Barclays sent a power point presentation that explained their proposal that had been made at the meeting in New York and term sheet that contained the proposal. The board did not deal with it then and on December 2, 2008 Mr. Neville again asked Mr. Bergeron to put the proposal to the Caisse's board. Mr. Neville testified that he did not think that was done. In exchanges of e-mails between Barclays' representatives and Mr. Bergeron in early December,

Barclays took the position that it had a binding agreement that had been reached earlier in the year in April, 2008. The Caisse denied the existence of any binding agreement.

102 One of the changes negotiated by the participants in the large Crawford restructuring due to the same changes in the market that were effecting Devonshire was a one year moratorium on collateral calls that could be made by asset providers. The Caisse followed suit and asked for the same thing from Barclays. On December 16, 2008 Mr. Neville made a proposal that Barclays would agree to such a moratorium on condition that the Caisse agree to a number of other changes, including increasing the initial recourse commitment of the Caisse to $1.5 billion for the term of the moratorium and thereafter unless certain conditions were met.

103 On December 18, 2008 Mr. Charles Quintal, who was assisting Mr. Bergeron with Devonshire, e-mailed Barclays with a proposal that changed the Barclays proposal in a number of respects. The changes, which Mr. Neville described as huge, included lengthening the moratorium to 14 months, limiting the recourse obligation of the Caisse to $900,000,000 with no further collateral calls available to Barclays and amending to the benefit of the Caisse the spread/loss triggers. The e-mail ended by Mr. Quintal stating that he appreciated that Barclays might not find the terms acceptable. Later the same day Barclays responded to Mr. Quintal and said they would agree to the 14 month moratorium on collateral calls by Barclays, but with a $1.2 billion recourse obligation on the Caisse, and would agree to widen the spread/loss triggers as proposed by the Caisse. Barclays said it was still reviewing the request to change the trigger that Barclays would have to end the moratorium.

104 On December 23, 2008 Mr. Neville and Mr. Quintal had a lengthy telephone discussion, in which Mr. Quintal re-iterated that the Caisse wanted a deal similar to the deal that was being negotiated by the Investors Committee for the remaining ABCP market and that was not going well for Barclays. Mr. Quintal threw out a number of $600,000,000 to $700,000,000 as the limit of the Caisse's liability for a collateral call, which was less than their earlier position of $900,000,,000 and increased the request for a moratorium for collateral calls to 18 months, longer than their earlier request for 14 months, with no ability to Barclays to terminate the moratorium at all regardless of the market losses of the underlying synthetic bond portfolios. On that day, the Investors Committee had announced that the moratorium in the larger Crawford restructuring had been increased from 14 to 18 months, and the Caisse sought the same from Barclays. Mr. Neville told Mr. Quintal that he would take the proposal back to the Barclays traders, on whose book the Devonshire trade was accounted for within Barclays, but that he was not optimistic that they were even close.

105 Christmas and New Years intervened with no further communications between Barclays and the Caisse.

106 On January 8, 2009, at 12:46 p.m., Mr. Lovisolo of Barclays sent an e-mail to Messrs. Bergeron and Quintal of the Caisse enclosing a term sheet that reflected what Mr. Lovisolo said was agreed between the parties in April, 2008. It did not reflect the later terms that had been discussed

between them since November, 2008. The e-mail requested that Messrs. Bergeron and Quintal assemble a meeting of the board of directors of the Caisse to "ratify our previous agreement on the restructuring of the Caisse's holdings". The e-mail concluded by stating that Barclays looked forward to receiving a signed copy of the term sheet by no later than 5 p.m., Monday January 12th. On cross-examination, Mr. Neville reluctantly acknowledged that the deadline in the e-mail could fairly be called an ultimatum.

107 Mr. Bergeron testified that upon receipt of the January 8, 2009 ultimatum requiring the Caisse to sign the April 9, 2008 term sheet, he felt insulted and had no intention of recommending it to the board of the Caisse.

108 The daily extension of the arrangements between Barclays and the Caisse was sent by Mr. Neville on January 8, 2009 at 4:47 p.m. There had been no communication between Barclays and the Caisse since the ultimatum had been sent earlier that day.

109 On January 9, 2009, Mr. Neville took steps to arrange for the liquidity payment that was later made to Devonshire on January 13, 2009 to be set up within Barclays, and the payment was booked internally on January 9, 2009 to be effective January 13, 2009.

110 On January 9, 2009 at 2:33 p.m., Mr. Neville and Mr. Quintal spoke on the telephone. Mr. Quintal told Mr. Neville that Mr. Bergeron said they were supposed to respond to the e-mail that afternoon but he did not think they would be in a position to deal with it by January 12 due to all of the work involved in the large Crawford restructuring that was to close the week of January 12. After Mr. Neville told Mr. Quintal that 5 p.m. on Monday, January 12 was a real deadline, Mr. Quintal said that Mr. Bergeron would address the e-mail that afternoon. Nothing further was heard from the Caisse before the extension to January 12, 2009 was e-mailed by Barclays at 4:58 p.m. on January 9, 2009.

(c) Analysis

111 A misrepresentation is an incorrect statement of a present or past fact that is false. See John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law Inc., 2005) at p. 326.

112 Partial disclosure of facts may also be misleading. See *Spinks v. Canada* [1996] 2 F.C. 563 (C.A.) per Linden J.A. at para. 29. In S.M. Waddams, *The Law of Contract*, 6th ed. at para. 439, it is stated:

> An incomplete statement may be as misleading as a false one, and such half-truths have frequently been treated as legally significant misrepresentations. Almost always something is said to induce the transaction and it is open to the court to hold that the concealment of the material facts can, when taken with general statements, true in themselves but incomplete, turn those statements into misrepresentations ... Silence may, in its contest, amount to an assertion that

there is nothing of significance to reveal.

113 See also *Xerex Exploration Ltd. v. Petro-Canada*, 6 B.L.R. (4th) 1 (Alta. C.A.), in which it was stated:

> We can see no reason to disturb the learned trial judge's finding that there was a misrepresentation by silence or incomplete disclosure. Ordinarily in contractual negotiations between sophisticated parties, operating at arm's length, there is no general duty of disclosure. When a representation is made during the course of negotiations, however, the party making it must ensure that it is accurate so that it does not amount to a misrepresentation. This gives rise to a further duty to speak when silence effectively renders a representation, already made, inaccurate. Having brought a particular subject up in negotiations, a party assumes a duty to ensure that the other party is aware of all the material facts relevant to that assertion.

114 Can it be said that the statements in the January 8 and 9, 2009 extension e-mails that "that there are still a number of issues being worked out regarding the proposed restructuring of the Devonshire Trust" and that "for the sake of good order" the extensions of the standstill agreement and suspension of the default notice should continue "to allow those negotiations to continue" were accurate? In my view, for a number of reasons, it cannot. The statements were misleading. These statements had been made daily for over eight months and the last two in question gave the impression that it was business as usual so far as negotiations were concerned. It was not.

115 Messrs. del Missier, Lovisolo and Neville gave evidence to the effect that when these last extensions were sent out, negotiations were continuing with a view or hope that they would result in some acceptable restructuring with the Caisse. For the reasons that follow, I do not accept that evidence.

116 By the time these extensions were sent to Devonshire, what had occurred, and I so find, is that the "deal team" at Barclays dealing with Devonshire, being the sales team, credit structuring team and trading team[9] involved in the negotiations had come to the view that the Caisse would never agree to any reasonable terms and the decision was taken to back away from the terms that had been discussed between Barclays and the Caisse in November and December, 2008. Instead, Barclays put an ultimatum to the Caisse on January 8, 2009 to sign by January 12, 2009 at 5 p.m. the term sheet that had been given to the Caisse on April 9, 2008. No one at Barclays thought the Caisse would sign that term sheet and the decision was all but formally made to terminate the Devonshire trades. That formality occurred on January 12, 2009 shortly after 5 p.m. when, after the Caisse had failed to sign the term sheet, Barclays took the decision to terminate the trades, and they took steps to do so on the following morning.

117 The conclusion I draw is that in sending out the April 2008 term sheet in January 2009, Barclays was effectively ending negotiations. The credit meltdown in world markets in October and

November, 2008 was dramatic. It led the parties in the larger Crawford restructuring to twice negotiate new terms in December, 2008 and to governments at both the provincial and federal levels agreeing to participate in massive funding obligations. The Caisse was a major player in that restructuring who benefited from those new terms. For Barclays to revert without notice to the April 2008 term sheet after it had made several concessions in negotiations with the Caisse in November and December 2008, could only serve to cause a negative reaction in the Caisse who quite clearly could not be expected to agree to it. It was not done with a view of eliciting some other offer from the Caisse. Barclays did not want any other offer from the Caisse.

118 The e-mail of January 8, 2009 from Barclays with the April 2008 term sheet requested Mr. Bergeron to convene a meeting of the board of the Caisse to confirm an agreement said to have been reached and contained in the April 9, 2008 term sheet. Yet the April 9, 2008 term sheet drafted by Barclays contained terms not discussed in the meeting in New York the day before and never agreed to afterwards, such as recourse increases of 6.25 % and 11.25% and cross-default provisions. Barclays knew that Mr. Bergeron had in December 2008 denied that any agreement had been reached in April, 2008. Mr. Bergeron had attended the meeting in New York on April 8, 2008 on behalf of the Caisse, as had Mr. Pascoe of National Bank. Their evidence, which I accept, was that while there was an agreement in principle reached on some issues, mainly on how to deal with the small noteholders, there was no binding economic agreement reached on all terms as between the Caisse and Barclays. As Mr. Pascoe testified, he left the meeting thinking that they had a framework for an agreement but that everyone understood they had a lot of work to do before they had an agreement.

119 Barclays knew that National Bank did not consider itself bound by any alleged agreement reached in New York in April, 2008. On September 23, 2008, Mr. Davis spoke to Barclays and proposed that Barclays take back the Devonshire notes held by National Bank for a nominal consideration. In an internal e-mail that day, Mr. Neville referred to the position of National Bank as being "slimy" after negotiating with Barclays for over a year and then walking away. If Barclays were right, it had an agreement with National Bank from the time of the New York meeting in April, 2008. No mention was made of any such agreement in the internal e-mail of Mr. Neville on September, 23, 2008.

120 The inference I draw is that in its e-mail of January 8, 2009 to the Caisse, Barclays was positioning itself to exit the Devonshire trades and that it knew that litigation would take place. Indeed Barclays issued and served its statement of claim on January 13, 2009 just moments after terminating the trades. The reference to an agreement reached in April 2008 in the e-mail of January 8, 2009 was, I believe, posturing by Barclays for the litigation that it knew would follow shortly.

121 Mr. James Lee, a director of trading for Barclays in New York and involved at the time in the economic analysis of the Devonshire trade and terms being discussed with the Caisse, was of the view by December 23, 2008 that because of the market changes, it made more economic sense for Barclays to terminate the Devonshire trades than to go through a restructuring on the terms being

discussed. Mr. Alexandre Pointier, to whom Mr. Lee reported, recommended that day that Barclays should "take a step back" and only mention the earlier proposal made to the Caisse, meaning the April, 2008 term sheet.

122 On January 7, 2009 Mr. Lee recommended that given that the market had clearly moved in favour of Barclays as against the Caisse, Barclays should move off its latest proposal of December 18, 2008. He testified that his view at the time was that the changes in the market over the holidays meant that the cost to Barclays of terminating the trades had come down and that terminating the trades made sense unless they could get a substantially better deal from the Caisse than had been proposed in December, 2008 by Barclays.

123 Barclays acted on these views by sending its ultimatum on January 8, 2009 to the Caisse with the term sheet that had been earlier provided to the Caisse on April 9, 2008, which required a response by January 12 at 5 p.m.

124 At the time the term sheet was sent on January 8, 2009, Barclays did not believe that the Caisse would sign it, which is hardly surprising given the negotiations that had taken place between the Caisse and Barclays in November and December, 2008 to change the April 9, 2008 term sheet as a result of the dramatic market changes that took place in the fall of 2008 following the collapse of Lehman Brothers. The investors in the larger Crawford restructuring had refused to close without changes being agreed in two rounds of changes in December, 2008. The Caisse was the largest investor in Canadian ABCP and a major player in the conduits involved in that restructuring and it would have been completely against the Caisse's economic interests at that stage to sign the April, 2008 term sheet.

125 The term sheet of April 9, 2008 was materially worse to the Caisse than the proposal of Barclays made on December 18, 2008. It did not contain any moratorium on collateral calls and required an initial $1 billion in recourse to be committed to by the Caisse. The trigger for collateral calls was to be a mark to market trigger instead of spread/loss triggers which Barclays had said in December they would accept in part. Nor was there any cap on collateral calls. Mr. Lee testified that he believed that the mark to market would have gone up after January 12, 2009 and that if the Caisse had accepted the April 2008 term sheet, it would have then been required to commit to additional recourse of over $1 billion.

126 Mr. Lee did not believe that the Caisse would accept the earlier proposal of Barclays made on December 18, 2009 and while reluctantly, agreed on cross-examination that it was probable that the Caisse would not sign the April 2008 term sheet sent on January 8, 2009.

127 Mr. Neville, who from the outset was the person on Barclays' sales team responsible for dealing with the Caisse, testified that at the time the term sheet was sent on January 8, 2009 he thought it unlikely that the Caisse would sign it.

128 On January 12, 2009 in the morning, Mr. Neville told Ms. Sandra Godard, Barclays'

relationship manager for large financial institutions based in Toronto, that neither he nor "anyone here" thinks the Caisse would sign the term sheet. Ms. Goddard told him that she was hearing the same thing and that she had had a heads up from Mr. del Missier, who is said to have ultimately made the decision to terminate the trades.

129 Mr. Neville, who sent out the extension e-mail of January 8, 2009 (the January 9 e-mail was sent by the Barclays New York legal team but copied to many, including Mr. Neville), testified in chief that over the week-end before January 12, 2009 his belief that the Caisse would sign the term sheet went down. He also testified that he hoped that the Caisse might come back with last minute negotiations. This evidence, I believe, was given in an effort to support his position that the e-mails were not misleading and to justify the timing of his comment to Ms. Goddard on January 12, 2009 that no one thought the Caisse would sign the term sheet. However, I cannot accept his evidence on this point.

130 Mr. Neville's assertion is contradicted by his evidence in several respects. At the time the term sheet was sent out on January 8, 2008 he thought it unlikely that it would be signed by the Caisse, and at no time did he say otherwise. He learned from his conversation with Mr. Quintal of the Caisse on January 9, 2009 that it was unlikely that the Caisse people could get to the e-mail by January 12th because of a weeklong closing process in Toronto of the large Crawford restructuring and when Mr. Neville said that the deadline of January 12th was a real deadline, Mr. Quintal said that Mr. Bergeron would address the e-mail that afternoon, which did not happen. There was nothing in the call with Mr. Quintal to give Mr. Neville any hope that the ultimatum would be accepted and Mr. Neville agreed on cross-examination that he knew from this call with Mr. Quintal that the Caisse was unlikely to sign the April 9, 2008 term sheet. I do not accept that Mr. Neville went into the week-end with positive views regarding the Caisse agreeing to the term sheet. Moreover, nothing material occurred over the week-end to make Mr. Neville change his views.

131 Mr. Lovisolo, to whom Mr. Neville reported, testified that he thought that the chances of the Caisse signing the term sheet were 30%. I question the reliability of Mr. Lovisolo's evidence and his purported recall of the percentages that he mentioned. Regardless, it is clear he did not think it likely the Caisse would sign the term sheet. In my view, in light of the drastically changed economic circumstances since April, 2008, the chances of the Caisse signing the April 2008 term sheet in January, 2009 were nil.

132 Mr. del Missier is the co-CEO of Barclays Capital. He authorized the term sheet to be sent to the Caisse on January 8, 2009. He was not communicating at the time with the Caisse, although he had met with the Caisse earlier on April 8, 2008. His information in December, 2008 and January, 2009 about the prospects for the Caisse agreeing to the term sheet was information learned from others within Barclays. He acknowledged on cross-examination that when the term sheet was sent to the Caisse, he thought there was a low probability that the Caisse would sign it.

133 I do not accept that although Barclays thought was that it was unlikely that the Caisse would

sign the term sheet, they thought there was a prospect that the Caisse would respond to the term sheet in a way that could lead to an agreement with Barclays such that it could be said there was negotiations still going on at the time of the extension e-mails in question.

134 The sales team involved at Barclays thought that the Caisse would not accept any reasonable terms, which was an indication that not only would the Caisse not sign the term sheet, but that it would not come back with any proposal that would be acceptable to Barclays. On January 7, 2009 Mr. Pointier, a trader and part of the credit derivates team, reported by e-mail to his superior Mr. Azzollini that after discussion with "sales", it was clear that the Caisse was not going to accept any reasonable terms. Mr. Neville, who was part of the sales team, testified that the discussion was a group discussion, in which he was involved, and involved more than one discussion.

135 Further, Mr. Neville told Mr. Davis of National Bank on January 13, 2009 that Barclays had given the Caisse a deadline of 5 pm on January 12, 2009 "to stop negotiating" and sign the term sheet. On the afternoon of January 13, 2009 Mr. Neville told Mr. Silgardo that it was the unanimous view of Barclays that they were never going to get anywhere with the Caisse who kept making increasing demands and so Barclays gave the Caisse an opportunity to change their position and come back to fall in line with Barclays. These statements, which were made on the telephone and recorded, were quite inconsistent with any belief of Mr. Neville at the time the extension e-mails of January 8 and 9, 2009 were sent that further negotiations with the Caisse might be successful.

136 Mr. Lovisolo testified that he thought that there was a 30% chance that the Caisse would respond to the ultimatum by making an alternative proposal, the implication of this evidence being that there was some prospect of further negotiations with the Caisse at the time the extension e-mails were sent on January 8 and 9, 2009. Again, I have doubts of the reliability of Mr. Lovisolo's evidence. In any event, I do not accept this implication.

137 Mr. Lovisolo did not think it likely that the Caisse would accept the ultimatum to sign the April 8, 2008 term sheet. Nor was he prepared to accept anything less, as is evident from a call he made on January 8, 2009 to Mr. Truell, whom Mr. Lovisolo said ran corporate communications for Barclays. He told Mr. Truell that they were giving the Caisse one final chance to sign the term sheet and if the Caisse did not sign it, they were going to "blow up the box", meaning terminate the Devonshire trades. There was no discussion regarding any other possibility such that negotiations with the Caisse might continue if the Caisse did not sign the term sheet. The reason why there was no such discussion, and the reason for the termination, is to be found in Mr. Lovisolo's call to Mr. Truell in which he said that the market had changed since December and that it was now economic for Barclays to blow up the trade. He also told Mr. Truell that Barclays did not want to be out after the group was done, which meant that Barclays did not want to be exposed to the Caisse after the large Crawford restructuring had been completed because it was concerned that the Caisse would then have less incentive to deal with Barclays and more incentive to walk away from the trade.

138 Mr. Lovisolo's real feelings towards the Caisse were contained in an e-mail of December 16,

2008 that he sent to Mr. del Missier and others in which he said that the strategy of the Caisse was to have Barclays negotiate against itself and to walk away if it could not get a deal it could live with and that he did not expect the Caisse to come back with a real counter proposal to what Barclays was then proposing. There was nothing that the Caisse did after that that could have given Mr. Lovisolo any comfort that the Caisse would continue negotiations that could realistically result in a deal with Barclays. He acknowledged on cross-examination his view that if the Caisse did not sign the term sheet, Barclays should and would likely terminate the Devonshire trade.

139 Mr. del Missier testified in his evidence in chief that when the term sheet was sent to the Caisse on January 8, 2009 he thought one response from the Caisse might be a counter-proposal and he was hopeful that they could re-engage with the Caisse to get a restructuring. He said that Barclays was not ending negotiations but fully expecting and hoping to continue. On cross-examination he testified that the parties were in negotiations and he thought that they might end up with a restructuring close to the terms agreed in April, 2008. While Mr. del Missier apparently ultimately gave approval to the recommendation to terminate the trades, I do not believe that what he testified to was the thinking of the deal team and I have some difficulty accepting his evidence as reliable.

140 While it was from others that Mr. del Missier was getting his information at the time, he was not able to say in the witness box that he was aware of what the deal team knew. On December 23, 2008 Mr. Quintal of the Caisse told Mr. Neville that what the Caisse wanted for a deal would "not be pretty" from Barclays point of view, a view that Mr. Neville held. Mr. del Missier testified that he was not aware of what was going back and forth and he could not recall if he was told of the position of the Caisse as expressed on December 23, 2008. Further he testified he did not recall if he was told of the view of the sales team by January 7, 2009 that the Caisse would never agree to any reasonable terms. If Mr. del Missier held the rosy view that he testified to, of which I have considerable doubt, it appears that it would have been a misinformed view.

141 What is more indicative of Mr. del Missier's view at the time was contained in an e-mail he sent to Mr. Silgardo on January 8, 2009, a few minutes before the e-mail was sent by Mr. Lovisolo to the Caisse with the April 9, 2008 term sheet. Mr. Silgardo was the CEO of Barclays Global Investors in Canada which managed money on behalf of large financial institutions. In his e-mail Mr. del Missier said that over the next 48 hours Barclays was going to try to put pressure on the Caisse to sign the agreement he said had been reached, and "if they don't sign we will likely terminate and things will get legal (and public) very quickly". He asked Mr. Silgardo to keep the information confidential. Mr. del Missier did not expect the Caisse to sign and said nothing about expecting the Caisse to come back with some proposal that he thought would lead to some other restructuring. On the same day he sent the same e-mail to Sandra Godard, Barclays' relationship manager for large financial institutions based in Toronto.

142 What Mr. del Missier told Mr. Silgardo was consistent with what Mr. Dunsche told Mr. Brandon Ashcroft, a Barclays' communications person, on the same day, January 8, 2009, to arrange

for a media statement to be released by Barclays in the event that the Devonshire trades were terminated. He told Mr. Ashcroft that in the first few weeks of January, 2009 the market had turned around and that the options that had been presented to the Caisse as concessions by Barclays were now a lot more expensive than terminating the trades. He also told Mr. Ashcroft that as a result, Barclays had taken all these other proposals off the table and given the Caisse an ultimatum to sign the earlier term sheet of April, 2008. Mr. Dunsche went so far as to say that while Barclays did not expressly say so, the strong hint made to the Caisse was that if the term sheet was not signed, Barclays' only recourse would be to terminate the trades.

143 I also have difficulty with Mr. del Missier's statement that he thought that they might end up with a restructuring close to the terms agreed in April, 2008. The dramatic market changes in the fall of 2008 as a result of the large financial failures meant that holders of ABCP notes could not agree to close any restructuring based on terms discussed or worked out before those changes occurred. Mr. del Missier either knew that or was too far from the market to have an informed view.

144 The framework agreement made in the larger Crawford restructuring in December, 2007 had to be extensively changed in December, 2008 in order to achieve a restructuring. The Caisse was the largest investor in the trusts that were restructured in that restructuring, and the economic forces in play in the larger restructuring would obviously have to come into play in the Devonshire restructuring. That is why Barclays had made so many concessions in negotiations with the Caisse in November and December, 2008 and no informed person could expect the Caisse to agree to terms close to those discussed in April, 2008.

145 There is an e-mail from Mr. del Missier sent shortly after midnight on January 12, 2009 that is peculiar. It suggests to me that Mr. del Missier was not much involved in the decision taken earlier in the day to terminate the Devonshire trade. I am of the view that his evidence as to what happened that day is unreliable.

146 On January 12 at 5:09 Mr. Lovisolo sent an e-mail to a number of people at Barclays, including Mr. del Missier, which stated that at 4:52 p.m. that afternoon Barclays had received an e-mail from the Caisse. Mr. Lovisolo did not say what the e-mail from the Caisse disclosed. After mid-night, at 12.49 a.m. on January 13, 2009, Mr. del Missier forwarded that e-mail to the Barclays Capital executive committee with the note "Still a chance of last minute settlement as our threat to terminate has appeared to have woken them up". While it is asserted that this e-mail is supportive of the position of Barclays that they still hoped for a negotiated settlement with the Caisse, I do not accept that.

147 There is no evidence that the e-mail from the Caisse at 4:52 p.m. was forwarded to Mr. del Missier and his evidence in chief was that he did not recall if he received it. On cross-examination he gave inconsistent statements regarding it, stating at one point he could not recall if he read it, or if "we" met as a group to discuss it, or if there was any discussion about it, and at another point stating that he read the e-mail from the Caisse at least in part before making the decision to

terminate the Devonshire trade. He testified in chief that he was aware of the basic message in the response of the Caisse and that he was very disappointed with it and accepted the recommendation to terminate the Devonshire trades. Yet he testified that his statement to the executive committee that there was still a chance of a last minute settlement as the Caisse had appeared to have woken up was based on the e-mail, which he had said was very disappointing to him.

148 When Mr. del Missier made the ultimate decision is unclear. He did not testify as to when that happened. Nor did anyone else. Mr. Lovisolo testified that shortly after the e-mail came in from the Caisse, the deal team met and decided to terminate the Devonshire trade. He said the persons present were himself, Mr. Neville, Mr. Dunsche, Mr. Wysocki, Mr. Warren and their counsel. He testified that they would not have terminated the trade without Mr. del Missier's approval and that it was fair to say that the decision to terminate was made subject to his approval. Mr. Lovisolo could not recall who telephoned Mr. del Missier for his approval. Mr. Neville's evidence was that the decision was a group discussion but that ultimately Mr. del Missier and Mr. Bommensath made the decision.

149 I gained the clear impression that Mr. del Missier does not remember much of that day. This is hardly surprising given his position and responsibilities at Barclays. It appears likely that Mr. del Missier was not aware at the time he sent his e-mail to the executive committee what the response of the Caisse was and it may well be that it was sometime after that e-mail was sent that he accepted the recommendation to terminate. What is more likely is that he and the deal team at Barclays had made the decision in their minds by the time the term sheet was sent to the Caisse on January 8, 2009 that when the Caisse did not sign the term sheet, which they expected to be the case, they would terminate.

150 Sometimes actions speak louder than words. On January 9, 2009, Mr. Kane of the London derivatives department of Barclays who is a trader who manages risk sent an internal e-mail to James Lee, Alex Pointier and others that he executed a hedge at the end of the day on January 8, 2009 "partly thinking about potential Devonshire impact next week." On January 12, 2009 at 1:41 p.m. London time (8:41 a.m. New York time) Mr. Kane sent another e-mail to the same people that stated that Barclays traders had managed to do a few trades "mainly in anticipation of Devonshire unwind". The timing of these trades, of course, was after the ultimatum of January 8, 2009 and prior to the deadline given to the Caisse to agree to the term sheet by 5 p.m. on January 12 and was contrary to any notion of any continuing negotiations if the Caisse did not agree to the ultimatum put to it. These e-mails reflected a belief that the Caisse was not going to agree and that the result would be a termination of the Devonshire trades.

151 While Mr. Kane was a junior trader, he was helping to trade the credit risk in the Barclays book. Mr. Pointier was the Barclays global head of correlation and exotic trading to whom he reported. There was no response from Mr. Pointier criticizing what Mr. Kane had done. Mr. Lee was not able to say whether Mr. Kane had been instructed to do the hedges, but no one was called to say that Mr. Kane was acting on his own. While Mr. Lee may not have been asked to do any

hedging regarding the termination prior to the evening of January 12, 2009, that does not mean others such as Mr. Kane acting under the authority of Mr. Pointier were not doing hedging in anticipation of a Devonshire termination. I can only assume that the evidence of Mr. Pointer would not have been helpful to Barclays, but whether that is the case, the inference I draw from the evidence is that Mr. Kane was not acting on his own without some instructions.

152 Also, on January 8, 2009, in the morning prior to the delivery of the ultimatum to the Caisse, Mr. Pointier asked Ms. Franke to reserve the profit and loss statement for the day until there was more clarity on Devonshire. Ms. Franke was a director in the product control group at Barclays covering the global correlation desk, including the Devonshire trade, and had responsibility for the oversight of the daily profit and loss calculation. Ms. Franke had "heard that rumour" that there "should [be] a real resolution by Monday." Ms. Franke had begun work by 10:00 a.m. on January 8, 2009 to gather the relevant trade information so "that when we terminate we knew the relevant trades."

153 Barclays relies upon an earlier ultimatum to Devonshire noteholders that had resulted in positive results so far as negotiations had concerned to support its contention that it thought the ultimatum to the Caisse on January 8, 2009 would result in some response from the Caisse that could lead to an agreement. I do not find that at all persuasive. On April 4, 2008 Barclays sent to these noteholders and the Investors Committee a draft term sheet with a deadline of 4 days. That resulted in the meeting in New York on April 8, 2008 at which the terms as to how the small noteholders were to be dealt with were apparently agreed in principle. However, the Barclays e-mail attaching the term sheet sent out on April 4, 2008 stated that the term sheet included "all of the essential terms that we have been discussing", not terms that had been discussed eight months previously in markedly different market conditions that had since been substantially altered by the parties, including Barclays.

154 Given that Barclays had sent out a term sheet to the Caisse on January 8, 2009 as an ultimatum, which the Barclays people involved in the transaction did not think the Caisse would accept, and given that Barclays intended to terminate the trades once the Caisse did not accept the ultimatum, all of this before the extensions of January 8 and 9, 2008 were sent, the extensions were misleading, both in the language used and in what was not said. It was misleading to say that there were issues being worked out. The negotiations were over from Barclays' point of view. Moreover, having made the statements that it did, it was misleading for Barclays not to disclose the ultimatum that it had made and its intention to terminate the trades if the ultimatum, which it did not think would be accepted, was declined. Thus the daily extensions of January 8 and 9, 2009 contained misrepresentations of facts.

(d) Result of misrepresentation

155 The parties agree that each daily extension formed a new contract. At issue is whether the extensions of January 8 and 9, 2009 should be rescinded because of the misrepresentations in them

that I have found to exist.

156 A material misrepresentation, whether innocent or fraudulent, may be grounds to set aside a contract entered into by one party in reliance on the representation. A fraudulent misrepresentation is a statement known to be false or made not caring whether it is true or false. For innocent misrepresentation the misrepresentation might be entirely honest and careful, there is no need for promissory intention, the negligence of the party seeking relief is no defence, and there is a presumption that a material representation did in fact cause the misrepresentee to enter into the transaction. The presumption can be rebutted by proof of no reliance on the misrepresentation. See S.M. Waddams, *The Law of Contracts*, 6th ed. at para. 419-421.

157 The requirement that the misstatement of fact be material means that the misrepresentation must relate to a matter that would be considered by a reasonable person to be relevant to the decision to enter the agreement in question. See J. D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at p. 300. McCamus further states at p. 301:

> In addition to being shown to be material, the misrepresentation must have constituted an inducement to enter the agreement upon which the misrepresentee relied. Thus, a representee who undertakes his or her own separate investigation of the facts would not be held to have relied on the misrepresentation. On the other hand, is clearly established that the representee has no obligation to engage in "due diligence" and make such an independent investigation, even where the means of doing so are made available by the misrepresenter. Further, it is clearly established that the misrepresentation need not be the exclusive or even a predominant inducement for entering the agreement. It must be established, simply, that it was an inducement. Moreover, once it is established that a misrepresentation is of such a nature that it is liable to induce the misrepresentee to enter the contract, it would be presumed against the misrepresenter that such inducement did occur.

158 As stated by McCamus, *supra*, it is not necessary for a plaintiff to establish that the misrepresentation was the sole inducement for acting and it matters not if the misrepresentation was only one of several factors contributing to the plaintiff's decision. See *Sidhu Estate v. Bains* (1996), 25 B.C.L.R. (3d) 41 at paras 35-36; *Kripps v. Touche Ross & Co.* (1997), 89 B.C.A.C. 288 (C.A.) at paras. 102-103; *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514 (C.A.) at para 81.

159 The issue of reliance is a question of fact to be inferred from all the circumstances of the case and evidence at the trial. See G.H.L. Fridman, *The Law of Contracts*, 5th ed. (Scarborough: Thomson Carswell, 2006) at p. 293.

160 Courts of equity in the past held that there could be no rescission after the contract induced by the misrepresentation had been executed except in the case of fraud, "error in *substantialibus*" or complete failure of consideration. See Waddams, *supra*, at para. 422 for a discussion of this history.

Professor Waddams states that recent cases suggest that courts will be willing to find an "error in *substantialibus*" whenever justice seems to require rescission and he argues for a flexible test. He stated:

> It is submitted that execution should be recognized as a relevant, but not decisive, factor in determining whether, in all the circumstances, rescission should be denied because it might affect third parties or because of the plaintiff's undue delay in seeking his remedy.

161 It is not argued that the statements which I have found to be misrepresentations were not material, nor could it be. They were relevant to the decision by Devonshire to accept the extensions in question. What is contended by Barclays is that there was no detrimental reliance on them by Devonshire.

162 Mr. Lafleur-Ayotte testified that in the fall of 2008 Quanto had been informed that the negotiations between Barclays and the Caisse were going well and that the parties were close to reaching an agreement with Barclays. Quanto was also informed that National Bank had sold all of its Devonshire notes to Barclays and that an offer would be made to all of the small holders of Devonshire notes to exchange their notes for MAV II notes being issued in the large Crawford restructuring that was to close in early January, 2009. He testified that the only other information that he had about the Barclays negotiations was the information in the daily standstill e-mails that the negotiations were ongoing, which he said was consistent with his understanding of the situation. He was not aware of the ultimatum made by Barclays to the Caisse on January 8, 2009 to sign the April 2008 term sheet by the close of business on January 12, 2009.

163 Mr. Lafleur-Ayotte testified in chief that if he had been told of the ultimatum made by Barclays and the deadline for a response, he would have verified the information with the Investors Committee. He testified that assuming he was told that the Caisse would not have accepted the Barclays ultimatum, Devonshire would have objected to the extensions on January 8 and 9, 2009 and its only option would have been to proceed with the termination of the swaps. He said that the only reason Devonshire did not terminate the swaps in August, 2007 was because of the Montreal Accord and Devonshire had committed to Barclays that it would not terminate the swaps if Barclays was negotiating in good faith with investors. If those negotiations had come to an end, there was no purpose in continuing with that arrangement and the only option would have been to protect the assets of Devonshire and take steps to terminate the swaps.

164 Robert Girard is a partner at Fasken Martineau in Montreal. He was a director of M & M Alternative Investment VII Corp., the Issuer Trustee of Devonshire, and was the person who signed documents such as the default notice on behalf of the Issuer Trustee and who liaised between Quanto and the board of directors of the Issuer Trustee. Mr. Girard was not aware of the ultimatum of Barclays made to the Caisse on January 8, 2009. He testified that his understanding on that day and the following day as to the state of negotiations between Barclays and the Caisse was that the

negotiations were ongoing and was based on the daily extension e-mails sent by Barclays on those two days. Nor was he aware of the response made by the Caisse to Barclays on January 12, 2009. He was surprised to learn of the termination of the swaps by Barclays on the morning of January 13, 2009.

165 Mr. Girard testified that if had been told of the ultimatum of Barclays of January 8, 2009 with a hard deadline of January 12, 2009 at 5 p.m. and been told that the Caisse would not accept the term sheet offered he would have consulted with Quanto and then recommended to the board of the Issuer Trustee to immediately address the subject of the termination of the swaps.

166 Counsel for Barclay's elicited on cross-examination evidence from Messrs. Lafleur-Ayotte and Girard that it relies on to counter the testimony of these witnesses given in chief. For reasons that follow, I do not think this evidence assists Barclays.

167 On cross-examination, Mr. Lafleur-Ayotte said that on the assumption that he had been told by the Caisse that Barclays had put a deadline on the Caisse to respond to its term sheet by 5 p.m. on January 12, 2009 and that the Caisse intended to respond to Barclays within the deadline, it would have been a difficult situation but he suspected that his advice would have been to not interfere with the daily standstills or object to them.

168 On cross-examination, Mr. Girard said that had Devonshire been advised that in the past Barclays had set deadlines with the noteholders and those deadlines had led to progress in negotiation, that on January 8, 2009 Barclays had made a proposal to the Caisse and unilaterally proposed to the Caisse that Barclays would extend the standstill with Devonshire to January 12, 2009, and that on January 9, 2009 the Caisse had indicated to Barclays that it would make a response to the Barclays proposal by January 12, 2009, Devonshire would not have objected to the daily extensions on January 8 and 9 through to January 12, 2009.

169 The issue is whether Devonshire reasonably relied on the statements made in the extension e-mails that I have found to be misrepresentations of fact. What Devonshire may have done had Mr. Lafleur-Ayotte or Mr. Girard been told things that they did not know is relevant in assessing their evidence, and in considering whether they reasonably relied on what they were told, but the underlying question is not what they may have done had they been told things that they were not.

170 The questions put by counsel for Barclays on the cross-examinations of Messrs. Lafleur-Ayotte and Girard did not put the facts as I have found them. That is, they were not asked what Devonshire would have done had they been told (i) that Barclays had come to the view that the Caisse would never agree to any reasonable terms, (ii) that Barclays had put in its ultimatum to the Caisse a term sheet from April 2008 that did not reflect the market upheavals that occurred in the fall of 2008 or the revised terms that had been negotiated by the Investors Committee for the large Crawford restructuring and negotiated to some extent between Barclays and the Caisse, (iii) that no one at Barclays believed that the Caisse would accept the term sheet, (iv) and those involved at Barclays intended to terminate the swaps once the Caisse did not accept the ultimatum.

171 In my view, and I so find, had Messrs. Lafleur-Ayotte and Girard been advised of these facts, they would have taken immediate steps necessary to terminate the swaps in order to protect the assets of Devonshire, including not agreeing to the extensions of the standstill and the default notice suspension.

172 Mr. Bergeron of the Caisse testified that if someone from Devonshire learned of the e-mail of January 8, 2009 from Mr. Lovisolo to the Caisse and asked him what the Caisse would do, he would have told Devonshire that the Caisse surely would not accept the ultimatum. I accept that evidence. His evidence on cross-examination, which I accept, was that he knew when he saw the e-mail from Mr. Lovisolo what his response would be. That response denied the existence of any prior agreement. Mr. Bergeron was insulted by the e-mail from Mr. Lovisolo and it would be more than unlikely that he would have given any different impression to Devonshire. Had Devonshire spoken to Mr. Bergeron before deciding what to do with the daily extensions of January 8 and 9, 2009, what Mr. Bergeron would have told them would have led Devonshire to immediately take steps to terminate the swaps.

173 Barclays relies on an e-mail exchange by Mr. Martis with Mr. Neville as evidence that Devonshire were not influenced by the language of the daily extensions. I do not think the exchange assists Barclays. On Friday, March 14, 2008 a draft extension agreement was circulated by Barclays. Mr. Martis, a solicitor for Devonshire in Montreal, was away and could not open the draft on his blackberry. His partner working on the matter was also away. Mr. Martis was concerned that his silence might be taken to be consent to the draft. On Saturday, March 16, 2008 he sent an e-mail to Mr. Neville in which he referred to his inability to access the draft and concern that his silence be taken as consent. He said that the intention of Quanto and Devonshire was that until such time Barclays and the investors reached an agreement, or that Barclays or the Investors Committee determined that the negotiations had terminated unsuccessfully, the status quo established in August should be maintained on identical terms. He said Barclays would be hearing on Monday from his partner regarding the draft.

174 I cannot accept that what Mr. Martis said in his e-mail in March, 2008 to tide things over until his partner could review draft documentation regarding an extension agreement would have continued to be the view of Quanto and Devonshire in January, 2009 had disclosure been made to them of the views and intentions of Barclays as I have found them to be. Barclays had effectively decided to terminate any further discussions with its ultimatum which it knew would not be accepted by the Caisse.

175 It is quite evident that Barclays did not want to disclose to Devonshire the true state of affairs and that Barclays had a concern that Devonshire might terminate the trades before Barclays if it had notice of the ultimatum.

176 Mr. Martis of Faskens, solicitors for the indenture trustee of Devonshire, e-mailed Mr. Neville and Mr. Bergeron on December 30, 2008 and asked that as the Montreal Accord

restructuring was now headed for a mid-January closing, would it now be appropriate to hear where Barclays stood with the Devonshire restructuring and when it might be expected to proceed to its consummation. Mr. Neville said he received the e-mail while he was skiing in Wyoming and did not respond to it. He said getting involved in Devonshire was not something he wanted to do and he did not think he had to respond. Mr. Dunsche on the same day e-mailed Mr. Neville and Mr. Lovisolo and said "Funny guy. Do we need to respond? Don't think so." Mr. Neville's explanation on cross-examination that they had received humorous e-mails from Mr. Martis in the past rang hollow as an explanation for Mr. Dunsche's comment to Mr. Neville.

177 On January 6, 2009 Mr. Martis e-mailed Mr. Neville and asked "Gregg, any chance of a reply to my e-mail?" Mr. Neville did not respond, although he was back in his office after the holidays. He testified that he did not recall focusing on it at the time. This response is hard to credit. Devonshire was a big issue at the time for Barclays and Mr. Neville and there has to be an explanation why he did not respond to Mr. Martis.

178 The inference I draw, in spite of Mr. Neville's denial, is that Barclays did not want Devonshire to know the state of play or to answer a direct question from Mr. Martis regarding the expectations of a Devonshire restructuring. Mr. Neville acknowledged that Barclays did not want any advance notice to be given to Devonshire of the liquidity payment by Barclays and reluctantly admitted on cross-examination that it was possible that Barclays did not want to put Devonshire in a position where it could take steps to terminate before Barclays did. He also acknowledged that there was a risk that if Devonshire was given notice of the ultimatum put to the Caisse, Devonshire might take steps to terminate the trades, although he said he thought that before doing so Devonshire would call the Caisse for permission. The failure to respond to Mr. Martis compounded the misleading nature of the extensions e-mails, which were also copied to Mr. Martis, in the face of these requests from Mr. Martis who clearly wanted to be advised of the situation.

179 In my view, and I so find, the misrepresentations in the extension e-mails of January 8 and 9, 2009 influenced the decision of Devonshire to accept those extensions and were reasonably relied on by Devonshire to its detriment. Moreover, had the true situation been disclosed in the e-mails, Devonshire would have taken immediate steps towards terminating the Devonshire trades in order to protect the trust assets.

180 Technically, it can perhaps be said that the two contracts entered into by the extensions of January 8 and 9, 2009 were executed, in that the standstill provisions continued. This, however, is not in my view any reason to refuse rescission based upon an innocent misrepresentation. No third-party rights will be disadvantageously affected by the rescission and the justice of the situation requires a rescission.

181 While it is not strictly necessary for the purposes of the misrepresentation claim to determine whether the misrepresentations amounted to a fraudulent misrepresentation, in my view they did. Mr. Neville, who sent the extension e-mail of January 8, 2009, and the Barclays sales team knew

that there were not a number of issues being worked out between Barclays and the Caisse and knew that the negotiations were at an end. They also knew of relevant facts such as the ultimatum put to the Caisse and the intention to terminate when the Caisse did not accept the ultimatum, which they expected would occur. The extension e-mail of January 9, 2009 was sent by Ms. Sheila Chapman, an in-house lawyer at Barclays in New York. What she knew is not in evidence as it is a privileged matter. However, the e-mail was copied to Mr. Neville and others in the Barclays sales team who again knew of the misrepresentations. I view these e-mails as being part of the litigation strategy that shortly thereafter unfolded. Barclays did not want to disclose to Devonshire what was going on with the Caisse and did not want to run the risk that Devonshire might terminate the swaps before it did. The e-mails, to the knowledge of the Barclays sales team, were false.

182 In the circumstances, Devonshire is entitled to rescission of the two extensions of January 8 and 9, 2009.

183 One result of the rescissions is that the two remaining days during which Barclays had to remedy its default in paying the liquidity demands before an event of default occurred began to run on January 9, 2009.

13. Can Barclays rely on the insolvency of Devonshire to terminate the swaps?

184 On January 13, 2009 Barclays delivered an early termination notice to Devonshire. The notice stated that an event of default had occurred with respect to Devonshire pursuant to section 5(a)(vii) of the ISDA Master Agreement and it designated January 13, 2009 as the early termination date. The notice did not state what the event of default was other than to refer to section 5(a)(vii) of the ISDA Master Agreement and did not state when the event of default had occurred.

185 Section 6(a) of the ISDA Master Agreement provides that the non-defaulting party is to specify the relevant event of default. In its notice of early termination on January 13, 2009, Barclays did not do so. It merely stated that an event of default had occurred with respect to Devonshire pursuant to section 5(a)(vii) of the ISDA Master Agreement. It did not specify which subsection of (vii) it relied on and said nothing of the facts it relied on. It did not specify any date of an alleged event of default.

186 Section 5(a)(vii) of the ISDA Master Agreement provides for 9 different classes of events as constituting an event of default, all of which involve financial distress of one kind or another. One of these, sub-clause 2, is now relied on by Barclays. It provides:

> (a) Events of Default. The occurrence at any time with respect to a party... of any of the following events constitutes an event of default (an "Event of Default") with respect to such party:-

...

(vii) Bankruptcy. The party...

(2) becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due;

187 Strictly speaking, section 5(a)(vii)(2) contains four events of default: (i) a party becomes insolvent; (ii) a party is unable to pay its debts: (iii) a party fails to pay its debts generally as they become due: or (iv) a party admits in writing its inability generally to pay its debts as they become due. Each is distinct and not cumulative.

188 With respect to the event of default that a party is unable to pay its debts, there is authority that evidence of a mere failure to pay the debt is not sufficient if there is evidence of a substantial reason for not paying. In *Re Taylor's Industrial Flooring Ltd.* [1990] BCC 44 (C.A.), referred to by Flaux J. in *Marine Trade S.A, supra,* Dillon L.J. stated:

> In my judgment, something more must be proved than simply that the company has not paid a debt. In some cases the circumstances surrounding the non-payment may justify the inference that the debtor is unable to pay its debts as they fall due. A series of dishonoured cheques might justify that inference. But in the present case a reason for non-payment has been put forward. The reason may not be a very good one, but unless it is not being put forward honestly, I do not see why an inference of inability to pay should be drawn from the fact of non-payment.

189 Barclays does not rely on the first event of default contained in section 5(a)(vii)(2), i.e. a party becomes insolvent. The word "insolvent" is not defined in the ISDA Master Agreement. In Firth, *Derivatives Law and Practice*, (London: Thomson Reuters (Legal) Limited 2010), it is opined that the word may have to do with a balance sheet test of insolvency. This need not be considered as Barclays relies on the other three events of default referred to in section 5(a)(vii)(2).

190 In its statement of claim, Barclays pleaded that from and after August 13, 2007 an event of default under section 5(a)(vii)(2) existed against Devonshire. In a ruling at the outset of the trial, I ruled that because of the scope of the bifurcation order, Barclays could not lead evidence at this stage on the issue of whether there was an insolvency of Devonshire prior to August 16, 2007, i.e. prior to the Suspension Notice. The word "insolvency" in the context of the ruling was not intended to distinguish the different events of default contained in section 5(a)(vii)(2).

191 Thus at this stage of the trial, Barclays contends that there was an event of default existing on January 13, 2009. Devonshire contends that for a number of reasons, Barclays cannot rely on the insolvency of Devonshire as a basis for terminating the swaps.

(a) Was Devonshire insolvent on January 13, 2009?

192 More particularly, the issue is whether there was an event of default on the part of Devonshire on January 13, 2009 at the time Barclays delivered its notice of early termination.

193 As at January 13, 2009, the Class A notes that matured on August 13 to 15, 2007 and thereafter up to November 7, 2007, totalling $209,716,441, had not been paid. Most of the Class FRN and Class E notes had long matured and were unpaid.

194 From August 13, 2007 to January 13, 2009, no Devonshire noteholders made a demand on any class of Devonshire notes or presented a note for payment. Sometime after the Montreal Accord, the Devonshire noteholders signed an extraordinary standstill resolution pursuant to the Devonshire trust indenture directing the indenture trustee from delivering any notice of default to Devonshire, exercising any powers to declare money due and payable, taking any steps to realize on security, enforcing payment of money, exercising any remedies under the trust indenture or under any statute or at law or equity or taking other steps to enforce the trust indentures. The resolution stated that the noteholders wished the powers they held be used to effect a temporary standstill to facilitate the Montreal Accord beyond March 14, 2008. The term of the standstill was stated to run to April 14, 2008 or such later date as the Investor Committee might advise the indenture trustee. There is no evidence whether the Investor Committee did later advise of an extension, but in light of the Investor Committee's continuing efforts to restructure through to January, 2009 and the fact that the indenture trustee took no steps the entire time contrary to the instructions contained in the extraordinary resolution, it can safely be inferred that the instructions were explicitly or implicitly continued.

195 Devonshire refers to authority that in considering whether a debtor has ceased to meet his liabilities as they become due (the BIA language for insolvency) a court should consider the attitude of creditors regarding payment. In *Re Tysak Ltd* (1981), 38 C.B.R. (N.S.) 142 Saunders J. stated:

> While the attitude of a creditor is not relevant to the issue of whether his account is overdue, the fact that a creditor is not pressing and is willing to tolerate delay in payment is, in my opinion, one circumstance that may be taken into account in determining whether a debtor has ceased to meet its liabilities.

See also *Re 345531 Ont. Ltd.*, (1980) 35 C.B.R. (N.S.) 18 per Saunders J.

196 Barclays counters this by relying on a statement of Ground J. In *Re Brock R.V. Centre* (2007), 33 C.B.R. (5th) 219, Ground J. stated:

> The law is clear that the fact that Brock R.V. was not being pressed for payment of a particular debt does not make it any less a liability for purposes of the B.J.A. In *Re Cappe* [1993] O.J. No. 775, I stated at pg. 6:
>
> > In *Re Hayes* (1979), 34 C.B.R. (N.S.) 280 (B.C.S.C.), the debtors argued as

> a defence that given creditors other than the petitioning creditor were not pressing for payment, they had not failed to meet their liabilities generally as they became due. The Court was of the view that in order to refuse a petition, a debtor must satisfy the court affirmatively that they are able to pay their debts, not that the creditors are not pressing for payment.

197 I have been referred to no case dealing with the language in the ISDA Master Agreement as to what is meant by the words "fails to pay its debts as they become due". I take the words of the BIA "ceases to meet his liabilities generally as they become due" to mean the same as the words "fails to pay its debts generally as they become due" in the ISDA Master Agreement.

198 Regarding the test for a party being "unable" to pay its debts, Devonshire relies on a statement of Briggs J. in *Re Cheyne Finance plc*, [2008] 2 All E.R. 987, dealing with the words "unable to pay its debts as they fall due" in the U.K. Insolvency Act relied on by Lord Neuberger MR in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc & Ors*, [2011] EWCA Civ 227, who stated:

> This is not dissimilar from the point made in relation to section 123(1)(e) by Briggs J in *Re Cheyne Finance plc* [2008] 2 All ER 987, para 51, when he contrasted "a momentary inability to pay ... as a result of temporary liquidity soon to be remedied" with "an endemic shortage of working capital" which renders "a company ... on any commercial view insolvent, even though it may be able to pay its debts for the next few days, weeks or months before an inevitable failure." ... The point that I think Briggs J was making is that section 123(1)(e) does not require slavish adherence to the immediate present. It is unnecessary to decide whether that is correct, although it is only right to say that, as at present advised, I am inclined to think that it is. However, that does not call into question the conclusion that section 123(2) applies to a company whose assets and liabilities (including contingent and future liabilities) are such that it has reached the point of no return.

199 Devonshire is a very unusual case. It is not about a debtor who was having financial difficulties unable to earn or raise enough cash to pay off its debts.

200 Once the financial crises in August 2007 took hold, the negotiations to restructure the ABCP market, including the negotiations for Devonshire, were with the intent that the asset providers, including Barclays, would enter into direct swap contracts with the noteholders of the various conduits, including the Devonshire noteholders. It was never contemplated that the noteholders would look to Devonshire. The swaps would be taken out of Devonshire. It is not surprising that the noteholders who were negotiating with Barclays instructed the trustee not to take any steps to enforce the notes.

201 The standstill arrangements between Barclays and Devonshire were consistent with this

dynamic as Devonshire agreed during the standstill not to enforce its rights against Barclays under its default notice, i.e. not to attempt to obtain the liquidity payments which it would require in order to pay the Class A notes unpaid at the time of the standstill, so long as Barclays complied with its obligations as a signatory to the Montreal Accord. The Montreal Accord contained a long-term proposal under which all outstanding ABCP would be converted into term floating rate notes maturing no earlier than their scheduled termination dates and the signatories, including Barclays, agreed in principle to the long-term proposal and to work in good faith to bring about its timely implementation. By agreeing to this long term proposal, Barclays could hardly have expected Devonshire to take any steps to attempt to pay off its noteholders.

202 Major note holders of Devonshire, including Desjardins and National Bank, sold their notes to Barclays. They did not attempt in any way to collect on their notes from Devonshire, nor did Barclays once it acquired these notes. Barclays had no intention during the standstill to attempt to collect on the Devonshire notes that it had acquired, and once it terminated the standstill its efforts were not to collect on the notes but rather to terminate the swap contracts and obtain the collateral held by Mellon Bank and arguably by Devonshire in order to compensate it for its loss as provided for in the ISDA Master Agreement.

203 On October 20, 2008, without any input from either Devonshire or Barclays, DBRS withdrew its rating of Devonshire. The DBRS press release stated: "As efforts continue to restructure Devonshire, it is now no longer necessary for DBRS to continue its rating of Devonshire." Up to then, Devonshire throughout had a AAA rating from DBRS. Without a rating, it would be impossible for Devonshire to issue new notes. Neither Barclays nor Devonshire objected to this withdrawal of the rating, obviously because neither contemplated that Devonshire would try to raise new capital to pay off its noteholders.

204 Barclays relies on a statement by Xeno Martis, a solicitor at Faskens acting for Devonshire, as constituting an admission in writing on the part of Devonshire of its inability generally to pay its debts as they become due. I would not accept this argument.

205 In December, 2007 there was a proposal to amend the trust indentures for the trusts that Quanto was administering, including Devonshire, in order to solve a tax issue. During the standstill, the affected trusts were collecting revenues from swap counterparties without corresponding expenses, creating a potentially unrecoverable tax liability for the trusts. Faskens recommended a solution to the Investor Committee. The solution was based upon a market practice of debtors to pay a forbearance fee to creditors. The obligation to pay the forbearance fee would correspond approximately to the taxable income that accumulated in the trust. The obligation to pay the forbearance fee would be at the bottom of the waterfall of payments to be made to creditors, so that the forbearance fee would not be paid before noteholders themselves were paid in full.

206 The note of Mr. Martis stated:

> ... The compensation being offered is simply a fee articulated in the form an

> interest expense. The Trusts are insolvent and are compensating the creditors that have the power to accelerate their debts with a fee in consideration of a standstill intended to allow its creditors to restructure their debt. Those creditors that have that power are the holders of all of the Notes and not just the holders of the A Notes. That is all we were doing...

207 Mr. Martis was making an argument to support the recommendation, in order to save a potential tax. In the end, what he proposed was not agreed to or carried into effect. He had no authority from Quanto or Devonshire to make an admission in writing of an event of default.

208 The standstill terminated at the close of business on January 12, 2009. Had someone taken the position at the opening of business on January 13, 2009 that Devonshire had ceased to pay its liabilities generally as they became due and thus should be put into bankruptcy under the BIA, it is difficult to think that in these circumstances the petition would have been successful. This situation is more than creditors not pressing for payment, which in itself is a circumstance which Saunders J. would take into account. It is a situation in which Barclays had agreed to a long-term proposal to change the terms of the outstanding notes to make them long term and was negotiating with the Devonshire noteholders to that end.

209 However, a bankruptcy order is a discretionary order. The fact that a bankruptcy order might not be made that day does not necessarily mean that Devonshire had not failed generally to pay its debts. While it may be a harsh conclusion, for the purposes of the ISDA Master Agreement I am of the view that on January 13, 2009 Devonshire had failed generally, and was unable, to pay its debts as they had become due.

(b) Did Barclays elect to abandon its right to rely on the insolvency of Devonshire?

210 Devonshire contends that by its actions Barclays should be taken to have abandoned its ability to rely on the insolvency of Devonshire.

211 The general conditions of the ISDA Master Agreement contain provisions regarding the requirement to pay money. They provide:

> 2. **Obligations**
>
> **(a) General Conditions.**
>
> (i) Each party will make each payment or delivery specified in each Confirmation to be made by it ...
>
> (iii) Each obligation of each party under section 2(a)(i) is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing ...

212 Therefore the obligation to make payments under the relevant agreements is subject to the condition precedent that there is no existing event of default. Thus, the obligation of Barclays to make payments to Devonshire for credit protection under the swap contracts was subject to the condition precedent that there was no insolvency event of default on the part of Devonshire.

213 Barclays did not take the position following the Suspension Notice that an event of default had been committed by Devonshire under 5(a)(vii) of the ISDA Master Agreement, which I shall refer to as taking the position that Devonshire was insolvent, or take steps to terminate the swaps. It could have. Barclays as a credit protection buyer continued to pay monthly payments to Devonshire as the credit protection seller against the possibility of defaults in the underlying portfolio of debt obligations. This carried on right to the end until Barclays delivered its early termination notice on January 13, 2009. Likewise, Barclays continued to charge Devonshire for liquidity protection against a market disruption event under the liquidity line until that protection terminated by its terms in February, 2008 by deducting the liquidity premium payable by Devonshire from the protection premium payable to Devonshire.

214 Devonshire contends that by making these protection payments and not taking steps to terminate under section 6(a) of the ISDA Master Agreement, Barclays elected to affirm the ISDA Master Agreement and abandoned its right to claim insolvency as an event of default.

215 Devonshire relies on a passage in Firth, *Derivatives Law and Practice*, (London: Thomson Reuters (Legal) Limited 2010). The same text is relied on by Barclays for a different point. In chapter 11, dealing with the ISDA Master Agreement, it is stated on p. 11-59 that a right to terminate will be lost if the non-defaulting party affirms the agreement. It is also stated that it is a question of fact whether this has occurred and that notwithstanding a non-waiver clause, for the non-defaulting party to continue to perform the agreement without protest for a significant period may be construed as an election by it to abandon its right to terminate. Two cases are cited for these propositions. Neither case deals with an ISDA Master Agreement.

216 The first case is *Motor Oil Hellas (Corinth) Refineries SA v. Shipping Corp of India* [1990] 1 Lloyd's Rep. 391 (H.L.). In that case, a vessel was chartered to load oil at a safe port. The port nominated by the charterer was not safe, but by various actions the owner was taken to have acted on the nomination. It was held that by its actions, the owner of the vessel elected to accept the nomination and thereby waived or abandoned its right to reject the nomination. In the course of his judgment, Lord Goff made an extensive analysis of the doctrine of election and affirmation of a contract. He stated, amongst other things :

> It is a commonplace that the expression "waiver" is one which may, in law, bear different meanings. In particular, it may refer to a forbearance from exercising a right or to an abandonment of a right. Here we are concerned with waiver in the sense of abandonment of a right which arises by virtue of a party making an election. Election itself is a concept which may be relevant in more than one

> context. In the present case, we are concerned with an election which may arise in the context of a binding contract, when a state of affairs comes into existence in which one party becomes entitled, either under the terms of the contract or by the general law, to exercise a right, and he has to decide whether or not to do so. His decision, being a matter of choice for him, is called in law an election. Characteristically, this state of affairs arises where the other party has repudiated the contract or has otherwise committed a breach of the contract which entitles the innocent party to bring it to an end, or has made a tender of performance which does not conform to the terms of the contract.
>
> ...
>
> In all cases, he has in the end to make his election, not as a matter of obligation, but in the sense that, if he does not do so, the time may come when the law takes the decision out of his hands, either by holding him to have elected not to exercise the right which has become available to him, or sometimes by holding him to have elected to exercise it. Instances of this phenomenon are to be found in s. 35 of the *Sale of Goods Act*, 1979. In particular, where with knowledge of the relevant facts a party has acted in a manner which is consistent only with his having chosen one of the two alternative and inconsistent courses of action then open to him - for example, to determine a contract or alternatively to affirm it - he is held to have made his election accordingly, just as a buyer may be deemed to have accepted uncontractual goods in the circumstances specified in s. 35 of the 1979 Act.

217 The second case cited in Firth, *supra,* is *Tele2 International Card Co. SA v. Post Office Ltd* [2009] All E.R. (D.) 144. In that case Tele2 had failed to provide a guarantee of its parent company to the Post Office for obligations under a phone card supply contract, which failure gave the Post Office the right to terminate the contract. However, it was held that under the doctrine of affirmation of a contract by election, the Post Office had elected not to terminate the contract by continuing with the contract for a year after the breach.

218 See also *Charter Building Company v. 1540957 Ontario Inc. (Mademoiselle Women's Fitness & Day Spa)*, 2011 ONCA 487 for a recent discussion by Epstein J.A. of the doctrine of election.

219 Section 6(a) of the ISDA Master Agreement provides that if at any time an event of default has occurred and is then continuing, the non-defaulting party may deliver a notice of early termination and thereby terminate the contract. The word "may" indicates that the non-defaulting party need not do so, but may elect to keep the contract running. There is a body of case law that

confirms that section 6(a) is a contractual right that may or may not be exercised. For example, in *Lomas et al. v. JFB Firth Rixson Inc. et al.*, [2010] EWHC 3372 (Chancery), Briggs J. held that on the bankruptcy of Lehman Brothers, which was an event of default, the counterparty to Lehman Brothers on interest rate swaps made under an ISDA Master Agreement was entitled to not deliver an early termination notice and to rely on section 2(a)(iii) to withhold payment of interest payments otherwise payable to Lehman Brothers under the swaps. Briggs J. stated that section 6(a) was plainly to be exercised in such a way as the non-defaulting party considered best served its own interests "by way of a choice between alternative remedies" arising out of its counterparty's default.
.

220 The words "and is then continuing" in section 6(a) suggest that the non-defaulting party may not be required to immediately deliver its notice of early termination upon an event of default, if that is the course which it wants to follow. That does not necessarily mean, however, that a non-defaulting party cannot by later actions be taken to have affirmed the contract. Firth, *supra*, says otherwise. No case was cited by Barclays in which a non-defaulting party under an ISDA Master Agreement continued to make payments to the defaulting party after an event of default and was held entitled at a later date to have the right to deliver an early termination notice.

221 What happened in *Enron Australia Finance PTY Ltd. (In Liquidation) v. TXU Electricity Ltd.*, [2003] 48 A.C.S.R. 266 (N.S.W.S.C.); aff'd [2005] NSWCA 12 (C.A.) was the same as in *Lomas et al. v. JFB Firth Rixson Inc. et al.* On the insolvency of Enron, the counterparty to electricity swap contracts under an ISDA Master Agreement did not deliver an early termination notice and was held entitled to rely on section 2(a)(iii) to withhold payments otherwise payable to Enron. What is the critical difference in those cases is that unlike Barclays, the non-defaulting parties chose their remedy by stopping the payments that would have been required had there been no event of default.

222 I agree with Devonshire that if, as is Barclays case, Devonshire became insolvent, Barclays elected to affirm the swap contracts by continuing to pay premiums to Devonshire for credit protection from losses in the underlying bond and ABCP portfolio and by continuing to charge and collect liquidity payments from Devonshire. It was open to Barclays not to enter into any standstill agreement, or elect at any time not to renew it, and to take the position that it was going to rely on section 2(a)(iii) and not make any further payments because of Devonshire's insolvency, but it did not do so. What its motivation was to keep making the payments is perhaps not relevant, but on my view of the evidence, the answer lies largely on the concern that Barclays had from the outset of the financial crises right through to January, 2009 of the effect on its "franchise", i.e. the effect on its reputation in the Canadian marketplace, if it were seen to be what it referred to as an "outlier" in terminating an ABCP program during reconstruction discussions. Barclays contends that it also did so on the strength of assurances from National Bank and the Caisse as to what it would do in a restructuring, but I think Barclays overstates considerably the assurances that it says it had from National Bank and the Caisse. It is clear that Barclays continued to make the premium payments with its eyes wide open.

223 Barclays could have taken the position that Devonshire was insolvent and refused by virtue of section 2(a)(iii) to make payments to Devonshire. It did not do so from August 16, 2007 onward. It elected not to exercise that right, which was effectively abandoning that right. Nor during that time did it elect to terminate the swap contracts. Even if Barclays was entitled under section 6(a) of the ISDA Master Agreement to sit on its hands after the insolvency of Devonshire until it was favourable to it to terminate the swap contracts, it would be quite inconsistent for it to elect to abandon its right to refuse payment to Devonshire due to Devonshire's insolvency, and to affirm the existence of the swap contracts, and now claim that it was entitled on January 13, 2009 to terminate the contracts on the basis of Devonshire's insolvency, which it pleads occurred from and after August 15, 2007.

224 Just because Barclays' case at the trial was that Devonshire was insolvent on January 13, 2009 does not protect Barclays. In its notice of early termination, Barclays did not specify any date of an alleged insolvency. In its statement of claim, Barclays pleaded that Devonshire was insolvent from August 15, 2007. On Barclays' case, if Devonshire was insolvent on January 13, 2009, Devonshire was also insolvent on August 15, 2007, prior to the date of the Suspension Notice, and on August 17, 2007 after the Suspension Notice, as the evidence indicates that from at least August 15, 2007 Devonshire did not have funds to pay the Class A notes that were not rolling as a result of Barclays refusing to acknowledge any liability under the liquidity facility. Indeed, Barclays argues that the liquidity backed notes, the Class A notes, were in default on their maturity, which means that Barclays argues that Devonshire was in default on these notes on which payment was due on each of at least August 14 and 15, 2007. As well, the Class FRN and Class E notes had long become due, after which Barclays continued to pay its price protection premiums to Devonshire. Interest on the FRN notes was not paid on August 16, 2007 and thereafter and on September 25, 2007 the Issuer Trustee informed the Indenture Trustee that default had occurred on the FRN notes.

225 To permit Barclays to terminate on January 13, 2009 on the basis of the insolvency of Devonshire, an insolvency that Barclays says commenced in August, 2007, in the face of Barclays afterwards making payments to Devonshire in spite of section 2(a)(iii), would be to ignore Barclays electing not to rely on section 2(a)(iii) and keeping the swap contracts in effect. In my view, in the circumstances, Barclays has to be taken to have elected not to terminate the swap contracts on the basis of the insolvency of Devonshire.

226 I conclude that for these reasons Barclays did not have the right on January 13, 2009 to terminate the swap contracts on the basis of the event of default relied on by Barclays. On that basis, its notice of early termination was ineffective.

227 Barclays takes the position that sections 9(b) or (f) of the ISDA Master Agreement preclude such a finding. I do not agree. These sections deal with waiver. What is at issue is an election exercised by Barclays to affirm the contract.

228 Section 9(b) provides that no waiver will be effective unless in writing and executed by each

of the parties.

229 Section 9(f) provides that a failure or delay in exercising any right will not be presumed to operate as a waiver. This section does not state that such a failure or delay could be deemed to be a waiver, but merely that a waiver will not be presumed.

230 In *Tele2 International Card Co. SA v. Post Office Ltd, supra*, it was held that a clause stronger than section 9(f) would not preclude a finding of abandonment by election. In that case the clause in question provided:

> Waiver
>
> In no event shall any delay, neglect or forbearance on the part of any party in enforcing (in whole or in part) any provision of this Agreement be or be deemed to be a waiver thereof or a waiver of any other provision or shall in any way prejudice any right of that party under this Agreement.

231 Aikens L.J. held that such a provision did not deal with the issue of election of whether or not to exercise a contractual right.

232 Even if what was at issue was simply a waiver, the case of *Fitkid (York) Inc. v. 1277633 Ontario Ltd.* [2002] O.J. No. 3959 indicates that a non-waiver clause is not necessarily the end of the matter. In that case, it was held by Swinton J. that a landlord who had the right to terminate a lease for failure of the tenant to pay rent waived that right by later accepting some rent and doing other acts consistent with the lease being in force. It was argued that the following provision in the lease precluded such a finding:

> Landlord's failure to insist upon a strict performance of any covenant of this Lease or to exercise any option or right herein shall not be a waiver or relinquishment for the future of such covenant, right or option, but the same shall remain in full force and effect. Acceptance of rent, whether due before or after and [sic] event of default, whether with or without knowledge of such default, shall not operate as a waiver by the Landlord of any right, including its right of forfeiture.

233 Swinton J. rejected that argument and stated:

> Even where there is a term in the lease governing waiver, the cases on waiver indicate that courts look at the conduct of the landlord to determine whether it has elected not to terminate the lease in the circumstances after the right of forfeiture arises. In my view, despite the wording of Paragraph 41 of the lease, the acceptance of rent accruing after the act which gave the landlord a right of

> forfeiture is a waiver in law, since that acceptance presupposes the continued existence of the landlord and tenant relationship.

234 There is also authority that variation of a contract is effective even if the contract purports to exclude subsequent oral variations and also that oral statements may operate as a waiver of rights evidenced by an earlier written document or may set up an estoppel. See S.M Waddams, *The Law of Contracts*, *supra*, at para. 329 and *Shelanu Inc. v. Print Three Franchising Corp* (2003), 64 O.R. (3d) 533 at para. 50.

(c) Is Barclays prevented by its own wrongdoing from relying on Devonshire's insolvency?

235 Barclays failed to make liquidity payments under the market disruption notices delivered by Devonshire on August 13, 14 and 15, 2007. For the purposes of this first portion of the trial, it is agreed that the notices were valid and that Barclays was in default in failing to make these payments, without prejudice to its position that it cured the defaults on January 13, 2009.

236 Devonshire takes the position that the failure by Barclays to make the liquidity payments was the proximate cause of its insolvency and that Barclays should not be able to take advantage of its breach by relying on Devonshire's insolvency.

237 Devonshire relies on the principle that no one should be permitted to take advantage of a state of affairs which he himself produced. In *Southcott Estates Inc. v. Toronto Catholic School Board*, [2010] O.J. No 1772 (C.A.) Sharpe J.A. stated:

> It is a well-established principle of contract law that a party cannot use its own breach or default in satisfying a condition precedent as a basis for being relieved of its contractual obligations.

238 This principle extends to preventing a party from taking a benefit under a contract as a result of his own breach. The law presumes that the parties do not intend to permit a party in breach from relying on its own wrong for the purposes of obtaining a benefit under a contract. In the absence of clear express language indicating that the parties in fact had that intention, this presumption will not be displaced. See *Alghussein Establishment v. Eton College*, [1991] 1 All ER 267 (H.L.). In that case, Lord Goff stated:

> Although the authorities to which I have already referred involve cases of avoidance, the clear theme running through them all was that no man can take advantage of his own wrong.... A party who seeks to obtain a benefit under a continuing contract on account of his breach is just as much taking advantage of his own wrong as is a party who relies on his breach to avoid a contract and thereby escape his obligations.

239 See also *Commissioner of Agricultural Loans of Ontario v. Irwin*, [1940] O.R. 489 at para. 15, per McTague J.A.

240 Barclays makes several points in response to Devonshire's position. It says that it subsequently made the liquidity payments and thereby remedied any alleged failure to pay. Thus there was no breach by Barclays that would prevent it from exercising rights under the ISDA Master Agreement. I cannot accept that. It is agreed for the purposes of this trial that Barclays breached its obligations under the liquidity line by failing to make payments to Devonshire on August 13, 14 and 15, 2007. Even if Barclays remedied the breach on January 13, 2009, that did not mean that there was no breach back in August 2007.

241 Barclays also contends that Devonshire seeks to reverse its own actions in entering into the Standstill Agreement and later the Montreal Accord in which the obligation of Barclays to make the liquidity payments was suspended. This ignores the fact, however, that it was the failure of Barclays to make the liquidity payments that initially caused Devonshire to take those measures to attempt to protect the interests of the Devonshire noteholders. Barclays had made clear to Devonshire that in its view there was no market disruption event and that it was not going to make the liquidity payments. It was not realistic, as suggested by Barclays in argument, for Devonshire to wait for three days to see if Barclays would make the liquidity payments. Not only had Barclays failed to make the liquidity payments, but it also on the evening of August 15, 2007 sent a mandatory collateral call on one of the two swaps which, because it is agreed for the purposes of this stage of the trial that there was a market disruption event at the time, could not have been validly made.

242 It is probably the case that at the time, the liquidity crisis in the independently sponsored ABCP market in Canada, partly at least caused by the refusal of the liquidity providers such as Barclays to acknowledge that a market disruption event had occurred, led to the Montreal Accord and, with respect to Devonshire, led Devonshire to agree to the Suspension Notice on August 16, 2007 and later to sign the Montreal Accord. It is not reasonable, however, on Barclays' case as pleaded, for Barclays to assert that it was not a cause of Devonshire's insolvency at that time. Barclays pleads that from and after August 13, 2007 an event of default under section 5(a)(vii)(2) existed against Devonshire as the Class A notes that did not roll on August 13, 14 and 15 were due and payable at maturity. That alone meant Devonshire was unable to pay its debts as they became due.

243 The Class E (extendible) and Class FRN (floating rate) notes to the knowledge of Barclays ranked pari passu with the Class A notes. This ranking was reflected in the Series A Supplemental Trust Indenture which was the subject of negotiations with Barclays. Interest became payable on one group of FRN notes on August 16, 2007. Although Devonshire had the funds to make the FRN interest payment on August 16th, this interest was not paid. The Issuer Trustee made the decision not to pay interest on the Class FRN notes because all of the notes were pari passu and the Trust did not want to treat one class of noteholders differently from the others. The Class E notes that came to maturity were extended and, once interest was payable on them, it was not paid for the same reason.

244 It is also probably the case, as Barclays asserts, that Devonshire would have needed to be part of the Montreal Accord to deal with the Class E and Class FRN notes because they were part of the same series as the Class A notes. Whether this would have been necessary had Barclays made liquidity payments on the Class A notes is a matter of speculation, but it is not a matter of speculation that Barclays failure was a prime cause of Devonshire agreeing to the Suspension Notice and later becoming a signatory to the Montreal Accord.

245 The event of default of Devonshire relied upon by Barclays, being Devonshire's inability to pay its debts as they became due, began when Barclays failed to make the liquidity payments on August 13, 14 and 15 2007. Because for the purpose of this stage of the trial it is agreed that Barclays was in default in failing to make those liquidity payments, the event of default of Devonshire relied upon by Barclays was first caused by Barclays. Insofar as the insolvency of Devonshire on January 13, 2009 related to the Class A notes, Barclays would impermissibly gain a benefit on account of its own breach or wrong.

246 I would not come to the same conclusion, however, regarding the insolvency of Devonshire on January 13, 2009 insofar as that insolvency relates to the Class FRN and Class E notes. The liquidity obligation of Barclays did not apply to these notes. Also, it was a decision by Devonshire, not Barclays, which led to those notes initially not being paid because they ranked pari passu with the Class A notes. To that extent, Barclays was not relying on its own breach on January 13, 2009.

(d) Should a term be implied preventing Barclays from relying on the insolvency of Devonshire?

247 Devonshire claims that a term should be implied in the ISDA Master Agreement that Barclays cannot rely on the insolvency of Devonshire caused by Barclays's failure to make the liquidity payment as a ground to terminate the swap contracts.

248 The tests for implying a term in a contract are well settled. A term it may be implied in a contract based on the presumed intention of the parties where the implied term is be necessary "to give business efficacy to a contract or is otherwise to meet the officious bystander test as a term which the parties would say, if questioned, that they had obviously assumed". What is important is a focus on the intentions of the actual parties. A court, when dealing with terms implied in fact, must be careful not to slide into determining the intentions of reasonable parties. This is why the implication of the term must have a certain degree of obviousness to it and why, if there is evidence of a contrary intention on the part of either party, an implied term may not be found on this basis. As well, no term will be implied that is inconsistent with the terms of the contract. See *M.J.B. Enterprises Ltd. v. Defence Construction (1951)*, [1999] 1 SCR 619 at para 27, per Iacobucci J. and *G. Ford Homes Ltd. v. Draft Masonry (York) Co. Ltd.*, (1983), 43 O.R. (2d) 401 (C.A.) at para. 9, per Cory J.A.

249 Terms have been implied in contracts to the end that a party may not take advantage of wrong doing. In *Gillespie v. Bulkley Valley Forest Industries Ltd.* (1973) 39 D.L.R. (3d) 586

(B.C.S.C.); aff'd 50 D.L.R. (3d) 316 (C.A.), cited in Waddams, *The Law of Contracts*, 6th ed, para. 499, a term was implied in a contract under which an employer agreed to repurchase a departing employees home if the employee had been employed for 12 months that the employer would not wrongfully terminate the employment.

250 An entire agreements clause that does not expressly bar an implied term does not preclude the implication of a term into a contract. See *CivicLife.com Inc. v. Canada*, [2006] O.J. No 2474, at para 48 (C.A.) at para. 52.

251 Devonshire asserts that that the implication of a term prohibiting Barclays from relying on its own failure to respond to a Market Disruption Notice is necessary to give business efficacy to the contract. Devonshire says that as a special purpose vehicle selling ABCP, its ability to pay its debts as they became due depended on the existence of a functioning market, or on ready access to liquidity in the event of a market disruption and that this fact receives objective confirmation in the emphasis placed on liquidity covenants by DBRS. Liquidity support in the event of a market disruption event was necessary to ensure a rating from DBRS of R-1 (high) of the Class A notes, without such rating the notes would not be marketable. DBRS was very involved in the criteria to be used in ABCP programs in Canada and the liquidity agreement reached between Devonshire and Barclays contained the latest DBRS criteria for a market disruption event made in June, 2006.

252 Devonshire contends that if, as Barclays suggests, it was possible for Barclays to refuse to perform its covenants and then capitalize on this refusal by terminating the swaps, the rationale behind the entire program would be undermined. Devonshire's arrangements could scarcely have been rated as they were if it were made plain to DBRS that Barclays could terminate the swaps in reliance on the consequences of its own failure to respond to a market disruption notice.

253 I would imply a term as suggested by Devonshire. It would not, as suggested by Barclays, read out the provisions of sections 5(a)(i) or 5(a)(vii)(2) or otherwise be inconsistent with the ISDA Master Agreement and related contracts. No one could seriously contend that a party in breach of an agreement would be able to rely on the results of that breach to exercise a contractual right of termination, absent a very clear provision in the contract authorizing that result.

254 Such an implied term, however, does not assist Devonshire because of the Class FRN and Class E notes that remained unpaid on January 13, 2009. That was not caused by Barclays.

(e) Could Barclays cure its failure to make the liquidity payments?

255 On January 13, 2009, just before 9 a.m., Barclays took steps to have wired to Devonshire's bank the liquidity payments demanded by Devonshire on August 13, 14 and 15, 2007. Shortly after that, Barclays delivered its notice of termination of the swap contracts.

256 Devonshire contends that Barclays was unable to remedy its failure to make the liquidity payments if it did not do so within three business days as provided in section 5(1)(a) of the ISDA

Master Agreement. Section 5(a)(i) makes it an event of default where:

> Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party.

257 Barclays contends that even if the time to remedy the failure had passed, it was entitled to terminate the swap contracts because under section 6(a) of the ISDA Master Agreement the event of default must "be continuing" at the time the notice of early termination is sent, which Barclays says is an indication in this case that it could remedy its failure. Section 6(a) provides:

> If any time an Event of Default with respect to a party (the "Defaulting Party") has occurred and is then continuing, the other party (the "Non-Defaulting Party") may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all outstanding Transactions.

258 Devonshire contends that the use of the word "remedied" in section 5(a)(i) is highly significant. It says that the ISDA Master Agreement does not provide that an event of default occurs if the amount that was supposed to have been paid is not paid within three business days. Rather, it provides that an event of default occurs if the defaulting party does not remedy "such failure", which means not just the failure to pay the amount due, but rather the failure to pay the amount due when due. Devonshire says that Barclays has "no right" to remedy its default once that has occurred. It distinguishes the default from a credit support default referred to in section 5(a)(iii)(1) which makes it a default if a failure to perform is continuing after any applicable grace period, suggesting in that case a failure could be remedied after the grace period.

259 I have difficulty with Devonshire's argument. I read nothing into section 5(a)(i) that deals with either an ability or inability to remedy the event of default after it has occurred.

260 Devonshire relies on two U.K. cases dealing with charterparty contracts that gave ship owners the right to terminate the charters "failing the punctual and regular payment" by the charterers. In *Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia* (*The Laconia*), [1976] 2 W.L.R. 668 (C.A.); rev'd [1977] A.C. 850 (H.L.)., it was held in the House of Lords, overruling the Court of Appeal on the point, that once a punctual payment of any instalment had not been made, a right of withdrawal accrued to the owners and the charterers could not avoid the consequences by tendering an unpunctual payment. The other case, *The Brimnes v. Tenax Steamship Co.*,

[1975] QB 929, contains a similar statement by Cairns L.J. in obiter.

261 I do not think these cases assist Devonshire. Firstly, they depended heavily on the obligation

in the charterparty to make payments "punctually". More importantly, the charterparty did not contain a provision such as section 6(a) which provides a right to terminate if an event of default has occurred "and is then continuing". Those words contemplate that an event of default, however it is caused, may cease to be continuing, i.e. some step may be taken to cause it to no longer be continuing. In the case of a failure to make a liquidity payment within three business days after a notice of default has been given, the step that would be required would be to make the payment. In this case, if the payment were made by Barclays after the three business days had elapsed, but before termination of the swap contracts by Devonshire, the event of default would not be continuing.

262 Thus I conclude that Barclays could cure its failure to make the liquidity payments, either by making the payment within the three business day period or after that if the trades were not terminated by Devonshire.

(f) Did Barclays make the liquidity payments on time to enable it to terminate the swaps?

263 On January 13, 2009, just before 9 a.m., Barclays took steps to have wired to Devonshire's bank the liquidity payments demanded by Devonshire on August 13, 14 and 15, 2007. Shortly after that, Barclays delivered its notice of termination of the swap contracts.

264 Devonshire contends that even if Barclays was otherwise entitled to terminate the swaps on January 13, 2009, Barclays was in default when it purported to do so because it failed to make the liquidity payments to Devonshire that morning before the termination occurred. Thus, Devonshire contends, Barclays was not a non-defaulting party at the time it purported to terminate the swaps, and as it is only a non-defaulting party who may terminate under section 6(a) of the ISDA Master Agreement, Barclays had no right to terminate. This contention involves an issue of (i) the interpretation of the relevant provisions of the ISDA Master Agreement and (ii) a technical question as to when the payment on January 13, 209 was made and received by Devonshire.

265 The obligation to make a liquidity payment is contained in Annex VI to the ISDA Master Agreement. The annex provides that if a market disruption notice has been delivered to Barclays by Devonshire, "[Barclays] shall pay to [Devonshire]" the amount specified in the notice.

266 Payments under an ISDA Master Agreement are governed by the following section:

2. Obligations

(a) General Conditions

[...]

(ii) Payments under this Agreement will be made on the due date for value on that date in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement, in freely transferable funds and in the manner customary for payments in the required currency.

267 Barclays sent its payment by wire transfer from its bank, CIBC, to Devonshire's bank, National Bank. The money was received in the National Bank general account at 9:00 a.m. on January 13, 2009. It was credited to Devonshire's account at 10:59 a.m. that day. Devonshire was not able to confirm that these funds were received until 11:12 a.m.

268 On January 13, 2009 Barclays sent notice to Devonshire that it had made arrangements for the liquidity payment by e-mail at 9:04 a.m. and notice of its early termination notices by fax (at 9:08 a.m. and 9:11 a.m.), by email (9:14 a.m.) and by hand delivery at a time unknown. Thus, at the time of the purported termination, the liquidity payment had been received by Devonshire's bank for some 8 minutes (four minutes after Barclays gave notice to Devonshire) but not yet credited to Devonshire's account.

269 This timing was well orchestrated. Barclays did not want any advance notice to be given to Devonshire of the liquidity payment, as expressed by Mr. Neville, who also reluctantly admitted on cross-examination that it was possible that Barclays did not want to put Devonshire in a position where it could take steps to terminate before Barclays did.

270 The arguments on this payment point are elaborate. The issue reminds one of a game of chess and the risk that one wrong move can prove calamitous.

271 Section 2(a)(ii) provides for payments to be made "in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement", "in freely transferable funds" and "in the manner customary for payments in the required currency". Devonshire contends that payment was not made to it until the funds were credited to it in its account and available to it for withdrawal. Barclays contends that was it important is when the payment was made, and that occurred when Devonshire's bank had the money. When it was deposited into Devonshire's account is irrelevant.

272 Under section 2(a)(ii), the payments are to be made "in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement". The word "Confirmation" is not defined in the ISDA Master Agreement. There is, however, a confirmation agreement entitled Amended and Restated Master Credit Derivatives Confirmation Agreement. There is no "place of account" specified in it or in the six annexes to it. Annex VI, dealing with the liquidity payment requirement, states only that Barclays shall pay to Devonshire the amount set out in the market disruption notice not later than 2:30 p.m. Thus, according to section 2(a)(ii) of the ISDA Master Agreement, payments are to be made "pursuant to this Agreement", which means they are to be made "to Devonshire".

273 In this case, as is the case with all wire transfers of large amounts of money between Canadian banks, the payment was made through the Large Value Transfer System (LVTS). The LVTS handles large real-time wire transfers between participant institutions and is operated by the Canadian Payments Association (CPA). Only member institutions in the CPA have access to the LVTS system. The LVTS is the only method for an immediately final and irrevocable payment in Canadian dollars other than by delivery of bank notes and coins. See Bradley Crawford, *The Law of Banking and Payment in Canada* (Looseleaf) (Aurora, ON: Canada Law Book, 2008) at paras. 12:10.10.

274 The CPA is a statutory body created under the *Canadian Payments Act* with the power to create by-Laws and rules governing LVTS payments. The LVTS by-laws are subordinate legislation pursuant to that *Act.*

275 Barclays contends that the conditions of payment prescribed in section 2(a)(ii) required the parties to make payments using the LVTS system. This presumably would flow from the language that payments will be made "in the manner customary for payments in the required currency".

276 There is no credit risk associated with payments through the LTVS system. See Bradley Crawford, *supra*, at p. 16-5:

> In the [LVTS], the system is so designed and operated that when the customer receives notice of the incoming payment, the payment is already irrevocably collected in good funds and on deposit with its bank. Even at the level of the banks, when an LVTS message arrives, the receiving financial institution has nothing to do except post it to the proper account and give notice to the account owner.

277 The LVTS by-laws provide that a payment will be available to a payee when its bank credits the funds to its account. They provide:

> FINALITY OF PAYMENT TO PAYEES
>
> Timing of Payments to Payees
>
> 43.(1) On actual receipt by a receiving participant [National Bank] of a payment message, the receiving participant shall make the amount of the payment message finally and irrevocably available to the payee [Devonshire] on the earlier of
>
> (a) the end of the LVTS cycle [5:30 p.m.], and
> (b) a reasonable request by the payee being made to the receiving participant for the amount of the payment message.

...

Finality of Payment

> 45. For the purposes of sections 43, 44 and 46 to 51, once a receiving participant [National Bank] has actually received a payment message, final and irrevocable availability of the amount of the payment message by a receiving participant to a payee [Devonshire] is deemed to occur on the earliest of
>
> (a) credit in the amount of the payment message, less any service charges (subject to any provisions that may be set out in the rules regarding the disclosure and the manner of processing of service charges), being made to the account of the payee,...

278 As to these provisions, Bradley Crawford, *supra*, states:

> These provisions appear to owe something to the precedent of the UNCITRAL Model Law on International Credit Transfers and, as such conform to the international norm for signalling the completion of a credit transfer operation...

279 Thus, so far as the LVTS system is concerned, the payment from Barclays to Devonshire became available to Devonshire in this case when it was credited to the account of Devonshire at 10:59 a.m.

280 Devonshire contends that as under the LTVS system the payment became available to Devonshire when it was credited to its account, it cannot be said that Devonshire received or had the use of the funds until those funds were put into its account, which took place at 10:59 a.m., nearly two hours after Barclays purported to terminate the swaps. Thus, Devonshire contends, Barclays was in default at the time of the purported termination and not able to terminate the trades. In this contention, I think Devonshire is correct.

281 Each side made reference to authorities in the U.K. to bolster their arguments. None of these are of course binding, but in any event I do not find them to be conclusive. One thing that becomes clear, however, is that a matter of minutes can be crucial as to whether payment was made in a timely matter.

282 Barclays relies on cases for the proposition that if there is no credit risk to the payment being received by the receiving bank the payee's right to payment arises when the bank receives the payment and it does not matter when the payee's account is credited with the funds. These cases involved charter parties where the owners attempted to revoke the contract due to alleged late payments.

283 In Zim *Israel Navigation Co. Ltd. v. Effy Shipping Corporation (the "Effy")*, [1972] 1 Lloyd's L.R. 18 (QB), a payment was to be made to the owners account at a branch of WD bank. It was

credited to WD bank's overseas branch account at Hanover bank, a correspondent bank, on October 5th. Notice of this was received by WD's overseas branch in London on October 6th and shortly thereafter credited to the owner's account at the WD branch. The owner, however, had terminated the charter on October 5th. It was held that the payment had not been made before the charter was terminated because the payment had not been credited to the named account and the owner could not have drawn on any account until October 6th. This case would appear to support Devonshire rather than Barclays. It stands for the proposition that payment is not effected until the payee is in a position to draw on its account for the amount of the funds transferred.

284 In *Tenax Steamship Co. Ltd. v. Reinante Transoceanica Navegacion S.A. (The Brimnes)*, [1973] 1 W.L.R. 386 (QB), the charterparty provided that payment was to be made in cash to the owner's account at Morgan Guaranty Trust (MGT) in New York. The owner sent instructions on April 1, the date for payment, to its bank Hambros, which upon receipt on April 2 sent by telex to MGT at 10. a.m. an order to pay instructing MGT to debit its account at MGT and credit the owner's account. Because a telex instruction was not considered legal tender, the time of payment was held to be the moment when MGT made the transfer from the Hambros account to the owner's account, which occurred at 6.07 p.m. However, approximately 15 minutes before this occurred, but long after the telex had been received by MGT, the owner terminated the charter. It was held that the payment was not made before the termination. This decision is irrelevant because it involved payment instructions by telex, not legal tender.

285 Barclays relies, however, on obiter in *Brimnes*, in which Brandon J. said that when payments on other occasions had been made by banker's cheques, it was reasonably clear that payment was effected when the banker's cheque was received by MGT. The point did not arise for decision. In the Court of Appeal, Edmund-Davies L.J. said in obiter that there was no contest that when payment by banker's cheque was made, the payment was made when received by MGT.

286 Both Barclays and Devonshire rely on the statement of Brandon J. that the words "payment in cash" in the charterparty did not mean only bills or other legal tender, but "any commercially recognized method of transferring funds the result of which is to give the transferee the unconditional right to the immediate use of the funds transferred". Barclays says the word "right to the funds" crystallized when National Bank received the funds. Devonshire says that under the LVTS that did not occur until the funds were put into its account. I think too much is being made of the words of Brandon J. He was intending to describe the quality of a payment, not when it might be available as between a transferee bank and its customer.

287 I do not think the case of *A/S Awilco of Oslo v. Fulvia S.p.A. Di Navigazione of Cagliari (The Chikuma)*, [1981] 1 W.L.R. 314 (H.L.) relied on by Devonshire is of much assistance. In that case, it was held that as the payment made by the charterers through its Italian bank on the due date was held not to be a payment in cash because under Italian banking law and the terms under which the payment was made, interest was not payable on the money for four days, and so the payment was held to amount to an overdraft facility.

288 Barclays relies on statements by Lord Denning M.R. and Lawton L.J. in *Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia* (*The Laconia*), [1976] 2 W.L.R. 668 (C.A.); rev'd [1977] A.C. 850 (H.L.). In that case, payment by the charterers was due on Sunday, April 12. It was conceded by the charterers that as the banks were closed on the week-end, payment should have been made by Friday, April 10. Arbitrators found that a punctual payment was to be made by 3 p.m. on Friday, April 10 at 3 p.m. and that a payment by bank order on April 13, 2009 was too late. On appeal, Donaldson J. upheld the award. His decision was reversed in the Court of Appeal, which held the payment could be made on Monday the 13th and that while the payment was not transferred by the owner's bank to the owner's account before the owner terminated the charterparty, it was sufficient that the payment had been received by the bank. The majority held that there had been waiver of the requirement that the payment was due on the Friday, April 10 by virtue of the owner's bank accepting the payment on April 13. Denning M.R. said that the bank was the agent of its customer. Lawton L.J. stated that once the payment was received by the bank, the customer could draw against the cash at once, and internal paper work did not affect that situation. In dissent, Bridge L.J. held that the owner had not waived the requirement that payment be made on April 10.

289 The House of Lords reversed the Court of Appeal decision, holding that the owner's bank had no authority from the owners to waive when payment was due and as the payment was not made on April 10, the charterers had the right on April 13 to terminate the charter. The issue as to whether payment by a bank order to a bank was sufficient to constitute payment to its customer was moot. Lord Wilberforce, with whom Lord Simon concurred, said in obiter "As between banks, a payment order is the equivalent of cash, but a customer cannot draw upon it. The amount must first be credited to his account, but he can, of course, make special arrangements for earlier drawing." Lord Fraser said that the payment would not have been made until it was credited to the owner's bank account, even though the payment order was one on which the payee's bank could safely rely because it was irrevocable and was made by a bank they could trust. He also said that he thought that the charterers must pay in sufficient time to allow for the period of processing normally required for the method of payment they had chosen. Lord Salmon said that while he preferred to express no concluded view, he was inclined to think there was no difference between dollar bills and a payment by money order. Lord Russell referred to the issue of payment in cash, and said while it was unnecessary to decide, he would incline to the view that a payment order between banks was the equivalent of cash and that it should suffice for payment to be tendered to the nominated bank to be credited to the named account.

290 Thus, in *Mardorf Peach* the issue as to whether payment to a bank is sufficient to be payment to its customer was moot, and in any event the various judges were split on the issue.

291 Whatever the common law on the point is in the United Kingdom, the LVTS by-laws govern this case. Under them, Devonshire did not have any unconditional right to the use of the funds once received by National Bank. It was only after the funds were transferred into Devonshire's account that it can be said that funds were made available to Devonshire. Barclays must be taken to have been aware of the LVTS by-laws and their effect.

292 With respect to the U.K. common law, the statement of Lord Fraser in *Mardorf Peach* that the payment would not have been made until it was credited to the owner's bank account seems to me to make commercial sense, as until that happens, the payee as a practical matter would not be able to draw on it. His statement that the payors must pay in sufficient time to allow for the period of processing normally required for the method of payment they had chosen also makes commercial sense. In the case of a wire transfer of funds through the LVTS, what that processing time is spelled out in the by-laws.

293 Barclays were in a hurry to carry out their plan of attack on the morning of January 13, 2009. Barclays had to know that Devonshire would in all likelihood not know of the payment into its account before it took steps to terminate the swap contracts. Barclays knew that Quanto, and particularly Mr. Lafleur-Ayotte, was in Toronto to review and sign documents in connection with the large Crawford restructuring. Their "Liquidity Amount Notice" was e-mailed at 9:04 a.m. and said that "Barclays has arranged for payment" of the liquidity amounts, not even that "Barclays has paid" those amounts. Four minutes later the early termination notice was sent. Mr. Lafleur-Ayotte learned that Barclays purported to terminate the Devonshire swap sometime after 9 a.m. when he was on his way to the Goodmans' offices to sign documents for the large Crawford restructuring of other Quanto administered trusts. He was not able to review the notices received from Barclays until after signing the closing documents.

294 In my view, Barclays acted unreasonably in moving with the haste that they did. They should have waited for a reasonable time to ensure at least that the funds had reached Devonshire's bank account. But whether or not Barclays acted reasonably, I find that Barclays failed to make payment of the outstanding liquidity amount before purporting to terminate the swap contracts. As Barclays was not a non-defaulting party, it had no right under section 6(a) of the ISDA Master Agreement to deliver its notice of early termination when it did.

14. Did Barclays act in breach of a duty of good faith?

295 Devonshire contends that Barclays owed obligations of good faith to Devonshire that were breached.

296 Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained for rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into. See *Transamerica Life Canada Inc. v. ING Canada Inc.* 68 O.R. (3d) 457 (C.A) at para. 53 per O'Connor A.C.J.O. and *Nareerux Import Co. v. Canadian Imperial Bank of Commerce,* [2009] O.J. No 4553 (C.A.) at para. 69 per Blair J.A.;

297 Courts have used the doctrine of good faith to police the bargain the parties have already made and to supervise performance of their contractual obligations. Even where good faith is not pleaded, in many contexts courts have held that one contracting party owes the other an implied duty to carry out its obligations or to exercise any discretion given by the contract in good faith. See *Transamerica, supra,* at para. 87 per Laskin J.A. and *CivicLife.com Inc. v. Canada (Attorney General)*, [2006] O.J. No 2474 (C.A.) at para 49, per Weiler J.A.

298 Contracts in which performance is dependent upon the exercise of discretion on the part of one of the parties are contracts that are characterized by an implied duty of good faith performance. In such circumstances, the discretion must be exercised reasonably and in good faith and in light of the purposes for which it was conferred. See *Nareerux, supra*, per Blair J.A. at para. 71 and John D. McCamus, *supra,* at p. 791.

299 Devonshire's claims relating to bad faith to some extent center on the events leading to the termination of the trades and to some extent on things that occurred before then.

300 Regarding the latter, Devonshire contends that it was in bad faith for Barclays not to explain its failure to make the liquidity payments in August 2007. I do not accept that Barclays had any such obligation and in any event it clearly took the position with Devonshire that in its view a market disruption event had not occurred. I see no obligation on the part of Barclays at that time to tell Devonshire that it was acquiring notes from bank sponsored ABCP trusts.

301 Regarding the negotiations between Barclays and the Devonshire noteholders, Devonshire points to the provisions in the documentation requiring Barclays to negotiate in good faith towards a restructuring. In the Montreal Accord, to which Barclays was a signatory, as well as major Devonshire noteholders, Barclays agreed to work in good faith with the other participants to bring about a timely implementation of the long-term proposal contained in it. Under the Montreal Accord, the negotiations leading to the large Crawford restructuring were carried out by the Investors' Committee. Whether, as Barclays asserts, this was merely an unenforceable agreement to agree is not the point, as there were contractual good faith obligations on Barclays. However, once the framework agreement in December 2007 was made by the other participants other than Barclays and Barclays dropped out of those negotiations, it is questionable whether a good faith obligation continued under the Montreal Accord in favour of the Devonshire noteholders.

302 However, there was a contractual obligation on the part of Barclays with Devonshire contained in the Suspension Notice that Barclays was to comply with its obligations as a signatory under the Montreal Accord. This imported into its agreement with Devonshire an obligation of Barclays to work in good faith with the other participants, including the major noteholders of Devonshire, to bring about the timely implementation of the long-term proposal contained in it. The extensions of the Montreal Accord standstills and the Suspension Notice continued to import this obligation.

303 Thus even though Barclays may not have owed a duty of good faith directly to the

Devonshire noteholders after it left the large restructuring negotiations, it owed a duty to Devonshire to carry out the negotiations with the Devonshire noteholders in good faith. This is understandable as it would not have made commercial sense to Devonshire to agree to the continuation of the standstills if Barclays was not dealing with the noteholders in good faith.

304 I agree, however, with Barclays that a duty of good faith does not preclude self-interested behaviour and that a party under such a duty may be required to temper its self-interest, but not to avoid it. See *Shelanu Inc. v. Print Three Franchising Corp* (2003), 64 O.R. (3d) 533 (C.A.) at para. 69 for the proposition asserted by Barclays that so long as a party under a duty of good faith deals honestly and reasonably with the other side, its counterparty's interests are not necessarily paramount.

305 Devonshire contends that Barclays initially booked its trade with Devonshire as a full recourse trade and that negotiations later premised on that booking had the effect of Barclays attempting to improve its economic position in the restructuring. I do not see this as any bad faith on the part of Barclays. Barclays was quite entitled in its negotiations with the Devonshire noteholders to attempt to improve its commercial position, just as the Devonshire noteholders were entitled to attempt to do the same.

306 I agree, however, with Devonshire that in the closing days leading to the purported termination of the swap contracts by Barclays on January 13, 2009, Barclays breached its good faith obligations. Barclays decided to terminate the swaps for its own economic reasons, which a party under an ISDA Master Agreement is entitled to do. But in doing so in this case, it breached its obligation to not act in a way that defeated the objectives of the agreements that they entered into and to be honest and candid with Devonshire.

307 Barclays took a number of steps leading to the termination of the swap contracts. The steps were taken pursuant to an obvious plan. It would be artificial to look at each step as taken independently of the other steps. They were all part of a concerted effort. The plan began no later than January 8, 2009 when, as Mr. Lovisolo said, they intended to "blow up the box", meaning to terminate the trades, for the economic reasons that he expressed to Mr. Truell that day.

308 Prior to the end of 2008, I do not think it can be said that Barclays was not negotiating in good faith with the Caisse, nor for that matter that the Caisse was not negotiating in good faith with Barclays. Each was asserting commercial positions in very difficult economic times that they were entitled to assert. However, in putting its ultimatum to the Caisse on January 8, 2009, Barclays in my view was not negotiating with the Caisse in good faith. It was reverting to a position taken for the most part eight months earlier in much different economic circumstances and it was not made with any expectation that it would be accepted by the Caisse. Rather, Barclays had to know that the Caisse would not accept it and Barclays had no intention other than to terminate the trades when that occurred. The ultimatum did not constitute good faith bargaining, but rather the first step in Barclays' termination and litigation strategy.

309 The daily standstill agreements of January 8 and 9, 2009 prevented Devonshire from taking any steps to enforce its rights resulting from the failure of Barclays to make the liquidity payments arising from the market disruption event notices delivered by Devonshire on August 13, 14 and 15, 2007 and, in particular, extended the continuation of the standstill of the cure period in which Barclays would have to either make the payment or have an event of default occur. The timing was not coincidental but rather designed to permit payment of the outstanding liquidity amounts on January 13, 2009 just minutes before the early termination notices to be delivered to Devonshire that morning. These standstill extension agreements were induced by misrepresentation, as I have found, that was the antithesis of good faith actions in furtherance of the purposes of the agreements between Barclays and Devonshire. Devonshire was entitled to the true facts from Barclays, which it did not receive.

310 Barclays contends that it was in an adversarial relationship with Devonshire and could not be expected to disclose to Devonshire in advance its litigation strategy. While this may be true, once it made statements of fact to Devonshire, it was obliged to ensure that those facts were not misleading, either directly or by omission.

311 The purpose of the obligation of Barclays to make a liquidity payment under Annex VI of the ISDA Master Agreement, as conceded by Mr. Howard in argument, was to provide Devonshire with funds to pay the holders of the Class A notes that were not rolling. When the liquidity payment was made by Barclays on the morning of January 13, 2009, it was not at all for that purpose. It was, as conceded by Mr. Howard, done to enhance the litigation strategy that was underway.

312 The Liquidity Amount Notice that Barclays delivered to Devonshire that day stated that Barclays was not under any obligation to make the payment and that while Barclays had arranged for the payment to be made, Barclays reserved the right to demand the return of the funds "subject to resolution of dispute". The litigation that Barclays commenced moments later claimed the return of the funds. The liquidity provisions in Annex VI of the ISDA Master Agreement did not provide for any Liquidity Amount Notice of the kind delivered by Barclays or provide for any conditional payment. The payment in these circumstances could not be used by Devonshire to pay any noteholders and was not an unconditional payment in accordance with the ISDA Master Agreement.

313 Barclays contends, however, that as long as the time to make the payment was preserved by the extension agreements, it could make it. However, apart from the fact that the payment was not made in accordance with the contractual provisions governing Barclays, it was not only the making of the payment in itself that is the issue, but it being part of a strategy that included a misrepresentation of the facts in order to extend the time to make the payment and the fact that the payment was not going to achieve the purpose it was designed and contracted for because of the imminent termination of the trades by Barclays and the imminent litigation to follow. The payment was not a good faith exercise with a view to securing the performance and enforcement of the contract made by the parties, but rather one that defeated the objectives of the agreement. As was said in *Transamerica*, it is such circumstances that courts have implied a duty of good faith with a

view to securing the performance and enforcement of the contract.

314 Much the same can be said with respect to the notice of early termination that was delivered by Barclays. Under section 6 (a) of the ISDA Master Agreement, Barclays had a right in the event of a default to deliver such a notice, assuming that there were no other problems of the kind that I have found to have existed. According to *Transamerica* and the other authorities to which I have referred, a duty of good faith could not be used to alter the express terms of the contract, and I would not do so. It is not the delivery of the notice of early termination itself that is the issue, but rather the other matters to which I referred that were done in furtherance of the plan.

315 Barclays relies on *Marathon Canada Limited v. Enron Canada Corp.*, (2008), 97 Alta. L.R. (4th) 137 (Q.B.), aff'd (2009), 99 Alta. L.R. (4th) 213 (C.A.) for the proposition that termination of an agreement in accordance with its terms is not a breach of good faith. I do not think that the case goes so far as to state the point categorically, but rather suggests there may be instances that could be in breach of such an obligation of good faith. In that case, the trial judge stated that exercising one's contractual right of termination is not evidence of a breach of good faith. On appeal, the Alberta Court of Appeal declined to consider this issue. The Court did state, however:

> We need not address this issue except to point out that the trial judge made no findings of fact that Enron was a vulnerable party, or that there was lack of good faith by Marathon, or that Marathon took an unfair opportunistic advantage for a "disingenuous" motive, or that Marathon ran roughshod over reasonable contractual expectations that existed in the Agreement. Although suggestions like this are braided into the appellant's arguments, there is no specific basis for an attack on good faith in the evidence and no specific challenge to the trial judge's finding on that issue. Under those circumstances, we do not need to address good faith.

316 In the circumstances, assuming that there were not the other problems involving the steps taken by Barclays, such as electing not rely upon insolvency of Devonshire and failing to make timely payment, I would hold that for the reasons given Barclays breached its good faith obligations to Devonshire in executing its strategy commencing January 8, 2009. Thus for these reasons it cannot rely upon the January 8 and 9, 2009 extensions of the standstill agreements or the conditional payment made to Devonshire on January 13, 2009. Thus for these reasons Barclays cannot rely on its notice of early termination on January 13, 2009.

15. Did Barclays have the right to terminate the ISDA Master Agreement?

317 For the reasons given, Barclays did not have the right to rely on its early termination notice on the morning of January 13, 2009. In summary those reasons are (i) Barclays by its election is taken to have waived the right to rely on the insolvency of Devonshire as an event of default, (ii) Barclays failed to make timely payment to Devonshire on January 13, 2009 before delivering its notice of early termination and (iii) Barclays may not rely on the conditional payment it made by

reason of its breach of its good faith obligations.

318 The delivery of the notice of early termination and the other steps taken, including the litigation that immediately followed, constituted a repudiation by Barclays of the ISDA Master Agreement and related agreements. Repudiation can be by words or conduct evincing an intention not to be bound by the contract. Such an intention may be evinced by a refusal to perform, even though the party refusing mistakenly thinks that he is exercising a contractual right. See Waddams, *The Law of Contracts, supra*, at para. 620.

16. Did Devonshire have the right to terminate the ISDA Master Agreement?

319 At 2:22 p.m. on January 13, 2009 Devonshire delivered a notice of early termination of the swap contracts and designated that date as the early termination date. Devonshire's termination notice stated that an event of default, namely Barclays' alleged failure to pay the liquidity amounts that had been demanded on August 13 and 14, 2007, for which a notice of default had been delivered on August 14, 2007, had occurred under section 5(a)(i) of the ISDA Master Agreement with Barclays as the defaulting party.

320 For the purposes of this stage of the trial, it is agreed that the market disruption notices delivered by Devonshire were valid and that Barclays was in default under those notices, without prejudice to the position of Barclays that its payment on January 13, 2009 cured any default.

321 I have held that the time during which Barclays could cure recommenced on Friday, January 9, 2009. The remaining two days of the three day period therefore expired at the close of business on Monday, January 12, 2009. Therefore an event of default under section 5(a)(i) occurred at the close of business on January 12, 2009. I have also held that Barclays's payment on January 13, 2009 did not cure its default. Thus Barclays for the purposes of this trial was a defaulting party under section 6(a) and Devonshire had the right to deliver its early termination notice designating January 13, 2009 as the termination date.

322 In its notice, Devonshire stated that the Suspension Notices did not suspend the obligation of Barclays to remedy its failure to pay. While I have found to the contrary, I do not think the notice was invalid for that reason. The default was clearly identified, namely the failure to make the payments as required under the notices of August 13 and 14 and the default notice of August 14, 2007. What was provided was far more information that the notice that had been sent earlier that day by Barclays which only referred to the section of the ISDA Master Agreement relied on by Barclays.

323 While I have held that Devonshire was insolvent on January 13, 2009, I have also held that Barclays had elected to waive reliance on Devonshire's insolvency. Thus for the purposes of section 6(a) of the ISDA Master Agreement, Devonshire is a non-defaulting party entitled to deliver notice of termination to Barclays.

324 If Devonshire were not able to deliver a notice of early termination under section 6(a), by its notice it made clear that it regarded the contract as at an end and thus accepted the repudiation of Barclays. The option to "accept" a repudiation can be exercised by communicating to the repudiating party that the other regards the contract as at end. The communication need not be by words if it can reasonably be inferred from the circumstances. See Waddams, *The Law of Contracts, supra*, at para. 623.

17. Settlement on Barclays default

325 The principles to be used in determining payments that are to be made as a result of an early termination are in some instances easily understandable and in other instances quite complex due to the complexity of the various agreements that are in play in this case.

326 Section 6(e) of the ISDA Master Agreement sets out a detailed set of alternative formulae for the purpose of determining the amounts to be paid on early termination. In relation to termination on the basis of an event of default, four different formulae are specified: First Method and Market Quotation, First Method and Loss, Second Method and Market Quotation, Second Method and Loss. In the Amended and Restated Schedule, Barclays and Devonshire selected Second Method and Market Quotation to apply.

327 Section 6(e)(i)(3) of the ISDA Master Agreement contemplates that where Second Method and Market Quotation applies, amounts, referred to as settlement amounts, may be owing both by the defaulting party to non-defaulting party and by the non-defaulting party to the defaulting party. This was referred to by Flaux J. in *Britannia Bulk* as a method of calculating close out positions on the termination of the contracts. Depending on the amounts owed by one to the other, the final payment could be one to be paid by the defaulting party to the non-defaulting party, or vice versa.

328 However, section 11 of Part I of the Amended and Restated Schedule to the ISDA Master Agreement and section 2.2(c) of an Intercreditor Agreement between Barclays and Devonshire both provide that if an early termination date is designated by Devonshire due to an event of default of Barclays, any settlement amount payable to Barclays shall be subordinated to amounts specified in another contract entitled Series A Supplemental Indenture, which is an agreement made by Devonshire with CIBC Mellon, the Indenture Trustee for the Devonshire noteholders, (the "Trust Indenture"). The Trust Indenture provides for the priority of payments to be made by the trustee in the event of a default. This provision is referred to by the parties as the "waterfall" provisions.

329 One of the amounts to which any settlement amount payable to Barclays for its losses under the ISDA Master Agreement is subordinated is the amount of the principal and interest owing to Devonshire's noteholders.

330 The uncontradicted evidence is that the outstanding principle and interest owing to the Devonshire noteholders as at January 13, 2009 was $718,687,020.60. Of the approximately $71 million paid by Barclays on January 13, 2009, $67.3 million may be considered to have been

"liquidity notes" issued to Barclays, which if the case would mean there would be $786,018,937.73 of notes outstanding in principal and interest.

331 As of January 13, 2009 Devonshire had approximately $112 million plus the $71 million liquidity payment made that day for a total of $183 million. If Barclays was in default, Devonshire is also entitled to the return of the $600 million plus interest posted as collateral, subject to the contention of Barclays that the $67.3 million it paid on January 13, 2009 is to be deducted from the $600 million. . Devonshire says that as a practical matter, as the value of Devonshire's assets after payment of the settlement amount by Barclays will still be less than the amounts owing to the noteholders for principal and interest, there is no need to determine Barclays' claim against such assets, as there would be no assets left to satisfy such a claim.

332 Barclays contends that its claim (i.e. "Loss" amount due to Barclays from Devonshire) should be calculated, and that such amount should be deducted from Devonshire's claim of loss. If this were correct, and Barclays' claimed loss of $1.2 billion were upheld, it would mean that nothing would be required to be paid by Barclays to Devonshire.

333 I do not accept that submission. It is based on Barclays's reading of the definition of "Loss" in the ISDA Master Agreement. However, it ignores the language of section 2.2(c) of an Intercreditor Agreement. It would make no commercial sense to provide that amounts to be paid to Barclays on its default for its loss are to be subordinated to the settlement amount payable to Devonshire, including amounts owing to Devonshire's noteholders, but that the settlement amount payable to Devonshire is to have deducted from it the Barclays loss. Such a result would eviscerate the effect of the Intercreditor Agreement.

334 Under the Market Quotation method of determining loss chosen by the parties in the ISDA Master Agreement, loss is to be determined with reference to quotations to be obtained from other market participants that would have the effect of preserving for the party not in default the economic equivalent of any payment that would be paid after the termination, had the termination not occurred. However, if less than three quotations are provided by other market participants, it is deemed that the Market Quotation cannot be determined.

335 In this case, Devonshire requested but failed to obtain any response from other market participants. Devonshire's request to market participants was made on February 9, 2009. Barclays is critical of this late date for the request, as section 6(d)(i) of the ISDA Master Agreement requires a party to make its calculation of loss on or soon as practicable following the early termination date. However, taken that Barclays had commenced its action on the morning of January 13, 2009 Devonshire would have needed time to consider with its legal advisors how to respond, and this delay does not seem unreasonable.

336 If a Market Quotation cannot be determined, the loss must be calculated by the party not in default. "Loss" is defined in the ISDA Master Agreement to mean, in the case of a claim by Devonshire,

> "Loss" means... an amount that [Devonshire]... reasonably determines in good faith to be its total losses and costs (or gain, in which case as expressed in a negative number) ... including any loss of bargain...Loss includes losses and costs (or gains) in respect of any payment ...required to have been made ...on or before the relevant Early Termination Date and not made... A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets".(underlining added)

337 Devonshire determined its loss to be the outstanding amounts owing for principal and interest on the Devonshire notes plus approximately $1 million for Unpaid Amounts. It relies on the evidence of Mr. Lafleur-Ayotte who testified that the ability to repay noteholders in full was what Devonshire lost with the termination of the swaps on January 13, 2009. Devonshire did not calculate any loss payable to Barclays because of the Intercreditor Agreement provisions subordinating any payment owing to Barclays. In my view, this method was reasonable.

338 Pursuant to the Intercreditor Agreement, Devonshire is entitled to be paid the $600 million delivered by it to Barclays at the outset of the transaction as security for its contingent obligation to Barclays if there were credit defaults in the underlying portfolio against which Barclays bought credit protection. It is agreed that Devonshire is entitled to be paid $1,061,916.48 as an Unpaid Amount as defined in the ISDA Master Agreement, if Barclays' calculations as to its loss are accepted. The parties differ, however, as to whether Barclays is entitled to deduct from those amounts the liquidity payment of approximately $67.3 million in principal which it paid to Devonshire on January 13, 2009.

339 That issue depends on the interpretation of the Market Disruption Support Amounts provisions in Annex VI, the Special Provisions Annex, to the ISDA Master Agreement. These provisions provided Barclays with an election as to how it would fund a liquidity call made by Devonshire in the event of a market disruption event. Barclays could (i) pay the amount of the liquidity call to Devonshire from the $600 million originally posted by Devonshire as security for its obligations, referred to as a "Synthetic Liquidity Arrangement" or (ii) purchase new Class A, Series A notes from Devonshire ("liquidity notes") in the amount of the liquidity call, referred to as a "Traditional Liquidity Arrangement". If Barclays did not notify Devonshire of its election, the Traditional Liquidity Arrangement was deemed to apply. Barclays was entitled to fulfil its obligation under (i) or (ii) in such portions as it elected, provided that if the Traditional Liquidity Arrangement applied, the proportion of the amount to be paid by way of such Traditional Liquidity Arrangement was not to be less than $75 million.

340 The Liquidity Amount Notice delivered by Barclays on January 13, 2009 was silent as to whether Barclays elected a Synthetic Liquidity Arrangement or a Traditional Liquidity Arrangement as the method of payment. Devonshire therefore takes the position that Barclays is deemed to have used (ii), i.e. deemed to have acquired liquidity notes under a Traditional Liquidity Arrangement. If this is the case, Barclays may not deduct the $67.3 million liquidity payment from

the $600 million to be paid to Devonshire.

341 Barclays takes the position that as the liquidity payment was less than $75 million, it cannot be taken to have elected a Traditional Liquidity Arrangement and that the payment is to be treated as a Synthetic Liquidity Arrangement. In that case, the $67.3 million would be deductible from the $600 million to be paid to Devonshire.

342 The material part of the Market Disruption Support Amounts provision in the Special Provisions Annex provides:

> Barclays may elect to pay such CP Redemption Amount [the liquidity call] ...either by (i) returning to [Devonshire] that part of the Initial Seller Payment [the $600 million] ..." a **Synthetic Liquidity Arrangement**" equal to the [liquidity call] or (ii) purchasing new Class A Series A Notes ("**Liquidity Notes**") from [Devonshire] in an amount equal to such [liquidity call]that are due and payable in full in 30 calendar days...(a "**Traditional Liquidity Arrangement**"). [Barclays] shall notify [Devonshire] of its election not later than 2:30 p.m. ...on the business day such market disruption notice is effective, and if [Barclays] fails to make such election, then clause (ii) shall be deemed to apply. [Barclays] may fulfil its obligation to pay any [liquidity call] pursuant to clause (i) or (ii) ... in such proportions as it elects, provided, if Traditional Liquidity Arrangement applies, then the proportion of the [liquidity draw] paid by way of such Traditional Liquidity Arrangement shall not be less than $75,000,000 ... Buyer and Seller acknowledge and agree that such amount and percentage was specifically negotiated by the parties and represents a fair and equitable percentage of risk that buyer would retain in respect of Traditional Liquidity Arrangement. If buyer has paid all are part of the CP Redemption amount pursuant to a Synthetic Liquidity Arrangement (the sum of such amounts being the "**Synthetic Liquidity Amount**"), Buyer may elect, at any time that the Synthetic Liquidity Amount has not been repaid to Buyer, to purchase Liquidity Notes from Seller pursuant to a Traditional Liquidity Arrangement in a principal amount up to the amount of such Synthetic Liquidity Amount that has not been so repaid. In such circumstances, Liquidity Notes in the relevant principal amount shall be delivered free to the Buyer and the purchase price of such Liquidity Notes will not be paid to Devonshire but will be retained by the Bank and shall be applied to reduce the Synthetic Liquidity Amount. (underling added)

343 On a literal reading of this provision, the requirement that a Traditional Liquidity Arrangement shall not be less than $75 million applies only if Barclays has elected to pay part or all of the liquidity calls by way of a Traditional Liquidity Arrangement. On this reading, as Barclays did not make any election, the fact that the liquidity payment was only $67.3 million makes no difference and Devonshire would be right in its argument that the liquidity payment is deemed to be

a Traditional Liquidity Arrangement with issuance of Class A notes to Barclays rather than a Synthetic Liquidity Arrangement as claimed by Barclays.

344 Barclays contends that the $75 million minimum required for it to acquire liquidity notes was put in for the protection of Devonshire noteholders. The terms of the liquidity notes permitted Barclays to designate an early termination date if not paid in 30 days, which would not be in the other noteholders' interests, even if Barclays had only a small amount of these notes. For that reason, the $75 million minimum was inserted as a protection to Devonshire so that before Barclays was to be permitted to acquire liquidity notes, and be in a position to terminate the swap transactions if not paid within 30 days, it would have to commit at least $75 million of its own money so that if it subsequently terminated the transactions, it would face a loss pro rata with the other noteholders. In other words, the $75 million minimum was meant to ensure that Barclays would have a substantial economic interest in the transactions and therefore have to think twice before terminating the swap transactions for failure of the notes to be paid in 30 days.

345 Devonshire argues that there was reason for a Traditional Liquidity Arrangement if Barclays did not make an election. This derives from the fact that a Synthetic Liquidity Arrangement benefits Barclays in that the use of a Synthetic Liquidity Arrangement leads to a reduction in the amount of collateral available to protect remaining noteholders without a corresponding risk transfer of the swap contracts to Barclays. The use of a Traditional Liquidity Arrangement, on the other hand, puts Barclays in the position of Series A noteholders, therefore transferring the risk of the underlying transactions back to Barclays for the amount of these notes. In order to avoid this risk transfer, which is built in the very structure of the agreements it has entered into with Devonshire, Barclays had and should have the burden of making such an election. Devonshire therefore says that the $75 million threshold is protection negotiated by Devonshire as a limit on the ability of Barclays to elect between Traditional and Synthetic Liquidity Arrangements.

346 The Special Provisions Annex gave an election to Barclays to determine how it wanted to fund a liquidity call. The purpose of the deeming provision that a Traditional Liquidity Arrangement would apply if Barclays failed to make an election is somewhat puzzling. In the normal course one would have thought that Barclays would decide what arrangement it wanted and elect accordingly.

347 The $75 million proviso was obviously not for Barclays' benefit. It was inserted to protect Devonshire. What purpose it would serve for the proviso to apply only to an election by Barclays to have a Traditional Liquidity Arrangement needs to be considered.

348 I have difficulty with the argument of Devonshire. I can see that if a Traditional Liquidity Arrangement were more beneficial to Devonshire than to Barclays, as Devonshire asserts, a presumption that the arrangement would be a Traditional Liquidity Arrangement if Barclays did not make an election would be in Devonshire's interest. However, if a Traditional Liquidity Arrangement were better for Devonshire, there would be no benefit to Devonshire in requiring

Barclays to have a minimum $75 million in order to have a Traditional Liquidity Arrangement. The $75 million is not a limit on the ability of Barclays to elect, as contended by Devonshire, but a minimum threshold.

349 Whatever its purpose, the $75 million threshold was inserted to restrict Barclays' election. If it applied only to a situation in which Barclays elected a Traditional Liquidity Arrangement but not in a situation in which Barclays failed to make an election, Barclays could avoid the restriction by simply failing to make an election. That would make no commercial sense and the parties could have not intended such a result.

350 Devonshire also argues that the circumstances at the time of the creation of the agreements dictate that the liquidity payments be treated as being under a Traditional Liquidity Arrangement. The liquidity arrangements contemplated in the Special Provisions Annex were subject to daily limits as to the amount of notes that were to mature on any day. The aggregate amount of liquidity that could be requested on any day could not exceed 25% of the Initial Limit of each transaction, being $100 million for Transaction 1 and $105 million for Transaction 2, i.e. it could not exceed $51.25 million. Thus the minimum threshold of $75 million for each Transaction could never be reached on any day, and the election of Barclays had to be made by 2:30 p.m. on the day of the liquidity call. Thus, if the purpose of the threshold was to deem any payment that was less than $75 million to be a Synthetic Liquidity Arrangement, there never could have been any Traditional Liquidity Arrangement and the deeming provision would have no purpose.

351 Devonshire contends therefore that the only commercially reasonable meaning to be given to the provision is that the $75 million threshold was not a daily threshold, but a cumulative one. In other words, once Barclays elected to make payments by way of a Traditional Liquidity Arrangement, it had to continue to make any further funding by way of a Traditional Liquidity Arrangement until it had funded at least $75 million by way of Traditional Liquidity Arrangement. One difficulty with this argument is that the provision does not say what Devonshire contends. Also, if another market disruption event did not occur, Barclays would be in a position to require payment of the liquidity notes it acquired within 30 days and terminate the swaps, which would not be in the other noteholders interests.

352 Barclays contends that in order to take advantage of a Traditional Liquidity Arrangement, it would have to fund at least $75 million of liquidity over several days by way of a Synthetic Liquidity Arrangement. Once the minimum of $75 million were reached, it could convert the Synthetic Liquidity Arrangement to a Traditional Liquidity Arrangement under the mechanism provided for in the provision. While that mechanism as drafted does not refer to a $75 million minimum, Barclays presumably would say that it was the intention that the minimum referenced earlier in the provision was applicable. This argument of Barclays at least has the advantage that a conversion from a Synthetic Liquidity Arrangement to a Traditional Liquidity Arrangement was specifically referred to in the provision. A requirement that once a Traditional Liquidity Arrangement for less than $75 million was elected by Barclays, further funding up to the $75

million had to be by way a Traditional Liquidity Arrangement, as argued by Devonshire, was not referred to in the provision.

353 Like other provisions in the contractual arrangements that are at issue, the reading of this Market Disruption Support Amounts provision in the Special Provisions Annex is tortured, which does little credit to the myriad of lawyers that were involved in the drafting process.

354 Taking all of this into account, I interpret the clause in question to mean that if Barclays elects a Traditional Liquidity Arrangement, or if Barclays is deemed to have elected a Traditional Liquidity Arrangement by not notifying Devonshire of its election, the $75 million proviso applies to prevent Barclays from acquiring liquidity notes under a Traditional Liquidity Arrangement. Thus I hold that Barclays funded the liquidity call under a Synthetic Liquidity arrangement and that it is entitled to deduct the payment of $67.3 million from the amount payable to Devonshire.

355 Accordingly, Devonshire is entitled to receive $532,668,082 as the Base Calculation Amount as well as the Unpaid Amounts claimed[10], together with interest. If the interest cannot be agreed, the parties may make written submissions as to the appropriate interest.

356 The measure of damages that Devonshire would be entitled to for Barclays' repudiation of the ISDA Master Agreement in the event Devonshire had no right to deliver a notice of early termination would in my view be the same as the settlement amount Devonshire is entitled to.

18. Settlement on Devonshire default

357 In view of the fact that I have held that Barclays was in default on January 13, 2009 and that any amounts payable to Barclays on the termination are subordinated to amounts payable to Devonshire by reason of the Intercreditor Agreement, it is perhaps not necessary to consider this issue. However, in light of the arguments, I will deal with it.

358 There are two major issues. The first is the amount of Barclays' Loss as defined by the ISDA Master Agreement. The second is the collateral Barclays is entitled to look to that is held by Devonshire, and in particular whether Barclays is limited to the $600 million posted by Devonshire as collateral at the outset of the transactions, or is also entitled to look to all of the assets of Devonshire, which including the payment of approximately $71 made by Barclays on January 13, 2009, totalling as of that date approximately $183 million.

359 Barclays claims that it was Devonshire's default that led to the termination of the two swaps on January 13, 2009 and that the loss suffered by Barclays is $1.2 billion. Barclays sent a statement of this amount to Devonshire on January 29, 2009.

(a) Evidence of Leslie Rahl

360 Devonshire attacks the claimed loss. It relies in part on the evidence of Leslie Rahl, who was

conceded by Mr. Howard to be an expert in "the general derivates area".[11] Barclays contends, however, that much of her evidence is inadmissible, and attacks it as well on the basis that her opinion is biased. The evidence of Ms. Rahl was put in by agreement that it was subject to objection by Barclays. I was provided with written argument by both sides and it was left that a ruling on the motion by Barclays to exclude all or part of her evidence would be dealt with as part of this judgment.

361 Admissibility of an expert's evidence is to be determined taking into account the principles enunciated in cases such as *R. v. Mohan*, [1994] 2 S.C.R. 9 and *R. v. Abbey* (2009), 97 O.R. (3d) 330. While a court should exercise a gatekeeper function, particularly if there is a jury, in my view that is of less importance in this case in which there is no jury and which, by agreement of the parties, the evidence has been heard and tested on cross-examination. See *Masters' Association of Ontario v. Ontario (A.G.),* [2001] O.J. No. 1444 (Div.Ct.).

362 Ms. Rahl has over 30 years experience in the derivatives market in a wide range of capacities, including as a derivatives trader and manager of a $100 billion derivatives division at Citibank. She has also sat on the board of directors of ISDA and chaired the committee responsible for drafting the original 1987 ISDA Master Agreement. She has been a director of Fannie Mae and chair of its risk policy and capital committee. She currently is a director of CIBC and a member of its risk committee and a director of the International Association of Financial Engineers. She has undertaken valuations of complex structured products for special purpose vehicles and reviewed collateralized debt obligation valuation practices for several institutional clients.

363 Barclays contends that Ms. Rahl has interpreted the contracts in issue and impermissibly expressed legal conclusions, purported to make findings of fact on contested issues and provided opinions for which there is no foundation. I do not intend to go through all of these arguments other than to say that in my view they are overstated. The core of her evidence concerns the proper method to determine loss under the swap contracts, which in this case is to be "reasonably determined in good faith". The experts called by Barclays, whose evidence was not challenged as inadmissible, also provided evidence of the proper method to value the loss to Barclays of the Devonshire swaps. These experts differed, as might be expected. Inevitably they dealt with contractual rights and obligations. What is "reasonable" in a complex case such as this is something that certainly can be the subject of expert evidence. In the end, of course, what the contracts in question mean is a matter for the court. To the extent the opinions of Ms. Rahl are based on any faulty legal assumptions or factual assumptions not proven, their reliability will be negatively affected.

364 There is no basis, in my view, to attack the evidence of Ms. Rahl as biased. She was no more an advocate than were the experts called by Barclays. She gave her evidence in a professional manner and made concessions where appropriate. She stuck to her guns when she felt it appropriate to do so, which in no way could be taken to be an advocate for her client in any pejorative sense. If anything, I found Dr. Hull, Barclays lead expert, to be far more argumentative than should have

been the case, to the point that his opinions must be treated carefully.

365 It is not practicable to examine all of the various parts of the evidence of Ms. Rahl, as Barclays invites me to do, to determine admissibility. Rather, in my view, her evidence should be admitted, subject to determining what weight should be given to it.

(b) Valuation date

366 Devonshire says that while ordinarily, if there had been no Suspension Notice or standstill, January 13, 2009 would be an appropriate date for the valuation. However, because of the Suspension Notice and the effect of the without prejudice suspension of the Default Notice contained in it, the date of valuation should be August 16, 2007, the date of the Suspension Notice. Alternatively, Devonshire says that it would be reasonable to value Barclay's loss as of November 27, 2007 or, using a discounted cash flow analysis plus risk premium, as of January 13, 2009.

367 In this case, the default relied on by Barclays was the insolvency of Devonshire caused by its failure to pay on its notes, which Barclays claimed began the moment notes were not paid on August 13, 2007.

368 Ms. Rahl testified that market practice on a default is to determine the economics of a transaction as of a date that is closely tied to the date of default. She noted that a party would want to terminate the transaction as quickly as possible in order to avoid being exposed to market movements where there is a risk that the counterparty may not reimburse it. She also testified that this uncertainty would make it difficult to know what kinds of hedging decisions to make. Further, she testified that large gaps between the date of default and valuation would result in this risk having to be built into the price of transactions or would change the way that banks and others currently calculate risk. In her market experience, she had never heard of any circumstances where a valuation of a swap occurred at a time not at or near the time of default.

369 Ms. Rahl also is of the view that the effect of Suspension Notice and the seventeen month standstill severely impacted the swaps, including the effect on value of the stop-loss provision and the liquidity facility, and that to fairly value Barclays' loss, a valuation date of August 16 or November 27, 2007 would better reflect the economic circumstances of the swaps.

370 It is undoubted that the ISDA Master Agreement does not contemplate a standstill such as seen in this case. Dr. Hull agreed that the ISDA agreements do not contemplate a standstill, that he had never seen a standstill like this nor a calculation of loss performed with a date seventeen months after a default. He agreed that in normal circumstances a default, termination and calculation of loss would follow quickly together in time and that it makes sense to calculate loss at or near the time of default and termination. Mr. Draycott, another expert called by Barclays, said the same thing and he too had never had any experience where a termination happened seventeen months after a default.

371 Devonshire relies on the Suspension Notice which provided that it "suspends without

prejudice the effect of the Default Notice..." Devonshire contends that in order to give the without prejudice nature of the Suspension Notice some meaning, Barclays' loss should be valued as of the date of the Suspension Notice. Devonshire further contends that the requirement that the Loss determination must be made "reasonably" imposes at least one limit: if the choice of a valuation date produces an unreasonable result, then a valuation date that does produce a reasonable result must be used instead.

372 I have difficulty with this argument. Devonshire essentially says that the reference to "without prejudice" means without harm being caused to it. Without prejudice in a legal setting has a fairly standard meaning, and it is not "without harm". If that is what was intended, it would in my opinion have taken more precise language than was used.

373 Devonshire relies on a U.S. bankruptcy case of *In re Lehman Brothers Holdings, Inc.*, Case No. 08-13555 (JMP), Bankruptcy, SDNY, September 15, 2009 (transcript), at 99-113 [*Metavante*]. I do not think it assists Devonshire. In that case, Metavante was a counterparty with Lehman on a contract swapping fixed for floating rate interest payments. The contract was as ISDA Master Agreement. On the bankruptcy of Lehman, Metavante took the position that it did not have to continue making payments to the estate of Lehman because of section 2(a)(iii) of the ISDA Master Agreement. It was held that because of U.S. bankruptcy law, as Lehman had not decided whether to assume or reject the contract, an executory contract, Metavante was required to continue making payments. Metavante argued that the safe haven provisions of the U.S. Bankruptcy Code, which gave it the right to terminate the swap contract, did not require it to terminate. It was held, however, that while those provisions gave a party the right to terminate to contract, it was contrary to the Bankruptcy Code to ride the market for a period of one year while taking no action. The case says nothing of whether absent the safe harbor provisions of the U.S. Bankruptcy Code, a party under an ISDA Master Agreement can or cannot sit on its hands after an event of default before delivering an early termination notice under section 6(a).

374 While there is a reasonableness requirement involved in establishing a loss under an ISDA Master Agreement, I do not think that it is permissible on that ground to change the valuation date to a date other than as prescribed. The definition of Loss in the ISDA Master Agreement provides that a party will determine its Loss as of the relevant Early Termination Date or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. If the loss calculation is determined to be commercially unreasonable, that may require a different calculation of loss, but it would not permit the valuation date to be changed.

375 For the purpose of determining Barclays' loss on the assumption that Devonshire was in default and Barclays was a non-defaulting party, I see no basis to ignore the contractual requirement for the valuation to be made as of January 13, 2009.

(c) Loss as of January 13, 2009

376 As stated, the parties chose Second Method and Market Quotation to apply in the event of a

default.

377 Under the Market Quotation method, quotations are to be requested by the non-defaulting party from third-party market participants for an amount to be paid to or by such party for a transaction that would have the effect of preserving the economic equivalent of any payment or delivery that but for the early termination of the swaps would have been required after the date of termination. If fewer than three quotations are provided, it will be deemed that the Market Quotation cannot be determined. Market quotation is defined, in part, as follows:

> **"Market Quotation"** means, with respect to one or more Terminated Transactions and a party making the determination, an amount determined on the basis of quotations from Reference Market-makers. Each quotation will be for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as positive number) in consideration of an agreement between such party ... and the quoting Reference Market-maker to enter into a transaction (the "Replacement Transaction") that would have the effect of preserving for such party the economic equivalent of any payment or delivery ... by the parties ... respect of such Terminated Transaction or group of Terminated Transactions that would, but for the occurrence of the relevant Early Termination Date, have been required after that date. ... If more than three quotations are provided, the Market Quotation will be the arithmetic mean of the quotations, without regard to the quotations having the highest and lowest values. If exactly three such quotations are provided, the Market Quotation will be the quotation remaining after disregarding the highest and lowest quotations. For this purpose, if more than one quotation has the same highest value or lowest value, then one of such quotations shall be disregarded. If fewer than three quotations are provided, it will be deemed that the Market Quotation in respect of such Terminated Transaction or group of Terminated Transactions cannot be determined.

378 On January 13, 2009, the date of termination, Barclays sent requests for firm quotations to four market makers in the CDS market (UBS, Deutsche Bank, Goldman Sachs and Bank of America). Only UBS responded with a quote of $2.18 billion. This was an "indicative" quotation which meant that it was not a firm or binding offer. As no quotations as required were provided to Barclays, it was deemed that the Market Quotation could not be determined.

379 The definition of Settlement Amount provides that if Market Quotation cannot be determined or would not in the reasonable belief of the party making the termination produce a commercially reasonable result, Loss is to apply. "Loss" is defined in the ISDA Master Agreement, in part:

> "**Loss**" means, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency

> Equivalent of an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, including any loss of bargain, cost of funding or at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or re-establishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made ... A party will determine its Loss as of the relevant Early Termination Date or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.

380 Firth, *Derivates Law and Practice*, *supra*, states at para. 11-161 that the party calculating its loss must use commercially reasonable procedures and that the result must be commercially reasonable.

381 Mr. Lee was responsible for the calculation of the "Loss", the amount which Barclays claims is its damages. He testified that Barclays proxied the Market Quotation process which he described as an attempt to find what the replacement cost was, assuming Barclays stood in the place of one of the dealers that it asked to bid. The valuation date was January 13, 2009, the early termination date.

382 The definition of Loss in the ISDA Master Agreement states that it is an amount that the party "reasonably determines in good faith to be its total losses". In this case, it appears that the Barclays lawyers had considerable influence in how the loss was to be calculated. On cross-examination, Mr. Lee said this was the first time he had done a loss calculation under the Loss definition. He was asked why he calculated the loss as he did. He said he did not recall and then said "This was in concert with legal. We had ongoing discussions as to how to run the process and I followed their lead". If legally the method used by Barclays was required, little harm was done. But if not, in these circumstances, where the lead was taken by lawyers rather than commercial actors in the market, considerable caution must be placed on any argument that so long as Barclays considered its loss calculation to be reasonable, that should be accepted.

383 As seen, the definition of Market Quotation is an amount to be paid to or by the party seeking the quotations that would have the effect of preserving for such party the economic equivalent of any payment or delivery in respect of the terminated swap that but for the early termination, would have been required after that date. In the case of Barclays and Devonshire, had the swaps not been terminated, the only payments that would have been required were the monthly premiums to be paid by Barclays to Devonshire for the credit protection of the underlying synthetic

bond portfolio. The liquidity protection for which Devonshire paid monthly premiums to Barclays had terminated. At the time the swap contracts were made, it was not expected that there would be any defaults in the underlying bonds that would require payments during the life of the contracts from Devonshire to Barclays. This is because the swaps were "super senior" swaps in which the credit protection was for the tranche of losses that had an attachment point of 15 % for the first transaction and 16% for the second. Even at the date of the early termination, it was not expected that there would be any future material loss in the underlying bond portfolio that would give rise to any payments from Devonshire to Barclays. There would also have been delivery of collateral required to be made by Devonshire in the event that Barclays' mark to market figures increased in the future, or a reduction in the event that they decreased.

384 The theory of whether there would be a loss or gain on early termination depended on whether, in the language of the market, the swaps were "in the money" or "out of the money" to a party. In this case whether Barclays was in or out of the money on the swaps at any time depended on the amount it was paying to Devonshire for credit protection. The amount that is paid for credit protection at any time in the market depends upon the market's view of risk of loss in the bond portfolio against which the protection is bought. Under the swap contracts between Barclays and Devonshire, Barclays was paying 61 basis points on a notional amount of protection of $6 billion worth of bonds.

385 If the market's appetite for risk increased at a later date, narrowing market spreads, the market price for protection on those bonds would decrease below 61 basis points and Devonshire would be said to be in the money as against Barclays as it would be receiving more than the market would have required on a new contract. Barclays would gain on an early termination at that time as it no longer would have to pay more than the market price for the protection, and this gain would be measured by the amount someone would have to pay to Barclays to take over Devonshire's position. On the other hand, if the market's appetite for risk decreased at a later date, and margins widened, as dramatically happened because of the market turmoil by the time of the early termination in this case, the market price for protection on the bonds would have increased above the 61 basis points that Barclays was paying, and Barclays would be said to be in the money as it would be paying less than what the market would have required on a new contract at that time. The value of Barclays's loss caused by the early termination would be the amount someone would have to be paid by Barclays to replace Devonshire.

386 Of the $1.2 billion claimed as a loss, $1.02 billion represents what Mr. Lee said was the market value of the two swaps (not including the risk on the ABS portfolio of the underlying portfolio) based on a model used by Barclays. The balance consists of various theoretical incremental hedge costs that would have been made, assuming Barclays was starting from a clean plate, i.e. starting a new swap agreement with a new party.

387 The value of $1.02 billion was obtained from a proprietary model developed by Barclays which it used on a daily basis to obtain what it calls a mark to market value of its various trading

positions. This model is of a type that was referred to by the experts as a Gaussian copula model. Inputs to the model were made daily by Barclays traders. Mr. Lee testified that the mark to market derived from the model is a representation of the market value of a derivative at a point in time. It calculated the market value by using mid-market values that did not include a risk premium for the trade.

388 A further $185 million of the claimed Loss related to hypothetical hedging costs that the Barclays model recommended for the replacement trade. The hedges were credit default swap hedges, to reflect the "offer side" price Barclays would have to pay above the mid-market mark to market value derived from the Barclays model, interest rate hedges, foreign-exchange hedges, correlation hedging and a charge referred to as a "quanto" charge. The final $13.7 million of the claimed Loss represented the hypothetical replacement cost of credit protection on the underlying ABS portfolio.

389 Thus, Barclays calculated its loss caused by the early termination to be what it said was the market value of the swaps of $1.02 billion, based on its model that it uses, plus theoretical hedging costs for a total of $1.2 billion.

390 Mr. Lee's calculation of loss was supported by Dr. Hull, who is a professor of derivatives and risk management at U of T's Joseph L. Rotman School of Management. He used different models, looked at various indexes and information and concluded that Barclays's valuation of the bond portfolio protection was reasonable. He valued the ABS protection and the incremental hedging costs at a little less than Barclays, saying his assumptions were conservative, and concluded that the amount due to Barclays was $1.082 billion. He opined that Barclays followed the required procedures and that its estimate of loss of $1.2 billion was reasonable.

391 Barclays' method of calculating its loss was also supported by Mr. Anthony Draycott who at one time was a derivatives trader and since 2007 has been a consultant involved in residential mortgage backed securities and exposures created as a result of synthetic exposures to residential mortgage backed securities. Mr. Draycott has no experience in transacting leveraged super senior derivative credit transactions. His opinion is that the only appropriate way to value a loss given the default of a counterparty is to estimate the cost of replacing the contract and that financial institutions would do that only by using mark to market models like that used by Barclays.

392 Professor Hull stated, and Ms. Rahl agrees, that assets can be valued in two broad ways: (1) using the valuations of related assets; or (2) estimating expected cash flows and discounting them to the present. They agree that market practice is normally to use the first approach, and in particular, by the use of a Gaussian copula model. Ms. Rahl refers to this as a mark to model method. Dr. Hull refers to it as a mark to market model. Mr. Draycott says that the only way to value the contract in question here is to use a mark to market model.

393 In this case, for several reasons, Ms. Rahl's opinion is that a mark to model method of calculating loss as of January 13, 2009 does not lead to a commercially reasonable valuation and

that a discounted cash flow valuation is more reasonable. The key difference between the experts is whether, in the circumstances of this case, a mark to model or cash flow-based valuation is justifiable as of January 13, 2009.

394 Barclays relies heavily on statements in U.K. cases to the effect that the Market Quotation measure and the Loss measure are intended to lead to broadly the same result, and argues that therefore a proxy for the Market Quotation method of calculating the settlement amount should be used.

395 In *Peregrine Fixed Income Limited (in liquidation) v. Robinson Department Store Public Company Limited plc.* [2000] Lloyd's Rep. Bank. 304 (Q.B.)(Commercial Div.), the issue was the gain that had to be paid by the non-defaulting party Robinson to the defaulting party Peregrine under an interest rate swap contract for the future payments that Robinson was relieved of as a result of the termination of the contract due to Peregrine having gone into liquidation which under the contract automatically terminated the contract. The defaulting party had already performed the whole of its side of the bargain. The present value of future payments that would have been paid by Robinson to Peregrine but for the termination was $87 million, whereas the quotations obtained under Market Quotation was only $9.5 million, the reason being that Robinson was also under financial stress and the market considered its risk of default to be high and thus substantially discounted what it would have to pay to take over the payments to be made by Robinson. Moore-Brick J. concluded that the Market Quotation method did not produce a commercially reasonable result and that the gain was to be calculated using the Loss method.

396 In the course of his reasons, Moore-Brick J. accepted submissions from Peregrine that his reading of the ISDA Master Agreement indicated that the Market Quotation measure and the Loss measure were intended to lead to broadly the same result. He stated:

> Loss is defined in terms which make it clear that loss of bargain is one of the principal heads of damage intended to be covered and both Section 6(e)(i)(3) and Section 6(e)(iv) indicate that the Market Quotation measure and the Loss measure are intended to lead to broadly the same result.

397 Section 6(e)(i)(3) does not deal with this issue. I am not sure that it can be said that section 6(e)(iv) leads to the categorical statement that the two measures are intended to lead to broadly the same result, such that as claimed by Barclays, the Loss method must calculate loss by using a proxy for the Market Quotation method. Section 6(e)(iv) was inserted to prevent an argument that the Market Quotation method was not to be a penalty. It provides:

> (iv) **Pre-Estimate**. The parties agree that if Market Quotation applies an amount recoverable under this Section 6(e) is a reasonable pre-estimate of loss and not a penalty. Such amount is payable for the loss of bargain and the loss of protection against future risks and except as otherwise provided in this Agreement neither party will be entitled to recover any additional damages as a consequence of such

losses.

398 If the Loss method required the loss to be calculated by using a proxy for the Market Quotation method, as contended by Barclays, one would have expected there would have been a similar clause dealing with the Loss method to prevent an argument that it too was a penalty. There is no such clause. This is understandable as the definition of Loss, unlike the definition of Market Quotation, does not prescribe any method to calculate Loss other than it must be reasonable. It deals with heads of loss.

399 Professor Hull testified on cross-examination that he always assumed that the Loss method was a proxy for the Market Quotation method, but was reluctant to say that the definition of Loss directed that as he said he was not an expert at reading legal documents and legal definitions. When pressed, he said he would rely on the last sentence of the definition. That sentence, however, makes clear that unlike the Market Quotation method, a party in determining its loss under the Loss method need not use quotations from leading dealers in the market. Ms. Rahl too testified on cross-examination that the practice and expectation is that Loss is a proxy for Market Quotation and that in normal circumstances one would expect that they would normally arrive at similar results. Her evidence was for several reasons the circumstances were not normal.

400 While it may be understandable in a legal context to say that the two measures are intended to lead to broadly the same result in a case such as the case before Moore-Brick J. in *Peregrine* in which the Market Quotation method led to three firm bids being received, and to conclude that the bids from the Market Quotation method led to a commercially unreasonable result as opposed to the Loss method, the case said nothing about how the Loss calculation should be made. The figure for Loss was agreed, being the present value of the future stream of payments that would not have to be made by Robinson because of the default of Peregrine. That method of valuation of Loss was not at all an attempt to use some model to proxy the Market Quotation method of valuing the gain.

401 I have difficulty with unequivocal statements such as that made by Gloster J. in *Pioneer Freight Futures Company Ltd. (in liquidation) v. TMT Asia Ltd.,* [2011] EWHC 778 (Comm.) that it is plain that Market Quotation and Loss purport to broadly achieve the same result. There is little in the inch thick book of "Key Agreements" before me that can be said to be plain. The definitions of Market Quotation and Loss are quite different and to say that they are intended to lead to the same result because the word "bargain" is contained in the no penalty provision for Market Quotation and also in the definition of Loss is to my mind too simplistic.

402 For the Market Quotation method to work requires clearly that there be a liquid market in the particular swap product. Parties to the ISDA Master Agreement who choose the Market Quotation method, such as Barclays and Devonshire, agree that on the termination of a contract, settlement will be made on the basis of what the liquid market tells them is the amount needed to replace the economic equivalent of any payment and delivery that would have been required to be made but for the termination. But if there is no liquid market for the swaps, as was the case as no firm bid was

available, does it follow that the contract means that the loss as defined in Loss is to achieve the same broad result as Market Quotation and that a proxy for Market Quotation is therefore to be used? How could one necessarily know what that broad result of Market Quotation was? If there were evidence of a market for the swaps, such as say two bids having been received, it might be possible to say that the two methods were intended to lead to the same result, but if not, how can one be so sanguine as to say that they were.

403 It may be just as commercially logical to think that the contract was meant to say that if there is a market price for the particular swap identified by leading market makers, settlement will be made on the basis of that market price. However, if a market price cannot be identified, the parties are left to determine the settlement amount by looking at the actual commercially reasonable loss or gain incurred. It makes little sense, in my view, for a party to say that there is no identifiable market price, because no one will make a firm bid, i.e. there is no market for the swap, and so we will use some construct to come up with a price as if there were a market and call that construct the market value of our loss. That would be making an assumption that there is a functioning market, and if there is no functioning market, I see no basis to construct one. The definition of Loss certainly does not indicate that in its language.

404 What principles should be used in determining Loss? The ISDA Master Agreement defines Loss, and it is that definition which governs.

405 Assuming that Barclays was entitled to terminate the swap contracts, its loss of bargain on early termination would be the value to Barclays of the contracts at the time of the termination. If the Market Quotation method could be used and at least three quotations were received, what the value of the terminated swaps was would be easily determinable.

406 Without a Market Quotation determination, as in this case, Barclays in my view must establish on a balance of probabilities that the market in fact would have been prepared to enter into a transaction to replace Devonshire on its swap contracts on the terms asserted by Barclays in its claim for Loss in this case. If Barclays is unable to establish that, then Loss must be determined on some other basis.

407 The construct of the $1.2 billion claim was based on a Gaussian copula model utilized by Barclays. How that model works and what goes into it is, to say the least, quite complex. That is clear from the reports of Professor Hall and Ms. Rahl. The dollar figure that Barclays derived from its model does not seem to be seriously in dispute as a figure derived from a model based approach. Professor Hull and Ms. Rahl each did a model analysis and both concluded that Barclays' figure was reasonable. Ms. Rahl, of course, did not think that a model analysis was appropriate if the valuation date was to be January 13, 2009. If a Gaussian copula model approach is accepted as the right method to value, no one can seriously quarrel with Barclays' number.

408 However, the fact that a model can be used to derive a price for a transaction for which there is no actual market price available, as in the case of Devonshire, does not necessarily mean that it is

the price that the swaps in question would trade for in the market, particularly when we know that the swaps in question did not attract a firm bid in the market at the time. I do not accept the assertion of Mr. Lee that there was a market for the Devonshire swap contracts. No firm bids were received.

409 I accept Ms. Rahl's evidence that the market for products such as the Devonshire swaps was a highly illiquid market. Professor Hull's evidence was that he had not done any analysis of whether there was liquidity for this product and he was not sure if it was liquid or not.

410 Mr. Lee did say that the inputs for the Barclays model were readily observable throughout 2008 and 2009, but on the evidence before me the fact that single name CDS or indexes of tranche risks traded does not necessarily mean that the indicated value that the model threw out was a value at which the Devonshire swaps would have traded on January 13, 2009. In this regard, Mr. Lee admitted that the Barclays model did not take into account the fact that the Devonshire swaps had triggers giving Barclays the right to make calls for more collateral. The triggers for collateral calls in the Devonshire swaps as negotiated in 2006 were triggers that the Devonshire investors such as the Caisse were no longer prepared to accept in the restructuring negotiations. Mr. Lee also admitted that the model did not take into account the fact that the Devonshire swaps were non-recourse, a feature he admitted would be relevant to someone wanting to step into the shoes of Devonshire. He admitted that someone such as UBS would want to be paid more if the swap were full recourse than if it were non-recourse. He also admitted that the model did not take into account the stop-loss feature that permitted Devonshire to terminate the swaps if a collateral call were made, although he questioned the value of that as Barclays could also terminate the swaps if a collateral call was not met by Devonshire.

411 Ms. Rahl's opinion is that although Barclays' loss calculation methodology could be considered mathematically accurate in evaluating a standalone collateralized swap obligation, it does not value the transaction with all of the features laid out in the transaction documentation. In this I agree and accept her view to the extent of Mr. Lee's admissions as to what was not included in the Barclays' model.

412 It is one thing to say that using a Gaussian copula model is standard market practice to value a trade, as Mr. Lee, Professor Hull and Mr. Draycott said, but that does not necessarily make it appropriate in all circumstances.[12] Professor Hull did not say he had seen such a model used to value a synthetic swap contract for determining Loss in circumstances in which it was not possible to use the Market Quotation because no bids were received, nor did he say that he had seen it used during an illiquid market.

413 Mr. Draycott's report was to the effect that a market maker such as Barclays values its contracts on a periodic basis using a mark to market model. He said that market makers assemble portfolios of derivative transactions with offsetting market risks in order to avoid creating an

aggregate P & L that is exposed to market risk. The methodology used to value these transactions is a mark to market model. What Mr. Draycott was talking about was the method of calculating the value of contracts during their currency, and not when there has been a termination and not in circumstances of a highly illiquid market. His report said that he understood, which I took him to mean that he did not have firsthand experience, that the purpose of a valuation caused by the event of default was to determine the actual, or estimated cost to the non-defaulting party of replacing the terminated derivative transaction. On his cross-examination he said that default of a derivative counterparty is an extremely rare occurrence and that there have been very few in history. He said he had done dozens of valuations of a derivative product on voluntary terminations, but what those were or in what circumstances was not said.

414 Mr. Draycott said in his report that there was a market for the Devonshire swap contracts on January 13, 2009. He also said that although there were few trades in bespoke tranches similar to the Devonshire swaps in January 2009, it was possible to observe market inputs. He relied on the bid from USB. He did not realize at the time of his report that the bid was not a firm bid and acknowledged his error on cross-examination. He also relied on the fact that Barclays bought some of the Devonshire notes from noteholders in 2008 at prices he said were determined by a valuation of the transactions in place between Barclays and Devonshire. On cross-examination, he said that was based on an assumption that the parties would have based the price on what the transaction was worth. He acknowledged that he did not take into account what else the parties might have been considering, such as whether there was any value to National Bank settling over what value may have been in the notes. In my view Mr. Draycott was overreaching in his statements that there was a market for the Devonshire swaps in January, 2009 and that there were observable market inputs. Mr. Draycott was not a trader in the market at that time and had no experience with swaps such as the Devonshire swap contracts. I do not accept his evidence that there was such a market or observable inputs.

415 In this case, the ABCP market in January 2009 had been frozen and in turmoil for seventeen months and the collapse of Lehman Brothers and other financial institutions had caused the worst financial crisis in the market in 2008 since at least the 1930s. The terms of the Montreal Accord restructuring twice had to be changed in the latter part of December 2008. It is hardly surprising that no firm bid to replace Devonshire in the swap contracts that it had with Barclays was received. It is clear that the market did not have an appetite for it.

416 The Caisse, the largest investor in the Canadian ABCP market, was no longer prepared in January 2009 to accept the original 2006 Devonshire trade terms. The Caisse, like other investors in the Montreal Accord restructuring, demanded a moratorium on collateral calls for 18 months, a cap on collateral calls that could be made afterwards and a change in the trigger for collateral calls from mark to market to spread/loss triggers, which Barclays did not want. If the Caisse would no longer live with the 2006 terms of the Devonshire swaps, it is unlikely that any other investor would have agreed to those terms. The lack of any firm bid in January 2009 when Barclays sought firm bids from four leading market dealers was an indication of that.

417 While under the Barclays valuation scenario, $1.02 billion would be paid to an investor replacing Devonshire, the investor would be required to post $600 million collateral as Devonshire had done at the outset, and also post an additional $900 million collateral. This was because of the increase in Barclays's mark to market figures that had occurred by January 13, 2009 and the increase of the trigger point to 16.5%. If those figures increased, further collateral would have to be posted by the new investor.

418 Barclays contends that an investor would have been prepared to post $1.5 billion in collateral, just as Devonshire did in 2006 by putting up $600 million in collateral. If that occurred, and if the marks continued to increase after January 13, 2009 due to the market upheaval and uncertainty at the time, the replacement investor would be obliged to post more of its own money as collateral. Selling notes to other investors by the new investor to raise money to meet the increasing collateral calls would in all likelihood not have been available as an option to the new investor. The sophisticated investors in the Devonshire notes would not accept the terms of the original swaps and it is unlikely anyone else would either. The market upheavals of 2008 in particular made such terms unmarketable, as became clear to Barclays in its negotiations with the Caisse in 2008. If other investors would not be prepared to accept such terms, why would a new investor dealing directly with Barclays be any different? If a collateral call made by Barclays was not met, Barclays would be in a position to terminate the swaps and claim a loss that if accepted, might eat up the collateral already posted by the new investor. There is certainly no evidence at all that any replacement investor would likely be ready to put up $1.5 billion in collateral in the market as it existed in January 13, 2009, and accept such a risk, even if it received $1.02 billion up front. The money up front was not for the purpose of the investor having money available for collateral calls, but to compensate for the lower basis points it would receive rather than what Barclays mark to market figures said should be earned.

419 In his evidence, Mr. Lee said that if a bidder such as UBS had said they would step into Devonshire's shoes for a payment of $850 million, Barclays would have accepted the bid. However, there is no evidence at all that UBS or any other investor would have been prepared to post $1.5 billion in collateral with an upfront payment of $850 million. The "indicative" or non-binding bid from UBS was for a payment of $2.18 billion to be paid to UBS, and Professor Hull agreed that it was not a commercially reasonable bid from Barclays' point of view either. His view, understandably, was that Barclays would not want to run the risk that the trigger point for a collateral call might move from 16.5%, where it was at on January 13, 2009, to 17% and see UBS refuse to put up more collateral and keep the difference between the $2.18 billion paid to it and the $1.5 billion in collateral it had put up.

420 Barclays points to evidence given by Ms. Rahl on her cross-examination that in the absence of the standstill agreement, she would have probably done what Mr. Lee and Professor Hull had done. Her view, however, was that the standstill had economic consequences, including having to value the Devonshire swaps on January 13, 2009 in highly illiquid times.

421 Barclays also points to Ms. Rahl's evidence that in order to purchase equivalent protection in January 13, 2009, Barclays would have had to pay over $1 billion on an unsecured basis. That is not evidence, in the context of her evidence as a whole, that she was of the view that such a contract would be made. Her evidence was to the opposite effect. Her view was that on the construct of the Devonshire swap contract terms, a replacement investor would receive $1 billion and be required to initially post $600 million. It would then be obliged to pay a further $900 million in collateral because of the movement in the mark to market figures. The request for firm bids by Barclays provided for this additional amount to be paid "immediately on the effectiveness of the Transactions". If it failed to post the further $900 million, Barclays would have lost the difference between the $1 billion it paid out and the $600 million it received in collateral. Her view was that Barclays would never make such a deal. She was not challenged on this. Even if, as Barclays contended in argument, it would never have closed the replacement trade with a new investor unless the total $1.5 billion were paid by the investor on closing, there was no evidence from Ms. Rahl or anyone else that such a replacement trade was likely to occur.

422 In my view, Barclays has not established that the model that it used valued the Devonshire swaps with its conditions as they existed from the time the swaps were agreed in 2006. What a different model might have calculated is of course not before me.

423 Nor am I satisfied that Barclays has established on a balance of probabilities that its claimed loss of $1.2 billion is a value that the market in fact would have placed on the Devonshire swaps and that its loss calculation is commercially reasonable. While its model indicated that its Devonshire swaps were in the money, and that their value was $1.2 billion, the evidence does not support such a real value. It is an artificial construct. Barclays has not established that the swaps had the replacement value it claims they had at the time it decided to terminate the Devonshire swaps in January, 2009.

424 What then is the measure of Barclays' loss on this transaction?[13] One is driven to consider the cash flow analysis of Ms. Rahl.

425 Ms. Rahl's opinion was that the most appropriate method was to determine Barclays loss based on the actual and real-world projected losses of the underlying synthetic portfolio over the remaining life of the trades had they remained in place. She calculated the loss to Barclays using a cash flow analysis. Her reasons for using a cash flow analysis rather than using a mark to model method of calculating the loss were severely criticized as being contrary to market practice. She acknowledged that the usual practice was to use a mark to market model, and said but for the standstill agreement and its adverse economic effect on what would have been the normal way the Devonshire trades worked she would likely have done the same thing.

426 Ms. Rahl used models of the kind that are ordinarily used by market participants in structured finance to project cash flows and by investors to decide whether to buy or sell trades as these models provide what she referred to as a real-world estimate of loss. This method differs from using

implied estimates taken from market data that contain market perception driven risk premiums. She used models developed by Standard & Poor's and Moody's Investor Services to predict losses on the underlying portfolio of bonds. She did this analyzing the Devonshire II portfolio as it was the riskier of the two. She concluded that the expected losses over the life of the trade that would exceed the attachment point for the trades, given expected defaults as of January 13, 2009, was $12,347. Professor Hull agreed that rating agencies such as Moody's use of historical data to reach a conclusion of expected losses was a recognized way of calculating real world financial losses. Mr. Draycott does not dispute that Ms. Rahl used the rating agencies' models as they intended them to be used, but he like Professor Hull disputed their relevance.

427 I accept Ms. Rahl's opinion that these models are used by market participants as she described. I also accept Ms. Rahl's evidence that during the period in question many financial institutions used credit loss projections for mortgage backed securities, collateralized debt obligations and other structured products because the variance between fundamental analyses and market quotes diverged so dramatically as market quotes reflected an illiquid or dislocated market.

428 Ms. Rahl then added to her de minimus figure of $12,347 a risk premium. Her evidence was that market spreads for a credit default swap imply a loss that is generally much higher than the real-world loss market participants would actually expect. She said that the difference between the real-world estimate of loss and the market implied estimate of loss is the market risk premium. Her opinion was that the events of late 2008 and early 2009 resulted in extraordinarily high and temporary risk premiums that did not reflect the likely losses in the future. She therefore used which she referred to as a "normalized" risk premium, which she derived by averaging the risk premiums in the CDS markets in August and November 2007. She also looked forward to the risk premium in the CDS market in April 2010 and determined that it was at the same level as her average of August and November 2007. Assuming that using a normalized risk premium is appropriate, I do not see anything wrong with looking at what happened after January 13, 2009 if it is used to consider the reasonableness of the assumptions that she made in using data prior to that date. It would not be appropriate to use it as a hind sight basis for her opinion, and I think it can be fairly said that she did not do so.

429 The risk premiums that Ms. Rahl derived in August and November 2007, and also in January 2009, were taken from mark to model valuations of the Devonshire II underlying bond portfolio. These valuations valued the swaps in August 2007 at $107 million, in November 2007 at $157 million and in January 2009 at $544 million. By subtracting the expected cash flow losses of nil in August and November, 2007 and $12,347 in January, 2009, she calculated the risk premiums at $109 million in August 2007, $157 million in November 2007 and $544 million in January 2009. She averaged the August and November 2007 figures to "normalize' the risk premiums to get a risk premium of $132 million for the Devonshire II portfolio, as compared to the risk premium for that portfolio in January 2009 of $544 million. She then assumed the risk premium for the Devonshire I portfolio would be no higher and likely lower than Devonshire II as it was a slightly less risky portfolio, and used a normalized risk premium for it using the Devonshire II risk premium of $132

million. The total risk premium she calculated was therefore $264 million.

430 Ms Rahl then added this total normalized risk premium of $264 million to the expected cash flow loss above the attachment point of $12,347 to get a total loss of $264 million.

431 I have some difficulty with this theory. If a reasonable forecast on a cash flow basis of what Barclays has lost by the termination of the swaps is the key, I do not understand why the loss is not the present value of the expected loss of $12,347. Dr. Hull agrees that the alternative cash flow method of valuing an asset is to estimate the cash flow and then discount that cash flow at an appropriate discount rate. He said nothing of adding some risk premium. Ms. Rahl herself said in her report that one could argue that the cash flow projection is the loss. She went on to say, however, that to be conservative, she would add a normalized risk premium to the cash flow.

432 However, the theory of what Barclays' actual loss is would not lead one to add a risk premium to an expected cash flow loss, based on a mark to model basis, which Ms. Rahl says is not an appropriate way to value in January 2009, let alone a premium of $264 million on $12,347. I do not understand the conceptual basis for doing so. In my view, the loss to Barclays is the present value of $12,347, which I will call $12,000 dollars as it is not known when the expected losses of the underlying portfolio would exceed the attachment points of 16 and 15 % on the two swaps.

433 If Barclays had incurred costs in closing hedges as a result of the early termination, it would be entitled to those costs. However it led no evidence of such costs.

434 It was Ms. Rahl's view that there should be deducted from the amount of the Barclays loss the liquidity payments that she says would have been made if Barclays had not breached its obligations in July 2007 and made the liquidity payments requested by Devonshire. Her view is that the full amount of the liquidity line would have been demanded and paid by November, 2007 because of the market conditions, and this amount should be deducted from whatever Barclays' loss is calculated to be. I would not make such a deduction. The loss of Barclays is calculated as of January 13, 2009 on the assumption it was entitled to terminate the swaps on that day, and by then the liquidity facility had expired. I understand Ms. Rahl's opinion that the standstill agreement changed the dynamics of the swaps as contracted for, which no one questions, but that was agreed. I would not make the deduction.

(d) Mitigation issues

435 In light of my decision on the quantum of Barclays' loss, these issues are of little importance. However as they were fully argued and evidence was led, I will deal with them.

436 Devonshire takes the position that Barclays had an obligation to mitigate its loss and that there were losses that Barclays could reasonably have avoided by taking appropriate hedging strategies in 2007 to avoid any losses above the collateral that was pledged by Devonshire to Barclays. It says that in a determination of Loss, the ISDA Master Agreement contemplates a

measure of damages precisely mirroring the ordinary common law damages payment. Loss is defined to include:

> an amount that party reasonably determines in good faith to be its total losses and costs ... including any loss of bargain, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or re-establishing any hedge or related trading position ...

437 Devonshire says that compensating a contracting party for the loss of bargain on the termination of a contract is precisely what the common law measure of damages is meant to achieve. S.M. Waddams, *The Law of Contracts*, states at paras. 698-699 that loss of bargain is the fundamental expectation measure of damages in contract law: the party is placed back in the place they would have been had the contract been performed.

438 Firth, *supra*, at para. 11.140 dealing with Loss states:

> The contractual measure of damages applies for this purpose, i.e. the objective is to ascertain what amount is necessary to put that party in the position it would have been in if the terminated transactions had been fully performed.

439 The obligation to act reasonably to avoid loss is often referred to as a duty to mitigate. It is a corollary to the requirement that the party claiming damages cannot be compensated for a loss that it could reasonably have avoided. At common law, loss that could reasonably be avoided cannot be regarded as having been caused by the breach. In case of doubt, the plaintiff will usually receive the benefit, because it does not lie in the mouth of the defendant to be overly critical of good faith attempts by the plaintiff to avoid difficulty caused by the defendants wrong. See S.M. Waddams, *supra*, at para. 15.140 and *Koch Marine Inc. v. D'Amica Societa di Navigazione A.R.L. (the "Elena d'Amico")* [1980] 1 Lloyd's Rep 75 at p. 89 (QB per Robert Goff J.)

440 Firth, *supra*, further states at para. 11.148:

> The determining party's duty to act reasonably and in good faith probably means that the Loss must be determined on the assumption that the determining party has taken reasonable steps to minimise any costs or losses it suffers as a result of the termination of the transactions. Equally, if the determining party has actually avoided such costs or losses, this probably has to be reflected in the computation, even if the steps it took went beyond what was reasonably required. Such an approach is similar to the common law rules on mitigation to the assessment of damages for breach of contract.

441 Barclays points to the provision in the Second Method and Market Quotation provisions that the parties chose which provides for a settlement of amounts owing by the defaulting party to the non-defaulting party and vice versa, and asserts that the common law of damages plays no part. It

relies on dictum of Moore-Bick J. in *Peregrine,* approved by Flaux J. in *Britannia Bulk* that the fact that a non-defaulting party must account to the defaulting party for any gain clearly deprives an event of default of most of its characteristics as a breach of contract. Barclays also refers to a comment by Flaux J. that it is a misconception to seek to equate the Loss provision with what the position would be if the non-defaulting party had a claim for damages at common law.

442 I agree with Barclays to the extent that the ISDA Master Agreement contemplates payments by a non-defaulting party to a defaulting party, the common law position that only the party that breaches a contract is liable to pay has been modified by contract. But that does not, in my view, necessarily mean that common law contractual principles are entirely abrogated.

443 Barclays also contends that the parties expressly contracted out of the necessity of mitigation. It relies on two provisions of the Amended and Restated Master Credit Derivatives Confirmation Agreement and its Annex 1. The first provides:

> Barclays Bank PLC does not guarantee the performance of or otherwise stand behind the reference entities or reference obligations referred to herein and is under no obligation to make good losses suffered as a result of credit events with respect to any such reference entity or reference obligation. Barclays Bank PLC is not required to hold any reference obligations and no inference may be drawn from this document that Barclays Bank PLC holds any such reference obligations or has any credit exposure to any reference entity. Devonshire acknowledges and agrees to the foregoing.

444 The second provides:

> The parties confirm that no Transaction is intended to be and no Transaction constitutes a contract of surety, insurance, guarantee or indemnity. The parties acknowledge that <u>the payments to be made by the Seller</u> [Devonshire] will be made independently and are not conditional upon the Buyer [Barclays] sustaining or being exposed to risk or loss and that the rights and obligations of the parties hereunder <u>are not dependent upon the Buyer</u> owning or having any legal, equitable or other interest in the Reference Obligations <u>or mitigating any actual loss suffered</u>. (underlining added)

445 I do not see the first clause as having anything to do with mitigation. It and the second clause are part of the structure of the "synthetic" nature of the credit default swaps, in which Barclays has no ownership interest in the underlying portfolio in which it is buying credit protection. The "payments" referred to in the second clause are clearly payments to be made by Devonshire to Barclays on the happening of Credit Events, i.e. when losses on the underlying portfolios reach the attachment point and credit protection payments become due. The reference to Barclays not having to mitigate any actual losses suffered can only be in reference to those payments and to losses suffered on the underlying bond or ABS portfolio that gives rise to the credit protection payment. It

has nothing to do with the measure of Loss in the ISDA Master Agreement.

446 Barclays also asserts that a duty to mitigate arises only on a breach, and that the breach here was on January 13, 2009. Thus there could be no obligation to mitigate before then. In this case, however, the breach relied on was the insolvency of Devonshire, which Barclays pleaded began on August 13, 3007 when notes that were not rolling became due. Barclays cannot resile from that pleading. The fact that Barclays waited until January 13, 2009 to declare a default would not preclude any duty to mitigate in the face of an earlier breach.

447 Hedging is a technique employed by market practitioners to neutralize the risks of a particular trade. Devonshire relies on the evidence of Ms. Rahl that a prudent manager of a CDS trading desk would have frozen the Devonshire trade as an economic hedge as of August, 2007. She testified that once the standstill came into place in August 2007, Barclays should have unwound or bought back trades that amounted to hedges on the Devonshire CDS protection in excess of the collateral. This would have had the economic effect for Barclays of it not facing any exposure above the capped amount regardless of the resolution of the standstill situation.

448 Ms. Rahl further testified that even if the hedges had not been frozen at the amount in August 2007, in light of the stop loss provision, at the very least Barclays should have capped the trade once the atop loss trigger was hit in November 2007. The 5% trigger had been breached by then and Barclays had clearly not been able, and was not entitled under the Montreal Accord, to receive any additional collateral.

449 On his cross-examination, Mr. Draycott agreed that it would be prudent for a trader to adjust his hedges if he had an expectation that the mark-to-market might not be recovered on a default.

450 Devonshire asserts that Barclays should have realized at the latest by November 27, 2007 that it would have no access to more collateral and that it should have protected itself from losses higher than the collateral it had access to by appropriate hedging. Barclays should have recognized that with a built-in recourse cap, the trade could not possibly be worth more than that to Barclays and, as a result, its reasonable good faith estimate of loss could not have exceeded the collateral.

451 Barclays contends that because of the way it ran its hedging, it would not be possible to isolate hedges related to Devonshire and deal with them individually. Mr. Lee testified that Devonshire was hedged throughout as part of a bespoke correlation book that contained approximately 500 bespoke tranche trades, 50,000 single name CDS trades, and several hundred interest rate and currency swaps all together having a $200 billion notional size.

452 Although the trade was viewed by Barclays' personnel as non-recourse, it did not initially book it as such. Barclays' internal trade approval noted that the trade was to be booked as a full-recourse CSO and that this was "viewed as acceptable without adjustment under current market conditions", but that if a collateral call trigger was likely "an adjustment to these sensitivities may be deemed necessary to account for the impact of the non-recourse feature." That trade approval

made the "maintenance of daily sensitivity adjustments in this situation ... a condition for approval."

453 Ms. Rahl testified that she understood this trade approval to mean that a trader may have to reduce his or her hedges to account for the non-recourse nature of the transaction. Ms. Rahl also noted that the reference to daily sensitivity adjustments meant that the precise mechanism to achieve appropriate hedging would have to be adjusted to reflect the fact that there was a stop loss on any collateral call trigger. She testified that she understood this document to approve an exception to usual practice and that she would expect a financial institution to keep track of these kinds of conditions or requirements, at least on a monthly, if not a daily, basis. Her evidence on this was not contradicted by anyone from Barclays. It confirms that Barclays knew from the outset that it might have to make appropriate adjustments to its hedging to reflect a non-recourse possibility.

454 Barclays relies upon evidence given by Ms. Rahl on cross-examination as an admission that hedging should not be considered. She stated:

> Q. And I'm going to turn to the subject of hedging. Would you agree with me that the ISDA practice is that market quotation and loss are calculated without reference to either the existence of hedges or lack of hedges?
>
> A. Based on our standing understanding, yes.
>
> Q. And you're aware, I don't want to get into the precedent thing again, but you are aware that there's legal cases' deciding that issue to that effect?
>
> A. Yes.
>
> Q. And if someone were completely unhedged or a speculator or badly hedged, that makes [no] difference in the calculation of the replacement value?

A. I would agree with you but not everybody would.

Q. For the moment I'm content if you do.

A. I do.

455 I take this evidence to relate to the calculation of value of a replacement transaction as referred to in the definition of Market Quotation. I did not understand this evidence to be any admission by Ms. Rahl that in calculating a Loss, it was not appropriate to consider the strategies that should have been used to mitigate expected losses.

456 Barclays relies on *Australia and New Zealand Banking Group Ltd. v. Société Générale*, unreported, September 21 1999 at p. 7, aff'd [2000] 1 All E.R. 682 (C.A.) as authority for the proposition that the definition of Loss did not include losses or gains on hedges that were not bound up in the early termination of the transaction. I do not read that case as assisting Barclays. Société Générale unsuccessfully argued that the amount due to be paid to the bank on early termination should be reduced by the losses it had incurred on hedges that it had entered into with a third party Russian Bank, the losses being caused by the collapse of the Russian currency and a banking moratorium being imposed. It was held by Aikens J., and upheld by the Court of Appeal, that the Loss provisions did not intend that losses resulting from the identity or particular circumstances of the counterparty to the hedge were covered by the words "loss. . . incurred as a result of [the Affected Party] terminating [or] liquidating ... any hedge". He held that such a result would be unlikely because it would throw any risk associated with identity or circumstances of the particular counterparty to the hedge upon the other party to the contract. That is not the issue here.

457 What puzzles me about the mitigation issue in this case is its practical effect. Barclays cannot recover more the available collateral, whether it is limited to the initial $600 million posted by Devonshire, as I have found, or also includes the extra cash of Devonshire in its bank account that Barclays asserted was the case. The effect of the mitigation argument of Devonshire is that the loss claimed by Barclays should have been capped by hedging strategies so that the loss was not in excess of what Barclays could collect on a termination of the trades.

458 In the circumstances, I see little purpose in deciding this mitigation issue. However, in my view the position of Devonshire should be accepted. I accept the views of Ms. Rahl that Barclays should have taken steps no later than November 27, 2007 to hedge the Devonshire transactions to limit its losses to what it could look to collect from Devonshire.

459 There is another mitigation issue, however, that would have been of some importance had I found Barclays' Loss to be what it claimed. In 2008 Barclays purchased approximately $220 million in face value of Devonshire notes for nominal consideration from Citibank, Desjardins and National Bank. Devonshire contends that through the purchase of these notes, Barclays mitigated $220 million worth of risk should Devonshire be in default. Accordingly, if Devonshire defaulted but retained assets, Barclays would share in approximately a third of the amount that would be returned to noteholders. Accordingly, Devonshire contended that any Loss amount payable to Barclays must be adjusted accordingly. Otherwise there would be double recovery.

460 On December 12, 2008 Mr. Lee was doing calculations on potential losses on the notes held by the Caisse and the small investors. His document referred to the notional exposure amount of each of the trades being $2 billion, rather than the original $3 billion. The reason was because of the purchase of the notes with a face value of $200 million, which represented a notional exposure of $2 billion, and Mr. Lee described this purchase in different ways, as "buying back the risk" , being "a hedge for our original $6 billion trade" and "equivalent to a sell of protection".

461 Barclays counters this by contending that Devonshire confuses Barclays' management of its risk and the determination of Barclays' Loss. It says that the purchase of the notes was a hedge of the Devonshire trades, but the fact that Barclays reduced its risk through this hedge does not affect the replacement cost of the trades, which were left fully intact until terminated on January 13, 2009. It said that it paid for the credit protection right up to the termination (although it claims it back on its interpretation of the waterfall provisions in the Trust Indenture).

462 No matter how the purchase of the Devonshire notes from Citibank, Desjardins and National Bank was described internally, it seems to me that if Barclays were entitled to payment from Devonshire collateral on of a settlement on a Devonshire default for its Loss, and were able as well to recoup payment on the notes it acquired in Devonshire because Devonshire had more collateral than the settlement amount to be paid to Barclays, it would amount to Barclays obtaining double recovery for its loss. To this extent, if Barclays Loss is less than the available collateral plus Devonshire's cash, there should be a deduction from Barclays' Loss calculation of the amount it will receive from its Devonshire notes so that the Loss payable to Barclays is net of the amount it will receive on its Devonshire notes.

463 As I have found Barclays loss to be $12,000, well less than the available collateral, Barclays will more than recover this amount by reason of its notes and thus its loss will be reduced to nil.

(e) Barclays' recourse

464 In light of the result, the issue of what assets Barclays had recourse to is moot. However, in light of the arguments made and evidence led, I will deal with it.

465 It is common ground that if Devonshire is the defaulting party under the ISDA Master Agreement, Barclays is entitled to set off amounts due to it from Devonshire against the initial payments of $600 million made by Devonshire.

466 Barclays contended that it was entitled as well to be paid from the "residual assets" of Devonshire, being $183 million plus accrued interest held by Devonshire in its bank accounts. This amount is made up of $75 million returned to Devonshire in October 2007 that had previously been paid to Barclays as a result of a move in the Barclays marks, the balance of the monthly credit protection payments made to Devonshire by Barclays under the ISDA Master Agreement from August 2007 to January 2009, which totalled approximately $37 million and the $71 million payment made to Devonshire on January 13, 2009.

467 Barclays' assertion is based on its interpretation of language in the Series A Supplemental Indenture ("Trust Indenture"). When one looks at the document and the myriad of clauses that are unintelligible without looking at definitions that are also complex, it does no credit to the drafters in the law firms who negotiated back and forth. Clear, simple drafting was lost in the process.

468 The Trust Indenture contains what has been referred to as a "waterfall", or priority, of

payments to be made by the indenture trustee CIBC Mellon Trust Company, from money to be paid to the trustee. The first priority is to cover costs of the trustee. The second is "in or towards payment and satisfaction of any Related Permitted Liens". Barclays contends that the amount to be paid to it by Devonshire on the default by Devonshire is a Related Permitted Lien.

469 Barclays relies upon the following definition of "Devonshire Financial Contract" from section 1.1(i) of the Series A Supplemental Indenture:

> "**Devonshire Financial Contract**" means the credit derivatives transactions evidenced by an ISDA master agreement between the Trust and the Bank, or their respective successors and permitted assigns, together with the related schedule, master confirmation agreement (including the credit support annexes and special provisions annex (the "**Liquidity Agreement**") and transaction supplements thereunder), confirmations of any other transactions thereunder and custodial agreements, as the same may be amended, restated, replaced, supplemented or otherwise modified from time to time, which, for greater certainty, (i) shall be a Related Asset Interest, Related Programme Agreement, Related Securitization Agreement and, with respect to the Liquidity Agreement, a Related Liquidity Agreement (ii) in respect of which the Bank shall be a Related Originator and a Related Specified Creditor and, with respect to the Liquidity Agreement, a Related Liquidity Provider, and the obligations of the Trust to the Bank under the Devonshire Financial Contract, including the security, lien and hypothec thereunder, shall be Related Obligations Secured and a Related Permitted Lien, (iii) but shall not be a Related Hedging Transaction." (underlining added)

470 Barclays reads the underlined language to say that the obligations of Devonshire to Barclays under the swap transactions resulting from the termination by Barclays shall be both Related Obligations Secured and a Related Permitted Lien. That is, the obligation is both an obligation and a lien.

471 To understand the argument, it is necessary to look to a number of definitions in section 1.1 of the Trust Indenture:

> "**Obligations Secured**" means all present and future debts, expenses, liabilities and obligations, direct or indirect, absolute or contingent, due, owing or accruing due or owing from time to time by the Trust to the Specified Creditors in their capacity as such. For greater certainty, amounts owing to any Specified Creditors by the Trust, at any time, shall include (i) the unpaid face amount of any Notes issued on a discount basis; (ii) the principal amount owing at such time, together with the accrued and unpaid interest on interest bearing Notes or Borrowings; (iii) accrued fees, whether or not then due and payable; and (iv) obligations to

> deliver or return collateral or other credit support under Programme Agreements.
>
> ...
>
> "**Permitted Liens**" means, in respect of any Series of Notes and the Related Collateral, such liens or other encumbrances expressly permitted in any of the Related Programme Agreements.
>
> ...
>
> "**Related**" is used in reference to the Notes of a particular Series or in the case of Notes forming part of a Multiple Issue Series, such Notes or a Transaction funded by such Notes, as applicable, and means, when used in conjunction with:
>
> ...
>
> "**Obligations Secured**" all Obligations Secured relating to the holders of such Notes and to Related Specified Creditors under the Related Programme Agreements, the Related Series Expenses and Related General Expenses or in the case of a Multiple Issue Series and a transaction financed or refinanced thereby, the obligations secured to the holders of the Notes of such Multiple Issue Series and to the Related Specified Creditors under the Related Programme Agreements the Related Issue Series and the Related General Expenses;
>
> ...
>
> "**Permitted Liens**" Permitted Liens under a Related Programme Agreement;

472 Devonshire says that these sections use the words "obligation" and "lien" in a sense which is consistent with their ordinary meaning. "Obligation" connotes amounts owing, whereas "lien" connotes some form of proprietary interest that secures an obligation. The definitions do not contemplate that something can, at one and the same time, be an obligation and a lien. The definition of Related Permitted Liens leads back to the definition of Permitted Liens which is defined as "such liens or other encumbrances". There is no mention in either the definition of Permitted Liens or Related Permitted Liens to "obligations". The definition of Related Obligations

Secured leads back to the definition of Obligations Secured which is defined as "all present and future debts, expenses, liabilities and obligations". There is no mention in either the definition of Related Obligations Secured or Obligations Secured that such definitions could encompass liens.

473 Under the ISDA Master Agreement and related agreements, Barclays holds collateral posted by Devonshire initially, being the $600 million, and any other collateral posted by Devonshire as the result of a collateral call by Barclays under the Seller Credit Support Annex, of which there is none. None of the $183 million cash of Devonshire that Barclays seeks to access is covered by any security agreement and thus is not a "lien or other encumbrance expressly permitted in any of the Related Programme Agreements", being the definition of a Permitted Lien.

474 Devonshire points out that under the waterfall provisions in the Trust Indenture, there are payments to be made to Barclays that would be unnecessary if Barclays were to be entitled to be paid as it contends as second place in the waterfall.

475 The waterfall provides for the payment of money by the indenture trustee as follows;

(a) First, in payment or reimbursement in the following order or priority:

(i) To each of the Indenture Trustee and the Issuer Trustee of the Related Proportionate Share of all fees and expenses ...

(b) **Second, in or towards payment and satisfaction of any Related Permitted Liens;**

(c) **Third,** in and towards payment of the following Related Obligations Secured then owing in the following order of priority:

(i)**The fees and expenses due and payable to Related Liquidity Providers** in connection with the provision of services and facilities under the Related Liquidity Agreements; and

(ii) The fees and expenses due and payable to Related Servicers in respect of the Related Collateral;

(d) **Fourth**, in or **towards the payment of unpaid interest and/or accrued discount on the Series A Notes** and the Related Borrowings, all amounts owing to counterparties under the Related Hedging Transactions and the Related Proportionate Share (the transactions giving rise to the Related Collateral being

the only Transaction with respect to the Series A Notes) of all amounts required to be paid by the Trust under the Financial Services Agreement and in accordance with the priorities established thereunder, pro rata, and thereafter **amounts owing in respect of principal on such Series A Notes and the Related Borrowings, pro rata;**

(e) Fifth, by deposit to the Series A Reserve Account to the extent of the Series A Reserve Amount;

(f) **Sixth, in or towards the payment and satisfaction of all amounts due to the Bank under the Devonshire Financial Contract which have been subordinated pursuant to the Intercreditor Agreement**;

(g) Seventh, in or towards payment of all amounts required to be paid by the Trust to the Related Agents under the Related Agency Agreements, pro rata;

(h) Eighth, in or toward payment of the following Related Obligations Secured then owing in the following order of priority:

(i) The Related Proportionate Share of all amounts required to be paid by the Trust to the Administrative Agent under the Administration Agreement;

(ii) All other amounts properly incurred and owing by the Trust and which are solely attributable to the Related Collateral, the Related Obligations Secured or the Related Programme Agreements and not otherwise specified in this Section 3.1;

(iii) The Related Proportionate Share of all other amounts properly incurred and owing by the Trust which are not solely attributable to any Related Collateral, Related Obligations Secured or Related Programme Agreements and not otherwise specified in this Section 3.1 including, without limitation, all amounts owing to counterparties under Hedging Transactions; and

(iv) The Related Proportionate Share of all amounts required to be paid by the Trust to the Issuing and Paying Agent under this Indenture.

The balance in the Related Collateral Account following the application of monies in accordance with the foregoing shall be remitted to the Trust. [Emphasis added]

476 Devonshire contends that if it is the case that all obligations owing to Barclays are covered by Related Permitted Liens in second priority in the waterfall, there would be no need for the waterfall to provide for (i) Barclays' fees and expenses as liquidity provider in third place in the waterfall, or (ii) payment on notes acquired by Barclays for liquidity advances under a Traditional Liquidity Arrangement in fourth place in the waterfall or (iii) amounts owning to Barclays that were subordinated to the noteholders in accordance with the Intercreditor Agreement in sixth place in the

waterfall. I accept this. It would be inconsistent for these other priorities to be provided to Barclays if all obligations owing to Barclays were covered in the second place in the waterfall under Related Permitted Liens.

477 It is no answer for Barclays to say that it did not need the third priority for its fees and expenses as liquidity provider as it deducted them from payments it made to Devonshire for credit protection. The priority was presumably put in for a purpose, and the issue is as to the interpretation of the relevant provisions. It is no answer for Barclays to say that if it acquired Devonshire notes as a liquidity provider, it would be entitled to the interest and payments on the notes under the waterfall as a noteholder and that Devonshire's obligations would be independent of the ISDA Master Agreement. Obligations under the liquidity provisions in Annex VI are not independent of the ISDA Master Agreement; they are part of it, and are included in the definition of Devonshire Financial Contract relied on by Barclays as obligations of Devonshire to Barclays. It is no answer for Barclays to say that the amounts due to it that were subordinated under the Intercreditor Agreement, i.e. if Barclays is in default, relates to a settlement amount. That would be an obligation of Devonshire to pay under the ISDA Master Agreement, and if Barclays is right as to the reach of Related Permitted Liens which ranks second in priority in the waterfall, it would give Barclays priority over what it has subordinated in the Intercreditor Agreement. None of these priorities to Barclays in the third, fourth or sixth ranking in the waterfall would be required if Barclays is correct in its interpretation of the Devonshire Financial Contract provision.

478 Devonshire contends that the maxim *reddendo singular singulis* should be used in the interpretation of the definition of Devonshire Financial Contract in the Trust Indenture. The part relied on by Barclays at the end of the definition is:

> and the obligations of the Trust to the Bank under the Devonshire Financial Contract, including the security, lien and hypothec thereunder, shall be Related Obligations Secured and a Related Permitted Lien, (iii) but shall not be a Related Hedging Transaction.

479 Black's Law Dictionary, 8th edition, defines the maxim *reddendo singular singulis* as "Each must be put in each separate place. That is, the several terms or items apply distributively, or each to its proper object". In other legal dictionaries it is said to mean "by rendering each his own", or to "refer each to each". Of course, Latin maxims can be an aid to interpretation of contractual or statutory provisions, but they are to be applied with caution. In this case, I think the maxim is helpful.

480 I accept the interpretation of Devonshire. I interpret the provision to mean that obligations of Devonshire to Barclays under the ISDA Master Agreement and related agreements shall be Related Obligations Secured and any security or lien under those agreements shall be a Related Permitted Lien. I cannot accept that the intention of the agreement was by the few words at the end of the definition of Devonshire Financial Contract relied on by Barclays to make obligations owed to

Barclays to be a Related Permitted Lien to stand in second place in the waterfall. Had the parties intended what is contended by Barclays, they ought to have expressed it far more clearly. The tenor of the Trust Indenture as a whole is contrary to Barclays' interpretation, and contrary to the separate notions of an obligation being an obligation and a lien being a lien.

481 Both parties referred to evidence to assist an interpretation in the event the clause was held to be ambiguous, including evidence of negotiations and actions taken after the agreements were made. In my view, the provision can be interpreted without reference to such evidence and I have not considered it.

19. Conclusion

482 The parties have understandably asked me not to make any order directing payments of any kind, and I do not do so. Apart from anything else, there is still the issue of whether the issues that were bifurcated need to be dealt with. The parties may discuss this with me at a 9:30 a.m. appointment.

F.J.C. NEWBOULD J.

cp/e/qlcct/qlvxw/qlced/qlhcs/qlgpr/qljxh

1 ISDA stands for International Swap Dealers Association, now the International Swaps and Derivatives Association. The form of the agreement was the 1992 form of the ISDA Master Agreement.

2 Why the word "synthetic" is used other than industry jargon is unclear. The concept is no different than one boy betting against another that the Toronto Maple Leafs will not end up worse than some agreed place in the standings, such as third from last, and no higher than some agreed place, such as fourth place, in the next NHL season. The reason why Barclays would have an interest in buying protections against a decline in value of assets it did not own was because Barclays was a "market maker", a swap dealer acting as an intermediary between sellers and buyers of credit protection and sought to profit by earning a spread between the cost of buying credit protection and selling credit protection. In this case, the evidence was that it was very difficult to find someone who would take the exact opposite view on a bespoke transaction with the exact portfolio of names and terms. A CDS is different from insurance in that the credit protection buyer is not required to own or have an economic interest in the underlying debt obligations against which it is buying protection.

3 Mark to market means that the swaps were valued daily based on Barclays model for doing so.

4 Although the underlying portfolio included asset and market backed securities, losses on them only became payable by Devonshire to Barclays if losses in the super senior tranche for the bond portfolio became payable.

5 Triple A rated corporation such as Volvo, Alcoa and Potash Corporation.

6 One of the trusts had been restructured in July, 2007.

7 This larger restructuring is referred to in these reasons as the large Crawford restructuring or the Montreal Accord restructuring.

8 These were not all small investors and included large institutions such as University of Alberta. They were referred to by all participants in the discussions as the "small noteholders".

9 Throughout this process internal and external legal advisors were heavily involved, and considered part of the deal team dealing with the issues. What legal advice was given is protected by privilege, and generally has not been waived.

10 If Barclays' calculations of loss were accepted, Barclays acknowledges this amount to be $1,061,916.48. If as the result of this decision the parties do not agree on the proper amount of the Unpaid Amounts, further written submissions may be made.

11 Barclays approached Ms. Rahl to retain her for this case, not knowing she had already been retained by Devonshire.

12 In his opening, Mr. Howard said that it is Barclays' contention that the parties were contractually required to value the trades at any point in time by using the Barclays model when determining if the market had moved to the point that collateral calls were triggered that would require Devonshire to post more collateral and that this contractual provision required the model to be used to value the trade on an early termination. This argument was not made in Barclays' written or oral submissions at the end of the case. The provision in question is contained in an annex to the ISDA Master Agreement called the Seller CSA, dealing with collateral calls, in which Exposure is defined as the amount that would be payable to Barclays as determined by Barclays in its sole discretion using its proprietary correlation model. My reading of the documents is that while Devonshire agreed to the use of Barclays' model for the purposes of determining whether collateral calls could be made, that provision did not purport to say that the model had to be used to value the swaps in the event of early termination. To have done so would have been inconsistent with the direction that Market Quotation was to be used if possible.

13 Barclays led evidence from Ms. Franke, a director in its product control group in London as to the accounting treatment of the Devonshire swaps in its books. Barclays acknowledges that her evidence is not relevant to the calculation of the Settlement amount, and I do not take it into account. The accounting treatment cannot establish what the Barclays loss was.

TAB 6

Case Name:

Fitkid (York) Inc. v. 1277633 Ontario Ltd.

Between
Fitkid (York) Inc., plaintiff, and
1277633 Ontario Limited and Living Properties Inc., defendants

[2002] O.J. No. 3959

[2002] O.T.C. 749

2002 CarswellOnt 3373

117 A.C.W.S. (3d) 479

Court File No. 00-CV-190037

Ontario Superior Court of Justice

Swinton J.

Heard: September 23, 24, 25, 26 and 27, 2002.
Judgment: October 11, 2002.

(63 paras.)

Counsel:

Wolfgang Kaufmann, for the plaintiff.
Craig A. Mills, for the defendant, Living Properties Inc.

---

1 **SWINTON J.**:-- Fitkid (York) Inc. has brought this action against its former landlord, 1277633 Ontario Ltd., claiming damages for wrongful termination of its lease, and against the property manager of the premises, Living Properties Inc., claiming damages in negligence. The landlord did not defend the action.

The Facts

2 Fitkid (York) Inc. was established around 1986. It operated from premises at 385 John Street in Thornhill until the termination of its lease by a lockout on April 17, 2000. At that time, it leased three units of the building, where it ran programmes of various types for young children, including arts and crafts, gymnastics, and swimming instruction. One of its units contained a pool, which was built at the tenant's expense at the time the building was built.

3 Dr. Howard Spillman was one of the four original investors. He has been the controlling shareholder since January, 1990. At that time, his daughter, Denise Lipson, took over the running of the business. He testified that the business lost money in its first four years, and losses continued, but began to decline in 1993 or 1994. For the five years prior to the termination of the lease, the company showed income after expenses of $94,042.00 (1996); $41,108.00 (1997); $48,233.00 (1998); $77,848.00 (1999); and $33,617.00 (2000).

4 At the time the lease was renewed in 1996, the building was owned by a numbered company, 1021935 Ontario Ltd., with two shareholders - Charlie Guiliani, the builder of the building, and Bill Fong, a commercial real estate agent. The new lease was for ten years, with a five year option to renew.

5 The lease provided for a base rent set out in Schedule D. In addition, Fitkid was to pay 75% of the water bill when due and a share of the real estate taxes and occupancy costs. Paragraph 10 of the lease allows the landlord, on or before the commencement of the calendar year, to estimate the reasonable amount of the tenant's share of real estate taxes for that year. The tenant is then bound to pay that amount in 12 equal monthly installments. Within 45 days after the end of the rental year (which was the calendar year), the landlord is required to provide a statement of the tenant's share of taxes for that year and any adjustments are to be made with the delivery of the statement. The tenant is to pay any deficiency upon demand by the landlord.

6 Paragraph 22(a) defines the landlord's occupancy costs, while paragraph 23 provides that the tenant shall pay as additional rents the tenant's proportionate share of the landlord's occupancy costs in accordance with paragraph 24. Paragraph 24 and 25 read:

> 24. LANDLORD'S ESTIMATE OF OCCUPANCY COSTS
>
> On or before the commencement of any Rental Year, the Landlord acting reasonably may estimate the amount of Landlord's Occupancy Costs for such Year, (based on the previous Rental Year, except in the first, with anticipated increases) and Tenant shall pay to Landlord Tenant's Proportionate Share thereof in equal monthly instalments, each equal to one-twelfth (1/12) of such estimate, which Tenant shall pay in advance on the first day of each calendar month of the Rental Year, provided that where it is necessary to calculate the instalment

payable in respect of part of a calendar month, the instalment payable shall be equal to the sum produced by multiplying such estimate by a fraction, the numerator of which is the number of days in the part of the month in question, and the denominator of which is 365.

25. RENTAL YEAR ADJUSTMENT

Within 45 days after the end of each Rental Year, Landlord shall furnish to Tenant a statement and where possible supporting invoices showing the actual gross amount of Landlord's Occupancy Costs during such Rental Year and a statement showing the Tenant's Proportionate Share thereof and showing in reasonable detail the information relevant to the calculation in accordance with clause 13 and determination thereof. If such amount is greater or less than the payments on account thereof made by Tenant pursuant to Paragraph 22(d) or 24 the appropriate adjustments shall be made within fourteen days after the delivery of such statement, and the Tenant shall pay any deficiency upon demand made by the Landlord.

7 In July, 1998, the building was sold by 1021935 Ontario Ltd. to a new numbered company, the defendant 1277633 Ontario Ltd., and the Fitkid lease was assigned. The new owner obtained a second mortgage on that property from Dr. Wai Ming Cheung for $1 million. Subsequently, the mortgage was renewed for a higher amount in April, 1999, and a third mortgage was also placed on the property. Dr. Cheung testified that he insisted, as a condition of that mortgage financing, that the defendant Living Properties be retained as property manager for the building from July, 1998. John Tucciarone, who was then an officer and director of the company and subsequently a one third shareholder, testified that the condition with respect to Living Properties was imposed as a condition of re-financing the second mortgage in the spring of 1999.

8 Given that Living Properties entered into a management agreement with the landlord on April 23, 1999, I find that it was retained as property manager as a condition of the re-financing. Dan Vucenovic, an experienced employee of Living Properties, was given the responsibility to manage this property, along with others in his portfolio. Prior to his retention, I find that the manager was an individual named Vladimir Aleksic, known as "Alex". While Alex at one time had a relationship with Living Properties, Denise Lipson testified that at some point he was working independently, as she contacted him at home. Therefore, Living Properties was not the manager in the period immediately prior to April, 1999.

9 Mr. Vucenovic discovered that there was a longstanding dispute between the landlord and tenant with respect to the condition of the roof. Denise Lipson described ongoing problems over many years with leaks in the roof. The landlord blamed this on excess humidity in the pool area and

wanted a contribution from Fitkid for repairs. On the suggestion of Mr. Vucenovic, Ms. Lipson began to put her complaints about the roof in writing around November of 1999, and there was a series of letters that followed in November, January and February. Ms. Lipson became concerned about safety for her clients and employees because of the condition of the roof.

10 Ms. Lipson withheld her February, 2000 rent because of the roof problem. She was served with a notice of default dated February 10. According to Mr. Vucenovic, the notice was issued under the instructions of all three shareholders of the landlord company. Ms. Lipson then paid her rent for that month. Some effort at repairs was made that month. While the landlord paid, there was evidently a dispute about who was ultimately responsible.

11 Around February 28, 2000, Mr. Vucenovic delivered an expense and realty tax reconciliation statement for the year 1999 to the tenants. These statements set out the actual costs of taxes, maintenance and utilities, and set out an amount of arrears to be paid by the tenant. In addition, the estimated cost of additional rent for 2000 was set out, and a demand made for 12 post-dated cheques for 2000 at this amount. A copy of the real estate bill was attached. He also spoke with many of the tenants to explain the adjustments claimed. Mr. Vucenovic explained that the reconciliation statement was not delivered within 45 days from the beginning of the calendar year, as set out in the lease, because he had had difficulties in obtaining invoices for the period of January to June, 1999 from the shareholders, who had had responsibility for the property management in that period.

12 According to these figures, Fitkid owed $8,896.54 for arrears, plus an additional amount of rent each month since January in the amount of $751.27. The monthly rent was increased from $10,191.45 to $10,942.72. Dr. Spillman testified that this statement came as a complete surprise, as they had received no additional claim for rent since 1996. Neither Mr. Vucenovic nor Mr. Tucciarone had knowledge of what had occurred prior to their involvement with the property.

13 The main concern with the arrears claimed seems to have arisen because of the tax statement from the City of Markham, which the landlord had received on December 2, 1999. It set out the 1999 taxes as $50,121.53, but also added clawbacks for 1998 and 1999 taxes in the amount of $16,628.08 and $13,687.84, arising because of provincial legislation changing the property tax system. On the statement, there is no indication that the landlord was in arrears on the taxes in 1999. Thus, the 1998 clawback appears to be a component of the 1999 taxes payable.

14 Ms. Lipson again withheld her March rent, and Fitkid received a written notice of default dated March 6, 2000, demanding the payment of arrears in the amount of $21,341.80 by March 21, 2000. The arrears were made up of the difference between the new and old rents for January and February, the March rent at the higher figure, and the arrears arising from the rent reconciliation. Paragraph 39(a) of the lease contains a proviso for re-entry on non-payment of rent or non-performance of covenants, which requires that 15 days prior written notice must be given by the landlord. Mr. Vucenovic testified that he was instructed to issue this notice by the principals of

the landlord company. Mr. Tucciarone testified that he and the other shareholders approved the issuance of this notice of default.

15 Mr. Vucenovic was informed by another tenant that he had made an error in the reconciliation statement, since the Fitkid lease required it to pay 75% of the water bill, while the original statement had divided that expense among all tenants according to their proportionate share. He then created a revised reconciliation statement, which he had delivered to Fitkid around March 8. That showed the arrears of rent owing for 1999 as $10,855.60 (although in testimony, Mr. Vucenovic identified a further mathematical error in the claim).

16 Ms. Lipson subsequently paid the March rent on March 16, but at the old level, and she indicated that she was obtaining the services of a lawyer. There was no correspondence from him until March 28, but prior to that there had been discussions between Mr. Vucenovic and Ms. Lipson with respect to the roof repairs and the calculation of amounts owing. For example, on March 8, Mr. Vucenovic wrote to Fitkid asking for a 50% contribution to the roof repairs, estimated at $52,800.00 plus GST.

17 During this period, it appears that Mr. Vucenovic was caught between the tenant and the landlord. As well, he described his relationship with the landlord as requiring him to consult two camps - the one with Mr. Fong and Mr. Guiliani and the other, Mr. Tucciarone. On the landlord's instructions, he wrote a letter dated March 30, 2000, in which he refused to provide copies of the invoices to back up the 1999 reconciliation until the rent owing was paid, although paragraph 25 of the lease requires the landlord to provide invoices, where possible, with the rent reconciliation statement. The new deadline for payment was set at April 3.

18 For Fitkid, it was important to resolve the roof issue, as well as the rent problem. There were ongoing discussions about the roof, including an offer on March 31 from the landlord, through its solicitor, Alan Savage, to share the cost of repairs equally. That offer remained open until April 7. Ultimately, however, the landlord took the position that the roof repairs and arrears were separate issues.

19 Fitkid paid its rent for April at the old level. Mr. Vucenovic took the cheque, under instructions from the landlord. While Mr. Vucenovic testified that it was the practice to apply a new cheque to the arrears, rather than to allocate it to the new rent accruing, this cheque was deposited on April 4, with a notation in the ledger that it was April rent.

20 On April 3, 2000, Mr. Vucenovic again wrote to the tenant's solicitor, Mr. Cohen, now offering access to the invoices at Living Properties' office until April 7. He also gave an explanation of the tax claim, which the tenant had questioned. Finally, he demanded that the amount of $10,855.60 be paid immediately in trust to the tenant's lawyer. I note that this is the amount of the 1999 adjustment, but not the amount of the increased rent in 2000.

21 On April 10, 2000, Mr. Vucenovic wrote to Mr. Cohen again, noting that no one had inspected

the invoices. He indicated that he had been instructed by the landlord to extend the time for review of the invoices and payment until April 13. If there was no payment, he said that the landlord would institute collection proceedings.

22 Fitkid then advised that they had called in municipal building and health inspectors to look at the situation of the pool. This led to a reply on April 11 from Mr. Savage that the rental arrears and the roof problem were separate, and he demanded payment by April 13, failing which the landlord would "exercise its rights under the law".

23 No payment was made by April 13. Mr. Vucenovic testified that he received instructions from the landlord to proceed with the termination of the lease. He prepared a letter to the bailiff, White & Co., which he sent to Mr. Tucciarone for signature. It authorized the bailiff to terminate the lease, and stated that arrears were owing of $13,860.68. Apparently, this is made up of the 1999 arrears, plus the difference between the old and new rent for January through April.

24 On Monday, April 17, the bailiff went into the premises and changed the locks. Ms. Lipson expressed great shock. She rushed to the site, and spent the day there advising clients who arrived for programmes about the lockout.

25 Dr. and Mrs. Spillman and Ms. Lipson met with their advisors, Mr. Cohen and Howard Weinberg, to decide how to proceed. Mr. Weinberg, who has extensive experience in shopping centre leases and operations, advised them not to re-open, because of the nature of the business. In his view, the fitness business had a bad reputation because of other business failures, and people would be wary of dealing with Fitkid in the future, given that they had to pay in advance.

26 Dr. Spillman and Ms. Lipson explained that they decided not to seek relief from forfeiture in the courts because of the nature of the business. While there was about $100,000.00 in the company account as advance payments for courses, rumours had spread that Fitkid was bankrupt. They feared that the damage to reputation was irreparable, and it would not be a wise decision to put more capital into the business to save it.

27 Instead, Ms. Lipson made efforts to find alternate premises for the programmes. She was able to re-locate some classes, but not the swimming programme. Ultimately, Fitkid's business was closed. Many parents received refunds of the money paid for programmes, although not all. Severance was paid to many staff members.

28 Fitkid then brought an action for damages against both the landlord and Living Properties. At trial, they claimed damages of $2,111,606.00, including claims for loss of income, expenses paid in the winding up of the business, money owed to clients, value of equipment left on the premises, and loss of value of the premises and leasehold improvements.

The Issue of Wrongful Termination

29 The plaintiff argues that the lease was wrongfully terminated by the landlord. While notice of default had been given on March 6, 2000, the plaintiff argues that the landlord's subsequent conduct constituted waiver of the right of forfeiture.

30 Breach of the tenant's obligation to pay rent gives the landlord certain rights, including the right of forfeiture. However, where a landlord has a right to forfeit a lease, the landlord may waive this right. The issue of waiver was discussed by the Court of Appeal in Malva Enterprises Inc. v. Rosgate Holdings Ltd. (1993), 14 O.R. (3d) 481, where Morden J.A. stated (at p. 7 Quicklaw):

> A landlord who has the right to forfeit a lease by reason of the tenant's default may waive the exercise of this right when, after the act or omission giving rise to the right of forfeiture has come to its knowledge, it does any act whereby it recognizes the relationship of landlord and tenant as still continuing ...

He went on to quote from authorities which have held that "[a]n action for, demand for, or receipt of rent accrued due since the cause of forfeiture with knowledge by the lessor of that cause is an implied waiver".

31 [26] The Court of Appeal reached a similar conclusion in Royal Inns Canada Ltd. (Trustee of Estate of) v. Bolus-Revelas-Bolus Ltd. (1982), 37 O.R. (2d) 339, finding that the acceptance of rent accruing after a notice of forfeiture by the landlord was a waiver, as this acknowledged the continued existence of the lease.

32 [27] Here, the plaintiff argues that there are four acts of waiver: the acceptance of the rent cheque dated April 1, 2000; the ongoing negotiations over the roof repairs, including the demand for a 50% contribution from the tenant after the notice of default on March 6; the revision of the amount owed in the March 8 revised reconciliation, which constituted a new demand; and the letter from Mr. Vucenovic on April 10 which stated that the tenant must pay or the landlord would implement collection proceedings.

33 [28] The defendant argues that there was no waiver due to the acceptance of the April rent because of paragraph 41 of the lease. Under the heading "remedies cumulative", the clause reads (emphasis added):

> No reference to nor exercise of any specific right or remedy by Landlord shall preclude Landlord from or prejudice Landlord in exercising any other right hereunder or pursuing any other remedy or maintaining any action to which it may otherwise be entitled either at law or in equity. Landlord's failure to insist upon a strict performance of any covenant of this Lease or to exercise any option or right herein shall not be a waiver or relinquishment for the future of such covenant, right or option, but the same shall remain in full force and effect. Acceptance of rent, whether due before or after and [sic] event of default, whether with or without knowledge of such default, shall not operate as a waiver

by the Landlord of any right, including its right of forfeiture.

34 [29] The plaintiff argued that despite this wording in the lease, there could still be waiver by the landlord's conduct. Reference was made to Sledz v. Edmonton Home Fair Ltd. (1997), 28 R.P.R. (3d) 132 (Alta. Q.B.), where the acceptance of post-dated rent cheques after the termination was held to be a waiver in law, even though a clause in the lease stated that a waiver must be in writing.

35 [30] Even where there is a term in the lease governing waiver, the cases on waiver indicate that courts look at the conduct of the landlord to determine whether it has elected not to terminate the lease in the circumstances after the right of forfeiture arises. In my view, despite the wording of Paragraph 41 of the lease, the acceptance of rent accruing after the act which gave the landlord a right of forfeiture is a waiver in law, since that acceptance presupposes the continued existence of the landlord and tenant relationship. Otherwise, there would be no entitlement to rent. In Malva, supra, the Court quoted Ewart, Waiver Distributed (1917) at p. 168 (pg. 7. Quicklaw):

> A demand for the payment of rent which fell due after a breach of a stipulation is evidence of an election to continue the tenancy notwithstanding the breach; for the demand necessarily implies the continued existence of the lease (without which there could be no rent), and is inconsistent with election to terminate. A fortiori, the institution of an action for the recovery of such rent furnishes similarly satisfactory evidence (emphasis added).

36 [31] Similarly, the British Columbia Court of Appeal discussed this issue in Delilah's Restaurants Ltd. v. 8-788 Holdings Ltd. (1992), 92 B.C.L.R. (2d) 342 (C.A.), a case discussed in Sledz, supra. There the majority stated at paragraph 29:

> The only question remaining is whether the fact that the hotel's waiver of para. 12 was not in writing is fatal to the restaurant's position, given the presence of a waiver clause in the lease. The short answer to this question is "no". This answer is provided by a 1920 decision of the Judicial Committee of the Privy Council, R. v. Paulson, [1920] 3 W.W.R. 372, affirming a decision of the Supreme Court of Canada, (1915), 52 S.C.R. 317. At p. 380 of that decision, Lord Atkinson, delivering the judgment of the Court, stated:
>
> > The next matters for consideration are: (1) What is the true effect, after a breach of covenant or contract involving a liability to forfeiture has occurred, of the payment of rent by the tenant and the receipt of it by the landlord with full knowledge of the breach; and (2) Whether the presence in the lease or contract of tenancy of a provision such as that which exists in the lease in the present case, that waiver of a breach shall not be operative unless expressed in writing, destroys or modifies that effect, and

> if the latter, to what extent. The authorities appear to their Lordships to establish that the landlord, by the receipt of rent under such circumstances, shows a definite intention to treat the lease or contract as subsisting, has made an irrevocable election so to do, and can no longer avoid the lease or contract on account of the breach of which he had knowledge.
>
> They further think the presence in a lease or contract of a provision requiring a waiver to be expressed in writing, such as exists in the present case, does not render inapplicable the principle established, and does not enable the landlord at the same time to blow hot and cold, to approbate and reprobate the same transaction, to say to his tenant,
>
>> You were my tenant under a lease or contract of tenancy all the time during which the rent which you have paid me and which I hold, has been accruing
>
> and at the same time to say to him,
>
>> You were only my tenant for half that time, and were a mere trespasser during the other half, for I evicted you or cancelled your lease in the middle of the time for which you paid me, I had no right to more than half the rent you paid, but I'll keep the whole of it.

37 [32] In my view, it is not only the acceptance of the April rent, but the course of conduct engaged in by the landlord after March 6, 2000 that constitutes waiver of its right of forfeiture. When one considers the testimony of Ms. Lipson, Mr. Vucenovic and Mr. Tucciarone, as well as the correspondence exchanged between the parties between March 6 and April 17, 2000, it is apparent that the landlord continued to treat the tenant for much of this period as if the lease continued in operation. Immediately after the notice of default, there was a demand that the tenant share in the cost of roof repairs. Throughout the next few weeks, there was discussion of both the roof repairs and the calculation of the arrears. Indeed, Mr. Vucenovic indicated that the greater cause of concern appeared to be the roof, rather than the charges.

38 [31] On March 21, the landlord did not exercise its right of forfeiture, despite the tenant's failure to pay. It continued to negotiate about the roof, and it made one of its demands for payment, on April 3, in the amount of $10,855.60, rather than the amount of increased rent owing since January. It is apparent that there were ongoing negotiations here in an effort to resolve two major disputes between landlord and tenant.

39 [32] The landlord then accepted the April rent cheque, which was recorded as a payment of April rent. Moreover, at the end of the occupancy, the landlord indicated to the bailiff that the amount due was $13,860.68 - an amount that included the extra rent that came due in April. Again, this demand for April rent is evidence of an ongoing landlord and tenant relationship after the act giving rise to the right to forfeiture.

40 [33] As well, when Mr. Vucenovic wrote on behalf of the landlord on April 10, he made reference to the landlord taking collection proceedings, not terminating the lease. While Mr. Savage wrote saying that the landlord would exercise its rights under the law, that does not indicate that the landlord would still pursue forfeiture. In sum, looking at the course of conduct, I find that there was a waiver at law of the landlord's right to forfeiture. Therefore, despite the wording of paragraph 41 of the lease, the termination on April 17 was wrongful.

41 [34] In reaching my conclusion, I have assumed that the notice of default was effective. I have serious doubts about that. Mr. Tucciarone testified that the landlord did not choose to exercise its right of forfeiture on March 21 as the shareholders decided to give the tenant a chance to satisfy itself of the amount owing. I note, however, that the landlord had not, at this point, complied with its obligation under the lease. Indeed, the landlord failed to comply with its obligations in several important ways. First, it did not provide the rent reconciliation statement in a timely manner (within 45 days of the beginning of the rental year). When it provided the statement, it did not provide invoices, except for a copy of the tax bill. While the lease states that invoices will be provided "where possible", the landlord took the position up until April 3 that the tenant could only see the invoices if it paid the amount demanded first. Even on that date, the tenant was told that it could see the invoices at Living Properties' office, and asked that payment be made first to the solicitor of the tenant in trust. This, in my view, is inconsistent with paragraph 25 of the lease. In addition, I note that the landlord treated the tenant as in arrears with respect to the adjustment for occupancy costs by March 6, even though the lease provides for 14 days for adjustment after the statement. Given that the rent reconciliation statement was not given until February 28, that part of the arrears attributable to occupancy costs was not due on March 6 when demanded (although tax adjustments were immediately due). Finally, I note that the demand for increased rent for 2000 should have been made before the calendar year began, and nothing in the lease speaks of a right to demand that rent could be adjusted retroactively to January 1, when the increase was first demanded February 28.

42 [35] In my view, the landlord's conduct after the notice of default - demanding that the tenant pay half the repairs, accepting the April cheque, and the continuing discussions with the tenant - indicated that the landlord treated the tenancy as continuing and constituted waiver of the right of forfeiture for the earlier breach. Therefore, when the landlord exercised the right to terminate on April 17, the termination was wrongful.

The Liability of Living Properties Inc.

43 [36] The plaintiff has claimed that Living Properties was negligent in the administration and

termination of the lease and, therefore, liable in damages to the plaintiff.

44 [37] Before there can be liability for negligence, there must be a duty of care on the part of the defendant to the plaintiff, a failure to meet the standard of care, and damage caused by the defendant. In my view, the plaintiff has failed to prove either that Living Properties owed it a duty of care or that the conduct of Living Properties caused its damages.

45 [38] In order to prove a duty of care, the plaintiff must prove that it suffered harm that was the reasonably foreseeable consequence of the defendant's act, and there is a close and direct relationship of proximity between the parties. Even if foreseeability and proximity are established, giving rise to a prima facie duty of care, a court must determine whether there are policy considerations outside the relationship of the parties which negative a duty of care (Cooper v. Hobart (2001), 206 D.L.R. (4th) 193 (S.C.C.) at 201, 203). Generally, proximity is determined through the use of categories, although the categories are not closed. In Cooper, the Supreme Court went on to say that defining proximity may involve looking at "expectations, representations, reliance and the property or other interests involved" (at 204).

46 [39] This is not a case where Living Properties is alleged to have caused damage to the property of the plaintiff, as in London Drugs Ltd. v. Kuehne & Nagel International Ltd., [1992] 3 S.C.R. 299. There, employees were held to owe a duty of care to their employer's customer when dealing with the customer's property. Here, the allegation is that Living Properties was negligent in the administration and termination of the lease, causing economic loss to the plaintiff.

47 [40] In my view, even if it was reasonably foreseeable that the wrongful termination of the lease would harm the plaintiff's business, Living Properties was not in a sufficiently proximate relationship with the plaintiff so as to give rise to a duty of care in the administration of the lease. Living Properties was at all times the agent of the landlord in the management of the leased property. It operated under a management agreement which set out its duties and made it the exclusive agent of the landlord. Essentially, it was responsible for the day to day administration of the building, the collection of rents, and the payment of expenses. A detailed list of its duties is found in paragraph 5. Clearly, it was to act in the landlord's interests in the administration of the lease - for example, in collecting rents and dealing with tenant complaints and problems and enforcing rules. As well, Living Properties acted on the instructions of the landlord, especially where the landlord decided to terminate a tenancy.

48 [41] While Mr. Vucenovic stated that he had a duty to be fair to the tenants, that does not translate into a legal duty of care. This is not a case where a tenant like Fitkid acted in reliance on statements by Living Properties. Nor could Fitkid reasonably expect Living Properties to be acting in its interests in administering the lease, given the contractual relationship between Living Properties and the landlord. In my view, there was no duty of care owed to the tenant by the landlord's property manager in the administration of the lease, given the lack of proximity between the tenant and Living Properties.

49 [42] Even if I am wrong with respect to the duty of care issue, in my view, negligence has not been proved. No evidence of the standard of care with respect to property agents was led, and so I can not determine whether Living Properties failed to live up to the standard of care.

50 [43] More importantly, Living Properties did not cause any loss to the plaintiff. Any damage caused to the plaintiff came about because of the wrongful termination of the lease by the landlord, and not because of the actions of Living Properties. I find that each notice of default was sent on the landlord's instructions, as were the decisions to extend the time for payment, and ultimately to terminate the tenancy despite the acts of waiver of the right to forfeiture. At the time of the decision to terminate, the landlord was acting under legal advice, not relying on Living Properties. Moreover, the orders to withhold the invoices until payment were made by the landlord, and the late issuance of the reconciliation statement was because of the landlord's delay in providing the invoices for the previous year. As well, the acts of waiver, such as the acceptance of the April rent and the offers with respect to the roof repairs, were those of the landlord. In sum, I find that it was the landlord who caused any loss to the tenant arising from wrongful termination of the lease, not the property manager. Therefore, the plaintiff's claim in negligence against Living Properties is dismissed.

Damages

51 [44] After the termination, the plaintiff made efforts to relocate the business, but ultimately closed its operations. It now claims damages under a number of headings. In my view, the proper measure of damages here is determined having regard to the position in which the plaintiff would have been, had the wrongful termination not occurred.

52 [45] The plaintiff claims $480,000.00 for loss of income from its business. This is calculated on the basis that the plaintiff made between approximately $33,000.00 and $94,000.00 over the last five years of operations. On average, it made $51,643.60, although I observe that revenues were declining regularly over the course of those five years. The plaintiff argued that it would have continued in the building for the six years of its lease and had an option to renew for five years. Therefore, it claimed loss of income of $480,000.00 for a ten year period.

53 [46] It is significant that revenues were declining over the last five years of operation, ending January 31, 2000. Given this fact, it appears to me that the plaintiff's business was becoming less and less profitable. Had it stayed in the building, it is clear that its rental expenses were going to increase in 2000, since nothing that was provided in evidence from the plaintiff has shown the inaccuracy of the amounts of rent claimed by the landlord. Therefore, I would quantify the lost income for the year ending 2001 at $20,000.00, taking into account the increased rent and 1999 adjustment and applying this with some regard to the last year's income level. I would quantify the income loss at $30,000.00 each year for the remaining years, had the business continued. Thus, I would quantify the loss of income at $170,000.00 to 2006 if the business continued until the end of the lease. In my view, it would not likely have continued past that date without a significant

infusion of capital, which Dr. Spillman indicated that he was not willing to provide. Moreover, I believe that the figure of $170,000.00 should be reduced because of the contingency that the business would not have continued until the end of the lease, given the steady decline in revenues and the increasing costs. Therefore, I award $150,000.00 for loss of income.

54 [47] I award nothing for the value of the equipment left on the premises or the loss of value of premises and leasehold improvements. Dr. Spillman estimated the value of the equipment at $50,000.00 and the loss of value of the premises at $1,416,000.00. I have good reason to question his numbers. He is not an experienced business valuator, and he gave no detailed justification for the valuation of the equipment. As for the premises, he based his estimate on what he paid originally for the improvements and the likely cost to replace them. No detail was provided, and the premises he describes are not new. Thus, there would be an issue of betterment if replacement value were awarded.

55 [48] However, even if I accepted his numbers, it would be inappropriate to award damages of this kind, since the award of loss of income assumes the continuation of the business over the course of the lease. This would have required the plaintiff to continue to use the equipment and leasehold improvements, for without them, it would not have been able to carry out its programs. Therefore, an award of these damages as well as the loss of income would result in double recovery. Finally, I have no way to value these items at the end of the lease, and I note that improvements such as the pool would remain the property of the landlord in any event in accordance with the lease.

56 [49] That leaves the claim for expenses paid by the plaintiff in the course of winding up its business in the amount of $75,000.00 and money potentially owing to clients in the amount of $90,606.00.

57 [50] The costs of winding up the business were mainly refunds to clients and severance payments, along with salaries for employees who continued. Ms. Lipson testified that the refunds ($18,292.64) were largely for clients who had enrolled for future programs whose money she was holding. It was estimated that the company had about $100,000.00 in cash at the time of termination because of the advance payments. I see no reason to compensate the plaintiff for the return of these funds. The calculation of loss of income takes into account the likely profit if these programmes had been given as usual. I do award the other costs, such as severance of employees and the costs of alternate facilities ($1,862.49), as these were costs incurred either because of the wrongful termination or to continue the business until it wound up. Subtracting legal costs and the refunds, the amount under this head of damages is $48,201.14.

58 [51] I do not award damages under the heading of contingent liability for refunds. Those refunds were never made, and it is now over two years since the termination of the lease. Therefore, no loss has been suffered by Fitkid.

59 [52] Living Properties argued that even if the defendants caused damage to the plaintiff, the

damages are excessive, given the plaintiff's duty to mitigate. Where the plaintiff could reasonably avoid losses, the defendant is not liable for those losses.

60 [53] When the plaintiff was locked out, it took no steps to seek relief from forfeiture. Ms. Lipson and Dr. Spillman explained that they consulted with their advisors and believed that the damage to the business' reputation could not be repaired. Therefore, they did not bring an application in the courts to obtain relief from forfeiture. Instead, they sought to relocate their classes, and ultimately closed the business.

61 [54] The lockout occurred on a Monday morning. It had already been announced that Fitkid would be closed from Wednesday on through Monday because of religious holidays. In theory, there was adequate time to seek a court remedy and, given my decision, such an application was likely to succeed in achieving relief for the plaintiff. In my view, had the plaintiff continued in the premises, it would have been able to explain to customers what had occurred. However, there would undoubtedly have been damage to the business. Clearly, there were many loyal customers who followed Fitkid to new locations, but there was real risk of a loss of business in the future.

62 [55] Given this, I do not find that the plaintiff failed to mitigate its losses by not bringing an application for relief from forfeiture. The plaintiff need take "reasonable" steps, but should not be judged harshly with the benefit of hindsight. The principals of the plaintiff made a business decision in response to advice from an experienced person and a hostile reaction from many clients, and I find that the decision was reasonable in the circumstances. Therefore, I do not reduce the damage calculation because of a failure to mitigate.

Conclusion

63 [56] The plaintiff will have judgment against 1277633 Ontario Ltd. for $198,201.14 plus pre- and post-judgment interest in accordance with the Courts of Justice Act. Its action against Living Properties is dismissed and, therefore, the cross-claim of Living Properties for contribution and indemnity from the landlord is dismissed. If the parties are unable to agree with respect to costs, they may make written submissions or schedule an appointment.

cp/e/nc/qlgkw/qlhcs

TAB 7

Case Name:

Shelanu Inc. v. Print Three Franchising Corp.

Between
Shelanu Inc., plaintiff (respondent), and
Print Three Franchising Corporation, defendant (appellant)
And between
Print Three Franchising Corporation, plaintiff by counterclaim (appellant), and
Shelanu Inc., Brian Deslauriers and Mary Deslauriers, defendants by counterclaim (respondents)

[2003] O.J. No. 1919

64 O.R. (3d) 533

226 D.L.R. (4th) 577

172 O.A.C. 78

38 B.L.R. (3d) 42

2003 CanLII 52151

123 A.C.W.S. (3d) 267

2003 CarswellOnt 2038

Docket No. C35392

Ontario Court of Appeal
Toronto, Ontario

Weiler, Austin and Laskin JJ.A.

Heard: August 26, 2002.
Judgment: May 20, 2003.

(140 paras.)

Franchises -- Franchise agreement -- Breach of agreement -- What constitutes -- Damages -- Duties of franchisor -- Duty of good faith -- Withdrawal from -- Notice requirements -- Royalties.

Appeal by the defendant Print Three Franchising Corporation and cross-appeal by the plaintiff Shelanu Inc. from a decision awarding Shelanu damages for breach of contract. BCD Print Inc. was a company that was owned by a husband and wife who also owned Shelanu. BCD had one Print Three franchise and Shelanu had two Print Three franchises. The owners decided to surrender the BCD franchise and to operate the two Shelanu franchises as a single entity, which affected the calculation of their royalty rebate. Subsequently, Print Three withheld some of the monthly royalty rebates and purported to deny the request to terminate one of the franchises and consolidate the others. In 1997, Shelanu brought an action to recover unpaid royalty rebates. Although Shelanu considered the franchise agreement terminated due to a number of breaches, Shelanu continued to remit royalty payments and continued to use the Print Three name on its store until October 1999. The franchise agreement provided for an expiry date of December 1999. Print Three denied any breach of obligation and counterclaimed for damages. The trial judge found that there was an enforceable oral agreement by Print Three to cancel the BCD franchise and allow BCD to combine its production operations with the retail operations of Shelanu. The trial judge also found that Print Three breached its duty of good faith toward Shelanu by attempting to rescind the oral agreement, by breaching representations with respect to promotional programs, by failing to make prompt payment of royalty rebates, and by establishing a separate, competing franchise operation. The judge awarded damages for breach of contract, but did not award separate damages for breach of duty of good faith. The counterclaim was dismissed but there was an assessment of damages on the basis of lost royalties and advertising fees for the 10-year life of a franchise agreement. On appeal, Print Three submitted that oral agreement was contrary to the terms of the written franchise agreement which stated that delay in exercising a right or breach of default was not a waiver of right, that no waiver, amendment or change of any terms was valid unless signed by all parties, and that the written agreement constituted the entire agreement.

HELD: Appeal and cross-appeal allowed in part. The wording of the clauses in the written agreement relied upon by Print Three did not conflict with the subsequent tripartite oral agreement. Print Three breached its obligation to pay Shelanu the royalty rebates in accordance with the oral agreement, such that Shelanu was entitled to damages as found by the trial judge. It was open to the trial judge to find that Print Three acted arbitrarily and unreasonably with respect to the promotional programs. However, the separate franchise operation established by Print Three was a different business that did not contribute to any losses by Shelanu, and its establishment did not constitute a breach of the duty of good faith. Furthermore, none of the breaches amounted to a fundamental breach which would have excused Shelanu from future performance, especially since Shelanu continued to use the Print Three name for more than two years after the notice of termination was issued. Accordingly, Shelanu was not entitled to recover any royalties paid to Print Three, but was entitled to receive credit for royalty rebates withheld by Print Three. The award of damages for the counterclaim was adjusted to account for the failure of the trial judge failed to consider the one-year

non-competition clause in the agreement.

Statutes, Regulations and Rules Cited:

Arthur Wishart Act (Franchise Disclosure) 2000, S.O. 2000, c. 3.
Patent Act, R.S.C. 1985, c. P.4.
Statute of Frauds.

Appeal From:

On appeal from the order of Justice Ian V.B. Nordheimer of the Superior Court of Justice dated October 31, 2000.

Counsel:

Benjamin Zarnett and Elliot S. Birnboim, for the appellant.
F. Scott Turton, for the respondents.

[Quicklaw note: A corrigendum was released by the Court August 5, 2003. The changes have been made to the text and the corrigendum is appended to this document.]

The judgment of the Court was delivered by

WEILER J.A.:--

I. INTRODUCTION

1 Print Three is a franchisor of copying and print stores. Shelanu was a Print Three franchisee owned by Brian Deslauriers and his wife Mary. Shelanu alleged that Print Three breached its obligations as a franchisor and, in addition to claiming damages, alleged that it was entitled to be released from further performance of its obligations as a franchisee from the date it gave notice of termination of the franchise agreement (the "agreement"). Print Three denied any breach of its obligations and counterclaimed for damages. Nordheimer J. held in favour of Shelanu with respect to both damages and fundamental breach and dismissed Print Three's counterclaim. Despite this finding, he assessed the damages under the counterclaim.

II. OVERVIEW

2 Print Three's appeal raises three main issues. The first issue is whether the trial judge erred in holding that Print Three breached any of its obligations to Shelanu. In connection with this issue, Print Three alleges that the trial judge erred in holding that it breached an oral agreement entered into after the written franchise agreement. The effect of the oral agreement was to entitle Shelanu to

a greater royalty rebate under the agreement. Print Three submits that the oral agreement is unenforceable due to the existence of an entire agreement clause and other clauses excluding oral amendments and waivers not in writing in the agreement (collectively referred to, for ease of reference, as the exclusion clauses) and due to lack of consideration. The second issue is whether the trial judge erred in holding that the parties owed each other a duty of good faith and that Print Three breached that duty by allowing for the establishment of a Le Print Express franchise. If Print Three did breach its obligations to Shelanu, the third issue is whether the breach was so fundamental that Shelanu was released from further performance of the agreement from the date it gave notice of termination of the agreement.

3 In the event that Shelanu was not released from further performance of its obligations as a franchisee, I must consider Shelanu's cross-appeal of the trial judge's assessment of damages under Print Three's counterclaim.

4 With respect to the first issue, based on the twofold approach I adopt, I would hold that the subsequent oral agreement is enforceable despite the existence of the exclusion clauses. First, I determine whether these clauses apply to the subsequent oral agreement and I conclude that they do not. I would also uphold the trial judge's finding that there was consideration for the oral agreement. Second, because the appellant has not appealed the trial judge's finding that the oral agreement exists and there is no dispute as to its terms, I find that the subsequent oral agreement represents the intentions and legitimate expectations of the parties and, in these circumstances, should prevail.

5 With respect to the second issue, the trial judge recognized a common law and statutory duty of good faith between Print Three and Shelanu. I would hold that the trial judge did not err in recognizing the existence of a duty of good faith at common law. For reasons I will specify later, the circumstances giving rise to the duty of good faith that the Supreme Court recognized in the employment context in Wallace v. United Grain Growers Ltd. (c.o.b. Public Press), [1997] 3 S.C.R. 701 are equally present in the franchisor franchisee relationship here. Print Three had a duty of good faith in the sense that it had an obligation to have regard to Shelanu's legitimate interests and to deal promptly, honestly, fairly and reasonably with Shelanu. I would also hold that the trial judge did not impose a higher, fiduciary duty on Print Three.

6 Given my conclusion, it is unnecessary to decide whether the Arthur Wishart Act, (Franchise Disclosure), S.O. 2000 c. 3, which applies to existing franchises, is applicable in this case where the acts in issue took place prior to the coming into force of the Act.

7 I agree with the trial judge that Print Three breached its obligations to Shelanu with respect to payment of royalty rebates and its advertising program. I disagree, however, with the trial judge's conclusion that the establishment of the Le Print Express business was a breach of Print Three's duty of good faith towards Shelanu. The trial judge committed a palpable and overriding error in coming to that conclusion.

8 With respect to the third issue, fundamental breach, having regard to my conclusion that the

establishment of the Le Print Express franchise was not a breach of Print Three's obligations towards Shelanu and to the fact that Shelanu continued to derive the benefit of the use of Print Three's name and an exclusive territory after it purported to terminate the agreement, I would hold that the trial judge erred in excusing Shelanu from further performance under the agreement.

9 In relation to the cross-appeal respecting damages though I have concluded that Shelanu was not excused from further performance under the agreement, I would hold that the trial judge committed an error in principle in holding Shelanu liable for damages over a period of 10 years, or the life of a franchise agreement. Instead, based on Shelanu's breach of its one-year non-competition clause, I would hold Shelanu liable for damages for one year. I would agree with the trial judge that Shelanu is liable to pay Print Three an amount equal to the loss of one franchise fee - namely $64,500 - for failing to surrender its customer list, telephone and fax numbers at the end of the agreement. In accordance with the figures used by the trial judge, I would assess the damages to Print Three for loss of revenue and loss of advertising fees for one year at $29,700 in addition to the franchise fee of $64,500 for a total of $94,200. My reasons follow.

III. LEGAL ISSUES

10 The decision of the trial judge is reported at [2000] O.J. No. 4129 and, therefore, a brief outline of the facts relating to the alleged breaches will suffice to appreciate the legal arguments and these reasons.

1. Enforceability of the Oral Agreement

A. Facts

11 In 1987, BCD Print Inc., a company owned by Brian Deslauriers, purchased a Print Three franchise for a location at 239 Bloor Street East in Toronto. BCD is not a party to this action although it is a party to the oral agreement.

12 Two years later, Brian Deslauriers and his wife Mary purchased the shares of Shelanu Inc., which had two Print Three franchises at 60 and 200 Bloor Street West. They entered into two new franchise agreements with Print Three for each of these locations and gave a personal guarantee of the debts of Shelanu. In September 1991, there was a downturn in the economy and, with the oral agreement of Jack Banks, the principal behind Print Three, Shelanu closed the operation at 200 Bloor Street West. Paragraph 26 of the franchise agreement required that any change to the terms or covenants of the agreement be in writing. No such documentation was ever requested or required by Print Three when the 200 Bloor Street West location was closed.

13 Over the next few years, the Deslauriers continued to struggle with their businesses and eventually BCD closed the 239 Bloor Street East location and moved it to 80 Bloor Street West. Pursuant to the written franchise agreement, Print Three was to lease the space but was not

interested in doing so. BCD leased the space directly at 80 Bloor Street West and used it as a production facility for Shelanu's business. Print Three did not object. Instead, Banks orally offered to let the Deslauriers surrender BCD's franchise but said that, if they did, he would feel free to put a new franchise in at 239 Bloor Street East. Afraid of the competition, the Deslauriers declined Banks' offer at this time.

14 On January 13, 1995, two years after the closure of the 239 Bloor Street East outlet, the Deslauriers met with Banks and asked him if they could surrender the BCD franchise. (By this time BCD had moved into space at 60 Bloor Street West, above the premises occupied by Shelanu). He agreed but asked that they confirm this agreement with his legal counsel. Three days later, Mary Deslauriers wrote a letter on BCD letterhead as follows:

> This is to confirm our discussion of Friday, January 13, 1995, with Jack Banks, that we would like to operate our business as one franchise, that being the franchise located at 60 Bloor St. W. Therefore, we are hereby cancelling our licensing agreement for the franchise formerly located at 239 Bloor Street East (location #73). We will then submit royalties for all revenues on one report. If possible, we would like this change to be effective January 1, 1995.

15 The reference to submitting royalties is a reference to Shelanu's obligation to pay Print Three a monthly royalty of 6% of gross sales pursuant to paragraph 3 of the franchise agreement.

16 The franchise agreement provided that a percentage of the royalties paid was to be remitted to the franchisee based on the franchisee's aggregate sales each quarter. As certain gross sales levels were met, the percentage of royalties rebated increased. As two franchises, the sales were split between BCD and Shelanu with the result that gross sales levels would be lower for both franchises and, consequently, the percentage royalty rebate owed by Print Three would be lower. Conversely, if Shelanu reported all sales, gross sales levels would be higher and the royalty rebate would be at a higher percentage.

17 In early February 1995, the Deslauriers reported as one franchise, Shelanu, and sent the royalty statement based on sales for the month of January. Charlotte Krebs, a Print Three employee, called Mary Deslauriers and told her that one franchise report was missing. Mary Deslauriers told her of the agreement reached with Banks. Subsequently, Krebs called Mary Deslauriers again and said that Banks might require a new franchise agreement to be signed. Mary Deslauriers was surprised at this and said she would speak to Banks. Although Mary Deslauriers called and left messages for Banks asking why a new agreement would be necessary, he never returned her call, and the question of a new franchise agreement was not raised again.

18 On April 6, 1995 Mary Deslauriers sent a letter to Krebs enclosing Shelanu's royalty cheque for March as one franchise. The letter stated in part:

> Since your inquiry, we have left several messages for Jack to see if he has any

> concerns about this. We have not heard back from him, so we assume that we are and have been since January, one franchise. We are therefore looking forward to a Royalty Rebate for this quarter accordingly.

19 Around this time a dispute arose between Print Three and many of the franchisees regarding advertising. This dispute is the subject of an issue called the Air Miles program that I will discuss later. The fact that the Deslauriers sided with the other franchisees on this issue angered Banks. On May 8, 1995, Banks expressed some of this anger during a telephone conversation with Mary Deslauriers. According to Mary Deslaurier's note, he stated, among other things, "Every franchise that did not pay the 3% for April [for the Air Miles advertising program], Jack [Banks] is going to go after, and he's going to close them down. And he's going to write a letter to us saying that he will never help us out again ..." Following this conversation, Banks wrote a letter to the Deslauriers purporting to deny the "request to terminate one of your franchise agreements and to consolidate your two centres".

20 The quarter following the phone call (July to September 1995) was the first time the royalty rebate was withheld. Print Three also withheld the royalty rebate for the fourth quarter (October to December 1995).

21 The royalty rebates remained an outstanding problem. Print Three also withheld royalty rebates for the second quarter of 1996 without explanation. On October 3, 1996, a meeting took place between Bob Davis, a former franchisee who had become president of Print Three, and the Deslauriers to deal with the issue of royalty rebates. Davis asked to see the production facility now located on the twelfth floor of 60 Bloor Street West and Brian Deslauriers refused to show it to him. He wanted to discuss the unpaid rebates. Towards the end of the meeting, Davis handed over a royalty rebate cheque for the royalty rebates due for the second quarter of 1996 apparently on the basis of there being two franchises. On October 7, 1996, the royalty rebates for the third and fourth quarters of 1995 were also paid on the basis that there were two franchises. On October 8, at Davis' request, Brian Deslauriers sent a letter to Davis again outlining the 1995 agreement he had with Banks. The next day Davis replied, stating they were in breach of the franchise agreement for refusing to allow him to see the production facility, and, as a result, were not entitled to any royalty rebate. The amount of this rebate was $2,241 or $8,947, depending upon whether the January 13, 1995 agreement was enforceable (i.e. depending on whether they were reporting as one or two franchises). Brian Deslauriers wrote back saying Davis could see the production facility any time it was convenient for him. This visit took place on January 16, 1996 and lasted only a few minutes. On January 24, 1996, Davis sent a letter to Brian Deslauriers indicating that he had decided he would continue to treat their operation as two stores for rebate purposes.

22 On May 2, 1997, Shelanu wrote a letter alleging a number of breaches of the franchise agreement and purporting to terminate the franchise agreement with Print Three. In August 1997, Shelanu commenced an action against Print Three for royalty rebates it claimed were owing. Despite the litigation, Shelanu continued to remit royalty payments on the basis of one franchise.

Shelanu also continued to use the name Print Three on its store until October 16, 1999. The franchise agreement expired naturally in December 1999.

23 Neither Banks nor Krebs testified at trial.

B. The Findings of the Trial Judge

24 Since neither Banks nor Krebs testified, the trial judge inferred that their evidence would not have supported the defence position respecting the lack of any oral agreement. From this inference, and the evidence as a whole, the trial judge found that an oral agreement was reached in January 1995 in which Print Three agreed to cancel BCD's franchise for the 239 Bloor Street East location and to allow BCD to combine its production operations with the retail operations of Shelanu. Because an oral agreement had been reached in January 1995, Banks' letter of May 1995 and Davis' letter in January 1996, unilaterally refusing to treat the production facility and the store at 60 Bloor Street West as one location, had no effect.

25 The trial judge rejected the appellant's argument that the agreement was unenforceable. He found that the defendant did not require any formal written documentation when Shelanu terminated the franchise at the 200 Bloor Street West location or when BCD closed the 239 Bloor Street East location and moved it to 80 Bloor Street West and, consequently, it was not now open to Print Three to insist on strict compliance with its rights under the written agreement.

26 With respect to the issue of consideration, the trial judge found that this was a three-party agreement and that there was consideration flowing to Print Three from both BCD and Shelanu. From BCD, Print Three obtained the release of the territory related to the 239 Bloor Street East location that it could then sell to a new franchisee. From Shelanu, Print Three received the benefit of Shelanu's improved financial situation. Presumably, the trial judge meant that Print Three received the benefit of increased royalties from Shelanu resulting from its increased sales which, in turn, were derived from the synergies of combining BCD's and Print Three's operations into one. On the issue of privity, the trial judge found that the representatives of both BCD and Shelanu, the Deslauriers, were present with Print Three's representative, Banks, at the meeting where the agreement was reached. He saw no reason why Shelanu - one of the parties to the agreement and its principal beneficiary - could not enforce it.

27 The evidence respecting the making of the oral agreement and its existence were explored extensively at trial. On appeal, the appellant accepts the finding of the trial judge that there was an oral agreement in January 1995, but submits that the trial judge erred in law in holding that this oral agreement was enforceable.

28 The paragraphs in the written franchise agreement which the appellant submits are contrary to the oral agreement are paragraph 20 (delay in exercising a right or breach of default is not waiver of right), paragraph 26 (no waiver, amendment or change of any terms unless signed by all parties) and paragraph 27 (this [written] agreement constitutes the entire agreement between the parties with

respect to all matters herein).

29 Simply put, the appellant's position is that the parties' bargain is to be equated with the document they have signed.

C. Analysis

i.) Exclusion Clauses: Interpretive Approach

30 Before deciding not to enforce the exclusion clauses, the trial judge did not specifically consider whether they applied to the oral agreement. This seems to me to be a necessary first step. Once a determination has been made that the exclusion clauses apply, the court can then consider whether they should be enforced.

31 Paragraphs 20, 26, and 27 are not limitation or exclusion clauses in the traditional sense that they limit or exclude liability for damages for breach of contract or for a tort connected to the contract. Their purpose is, rather, to limit the parties' duties to each other to what has been reduced to writing and, as a corollary, to exclude any other duties. More specifically, an entire agreement clause seeks to exclude liability for statements other than those set out in the written contract and is sometimes referred to as an exclusion clause. See H.G. Beale et al., eds. Chitty on Contracts, 28th ed. (London: Sweet & Maxwell, 1999), vol. 1 at 12-102; Kenyon, Son & Craven Ltd. v. Baxter Hoare & Co. Ltd., [1971] 1 W.L.R. 519 (Q.B.) at 522; Betker v. Williams (1991), 86 D.L.R. (4th) 395 (B.C.C.A.); Zippy Print Enterprises Ltd. v. Pawliuk (1994), 100 B.C.L.R. (2d) 55 (C.A.). Further, in construing an entire agreement clause, in Beer v. Townsgate I Ltd. (1997), 36 O.R. (3d) 136 at 147 (C.A.) this court resorted to the reasoning typically associated with an exclusion clause that limits liability for damages.

32 The approach that I am adopting here is consistent with the approach to construing and enforcing exclusion or limitation clauses relating to damages as stated in Hunter Engineering Co. v. Syncrude Canada Ltd., [1989] 1 S.C.R. 426. Dickson C.J., with whom La Forest J. concurred, held that exclusion clauses are not inherently unreasonable. In construing an exclusion clause, the issue to be addressed is whether, as a matter of construction, the exclusion clause covers the alleged occurrence or breach in question. Exclusion clauses are to be approached with the aid of the cardinal rules of contractual construction: they must be read contra proferentem and clear words are necessary for the exclusion clause to apply. See Photo Production Ltd. v. Securicor Transport Ltd., [1980] A.C. 827 (H.L.) per Lord Wilberforce at 846, cited by Dickson C.J. at 458-459 of his judgment.

33 When the exclusion clause covers the alleged occurrence or breach, the question is whether to enforce the exclusion clause. Where the court is of the opinion extreme unfairness would result from the enforcement of an exclusion clause, such as, for example, where there was inequality of bargaining power, this concern should be addressed directly through the doctrine of

unconscionability. Dickson C.J. held that courts should no longer use the term fundamental breach to avoid the operation of an exclusion clause as this term is confusing. The approach of directly addressing the concerns respecting enforcement of the exclusion clause would allow the courts to focus expressly on the real grounds for refusing to enforce a contractual term agreed to by the parties.

34 The other major opinion in Hunter Engineering, supra, is that of Wilson J. with whom L'Heureux-Dubé J. concurred. Wilson J. held that the court's responsibility did not end with construing the contract to ascertain the bargain that the parties had made. She was of the opinion that the court had a responsibility to assess the reasonableness of enforcing the exclusion clause in the contract in light of subsequent events. The doctrine of unconscionability did not suffice to relieve a party from the effect of an exclusion clause that operated unfairly because it was traditionally restricted to inequality of bargaining power and the circumstances existing at the time the contract was made: See Hunter Engineering, supra, at pp. 511-518. See also N. Rafferty, "Developments in Contract and Tort Law: The 1999-2000 Term" (2000) 13 S.C.L.R. (2d) 125 at 141-143.

35 In Guarantee Co. of North America v. Gordon Capital Corp., [1999] 3 S.C.R. 423, the Supreme Court of Canada "... interpreted Hunter Engineering in such a way as to indicate that there was little distinction between the approaches of Dickson C.J. and Wilson J." respecting the enforceability of exclusion clauses: Rafferty, supra, at 143. I agree. At paragraph 52 of the reasons in Gordon Capital, supra, Iacobucci and Bastarache JJ. stated:

> The only limitation placed upon enforcing the contract as written .... would be to refuse to enforce an exclusion of liability in circumstances where to do so would be unconscionable, according to Dickson C.J., or unfair, unreasonable or otherwise contrary to public policy, according to Wilson J.

36 With this framework for contractual interpretation in mind, I will now turn to the agreements in issue with a view to determining whether the paragraphs in issue apply to the oral agreement.

ii.) Does the Tripartite Oral Agreement Conflict with the Wording of the Exclusion Clauses in the Franchise Agreement?

37 Paragraph 3B of the agreement requires the franchise owner to pay a continuing royalty - amounting to six percent of all monthly gross sales - for the use of the franchisor's on-going assistance, trademarks and know-how. Regardless of whether Shelanu operated as one franchise or as two, it had to pay Print Three six percent of all monthly gross sales. It was in relation to the royalty rebate provided for in the agreement that the dispute arose. In this regard the wording of the agreement is again instructive. Paragraph 3C states that the rebate on quarterly gross sales from $81,501 to 135,850 is 33 and 1/3%. On sales between $135,851 and $190,190, the rebate is 66 and 2/3%, and on sales over $190,191 it is 100%. The next relevant sentence is:

> The foregoing royalty rebate calculation assumes Franchise Owner has just one (1) location.
>
> If the franchisee has two locations, gross sales must attain $163,001 before the rebate of 33 1/3% of gross sales is payable [emphasis added].

38 Paragraph 5 requires the franchise owner to operate only at the location specified in the agreement. The address indicated for Shelanu's approved location is 60 Bloor Street West, Toronto, Ontario. With respect to Shelanu's franchise agreement, nothing changed in January 1995; it was operating as a single franchise out of a single location, namely 60 Bloor Street West. Consistent with the oral agreement reached with Jack Banks on January 13, 1995, BCD had cancelled its franchise with Print Three. BCD effectively merged with Shelanu; however, Shelanu's franchise did not change. It continued to operate as a single franchise under the terms of the franchise agreement. The oral agreement reached was not inconsistent with paragraph 5.

39 I will now consider whether the paragraphs in issue are inconsistent with the alleged oral agreement.

40 Paragraph 20 states:

> No delay or omission to exercise a right, power or remedy accruing to one party on any breach or default of this Agreement shall be construed as a waiver of such right, power or remedy of said party nor will it prevent Franchisor from thereafter enforcing strict compliance with any and all of the terms and conditions herein set forth.

41 The words "right, power or remedy" are not used in a vacuum but relate to "any breach or default of this Agreement". Paragraph 20 has no application because Shelanu was not in breach of its agreement and because paragraph 20 does not apply to the three party oral agreement that was reached. It applies only to "this Agreement", that is, the written franchise agreement between Print Three and Shelanu.

42 The appellant also relies on paragraphs 26 and 27 of the franchise agreement between Shelanu and Print Three. Paragraph 26 is as follows:

> No waiver, amendment or change of any of the terms or covenants of this Agreement or non-compliance therewith, shall be binding or effective unless effected by a notice signed by any and all parties hereto. The Franchise Owner shall execute such further and other documents, including, without limitation a registered user agreement in respect of the Mark, as may be required from time to time, by the franchisor, to carry out the full intent and purpose of this Agreement.

43 Again the words, "waiver amendment or change" are not used in a vacuum. They are tied to "any of the terms or covenants of this Agreement". Shelanu owned one franchise and there was no change in its obligations relating to the terms or covenants of that agreement. This is indirectly acknowledged in paragraph 36 of the appellant's factum which states, "Nothing about Print Three observing or not observing the January 13, 1995 Agreement could be a breach of Shelanu's Franchise Agreement".

44 The oral agreement would only be enforceable if it was valid and binding on all three parties, including BCD. BCD's written franchise agreement with Print Three contained the same wording as Shelanu's. In considering the enforceability of the tri-partite agreement I will also therefore consider whether the exclusion paragraphs applied to BCD. Paragraph 20 of the written agreement between BCD and Print Three also applies only to the two parties and would not apply to the three party oral agreement that was reached. I turn now to consider whether, as against BCD, the words, "waiver, amendment or change" in paragraph 26 would apply. The surrender of the franchise was not a waiver or amendment to BCD's franchise agreement as both these words envisage the continuation of some aspect of the franchise agreement and not, as is the case here, its surrender and termination by agreement of the parties. As Cory J. held in Schmidt v. Air Products of Canada Ltd., [1994] 2 S.C.R. 611 at para. 66 in concluding that a power to amend a trust did not include the power to revoke it, "... amendment means change not cancellation which the word revocation connotes." Similarly, in this case, we are dealing with a revocation of a franchise licence, not an amendment or change to the licence. Further, in interpreting the Patent Act, R.S.C. 1985, c. P.4, in Harvard College v. Canada (Commissioner of Patents), [2002] S.C.J. No. 77, at para. 161, McLachlin C.J.C. on behalf of the majority, stated:

> It is a well-known principle of statutory interpretation that the meaning of questionable words or phrases in a statute may be ascertained by reference to the meaning of the words or phrases associated with them (P.-A. Côté, The Interpretation of Legislation in Canada (3rd ed. 2000), at pp. 313-14). Also, a collective term that completes an enumeration is often restricted to the same genus as those words, even though the collective term may ordinarily have a much broader meaning (at p. 315).

45 The principles which govern the interpretation of contracts are essentially the same as for statutory interpretation: River Wear Commissioners v. Adamson (1877), 2 App. Cos. 743 (H.L.) at 763-765 adopted by L'Heureux-Dubé J. in dissent but not on this point in Manulife Bank of Canada v. Conlin, [1996] 3 S.C.R. 415 at para. 40 and also Manitoba (Hydro-Electric Board) v. John Ziglio Co., [1999] M.J. No. 506 (C.A.). Applying these principles of interpretation to the phrase, "waiver, amendment or change" in this case, the word change would be construed as including a change that would nevertheless result in the continuation of the agreement not, as here, its revocation and termination. The paragraph does not contemplate what occurred pursuant to the oral agreement, namely, a surrender and revocation of the franchise for 239 Bloor Street East by mutual agreement. Paragraph 26 in BCD's agreement does not conflict with the oral agreement.

46 Paragraph 27 of the agreement reads as follows:

> This agreement constitutes the entire Agreement between the parties with respect to all of the matters herein and its execution has not been induced by, nor do any of the parties hereto rely upon or regard as material, any representation or right not incorporated herein. Any representations, inducements, promises, and agreements, oral or otherwise not contained herein shall have no force or effect in the construction of the rights and obligations of the parties created by this Agreement.

47 Paragraph 27 deals "with ... all of the matters herein" and states that any oral or other representations have no force or effect in the "construction of the rights and obligations of the parties created by this Agreement". The rights and obligations of the parties to the oral agreement, namely, BCD, Shelanu and Print Three are, as I have said, not "matters herein" and were not "created" by the franchise agreement between Shelanu and Print Three or, for that matter, BCD and Print Three.

48 Further, the ordinary meaning of the language used in paragraph 27 is that the written agreement represented the entire agreement between the parties at the time it was signed. J. Beatson, in Anson's Law of Contract, 27th ed. (Oxford: Oxford University Press, 1998) at 494-95 states:

> A simple contract, ... whether in writing or not, may be varied by a subsequent agreement either written or oral. This in no way conflicts with the rule that extrinsic evidence is not admissible to vary or add to the contents of the written document, for that principle merely refers to the ascertainment of the *original* intention of the parties [emphasis added].

49 Indeed, an exception to the parol evidence rule is the existence of any subsequent oral agreement to rescind or modify a written contract provided that the agreement is not invalid under the Statute of Frauds: Ellis v. Abell, [1884] O.J. No. 70, 10 O.A.R. 226 at para. 85.

50 Clauses such as the entire agreement clause in issue here are normally used to try to exclude representations made prior to the signing of the written agreement. See P.M. Perell, "A Riddle Inside an Enigma: The Entire Agreement Clause" (1998) The Advocates' Q. 287. Nothing in paragraph 27 suggests that an oral agreement to surrender the franchise several years later would be of no effect. It cannot be said the entire agreement clause was clearly intended to cover any and all future contractual relations between Shelanu and Print Three. See Turner v. Visscher Holdings, [1996] B.C.J. No. 998 (B.C.C.A.). The fact that Print Three and Shelanu entered into and acted upon an oral agreement respecting the surrender of the franchise at 200 Bloor Street West indicates this was not the case. Indeed, J.M. Perillo, ed., Corbin on Contracts (St. Paul, MN: Western Publishing Co., 1993) states at para. 1295 that an express provision in a written contract forbidding oral variation of the terms of a contract or its discharge is generally unsuccessful with respect to

subsequent agreements. The reason he gives is that:

> Two contractors cannot by mutual agreement limit their power to control their legal relations by future mutual agreement. Nor can they in this manner prescribe new rules of evidence and procedure in the proof of facts and events.

51 Paragraph 27 has no application either.

52 The wording of the exclusion paragraphs does not conflict with the subsequent tri-partite oral agreement of January 13, 1995 and does not prevent effect being given to this oral agreement.

(iii) Discretion not to enforce the exclusion clauses

53 In view of my conclusion above it is not strictly necessary for me to address the enforceability of the exclusion clauses. However, given the trial judge's conclusion and the extent of argument on the question of whether he erred in refusing to give effect to the clauses, I will consider this issue.

54 At the trial, the existence of the oral agreement and thus the intention of the parties was in issue. The trial judge relied on the parties' subsequent course of conduct to infer that they did not intend to continue to be bound by the exclusion clauses in the agreement. The trial judge found that Print Three had orally agreed to the surrender of a franchise by Shelanu on a previous occasion, and had allowed Shelanu to change locations and to lease space directly without anything being in writing. Where the parties have, by their subsequent course of conduct, amended the written agreement so that it no longer represents the intention of the parties, the court will refuse to enforce the written agreement. This is so even in the face of a clause requiring changes to the agreement to be in writing. See Colautti Construction Ltd. v. City of Ottawa (1984), 9 D.L.R. (4th) 265 (Ont. C.A.), per Cory J.A.

55 On appeal, the appellant has conceded the existence of the oral agreement and its terms but asks this court to enforce the written agreement instead. That submission, in effect, asks this court not to give effect to the intention of the parties. Such a submission is contrary to the classical theory of contract interpretation which emphasizes that courts should ascertain and give effect to the intention of the parties: R. Sullivan, "Contract Interpretation in Practice and Theory" (2000), 13 S.C.L.R. (2d) 369.

56 Sullivan states, at 378, that, "if a conflict arises between the intention of the parties as inferred from the totality of the evidence on the one hand and the meaning of the text on the other, intention should win." Professor Waddams has also argued that if a party knows or has reason to know that a written contract on which that party relies does not represent the intention of the other party, it should not be enforced. See S.M. Waddams, The Law of Contracts, 3rd ed. (Toronto: Canada Law Book, 1993) at paras. 328-329.

57 The rationale of Sullivan and Waddams is similar, namely, that in addition to certainty, legal

values such as fairness, equity and justice underlie contractual interpretation and enforcement. Before the court allows the coercive power of the state to be used to serve the private interests of a party to a contract, the court will want to ensure that the contract does not offend these legal values.

58 I would also note that the agreement that we are dealing with is a franchise agreement. A franchise agreement is a type of contract of adhesion, that is, a type of contract whose main provisions are presented on a "take it or leave it basis". In such situations, the case for holding that an exclusion clause represents the intention of the signer and that the signer should be bound by it is weaker because there is usually an inherent inequality of bargaining power between the parties. See Waddams, supra, at para. 342. Examples of cases involving contracts of adhesion where this Court has refused to apply an exclusion clause because it did not accord with the intention or reasonable expectations of the parties include: Beer v. Townsgate I, supra, Solway v. Davis Moving & Storage Inc. (c.o.b. Kennedy Moving Systems), [2002] O.J. No. 4760 (C.A.) at para. 21 and Zurich Insurance Company v. 686234 Ontario Ltd., [2002] O.J. No. 4496 (C.A.). See also Mellco Developments Ltd. v. Portage la Prairie (City), [2002] M.J. No. 381 (C.A.).

59 Enforcing an exclusion clause that is contrary to the reasonable expectation and understanding of the parties in these circumstances would not be fair or reasonable and would also come within the exception enunciated in Gordon Capital, supra.

60 I would hold that even if the exclusion clauses applied, the trial judge was entitled to refuse to enforce paragraphs 20, 26, and 27 of the agreement.

(iv) Consideration

61 I also agree with the trial judge's conclusion that there was consideration for the oral agreement. BCD provided consideration by giving up its territory. Shelanu provided consideration by promising to report the joint earnings of itself and BCD, thereby agreeing to pay the six per cent royalty on higher sales. Rather than having two franchises that were in financial difficulty, Print Three gained the benefit of one healthy franchise and the peace of mind and greater financial certainty of royalties in difficult economic times that brought. The consideration from Print Three was its promise to allow Shelanu to merge BCD's sales with its sales and to report them as one.

62 For these reasons, I would hold that the trial judge did not err in finding that Shelanu was entitled to enforce the three-party oral agreement against Print Three. Print Three breached its obligation to pay Shelanu the royalty rebate in accordance with the oral agreement and, therefore, is liable for damages as found by the trial judge.

2. The Duty of Good Faith and Fiduciary Duty

63 The trial judge found that the appellant owed the respondent a duty of good faith either under The Arthur Wishart Act, supra, or at common law. Having regard to my conclusions regarding good faith, set out below, it is unnecessary to decide whether the Arthur Wishart Act, which applies to

existing franchises, is applicable in this case where the acts in issue took place prior to the coming into force of the Act.

A. Circumstances Giving Rise to a Duty of Good Faith

64 In Wallace v. United Grain Growers Ltd. (c.o.b. Public Press), [1997] 3 S.C.R. 701, the majority of the Supreme Court was prepared to recognize a good faith obligation in employment contracts. Indeed, at paras. 91-95, Iacobucci J. held that contracts of employment have unique characteristics that set them apart from ordinary commercial contracts. He described three special characteristics of employment contracts: 1) the formation of the contract is not the result of the exercise of bargaining power between two equals; 2) the person in the weaker position is unable to achieve more favourable contractual terms because of, for example, that person's inability to access information; 3) the power imbalance continues to affect other facets of the relationship after the contract has been entered into.

65 In some instances a duty of good faith may arise ordinarily out of the nature of the relationship, or the circumstances created by the other party: see 978011 Ontario Ltd. v. Cornell Engineering Co. (2001), 53 O.R. (3d) 783 (C.A.) at para. 35.

66 The relative position of the parties as outlined by Iacobucci J. in Wallace also exists in the typical franchisor-franchisee relationship. First, it is unusual for a franchisee to be in the position of being equal in bargaining power to the franchisor: See Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc. (1998), 114 O.A.C. 357 (C.A.), per Goudge J.A. at para 16; Machias v. Mr. Submarine Ltd., [2002] O.J. No. 1261 (S.C.J.) at para. 109. The second characteristic, inability to negotiate more favourable terms, is met by the fact that a franchise agreement is a contract of adhesion. As I have indicated, a contract of adhesion is a contract in which the essential clauses were not freely negotiated but were drawn up by one of the parties on its behalf and imposed on the other. Further, insofar as access to information is concerned, the franchisee is dependent on the franchisor for information about the franchise, its location and projected cash flow, and is typically required to take a training program devised by the franchisor. The third characteristic, namely that the relationship continues to be affected by the power imbalance, is also met by the fact the franchisee is required to submit to inspections of its premises and audits of its books on demand, to comply with operation bulletins, and, often is dependent on, or required to buy, equipment or product from the franchisor. It is hardly surprising, therefore, that a number of courts, including the Manitoba Court of Appeal in Imasco Retail Inc. (c.o.b. Shoppers Drug Mart) v. Blanaru, [1995] 9 W.W.R. 44 (Man. Q.B.), aff'd, [1997] 2 W.W.R. 295 (C.A.) have recognized that a duty of good faith exists at common law in the context of a franchisor-franchisee relationship.

B. Whether the trial judge held Print Three to a fiduciary duty

67 The appellant submits that the trial judge held Print Three to a higher standard than that imposed by the duty of good faith, namely, the duty of a fiduciary. The appellant's submission that

the trial judge applied a fiduciary standard to Print Three rests on the trial judge's comment that the relationship of franchisor to franchisee is akin to a partnership. The appellant states partners owe each other a fiduciary duty and that this is the standard that he applied to Print Three's relationship with Shelanu.

68 The imposition of a duty of good faith and a fiduciary duty are closely related. As stated in Cornell, supra at para. 33 they, along with the standard of unconscionability:

> [a]re points on a continuum in which the law acknowledges a limitation on the principle of self-reliance and imposes an obligation to respect the interests of the other. They are defined by P. Finn, "The Fiduciary Principle" in T. Youdan, ed., Equity, Fiduciaries and Trusts, (1989), 1 at 4 as follows:
>
>> "Unconscionability" accepts that one party is entitled as of course to act self-interestedly in his actions towards the other. Yet in deference to that other's interests, it then proscribes excessively self-interested or exploitative conduct. "Good faith," while permitting a party to act self-interestedly, nonetheless qualifies this by positively requiring that party, in his decision and action, to have regard to the legitimate interests therein of the other. The "fiduciary" standard for its part enjoins one party to act in the interests of the other -- to act selflessly and with undivided loyalty. There is, in other words, a progression from the first to the third: from selfish behaviour to selfless behaviour. Much the most contentious of the trio is the second, "good faith." It often goes unacknowledged. It does embody characteristics to be found in the other two [footnotes omitted].

69 There is at least one important difference between the duty of good faith and a fiduciary duty. If, for example, A owes a fiduciary duty to B, A must act only in accordance with B's interests when A exercises its powers or exercises a discretion arising out of the relationship: see York Condominium Corp. No. 167 et al. v. Newrey Holdings Ltd. et al. (1981), 122 D.L.R. (3d) 280 (Ont. C.A.) at 289, leave to appeal to the Supreme Court of Canada refused [1981] 1 S.C.R. xi; Hodgkinson v. Simms, [1994] 3 S.C.R. 377. If, on the other hand, A owes a duty of good faith to B, A must give consideration to B's interests as well as to its own interests before exercising its power. Thus, if A owes a duty of good faith to B, so long as A deals honestly and reasonably with B, B's interests are not necessarily paramount: see for example Mason v. Freedman, [1958] S.C.R. 483.

70 The trial judge recognized that the relationship between a franchisor and a franchisee would not normally be characterized as a fiduciary one in accordance with Jirna Ltd. v. Mister Donut of Canada Ltd., [1972] 1 O.R. 251 (C.A.), aff'd, [1975] 1 S.C.R. 2. I do not agree that it logically follows from the trial judge's reference to partners that he applied the fiduciary standard in this case. At a later point in his reasons, the trial judge reiterated that a franchise relationship was akin to that

of a partnership and, accordingly, like a partnership required mutual respect. He quoted from the decision of Kelly J. in Gateway Realty Ltd. v. Arton Holdings Ltd. (1991), 106 N.S.R. (2d) 180 (Sup. Ct.) at 191-192, aff'd (1992), 112 N.S.R. (2d) 180 (C.A.), to the effect that parties to a contract are required to exercise their rights under that agreement honestly, fairly, and in good faith, and that, when a party acts contrary to community standards of honesty and reasonableness or fairness, he acts in bad faith. The trial judge well knew the distinction between a duty of good faith and a fiduciary duty and did not hold Print Three to a fiduciary duty.

71 Moreover, the fact that contractual terms are ultimately complied with, does not mean that there has been no breach of the duty of good faith.

C. Breaches of Print Three's obligations as found by the trial judge

72 The trial judge found that Print Three breached its duty of good faith towards Shelanu in four respects. The specific breaches found by the trial judge are:

* Print Three's attempts to rescind the May 1995 agreement were not only a breach of that agreement but, in the circumstances, evinced a lack of good faith dealing by the franchisor;
* Print Three unilaterally changed the terms and conditions upon which the franchisees agreed to participate in the Air Miles program, and in so doing, breached the representations made and acted upon by Shelanu;
* Print Three failed to make prompt payment of several royalty rebates and its refusal to pay a royalty rebate for the fourth quarter of 1996; and
* Print Three's establishment of the Le Print Express system, "not only would but did take work and customers from existing Print Three franchises." As a consequence he held that, "... the establishment of such an enterprise by the very person who owned and controlled the defendant was fundamentally at odds with the defendant's obligations, including the obligation to deal in good faith, to its franchisees."

73 In relation to the first three breaches, the trial judge awarded damages for breach of contract. He did not award separate damages for breach of the duty of good faith. No damages were awarded for the establishment of the Le Print Express franchise. The breaches, including his finding respecting the establishment of the Le Print Express franchise, led the trial judge to conclude that Print Three did not intend to honour or be bound by the commitments it had made to its franchisees and that, as a result, Shelanu should be discharged from any further obligation under the contract.

74 Whether or not a party under a duty of good faith has breached that duty will depend on all the circumstances of the case, including whether the party subject to a duty of good faith conducted itself fairly throughout the process. See by analogy: 702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters (2000), 184 D.L.R. (4th) 687 (Ont. C.A.), per O'Connor J.A., at paras. 28-37 leave to appeal to Supreme Court of Canada dismissed, [2000] S.C.C.A No. 258. See also the

decision of Laskin J.A. in the Court of Appeal in Whiten v. Pilot Insurance Co. (1999), 170 D.L.R. (4th) 280 in dissent, aff'd, [2002] S.C.J. No. 19.

3. Breaches of Print Three's Obligations to Shelanu

A. Royalty Rebates

i.) Refusal to recognize the 1995 oral agreement

75 I have already dealt with the facts and findings of the trial judge in relation to the 1995 oral agreement and have held that Print Three breached that agreement.

76 Where a duty of good faith exists, not every breach of contract will be a breach of the duty of good faith. An honest disagreement concerning the interpretation of a franchise agreement ultimately decided in favour of the franchisee could be a breach of contract but need not be a breach of the duty of good faith owed by the franchisor. Denial of payment under an agreement should not, however, be made in order to gain leverage or bargaining advantage in a dispute with the other party or out of vindictiveness. In this case the evidence indicates that Print Three's refusal to pay Shelanu the royalty rebate pursuant to the oral agreement was linked to Banks' anger concerning Shelanu's position respecting the Air Miles advertising program. There was evidence upon which the trial judge could hold that the refusal to recognize the 1995 oral agreement was also a breach of the duty of good faith.

ii.) Delay in payment of undisputed royalty rebates

77 Print Three withheld all royalty rebates payable to Shelanu for the third and fourth quarters of 1995 (July to September 1995 and October to December 1995). All royalty rebates for April to June 1996 were also withheld but that portion about which there was no dispute was paid when Bob Davis met with Shelanu in October 1996. Similarly, the rebates for 1995 were paid in September. No explanation was given for the delay in paying that portion of the royalty rebate about which there was no dispute. The trial judge found Print Three acted arbitrarily in withholding payment of the royalty rebates. I agree Print Three had no reasonable basis for refusing to pay the royalty rebates that were not in dispute.

78 The fact that the royalty rebates were ultimately paid does not mean that Print Three did not breach its obligations towards Shelanu. The duty of good faith comprises a time component. That time component requires the party under a duty of good faith to respond promptly to a request from the other party and to make a decision within a reasonable time of receiving that request. Parties under a duty of good faith also have an obligation to make payment of any amounts that are clearly owed to the other party in a timely manner: 702535 Ontario Inc. v. Lloyd's London, supra.

iii.) Disputed royalty rebate because of refusal to allow inspection

79 Print Three submits that the royalty rebate for the fourth quarter of 1996 was never paid because the Deslauriers refused to allow Davis to inspect the production facility at 60 Bloor Street West. Brian Deslauriers testified that he did not take Davis' request seriously because the stated purpose of the meeting on October 3, 1996 was to discuss the 1995 agreement and he wished to get on with that discussion. The royalty rebate for the fourth quarter of 1996 remained outstanding at the commencement of trial.

80 The trial judge found that, on a strict reading of the franchise agreement, Davis was entitled to conduct an inspection but that, in view of Print Three's past practice of not enforcing the strict terms of the franchise agreement, Shelanu was entitled to some form of notification that Print Three intended to strictly enforce its rights under the agreement and that, in any event, Print Three could not withhold the royalty rebate once Shelanu made it clear Davis could inspect the production facility. The respondent submits that the trial judge erred in ordering that a royalty rebate be paid for this period. I would uphold the trial judge's conclusion that the rebate is payable based on a different analysis of the franchise agreement.

81 A franchisee is only entitled to receive a royalty rebate according to paragraph 3C of the franchise agreement: "if he or she has fully complied with all the terms and conditions of this agreement during the pertinent time period."

82 Paragraph 3C defines what constitutes full compliance with the agreement It stipulates that "[i]n addition to other provisions of this agreement", "full compliance means timely submission of provincial sales tax returns, timely payment of advertising fees, royalties, other amounts owing to the franchisor or amounts guaranteed by the franchisor to third parties." The phrase, "other provisions of this agreement" is vague and ambiguous. The terms specified all have a financial component. It makes commercial sense that Print Three would not grant Shelanu a rebate if Shelanu were in default of money owing to it for which it could be responsible to pay; this is the main thrust of the provision.

83 Paragraph 5G of the franchise agreement states that the Franchisee shall permit the franchisor to enter on the premises to conduct:

> [a] compliance audit to determine whether Franchise Owner is abiding by the terms of this Agreement and conforming to standards of operation as may have been otherwise detailed in the Operations Manuals, Technical Bulletins or other publications supplied by Franchisor. Franchisor may advise Franchise Owner in writing regarding any deficiencies in Franchise Owner's compliance with Franchisor's standards. Franchise Owner shall have thirty (30) days to cure such deficiencies from the date such written notice is received by Franchise Owner.

84 On the other hand, paragraph 7B states that the franchisee shall permit the franchisor to enter

the premises:

> [i]n order to inspect and audit all aspects of Franchise Owner's business including, but not limited to: books, records, facilities, business equipment, materials and any other matters relating to Franchise Owner's obligations set out in this Agreement.

85 Thus the right to inspect is contained in both paragraph 5G and 7B. Paragraph 5G envisages a compliance audit with respect to standards of operation and gives a franchisee 30 days in which to cure a "deficiency". The term "breach" is not used. The word "deficient" is defined in Webster's Dictionary, 1989 ed., as "inadequate". A franchisee could be in compliance with its franchise agreement but still have inadequacies in its operation that the franchisor wanted corrected. Provided the deficiency was corrected within 30 days the franchisee would be in compliance with the agreement. Paragraph 7B contains similar wording but envisages a financial audit and contains no time component.

86 There is no evidence to suggest that Davis wished to conduct a financial audit or, indeed, an audit of any kind. He simply stated he wished to inspect the premises. In any event, upon receiving written notice from Print Three, Shelanu promptly offered to remedy the situation. The inspection had no financial impact and none of the specific requirements defined as "full compliance" was breached. In these circumstances, Shelanu's refusal did not affect its right to a royalty rebate and Print Three could not refuse to pay it.

87 I would not have considered the dispute with respect to this single payment to be a breach of Print Three's duty of good faith, in and of itself.

88 Shelanu is entitled to the payment of the disputed royalty rebates.

B. Air Miles

i.) Facts and finding of the trial judge

89 The franchise agreement provided that franchisees were to pay an annual three per cent advertising fee to Print Three. The relevant portion of paragraph 9 respecting advertising states:

> Due to the inherent importance and value of advertising and the need for standardization and promotion of the Print Three public image and program, the Franchise Owner agrees to pay to Franchisor an advertising fee of THREE PERCENT (3%) of each month's gross sales. Such payment is due by the tenth (10th) day of the month following the month for which the gross sales were made. The advertising fees paid directly to the Franchisor are intended to reasonably compensate Franchisor for the actual cost of advertising and

> promotional campaigns; provide reasonable and adequate compensation for Franchisor's personnel engaged in the preparation, purchase and arrangement of advertising activities; and to reimburse Franchisor for any fees paid to advertising and other organizations. Franchisor shall have complete discretion to use such advertising funds in such ways as it feels will best promote the products and services offered by the franchise system.

90 Following a vote by the franchisees, the advertising fee was suspended between 1991 and 1994, primarily because of the recession. In November 1994, at the franchisees' convention, a vote was held on whether to reintroduce the fee and whether to enter into the Air Miles program. The trial judge found that, without the vote, the franchisees could be obligated to pay the fee and the vote was really about whether to embark on the Air Miles program or some other advertising program. Print Three represented that, "the entire three percent advertising fee had to go to the Air Miles program in order for Print Three to qualify to be part of that program". Based on the documents presented in evidence, the trial judge found that that representation was false. The misrepresentation was important because one of the reasons the franchisees were reluctant to participate in the program was that it would consume all of the advertising fees.

91 A second reason that some franchisees, including the Deslauriers, were opposed to participating in the Air Miles program was because it was apparent to them that, although all of the advertising fees went into the program, not all of the benefits of that program would be capable of being used for the franchisees' business. The trial judge found that in order to get over the franchisees' opposition to the Air Miles program, Print Three represented to the franchisees that any air miles purchased under the program, and not distributed by the franchisees to their customers, could be used by the franchisees for their own purposes including personal travel. Both Print Three's letter dated May 2, 1995 and the operations manual for the program support the trial judge's finding in this regard.

92 Shortly after the Air Miles program began, however, Print Three changed these arrangements and directed that all undistributed Air Miles for each outlet could only be used with its approval. The unused Air Miles were placed in accounts in the personal names of certain of its employees. The trial judge found that this unilateral change was a clear breach of the representations made to the franchisees. He held that Shelanu was entitled to damages equivalent to the value of the undistributed Air Miles earned by its franchise to the end of the program.

ii.) Argument and analysis

93 The appellant submits that any representations respecting unused Air Miles were not in writing and signed by the parties and, therefore, cannot be enforced because they amounted to an amendment of the franchise agreement that was not in writing and signed by the parties as required by that agreement. Further, Print Three submits that it had an absolute discretion respecting the use of the advertising funds and any use of unused Air Miles and thus, the fact it did not abide by its

representations is of no consequence. Finally, the appellant also asserts that the representations were "gratuitous offers to Shelanu regarding advertising which were more advantageous than the terms of the Franchise Agreement".

94 I have already indicated that parties to a written agreement may subsequently enter into a new oral agreement. I have also indicated that courts will refuse to enforce a written agreement requiring that amendments be in writing where that clause no longer represents the intention of the parties. (See paras. 54 and following). With respect to the Air Miles program, the parties agreed to an oral amendment of the agreement respecting advertising fees and their subsequent conduct is indicative that the oral agreement was performed in part. The trial judge clearly found that not all of the money collected was used for the Air Miles program - the only advertising undertaken - and this finding is supported by the evidence.

95 The appellant's submission that Print Three possessed an absolute discretion with respect to the use of advertising funds ignores paragraph 9 of the franchise agreement which stipulates that the three percent advertising fee is to compensate Print Three "for the *actual cost* of advertising and promotional campaigns" [emphasis added], to provide reasonable compensation to its employees in preparing and purchasing advertising activities, and to reimburse the franchisor for advertising fees paid. Furthermore, nothing in paragraph 9 gives Print Three the right to use Shelanu's three percent advertising fees for non-advertising related or personal purposes as happened here. Paragraph 26 of the agreement respecting amendments being in writing has nothing to do with excusing breaches of the agreement.

96 Even if paragraph 9 is only a statement of intent and Print Three had an absolute discretion with respect to the use of the Air Miles, Print Three could not exercise that discretion without regard to Shelanu's interests; it was obliged to exercise the discretion in a reasonable manner. See J.D. McCamus, "The Duty of Good Faith Contractual Performance" (N.J.I.: Civil Law Seminar, Contract Law: From Form to Remedies, Osgoode Hall Law School, 17 May 2000). Professor McCamus is of the opinion that under ordinary contract principles, a party has an obligation to act reasonably in exercising a discretionary power. Applying this principle, he says the same result could have been reached in cases recognizing the existence of a duty of good faith in the execution of a contract such as Mason v. Freedman, [1958] S.C.R. 483 at 486; Greenberg v. Meffert (1985), 18 D.L.R. (4th) 548 (Ont. C.A.), leave to appeal to the Supreme Court of Canada dismissed (1985), 30 D.L.R. (4th) 768; Le Mesurier et al. v. Andrus (1986), 25 D.L.R. (4th) 424 (Ont. C.A.); and Gateway Realty Ltd. v. Arton Holdings Ltd., supra. In Greenberg v. Meffert et al., supra, where a breach of a duty of good faith was found, this court held that the words "at the sole discretion", in relation to payment of commission by a real estate company to its real estate agent after termination of the relationship meant that the company, "must act reasonably in exercising its discretion, and also honestly and in good faith." Those standards not having been attained, the agent was entitled to his commission. Here, the trial judge found Print Three acted arbitrarily and unreasonably and not in conformity with the standards for exercising a discretion. On the evidence, it was open to him to make this finding.

97 Lastly, the misrepresentations were not a gratuitous offer. The consideration for the agreement to credit unused air miles was that Shelanu entered into the Air Miles program as opposed to some other advertising program.

98 As found by the trial judge, Shelanu is entitled to the cash value of the unused Air Miles.

C. Le Print Express

i.) Facts and finding of the trial judge

99 Around October 1990, the appellant set up a business initially known as Print Three Express that subsequently became known as Le Print Express. The trial judge found that these outlets were to be smaller than Print Three franchises in order to target individuals and small businesses. The cost to purchase these franchises was lower than the cost to purchase a Print Three franchise and some financing was also offered to potential Le Print Express franchisees. Shelanu complained that the establishment of the Le Print Express concept involved the franchisor in a business that competed with existing Print Three franchises. Brian Deslauriers testified that Le Print Express offered the same kinds of products and services that were, to a large extent, offered by Print Three. In support of his evidence he produced a flyer from the Le Print Express at the Eaton Centre that had been faxed to Shelanu. He further testified that contrary to his understanding that the Le Print Express operations were to be small, occupying 200 square feet, the Eaton operation was three to four times this size and had the same kind of equipment and capabilities as Shelanu. The same personnel and staff who operated and marketed Print Three franchises also handled the requirements of the new franchise. The trial judge held:

> It seems to me to be intrinsically troublesome for a franchisor to develop a concept for a new franchise operation that will operate in competition with its existing franchise operation. Even though Le Print Express franchisees were directed at a specific segment of the industry, I am satisfied that they not only would, but did, take work and customers from existing Print Three franchisees. As a consequence, in my view, the establishment of such an enterprise by the very person who owned and controlled the defendant was fundamentally at odds with the defendant's obligations, including the obligation to deal in good faith, to its franchisees. The defendant could not properly and fairly institute this new concept without at least obtaining the agreement of the existing Print Three franchisees to this crucial change to their contractual relationship which, of course, the defendant made no attempt to do. The establishment of the Le Print Express franchises fundamentally altered the nature of the Print Three franchise network and impacted directly on the business environment in which the Print Three franchisees operated.

ii.) Argument and analysis

100 The appellant challenges the trial judge's finding of fact that Le Print Express competed with Shelanu's business as well as his conclusion that the establishment of this business took work and customers from Print Three franchisees and Shelanu in particular. The appellant emphasizes that, while there may have been some overlap of services, Le Print Express was in a different business sector than Print Three.

101 In Housen v. Nikolaisen, [2002] S.C.J. No. 31, the Supreme Court held, at para. 10, that "[t]he standard of review for findings of fact is that such findings are not to be reversed unless it can be established that the trial judge made a palpable and overriding error'" [citations omitted]. This deferential standard is also applicable to appellate review of inferences of fact: see Housen, supra at para. 25.

102 The franchise agreement is silent as to whether the franchisor can engage in a similar business during the term of the agreement.[1] Print Three did, however, agree not to take any action that would be likely to injure the goodwill or reputation associated with the Print Three trademark, logo or mark.

103 Print Three targeted corporate accounts, whereas Le Print Express did small copying jobs for individuals and small businesses. None of the Le Print Express franchises was established within Shelanu's exclusive territory; the three Le Print Express locations were the Eaton Centre, Union Station, and Scotia Bank Plaza. Shelanu did not complain about Le Print Express for almost seven years after it was established and Shelanu presented no evidence that it lost income as a result of competition from Le Print Express. The trial judge's reasons do not address these considerations.

104 The trial judge also rejected a number of Shelanu's submissions that would have affected its claim respecting Le Print Express. Shelanu's statement of claim claimed damages for misrepresentation on the basis that the franchise agreement contained representations that Print Three was an expanding organization; it had a commitment to continue to introduce leading edge technologies and systems in document reproduction technology; it would continue to develop the credibility and presence of the Print Three name and logo; and it would continue to improve and modify the know-how it had developed. The trial judge held that the failure of these representations to materialize were not breaches of the franchise agreement but goals that had not been achieved. In other words, they were not representations of fact.

105 On the issue of technology, the trial judge described the contribution of Print Three as the bare minimum a franchisee ought to expect in return for royalty payments and held that "... in the end result, I am not satisfied on the evidence that the failures of the defendant [Print Three] on this issue were so great as to constitute a breach of its obligations under the franchise agreement." The trial judge noted that the evidence in this case was like that in Khagen Investments Ltd. v. 710497 Ontario Ltd., [1999] O.J. No. 2152 (S.C.J.), in that there was no evidence as to the standard of service given to other franchisees or whether provision of the same level of service to other

franchisees resulted in their failure. He held that these issues could not justify Shelanu's position that it was entitled to treat the franchise agreement at an end as of May 8, 1997.

106 Brian Deslauriers testified that the number of Print Three franchises declined after Le Print Express was created. The trial judge held that, on balance, the reduction in the number of Print Three franchises was largely the result of prevailing economic conditions. By implication, therefore, the establishment of Le Print Express did not contribute to the decline in the number of Print Three franchises.

107 I would, therefore, hold that the appellant has met the high standard required to overturn a trial judge's finding of fact that Le Print Express competed with Shelanu and took business from it. My reasons for doing so may be summarized as follows: 1) the different nature of the business engaged in by Le Print Express; 2) Shelanu's delay in complaining about the establishment of that business; 3) the lack of evidence before the trial judge as to Shelanu's consequential loss of income; 4) the trial judge's findings that there had been no misrepresentation concerning what Print Three was to provide in exchange for royalty payments and that Print Three had done the minimum required to discharge those obligations; and 5) the trial judge's finding that the decline in Print Three franchises was primarily due to prevailing economic conditions. The finding that Print Three breached "reasonable commercial standards" must also fail for the same reasons.

108 Inasmuch as I have not upheld the trial judge's finding of fact in respect of Le Print Express, I would not uphold his conclusion that the establishment of Le Print Express was a breach of Print Three's duty of good faith.

4. Fundamental Breach

A. The findings of the trial judge

109 The trial judge concluded that the various failings and breaches of the franchise agreement by Print Three constituted a fundamental breach of the franchise agreement. The trial judge further held Shelanu was entitled to terminate the franchise agreement because the breaches

> [a]lso reveal an attitude of the defendant generally toward this franchisee, at least, and toward its obligations under the franchise agreement which demonstrates an intention by the defendant that it was not going to be bound by, nor honour, its obligations under the franchise agreement unless it suited its purpose to do so.

B. The standard of review and analysis

110 A trial judge's finding of fundamental breach is a matter of mixed fact and law. This is

because it is a question "about whether the facts satisfy the legal tests": Housen, supra, at para. 26 citing Canada (Director of Investigation and Research) v. Southam Inc., [1997] 1 S.C.R. 748 at para. 55. The appropriate standard of review is dependent on where the error lies. As stated by Iacobucci and Major JJ. at para. 36:

> Matters of mixed fact and law lie along a spectrum. Where, for instance, an error with respect to a finding of negligence can be attributed to the application of an incorrect standard, a failure to consider a required element of a legal test, or similar error in principle, such an error can be characterized as an error in law, subject to a standard of correctness. Appellate courts must be cautious, however, in finding that a trial judge erred in law in his or her determination of negligence, as it is often difficult to extricate the legal questions from the factual. It is for this reason that these matters are referred to as questions of "mixed law and fact". Where the legal principle is not readily extricable, then the matter is one of "mixed law and fact" and is subject to a more stringent standard. The general rule, as stated in Jaegli Enterprises, supra, is that, where the issue on appeal involves the trial judge's interpretation of the evidence as a whole, it should not be overturned absent palpable and overriding error.

Thus, as stated by Rosenberg J.A. in Algoma Steel Inc. v. Union Gas Ltd., [2003] O.J. No. 71 (C.A.) at para. 19, "where the issue concerns application of a legal standard to a set of facts the question is one of mixed fact and law and a somewhat less deferential standard may be appropriate, although not the standard of correctness required for questions of law."

111 In order to conclude that Print Three had committed a fundamental breach of its obligations to Shelanu, the trial judge relied on the evidence as a whole, requiring the application of the more stringent standard of review. At the same time, it must be borne in mind that I have not upheld the trial judge's finding that Print Three breached its duty of good faith to Shelanu by establishing the Le Print Express franchise. It is therefore necessary to consider whether the remaining breaches can support the trial judge's conclusion that there was a fundamental breach of the agreement. I am of the opinion that they cannot. As of the date Shelanu gave notice of termination of its obligations to Print Three, Print Three had abused its discretion respecting Air Miles, failed to make payment of the full royalty rebate based on there being a single franchise, delayed in making payment of royalty rebates admittedly due on three occasions, and refused to pay one royalty rebate allegedly based on Shelanu's breach of the franchise agreement for refusing to allow Davis to inspect its premises. The breaches respecting the Air Miles program and non-payment of royalty rebate were the subject of damages awarded by the trial judge.

112 It is also necessary to consider what appears to me to be a further palpable and overriding error on the part of the trial judge. This is the trial judge's failure to consider the fact that although Shelanu gave notice of termination of the agreement on May 8, 1997, it continued to use the name Print Three for a further two and a half years and continued to have an exclusive territory. Shelanu

was therefore able to carry on the commercial purpose of the agreement.

113 In Majdpour v. M & B Acquisition Corp (2001), 56 O.R. (3d) 481 (C.A.), the event alleged to have triggered a fundamental breach of the franchise agreement by the franchisor was a bankruptcy. Because the franchisee was able to carry on the commercial purpose of the agreement intact after the bankruptcy, MacPherson J.A. dismissed the franchisee's claim it was discharged from further performance. That reasoning is equally applicable in this case.

114 In dismissing the claim for fundamental breach, MacPherson J.A. noted that the test was a restrictive one, namely, whether the conduct of one party deprived the other party of substantially the whole benefit' of the contract' as stated by Wilson J. in Hunter Engineering, supra.[2] This is the classic formulation of the test as set out by Diplock L.J. in Hongkong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd., [1962] 2 Q.B. 26 (C.A.) at 66:

> [d]oes the occurrence of the event deprive the party who has further undertakings still to perform of substantially the benefit which it was the intention of the parties as expressed in the contract that he should obtain in consideration for performing those undertakings.

115 Print Three submits that, because the trial judge relied on the words of Gonthier J. at para. 33 of his reasons in Farber v. Royal Trust Co., [1997] 1 S.C.R. 846, namely that, "where one party to a contract demonstrates an intention no longer to be bound by it, that party is committing a fundamental breach of the contract that results in its termination," the trial judge applied the wrong legal test for fundamental breach. The appellant submits that this phraseology is only appropriate for employment law contracts and that the only correct phraseology for fundamental breach is whether the failure of one party to perform its contractual obligations had the effect of depriving the other of "substantially the whole benefit" of the contract.

116 I do not agree that the phraseology used by Gonthier J. in Farber, supra, is restricted to the employment law context. Indeed this is precisely the phraseology used by G.C. Cheshire and C.H.S. Fifoot to describe the circumstances in which a breach of contract will excuse further performance in their text The Law of Contract, 5th ed. (London: Butterworths, 1960) at 488:

> A breach of contract is a cause of discharge only if its effect is to render it purposeless for the innocent to proceed further with performance. Further performance is rendered purposeless if one party either shows an intention no longer to be bound by the contract or breaks a stipulation of major importance to the contract.

117 I agree, however, that the deprivation of "substantially the whole benefit of the contract" is the phraseology adopted by this court to describe the test for fundamental breach in Robson v. Thorne, Ernst & Whinney (1999), 127 O.A.C. 215, at para. 18 (C.A.) and Bayer v. Aktiengesellschaft et al. v. Apotex (1998), 113 O.A.C. 1 at para. 34 (C.A.) as well as Majdpour,

supra. In the circumstances of this case, the phraseology chosen by the trial judge to describe the test for fundamental breach may not have been the most appropriate one to define the sort of breach that would excuse Shelanu from further performance of its obligations.

118 Professor Waddams addresses the variety of expressions that have been used to define the sort of breach that will excuse a party from further performance under a contract in his text: Waddams, supra at para. 583. Waddams says that behind all of these expressions lies a single notion, that of substantial failure of performance. Irrespective of the expression used, he proposes five factors derived from the jurisprudence to measure whether future performance under a contract should be excused at para. 587. In 968703 Ontario Ltd. v. Vernon (2002), 58 O.R. (3d) 215 (C.A.) this court, after referring to the decisions in Robson, supra, and Bayer, supra, adopted and applied the factors suggested by Waddams to measure whether future performance should be excused. They are: (a) the ratio of the party's obligation not performed to the obligation as a whole; (b) the seriousness of the breach to the innocent party; (c) the likelihood of repetition of such breach; (d) the seriousness of the consequences of the breach; and (e) the relationship of the part of the obligation performed to the whole obligation. Applying those factors to the breaches by Print Three in this case would not lead to the conclusion that Shelanu should be excused from further performance of its obligations.

119 Applying Waddams' guidelines in this case would not lead to the conclusion that Shelanu should be excused from future performance. The first and fifth factors appear to be aimed at helping a court to ascertain whether the contract was substantially performed. See Fairbanks Soap Co. v. Sheppard, [1953] 2 D.L.R. 193 (S.C.C.). The crux of the agreement between Print Three and Shelanu was the licence to use Print Three's name and trademark in exchange for royalty payments and its exclusive territory. Print Three did not revoke or undermine Shelanu's licence to use Print Three's name and trademark and Shelanu continued to use them. In return, Shelanu was obligated to make royalty payments which it did. Over the ten years of the franchise agreement, Print Three also paid Shelanu the majority of its royalty rebates. I would also disagree that Print Three evinced an intention to no longer be bound by the agreement as a whole although it certainly refused to be bound by parts of it. Print Three did not place another franchisee in Shelanu's territory until after Shelanu's franchise agreement had expired. Shelanu was not deprived of substantially the whole of the benefit of its agreement with Print Three.

120 The second and fourth factors are aimed at measuring the effect of the breach on the innocent party while the third factor, the likelihood of repetition of the breach, is aimed specifically at whether the aggrieved party should be released because continued performance would be intolerable due to repetition of the breaches. To a small business like Shelanu, the delay in payment of royalty rebates on three occasions, the failure to pay the rebate based on there being a single franchise and the abuse of discretion respecting the advertising program were undoubtedly serious but they do not appear to have made it intolerable for Shelanu to continue to operate the franchise because that is what it continued to do.

121 Consequently, Shelanu is not entitled to recover the royalties paid by it since May 8, 1997 which the trial judge assessed at $199,622 nor the $59,870. in advertising fees paid by it after that date. (The latter amount would be subject to any credit for unused Air Miles until that program was discontinued.)

122 Lastly, I would point out that in Hunter Engineering, supra, the court was concerned with the delivery of damaged equipment. The court was not dealing with a contractual relationship that required the parties to continue to interact with each other on an ongoing basis. The same is also true of the situation in Hongkong Fir Shipping, supra. In the context of a franchise agreement, which, as I have noted bears certain similarities to the employment law situation, there is an ongoing, interactive relationship. I note that, following Farber, supra, this court has held that a party may be excused from further performance of an employment contract and the employer held in constructive breach of the agreement where the employer's treatment of the employee makes continued employment intolerable: Shah v. Xerox Canada Ltd., [2000] O.J. No. 849 (C.A.). See also Whiting v. Winnipeg River Brokenhead Community Futures Development Corp. (1998), 159 D.L.R. (4th) 18 (Man. C.A.).

123 Having regard to the current jurisprudence, the trial judge might have chosen more apt phraseology to describe the test for fundamental breach but I would not hold that the trial judge erred in law in using the phraseology that he did. Rather, as I have indicated, it is in the application of the test for fundamental breach that he erred.

C. Amounts owing because there was no fundamental breach

124 Because Shelanu is not excused from its obligations under the franchise agreement, Shelanu is not entitled to recover the royalties it paid to Print Three, which the trial judge assessed at $199,622.

125 Against the amount of $199,622, I would hold, however, that Shelanu is entitled to receive credit for royalty rebates withheld by Print Three.

126 Shelanu's notice of termination would not, of itself, disentitle Shelanu to the royalty rebate provided that it continued to be in compliance with its obligations under the agreement. Because the agreement did not expire until December 1999 and Shelanu continued to pay royalties that Print Three accepted until October of that year, it was not in breach of the one-year non-competition clause contained in the agreement while it paid royalties. The trial judge held that an error Print Three made with respect to a Yellow Pages advertisement was not a breach of the agreement and I would agree with his conclusion in that regard.

127 Shelanu is entitled to a royalty rebate credit during the period it paid royalties.

128 Print Three is entitled to the $59,870 in advertising fees paid by Shelanu after it gave notice of termination. The latter amount would be subject to any credit for unused Air Miles until that

program was discontinued, or to the advertising rebate otherwise payable under the agreement.

129 Having found that the trial judge erred in holding that Print Three had fundamentally breached the franchise agreement I now turn to Print Three's appeal from the trial judge's dismissal of its counterclaim and Shelanu's cross-appeal on damages.

5. The Counterclaim and Cross-Appeal

130 I approach my review of the damages assessed bearing in mind that a trial judge's assessment of damages is ordinarily entitled to great deference. As stated by the Supreme Court of Canada in Naylor Group v. Ellis-Don Construction, [2001] 2 S.C.R. 943 at 977-78:

> It is common ground that the Court of Appeal was not entitled to substitute its own view of a proper award unless it could be shown that the trial judge had made an error of principle of law, or misapprehended the evidence, or it could be shown there was no evidence on which the trial judge could have reached his or her conclusion, or the trial judge failed to consider relevant factors in the assessment of damages, or considered irrelevant factors, or otherwise, in the result, made "a palpably incorrect" of "wholly erroneous" assessment of the damages. Where one or more of these conditions are met, however, the appellate court is obliged to interfere.

131 The trial judge held that, in the event he was wrong in concluding there had been a fundamental breach of the agreement, Print Three was entitled to damages that he assessed at $465,500 over a ten-year period. The award has three components: $64,500 for the waiver of a franchise fee; $225,000 for lost royalties and $176,000 for lost advertising fees, both calculated over a 10-year period.

132 The trial judge dismissed the following claims by Print Three, because there was no evidence to support those assessments:

* A claim for $750,000 for Shelanu's business, as a turn-key operation, on the basis that "[a]ll of the assets of that business would be the property of the plaintiff with the exception of the name and the telephone number."
* A complaint that Shelanu did not assign the lease in accordance with paragraph 15F of the franchise agreement. Print Three took no steps to negotiate a lease so Shelanu could stay in its location when the existing lease expired during the currency of the franchise agreement and Print Three was subject to a number of judgments from creditors. The trial judge held the only commercially reasonable thing for Shelanu to do was to negotiate the lease in its own name.
* A claim for $180,000 for the cost of equivalent signage. While the trial judge accepted that the loss of the Print Three name in a well-travelled

shopping concourse area in a busy section of Toronto could result in damages, he dismissed that claim because there was no evidence before him sufficient to establish an actual loss or the amount of such a loss.

* The claim for one new or renewed franchise in Shelanu's territory on the basis that Mr. Davis' evidence that another franchisee would be unwilling to locate in the territory was nothing more than sheer speculation.

133 Only the finding respecting the lease requires further comment. Under clause 19 of the franchise agreement, Print Three had agreed to give Shelanu an exclusive territory at 60 Bloor Street West until the expiry of the franchise in 1999. In failing to renegotiate the terms of the lease or, if that was not possible, offering to relocate Shelanu at Print Three's expense within the territory, Print Three breached this provision. Once Shelanu had renegotiated the lease in its own name, Print Three did not execute a sublease with Shelanu and reimburse it for any rental deposit as required by the franchise agreement. Given the lapse of time of about three years with neither party complaining about the state of the lease this appears to be yet another instance of the parties amending the agreement by their conduct about which Print Three cannot now complain. In any event, having failed to fulfill its obligations under the franchise agreement, Print Three cannot benefit from its breaches by asserting the right to have the lease assigned to it at the end of the franchise agreement.

134 I must now deal with the claims the trial judge did allow. The waiver of the franchise fee arose when Paul Kim, an existing franchisee, approached Print Three about putting a franchise in Shelanu's territory about six months prior to the expiry of Shelanu's franchise. Print Three gave Mr. Kim a franchise just north of Shelanu's territory. The Kim franchise was required to operate in direct competition with Shelanu, which continued to operate at the Bloor Location, and, since Print Three could not deliver either the Bloor Location, the customer list, the telephone or fax numbers to the Kim Franchise, Print Three waived its usual franchise fee of $64,500 in order to secure the Kim Franchise without this. The trial judge found that in order for Print Three to mitigate its damages it was necessary for Print Three to waive its franchise fee in granting Mr. Kim a franchise. Having regard to the evidence, there is no basis on which to interfere with the trial judge's finding in this regard.

135 The trial judge's award of damages for lost royalties and advertising fees over a period of 10 years is problematic. The underpinning for his conclusion appears to be in paragraph 81 of his reasons wherein he stated:

> The loss of the 6% royalty and the loss of the advertising fees for ten years assumes that the plaintiff would have continued to be a franchisee or that another franchisee would have been found for the plaintiff's location. *While that assumption is fair enough,* the claim must be subject to a duty to mitigate, that is, the defendant had an obligation to mitigate its damages by locating another franchisee in the same territory where the plaintiff was continuing to operate. Indeed, the defendant did exactly that when it sold a franchise to Mr. Kim, an

> existing franchisee, to operate a franchise outlet on Cumberland Street which is just north of the plaintiff's location [emphasis added].

I am of the opinion that the trial judge erred in assessing damages based on this assumption.

136 In assessing damages the onus is on Print Three to prove its damages on a reasonable preponderance of credible evidence. The trial judge was required to put Print Three in the same position it would have been in had the agreement been performed, that is, had Shelanu not competed for one year in a defined geographic area. Having regard to the trial judge's finding that Print Three was not entitled to Shelanu's business or lease once the franchise agreement ended, which I have upheld, another franchisee could not have been placed in Shelanu's location. The trial judge was not entitled to base his award of damages on an assumption that did not accord with the specific facts of this case. Print Three would not have had a franchisee in Shelanu's location. It would only have had, as it did, a franchisee located just north of Bloor and Cumberland.

137 The trial judge erred in principle in concluding that Print Three was entitled to damages based on the projected revenue stream from Shelanu's franchise less Mr. Kim's projected revenue over a ten-year period, the entire life of a franchise agreement. If Shelanu had observed the one-year non-competition clause in the franchise agreement, there is no evidence to suggest that all of Shelanu's customers would have become customers of the new franchisee. The Shelanu Print Three franchise was not the only copying business in the geographic area. The geographic restrictions contained in the one-year non-competition clause were five miles from one specific franchisee and seven miles from another. If Shelanu had moved its business just outside the geographic area, there is no evidence to suggest it would have lost all its customers or personal goodwill. As noted earlier, the evidence indicates that Shelanu targeted corporate and business accounts, not walk-in trade. After one year, Shelanu was entitled to compete again with Print Three within the same geographic area. There is no evidence that, after one year, Shelanu's goodwill would have been so impaired that many of its customers would not have returned to it.

138 Based on Shelanu's breach of the non-competition clause some damages must also be assessed for loss of revenue to Mr. Kim over one year. The figures for all forty-two Print Three franchisees for the five years prior to October 1999, disclosed that the average franchisee paid approximately $25,000 annually in royalties and $4,700 annually in advertising fees. This figure was about one-half the annual royalties and advertising fees paid by Shelanu. The trial judge chose to adopt this average figure as the basis for his calculation and Print Three does not challenge it as being too low. By taking the average yearly sales of the average franchisee as his basis for awarding damages for loss of royalties and advertising fees the trial judge effectively took account of the complex contingencies that Shelanu's personal goodwill may not have been transferred to another franchisee and that Mr. Kim may not have been as competent as Shelanu in operating its franchise. In Martin v. Goldfarb (1998), 41 O.R. (3d) 161 (C.A.) at 187, Finlayson J.A. held that a defendant is not entitled to have damages assessed by guesswork when the party bearing the burden of adducing the evidence has failed to do so. However, where there are complex contingencies,

incapable of proof, a court must then do its best to assess the quantum of damages.

139 Having regard to these considerations, in addition to the franchise fee of $64,500, I would substitute an award of damages for one year's loss of revenue and advertising fees which, in accordance with the trial judge's figure for one year, I would fix at $29,700 for a total of $94,200.

IV. Disposition

140 For the reasons given, I would allow both the appeal and cross-appeal as indicated. In view of the divided success on this appeal I would order that the parties bear their own costs.

WEILER J.A.
AUSTIN J.A. -- I agree.
LASKIN J.A. -- I agree.

* * * * *

Corrigendum
Released: August 5, 2003

Paragraph 62 now reads, "Print Three breached its obligation to pay Shelanu the royalty rebate in accordance with the oral agreement and, therefore, is liable for damages as found by the trial judge."

Paragraph 72, bullet #1, now reads, "Print Three's attempts to rescind the May 1995 agreement were not only a breach of that agreement but, in the circumstances, evinced a lack of good faith dealing by the franchisor;"

Paragraph 85 now reads, "The term "breach" is not used. The word "deficient" is defined in Webster's Dictionary, 1989 ed., as "inadequate"."

1 The present regulations to the franchise legislation in Ontario now require that the franchise agreement contain a statement of the franchisor's policy respecting setting up a competing business by it. The regulations also require that the franchisee be provided with a description of the franchisor's policy, if any, respecting the proximity between an existing franchise and another franchise granted by the franchisor that distributes similar products or services under a different trade-mark, trade name or logo. In the absence of such disclosure, ".... there is an expectation on the part of the franchisee that the franchisor will not establish a corporate or franchise location (or another business or channel of distribution) within such proximity or in

such a manner that would negatively effect the franchisee's business." See J.P. Hoffman, "Statutory Obligations of Fair Dealing and Good Faith in Canada" (2nd Annual Franchise Law Conference: A New Act, A New Era of Disclosure - One Year Later, Ontario Bar Association C.L.E., 22 February, 2002) [unpublished], at 22. Among the cases discussed are Supermarché A.R.G. Inc. v. Provigo Distribution Inc., [1997] A.Q. No. 3710 (C.A.), which held that Provigo owed the supermarkets bearing its name a duty to provide assistance and to support the franchise system and not to compete with it, particularly in the area of pricing. Provigo had breached its statutory duty of good faith under the Civil Code. Kelsey Group Inc. v. 75766 Ontario Ltd., [1990] O.J. No. 598 (H.C.J.) where notices of termination delivered by the franchisor to its franchisee were held to be a smoke screen to enable it to establish another franchise in the franchisee's territory; and Metro- Pacific Cellular Inc. v. Rogers Cantel Inc. et al. (1994), 57 C.P.R. (3d) 538 (B.C. Sup. Ct.), where the court held that Cantel could not compete directly with its non-exclusive dealer in downtown Vancouver.

Presumably one factor that would be a consideration as to whether the franchisor can set up a competing business is whether the franchisee has an exclusive territory.

2 In Hunter Engineering, supra, at para. 137ff. Dickson C.J. restricted his comments to the use of fundamental breach in the context of enforcing exclusion clauses in a contract and did not express an opinion on the other meaning of fundamental breach which he termed "substantial failure of performance" to relieve a party from future obligations under a contract.

TAB 8

Case Name:

Falk Bros. Industries Ltd. v. Elance Steel Fabricating Co.

Falk Bros. Industries Ltd. and Canadian Surety Company, appellants;
v.
Elance Steel Fabricating Co. Ltd., respondent.

[1989] S.C.J. No. 97

[1989] A.C.S. no 97

[1989] 2 S.C.R. 778

[1989] 2 R.C.S. 778

62 D.L.R. (4th) 236

99 N.R. 228

[1990] 1 W.W.R. 29

J.E. 89-1362

80 Sask.R. 22

39 C.C.L.I. 161

35 C.L.R. 225

[1989] I.L.R. 9709

[1989] I.L.R. para. 1-2506 at 9709

17 A.C.W.S. (3d) 700

File No.: 20679.

Supreme Court of Canada

1989: May 25 / 1989: September 28.

Present: Dickson C.J. and Lamer, Wilson, La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory and McLachlin JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR SASKATCHEWAN

Insurance -- Surety bond -- Notice of claim given after expiry of notice period stipulated in bond -- Insurance Act providing for relief -- Whether relief confined to statutory conditions or extended to contractual provisions -- If applicable to contractual conditions, whether failure to give notice within the time prescribed by the bond constituting "imperfect compliance" or "non-compliance" -- The Saskatchewan Insurance Act, R.S.S. 1978, c. S-26, s. 109.

Respondent claimed on a debt owed by Falk Bros. Industries Ltd. together with interest under a bond issued by the Canadian Surety Company. Notice of the claim, however, was given 28 days after the expiry of the 120-day period for notice set out in the bond. The chambers judge found, on respondent's application, that s. 109 of The Saskatchewan Insurance Act empowered him to relieve against forfeiture occurring because of this breach of the bond's time limitations and then proceeded to grant such relief. The Court of Appeal allowed the appeal of the Canadian Surety Company with respect to the actual grant of the relief, but dismissed its appeal from the chambers judge's ruling that the court had authority to grant relief against forfeiture. The issues before this Court were: (1) whether s. 109 was confined to statutory conditions or extended to contractual provisions; and (2) if it extended to contractual conditions, whether failure to give notice within the time prescribed by the bond constituted "imperfect compliance" within s. 109 or, alternatively, "non-compliance". Respondent conceded that the actual grant of relief was improper given that only a declaration as to whether it could obtain such relief had been sought.

Held: The appeal should be dismissed.

Section 109 extends to contractual as well as statutory conditions. It should be read as empowering the Court to relieve against forfeiture "Where there has been imperfect compliance with: (1) a statutory condition as to the proof of loss to be given by the insured; or (2) other matter or thing required to be done or omitted by the insured ...." This broad interpretation is appropriate given that s. 109 is remedial legislation and in light of the interpretation that has been adopted by the courts for more than a decade. The contract in question and the conduct of the parties with relation to it arose in this jurisprudential context. Making relief available for contractual breaches pursuant to s. 109 of The Saskatchewan Insurance Act accordingly cannot be said to be unfair or contrary to the intention of the parties. The statutory terms are as much a part of the bargain as non-statutory terms.

Failure to give notice within the time prescribed by the bond constituted "imperfect compliance" within s. 109. It is a less serious breach than failure to bring an action within a stipulated time and

relates to "proof of loss" or "other matter or thing required to be done or omitted by the insured with respect to the loss". Relief from forfeiture can be granted in respect of delayed notices of claims.

Cases Cited

Referred to: Minto Construction Ltd. v. Gerling Global General Insurance Co. (1978), 86 D.L.R. (3d) 147; Canadian Equipment Sales & Service Co. v. Continental Insurance Co. (1975), 59 D.L.R. (3d) 333; Fitzgerald v. Casualty Co. of Canada (1981), 31 Nfld. & P.E.I.R. 521; Janet Estate and Kallos v. Saskatchewan Government Insurance (1984), 30 Sask. R. 185; V & G Polled Herefords v. Lloyd's Non-Marine Underwriters (1986), 51 Sask. R. 81; Dashchuk Lumber Ltd. v. Proman Projects Ltd. (1987), 59 Sask. R. 193; Moxness v. Saskatchewan Government Insurance Office, [1977] 3 W.W.R. 393; North Lethbridge Garage Ltd. v. Continental Casualty Co., [1930] 1 W.W.R. 491; D. S. Ashe Trucking Ltd. v. Dominion Insurance Corp. (1966), 55 W.W.R. 321; National Juice Co. v. Dominion Insurance Co. (1977), 18 O.R. (2d) 10; Presco Industrial Ltd. v. Saskatchewan Government Insurance Office (1967), 61 W.W.R. 637; Hogan v. Kolisnyk, [1983] 3 W.W.R. 481.

Statutes and Regulations Cited

Interpretation Act, R.S.S. 1978, c. I-11, s. 11. Saskatchewan Insurance Act, R.S.S. 1978, c. S-26, s. 109.

APPEAL from a judgment of the Saskatchewan Court of Appeal (1987), 62 Sask. R. 304, 42 D.L.R. (4th) 181, [1987] 6 W.W.R. 679, [1988] I.L.R. 1-2266, 27 C.C.L.I. 20, allowing an appeal from that part of a judgment of Estey J. in Chambers granting relief but dismissing an appeal from that part of his judgment declaring that the court had authority to grant relief against forfeiture under s. 109 of The Saskatchewan Insurance Act (1986), 52 Sask. R. 283, 31 D.L.R. (4th) 76, [1987] I.L.R. 1-2143, 22 C.C.L.I. 268. Appeal dismissed.

R.P. Rendek, Q.C., for the appellants.
Q.D. Agnew, for the respondent.

Solicitors for the appellants: Rendek Kaufman Embury, Regina.
Solicitors for the respondent: Agnew & Company, Saskatoon.

The judgment of the Court was delivered by

1 **McLACHLIN J.**:-- The issue raised in this case is whether s. 109 of The Saskatchewan Insurance Act, R.S.S. 1978, c. S-26, (the Insurance Act) permits the Court to grant relief from

forfeiture where the claimant failed to give notice of his claim to the insurer within the time prescribed by a labour and material payment bond.

The Background

2 Elance Steel Fabricating Co. Ltd. claimed under a bond issued by the Canadian Surety Company on account of a debt due and owing, together with interest for supply of metal to Falk Bros. Industries Ltd. Elance failed to give notice of its claim within the period specified in the bond, making its claim 28 days after expiry of the 120-day period for notice provided in paragraph 6 of the bond.

3 Elance applied to the chambers judge for an order declaring that it was entitled to relief from forfeiture from the breach of the time limitations for the filing of the notice of claim specified in the bond. The chambers judge held that s. 109 of the Insurance Act empowered him to relieve against forfeiture and then proceeded to grant such relief. Elance concedes that the actual grant of relief was improper since it had only requested a ruling as to whether it could obtain such relief.

4 The Court of Appeal allowed the appeal of the Canadian Surety Company with respect to the actual grant of the relief, but dismissed its appeal from the chambers judge's ruling that the court had authority to grant relief against forfeiture under s. 109 of the Insurance Act. Canadian Surety now appeals to this Court.

The Legislation

5 Section 109 of the Insurance Act provides:

> 109. Where there has been imperfect compliance with a statutory condition as to the proof of loss to be given by the insured or other matter or thing required to be done or omitted by the insured with respect to the loss and a consequent forfeiture or avoidance of the insurance in whole or in part and the court considers it inequitable that the insurance should be forfeited or avoided on that ground, the court may relieve against the forfeiture or avoidance on such terms as it considers just.

6 Similar provisions are found in Insurance Acts throughout Canada.

The Issues

7 The only issue is whether s. 109 empowers the Court to grant relief against forfeiture for breach of a contractual condition prescribing a period within which notice of a claim must be given.

8 This issue raises two sub-issues:

(1) Is s. 109 confined to statutory conditions as opposed to contractual

provisions; and

(2) If s. 109 extends to contractual conditions, does failure to give notice within the time prescribed by the bond constitute "imperfect compliance" within s. 109 or, alternatively, "non-compliance"?

Discussion

1. Is s. 109 Confined to Statutory Conditions as Opposed to Contractual Conditions?

9 The term breached in the instant case was a term of the contract: it was not a statutory condition. Canadian Surety submits that the Court has no power to grant relief under s. 109 of the Insurance Act because the section is confined to statutory conditions.

10 The wording of s. 109 is ambiguous. It can be read as empowering the Court to relieve against forfeiture "Where there has been imperfect compliance with a statutory condition as to: (1) the proof of loss to be given by the insured; or (2) other matter or thing required to be done or omitted by the insured ...." (Punctuation and numbering added). On this reading, s. 109 is confined to statutory conditions, the entire phrase which follows modifying "statutory conditions". This reading of the section is strained; one feels the word "any" should be added before "other matter".

11 Alternatively, s. 109 can be read as empowering the Court to grant relief "Where there has been imperfect compliance with: (1) a statutory condition as to the proof of loss to be given by the insured; or (2) other matter or thing required to be done or omitted by the insured ...." (Punctuation and numbering added). On this interpretation, s. 109 extends to contractual conditions. This interpretation is also awkward; again, one feels the word "any" should be inserted before "other matter".

12 The question before us is which of these two interpretations should be adopted. In my opinion, a number of considerations favour adoption of the second interpretation with the consequent extension of s. 109 to contractual as well as statutory conditions.

13 The first consideration is that s. 109 is a remedial section and as such should be given an appropriately broad interpretation. In Minto Construction Ltd. v. Gerling Global General Insurance Co. (1978), 86 D.L.R. (3d) 147, citing Canadian Equipment Sales & Service Co. v. Continental Insurance Co. (1975), 59 D.L.R. (3d) 333 (Ont. C.A.), MacKinnon J.A. noted at p. 151 that the equivalent Ontario "section is 'an ameliorating clause', and [that] it should be given a fair, large and liberal interpretation". In the same vein, see also The Interpretation Act, R.S.S. 1978, c. I-11, s. 11 which provides:

> 11. Every Act and every regulation and every provision thereof shall be deemed remedial, and shall receive such fair, large and liberal construction and interpretation as best ensures the attainment of the object of the Act, regulation or

provision.

The purpose of allowing relief from forfeiture in insurance cases is to prevent hardship to beneficiaries where there has been a failure to comply with a condition for receipt of insurance proceeds and where leniency in respect of strict compliance with the condition will not result in prejudice to the insurer. This purpose is consistent with interpreting s. 109 as permitting the court to grant relief from contractual as well as statutory conditions.

14 The second consideration is that for more than a decade, courts across the country have adopted the second, more generous interpretation: see Minto Construction Ltd. v. Gerling Global General Insurance Co., supra; Canadian Equipment Sales & Service Co. v. Continental Insurance Co., supra; Fitzgerald v. Casualty Co. of Canada (1981), 31 Nfld. & P.E.I.R. 521 (Nfld. S.C.T.D.); Janet Estate and Kallos v. Saskatchewan Government Insurance (1984), 30 Sask. R. 185 (Q.B.); V & G Polled Herefords v. Lloyd's Non-Marine Underwriters (1986), 51 Sask. R. 81 (Q.B.); Dashchuk Lumber Ltd. v. Proman Projects Ltd. (1987), 59 Sask. R. 193 (Sask. C.A.). In the face of this uniform jurisprudence in favour of extending s. 109 or its equivalents to purely contractual clauses, none of the legislatures has acted to alter the wording of s. 109. Since the contract here in question and the conduct of the parties with relation to it arose in that jurisprudential context, it cannot be said to be unfair or contrary to the intention of the parties that relief now be available for contractual breaches pursuant to s. 109 of the Insurance Act.

15 Finally, I should note that I cannot accept the argument that extending s. 109 to ordinary contractual clauses in insurance contracts constitutes undue interference with contractual rights. An argument based on privity of contract is difficult to advance where the claimant is a third party. Moreover, since relief from forfeiture is required only where there has been a breach of contract, it is inherent in s. 109 that it must derogate from contractual arrangements if it is to have any effect. While the parties have no choice as to the statutory terms, these are as much a part of their bargain as non-statutory terms.

16 In summary, the rules of statutory construction and precedent favour interpreting s. 109 as extending to non-statutory terms of insurance policies. There is no reason to depart from the interpretation of such clauses which has been uniformly adopted across the country. I conclude that s. 109 should be read as empowering the court to grant relief from forfeiture for breaches of terms of insurance contracts other than statutory conditions.

2. Does Failure to Give Notice Within the Prescribed Time Period Constitute Imperfect Compliance Under s. 109 of the Insurance Act or Non-Compliance?

17 Should failure to give notice of claim within the time prescribed by the bond be considered as imperfect compliance, against which the court may relieve in appropriate cases, or is it non-compliance, in which case the court has no power under s. 109 to grant relief? The distinction between imperfect compliance and non-compliance is akin to the distinction between breach of a term of the contract and breach of a condition precedent. If the breach is of a condition, that is, it

amounts to non-compliance, no relief under s. 109 is available.

18 The case law has generally treated failure to give notice of claim in a timely fashion as imperfect compliance whereas failure to institute an action within the prescribed time period has been viewed as non-compliance, or breach of a condition precedent. Thus, courts have generally been willing to consider granting relief from forfeiture where notice of claim has been delayed: Canadian Equipment Sales & Service Co. v. Continental Insurance Co., supra; Minto Construction Ltd. v. Gerling Global General Insurance Co., supra; Moxness v. Saskatchewan Government Insurance Office, [1977] 3 W.W.R. 393 (Sask. D.C.); Janet Estate and Kallos v. Saskatchewan Government Insurance, supra; North Lethbridge Garage Ltd. v. Continental Casualty Co., [1930] 1 W.W.R. 491 (Alta. S.C., App. Div.). See also: Dashchuk Lumber Ltd. v. Proman Projects Ltd., supra.

19 On the other hand, cases in which failure to meet a time requirement has been held to be non-compliance rather than imperfect compliance have largely been cases in which the time period was for the commencement of an action rather than for the giving of notice: D. S. Ashe Trucking Ltd. v. Dominion Insurance Corp. (1966), 55 W.W.R. 321 (B.C.C.A.); National Juice Co. v. Dominion Insurance Co. (1977), 18 O.R. (2d) 10 (Ont. C.A.).

20 The reasons for the distinction are bi-fold. First, failure to give notice of claim has been viewed as a breach of a term rather than a breach of a condition. Clearly, being akin to failure to meet a limitation period, failure to bring an action within the time required is a more serious breach than failure to give timely notice. A notice of a claim simply informs the insurer of the possibility of a future action, thereby allowing the insurer some time to investigate the merits of the claim and to negotiate a settlement: the actual bringing of an action, however, is the legal crystallization of the claim which sets its parameters and magnitude. Second, and probably more importantly, failure to give notice of the claim within the time required is a defect in provision of proof of loss for which relief against forfeiture is, by the terms of the statute, available. "Where there has been imperfect compliance with the statutory condition as to the proof of loss to be given by the insured or with any other matter or thing required to be done or omitted by the insured with respect to the loss and a consequent forfeiture or avoidance of the insurance in whole or in part", s. 109 gives the court power to relieve from such forfeiture or avoidance. But it is only in respect of such statutory conditions as to proof of loss or other matters or things that are required to be done or omitted with respect to the loss that the court has this power. Culliton C.J.S. made this point in Presco Industrial Ltd. v. Saskatchewan Government Insurance Office (1967), 61 W.W.R. 637 (Sask. C.A.). There, a condition which imposed a time limitation for the bringing of an action was held to not fall into this category (at p. 639):

> [The time limitation condition] does not work a forfeiture or avoidance; it does not bar any right -- it only bars a remedy. This was the view expressed by Williams, C.J.Q.B., in Luke's Elec. Motors & Machinery Ltd. v. Halifax Insur. Co. (1953-54) 10 WWR (NS) 539, at 550, 551, 61 Man R 297, with which view I

am in complete agreement. A similar opinion was expressed by Tysoe, J.A. in D. S. Ashe Trucking Ltd. v. Dom. Ins. Corpn. (1966) 55 WWR 321 (B.C.). In that case Tysoe, J.A. considered the effect to be given to the condition of a policy which read:

> "14. Every action or proceeding against the Insurer for the recovery of any claim under or by virtue of this contract shall be absolutely barred unless commenced within one year after the loss or damage occurs."

At p. 349 he said:

> "The statutory condition does not relate to the appellant's contractual obligations, but to the right of the respondent to enforce them by action or proceeding. The appellant's liability remains but the right of the respondent to enforce it by action or proceeding is lost at the expiration of the one-year term."

On the other hand, the case law is clear that notices of claims relate to proof of loss and therefore fall within the ambit of the forfeiture relief provisions. Hence, in Hogan v. Kolisnyk, [1983] 3 W.W.R. 481 (Alta Q.B.), Miller J. said:

> It is now clearly established that notice of loss falls within the term "proof of loss", and that relief can be given with respect to failure to comply with the requirement of notice: Prairie City Oil Co. v. Standard Mut. Fire Ins. Co. (1910), 44 S.C.R. 40; Bodnorchuk v. Union Marine & Gen. Ins. Co. Ltd. [1957] I.L.R. 1-267, reversed [1958] S.C.R. 399, [1958] I.L.R. 1-287, 13 D.L.R. (2d) 609.

21 I agree that failure to give notice of claim within a given period is a less serious breach than failure to bring an action within a stipulated time. I also agree that it relates to "proof of loss" or "any other matter or thing required to be done or omitted by the insured with respect to the loss". I am therefore of the view that relief from forfeiture can be granted in respect of delayed notices of claims.

22 For these reasons, I conclude that the failure to give notice of claim within the prescribed time period constitutes imperfect compliance rather than non-compliance and that Elance is eligible to claim relief from forfeiture in this case.

Conclusion

23 In summary, I conclude that s. 109 of The Saskatchewan Insurance Act is not confined to

statutory conditions, and that failure to provide notice of claim in a timely fashion is imperfect compliance under s. 109. It follows that the Court has the power to grant relief under s. 109.

24 I would dismiss the appeal with costs.

TAB 9

Case Name:

Moore (Re)

IN THE MATTER OF the Bankruptcy of Matthew David Moore of the City of Brampton, in the Regional Municipality of Peel, Province of Ontario
Between
The Superintendent of Bankruptcy, Appellant, and
407 ETR Concession Company Limited and Matthew David Moore, Respondents

[2013] O.J. No. 5837

2013 ONCA 769

314 O.A.C. 153

235 A.C.W.S. (3d) 378

369 D.L.R. (4th) 385

7 C.B.R. (6th) 167

118 O.R. (3d) 161

53 M.V.R. (6th) 169

2013 CarswellOnt 17670

Docket: C54560

Ontario Court of Appeal
Toronto, Ontario

D.H. Doherty, J.M. Simmons and S.E. Pepall JJ.A.

Heard: June 10, 2013.
Judgment: December 19, 2013.

(119 paras.)

Bankruptcy and insolvency law -- Discharge of bankrupt -- Absolute discharge -- When granted -- Debts not released by discharge -- Appeal by Superintendent of Bankruptcy from order requiring discharged bankrupt to pay Highway 407 tolls prior to obtaining vehicle permit allowed -- Toll company, creditor in bankruptcy, not entitled to different treatment than other creditors whose debts released by discharge -- Refusing permit to discharged bankrupt would thwart purpose of fresh start principle of bankruptcy and insolvency system -- Section 22(4) declared inoperative with respect to discharged bankrupts -- Bankruptcy and Insolvency Act, ss. 69, 72, 178.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- General principles -- Legislation -- Appeal by Superintendent of Bankruptcy from order requiring discharged bankrupt to pay Highway 407 tolls prior to obtaining vehicle permit allowed -- Toll company, creditor in bankruptcy, not entitled to different treatment than other creditors whose debts released by discharge -- Refusing permit to discharged bankrupt would thwart purpose of fresh start principle of bankruptcy and insolvency system -- Section 22(4) declared inoperative with respect to discharged bankrupts -- Bankruptcy and Insolvency Act, ss. 69, 72, 178.

Transportation law -- Motor vehicles and highway traffic -- Vehicle licensing -- Conditions -- Rules of the road -- Highways and roads -- Toll highways -- Liability -- Vehicle registration suspension -- Appeal by Superintendent of Bankruptcy from order requiring discharged bankrupt to pay Highway 407 tolls prior to obtaining vehicle permit allowed -- Toll company, creditor in bankruptcy, not entitled to different treatment than other creditors whose debts released by discharge -- Refusing permit to discharged bankrupt would thwart purpose of fresh start principle of bankruptcy and insolvency system -- Section 22(4) declared inoperative with respect to discharged bankrupts -- Highway 407 Act, ss. 15, 22.

Appeal by the Superintendent of Bankruptcy from a decision concluding Moore, a discharged bankrupt, had debts to the company operating the Highway 407 toll highway that survived his discharge. Moore was a truck driver who incurred a large debt to the company for his use of Highway 407. He lost his vehicle permit for non-payment of tolls, but continued to use Highway 407. He made an assignment into bankruptcy and the company was listed as one of his creditors. Moore had a motor vehicle accident and could not longer work as a truck driver. He retrained to become a car salesperson and needed a vehicle for his work. He applied for a vehicle permit and ultimately obtained one. He received an absolute discharge from bankruptcy and his debt to the company was extinguished, then restored upon appeal by the toll company. His vehicle permit was cancelled. The Superintendent then became involved, challenging the correctness of the decision and its impact on the integrity of the bankruptcy and insolvency system.

HELD: Appeal allowed. Moore was granted an absolute discharge from bankruptcy and was entitled to be issued a vehicle permit without paying his Highway 407 tolls. Section 22(4) of the Highway 407 Act was declared inoperative to the extent that it thwarted the purpose of providing a discharged bankrupt with a fresh start. There was no operational conflict between the Highway 407

Act and the Bankruptcy and Insolvency Act, because Moore was under no obligation to obtain a vehicle permit by paying his debt to the toll company, and the toll company was under no obligation to enforce its collection remedies against Moore. However, section 22(4) of the Highway 407 Act was incompatible with the fresh start or financial rehabilitation purpose of the Bankruptcy and Insolvency Act. The toll company was not entitled to special treatment over other creditors in Moore's bankruptcy.

Statutes, Regulations and Rules Cited:

Bankruptcy Act, R.S.C. 1985, c. B.3,

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 67, s. 69.2(1), s. 71, s. 72, s. 121, s. 124, s. 168.1, s. 178(1), s. 178(2), s. 193(e)

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36,

Constitution Act, 1867, R.S.C. 1985, App. II, No. 5, s. 92 R

Execution Act, R.S.O. 1990, c. E.24, s. 2(1)6

Highway 407 Act, 1998, S.O. 1998, c. 28, s. 15, s. 16, s. 22, s. 22(1), s. 22(4), s. 25

Highway Traffic Act, R.S.O. 1990, c. H.8, s. 51, s. 198

Appeal From:

On appeal from the order of Justice Frank J.C. Newbould of the Superior Court of Justice dated October 25, 2011, with reasons reported at 30 M.V.R. (6th) 137.

Counsel:

Liz Tinker and Mark Taggart, for the appellant.

J. Thomas Curry, Andrew Parley and Jon Laxer, for the respondents.

David Thompson and Matthew G. Moloci, for the interveners.

The judgment of the Court was delivered by

S.E. PEPALL J.A.:--

A. INTRODUCTION

1 Highway 407 is a public-private partnership between the respondent, 407 ETR Concession Company Limited ("ETR"), and the Government of Ontario. The electronic, open-access highway was established to enhance transportation in and around the Greater Toronto Area.

2 ETR is a private company that owns and operates Highway 407 pursuant to a 99-year lease and certain concession agreements with the Ontario government. The *Highway 407 Act*, 1998, S.O. 1998, c. 28 (the "*407 Act*"), enables ETR to establish, collect and enforce tolls, administration fees and interest ("toll debt") charged to members of the public for their use of the highway.

3 By operation of s. 22(4) of the *407 Act*, toll debt owing to ETR may be enforced against a discharged bankrupt through the suspension of his or her vehicle permit by Ontario's Registrar of Motor Vehicles. The appellant, the Superintendent of Bankruptcy (the "Superintendent"), argues that the doctrine of federal paramountcy renders s. 22(4) inoperative with respect to a discharged bankrupt for two reasons. First, s. 22(4) conflicts with the operation of s. 178(2) of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3 ("*BIA*"), which provides that a discharge releases a bankrupt from all claims provable in bankruptcy. Second, s. 22(4) frustrates the purposes of the bankruptcy and insolvency system.

4 This appeal addresses whether these two statutory schemes can co-exist in the limited context of a discharged bankrupt. For the reasons that follow, I am of the view that they cannot.

5 Although served, the Attorney General for the Province of Ontario did not appear to defend the provincial statutory scheme or to advance any public policy argument in support of its application in the circumstances of a discharged bankrupt.

B. FACTS

6 Matthew David Moore was a truck driver. He had two vehicles. Due to his use of Highway 407, he incurred indebtedness to the ETR which he failed to pay. As a result, in March 2005 and December 2006, ETR sent notices of his non-payment relating to two separate vehicles to the Registrar of Motor Vehicles for the Province of Ontario (the "Registrar"). When the vehicle permit for one of the vehicles expired in August 2005, it could not be renewed. Nonetheless, Moore continued to use Highway 407 for another 18 months contrary to s. 51 of the *Highway Traffic Act*, R.S.O. 1990, c. H.8. As of October 2007, Moore's indebtedness to ETR amounted to $34,977.06.

7 Moore made an assignment into bankruptcy on November 10, 2007. ETR was listed as a creditor on Moore's statement of affairs filed in his bankruptcy proceedings, however, it did not file a proof of claim. A proof of claim would have enabled ETR to make submissions at any hearing into Moore's discharge from bankruptcy and to share rateably with Moore's other unsecured creditors in the bankruptcy.

8 After his assignment into bankruptcy, Moore was involved in a slip and fall. As a result of this accident, he retrained to become an automotive salesperson and now works in that field. He gave evidence that he requires a vehicle permit for his livelihood.

9 Moore obtained a conditional discharge from bankruptcy in February 2011. He requested an Ontario Ministry of Transportation ("MTO") vehicle permit. MTO refused his request due to his outstanding indebtedness to ETR.

10 On June 21, 2011, Moore obtained an absolute discharge from bankruptcy.

11 Moore then moved before a Registrar in Bankruptcy seeking a declaration that his debt to ETR was released as a result of his discharge, and an order compelling the MTO to issue a vehicle permit to him upon the payment of the usual licensing fees. ETR was served but due to inadvertence, did not attend at the motion. Neither did the Superintendent. The Registrar in Bankruptcy granted the requested declaration on September 8, 2011. Specifically, she ordered that:

(1) the discharge of the bankrupt dated June 21, 2011 released him from all claims provable in bankruptcy, including the debt of ETR as at November 10, 2007, and

(2) the Ministry of Transportation was directed to issue plates to him upon payment of the usual licensing fees.

12 ETR then brought a motion before a judge seeking to set aside the order of the Registrar in Bankruptcy. Moore brought an amended motion essentially seeking the same relief he had already sought and obtained. The Superintendent was not served with either of these motions.

13 The motions judge granted ETR's motion and dismissed Moore's motion. As of October 25, 2011, the date of the order, Moore's toll debt to ETR amounted to $88,767.83. The motions judge concluded that there was no operational conflict between s. 22(4) of the *407 Act* and s. 178(2) of the *BIA*. Although the motions judge noted that one of the purposes of the *BIA* is financial rehabilitation, he did not consider this purpose in the context of the second branch of the paramountcy analysis, that is, whether any legislative purpose of the *BIA* was thwarted. He did not consider whether the operation of s. 22(4) to collect pre-bankruptcy indebtedness impeded Moore's ability as a discharged bankrupt to have a "fresh start" post-bankruptcy or resulted in unequal treatment of unsecured creditors.

14 The Superintendent was concerned about the correctness of the motions judge's decision and its impact on the integrity of the bankruptcy and insolvency system. Moore advised the Superintendent that he was not pursuing an appeal because he had received a "very, very attractive offer" to settle from ETR. The Superintendent therefore sought to appeal the order.

15 ETR moved to quash the Superintendent's notice of appeal. The Superintendent then sought

leave to appeal the motion judge's decision. This Court (Weiler, Blair and Rouleau JJ.A.) concluded that while the Superintendent did not have the right to bring an appeal, the circumstances were exceptional, and leave to appeal under s. 193(e) of the *BIA* should be granted.

16 On November 26, 2012, Blair J.A. granted intervener status to Michael Dow, Gwendolyn Miron and Peter Teolis, proposed representative plaintiffs in a class action proceeding against ETR relating to its collection of toll debt in a bankruptcy context.

C. ISSUES ON APPEAL

17 The issues on this appeal are:

(i) Does s. 22(4) of the *407 Act* conflict with the *operation* of s. 178 (2) of the *BIA*?

(ii) Does s. 22(4) of the *407 Act* conflict with the *purpose* of the bankruptcy and insolvency system because it (a) thwarts the objective of providing the bankrupt with a fresh start or (b) creates a new class of debt that survives bankruptcy and frustrates Parliament's intention to treat all unsecured creditors equally?

18 While argued by the interveners, this appeal does not extend to address the time period post-bankruptcy and pre-discharge and more particularly, the effect of the *BIA* stay of proceedings on a bankrupt's debt obligations.

D. LEGISLATIVE SCHEMES

(i) **The *407 Act***

19 In *407 ETR Concession Co. Ltd. v. Ontario (Registrar of Motor Vehicles)* (2005), 82 O.R. (3d) 703 (Div. Ct.), at para. 27, the court described the purpose of the *407 Act*:

> [T]he purpose of the [*407 Act*] was to privatize the operation of Highway 407 and, given its open-access character, to provide [ETR] with an effective method of toll collection. The legislature recognized that plate denial is a necessary feature of an open-access toll highway given the exceptionally large number of transactions, the small balances and the cost of other means of debt collection.

20 The legislative debates surrounding the enactment of the *407 Act* indicate that it was intended to relieve congestion on Highway 401 in and around the Greater Toronto Area, reduce the pollution caused by idling cars, and create jobs while striking an optimal risk-sharing arrangement with the private sector. See *Ontario, Legislative Assembly, Official Report of Debates (Hansard)*, 36 Parl., 2nd Sess., No. 47 (21 October 1998), at 1520 (Rob Sampson); 36 Parl., 2nd Sess., No. 48A (22 October 1998) at 2120 (John Gerretson); 36 Parl., 2nd Sess., No. 50A (27 October 1998) at 1940 (Doug Galt).

21 The *407 Act* designates Highway 407 as a private toll highway. In its capacity as owner, ETR

is required to provide the public with open access to the highway. Members of the public who use the highway are obliged to pay a toll and any related fees to ETR. ETR may establish, collect and enforce payment of tolls and administration fees. These powers are only to be exercised in accordance with the terms and conditions of an agreement entered into by the Minister for Privatization for the Province and ETR. (No such agreement was before the Court on this appeal.) Toll debt collected by or on behalf of ETR is the property of ETR. There are no toll booths, and no fees are paid at the entrance to or exit from the highway. The system is electronic, and ETR invoices the owner of the vehicle permit or the lessee of an electronic transponder or toll device that has been mounted on to the user's vehicle.

22 Pursuant to s. 15 of the *407 Act*, the toll debt is payable on the day an invoice is sent. If not paid within 35 days, ETR may send a notice of failure to pay to the debtor. If not paid within 90 days thereafter, ETR may send a s. 22 notice to both the debtor and the Registrar.

23 The relevant sub-sections of s. 22 of the *407 Act* state:

> 22.(1) If a toll, and the related fees and interest, are not paid within 90 days of the day a person receives a notice of failure to pay under section 16, the owner [ETR] may notify the Registrar of Motor Vehicles of the failure to pay.
>
> ...
>
> (3) The owner [ETR] shall promptly inform the person who received notice of failure to pay under section 16 that notice has been given to the Registrar of Motor Vehicles under subsection (1).
>
> (4) If the Registrar of Motor Vehicles receives notice under subsection (1), he or she shall, at the next opportunity, refuse to validate the vehicle permit issued to the person who received the notice of failure to pay under section 16 and refuse to issue a vehicle permit to that person.
>
> ...
>
> (6) If notice has been given to the Registrar of Motor Vehicles under subsection (1) and the toll and related fees and interest are subsequently paid, the owner [ETR] shall immediately notify the Registrar of the payment.
>
> (7) If the Registrar of Motor Vehicles is notified by the owner [ETR] that the toll, fees and interest have been paid or is notified by the dispute arbitrator that the person is not responsible for paying the toll, fees and interest, the Registrar shall,
>
> (a) validate any vehicle permit that he or she refused to validate under subsection (4);
>
> (b) issue a vehicle permit to a person if it was refused under subsection (4).

24 As can be seen, the effect of this statutory provision is to permit ETR to enforce payment of toll debt. Once the Registrar receives notice from the ETR of a failure to pay, the Registrar <u>must</u> refuse to validate the debtor's vehicle permit and may not issue a vehicle permit to that person. Once ETR notifies the Registrar that payment has been made (or the Registrar is notified by the dispute arbitrator that the debtor is not responsible for paying the toll), the Registrar shall validate and issue a vehicle permit.

25 There is nothing in the *407 Act* that requires a driver to use Highway 407. Conversely, ETR is unable to refuse anyone access to the highway, including debtors who have failed to pay toll debt. To enforce payment, it must rely on the powers granted under the *407 Act*.

26 There is no dispute that s. 22 of the *407 Act* is validly enacted pursuant to the Province's authority under s. 92 of the *Constitution Act, 1867* and is therefore within the Province's competence. As the motions judge noted at para. 33 of his reasons, there is also no quarrel with the proposition that the purpose of s. 22(4) is to enforce payment of a debt. Similarly, there is no issue that the denial of vehicle permits is a legitimate mechanism to achieve the purposes of the Highway 407 private/public partnership and the operation of that highway. Indeed, for most of those members of the public who use Highway 407, the issues before this court are immaterial. The appellant's challenge relates only to a member of the public who is a discharged bankrupt.

(ii) **The *BIA***

27 Bankruptcy is triggered by insolvency. It is a procedure that is governed by statute. The *BIA* is the comprehensive code that addresses bankruptcy. Rand J. captured the essence of the bankruptcy process in *Canadian Bankers' Association v. Attorney General of Saskatchewan*, [1956] S.C.R. 31, at p. 46:

> Bankruptcy is a well understood procedure by which an insolvent debtor's property is coercively brought under a judicial administration in the interests primarily of the creditors. To this proceeding not only a personal stigma may attach but restrictions on freedom in future business activity may result. The relief to the debtor consists in the cancellation of debts which, otherwise, might effectually prevent him from rehabilitating himself economically and socially.

28 The Supreme Court reiterated these public policy objectives in *Sam Lévy & Associés Inc. v. Azco Mining Inc.*, 2001 SCC 92, [2001] 3 S.C.R. 978, at paras. 33 and 65.

29 In *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453, at para. 7, Gonthier J. stated that the bankruptcy system serves two distinct goals: the equitable distribution of a bankrupt's assets among the estate's creditors *inter se* and the financial rehabilitation of insolvent individuals.

30 In *The 2013 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 2013), at p. 2,

Lloyd W. Houlden, Geoffrey B. Morawetz and Janis P. Sarra describe the purposes of the *BIA* as follows:

> It is a fundamental purpose of the *Act* to provide for the financial rehabilitation of insolvent persons. The *Act* permits an honest debtor, who has been unfortunate, to secure a discharge so that he or she can make a fresh start and resume his or her place in the business community.
>
> The *Act* was passed to provide for the orderly and fair distribution of the property of a bankrupt among his or her creditors on a *pari passu* basis.
>
> ...
>
> The Act provides a regime whereby the creditors of the bankrupt will pursue their claims by collective action through the trustee so that the assets of the bankrupt can be realized and distributed on an equitable basis subject to the priorities of preferred creditors and the rights of secured creditors. [Citations omitted.]

31 This last purpose was emphasized by Deschamps J. in *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379, at para. 22:

> While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:
>
>> They all provide a collective proceeding that supersedes the usual civil process available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]
>
> The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will

> realize its claims against the debtor's limited assets while the other creditors attempt a compromise.

32 When a person becomes bankrupt, all of his or her property vests in the trustee in bankruptcy: s. 71. Section 69.2(1) of the *BIA* precludes "any remedy against the debtor or the debtor's property" once in bankruptcy. The exercise of a remedy to collect and enforce is stayed by the bankruptcy.

33 The bankrupt's property is then divisible among the bankrupt's creditors unless an exemption applies: s. 67. Exemptions include prescribed payments relating to the essential needs of an individual and property that is exempt from execution or seizure under provincial laws. As a result of the operation of s. 67 and s. 2(1)6 of the *Execution Act*, R.S.O. 1990, c. E.24, a motor vehicle not exceeding $5,000 in value is exempt.

34 Pursuant to s. 121 of the *BIA*, all debts and liabilities, present or future, to which the bankrupt is subject on the day of bankruptcy are deemed to be claims provable in bankruptcy. Pursuant to s. 124, every creditor shall prove his or her claim, failing which, the creditor is not entitled to share in any distribution that is made. All unsecured claims provable in bankruptcy are to be paid rateably. The duties and the discharge of a bankrupt are addressed in Part VI of the *BIA*. Creditors who have filed a proof of claim receive notice of the discharge hearing and may make submissions and address their concerns at the hearing. As mentioned, if a creditor fails to file a proof of claim, it may not participate in any distribution of the debtor's property.

35 In *Vachon v. Canada Employment and Immigration Commission*, [1985] 2 S.C.R. 417, at p. 426, Beetz J. observed that an ordinary unsecured creditor with a claim provable in bankruptcy can only obtain payment of that claim subject to and in accordance with the terms of the *BIA*. The procedure laid down by that Act completely excluded any other remedy or procedure.

36 Section 168.1 and following of the *BIA* address the discharge procedures. Subsection 178(2) provides that "[s]ubject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy." Examples of subsection (1) exceptions include debts arising from "any enactment of a province that provides for loans or guarantees of loans to students" and debts arising from an order or agreement for child or spousal support. No exception is specified for provincial driving or vehicle licensing debts generally or ETR toll debts specifically.

37 Not surprisingly, the regime results in hardship for many creditors. In *Schreyer v. Schreyer*, 2011 SCC 35, [2011] 2 S.C.R. 605, a wife argued that her equalization claim survived her husband's bankruptcy. Writing for the Supreme Court, LeBel J. described the nature of the insolvency regime and the application of s. 178(2) at paras. 19-21:

> The very design of insolvency legislation raises difficult policy issues for Parliament. Legislation that establishes an orderly liquidation process for situations in which reorganization is not possible, that averts races to execution and that gives debtors a chance for a new start is generally viewed as a wise

> policy choice. Such legislation has become part of the legal and economic landscape in modern societies. But it entails a price, and those who might have to pay that price sometimes strive mightily to avoid it. Despite the proven wisdom of the policies underpinning the insolvency legislation, it is understandable that few appreciate the "haircuts" or even outright losses that bankruptcies trigger. So creditors seek to obtain security or third-party guarantees. In other cases, statutory exemptions from the application of the *BIA* may apply. For a long time, governments took care to protect their own interests, but they now generally accept, albeit with some reluctance, that they should share the fate of ordinary creditors (*Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379). Other types of exemptions that seem fair or even necessary are set out in the *BIA*. However, the more exemptions there are, the less likely it is that the basic policy objectives of insolvency legislation can be achieved.
>
> As a consequence, the interpretation of the *BIA* requires the acceptance of the principle that every claim is swept into the bankruptcy and that the bankrupt is released from all of them upon being discharged unless the law sets out a clear exclusion or exemption.
>
> ...
>
> For creditors, the discharge means that they "cease to be able to enforce claims against the bankrupt that are provable in bankruptcy" (L. W. Houlden, G. B. Morawetz and J. Sarra, *Bankruptcy and Insolvency Law of Canada* (4th ed. (loose-leaf)), vol. 3, at p. 6-283).

38 In that case, the Supreme Court determined that a provable claim under the *BIA* was to be broadly defined. The Court upheld the decision that the wife's equalization claim was provable in her husband's bankruptcy and was therefore released by his discharge.

39 Section 72 of the *BIA* touches on the effect of provincial legislation. It provides that:

> 72.(1) The provisions of this Act shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property and civil rights that are not in conflict with this Act, and the trustee is entitled to avail himself of all rights and remedies provided by that law or statute as supplementary to and in addition to the rights and remedies provided by this Act.
>
> (2) No bankruptcy order, assignment or other document made or executed under the authority of this Act shall, except as otherwise provided in this Act, be within the operation of any legislative enactment in force at any time in any province

> relating to deeds, mortgages, hypothecs, judgments, bills of sale, chattel mortgages, property or registration of documents affecting title to or liens of charges on real or personal property or immovables or movables.

40 Lastly, the *BIA* constitutes a complete code governing the bankruptcy process. In *Husky Oil*, at para. 85, Gonthier J. stated:

> Parliament has enacted a complete code in the *Bankruptcy Act*, one which necessarily calls upon provincial law for its operation. But Parliament's invitation stipulates an important limitation at the threshold of its domain, namely, that provincial law simply cannot apply when to do so would entail subverting the federal order of priorities in the *Bankruptcy Act*.

41 There are sound policy reasons in support of Parliament's decision to enact such a comprehensive code:

- creditors are placed on an equal footing, in a single proceeding;
- the trustee in bankruptcy may collect all of the bankrupt's available assets for the benefit of his or her creditors;
- the exemptions in the *BIA* will ensure that the bankrupt has enough to live on;
- once the bankrupt is discharged, he or she is released from all claims provable and can embark on a "fresh start" in life, or put differently, financial rehabilitation;
- uncertainty about which claims or debts are not released by a discharge is limited, as the exceptions are expressly described in the *BIA*.

E. MOTIONS JUDGE'S REASONS

42 Having discussed the applicable legislation, I will now turn to the motions judge's reasons.

43 The motions judge commenced his analysis by identifying the purpose of ss. 16 to 25 of the *407 Act*. In describing s. 22, at para. 14, he said that "its purpose is directed to the collection of a debt." ETR did not quarrel with the proposition that the purpose of s. 22(4) is to enforce payment of a debt. In a footnote, the motions judge stated that ETR pointed out that the collection of debts was in the public interest as well as in the interest of ETR, to ensure that the partnership flourishes.

44 The motions judge noted the presumption of constitutionality. He then proceeded to observe that s. 178(2) of the *BIA* does not extinguish indebtedness; rather, it releases bankrupts from claims provable in bankruptcy. He stated that the first goal of the bankruptcy system is to ensure the equitable distribution of a bankrupt's assets among the estate's creditors. That said, a motor vehicle licence is not an asset belonging to the debtor; it is a privilege granted by a government authority and does not affect the equitable distribution of a bankrupt's assets. Accordingly, s. 22(4) of the *407*

Act did not conflict with the scheme of the *BIA*. Furthermore, it did not affect in any way the equitable distribution of the bankrupt's property. As a result of these observations, the motions judge held that there was no operational conflict between s. 22(4) of the *407 Act* and the *BIA*.

45 As mentioned, the motions judge did not consider the second branch of the paramountcy doctrine. This would have involved an analysis of whether the legislative purpose of the *BIA* was thwarted by the operation of s. 22(4). As part of his paramountcy analysis, the motions judge did not consider whether the collection of pre-bankruptcy indebtedness impeded Moore's ability as a discharged bankrupt to have a "fresh start" post-bankruptcy or resulted in unequal treatment of unsecured creditors.

F. STANDARD OF REVIEW

46 As the issue on appeal is a question of law, the standard of review is correctness: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, at para 8.

G. POSITIONS OF THE PARTIES

(i) The Appellant's Position

47 In brief, the appellant Superintendent submits that when s. 22(4) of the *407 Act* is used to enforce claims provable in bankruptcy against discharged bankrupts, it is in operational conflict with the *BIA*. Relying on *Schreyer*, the appellant argues that while a discharge does not extinguish a claim, creditors "cease to be able to enforce claims against the bankrupt that are provable in bankruptcy." ETR, like other unsecured creditors, is prohibited from enforcing its monetary claim after discharge, but s. 22(4) permits it to do indirectly that which it is prohibited from doing directly, thus bringing the operation of the subsection into direct conflict with s. 178(2) of the *BIA* in the case of a discharged bankrupt.

48 The appellant also submits that s. 22(4) of the *407 Act* frustrates the two main purposes of the bankruptcy regime: the financial rehabilitation of insolvent individuals (also referred to as the "fresh start" principle) and the equal treatment of all unsecured creditors. Firstly, the motion judge erred in failing to properly direct his attention to the fresh start objective. Section 22(4) frustrates this objective in that it permits ETR to coerce a bankrupt into satisfying debts released by a discharge in bankruptcy. Secondly, the only exceptions to the *pari passu* distribution of property among equal ranking creditors are listed in s. 178(1). ETR's debt does not fall within any such exception. The effect of the motion judge's decision is to create a new class of debts that survives bankruptcy. Based on the motion judge's decision, ETR need not participate in the bankruptcy process at all but can recover its entire debt nonetheless.

49 The appellant concludes by noting that s. 22(4) is valid provincial legislation and was not drafted to conflict with the *BIA*. However, when that subsection is applied in a bankruptcy situation, it conflicts with the *BIA* and frustrates the two main purposes of the bankruptcy system. To that

extent, s. 22(4) is inoperable based on the doctrine of paramountcy.

(ii) **The Respondent's Position**

50 The respondent ETR answers by submitting that no federal head of power enables Parliament to require provinces to grant vehicle permits or to require third parties to extend credit to a discharged bankrupt.

51 Operational conflict is only engaged where dual statutory compliance is impossible. This is not the case in this appeal.

52 As for purposive conflict, the respondent submits that provincial laws should only be declared inoperative due to frustration of a federal purpose in the clearest of cases. Inoperability arises where there is just one reasonable interpretation of the provision in issue and that interpretation frustrates the purpose of the federal law. In ETR's submission, s. 22 of the *407 Act* does not frustrate the financial rehabilitation of the bankrupt, reorganize the priorities of creditors, or reorder how the bankrupt's assets are to be distributed. Section 178(2) does not extinguish indebtedness; it simply releases the debtor from claims provable in bankruptcy. The MTO's right to suspend vehicle permits is unaffected by bankruptcy. Moreover, the object of financial rehabilitation must be balanced against the creditor's interest in protecting itself. If allowed, this appeal would force the Province of Ontario to grant vehicle permits to discharged bankrupts thereby empowering them to accumulate additional debt to ETR.

53 The respondent also submits that certain provincial highway traffic and other legislation will be affected if this appeal is allowed.

(iii) **The Interveners' Position**

54 The interveners agree with ETR that there is no operational conflict between the two statutes, but argue that there is a purposive conflict.

55 The interveners submit that the central issue in this appeal is whether ETR may use the vehicle permit denial remedy in the face of a stay of proceedings pre-discharge, and enforce payment of pre-bankruptcy indebtedness post-discharge. The procedure in the *BIA* precludes any other remedy or procedure to obtain payment of a claim provable in bankruptcy. The remedy at issue in this appeal operates to allow ETR to recover its debts in another manner; it is a method of debt collection and nothing more.

56 Section 69.2(1) of the *BIA* excludes "any remedy against the debtor or the debtor's property." The denial of the vehicle permit is against the debtor, regardless of whether the permit is a privilege or property. The effect of the denial is to prevent a bankrupt from driving anywhere in Ontario, not just on Highway 407. The *BIA* stay of proceedings prohibits the exercise of the remedy.

57 The interveners distinguish the other legislation relied upon by ETR. They argue that in instances where provincial highway traffic legislation allows for the suspension of licences, the legislation specifically provides that the release of debts through bankruptcy has no effect on licence denial. The *407 Act* contains no such provision.

H. ANALYSIS

58 Before embarking on an analysis of the interaction between the *BIA* and the *407 Act*, certain basic principles should be addressed.

59 Firstly, where there is an inconsistency between validly enacted but overlapping provincial and federal legislation, the provincial legislation is inoperative to the extent of the inconsistency: *Rothmans, Benson & Hedges Inc. v. Saskatchewan*, 2005 SCC 13, [2005] 1 S.C.R. 188, at para. 11. The remainder of the provincial legislation is unaffected. This is the doctrine of federal paramountcy.

60 Secondly, there are two ways in which a claim of paramountcy may arise. These were described by McLachlin C.J. in *Quebec (Attorney General) v. Canadian Owners and Pilots Association,* 2010 SCC 39, [2010] 2 S.C.R. 536, at para. 64:

(i) where there is an operational conflict between federal and provincial laws such that dual compliance is impossible; and
(ii) where dual compliance is possible, but the provincial law is incompatible with, or frustrates the purpose of, the federal legislation. As stated in *Canadian Western Bank*, at para. 73,

> [T]here will be cases in which imposing an obligation to comply with provincial legislation would in effect frustrate the purpose of a federal law even though it did not entail a direct violation of the federal law's provisions.

61 Thirdly, the party seeking to invoke the doctrine of paramountcy bears the burden of proof: *British Columbia (Attorney General) v. Lafarge Canada Inc.*, 2007 SCC 23, [2007] 2 S.C.R. 86, at para. 77.

62 The invocation of federal paramountcy on the basis of frustration of purpose requires clear proof of purpose and the standard is high. Mere permissive federal legislation does not suffice: *Canadian Owners and Pilots Association*, at paras. 67 and 68.

63 Fourthly, in considering a potential conflict, a court should first decide whether the two laws in issue are validly enacted. This involves an examination of the pith and substance of the impugned legislation. The analysis may concern the legislation as a whole or only certain of its provisions:

Canadian Western Bank v. Alberta, 2007 SCC 22, [2007] 2 S.C.R. 3, at para. 25.

64 To determine the pith and substance, the purpose of the enacting body and the legal effect of the law should both be examined: *Canadian Western Bank*, at para. 27. The dominant purpose of the legislation is decisive and incidental effects do not disturb the constitutionality of an otherwise *intra vires* law: *Canadian Western Bank*, at para. 28.

65 Lastly, Canada's federal system must balance flexibility and predictability. As such, when addressing the validity of statutes, there is a presumption of constitutionality. Based on this presumption, a government is presumed to have enacted a law that does not exceed its powers. Judicial restraint is the operative principle. As Professor Peter Hogg describes in his book, *Constitutional Law of Canada*, 5th ed. (Scarborough: Thomson Carswell, 2007) vol. 1, at p. 449, due to this presumption, "in choosing between competing, plausible characterizations of a law, the court should normally choose that one that would support the validity of the law." As stated in *Canadian Western Bank*, at para. 37, and reiterated in *Chatterjee v. Ontario (Attorney General)*, 2009 SCC 19, [2009] 1 S.C.R. 624, at para. 2, "a court should favour, where possible, the ordinary operation of statutes enacted by *both* levels of government" (emphasis in original). Co-operative federalism should be facilitated, not impeded. This approach is consistent with the "dominant tide" of modern federalism: *Reference re Securities Act*, 2011 SCC 66, [2011] 3 S.C.R. 837, at para. 57.

66 In keeping with this approach, when a federal statute can be properly interpreted so as not to interfere with a provincial statute, such an interpretation is to be applied in preference to an alternative construction which would bring about a conflict between the two statutes: *Canadian Western Bank*, at para. 75; and *Marine Services*, at para. 69. The fact that Parliament has legislated in respect of a matter does not lead to the presumption that in so doing it intended to rule out any possible provincial action in respect of that subject: *Canadian Western Bank*, at para. 74; and *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6, at para. 57.

(a) Operational Conflict

67 The first issue to consider is whether there is an operational conflict between s. 22(4) of the *407 Act* and s. 178(2) of the *BIA*. In this regard, the appellant relies on dicta in *Husky Oil* to argue that an operational conflict exists between the two statutes. In response, ETR submits that the majority position in *Husky Oil* has been overtaken by subsequent jurisprudence such as *Canadian Western Bank* and *Chatterjee*.

(i) Applicable Test

68 The test for operational conflict was established in *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161, at p. 191. On behalf of the majority, Dickson J. explained that an operational conflict exists "where one enactment says 'yes' and the other says 'no'; 'the same citizens are being told to do inconsistent things'; compliance with one is defiance of the other."

69 Early case law limited the application of the doctrine of paramountcy to cases of operational conflict. The frustration of purpose branch of paramountcy had not yet been developed.

70 However, in *Bank of Montreal v. Hall*, [1990] 1 S.C.R. 121, La Forest J. appeared to broaden the test from *Multiple Access.* He stated at p. 154 that "dual compliance will be impossible when application of the provincial statute can fairly be said to frustrate Parliament's legislative purpose." Although not so identified at the time, this decision would later come to be viewed as establishing a separate branch of federal paramountcy, namely, frustration of purpose.

71 *Husky Oil* followed on the heels of *Hall* in 1995. In dealing with paramountcy, the majority relied on *Hall* and did not cite the test from *Multiple Access.* The Court addressed the issue of conflict between the *Bankruptcy Act* and a provincial statute which purported to allow a creditor to recover a debt outside of the bankruptcy process. The impugned provincial legislation made the principal of a defaulting contractor personally liable to Saskatchewan's workers' compensation fund. A principal who was required to make a payment to the fund was then permitted to set that amount off against any amount the principal owed to the bankrupt contractor's estate. At para. 39, Gonthier J., on behalf of the majority, observed that the form of a provincial interest must not be allowed to triumph over its substance:

> The provinces are not entitled to do indirectly what they are prohibited from doing directly; ... there need not be any provincial intention to intrude into the exclusive federal sphere of bankruptcy and to conflict with the order of priorities of the *Bankruptcy Act* in order to render the provincial law inapplicable. It is sufficient that the effect of provincial legislation is to do so. [Emphasis in original.]

72 In that case, the majority found that the effect of the provincial legislation in securing the Board's debt against the bankrupt's estate conflicted with Parliament's intention to establish priorities as described in the *Bankruptcy Act,* R.S.C., 1985, c. B-3. The offending provincial statutory provisions were therefore determined to be inapplicable in a bankruptcy context.

73 The majority summarized the Court's jurisprudence in the "bankruptcy quartet" (*Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35; *Deloitte Haskins and Sells Ltd. v. Workers' Compensation Board*, [1985] 1 S.C.R. 785; *Federal Business Development Bank v. Quebec (Commission de la santé et de la sécurité du travail)*, [1988] 1 S.C.R. 1061; *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24), concluding at paras. 32-39 that the quartet stands for six propositions:

(1) provinces cannot create priorities between creditors or change the scheme of distribution on bankruptcy under s. 136(1) of the *Bankruptcy Act*;

(2) while provincial legislation may validly affect priorities in a non-bankruptcy situation, once bankruptcy has occurred, section 136(1) of the *Bankruptcy Act* determines the status and priority of the claims specifically dealt with in that

section;

(3) if the provinces could create their own priorities or affect priorities under the *Bankruptcy Act* this would invite a different scheme of distribution on bankruptcy from province to province, an unacceptable situation; and

(4) the definition of terms such as "secured creditor", if defined under the *Bankruptcy Act*, must be interpreted in bankruptcy cases as defined by Parliament, not the provincial legislatures. Provinces cannot affect how such terms are defined for purposes of the *Bankruptcy Act*;

...

(5) in determining the relationship between provincial legislation and the *Bankruptcy Act*, the form of the provincial interest created must not be allowed to triumph over its substance. The provinces are not entitled to do indirectly what they are prohibited from doing directly; and

(6) there need not be any provincial intention to intrude into the exclusive federal sphere of bankruptcy and to conflict with the order of priorities of the *Bankruptcy Act* in order to render the provincial law inapplicable. It is sufficient that the effect of provincial legislation is to do so. [Emphasis in original.]

74 The Court did remark at para. 36 that for a provincial law to be inapplicable, the Court must find a "clear conflict, that is, an inconsistent or mutually exclusive result." Applying the six propositions to the facts of *Husky Oil*, the Court found a conflict. In contrast, the dissent applied the strict *Multiple Access* test and found that there was no conflict because the *Bankruptcy Act* did not prohibit that which the provincial legislation authorized.

75 Although not so described in the case, in my view, the majority in *Husky Oil* is best understood as a decision involving frustration of a federal purpose rather than an operational conflict. Firstly, the majority did not rely on *Multiple Access* but on *Hall*, a case which is now viewed as a frustration of purpose decision. Secondly, the majority relied on the effect of the provincial legislation and indirect conflict to ground its paramountcy analysis and not the strict operational conflict test found in *Multiple Access*.

76 The treatment accorded *Husky Oil* is seen in the Supreme Court's subsequent insolvency decisions and particularly in the dicta of Deschamps J. in *GMAC Commercial Credit Corporation - Canada v. T.C.T. Logistics Inc.*, 2006 SCC 35, [2006] 2 S.C.R. 123. The majority's decision did not turn on the paramountcy doctrine, however, Deschamps J. invoked paramountcy in dissent, stating:

> In *Husky Oil*, Gonthier J., writing for the majority, ... not only noted that provinces may not *directly* affect priorities under the *Bankruptcy Act*, but also stated propositions that permit the paramountcy doctrine to be applied where provincial legislation *indirectly* conflicts with the *BIA*...

> Although the propositions enunciated in *Husky Oil* relate more specifically to conflicts between provincial statutes and the scheme of distribution established in the *BIA*, they have a scope that extends beyond that specific context, and they demonstrate how the paramountcy doctrine applies in the context of bankruptcy. [Emphasis in original.]

77 In 2012, Deschamps J. again cited the majority in *Husky Oil,* holding that provinces cannot affect the order of priorities set out in the *BIA* (see *Newfoundland and Labrador v. AbitibiBowater Inc.*, 2012 SCC 67, [2012] 3 S.C.R. 443, at para. 19).

78 However, in *Indalex*, the Supreme Court again had the opportunity to apply the doctrine of paramountcy in an insolvency context. Deschamps J. cited *Husky Oil*, at para. 56, to the effect that the "provincial legislature cannot, through measures such as a deemed trust, affect priorities granted under federal legislation". She did not repeat the six propositions enunciated in *Husky Oil.* Rather, she went on to apply the *Multiple Access* test as restated in *Canadian Western Bank.* Based on that test, she found that there was a direct conflict between the provincial legislation and an order made under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 such that, at para. 60, "compliance with the provincial law necessarily entails defiance of the order made under federal law."

79 It is therefore clear that for the purposes of operational conflict, the *Multiple Access* test is applicable and not the principles described in *Husky Oil.*

80 Moreover, the Supreme Court has consistently cited the *Multiple Access* test in other cases. See *Canadian Western Bank*, at para 71; *Chatterjee*, at para. 36; *Lafarge*, at para. 76; *Rothmans*, at para. 11; *Law Society of British Columbia v. Mangat*, 2001 SCC 67, [2001] 3 S.C.R. 113, at para. 69; *114957 Canada Ltée (Spraytech, Société d'arrosage) v. Hudson (Town)*, 2001 SCC 40, [2001] 2 S.C.R. 241, at para. 34; *M & D Farm Ltd. v. Manitoba Agricultural Credit Corp.*, [1999] 2 S.C.R. 961, at para. 40.

81 Most recently, in *Marine Services International Ltd. v. Ryan Estate*, 2013 SCC 44, at para. 68, the Supreme Court restated the test in the following terms: "Where the federal statute says "yes" and the provincial statute says "no", or vice versa, compliance with one statute means a violation of the other statute. It is the archetypical operational conflict."

82 In its recent jurisprudence, the Supreme Court has applied the test from *Multiple Access* narrowly to find an operational conflict only where it was impossible to comply with both statutes: see *Indalex*.

83 Where the federal legislation was merely permissive, the Court did not find a conflict because it was possible to comply with both laws: see *Quebec (Attorney General) v. Canada (Human Resources and Social Development)*, 2011 SCC 60, [2011] 3 S.C.R. 635 and *Canadian Owners and Pilots Association.* Where the legislation could be interpreted to avoid a conflict, or where there

were other means of avoiding a conflict, the Court did not find a conflict: see *Marine Services International Ltd.*; *Chatterjee* and *Canadian Western Bank*. As such, the test for operational conflict is to be strictly applied and is engaged only where dual compliance is impossible.

(ii) **Application**

84 Turning then to the facts that underlie this appeal, there is no issue that both the *BIA* and the *407 Act* are validly enacted, the former falling under federal authority and the latter under provincial authority. The purpose of the *BIA* is to establish an organized system for the distribution of a bankrupt's estate, and to provide for the financial rehabilitation of the bankrupt. The purpose of the *407 Act* is to establish a private toll highway with open access to the public, and to set out how the highway will operate. However, as noted by the motions judge, the purpose of s. 22(4) of the *407 Act* is to collect ETR's debt. The legal effect of the *407 Act* is to permit ETR to operate the highway and to establish, collect and enforce toll debt from users regardless of their bankruptcy status. As noted in para. 33 of the motions judge's reasons, ETR does not quarrel with the proposition that the purpose of s. 22(4) of the *407 Act* is to enforce payment of a debt. It also cannot be seriously contested that ETR's claim to toll debt is a claim provable in bankruptcy. The insertion of the province's licensing authority does not alter this conclusion.

85 I must then consider the approach established by the Supreme Court in *Multiple Access,* as restated most recently in *Marine Services*: can there be dual compliance?

86 It is fair to conclude that Moore could be in compliance with both statutes. While he would not be able to drive his own car, he could forego obtaining a vehicle permit and not pay the toll debt to ETR. Alternatively, he could pay the debt and obtain a vehicle permit. As he is not required to pay the debt and the *BIA* does not require him to obtain a vehicle permit, there is no impossibility of dual compliance insofar as he is concerned.

87 What of ETR? Can it be in compliance with both statutes?

88 The alleged conflict in this case is between s. 178(2) of the *BIA*, which releases the discharged bankrupt from most claims, and s. 22(4) of the *407 Act*, which permits ETR to initiate a process by which the debtor will be denied a vehicle permit until he or she discharges the debt to ETR.

89 As indicated in *Schreyer,* at para. 21, s. 178(2) of the *BIA* bars creditors from enforcing their claims after discharge. Section 124 of the *BIA* provides that before an unsecured creditor is entitled to share in the distribution of the bankrupt's property, it must file a proof of claim. Under s. 178(2) of the *BIA*, such claims are then released on discharge unless they fall within one of the exceptions clearly set out in s. 178(1). Pursuant to s. 22(4) of the *407 Act*, ETR need not file a proof of claim and may collect all of its debt from a bankrupt in the absence of an exception. It can opt to ignore the regime established for all other creditors of the bankrupt.

90 That said, the provincial legislation in this case is permissive in that it does not require ETR to

initiate the collection process. ETR could comply with both statutes by declining to pursue its remedy under s. 22. But, can ETR rely on s. 22(4) to enforce its claim against Moore? ETR asserts that it relies heavily on the collection process embodied in s. 22 as it cannot deny access to users who refuse to pay their bills, and other means of debt collection are costly. If ETR has the choice of declining to enforce, but routinely chooses to enforce, is there still no operational conflict?

91 In substance, s. 22(1) provides ETR with the choice of causing the collection of a debt from a discharged bankrupt, a choice which the *BIA* expressly abrogates. In this sense, the *BIA* says "no" and the *407 Act* says "yes."

92 However, to find an operational conflict where it is possible to comply with both laws would not be in keeping with the strict test for operational conflict which the Supreme Court has consistently applied. Furthermore, to take a more substantive approach to operational conflict would also render the "frustration of federal purpose" branch of the paramountcy test largely superfluous.

93 On a strict reading of the test for operational conflict, there is no impossibility of dual compliance. Section 22 of the *407 Act* gives ETR the choice to notify the Registrar of a failure to pay. ETR may comply with both laws by declining to initiate the enforcement procedure. Where bankruptcy occurs after the ETR has initiated the enforcement procedure, compliance depends on the debtor. He is not required to obtain vehicle permits and is not required to pay his debt. Similarly, the Registrar cannot compel him to do so. I conclude that there is no operational conflict between s. 22(4) of the *407 Act* and s. 178(2) of the *BIA*.

(b) Conflict of Purpose

94 The next issue to consider is whether the operation of s. 22(4) of the *407 Act* conflicts with the purpose of the *BIA*. As mentioned, the purpose of s. 22(4) is to collect toll debt. There are two *BIA* purposes in issue: the fresh start principle and the equal treatment of unsecured creditors. Given my conclusion on the former, it is unnecessary to address the latter.

(i) **Applicable Test**

95 In 2010, in *Canadian Owners and Pilots Association*, at para. 64, the Supreme Court described frustration of federal purpose as a "second branch" of the doctrine of paramountcy.

96 At para. 66, McLachlin C.J. described the test for frustration of purpose as follows:

> The party seeking to invoke the doctrine of federal paramountcy bears the burden of proof. That party must prove that the impugned legislation frustrates the purpose of a federal enactment. To do so, it must first establish the purpose of the relevant federal statute, and then prove that the provincial legislation is incompatible with this purpose. The standard for invalidating provincial legislation on the basis of frustration of federal purpose is high; permissive

> federal legislation, without more, will not establish that a federal purpose is frustrated when provincial legislation restricts the scope of the federal permission. [Citations omitted.]

97 The Supreme Court cited this articulation of the test in its most recent paramountcy decision, *Marine Services*, at para. 69.

98 As discussed above, in assessing whether the provincial legislation frustrates a federal purpose, it must be recalled that when a federal statute can be properly interpreted so as not to interfere with a provincial statute, such an interpretation is to be applied in preference to an alternative construction which would bring about a conflict between the two statutes. The fact that Parliament has legislated in respect of a matter does not lead to the presumption that in so doing it intended to rule out any possible provincial action in respect of that subject.

(i) Fresh Start Principle

(a) The Fresh Start Purpose of the *BIA*

99 I have already referred to the fresh start principle which underlies the *BIA* and which permeates the jurisprudence on bankruptcy legislation. From a debtor's perspective, and indeed society's, financial rehabilitation is a primary goal of the bankruptcy regime. At its heart, permitting a creditor to insist on payment of pre-bankruptcy indebtedness after a bankruptcy discharge frustrates a bankrupt's ability to start life afresh unencumbered by his or her past indebtedness. As often repeated in United States bankruptcy jurisprudence, one of the purposes of bankruptcy legislation is to give debtors "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." See for example *Local Loan Co. v. Hunt*, 292 U.S. 234 at 244 (1934); *Perez v. Campbell*, 402 U.S. 637 at 648 (1971); *Grogan v. Garner*, 498 U.S. 279 at 286 (1991). Indeed, although obviously inapplicable in Canada, the Supreme Court of the United States held in *Perez* that state laws that attempted to enforce payment of a bankrupt's indebtedness through licence denial were invalid because they conflicted with the fresh start principle.

100 In Canada, there are some claims that constitute exceptions to the fresh start principle. As mentioned, there are those claims that are expressly excluded from the ambit of s. 178(2). They are described in s. 178(1) of the *BIA*. One such claim was described by this court as the kind "which society (through the legislators) considers to be of a quality which outweighs any possible benefit to society in the bankrupt being released of these obligations": *Buland Empire Development Inc. v. Quinto Shoes Imports Ltd.* (1999), 123 O.A.C. 288 (C.A.), at para. 18. The claims excepted in s. 178(1) include certain specified provincial programmes. There is no exception for toll debt owing to ETR.

101 In *Schreyer*, LeBel J. observed, at para. 19, that giving debtors a chance for a new start is

generally viewed as a wise policy choice. He went on to state that exemptions that seem fair or even necessary are set out in the *BIA*. However, "the more exemptions there are, the less likely it is that the basic policy objectives of insolvency legislation can be achieved."

102 In my view, the appellant has satisfied its burden of establishing the fresh start purpose of the *BIA*.

(b) Incompatibility of s. 22(4) of the *407 Act*

103 The parties addressed two competing lines of cases in support of their respective positions. I do not propose to review all of the cases cited. Some deal with the operational conflict branch of the paramountcy analysis or the validity of certain provincial legislation as a whole. (The 407 Act as a whole is not in question in this case.) Moreover, many of the cases relied upon were decided before the frustration of federal purpose branch of the paramountcy doctrine was solidified in Supreme Court jurisprudence.

104 There is limited provincial appellate commentary on comparable legislative regimes. *KPMG Inc. v. Alberta Dental Association (Re Hover)*, 2005 ABCA 101, 363 A.R. 170 was a decision of the Alberta Court of Appeal. It involved a case of professional misconduct by a dentist and the enforcement of disciplinary requirements consisting of the payment of a fine and associated costs. Due to the disciplinary objective of the underlying provincial regulatory authority, the court found that requiring a suspended licensee to pay outstanding fines in order to have his license reinstated did not conflict with the *BIA* even though the payor was a discharged bankrupt. The power to suspend was founded not on non-payment of a debt but on a finding of professional misconduct. If professional sanctions or conditions on licences were no longer operable in the case of a discharged bankrupt, self-regulating bodies would lose the ability to regulate their members' conduct once in bankruptcy. Further, the purpose of the dental licence suspension was not to enforce a debt but to impose conditions on licences which should be withheld from irresponsible individuals.

105 That said, at para. 58, Paperny J.A. distinguished the case from others where "[t]he suspension of a driver's licence was motivated for an improper purpose, that is, to obtain payment that the licensing authority would not otherwise be entitled to in a bankruptcy." This suggests that where the purpose of the suspension is to collect a debt, there would be a conflict with the *BIA*.

106 I will also address *Re Caporale*, [1970] 1 O.R. 37-38 (S.C.), a decision of Houlden J. (as he then was), which was relied upon by ETR. That case simply involved an application to discharge a bankrupt. The bankrupt had been involved in a motor vehicle accident and the judgment had been assigned to the MTO. The MTO appears to have disputed the application for a discharge. In a very brief oral endorsement, Houlden J. granted the discharge noting that the bankrupt had been making payments to the MTO and the MTO would not be prejudiced by the granting of the discharge. He stated that the MTO had an effective remedy in that it could refuse the debtor the privilege of driving in Ontario until he had repaid the full amount of damages awarded against him arising from a motor vehicle accident that had been paid out of the Unsatisfied Judgment Fund. Houlden J. did

not perform any paramountcy analysis, and it would appear that the decision was rendered in the context of a contested discharge application.

107 I do not view these cases as being akin to the appeal before this court. The purpose of the legislation in those cases was directed at the province's regulatory responsibilities and the public interest in establishing and enforcing standards of professional conduct for dentists, and presumably the promotion of safe and responsible driving.

108 Although public safety is not at stake in this appeal, ETR argues that the collection of debts arising from the use of Highway 407 is in the public interest, as well as in ETR's interest, so as to ensure that the public private partnership flourishes. I note in this regard that the Province did not advance such a position on this appeal. Furthermore, as noted by the motions judge, the purpose and effect of s. 22(4) are to enforce the collection of debts. This is the substance of the subsection.

109 I would also observe that s. 198 of the *Highway Traffic Act* expressly states that, where a person has failed to satisfy a judgment for damages occasioned by a motor vehicle, his or her driver's licence shall be suspended and remain suspended until judgment is satisfied or discharged "otherwise than by a discharge in bankruptcy". No such language is found in the *407 Act*. Arguably, this reflects a provincial intention that the collection of ETR's indebtedness would be affected by bankruptcy. In *Section 270 of the Highway Traffic Act* (Report 97) (Winnipeg: Manitoba Law Reform Commission, 1997), the Manitoba Law Reform Commission discussed the provincial counterpart to Ontario's s. 198 at p. 7:

> In those jurisdictions whose statutes are silent on the effect of bankruptcy, it is presumably arguable that bankruptcy would be held to discharge the debt within the meaning of the motor vehicle statute, thus clearing the way for a reinstatement of the suspended licence and registration.

110 In any event, this decision only addresses the legislation in issue on this appeal and does not purport to encompass statutes that reflect their own individualized legislative objectives.

111 It must also be recalled that the appellant does not seek a declaration that s. 22(4) of the *407 Act* is invalid, but only that it is inoperable in relation to discharged bankrupts. Discharged bankrupts do not represent a large segment of the adult population in Canada or in Ontario, and there was no evidence that would suggest that they are disproportionate users of Highway 407. Typically, all unsecured creditors are negatively affected by bankruptcy and, as noted by LeBel J. in *Schreyer*, at para. 19, few appreciate the "haircuts" or losses that bankruptcies trigger. The introduction into the mix of a private commercial participant in a public-private enterprise is inadequate in my view to remove the evident inconsistency with such a fundamental purpose of the *BIA* as financial rehabilitation of the discharged bankrupt. The *407 Act* should not be used to permit ETR to occupy the collector's lane.

112 While co-operative federalism should be the goal, it should not serve to undermine one of the

two key rationales for the bankruptcy regime.

113 I also agree with the appellant that it is no answer to say that a vehicle permit is a privilege. Denial of a vehicle permit may constitute a significant deprivation. The non-renewal of a vehicle permit does not just affect a discharged bankrupt's ability to drive his or her own vehicle on Highway 407 but on any road in Ontario. Frequently it is essential to employment as well as family transportation requirements and responsibilities. Ontario is a vast province. Denial of a vehicle permit has the potential to result in great hardship to a discharged bankrupt struggling to start anew. The importance of a motor vehicle is recognized in the assets identified by Parliament and the Legislature as being exempt from execution or seizure.

114 I accept that as Highway 407 is an open-access road, ETR cannot stop a bankrupt from using the highway. That said, if ETR had filed a claim in Moore's bankruptcy, its concerns could have been raised at a discharge hearing. Additionally and significantly, a vehicle permit may be denied based on debts incurred after an individual's discharge from bankruptcy.

115 In my view, the appellant has established that s. 22(4) of the *407 Act* is incompatible with the fresh start or financial rehabilitation purpose of the *BIA*. Indeed, it frustrates the *BIA*'s heart and the very foundation on which insolvency legislation stands.

116 In conclusion, in keeping with a restrained approach to paramountcy and recognizing the presumption of constitutionality, I am of the view that there is a clear conflict between s. 22(4) of the *407 Act* and the fresh start purpose of the bankruptcy system.

(ii) **Equitable Treatment of Unsecured Creditors**

117 The appellant also argues that the enforcement of ETR's claim pursuant to s. 22(4) frustrates the purpose of the bankruptcy and insolvency system by creating a new class of debt that survives bankruptcy and which frustrates Parliament's intention to treat all unsecured creditors equitably. As mentioned, given my conclusion on the fresh start purpose, there is no need to address this submission.

I. DISPOSITION

118 For these reasons, I would allow the appeal and, as requested by the appellant, set aside the order of the motions judge. In its place, I would substitute an order that:

(1) the discharge of Moore dated June 21, 2011 released him from all claims provable in bankruptcy, including the debt of the 407 ETR as at November 10, 2007 and

(2) the Ministry of Transportation is hereby directed to issue license plates to Moore upon payment of the usual licensing fees.

Further, I would declare that s. 22(4) of the *407 Act* is inoperative to the extent that it thwarts the purpose of providing a discharged bankrupt with a fresh start.

119 As agreed, the respondent shall pay the appellant $36,000 in partial indemnity costs inclusive of disbursements and applicable taxes. The interveners shall bear their own costs.

S.E. PEPALL J.A.
D.H. DOHERTY J.A.:-- I agree.
J.M. SIMMONS J.A.:-- I agree.

TAB 10

Case Name:
Van der Liek (Re)

[1970] O.J. No. 1053

14 C.B.R. (N.S.) 229

Ontario Supreme Court - High Court of Justice
In Bankruptcy

Houlden J.

October 20, 1970.

(7 paras.)

Counsel:

C.H. Morawetz, Q.C., for the trustee.
J. Cannings, for Anna Maria Van der Liek.

---

1 HOULDEN J.:-- This is an appeal from a decision of the registrar [13 C.B.R. (N.S.) 28] in which he found that certain security obtained by the Royal Bank of Canada constituted a preference. The matter has been settled but there are certain items on which I wish to comment, realizing that my comments are obiter but I make them in the hope that they may be of assistance to solicitors practising in the bankruptcy court. I should point out that neither counsel appearing on the appeal was in any way involved in the trial proceedings.

2 In order to raise the prima facie presumption that there has been a fraudulent preference so that the onus is cast upon the defendant to rebut it, the trustee must establish three things:

1. The conveyance, transfer, charge, payment, etc., took place within three months of bankruptcy. If the conveyance, etc. is in favour of a related person, the period is, of course, 12 months under s. 64A [en. 1966-67, c. 32, s. 11]. Ordinarily there is no problem in establishing the date of the transaction but occasionally difficult

questions arise. For instance, it has been held that the day on which the petition is filed in the case of a receiving order, is excluded in calculating the three-months, period: Re Dawes; Ex parte Official Receiver (1897), 4 Mans. 117.

2. It must be proved that the debtor was an insolvent person at the date of the alleged preference: Re Manuel; Ex parte Brody, Chernin and Mendelson (1923), 3 C.B.R. 628 (N.S.); Re Hart Brothers Construction Ltd. (1954), 34 C.B.R. 116, 12 W.W.R. (N.S.) 711 (B.C.) Section 2(j) defines "insolvent person" and the section provides three definitions of insolvency.

3 The court will not presume insolvency. It must be proved and if it is not, then the application must be dismissed: Re Audio Records Ltd.; Hamel v. Galet (1962), 4 C.B.R. (N.S.) 99 (Que.).

4 In this case, the proof of insolvency left a great deal to be desired, and I would like to say a few words about how insolvency should be proved to the court. The usual method is to call two or three creditors whose claims were overdue at the date of the preference. It might be possible for the trustee to prepare a balance sheet to show insolvency within the meaning of s. 2(j)(iii) but from my own experience, the records of a bankrupt are usually in such a state that this is very difficult and the method I have suggested is usually the most convenient way of establishing insolvency.

5 3. It must be shown that as a result of the conveyance, transfer, etc., the creditor received a preference. At the trial of this application, the trustee proved that the giving of the mortgage conferred a preference over other creditors at the date of the bankruptcy. In my judgment, this is not right. In preparing for the hearing of this appeal, I was surprised to find no case which had squarely faced this issue. There are a number of cases which say that it must be shown that there is a preference in fact, but none deals with the issue of what is the relevant time. Until I am overruled by a higher court, I propose to require that in applications attacking fraudulent preferences, it must be shown that the effect of the conveyance, transfer, etc. was at the date when it was made to give preferential treatment to the creditor who received it.

6 The matter of preference or no preference is ordinarily proved by evidence of other creditors that their accounts which were outstanding at the relevant date, were still unpaid at the time of the bankruptcy so that the creditor who received the security, etc. will, as a result of receiving it, be given different treatment than other creditors. The creditors, who give this evidence, will ordinarily be the same creditors who prove the insolvency.

7 When the trustee has proved these three essentials, he need proceed no further and the onus is then on the creditor to satisfy the court, if he can, that there was no intent on the part of the debtor to give a preference. If the creditor can show on the balance of probabilities that the dominant intent of the debtor was not to prefer the creditor but was some other purpose, then the application will be dismissed, but if the creditor fails to meet the onus, then the trustee succeeds.

TAB 11

Case Name:

Orion Industries Ltd. (Trustee of) v. Neil's General Contracting Ltd.

Between
Grant Thornton Alger Inc. in its capacity as, Trustee of Orion Industries Ltd., Appellant, (Applicant), and
Neil's General Contracting Ltd., Respondent, (Respondent)

[2013] A.J. No. 1026

2013 ABCA 330

235 A.C.W.S. (3d) 880

556 A.R. 389

7 C.B.R. (6th) 329

89 Alta. L.R. (5th) 14

2013 CarswellAlta 1795

Docket: 1201-0233-AC

Registry: Calgary

Alberta Court of Appeal
Calgary, Alberta

P.A. Rowbotham, B.K. O'Ferrall and B.L. Veldhuis JJ.A.

Heard: March 7, 2013.
Judgment: September 30, 2013.

(36 paras.)

Bankruptcy and insolvency law -- Proceedings -- Appeals and judicial review -- Practice and procedure -- Setting aside transactions prior to bankruptcy -- Fraudulent preferences, conveyances

or transactions -- Appeal by trustee in bankruptcy from refusal to set aside payment to creditor dismissed -- Insolvent company made payment to creditor to ensure access to piece of equipment insolvent company was trying to sell to avoid bankruptcy -- Impugned payment, which occurred within three months of insolvent company's bankruptcy, gave creditor preference over other creditors -- Insolvent company's desire to realize upon asset was reasonable response to a financial imperative.

Appeal by the trustee in bankruptcy from the refusal to set aside a payment the company made to one of its creditors on the eve of the company's bankruptcy. Within three months of its bankruptcy, the insolvent company made a payment to one of its creditors. The payment was made because the insolvent company believed the creditor could and would deny the insolvent company access to and, thereby, prevent the sale of a piece of equipment the insolvent company was trying to sell to avoid the bankruptcy. More than half of what the insolvent company owed the creditor was for the dismantling and storage of the piece of equipment the insolvent company intended to sell. The trustee in bankruptcy applied for a declaration the payment to the creditor was void by virtue of s. 95(1)(a) of the Bankruptcy and Insolvency Act as a preferential payment. The bankruptcy judge refused to set aside the payment. He found the creditor rebutted the presumption of preferential payment as the evidence established the insolvent company made the payment to secure access to the piece of equipment it intended to sell to generate revenue, which was a legitimate and sensible business decision.

HELD: Appeal dismissed. The impugned payment, which occurred within three months of the insolvent company's bankruptcy, gave the creditor a preference over other creditors. As a result, the payment was a preferential payment capable of being set aside at the instance of the trustee in the absence of evidence it was not made with a view to giving the preference. However, the payment was not made with a view to giving the creditor a preference over other creditors. The insolvent company's desire to realize upon its asset was a reasonable response to a financial imperative.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, RSC 1985, c B-3, s. 95, s. 95(1) (a), s. 95(2)

Appeal From:

Appeal from the Order by The Honourable Mr. Justice S.J. LoVecchio. Dated the 29th day of August, 2012. Entered on the 26th day of September, 2012 (Docket: 25-1517829).

Counsel:

R.N. Billington, Q.C., J.M. Blitt, for the Appellant.

M.L. Engelking, for the Respondent.

Memorandum of Judgment

The following judgment was delivered by

1 THE COURT:-- This is an appeal of a bankruptcy judge's refusal to set aside a payment made by a company to one of its creditors on the eve of company's bankruptcy.

2 The appellant is the trustee in bankruptcy of the bankrupt company which sought to set aside the payment made by the insolvent company. The respondent is the creditor of the bankrupt company which received the payment.

3 The trustee in bankruptcy had applied for a declaration that the payment to the respondent creditor was void by virtue of section 95(1)(a) of the *Bankruptcy and Insolvency Act*, RSC 1985 c B-3. Section 95(1)(a) provides that a payment made by an insolvent person to a creditor with a view to giving that creditor a preference is void as against the trustee in bankruptcy.

4 Section 95(2) of the *Bankruptcy and Insolvency Act* provides that if a payment to a creditor has the effect of giving that creditor a preference, it will be presumed to have been made with a view to giving a voidable preference unless there is evidence establishing that the payment was not made with the view to giving that creditor a preference over other creditors.

5 The term "fraudulent preference" has sometimes been used in this context. Obviously, if the preference is fraudulent, it is voidable. However, in *Piikani Energy Corporation (Re)*, 2012 ABQB 187, 537 AR 211, rev'd on other grounds 2013 ABCA 293, Justice Graesser suggested that the use of the term "fraudulent" is sometimes inappropriate. We agree. Using the term "fraudulent preference" may wrongly impugn the integrity of the creditor receiving the payment because it may not know that it is being paid in preference to others. It may also wrongly impugn the integrity of the debtor making the payment because it may not know that its destiny, within the next three months, is bankruptcy. As Justice Graesser pointed out, neither may be aware that bankruptcy is imminent when the payment is made. Also, when the payment is made, it may not be apparent to either party that the payment in fact gives a preference to the recipient creditor over other creditors. That is, the fact that such payment has had the effect of conferring a preference may only be apparent with the benefit of hindsight. Sometimes, of course, only the insolvent debtor knows that a preference is being given. The creditor receiving the payment does not.

6 A preferable phrase to describe these potentially voidable payments is "preferential payment". Preferential payments are those which in fact confer a preference on one creditor over another. Preferential payments are not voidable *per se.* Only those preferential payments made with a view to giving the preference are voidable at the instance of the trustee. But if the payment confers a

preference in fact, the presumption will be that the payment was intended to confer the preference. And if the presumption is not rebutted, the payment will be void as against the trustee.

7 Here it is acknowledged that the impugned payment gave the respondent creditor a preference over other creditors. It is also acknowledged that this occurred within three months of the insolvent company's bankruptcy. So, there was no doubt the payment was a preferential payment capable of being set aside at the instance of the trustee in the absence of evidence that it was not made with a view to giving the preference.

8 The issue before the bankruptcy judge and on appeal was whether the creditor which received the preferential payment had rebutted the presumption in section 95(2) of the *Bankruptcy and Insolvency Act*, namely the presumption that a payment which has the effect of giving a preference is presumed to be a payment made with a view to giving a preference. The issue then was whether there was "evidence to the contrary", i.e., evidence that the payment was not made with a view to giving a preference or, put another way, evidence that the payment was not intended to be preferential.

9 The bankruptcy judge found that the presumption had been rebutted by evidence about why the payment had been made. The evidence was that it was made by the insolvent company to secure access to an asset which might be sold to generate revenue. As such, the bankruptcy judge found that the payment was valid, not made with a view to giving a preference, and therefore not voidable at the instance of the trustee.

10 It is settled law that the onus or burden of rebutting the presumption in section 95(2) is on the creditor receiving the preferential payment. Discharging that burden is difficult because the creditor receiving the payment may not know what motivated the payment. And though the onus is on the creditor receiving the payment to rebut the presumption of preference, it is the intention of the insolvent debtor which governs: *Salter & Arnold Ltd v. Dominion Bank*, [1926] SCR 621, [1926] 3 DLR 684 at 686.

11 It is also settled law that a payment made in the ordinary course of business, such as those made to discharge debts incurred in the conduct of the bankrupt's business, will not be found to have been made with a view to giving a preference. If it can be established that the preferential payment was made in the ordinary course of the bankrupt's business, the presumption that the payment was made with a view to giving a preference will be rebutted, see *Canadian Credit Men's Association Ltd. v. Jenkins*, [1928] 3 DLR 139 at 144, 10 CBR 77 (Ont SC App Div).

12 What constitutes a payment made in the ordinary course of business is fact dependent. But, payments made to purchase goods or services required for the on-going conduct of the bankrupt's business have been found to be payments made in the ordinary course of business. Payments made to honour contractual obligations allowing the insolvent to carry on business have been found to be payments made in the ordinary course of business. And even a preferential payment made by an insolvent company at a time when its financial collapse is inevitable may be found to be legitimate

if the payment was made with a view to generating income or liquidating assets to satisfy the insolvent's creditors: *St Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.*, 2005 NBCA 55, 255 DLR (4th) 137, *[St Anne-Nackawic]*.

13 In this case, the evidence with respect to why the preferential payment was made came from the chief financial officer of the insolvent company which handled the insolvent company's accounting and financial affairs and which was also its majority shareholder and largest creditor. Evidence with respect to the payment also came from the principal of the creditor which received the payment.

14 The insolvent company's chief financial officer testified that the preferential payment was made because he believed that the creditor which received the payment could and would deny the insolvent company access to, and thereby prevent the sale of, a piece of equipment which it was trying to sell in order to avoid bankruptcy. Additionally, he testified that the payment was made in the belief that the creditor who received the preferential payment could and would cause a major client of the insolvent company to quit doing business with it, thereby putting the insolvent company out of business.

15 The creditor's evidence was that it had dismantled the insolvent company's asset and then, at the insolvent company's request, transported the components to a storage site which the creditor owned. The insolvent company's plan was to sell the asset to generate revenue. A similar asset had previously been sold for just that purpose. It was the creditor's evidence that more than half the money it was owed by the insolvent company was for dismantling and transporting the asset which the insolvent company hoped to sell to generate income. The creditor's evidence was that it would not release the asset unless it was paid for the services it had provided.

16 Having considered the foregoing evidence and the parties' arguments, the bankruptcy judge found that the section 95(2) statutory presumption that the preferential payment was made with a view to giving the creditor which received the payment a preference had been rebutted. That is, the bankruptcy judge found that the evidence to the contrary rebutted the presumption that the preferential payment was intended to give a preference. We see no palpable or overriding error in that finding.

17 The bankruptcy judge found that the "dominant intent" of the insolvent company in making the payment was "to ensure that a certain valuable asset ... could be protected because they (the insolvent company) wanted to liquidate it and hopefully get their money back." The bankruptcy judge found that to be a legitimate and sensible business decision.

18 The New Brunswick Court of Appeal's decision in *St Anne-Nackawic* is instructive. There the Court held that when the insolvent debtor paid one creditor at the expense of others for the purposes of generating income to pay a secured creditor of the insolvent debtor, the payment was not a voidable preference.

19 The facts of that case were similar to those in this appeal. The bankrupt operated a pulp mill. It typically shipped pulp to the creditor's warehouse. One day prior to declaring bankruptcy, the bankrupt paid this creditor about $500,000 to ensure that pulp being stored there would be shipped, thereby generating income. When it made this payment, the bankrupt knew it would be declaring bankruptcy the following day.

20 The trustee in bankruptcy sought and obtained a declaration that the payment was void under section 95 of the *Bankruptcy and Insolvency Act*. The Court of Appeal set aside the bankruptcy judge's declaration, holding that the evidence disclosed that the payment was not made with a view to giving the creditor a preference over other creditors, but rather was intended to generate income, which income would be available to satisfy the claims of the secured creditor.

21 While the Court of Appeal did not articulate a test for determining whether a payment is made with a view to giving a preference, it did consider what the trustee might have done had the impugned payment not been made by the insolvent prior to bankruptcy. The Court of Appeal was of the view that the trustee might well have made the payment it was now attacking because it would have generated much needed income for the bankrupt.

22 That analysis is instructive. What would the trustee have done with the funds used to pay the preferred creditor in this appeal? Assuming the trustee had no better information than the financial officer of the insolvent company had at the time of the impugned payment, it might well have paid the creditor with a view to generating income by freeing up a stored asset for a possible sale.

23 Counsel for the trustee argues that the payment, unlike the payment in *St Anne-Nackawic*, did not generate income for the insolvent company. Furthermore, he argues, it was not objectively reasonable for the insolvent company to pay the creditor because there was no actual or pending sale of the asset. Indeed, there was not even a prospective purchaser on the horizon. Given that fact, counsel for the trustee argued that it was not commercially necessary, reasonable or sensible to protect the asset by paying the creditor for dismantling, transporting and storing it.

24 However, the bankruptcy judge concluded that the payment was commercially necessary in order to secure access to an asset which could be sold to generate revenue and it was therefore not made with a view to giving a preference. That conclusion must be accorded deference.

25 But, to address the appellant's argument, the absence of an actual or pending sale did not make the purpose of the payment, or the intention of the insolvent debtor in making it, objectively unreasonable. The payment might well have paved the way for the generation of income and certainly removed an obstacle to generating income. Had the payment not been made, the very least that could be said is that the prospects of selling the asset would have been diminished.

26 This raises the issue of "pressure". As previously set out, section 95(2) of the *Bankruptcy and Insolvency Act* provides that, in the absence of evidence to the contrary, a payment which has the effect of giving a creditor a preference is presumed to have been made with a view to giving the

preference, even if made under pressure. The section also provides that evidence of pressure is not admissible to validate a preferential payment. So, evidence of pressure cannot be used to rebut the presumption that a preferential payment was made with a view to giving the preference and therefore voidable.

27 The pressure argued by the trustee was evidence of a threat or perceived threat by the creditor to inform the insolvent company's largest customer that the insolvent company was delinquent in paying its debts. The insolvent company's largest customer apparently had a policy which required those providing services to it to pay their suppliers in a timely manner, or else lose its business.

28 This pressure argument was not advanced before the bankruptcy judge. The argument below revolved around the presumption that the preferential payment made with a view to conferring a preference and therefore voidable at the instance of the trustee in the absence of evidence to the contrary. And the evidence to the contrary argument revolved around the reasonableness of paying the creditor in order to protect an asset which might not be capable of generating revenue for the insolvent company.

29 It may not, strictly speaking, be necessary for us to deal with the pressure argument because if there is evidence rebutting the presumption that a preferential payment was made with a view to giving the preference, then the fact that there might also have been evidence of pressure is irrelevant. Evidence of pressure, of course, cannot be adduced to rebut the presumption of preference; but in this case there was evidence independent of the pressure evidence which was found to rebut the presumption. There is nothing in the bankruptcy judge's reasons or in his exchanges with counsel to suggest that he relied on the evidence of pressure which was argued on appeal to support his finding that the presumption had been rebutted.

30 However, in addition to the evidence of the pressure of the threat or perceived threat that the insolvent company's delinquencies would be reported to its largest customer, there was also the evidence of the creditor's insistence that it be paid before access to the asset would be given. That evidence might also be construed as evidence of pressure and the bankruptcy judge did rely on that evidence as rebutting the presumption that a preference was intended. However, the bankruptcy judge characterized that evidence not as evidence of pressure but rather as evidence of a normal business imperative.

31 Prior to the enactment of Canada's bankruptcy legislation, a payment by an insolvent debtor which had the effect of giving one or more of the debtor's creditors a preference over other creditors was not voidable if it were made under pressure. The rationale for this judicial exception to the rule that preferential payments by insolvent debtors were voidable (in those days at the instance of the insolvent debtor's creditors) was that the conferring of a preference necessarily involved a voluntary act. The making of a payment under pressure was not considered to be a voluntary act. Indeed, a creditor's mere demand for payment was sufficient to show that the payment was involuntary and therefore not voidable: *Molson Bank v. Halter* (1890), 18 SCR 88 (available on QL).

32 Then, Canada's first bankruptcy legislation, in 1919, prohibited pressure as a factor capable of validating an otherwise voidable preferential payment. Likewise, under today's *Bankruptcy and Insolvency Act*, pressure cannot be invoked to rebut the presumption that a preferential payment to a creditor was made with a view to giving a preference. Indeed, evidence of pressure is inadmissible.

33 The question then is, was the evidence that the respondent creditor would not release the asset unless it was paid, evidence of pressure and therefore inadmissible and not capable of validating an otherwise preferential payment? Or, was it simply evidence of a commercial imperative which required the payment to be made in order to generate income?

34 The answer, of course, depends upon how the evidence is characterized. And characterizing such evidence is something upon which reasonable people can disagree: *Norris (Bankrupt), Re* (1996), 193 AR 15, 45 Alta LR (3d) 1 (CA).

35 The bankruptcy judge characterized the evidence of the insolvent company's desire to realize upon its asset as a reasonable response to a financial imperative. The amount of income hoped to be generated by liquidating the asset was considerably greater than the cost of paying the creditor. Also, if the asset had been sold for the price the insolvent debtor thought it could fetch, the income generated might have gone a long way toward saving the insolvent company from bankruptcy. For those reasons, we find that the bankruptcy judge's characterization of the evidence was reasonable and entitled to deference.

36 In the result, the trustee's appeal is dismissed.

P.A. ROWBOTHAM J.A.
B.K. O'FERRALL J.A.
B.L. VELDHUIS J.A.

TAB 12

Indexed as:

Eland Distributors Ltd. (Re)

IN THE MATTER OF The Bankruptcy of Eland Distributors Ltd., and Eland Distributors (Eastern) Ltd., doing business as Toys & Wheels

[1998] B.C.J. No. 1761

81 A.C.W.S. (3d) 219

Vancouver Registry No. B155790/B155792

British Columbia Supreme Court (Bankruptcy)
Vancouver, British Columbia

Baker J.
(In Chambers)

Heard: December 1 - 2, 1997.
Judgment: filed July 23, 1998.

(30 pp.)

Bankruptcy -- Setting aside transactions prior to bankruptcy -- Fraudulent preferences -- Preference, transactions not in ordinary course of business -- Rebuttal of presumption of preference.

Application by the trustee in the bankruptcy to set aside certain payments made to a supplier on the basis that the payments constituted a fraudulent preference. The two Eland companies made an assignment into bankruptcy in December of 1994. In the three months prior to that date they made payments to Irwin Toys on account of past indebtedness. The companies' losses reached an all-time high during the immediate Christmas period, which was usually a high revenue time. Also, the companies' principal advised their creditors that they would not be able to make payments as they came due.

They also requested that the suppliers stop shipment of further goods. By the date of the assignment, liabilities exceeded assets by $8,500,000. The payment to Irwin, which was one of

Eland's biggest suppliers, represented the largest reduction of accounts payable during that time period, and reduced Eland's indebtedness to Irwin by a significant percentage in comparison with other creditors. Irwin was responsible for only a small percentage of the supply of goods during that period in relation to other creditors. Irwin claimed that the payments did not constitute a preference in that the payments were to ensure the continued supply of toys for the Christmas season.

HELD: Application granted. The payments were set aside as being fraudulent preferences. There was no doubt that the Eland companies were insolvent at the time the payments were made, such that the only live issue was whether Irwin and Eland could rebut the presumption that the payments were made with a view to giving a preference to Irwin. Their contention that the payments were made to ensure the supply of goods did not accord with the facts. Eland was not in a position to carry on its business in the ordinary fashion at the time the payments were made to Irwin, such that the payments were not made in the ordinary course of business.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 2, 95, 95(2).

Bankruptcy Rules, Rule 89.

Companies Creditors Arrangement Act.

Fraudulent Conveyance Act, R.S.B.C. 1979, c. 142.

Fraudulent Preference Act, R.S.B.C. 1979, c. 143.

Counsel:

Geoffrey Thompson, for Irwin Toy Limited.
Marcel J. Peerson, for Arthur Andersen Inc.

---

1 **BAKER J.**:-- Eland Distributors Ltd. and Eland Distributors (Eastern) Ltd. owned and operated the chain of retail toy stores called "Toys & Wheels". On December 30, 1994, both companies filed assignments in bankruptcy and Arthur Anderson Inc. was appointed Trustee. In the three months preceding the date of bankruptcy, the companies paid $889,685.83 to a creditor, the respondent Irwin Toy Limited. The Trustee seeks a declaration that the payments to Irwin were fraudulent and void against the Trustee by application of Section 95 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, (the "BIA") the Fraudulent Conveyance Act, R.S.B.C. 1979, c. 142, and the Fraudulent Preference Act, R.S.B.C. 1979, c. 143.

2 Irwin says the payments it received were not fraudulent. It seeks the dismissal of the Trustee's application or, alternatively, an order setting the matter for trial.

IS THE MATTER SUITABLE FOR DISPOSITION IN A SUMMARY MANNER?

3 Rule 89 of the Bankruptcy Rules reads:

> Where a trustee or any other person applies to the court to set aside or avoid any settlement, conveyance, charge, obligation, proceeding, transfer, security or payment, or for a declaration for or against the title of the trustee to any property, the court may
>
> (a) proceed in a summary manner to try the question or issue in the case.

4 The Eland companies assigned into bankruptcy on December 30, 1994. The Trustee first demanded repayment of the sums claimed in this proceeding in December 1995. The notice of motion was filed March 27, 1997. By that date, all of the assets of the Eland companies in bankruptcy had been sold. The motion was originally scheduled to be heard on March 27, 1997. Numerous affidavits have been filed with several affidavits filed in reply. Written submissions were filed with the Court to supplement the oral submissions of counsel.

5 There are few factual disputes, and none that cannot be resolved by reference to other evidence, including the accounting records of the Eland companies, and other documents found in the companies' business records. I am of the view that this matter can and should be decided on a summary basis.

SECTION 95 OF THE BANKRUPTCY AND INSOLVENCY ACT

6 The relevant portions of section 95 of the BIA are reproduced here:

> (1) ......every payment made........ by any insolvent person in favour of any creditor ....with a view to giving that creditor a preference over the other creditors shall, if the person making...it becomes bankrupt within three months after the date of...paying.....it, be deemed fraudulent and void as against the trustee in the bankruptcy.
>
> (2) Where any.......payment....mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been.....paid......with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.

7 If the Trustee establishes that a payment was made to a creditor within three months prior to the date of bankruptcy, that the debtor was insolvent at the time the payment was made, and that the effect of the payment was to prefer one creditor over others, then in the absence of evidence to the contrary, the Trustee has met the burden of proof that the payment was made with the intention of preferring the creditor who received it.

WERE THE PAYMENTS MADE WITHIN THREE MONTHS OF THE DATE OF BANKRUPTCY?

8 The first of the three matters the Trustee must establish is not in issue in this case. In mid-September 1994, Eland gave Irwin five post-dated cheques. The cheques were dated October 17, October 25, November 10, November 18, and November 28, 1994. All of the cheques were deposited and paid on or about those dates. Irwin does not dispute that the payments were made within three months prior to the date of bankruptcy. There is also judicial authority for the proposition that the relevant date is the date on which the payment is received by the creditor. See Re Vaga Construction Company Limited; Trustee v. Liutkus, (1966) 9 C.B.R. (N.S.), affirmed 9 C.B.R. (N.S.) 307n, a decision of Bankruptcy Registrar F.G. Cook, Q.C. in the Ontario Supreme Court, affirmed by Justice McDermott of that Court; and Re Lock Enterprises (1971) 16 C.B.R. (N.S.) 83, (B.C.S.C.), in which Justice Verchere adopted and applied the reasoning in Re Vaga.

9 I find the payments were made within three months of the bankruptcy.

WAS ELAND INSOLVENT WHEN THE PAYMENTS WERE MADE?

10 Section 2 of the BIA defines an insolvent person as:

> ...means a person who is not bankrupt and who resides or carries on business in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

11 The criteria are disjunctive and the Trustee need establish only one of the factors. The Court will not presume insolvency, it must be proved, and the evidence must establish that the debtor was insolvent as defined in the BIA at the time of the impugned payment. See Re Van der Liek, (1970) 14 C.B.R. (N.S.) 229, (Ont. S.C.)., and Re Blenkarn Planer Ltd. (1958), 37 C.B.R. 147 (S.C.B.C.).

In Re Society Shop Inc., a decision of the Registrar of the Ontario Supreme Court in Bankruptcy, cited at (1975) 20 C.B.R. (N.S.) 72, at page 74, Registrar Ferron stated:

> Insolvency at the date of payment cannot be presumed from prior or subsequent events, although such events may be some evidence of insolvency.

12 With great deference to the Registrar, I would take issue with the statement made if intended as a general proposition of law. The Trustee must prove insolvency, but it may be established by circumstantial or direct evidence or a combination of the two. There may well be cases in which insolvency at a particular date can be established by convincing proof that prior to the date of the impugned transaction the debtor was insolvent, and that after that date the debtor was insolvent, and that there was no material change in the debtor's circumstances in the interim, from which the Court may infer that the debtor was insolvent at the date the impugned transaction took place. The issue is the adequacy of the proof of insolvency, not the nature of the evidence.

13 The evidence in this case establishes the facts that follow.

14 Eland Distributors Ltd. was incorporated by Hugh Saville Eland in 1961. The company did business under the name "Toys & Wheels". In 1982, Reginald Eland, Hugh Eland's son, incorporated Eland Distributors (Eastern) Ltd. and became its President. In 1988 Eland Distributors (Eastern) Ltd. became a wholly owned subsidiary of Eland Distributors Ltd. In 1991, Hugh Eland left the companies and another of his sons, Chris Eland, became President of Eland Distributors Ltd. The two companies, referred to collectively in these Reasons as "Eland" worked together to operate the network of retail stores known as "Toys & Wheels". By 1994, there were 78 Toys & Wheels outlets in operation.

15 The retail toy business is a seasonal business. In order to have stock on hand to accommodate customers during the Christmas shopping rush, Eland usually built up its inventory of toys in the fall of each year, with inventory on hand peaking in September and October, and declining to its lowest point by the end of December, or January of the following year. Because of the seasonal nature of the retail toy business, some toy suppliers regularly invoiced customers when toys were shipped, but allowed the customer to defer payment until December. This accommodation is described by Bryan Irwin, the Vice-President of Irwin Toy Limited, as "December Dating". Others, however, required payment within 60 or 90 days of the date on which goods were delivered and invoiced. Irwin did not extend credit to Eland on the basis of "December Dating" and neither did Hasbro and Lego, two of Eland's other large suppliers. Although there is evidence that some of Eland's suppliers allowed "December Dating", the evidence indicates many did not.

16 Eland's Toys & Wheels business generally operated at a loss during the months of January to October of each year, and depended for its profitability on the sales of toys during November and December of each year. Historically, approximately 50% of Eland's annual sales occurred in those two months. Accordingly, the financial position of the Eland companies was better at the end of December each year than at any other time during the year.

17 The retail toy business in Canada is extremely competitive. Beginning in the late 1980's, increased competition from large retail chains, including Wal-Mart and Toys R Us, had a deeply negative impact on the profitability of Eland's Toys & Wheels stores. Between 1991 and 1993, for example, 11 Toys & Wheels stores affected by the opening of nearby Toys R Us stores, moved from a net income position of $1.3 million to a net loss of $30,000.

18 In 1992, Eland showed a small profit of $167,000 by the end of November, and realized a year-end profit on sales of $707,000 on sales of $47 million, a rate of return on sales of only 1.5%. In 1993, the situation deteriorated. At the end of November 1993, Eland had a year to date loss of $3.6 million, and by the end of 1993 had realized a profit on sales of only $572,000 on sales of $48.6 million, a rate of return on sales of only 1.1%. Eland's projections for 1994 and 1995 indicated that the company could expect only marginal profits.

19 In view of its deteriorating financial position and pessimistic budget projections, in January 1994 Eland sought advice from Robert Cobb of Peat Marwick Thorne Inc. Mr. Cobb is a licensed trustee in bankruptcy. Mr. Cobb prepared some notes dated January 14, 1994 which he discussed with Gerry Stevenson, Eland's controller, and perhaps with other Eland managers. Mr. Stevenson prepared some notes of questions for his discussions with Mr. Cobb.

20 The notes made by Mr. Cobb and Mr. Stevenson indicate the nature of the concerns of Eland managers in early 1994. Mr. Cobb's notes refer to the Bankruptcy & Insolvency Act, and begin with the note "must be insolvent to file".

21 The notes also refer to the Companies Creditors Arrangement Act ("CCCA"); to lease repudiations; to the criteria for insolvency under the BIA; the possibility of staff, warehouse, and retail store reductions; a possible proposal under the BIA and arrangements to continue the operations of the companies during the proposal period; and an item referred to as "timing of filing".

22 Mr. Stevenson's list of questions for Mr. Cobb is equally illustrative of the state of mind of the Eland companies' chief financial officer. The questions include the following:

> "What are the classes of creditors? - are landlords & suppliers in the same class? - what if at the time of the proposal, we are current with landlords? would they even be considered as a class of creditor?
>
> If we repudiate a lease & the proposal is accepted - do we pay 6 months immediately? - can we remain in business at that location?
>
> Estimated cost of putting together CCA proposal

> Is there a downside to doing this before Christmas? Best timing?

23 In March 1994, Wal-Mart bought out Woolco, a development expected to further erode Eland's market position. In May 1994, Toys R Us announced plans to open at least 5 new stores by fall 1994. In light of these developments, and the magnitude of sales decreases Eland had typically experienced in the past when a Toys R Us store opened near a Toys & Wheels outlet, it became apparent to Eland's management, according to a memorandum in Mr. Stevenson's file:

> ...that competitive pricing and cost cutting measures alone would no longer be adequate to ensure the long run viability of Toys & Wheels as it currently operated.

24 Eland began to investigate restructuring possibilities. By June 1994, Mr. Cobb had prepared an initial draft of a "Restructuring Work Plan" for Eland. Two scenarios are considered in the Plan - restructuring the companies' operations to allow it to compete effectively in view of the anticipated impact on Toys & Wheels of more Toys R Us stores opening near Toys & Wheels outlets, and an "alternative liquidation plan" described as "Plan B", including "a detailed how to wind down/liquidation and maximize proceeds". The Plan refers to preparation of a proposal under the BIA as part of a package to be used in approaching landlords.

25 Eland's financial statements for the fiscal year ending December 31, 1993 were sent to Toys & Wheels suppliers in early June 1994. The statements disclosed 1993 net earnings after tax of only $206,000. The statements also revealed that in 1993, a loan of $1.9 million owed to H & G Eland Holdings Ltd., a related company, had been converted from a long term liability to a current liability.

26 By this time, according to a memorandum in Mr. Stevenson's file, Eland had revised its financial projections and was projecting a loss from operations in 1994 of $1 million, and a loss in 1995 of $2 million. One of the options the company was considering was a "company controlled liquidation followed by a restart of operations", according to another memorandum in Mr. Stevenson's file. Part of the controlled liquidation would include the termination of leases. At this point, Eland still believed that it could conduct business as usual to the end of the 1994 fiscal year, with restructuring to occur in early 1995.

27 By July 4, 1994, Mr. Cobb had prepared a Restructuring Work Plan for Eland. Among the 6 alternatives outlined, Mr. Cobb identified a controlled liquidation with 48 of 78 stores to close; a controlled liquidation of the entire operation without formal legal proceedings; a proposal under the BIA or CCCA; or bankruptcy. The sixth and final alternative described in the Plan was a recommencement of operations following complete liquidation, with fewer stores, perhaps as few as 10, in the best locations.

28 Kubas & Plant Consultants were hired by Eland and prepared a proposal in August 1994 entitled "Repositioning Project". Kubas & Plant advised Eland to determine whether Toys &

Wheels could survive competing directly against Toys R Us, and whether Toys & Wheels could adjust its format to create a "successful niche" for the sale of its products in a more specialized way.

29 By August, Eland's controller had prepared profit projections for 1994 and 1995 indicating that Eland was expecting to lose as much as $1.19 million by the end of 1994, before tax, and $1.9 million by the end of 1995. By the end of August, Eland's net loss for the year to date was $3.46 million, compared to a net loss in 1993 for the same period of $2.47 million.

30 By August 1994, Eland was falling behind in payments to creditors. By the end of August, accounts owing by Eland to Hasbro Canada Inc. were past due to the extent of $900,000, and accounts owing to Lego Canada Inc. were past due to the extent of $25,900.

31 Eland had also fallen behind in payments to Irwin Toy Limited. Bryan Irwin met with Chris Eland on September 14, 1994 to discuss the very high level of accounts owing to Irwin. Irwin had put Eland on a 90-day payment program, but Eland was in arrears on some invoices, and Chris Eland indicated to Bryan Irwin that Eland was having cash flow problems and would not be able to meet some of the upcoming payment dates in respect of other Irwin invoices. Following this discussion, Eland mailed to Irwin the five post-dated cheques that resulted in the payments that are the subject of these proceedings.

32 The deteriorating financial position of Eland was sufficiently alarming that by the end of September, Mr. Cobb had obtained a legal opinion for Eland advising on the principal personal liabilities of directors in insolvent companies in British Columbia.

33 By the end of September 1994, Eland's loss for the year to date was $3.89 million compared to a loss of $2.78 million for the comparable period in 1992. Overdue accounts owing to Hasbro and Lego had increased to $1 million and $36,000 respectively. On October 17, 1994, the first of the post-dated cheques delivered to Irwin was paid, in the amount of $193,456.56.

34 Colin Fleming of Peat Marwick met with Reginald and Chris Eland on October 19, 1994 to discuss a strategy for the orderly liquidation of the Toys & Wheels inventory and divestiture of the remaining assets. Mr. Fleming sent a letter to the Eland brothers on October 21, 1994 outlining the preliminary activities Peat Marwick would perform "pursuant to an organized divestiture engagement". The letter states that 10 Toys & Wheels stores would be closed between October 21 and December 31, 1994 "as part of a structured and orderly liquidation". As part of the overall liquidation process, Peat Marwick would initiate a search for prospective purchasers of the "business and/or remaining assets".

35 On October 20, 1994, Chris Eland wrote to all Toys & Wheels suppliers, including Irwin. The letter indicated that Toys & Wheels would be repositioned in 1995, that this would require "a significant reduction of stock levels", and:

> In order to facilitate this reduction of inventory, we want our suppliers to assist

> us by reducing wherever possible our on hand purchase order commitments. We request that all further shipments of merchandise be stopped until such time as we have had a chance to review with you our current outstanding purchase orders.

36 On October 25, 1994, the second of the post-dated cheques given to Irwin was paid, in the amount of $139,924.40. By the end of October 1994, Eland's year to date loss was $4.26 million compared to a loss for the same period in 1992 of $3.36 million. Overdue accounts owing to Hasbro and Lego had increased to $1.27 million and $231,000 respectively.

37 In November, the Eland companies opened several new trust accounts at its bank in order to ensure that statutory obligations for provincial sales tax, goods and services taxes, employee deductions, and wages and vacation pay - all obligations for which directors could be personally liable in the event of insolvency - would be satisfied.

38 On November 9, 1994, Mr. Stevenson, Eland's controller, provided Mr. Plant of Kubas & Plant with revised financial projections indicating that Toys & Wheels was now projecting a loss of $2.23 million, before tax, for 1994.

39 On November 10, 1994, the third cheque given to Irwin was paid, in the amount of $173,142. The fourth cheque was paid on November 18, 1994 in the amount of $82,420.97 and the fifth and final payment was made on November 28, 1994 in the amount of $301,936.16.

40 By the end of November, the year to date loss had risen to $4.77 million, compared to $3.6 million in the same period in 1992.

41 On December 9, 1994, Eland wrote to all of its trade creditors informing them that Toys & Wheels had experienced lower than expected pre-Christmas sales to date and would be delaying payments to its creditors. The letter, signed by Chris Eland, stated that "We will be treating all our trade creditors equally." The letter warned that if any creditors commenced legal proceedings, Toys & Wheels would have to file a Notice of Intention to Make a Proposal, and that the costs associated with such a filing could reduce the companies' ability to maximize the amount that it would otherwise be able to pay to suppliers. The letter invited trade creditors to attend a meeting in Toronto on December 20, 1994.

42 On December 30, 1994, the Eland companies filed assignments in bankruptcy. By that date, the year to date loss had grown to $4 million.

43 The statement of affairs filed in the bankruptcy on December 30, 1994, signed by Chris Eland, disclosed total liabilities of $11.9 million, including $9.68 million owed to unsecured creditors, and total assets of only $3.4 million. Liabilities exceeded assets by $8.5 million. By October 1996, all of the assets of Eland had been sold, and the trustee in bankruptcy expected that the distribution to creditors would amount to approximately $ .30 on the dollar.

44 Graham Nash, the trustee in bankruptcy at Arthur Anderson Inc. who administered the Eland bankruptcy until October 1996, reviewed the records of Eland for the three months preceding bankruptcy, and found that during those three months, Eland had acquired no significant assets, except for some additional inventory, and had made no significant dispositions of assets except payments to creditors, and sales of inventory. Based on his review of the records, Mr. Nash came to the conclusion that Eland's liabilities exceeded its assets to an even greater extent in the three months prior to the date of bankruptcy, than at the date of bankruptcy. I accept Mr. Nash's evidence in this regard.

45 Irwin contends that the Eland companies were not insolvent during the period September to December 1994. They point, for example, to the fact that on November 30, 1997, Eland valued its inventory on hand at $16.4 million while accounts payable at that date totalled only $10.1 million. This information is not accurate, to begin with. Eland's internal accounting records show that in November inventory was listed at $14.6 million. More importantly however, Irwin's contention ignores Toys & Wheels' very high cost of sales, and the fact that the definition of "insolvent person" refers to assets being valued on the basis of "if disposed of at a fairly conducted sale under legal process".

46 The fact that the value of the inventory according to the definition used in the BIA would result in a lower value for the assets of Eland that that shown on their internal inventory accounting is illustrated by reference to the situation in December 1994. In December 1994, Eland's own internal accounting system valued the inventory on hand at $6.8 million. However, Eland's management valued the same inventory at only $2.9 million in the company's statement of affairs filed on December 30, 1994 in connection with the assignment in bankruptcy. Applying the same ratio to the inventory on hand in November would reduce the value of the inventory for insolvency purposes from $14.6 million to $6.2 million.

47 The evidence establishes conclusively that at the time the impugned payments were made to Irwin, the Eland companies were insolvent. The companies were unable to meet their obligations to trade creditors as they became due, had ceased paying their current obligations in the ordinary course of business, and the aggregate of the companies' property, if disposed of at a fairly conducted sale under legal process, was insufficient to enable payment of all obligations due and accruing due.

DID THE PAYMENTS TO IRWIN HAVE THE EFFECT OF GIVING IRWIN A PREFERENCE OF OTHER CREDITORS?

48 In September 1994, Eland had approximately 100 creditors, 53 of which were owed in excess of $10,000 each. By the end of November, although Eland had made some payments to creditors on account, the amount owing to Eland's creditors in total had increased from $8.1 million to $10.1 million. The 53 significant creditors were owed just over $8 million at the end of September, and the indebtedness to those creditors had increased to $9.5 million by the end of November.

49 Of the 53, accounts payable to 34 remained the same or increased. Accounts payable owing to

only 19 of them, including Irwin, were reduced during the three months preceding Eland's bankruptcy. With the exception of Irwin and four other significant creditors against whom the Trustee intends to pursue preference claims, the largest reduction in accounts payable to any of the 19 creditors whose accounts were reduced, was $64,000.

50 Irwin's accounts, on the other hand, were reduced from $1.011 million owing at the end of September to only $238,000 at the end of November, a reduction of $773,000 and a percentage reduction of 76%. During this period, Irwin received approximately 27.5% of all payments made to creditors, and over 29.5 % of the payments made to significant creditors, although during this period, Irwin's percentage of shipments of new goods was only 2.3% of shipments made by general suppliers, and 2.6% of shipments made by significant creditors.

51 Statements prepared by the Trustee indicate that during this period, Irwin also received payments that, expressed as a percentage of overdue accounts, greatly exceeded payments made to other significant creditors with overdue accounts. Payments made to Hasbro in the same period were between 5 to 16.6% of overdue accounts. Payments to Lego were between 15.2 and 27.9%. Payments to Irwin ranged from a low of 47.4% to a high of 100% of overdue accounts. The payments on October 17 and 25, 1994 actually retired the overdue accounts owing to Irwin on those dates, since the payments represented satisfaction of 99 to 100% of Irwin's overdue accounts, while other creditors with overdue accounts remained unpaid.

52 These facts reveal that while Eland made payments to some of its creditors during this period, the large payments made to Irwin had the effect of giving Irwin a preference over both the general body of creditors, and specific creditors whose accounts were also overdue.

EVIDENCE TO THE CONTRARY

53 The Trustee has proved that the payments made to Irwin were made within three months of the date of Eland's bankruptcy, that Eland was insolvent throughout the fall of 1994, and, accordingly, at the time each of the payments was made, and that the effect of the payments was to prefer Irwin over other Eland creditors. In these circumstances, section 95(2) of the Bankruptcy and Insolvency Act comes into play, and a prima facie presumption arises, in the absence of evidence to the contrary, that the payments were made with a view to giving Irwin a preference over other creditors. Salter and Arnold Limited v. Dominion Bank (1926) 7 C.B.R. 639 (S.C.C.)

54 Only the bankrupt's intention is relevant. The intention of the recipient of the impugned payment is irrelevant. See Hudson v. Benallack, (1975) 21 C.B.R.(N.S.) 111 (S.C.C.). The Court should decline to follow decisions predating Hudson v. Benallack that suggest that the debtor and creditor must be shown to have been engaged in a fraudulent, joint scheme, or hold that a payment did not constitute a preference because the creditor did not know that the debtor was insolvent.

55 In this case, the affidavit of Chris Eland, the President of Eland Distributors Ltd., was filed in support of Irwin's contention that Eland did not intend to prefer Irwin over other creditors. Mr.

Eland deposed that the payments to Irwin were not unusual or uncommon, and that Eland did not intend to confer a preference on Irwin. While Mr. Eland's assertions in this regard must be considered, it is clear that while the intention to prefer must be an intention in fact, the test is an objective one. As the Court said in Re Holt Motors Ltd.; (1966) 9 C.B.R. (N.S.) 92, at page 95:

> ...it is for me to determine what was the intention. This must be a matter of inference. The test which I consider should be applied is an objective and not a subjective one; that is to say, the intention which should be attributed to the parties will always be that which their conduct bears when reasonably construed and not that which long after the event, they claim they believe was present in their minds.

56 If the preferred creditor can establish that the dominant intent of the debtor, viewed objectively, was not to prefer the creditor, but was some other purpose, the onus has been satisfied. See Re Toyerama Ltd., (1983) 47 C.B.R. 233 (Ont.S.C.).

57 In this case, Irwin submits that the presumption of intent to prefer is rebutted by evidence that the payments to Irwin were made in the ordinary course of business - that Eland made the payments to Irwin to obtain a continued supply of merchandise in order to stay in business, and that Irwin was merely a diligent creditor.

58 In order to determine whether a transaction took place "in the ordinary course of business" the Court should consider the circumstances of the case, and take into account the type of business carried on by the debtor and creditor. Re Pacific Mobile Corp. v. American Biltrite (Canada) Ltee., (1985) 55 C.B.R.(N.S.) 32 (S.C.C.).

59 Irwin had been supplying toys to Eland for more than 20 years prior to the date of bankruptcy. Like Eland, Irwin is a family-controlled Canadian company. Bryan Irwin described Eland as "a very good customer" and that "Irwin had an excellent business relationship with Eland". Irwin's sales to Eland increased from $738,000 in 1992, to approximately $1.32 million in 1993, and $1.51 million in 1994.

60 Prior to 1991, Irwin had offered "December Dating" terms to Eland, but after 1991, Irwin required Eland to pay its invoices within 90 days. By October 20, 1993, Eland had fallen behind in payments to Irwin. Eugene McLaughlin, Irwin's credit manager, telephoned Chris Eland about the outstanding accounts and proposed that Eland provide a series of post-dated cheques to "cover current outstanding and future shipments". Mr. McLaughlin's proposal was 4 cheques of $125,000 each payable November 15, and 30, December 13 and 30, 1993; and two $100,000 cheques payable January 15 and January 31, 1994, with the balance of the November invoices to be paid in February, and a $3000 discount to be credited in February.

61 Mr. Stevenson of Eland replied to this proposal with a counterproposal for four cheques in the amount of $140,000 each, payable December 1, 10, 20 and 30, with the $3000 discount. Eventually,

however, Eland paid, and Irwin agreed to accept two postdated cheques totalling $560,000, payable December 10 and 20, 1993. Essentially this amounted to an agreement for "December Dating".

62 In 1994, Irwin altered Eland's payment terms, offering a 2% discount for payment within 30 days, otherwise invoices were due in 90 days. The discount was offered to encourage prompt payment.

63 By September 1994, invoices delivered to Eland in June 1994 remained outstanding and were overdue. Bryan Irwin visited Vancouver on September 14, 1994 and met with Chris Eland. Chris Eland told Bryan Irwin that Eland was having cash flow problems due to having agreed to make F.O.B. purchases for merchandise from other suppliers, and while Eland would make payments on the accounts, "they would be somewhat tardy".

64 According to a letter from Irwin's counsel sent to the Trustee, the five cheques provided to Irwin a couple of days after Chris Eland met with Bryan Irwin were all for outstanding invoices which were either already in arrears on September 14, or would be in arrears on the date the cheques were deposited. All of the cheques were payable before December, indicating that in 1994, Irwin was not prepared to allow Eland "December Dating" on its accounts.

65 Both Bryan Irwin and Chris Eland say that Eland paid Irwin in order to ensure that Irwin would continue to supply Eland with toys, in particular, a toy called "Power Rangers" which was an extremely popular toy in 1994. Irwin had the exclusive right to distribute Power Rangers in Canada. Chris Eland says that Eland made the payments to Irwin so that Toys & Wheels could secure additional shipments of Power Rangers for the Christmas season.

66 In a letter from Irwin's counsel to the Trustee, Irwin asserts that at the meeting in September, 1994, Eland agreed to purchase and Irwin agreed to supply $2.9 million worth of toys to the end of 1994. After September 14, 1994, however, Irwin did not ship any more toys to Eland until October 20, 1994. Between October 20, 1994 and November 8, 1994, Irwin shipped goods worth $117,000. No goods were shipped to Eland after November 8. Of the goods shipped, only two shipments included Power Rangers, and the value of the Power Ranger shipments was only $22,000 in total.

67 It should also be noted that on October 20, 1994, Chris Eland wrote to all of Eland's suppliers, including Irwin, asking that all further shipments of merchandise be stopped.

68 These facts establish that even if Eland's intention in September 1994 was to secure delivery of Power Rangers from Irwin, that justification for the payments to Irwin no longer existed when the payments were made. The October 17 payment was made only 3 days before Eland formally notified its suppliers, including Irwin, to stop all further shipments of inventory. It is reasonable to infer that by the time the October 17 payment was made, Eland knew that it could no longer carry on in the ordinary course of business. By then, Eland was taking steps to try to cancel orders at a time when it would normally be building up inventory to meet the Christmas demand. Eland no longer had a business reason for making payments to Irwin and the payments were not made in the

ordinary course of business. Eland was no longer operating in the ordinary course of business.

69 In his affidavit, Chris Eland deposed that Toys & Wheels was not insolvent during the fall of 1994, but this assertion cannot stand in light of the overwhelming evidence that Eland was insolvent, and knew itself to be so. Mr. Eland's assertion that he expected Toys & Wheels to be able to make all of its payments and satisfy all of its obligations by a strong Christmas season, "as it had done in years past" is simply not credible.

70 Eland had a sophisticated accounting system. Eland knew that its losses in each month in 1994 were much greater than the monthly losses in 1993. In August 1994, for example, the year to date losses exceeded 1993 losses for the same period by $992,000. The situation was worse by the end of September, when year to date losses were more than a million dollars more than in 1993. By October, the year to date losses were $904,000 greater than the same period in 1993. By November, the year to date losses were $1.16 million greater than in the same period in 1993. In 1993, the companies had realized only a tiny profit, $206,000. Mr. Eland could not have believed, given increased competition, that Toys & Wheels could meet its obligations in December.

71 By August, Mr. Stevenson, Eland's controller, was predicting a loss by the end of 1994 of $1.9 million. It is inconceivable, given these facts, and the facts referred to earlier in these Reasons, that Chris Eland could have been unaware of the magnitude of Toys & Wheels' financial problems in September, October and November 1994.

72 Mr. Eland deposed that it was not until a few days before Christmas 1994, that he realized that Toys & Wheels problems were insurmountable and that the business was not going to be able to carry on. He says that until that date he was trying to negotiate a sale, amalgamation, merger or reverse takeover of the business, with a company called Master Player. The negotiations collapsed on December 20, 1994, Mr. Eland says. The existence of negotiations, about which no details have been provided, with a company that itself became bankrupt ten months later, does not demonstrate either that Toys & Wheels was solvent, or that Mr. Eland believed it to be so. In fact, Mr. Eland's assertion that it was not until late December that he realized Toys & Wheels' problems were insurmountable is strongly contradicted by other evidence, referred to earlier in these Reasons, about the ongoing discussions within the Eland companies and the state of its collapse revealed by the companies' own internal accounting records. Mr. Eland was present, for example, at a meeting on October 19, 1994 with Colin Fleming of KPMG at which they discussed a strategy for the orderly liquidation of Toys & Wheels inventory and a subsequent divestiture of the remaining assets. In November 1994, Toys & Wheels had, for the first time, established separate trust accounts at its bank for payments for which directors - of which Mr. Eland was one - could be held personally liable in the event of insolvency.

73 It is true that the Trustee has not shown a motive for the preferential payments made by Eland to Irwin. The evidence does not establish a non-arm's length relationship between Eland and Irwin. Counsel for the Trustee suggested that the fact that the two companies were both Canadian,

family-controlled businesses, may have motivated Eland to try to ensure that Irwin did not suffer too great a loss as a result of Eland's business failure. In the reorganization plans discussed in 1994, there were suggestions that the Eland brothers might try to salvage some of the Toys & Wheels outlets following a liquidation of the company, and would need the assistance of a supplier for their new enterprise. But there is no evidence to raise these suggestions above the level of speculation.

74 However, while proof of a motive to prefer one creditor over others may assist, proof of motive is not essential. Irwin has failed to meet the prima facie case of preference. Taken as a whole, and viewed objectively, the evidence establishes that the payments made to Irwin in October and November were not made in the ordinary course of business and were not made to obtain a continued supply of merchandise. Each of the payments was made to Irwin at a time when Eland was insolvent. The payments were made within three months of the bankruptcy. The payments had the effect of giving Irwin a preference over other creditors. The presumption that the payments were made with a view to giving Irwin a preference over other creditors has not been rebutted by evidence to the contrary.

75 The payments made on October 17, 25, November 10, 18 and 28, are void as against the Trustee. Irwin shall pay the sum of $890,062.84, to Arthur Anderson Inc., Trustee of the Estates of Eland Distributors Ltd. and Eland Distributors (Eastern) Ltd., bankrupts, together with Court Order Interest calculated from and after January 21, 1997, the date this application was filed. The Trustee is also entitled to costs of these proceedings to be paid by Irwin.

BAKER J.

cp/d/sfr/kjm

---- End of Request ----
Download Request: Current Document: 1
Time Of Request: Tuesday, June 03, 2014 12:15:53

TAB 13

** English Version **

Case Name:

St. Anne Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.

IN THE MATTER OF the Bankruptcy of St. Anne Nackawic Pulp Company Ltd.
Between
Logistec Stevedoring (Atlantic) Inc., (respondent) appellant, and
A.C. Poirier & Associates Inc., Trustee in Bankruptcy of St. Anne Nackawic Pulp Company Ltd., (applicant) respondent

[2005] N.B.J. No. 204

[2005] A.N.-B. no 204

2005 NBCA 55

255 D.L.R. (4th) 137

286 N.B.R. (2d) 95

9 B.L.R. (4th) 1

13 C.B.R. (5th) 125

139 A.C.W.S. (3d) 803

2005 CarswellNB 285

No. 186/04/CA

New Brunswick Court of Appeal
In Bankruptcy and Insolvency

W.S. Turnbull, A. Deschênes and J.T. Robertson JJ.A.

Heard: March 22, 2005.
Judgment: June 2, 2005.

(19 paras.)

Civil procedure -- Appeals -- Application judge erred in not considering dominant intent of bankrupt in transaction alleged to be fraudulent -- Appeal by respondent from decision of application judge reported at [2004] N.B.J. No. 477 allowed.

Insolvency law -- Legislation -- Bankruptcy and Insolvency act -- Practice -- Setting aside transactions prior to bankruptcy -- Fraudulent preferences -- Section 95 of Act having no application where insolvent debtor effecting payment with a view to generating income to be applied against debts of both secured and unsecured creditors.

Appeal by the respondent, Logistec Stevedoring (Atlantic), against the applicant, the trustee in bankruptcy of St. Anne Nackawic Pulp, from the application judge's decision that a $562,574 payment made by St. Anne's Pulp constituted a fraudulent preference. Logistec provided warehousing and other services for the products of St. Anne's Pulp at the Port of Saint John. The day before St. Anne's Pulp's assignment in bankruptcy, Logistec was owed the disputed amount from St. Anne's Pulp. On that previous day, Logistec held 10,000 tones of pulp product owned by St. Anne's Pulp that was needed to fulfill contracts. On the date of bankruptcy, St. Anne's Pulp paid the disputed amount to Logistec and then Logistec shipped its product. The application judge held that the payment was for a past due debt to Logistec, who knew that St. Anne's Pulp was insolvent. As such, St. Anne's Pulp's intent was, in the face of imminent bankruptcy, to prefer or favour, before losing control of its assets, a particular creditor over others. The application judge granted the trustee payment for the amount.

HELD: Appeal allowed. The application was dismissed. The application judge failed to consider whether the payment was made with the dominant intent of preferring one creditor over others. The three conditions precedent of a preference were made out: they payment was made within three months of bankruptcy, St. Anne's Pulp was insolvent at the time of the payment and Logistec received a preference in fact over creditors. However, Logistec's receipt of a preference in fact was not a sufficient basis for declaring the payment a fraudulent preference. Logistec rebutted the presumption that the payment was a fraudulent preference. It was evident that St. Anne's Pulp did not make the payment with the dominant intent of preferring Logistec over other creditors. Its dominant intent was to generate income from accounts receivable, the proceeds of which would be applied first against the debt to its secured creditor. For every dollar St. Anne's Pulp paid to Logistec, it generated at least five dollars in accounts receivable by fulfilling the pulp contracts. The transaction made good commercial sense. Section 95 of the Act had no application where an insolvent debtor was effecting payment with a view to generating income to be applied against the

debts of both secured and unsecured creditors.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 95, 95(1), 95(2)

Statute of Elizabeth, 1570

Appeal From:

Appeal from judgment of the New Brunswick Court of Queen's Bench, December 21, 2004.

Counsel:

For the appellant: D. Leslie Smith, Q.C.

For the respondent: G. Patrick Gorman, Q.C.

THE COURT: The appeal is allowed and the order dated January 7, 2005 set aside. The application for declaratory and ancillary relief is dismissed. The appellant is entitled to costs of $3,000 throughout. Reasons for judgment by: J.T. Robertson J.A. Concurred in by: W.S. Turnbull and A. Deschênes JJ.A.

1 **J.T. ROBERTSON J.A.**:-- We are asked to decide whether the application judge erred in holding that a $500,000 payment made by an insolvent debtor to one of its creditors qualifies as a fraudulent preference within the meaning of s. 95 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 (BIA). In my respectful view, the application judge erred. Specifically, he failed to ask whether the impugned payment was made with the "dominant intent" of preferring one creditor over the others. When that test is applied to the facts of the present case, it is evident that the debtor harboured no such intent. Admittedly, the creditor in receipt of the payment received a "preference in fact", but that is not a sufficient basis for declaring the payment a fraudulent preference. As will be explained, s. 95 has no application in circumstances where the insolvent debtor is effecting a payment with a view to generating income to be applied against the debts of both secured and unsecured creditors. This remains true even if it were unrealistic to expect that the unsecured creditors would share in the income generated.

2 The essential facts are as follows. Until September 15, 2004, St. Anne Nackawic Pulp Company Ltd. had been operating a pulp mill in Nackawic, New Brunswick. That corporation is a wholly owned subsidiary of St. Anne Industries Ltd. St. Anne Industries is also the primary secured creditor of St. Anne Pulp under a registered general security agreement, the validity of which is

being challenged in other proceedings. Finally, St. Anne Industries is a wholly owned subsidiary of Parsons & Whittemore Inc. of New York. On September 15, 2004, St. Anne Pulp made a voluntary assignment in bankruptcy. A trustee was appointed on that date, but later replaced by the respondent, A.C. Poirier & Associates Inc. Prior to the bankruptcy, it was customary for St. Anne Pulp to transport its pulp to Saint John where it was stored in a dockside warehouse belonging to the appellant, Logistec Stevedoring (Atlantic) Inc. Logistec was also responsible for loading of pulp onto ships and trucks. On September 14, 2004, one day prior to the filing for bankruptcy, Logistec was informed by St. Anne Pulp that it would be ceasing operations but that it wanted to ensure that the 10,800 tonnes of pulp, being presently stored in Logistec's warehouse, would be released and loaded onto two ships that were to arrive in Saint John on or about September 18, 2004. As well, one shipment was to be effected by truck. In response, Logistec asserted that it possessed a warehouseman's lien on the goods and refused to release and load any pulp unless it received prior payment, in full, with respect to past due accounts. Logistec informed St. Anne Pulp that it was owed $562,574.72 plus amounts not yet posted to the account. Initially, Logistec demanded payment from anyone other than St. Anne Pulp in order to avoid the possibility of someone alleging the payment was a fraudulent preference. Eventually, Parsons & Whittemore agreed to indemnify Logistec in the event the payment from St. Anne Pulp to Logistec was successfully challenged. The impugned payment was made on September 14, 2004. The next day St. Anne Pulp made a voluntary assignment in bankruptcy. On the same date, St. Anne Industries appointed a receiver under the terms of its security agreement. On September 16, 2004, Logistec determined that a further $232,945.91 would be needed to settle the account. The receiver paid this amount with funds drawn on St. Anne Pulp's bank account, over which St. Anne Industries had taken security. As of September 27, 2004, all the pulp in the warehouse had been shipped.

3 On December 10, 2004, the respondent trustee filed an application for a declaration that the $562,574.72 payment was fraudulent and void under s. 95 of the BIA. Correlatively, the trustee sought judgment for that amount. On December 21, 2004, the application was heard. On the same date the application judge granted the relief requested. His decision is now reported at [2004] N.B.J. No. 477 (Q.B.) (QL). The reasons for judgment address two issues. The first was whether the application proceedings should be converted into an action. On this issue, the application judge ruled in favour of the trustee. Although Logistec pursued this issue on appeal, there is no need to convert this matter into an action. The only factual matter which the parties failed to resolve concerns the extent to which the $500,000 payment related to work already performed, as opposed to work to be performed. However, that factual determination is only relevant if the payment in question were declared a fraudulent preference, in which case part of the payment may have been valid. As I find that the payment in question does not constitute a fraudulent preference, there is no need to dwell on the first issue. As to the second issue, I turn to s. 95. At the relevant time, ss. 95(1) and (2) read as follows:

> 95(1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in

> trust for any creditor with a view to giving that creditor a preference over the other creditors is, where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in the bankruptcy.
>
> (2) Where any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.

[Note that the wording of ss. 95(1) and 95(2) was amended, effective December 15, 2004, but those changes have no effect on the disposition of this case.]

4 The law is settled with respect to the interpretation and application of s. 95 of the BIA. In order for a payment to a creditor to qualify as a fraudulent preference three conditions precedent must be met: (1) the payment must have been made within three months of bankruptcy; (2) the debtor must have been insolvent at the date of the payment; and (3) as a result of the payment the creditor must have in fact received a preference over other creditors (see Re Van der Liek (1970), 14 C.B.R. (N.S.) 229 (Ont. H.C.J.).

5 Once the three conditions precedent have been met, a presumption arises that the payment was made "with a view to giving that creditor a preference over the other creditors." However, it is a rebuttable presumption. In that regard, the courts have interpreted the above-quoted phrase as placing an onus on the creditor to establish that the debtor's dominant intent was not to prefer that creditor. The genesis of the dominant intent test is invariably traced to the following passage in Re Van der Liek, at pages 231-32:

> When the trustee has proved these three essentials, he need proceed no further and the onus is then on the creditor to satisfy the court, if he can, that there was no intent on the part of the debtor to give a preference. If the creditor can show on the balance of probabilities that the dominant intent of the debtor was not to prefer the creditor but was some other purpose, then the application will be dismissed, but if the creditor fails to meet the onus, then the trustee succeeds.

6 Certain factors may or not be relevant to the task of ascertaining the debtor's dominant intent. Based on the Supreme Court's decision in Hudson v. Benallack, [1976] 2 S.C.R. 168, it is settled law that the creditor's knowledge of the debtor's insolvency at the time of the payment is an irrelevant consideration. On the other hand, it is relevant that the corporate debtor knew of its

insolvency at the date of the payment. If the debtor is related to the creditor the payment will be scrutinized with greater care and suspicion. However, it is no defence to an allegation of fraudulent preference that the creditor exerted pressure on the insolvent debtor to secure the payment. According to s. 95(2), pressure is no longer a ground for upholding a transaction which is otherwise preferential within the meaning of s. 95(1). Finally, as the dominant intent test is an objective one, we need not be concerned with the subjective intent of the insolvent debtor at the time of the payment. The requisite intent will be drawn from all of the relevant circumstances, as opposed to the debtor's personal ruminations. See generally Lloyd W. Houlden & Geoffrey B. Morawetz, Bankruptcy & Insolvency Law of Canada, looseleaf (Toronto: Carswell, 1992) at 4-66 to 4-67, 4-79.

7 Returning to the facts of the present case, the parties agree that conditions precedent (1) and (2) have been met. However, Logistec argues that it was not the beneficiary of a preference in fact and, therefore, s. 95 has no application. A concise and accurate statement of the law as to the relationship between the concept of preference in fact and dominant intent is found in Re Norris (1996), 193 A.R. 15 at para. 16 (C.A.):

> In considering this section, it is well to keep in mind the distinction between preference in fact and fraudulent preference as that latter is defined in the Act. There can be no doubt in this case that Revenue Canada received a preference in fact from the payment of tax made by this debtor on November 25, 1992. Its debt was paid where the debt owing to other ordinary creditors were not. What would render that preference in fact a fraudulent one under s. 95 is the accompanying intent of the insolvent debtor who in the face of imminent bankruptcy is moved to prefer or favour, before losing control over his assets, a particular creditor over others who will have to wait for and accept as full payment their rateable share on distribution by the Trustee in the ensuing bankruptcy. It is called fraudulent because it prejudices other creditors who will receive proportionately less, or nothing at all, and upsets the fundamental scheme of the Act for equal sharing among creditors. That accompanying intent to favour one creditor over another is what makes a preference in fact a fraudulent preference and is referred to in the cases as the "dominant intent". ...

8 In my view, Logistec's argument would have been persuasive had the impugned payment related solely to work or services to be performed in regard to the pulp that was being stored in Logistec's warehouse at the time of the payment. In other words, had the entire $500,000 payment related to the storage and shipping of the 10,800 tonnes of pulp in Logistec's warehouse, Logistec's argument would have been well founded. The situation would be no different had Logistec sold St. Anne Pulp a piece of machinery within the three months preceding the bankruptcy and St. Anne Pulp paid in cash. Such a payment would not qualify as a preference, but rather as a purchase and sale made in the ordinary course of business. However, counsel for Logistec conceded that part of the $500,000 was to be applied against amounts already owing for work undertaken in the past. In

these circumstances, Logistec did receive a preference in fact when contrasted with St. Anne Pulp's other creditors who were also awaiting payment of their outstanding accounts. That said, the mere establishment of a preference in fact does not lead to the conclusion that the payment qualifies as a fraudulent preference within the meaning of s. 95 of the BIA. What we are left with is a rebuttable presumption that the payment in question so qualifies.

9 Logistec bore the onus of establishing that St. Anne Pulp's dominant intent was not to prefer Logistec over the other creditors. Alternatively stated, the onus was on Logistec to establish that St. Anne Pulp's dominant intent was to achieve a purpose other than to prefer Logistec. Regrettably, the application judge did not address that issue. For this reason, this court must draw the necessary inference from the primary findings of fact, as found by the application judge. Those facts are not in dispute.

10 St. Anne Pulp's dominant intent may be formulated in at least one of four ways. First, it can be argued that it intended to bestow a preference on Logistec over the other creditors. This is the position of the trustee in bankruptcy. Second, it can be argued that St. Anne Pulp made the payment in order to honour its contractual obligations to its customers who had purchased the pulp and, hence, to ensure that the goods were duly shipped. This is the position of Logistec. The third and fourth characterizations flow from the second. Third, it can be argued that St. Anne Pulp's dominant intent was to generate income in the form of accounts receivable. Moneys collected would be applied against amounts owing to creditors and in the order of priority established at law. Fourth, it can be argued that St. Anne Pulp's dominant intent was to maximize St. Anne Industries' recovery on its secured debt. This characterization is a logical extension of the reality that, as the primary secured creditor, St. Anne Industries is entitled to the proceeds arising from the sale of inventory in priority to the unsecured creditors. If it can be fairly said that St. Anne Pulp's dominant intent falls within either the second, third or fourth formulations, it is my view that the payment in question does not qualify as a fraudulent preference under s. 95 of the BIA. I so find. My formal reasoning is as follows.

11 At common law and even after passage of the Statute of Elizabeth in 1570 (fraudulent conveyances) there was no impediment against an insolvent debtor preferring one creditor over another. The question of why a debtor would prefer one creditor over another goes to the question of the debtor's underlying motive, which text writers point out is irrelevant to the issue of dominant intent. Admittedly, it is easy to blur the legal distinctions often drawn between motive, intent, purpose or object. Be that as it may, one cannot help but ask why a debtor would prefer one creditor over another. In some cases the answer is self-evident. The common law allowed an insolvent debtor to engage in selective generosity by paying first those he liked most. Thus, payment to a creditor who is a family member or friend is more apt than not to qualify as a fraudulent preference within the meaning of s. 95 of the BIA: see Craig (Trustee of) v. Devlin Estate (1989), 63 Man.R. (2d) 122 (C.A.). Ironically, there is also a reported case in which the debtor allegedly made the payment to a non-related creditor (Revenue Canada) in order to prefer a creditor who was a close but distant relative: see Norris (Re). But even if there is no close relationship between the debtor

and the preferred creditor, the payment may be caught by s. 95. For example, where the payment is made to a creditor with respect to an indebtedness that had been guaranteed by the debtor's spouse, the payment has been held to be a fraudulent preference: see Royal Bank of Canada v. Roofmart Ontario Ltd. (1990), 74 O.R. (2d) 633 (C.A.) and also Re Royal City Chrysler Plymouth Limited (1998), 38 O.R. (3d) 380 (C.A.).

12 As a general observation, it is evident that the cases in which the creditor has been unable to rebut the presumption arising under s. 95 of the BIA generally involve two factual patterns. First, the insolvent debtor and the creditor in receipt of the payment are somehow related (e.g., family members). Second, the payment to an arm's length creditor has the subsidiary effect of conferring an unjustified benefit or advantage on the insolvent debtor or a family member. While these factual patterns are not exhaustive, it is clear that the facts of the present case do not support a finding that St. Anne Pulp's dominant intent was to prefer Logistec over the other creditors. But that is not the end of the matter. It is still necessary to isolate, by inference, St. Anne Pulp's dominant intent. In my view, its ultimate goal was to generate income from its accounts receivable, the proceeds of which would be applied first against the debt owing to St. Anne Industries, the primary secured creditor. In brief, St. Anne Pulp's dominant intent was to maximize the amount that the receiver would recover on behalf of St. Anne Industries from the sale of the existing inventory. Does this inference support the allegation of fraudulent preference under s. 95 of the BIA? In my view, it does not for two reasons. First, s. 95 speaks of fraudulent preference in terms of the creditor who received the payment. In this case, it was Logistec who received the payment, not St. Anne Industries. Second, and more importantly, St. Anne Industries cannot be accused of obtaining a fraudulent preference when as a matter of law it is entitled to a preference as a secured creditor of St. Anne Pulp. It is St. Anne Industries that has priority over the unsecured creditors by virtue of its security agreement. St. Anne Industries is to be paid first. If the income generated resulted in a surplus that surplus would be shared pro-rata amongst the unsecured creditors. The fact that St. Anne Pulp made the impugned payment to Logistec with a view to generating income which would be applied first against the debt owing to the secured creditor, St. Anne Industries, and then against amounts owing to the unsecured creditors, cannot be regarded as a valid basis on which to declare the payment to Logistec a fraudulent preference.

13 My understanding of the law is that in circumstances where an insolvent debtor pays one creditor at the expense of another for purposes of carrying on business, the payment will more likely than not be deemed not to constitute a fraudulent preference within the meaning of s. 95 of the BIA. I need only refer to two cases in support of this proposition. In Davis v. Ducan Industries Ltd. (1983), 45 C.B.R. (N.S.) 290 (Alta. Q.B.) the bankrupt was a manufacturer of recreational vehicles. The creditor who received the questionable payment was a supplier of parts that the debtor used in its business. The supplier refused to continue to do business with the debtor unless payments were made towards its large outstanding account. Less than three months before the bankruptcy, the debtor made payments to the supplier. Once the debtor became bankrupt, another creditor challenged this transaction as a fraudulent preference. The court found that the dominant intent of the bankrupt in making the payments to the supplier was to secure supplies to continue to run its

business and not to give the creditor a preference. Similarly, in Econ Consulting Ltd. (Trustee of) v. Deloitte, Haskins & Sells (1985), 31 Man.R. (2d) 313 (C.A.) the bankrupt made a payment of $10,000 to accountants in respect of an outstanding account sixteen days prior to making an assignment in bankruptcy. The debtor's income tax returns were due and the accountants required the payment before they would prepare income tax returns for the debtor. The Court of Appeal cited this finding of the application judge with approval:

> I am satisfied that Econ made this payment not to give a preference to Deloitte but to get what it needed and required, i.e. its income tax returns prepared. I think that Deloitte would not have received payment if it had not been necessary for Econ to do so in order to persuade Deloitte to do the work that had to be done.

14 Under Canadian law, if a creditor refuses to perform an act for an insolvent debtor, such as delivering goods or preparing income tax returns, unless its existing account is paid in full or in part, and the account is so paid in order to have the act performed, the transaction will not be deemed a fraudulent preference. This is because the debtor made the payment, not for purposes of preferring the creditor, but rather to obtain the performance of an act which is consistent with what is expected of someone who is acting in the ordinary course of business: see Houlden & Morawetz at 4-79 to 4-80.

15 I admit that in the present case St. Anne Pulp did not make the payment for purposes of carrying on its pulp business in the long term. The impugned payment was made one day prior to St. Anne Pulp's voluntary assignment in bankruptcy. In the interim, however, it was entitled to carry on business albeit for a day. The truth of the matter is that St. Anne Pulp was acting in the best interests of all concerned when it made the payment to Logistec. Let me explain.

16 It would have been irresponsible for either St. Anne Pulp, the trustee or the privately appointed receiver to allow the inventory of pulp to sit in Logistec's warehouse. St. Anne Pulp had entered into binding contracts for the sale of this product. The goods had to be shipped, otherwise St. Anne Pulp would have been in breach of its contractual obligations and liable for any consequential damages. When completed, those contracts generated income for St. Anne Pulp. The net amount invoiced on the three contracts in question was $1.3 million (U.S.), $2.3 million (U.S.) and $300,000 (Cdn.). Together, the shipment of the pulp generated more than $4.6 million (Cdn.) in accounts receivable. That amount is net of the $800,000 paid to Logistec to ensure the shipment of the pulp ($562,574.72 + $232,945.91 = $795,520.63). In effect, for every $1 paid to Logistec, St. Anne Pulp generated at least $5 in accounts receivable. In addition, by fulfilling the pulp contracts, future pulp sales might not otherwise be jeopardized if the trustee or the receiver decided to operate St. Anne Pulp pending a disposition of the mill.

17 What the trustee fails to appreciate is that although a debtor is insolvent, it is entitled to carry on in the ordinary course of business even if only for a day, so long as it is acting in a commercially reasonable manner and, therefore, in the best interests of all concerned. As well, the trustee appears

to be proceeding on the mistaken assumption that prior to the voluntary assignment in bankruptcy any moneys held in St. Anne Pulp's bank account could be used only for purposes of effecting a settlement of all debts on a pro-rata basis. The reality is that if anyone possessed a priority with respect to moneys in St. Anne Pulp's bank account, it was St. Anne Industries under its general security agreement. That security extended not only to St. Anne Pulp's accounts receivable and inventory, but also to all moneys held on St. Anne Pulp's account. It is out of that bank account that the receiver paid Logistec $232,000 in order to secure shipment of the pulp. Had St. Anne Pulp not made the payment to Logistec on September 14, 2004, here is what would have happened. On the following day, the newly appointed receiver would have seized the moneys held in St Anne Pulp's bank account. From that account the receiver would have paid the full amount owing to Logistec, for both past and present work. As it happens, the fact that a substantial payment was made one day prior to the bankruptcy is of no moment. Finally, I should point out that the payment to Logistec will work to the benefit of the unsecured creditors in the event St. Anne Industries' security agreement is successfully challenged and declared invalid. The income generated by that payment ($5 for every $1 paid to Logistec) would become available to all unsecured creditors.

18 At first blush the "optics" of this case cast a long shadow over the actions of St. Anne Pulp, St. Anne Industries and, ultimately, Parsons & Whittemore. It is understandable that Logistec was adamant that it receive an indemnity from Parsons & Whittemore with respect to the possibility the payment in question would be successfully challenged as a fraudulent preference under s. 95 of the BIA. The fact that the payment was made one day prior to the voluntary assignment in bankruptcy, and that both Logistec and St. Anne Pulp were aware of the latter's insolvency, threw suspicion over the transaction. However, when properly viewed, the transaction made good commercial sense. There is no doubt that St. Anne Industries was the true beneficiary of St Anne Pulp's payment to Logistec. But no one can complain of the preferential treatment being accorded that secured creditor. The preference arises as a matter of the security contract and is sanctioned by both the common law and the BIA.

19 For these reasons, I would allow the appeal, set aside the order dated January 7, 2005 and dismiss the application for declaratory and ancillary relief. The appellant is entitled to costs of $3,000 throughout.

J.T. ROBERTSON J.A.
We concur:
W.S. TURNBULL J.A.
A. DESCHÊNES J.A.

---- End of Request ----
Download Request: Current Document: 1
Time Of Request: Tuesday, June 03, 2014 11:00:32

TAB 14

Case Name:

Conte Estate v. Alessandro

Between
Elisa Conte, Executrix and Trustee for Cesidio Conte and Elisa Conte, plaintiffs, and
Joe Alessandro also known as Giuseppe Alessandro, a bankrupt, Gregorina Alessandro, Alba Alessandro and A. Farber & Partners Inc., Trustee in bankruptcy of the estate of the said Giuseppe (also known as) Joe Alessandro, defendants

[2002] O.J. No. 5080

[2002] O.T.C. 1035

2002 CanLII 20177

119 A.C.W.S. (3d) 951

2002 CarswellOnt 4507

Court File No. 96-CU-114234

Ontario Superior Court of Justice

Rouleau J.

Heard: September 17-18, 20 and 23, 2002.
Judgment: December 10, 2002.

(66 paras.)

Fraud and misrepresentation -- Fraudulent conveyances and preferences -- Impeachable conveyances and preferences under modern statutes -- Conveyance to defeat or prefer creditors -- Practice -- Settlements -- Enforceability.

Action by Cesidio and Elisa Conte to set aside two transactions as fraudulent conveyances. In 1972,

a numbered company purchased a vacant cottage lot. The defendant, Joe Alessandro, took title to the property in his name to uses, which he claimed had the same effect as taking title in trust. Joe Alessandro and Cesidio Conte were business partners. In 1988, Joe purchased the business from Cesidio with a down payment of $50,000 plus a promissory note for $350,000. The note became due in February 1993, and Cesidio and Elisa demanded payment. The debt was not paid. In December 1993, Joe entered into an agreement with his wife and daughter, the defendants Gregorina Alessandro and Alba Alessandro, in which Alba agreed to advance sums to Joe and Gregorina and in which Joe purported to hold the cottage property in trust for Gregorina. In June 1994, Cesidio and Elisa brought an action to recover the debt due under the promissory note. In August 1994, when Joe was insolvent, he transferred the property to Gregorina for two dollars. In April 1996, Cesidio and Elisa obtained judgment in their action on the note. In October 1996, Alba registered a mortgage against the property. She claimed that the consideration for the mortgage was a series of payments to Gregorina made under the loan agreement. In November 1996, Cesidio and Elisa brought an action to set aside both the transfer from Joe to Gregorina, and the mortgage given by Gregorina in favour of Alba. Cesidio later died and the action was continued by his estate. The defendants sought to dismiss the claim on the basis of an alleged settlement agreement.

HELD: Action allowed. It was improbable that Joe took the property in trust for Gregorina. It was more likely that he acquired the complete interest in the property. The 1994 transfer to Gregorina was a non-arm's length transaction for no consideration at a time when Joe was insolvent. It was made shortly after the plaintiffs issued their statement of claim on the promissory note. Joe continued to use and benefit from the property after the transfer. Those facts raised a presumption of fraud. It was improbable that the mortgage transaction was a regular financial arrangement between Alba and Gregorina. The evidence of consideration for the mortgage was insufficient. The mortgage was part of a scheme, together with the transfer, to put the property out of the reach of Joe's creditors. Therefore, the transactions were set aside. Although Cesidio had executed some settlement documents, the evidence did not reveal that the parties had entered into a settlement that resolved all the issues of the action or that any settlement funds had been paid.

Statutes, Regulations and Rules Cited:

Assignments and Preferences Act, R.S.O. 1990, c. A.33, ss. 4(1), 4(2), 4(3), 5(1).
Fraudulent Conveyances Act, R.S.O 1990, c. F.29, ss. 2, 3.
Statute of Uses, R.S.O. 1897, c. 331.

Counsel:

Joseph J. Colangelo, for the plaintiffs.
William G. Dingwall, Q.C., for the defendants.

ROULEAU J.:--

I. INTRODUCTION

1 This action was brought by Cesidio and Elisa Conte ("Cesidio" and "Elisa" respectively) to set aside two non arm's length transactions and to declare them fraudulent and void. The first non arm's length transaction was a conveyance of 1629 James Street, Tiny, Ontario ("the property") from the defendant Giuseppe Alessandro ("Joe") to his wife, the defendant Gregorina Alessandro ("Gregorina"). The second non arm's length transaction was a $225,000 mortgage placed on the property by Gregorina in favour of her daughter, the defendant Alba Alessandro ("Alba"). The plaintiffs also sought other ancillary relief, and the defendants counterclaimed seeking declarations that the property is in fact beneficially owned by Gregorina and that Alba's mortgage is valid.

2 The issue in this action is whether the two transfers of property were fraudulent conveyances: the transfer of property from an insolvent husband to his wife and the subsequent mortgage of the property by the wife to their daughter. I have concluded that both transactions are fraudulent conveyances.

II. THE FACTS

3 The plaintiff Cesidio died before trial, and the action was continued by his estate. As his death was anticipated, the parties videotaped his testimony which was admitted at trial.

4 The defendant Joe declared bankruptcy in February 2002 and, by order of Wilson J., the plaintiffs were allowed to continue the present action. The trustee in bankruptcy decided not to continue to defend the action and consented to judgment against the bankrupt. For purposes of the trial, therefore, only the defendants Gregorina and Alba defended.

A) THE DEBT

5 Cesidio and Joe were former partners with two others in a lumber business. In the late 1980s, Joe bought out Cesidio for $400,000 made up of $50,000 cash and a $350,000 promissory note due February 1, 1993. When the note became due in February 1993, the plaintiffs demanded payment but the debt was not paid. Cesidio brought an action for recovery of the $350,000 which resulted in the judgment of Cameron J. dated April 3, 1996. This judgment awarded Cesidio and Elisa Conte $413,768.33 and solicitor and client costs. The judgment bears interest at 10% annually.

6 Despite repeated attempts at collection including a judgment debtor examination, nothing has been paid on this debt. As at the 17th day of September 2002, I was advised that the value of the judgment, with interest, was $642,831.74.

B) THE PROPERTY

7 In 1972, a numbered company purchased the property that was, at the time, a vacant cottage lot

near Georgian Bay. Shortly thereafter the defendant Joe took title of the property in his name "to uses." Although there is conflicting evidence on the point, it appears that the property was purchased as part of an arrangement among several partners to acquire a series of properties, divide these into building lots and resell them at a profit. Because the partners were purchasing several adjoining lots, they purchased these in a sort of "checker board" arrangement putting properties in their names, in the names of their spouses or in joint ownership.

8 According to the testimony of one of the partners, Giuseppe Marchese, the property was one of five properties acquired by him and three other partners, the defendant Joe, Raffaele Morano and Domenic Scroll. Four of the properties (the "Block D properties") were adjoining, and these were registered in each of the names of the defendants, Gregorina and Joe, and in the names of Raffaele "to uses" and Mariaella Morano. The property which was not adjoining to the others was, as set out above, registered in the name of the defendant Joe "to uses." The sale of the Block D properties generated sufficient monies to cover the full purchase price of the five properties. Therefore the remaining property held by Joe for the four partners was the "profit" of the four partners.

9 According to Giuseppe Marchese, sometime later Joe bought out the interest in the property owned by the three other partners paying $3,000 to each of them. No transfer was necessary since the property was already in Joe's name.

10 In August 1994 the property was transferred from Joe "to uses" to Gregorina for nominal consideration. The land transfer tax affidavit stated that the consideration was $2.00 and that Gregorina "has been the sole beneficial owner during the entire period the lands had been registered in the name of Joe."

C) THE MORTGAGE

11 In October 1996, Alba registered a mortgage in the amount of $225,000 against the property. Alba testified that the consideration for the mortgage was a series of payments made by her to Gregorina during the period December 1993 to April 3, 1995. This series of advances had been made under an agreement entered into among the three defendants in December 1993 (the "loan agreement"). According to Alba the advances were made because her mother needed the money.

12 There was a series of thirteen cheques totalling $258,500 entered into evidence. The defendants claimed the cheques were advances made pursuant to the loan agreement. Although the cheques were all drawn on Alba's account, Joe signed every cheque but one. The three payees of the cheques were Alessandro Holding Ltd., Joe Alessandro, and Joe and Gregorina Alessandro jointly. Little is known of the source and use of these funds as the bank statements were not entered into evidence. Alba testified that by the time she reached her early twenties, she had made hundreds of thousands of dollars trading in penny stocks. Again, no documentation was provided in support of this. It also appeared from Joe's testimony that he was a member of the Board or may have played some role in one or more of the companies, the stock of which Alba traded and profited from.

13 Pursuant to the terms of the loan agreement, the advances of $258,500 would have become due in April 1997. It appears that there was no repayment of these sums.

14 The mortgage was registered in October 1996, and full payment was due one year later. During the first year of the mortgage, Gregorina paid interest. However, on October 1, 1997, when the balance became due, payments stopped, and the mortgage went into default.

D) CHRONOLOGY

15 The plaintiffs suggest that much can be inferred from the timing of various events. They have put forward a chronology setting out the dates of various key events. I agree that the timing is important and therefore will set out some of the key dates and events in this judgment. They are as follows:

September 26, 1972	Purchase of the subject property by Joe "to uses"
February 1, 1988	Joe purchases the lumber business from Cesidio and Elisa for $400,000; $50,000 payable in cash and the balance of $350,000 by promissory note
February 11, 1993	Demand for payment by the plaintiffs of the $350,000 note
December 3, 1993	Loan agreement among Alba, Joe and Gregorina pursuant to which Alba agrees to advance sums to Joe and Gregorina in the future. The agreement includes a recital that Joe holds the property in trust for Gregorina
December 6, 1993	First advance made under the loan agreement. It is a $5,000 cheque to Alessandro Holdings Ltd.
June 7, 1994	Statement of Claim issued by Cesidio and Elisa to obtain re-payment of the $350,000 debt
August 30, 1994	Transfer of the property from Joe to Gregorina for $2
April 3, 1996	Judgment of Justice Cameron in the debt action granting judgment in the amount of $413,768.33, plus post-judgment interest at 10%. Included in the reasons for Justice Cameron is the statement that alleged oral agreements put forward by Joe did not occur and that Justice Cameron did not believe

	Joe.
July 3, 1996	Examination in aid of execution of Joe
October 4, 1996	Execution of charge on the property by Gregorina and Joe in favour of their daughter Alba
November 14, 1996	Statement of claim in the present action is issued.

III. ISSUES

16 The issues in this case are as follows:

(a) was the transfer from Joe to Gregorio a fraudulent conveyance?
(b) was the mortgage from Gregorina to Alba a fraudulent conveyance?
(c) Did the plaintiffs and defendants settle the claim before the trial?

IV. THE LAW

A) STATUTORY FRAMEWORK

17 The plaintiffs rely principally on two statutes, the Fraudulent Conveyances Act, R.S.O. 1990, c. F.29 and the Assignments and Preferences Act, R.S.O. 1990, c. A.33.

18 The relevant portions of the Fraudulent Conveyances Act are as follows:

> 2. Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns. R.S.O. 1990, c. F.29, s. 2.
> 3. Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge of the intent set forth in that section. R.S.O. 1990, c. F.29, s. 3.

19 The relevant portions of the Assignments and Preferences Act are as follows:

> Nullity of gifts, transfers, etc., made with intent to defeat or prejudice creditors
>
> 4.-(1) Subject to section 5, every gift, conveyance, assignment or transfer,

delivery over or payment of goods, chattels or effects, or of bills, bonds, notes or securities, or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made by a person when insolvent or unable to pay the person's debts in full or when the person knows that he, she or it is on the eve of insolvency, with intent to defeat, hinder, delay or prejudice creditors, or any one or more of them, is void as against the creditor or creditors injured, delayed or prejudiced. R.S.O. 1990, c. A.33, s. 4(1).

(2) Subject to section 5, every such gift, conveyance, assignment or transfer, delivery over or payment made by a person being at the time in insolvent circumstances, or unable to pay his, her or its debts in full, or knowing himself, herself or itself to be on the eve of insolvency, to or for a creditor with the intent to give such creditor an unjust preference over other creditors or over any one or more of them is void as against the creditor or creditors injured, delayed, prejudiced or postponed.

(3) Subject to section 5, if such a transaction with or for a creditor has the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them, it shall, in and with respect to any action or proceeding that, within sixty days thereafter, is brought, had or taken to impeach or set aside such transaction, be presumed, in the absence of evidence to the contrary, to have been made with the intent mentioned in subsection (2), and to be an unjust preference within the meaning of this Act whether it be made voluntarily or under pressure.

Assignments for benefit of creditors and good faith sales, etc., protected

5.(1) Nothing in section 4 applies to an assignment made to the sheriff for the area in which the debtor resides or carries on business or, with the consent of a majority of the creditors having claims of $100 and upwards computed according to section 24, to another assignee resident in Ontario, for the purpose of paying rateably and proportionately and without preference or priority all the creditors of the debtor their just debts, nor to any sale or payment made in good faith in the ordinary course of trade or calling to an innocent purchaser or person, nor to any payment of money to a creditor, nor to any conveyance, assignment, transfer or delivery over of any goods or property of any kind, that is made in good faith in consideration of a present actual payment in money, or by way of security for a present actual advance of money, or that is made in consideration of a present actual sale or delivery of goods or other property where the money paid or the goods or other property sold or delivered bear a fair and reasonable relative value to the consideration therefor. R.S.O. 1990, c. A.33, s. 5 (1).

B) PRESUMPTION OF FRAUD

20 In this type of case it is unusual to find direct proof of intent to defeat, hinder or delay creditors. It is more common to find evidence of suspicious facts or circumstances from which the court infers a fraudulent intent.

21 These suspicious facts or circumstances are sometimes referred to as the "badges of fraud." These badges of fraud are evidentiary indicators of fraudulent intent and their presence can form the prima facie case needed to raise a presumption of fraud. These badges of fraud can be traced back to Twyne's case (1602), 3 Co. Rep. 80 and are elaborated upon in Prodigy Graphics Group Inc. v. Fitz-Andrews, [2000] O.J. No. 1203 (S.C.J.).

22 The presence of one or more of the badges of fraud raises the presumption of fraud. Once there is a presumption, the burden of explaining the circumstantial evidence of fraudulent intent falls on the parties to the conveyance. The persuasive burden of proof stays with the plaintiff; it is only the evidentiary burden that shifts to the defendants.

23 In cases of non arm's length transactions, independent corroborative evidence is strongly recommended but not required if the defendants' evidence is found to be credible. In Koop v. Smith (1915), 51 S.C.R. 554, Duff J. discussed the need for corroborative evidence in a case involving a transaction between two near relatives for no consideration. Duff J., at p. 559 stated as follows:

> I think the true rule is that suspicious circumstances coupled with relationship make a case of res ipsa loquitur which the tribunal of fact may and will generally treat as a sufficient prima facie case, but that it is not strictly in law bound to do so; and that the question of the necessity of corroboration is strictly a question of fact. Having examined the evidence carefully I am satisfied that the learned trial judge was entitled to take the course he did take and not only that the evidence, as I read it in the record, casts the burden of explanation upon the respondent, but that the testimony given by her brother ought not in the circumstances to be accepted as establishing either the actual existence of the debt or of the bona fides of the transaction.

24 Another useful case is Petrone v. Jones (1995), 33 C.B.R. (3d) 17 (O.C.G.D.). That case supports the proposition that where, as in the present case, the transferor is transferring the only asset he has remaining with which to pay his debts, there is a presumption of an intent to defeat creditors. Wright J., at p. 20, stated the proposition as follows:

> In the absence of any direct proof of intention, if a person owing a debt makes a settlement which subtracts from the property which is the proper fund for the payment of those debts, an amount without which the debts cannot be paid then,

> since it is the necessary consequence of the settlement that some creditors must remain unpaid, it is the duty of the judge to direct a jury that they must infer the intent of the settlor to have been to defeat or delay his creditors. (Sun Life Assurance Co. v. Elliott (1900), 31 S.C.R. 91.)
>
> Even if we consider the direct evidence that the defendant had no intention of defeating, hindering, et cetera the claims of the plaintiff, can this evidence remain standing in the face of the undoubted evidence that for the past year the defendant has in fact acted in every way to defeat, hinder or delay the plaintiff's claim?
>
> Even if the defendant had no intention, at the time of the conveyance, of defeating, hindering or delaying the plaintiff's claim, surely his actions since that date, the defence of the claim on the promissory note, the defence of this action, prevent him from raising that lack of specific intent as a defence.
>
> Further: even if the plaintiff did not intend to defeat, hinder or delay this creditor but effected the transfer with a view to defeating, hindering or delaying potential future creditors his defence would still fail.

V. ANALYSIS

25 The plaintiffs' position is that the many suspicious circumstances and badges of fraud surrounding the transfer of the property by Joe to Gregorina and the mortgage by Gregorina to Alba raise the presumption of fraud which has not been rebutted. This leads to the inevitable conclusion that the mortgage and the transfer of the property should both be set aside pursuant to the Fraudulent Conveyances Act.

A) ASSIGNMENTS AND PREFERENCES ACT

26 The plaintiffs have also relied on the Assignments and Preferences Act as a basis to set aside the mortgage. For the Act to apply, the transferor (or mortgagor) must be insolvent. It may well be that Joe was insolvent at the time that the mortgage was placed on the property, but the mortgage was granted by Gregorina. No evidence was led suggesting that Gregorina was insolvent. Even though Joe, as spouse, consented to the transaction, I do not believe that this would bring the Assignment and Preferences Act into play.

B) REQUIREMENTS TO PROVE FRAUDULENT CONVEYANCE

27 The plaintiffs need to show that both the transfer to Gregorina and the subsequent mortgage to Alba were both part of a scheme to defeat, hinder, delay or defraud the plaintiffs contrary to the Fraudulent Conveyances Act.

28 If I find that the conveyances were made with intent to defeat, hinder, delay or defraud creditors it would still not be void if the defendants could establish that the transactions were made for good consideration, were bona fide and the transferee or mortgagee was a person not having, at the time of the transaction, notice or knowledge of the intent to defraud. The onus to show this, however, is on the defendants. (Bank of Montreal v. Jory, [1981] B.C.J. No. 1014 (B.C.S.C.)).

C) TAKING TITLE "TO USES"

29 The taking of title "to uses" was the subject of much argument. The defendants maintain this has the same effect as taking title "in trust." The plaintiffs maintain that it is simply a form of title that was used at that time to avoid the obligations flowing from dower. While both positions may be sustainable, the real determinant is the intention of the parties. Therefore, I see no need to deal with the Statute of Uses, R.S.O. 1897, c. 331 and its application to the present case.

D) THE DEFENDANTS' CASE

30 The defendants admit that the transfer from Joe to Gregorina was not made for consideration. They take the position that the transfer was simply putting the property into Gregorina's name on the basis that, since the mid-70s, it had been held by Joe on behalf of Gregorina. They point to the fact that title had been taken by Joe "to uses" as evidence of this. If accepted, this is a complete answer to the plaintiffs' claim.

31 If the court sets aside the transfer to Gregorina as a fraudulent conveyance, the defendants take the position that the mortgage on the property is valid and enforceable. It would remain as a charge on the property and take priority over the plaintiffs' claims.

32 Finally, the defendants take the position that the action has been settled and that, as a result, the claim should be dismissed.

E) THE EVIDENCE

33 The events surrounding this action date back, in some cases thirty years. As a result, some allowance must be made for faulty memories and for the difficulty in proving certain facts. Similarly, the real estate transactions carried out in the 1970s, including the acquisition of the property by Joe "to uses," involved many different lots contributing to confusion in the testimony and recollection of the parties.

34 Even accounting for this, the evidence put forward by the defendants is far from satisfactory. I noted a number of significant inconsistencies. Some of the more significant inconsistencies

surrounding key events were as follows:

1. Gregorina testified that the property had always been in her name. However, there was also evidence that:

   - according to land registry records the property was put into the name of Joe "to uses" in 1972 and not transferred to Gregorina till August 1994
   - Joe's discovery evidence was that the 1994 transfer of the property was made at Gregorina's request
   - Gregorina's discovery evidence was that the property was transferred to her because Joe had problems at the bank and did not want to lose the cottage.

2. Alba testified that she gave her mother a mortgage because her mother needed the money. However, there was also evidence to the effect that:

   - the mortgage was placed on the property after all of the funds said to support the mortgage were advanced;
   - the advances purportedly supporting the mortgage were not made to Gregorina, they were made principally to Alessandro Holdings Ltd., a company apparently controlled by Joe, and to a lesser degree to Joe and Gregorina jointly.
   - Joe's discovery evidence was that some of the money was to pay his debts at the Royal Bank for which Gregorina was co-signer.
   - all but one of the cheques drawn on Alba's account were signed and likely initiated by Joe.
   - Although Alba's testimony on this point is somewhat evasive, it is likely that Gregorina was giving Alba significant gifts, including cash gifts, in the same period that the alleged advances were made and remained outstanding;
   - Alba testified that it was her mother that gave the necessary instructions to the lawyer regarding the mortgage, but Gregorina's discovery evidence was that all of the paper work regarding the property was prepared or arranged by Alba;

3. Joe testified that he was never a partner in the venture that acquired the property and the Block D properties. He also testified that there were four

partners: Gregorina, Giuseppe Marchese, Domenic Sgro and Raffaele Morano. Other evidence on the point, however, was as follows:

- evidence of Gregorina that there were three partners: her, Morano and Marchese.
- the evidence of Giuseppe Marchese was that there were four partners and that one of those four was Joe and not Gregorina;
- Joe gave previous evidence that there were five partners and that he had never held any property in trust. At trial he changed his testimony and said that these prior sworn statements were made in error.

35 When I review the whole of the evidence and consider the reliability of the various witnesses I find Joe's testimony that he took the property in trust for four partners, including his wife, and that it was Gregorina who, as one of the four beneficiaries, paid out the other three partners thereby becoming the sole beneficial owner of the property to be self-serving and improbable. The evidence is more consistent with Joe being the partner who acquired the complete interest in the property sometime in the mid 70s, and I so find.

36 The 1994 transfer to Gregorina was a non arm's length transaction for no consideration at a time when Joe was insolvent. It was an attempt to put the property out of the reach of his creditors.

37 Support for this conclusion includes the following:

1. The clear and cogent evidence of Giuseppe Marchese. He testified that there were four partners, one of whom was Joe, and that after the Block D properties were sold, Joe bought out his partners by paying each of them $3,000. As a result, Joe became the sole owner of the property.
2. When one reviews all of the transactions shown in the various property registers for the area, it is clear that Joe and his partners bought and sold many properties. It does not seem reasonable that Joe would put this particular property into his name when he had no interest in it. Some properties were put in his name, in Gregorina's name and in their joint names and there seems little logic in his name appearing on title of this particular property if he had no interest in it.
3. The way Joe acted and parts of his testimony suggest that he was directly and intimately involved in these transactions and are more consistent with Joe being a partner than not.
4. Gregorina's discovery evidence read in at trial was that Joe transferred the property into her name because he had problems with the bank and did not want to lose the cottage.

5. The evidence of Cesidio and Sylvio Conte, Cesidio's son, was that Joe had advised them both that the property was "his cottage," that is, Joe's cottage.

38 I turn now to Gregorina's evidence on the question of ownership. As set out previously, her testimony at trial was that the property had always been hers and in her name. She was visibly emotional about it, and it may well be that at the time of trial this was her honest belief. This belief, even if sincere, does not make it so. There were many transactions and payments made in the early 70s. From her testimony, it was clear that Gregorina did not know which specific property would have been put into her name nor which property was put into the name of her husband.

39 She testified repeatedly that the cottage lot she bought was on Ronald Avenue and, after being told that the property was located on James Street, said she must have forgotten that the lots she purchased were scattered on different streets. In fact she and Joe did buy a lot on Ronald Avenue as part of the many transactions in the area, and it is on this lot that they built their first cottage. The Ronald Avenue lot is not, however, the lot that is the subject of the present litigation. The Ronald Avenue cottage was later sold and a second cottage was built on the property located on James Street which, as stated earlier, was also acquired as part of these transactions but is in the name of Joe "to uses".

40 In my view, the property on which the current cottage is situated, the property that is the subject of this litigation, was not a property that Gregorina bought in the 1970s. Her testimony concerning her alleged purchase of the property is confused, inconsistent and changing. The evidence is more consistent with Joe having acquired that property.

41 I now turn to the transactions themselves - the transfer and subsequent mortgaging of the property.

F) BADGES OF FRAUD

42 From the chronology and facts we can identify a series of "badges of fraud" for both the transfer and mortgaging of the property.

1. Transfer from Joe to Gregorina

43 Based on my earlier finding that Joe did not hold the property in trust and had in fact become the owner of the property in the 70s, the 1994 transaction should be viewed as a simple transfer rather than a transfer to the beneficiary under a trust arrangement. I will therefore turn to a review of some of the badges of fraud and how they relate to the transfer to Gregorina. They are as follows:

a) The transferor has few remaining assets after the transfer:

- the property transferred was the only asset owned by Joe and was

done at a time when Joe was insolvent.

b) Transfer to a non arm's length person:

- the transfer was non arm's length from Joe to his wife.

c) There are actual or potential liabilities facing the transferor or he is about to enter upon a risky undertaking:

- the transfer was made very shortly after the plaintiffs issued the statement of claim to recover the $350,000 debt owed by Joe.

d) Grossly inadequate consideration:

- the consideration for the transfer from Joe to Gregorina was nominal.

e) The transferor remains in possession or occupation of the property for his own use after the transfer:

- Joe continued to use and benefit from the property after the transfer to Gregorina.

f) The deed contains a self-serving and unusual provision:

- the land transfer tax affidavit contained a self-serving statement being that the transferee had been the sole beneficial owner during the entire period the lands were registered in the name of Joe.

g) The transfer was effected with unusual haste:

- after holding for over 20 years the transfer is effected shortly after

the plaintiffs issued the statement of claim.

44 The presence of one or more of these badges of fraud raises a presumption of fraud. As set out earlier, while the persuasive burden of proof remains with the plaintiffs, the burden of explaining the circumstantial evidence of fraudulent intent now shifts to the defendants.

45 In addition to these badges of fraud there is the evidence of Gregorina which was read in from the discovery transcript. Her evidence was that the transfer was done to take the property out of reach of the bank, one of Joe's creditors. Considering this evidence, not only was there little or no evidence to explain the circumstantial evidence of fraudulent intent and rebut the presumption of fraud, there was direct evidence supporting the fraudulent intent.

2. Mortgage Between Gregorina and Alba

46 When we look for badges of fraud in a mortgage transaction that is alleged to be the second part of a two part scheme to defeat or delay creditors we need to adapt the principles somewhat to take into account the unique circumstances. Some of the badges of fraud and how they relate to the mortgage of the property are as follows:

a) Transfer to a non arm's length person:

- the transaction was non-arm's length, being between Gregorina and her daughter Alba.

b) The effect of the transaction is to delay and defeat creditors:

- there was a risk that the transfer would be set aside and the property seized by creditors, therefore, the mortgage served to protect against that.

c) Payment to a person not a party to the disposition:

- the consideration for the mortgage and the making of the mortgage were not contemporary. The consideration did not go to Gregorina but rather went principally to a company apparently controlled by Joe, and to Joe and Gregorina jointly.

d) The transfer was effected with unusual haste:

- the timing of the loan agreement which underlies the mortgage was shortly after the plaintiffs demanded payment from Joe; and:
- Gregorina and/or Alba registered the mortgage on the property shortly after the date of the judgment debtor examination of Joe.

e) The absence of a sound business or tax reason for the transaction:

- Alba and Gregorina were mother and daughter. Alba had received numerous gifts of money and goods from her mother. There was no business or tax reason for the mortgage and no reason why the mortgage should be placed on the cottage lot rather than Gregorina's home in Toronto.

f) The deed contains a self-serving and unusual provision:

- The loan agreement which deals with the purported loan from Alba to Gregorina and Joe contains a recital describing Joe as the holder in trust of the property, and Gregorina is the beneficial owner.

47 The existence of one or more of these various badges of fraud serves to shift the burden of explaining the circumstantial evidence of fraudulent intent to the defendants.

48 The defendants allege that the mortgage flowed from the loan agreement and that the mortgage was placed on the property as consideration for the advances made pursuant to the loan agreement.

49 When one reviews the mortgage transaction in the context of all of the other facts and events surrounding the property it is, in my view, improbable that the mortgage was a regular financial arrangement between Alba and Gregorina. The mortgage and the loan agreement were part of the scheme to keep the property out of the reach of Joe's creditors.

50 The advances under the loan agreement were to or for the benefit of Joe, and Gregorina did not have much involvement in it. The loan agreement was likely triggered by the plaintiffs' demand for payment from Joe or other creditors' demands. The mortgage was intended to protect the cottage from being seized by creditors and sold to provide money to repay Joe's debts.

51 While Joe, Gregorina and Alba each tried to characterize these transactions as regular and

proper, I found the evidence of each of them to be self-serving and unreliable. On the balance of probabilities, I am satisfied that the dominant purpose of both of the transactions was to prevent creditors from having access to the property for payment of Joe's debts. Gregorina and Alba were both well aware of Joe's financial situation. While Gregorina did not appear to me to be sophisticated enough to structure the various transactions, I find that she willingly cooperated with Alba and Joe who undertook to put the property out of the reach of Joe's creditors.

G) WAS THERE CONSIDERATION FOR THE MORTGAGE?

52 If the defendants can establish that either of the transactions was made for good consideration and was a bona fide transaction to a person not having notice or knowledge of the intent to defraud, then the grantee may keep the property free of the taint of fraud.

53 With respect to the transfer of the property from Joe to Gregorina, there was no valuable consideration, and I need go no further.

54 With respect to the mortgage, the defendants tried to show that the mortgage was given for good and valuable consideration. The burden was on the defendants to establish consideration. The evidence presented by the defendants is not sufficient to discharge the burden of proof in this case. The production of various cheques, most of which were payable to one of the companies controlled by Joe was unconvincing as it was clear on the whole of the evidence that Joe was controlling the flow of funds. In the absence of the various bank accounts showing the source of the monies and the ultimate disposition of the funds, I am not satisfied that the advances were bona fide payments made by Alba to Gregorina in support of the mortgage. In addition, as stated earlier, I find that Alba was well aware of the reason for these various transactions, and it was no coincidence that she sought to place a mortgage on the property rather than on other assets in the name of Gregorina.

55 I find, on a balance of probabilities, that the transfer to Gregorina and the mortgage were done with an intent to defeat, hinder, delay or defraud the creditors. The transfer and the mortgage were not made for consideration nor was the mortgage made in good faith to a person who, at the time of the placing of the mortgage, had no notice or knowledge of the intent to defeat, hinder, delay or defraud the creditor.

H) ALLEGED SETTLEMENT

56 A full and final release, a consent and an agreement to settle the claim, all executed October 7, 1999, were entered into evidence.

57 The defendants allege that the action was settled and that, as a result, the claim ought to be dismissed.

58 In his videotaped evidence, Cesidio confirmed that he did in fact execute the documents but that this had been done on the understanding that the executed documents would be exchanged

through intermediaries against payment in full of the debt. He testified that no payment was ever made. As a result, he never authorised the release of the settlement documents, and no settlement was effected.

59 Joe testified that the settlement negotiations were conducted through an intermediary and that he had paid the settlement funds.

60 It is not clear from Joe's evidence what amount was to be paid in settlement of the claim. Other than Joe's testimony, the only evidence of payment of any settlement funds was a certified cheque for $72,000 dated July 13, 1999, payable to J. Sansone, a friend of the families. There was no evidence provided regarding who cashed the cheque in October 1999 nor how the funds were used.

61 The burden is on the defendants to establish that a settlement has been concluded. Given the evidence of Cesidio denying any payment, the proof that the settlement funds were actually paid is essential. Mr. Sansone was never called to testify concerning what the $72,000 payment to him was for nor has any other document been tendered showing that this, or any other sum, was ever paid to the plaintiffs.

62 The defendants have not satisfied me on a balance of probabilities that a settlement was entered into which resolved all of the issues in this action. They offered no satisfactory explanation for the failure to call the payee of the cheque, J. Sansone. By reason of that failure I draw an inference adverse to the defendants that the testimony of that witness would not have assisted the defendants' case.

63 In any event, the amount paid to Mr. Sansone was less than the amount allegedly agreed upon, and other than Joe's testimony, there is no evidence that these sums were paid. The defendants have not satisfied me that any consideration was paid for the alleged settlement. I therefore conclude that this defence must fail.

VI. CONCLUSION

64 In the result, I grant judgment setting aside the transfer of the property described municipally as 1629 James Street, Tiny, Ontario, from Giuseppe Alessandro to Gregorina Alessandro, Instrument 01263935 dated August 31, 1994. I also grant judgment setting aside the charge granted on that same property by Gregorina Alessandro to Alba Alessandro, instrument 01325897 dated October 11, 1996.

65 In view of my conclusions in respect of the plaintiffs' claims, I dismiss the defendants' counterclaim.

66 If the parties are unable to agree on the issue of costs, the plaintiffs are to provide me with written submissions within 15 days of the release of these reasons, and the defendants are to

respond in writing to these within 10 days thereafter.

ROULEAU J.

TAB 15

Case Name:

Canwest Global Communications Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, C-36, as amended
AND IN THE MATTER OF a Plan of Compromise or Arrangement of Canwest Global Communications Corp. and other Applicants

[2011] O.J. No. 1590

2011 ONSC 2215

75 C.B.R. (5th) 156

2011 CarswellOnt 2392

Court File No. CV-09-8396-00CL

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

April 7, 2011.

(44 paras.)

Counsel:

Douglas J. Wray and Jesse B. Kugler, counsel for the Applicant Communications, Energy and Paperworkers Union of Canada ("CEP").

David Byers and Maria Konyukhova, counsel for the Monitor.

REASONS FOR DECISION

S.E. PEPALL J.:--

Introduction

1 The Communications, Energy and Paperworkers Union of Canada ("CEP") requests an order lifting the stay of proceedings in respect of certain grievances and directing that they be adjudicated in accordance with the provisions of the applicable collective agreement. In the alternative, CEP requests an order amending the claims procedure order so as to permit the subject claim to be adjudicated in accordance with the provisions of the collective agreement.

Background Facts

2 On October 6, 2009, the CMI Entities obtained an initial order pursuant to the *CCAA* staying all proceedings and claims against them. Specifically, paragraphs 15 and 16 of that order stated:

> **NO PROCEEDINGS AGAINST THE CMI ENTITIES OR THE CMI PROPERTY**
>
> 15. **THIS COURT ORDERS** that until and including November 5, 2009, or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against or in respect of the CMI Entities, the Monitor or the CMI CRA or affecting the CMI Business or the CMI Property, except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of Proceedings affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of Proceedings affecting the CMI CRA), or with leave of this Court, and any and all Proceedings currently under way against or in respect of the CMI Entities or the CMI CRA or affecting the CMI Business or the CMI Property are hereby stayed and suspended pending further Order of this Court. In the case of the CMI CRA, no Proceeding shall be commenced against the CMI CRA or its directors and officers without prior leave of this Court on seven (7) days notice to Stonecrest Capital Inc.
>
> **NO EXERCISE OF RIGHTS OR REMEDIES**
>
> 16. **THIS COURT ORDERS** that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of the CMI Entities, the Monitor and/or the CMI CRA, or affecting the CMI Business or the CMI Property, are hereby stayed and

> suspended except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of rights and remedies affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of rights or remedies affecting the CMI CRA), or leave of this Court, provided that nothing in this Order shall (i) empower the CMI Entities to carry on any business which the CMI entities are not lawfully entitled to carry on, (ii) exempt the CMI Entities from compliance with statutory or regulatory provisions relating to health, safety or the environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of claim for lien.

3 On October 14, 2009, as part of the CCAA proceedings, I granted a claims procedure order which established a claims procedure for the identification and quantification of claims against the CMI Entities. In that order, "Claim" is defined as any right or claim of any Person against one or more of the CMI Entities in existence on the Filing Date[1] (a "Prefiling Claim") and any right or claim of any Person against one or more of the CMI Entities arising out of the restructuring on or after the Filing Date (a "Restructuring Claim"). Claims arising prior to certain dates had to be asserted within the claims procedure failing which they were forever extinguished and barred. Pursuant to the claims procedure order, subject to the discretion of the Court, claims of any person against one or more of the CMI Entities were to be determined by a claims officer who would determine the validity and amount of the disputed claim in accordance with the claims procedure order. The Honourable Ed Saunders, The Honourable Jack Ground and The Honourable Coulter Osborne were appointed as claims officers. Other persons could also be appointed by court order or on consent of the CMI Entities and the Monitor. This order was unopposed. It was amended on November 30, 2009 and again the motion was unopposed. As at October 29, 2010, over 1,800 claims asserted against the CMI Entities had been finally resolved in accordance with and pursuant to the claims procedure order.

4 On October 27, 2010, CEP was authorized to represent its current and former union members including pensioners employed or formerly employed by the CMI Entities to the extent, if any, that it was necessary to do so.

5 On the date of the initial order, CEP had a number of outstanding grievances. CEP filed claims pursuant to the claims procedure order in respect of those grievances. The claim that is the subject matter of this motion is the only claim filed by CEP that has not been resolved and therefore is the only claim filed by CEP that requires adjudication. There is at least one other claim in Western Canada that may require adjudication.

6 John Bradley had been employed for 20 years by Global Television, a division of Canwest Television Limited Partnership ("CTLP"), one of the CMI Entities. Mr. Bradley is a member of CEP. On February 24, 2010, CTLP suspended Mr. Bradley for alleged misconduct. On March 8, 2010, CEP filed a grievance relating to his suspension under the applicable collective agreement.

On March 25, 2010, CTLP terminated his employment. On March 26, 2010, CEP filed a grievance requesting full redress for Mr. Bradley's termination. This would include reinstatement to his employment. On June 23, 2010 a restructuring period claim was filed with respect to the Bradley grievances on the following basis:

> The Union has filed this claim in order to preserve its rights. Filing this claim is without prejudice to the Union's ability to pursue all other remedies at its disposal to enforce its rights, including any other statutory remedies available. Notwithstanding that the Union has filed the present claim, the Union does not agree that this claim is subject to compromise pursuant [to the CCAA][2]. The Union reserves its right to make further submissions in this regard.

7 In spite of the parties' good faith attempts to resolve the Bradley grievances and the Bradley claim, no resolution was achieved.

8 The Plan was sanctioned on July 28, 2010 and implemented on October 27, 2010. At that time, all of the operating assets of the CMI Entities were transferred to the Plan Sponsor and the CMI Entities ceased operations. The CTLP stay was also terminated. The stay with respect to the Remaining CMI Entities (as that term is defined in the Plan) was extended until May 5, 2011. Pursuant to an order dated September 27, 2010, following the Plan implementation date the Monitor shall be:

(a) empowered and authorized to exercise all of the rights and powers of the CMI Entities under the Claims Procedure Order, including, without limitation, revise, reject, accept, settle and/or refer for adjudication Claims (as defined in the Claims Procedure Order) all without (i) seeking or obtaining the consent of the CMI Entities, the Chief Restructuring Advisor or any other person, and (ii) consulting with the Chief Restructuring Advisor in the CMI Entities; and

(b) take such further steps and seek such amendments to the Claims Procedure Order or additional orders as the Monitor considers necessary or appropriate in order to fully determine, resolve or deal with any Claims.

9 The Monitor has taken the position that if the Bradley matter is not resolved, the claim should be referred to a claims officer for determination. It is conceded that a claims officer would have no jurisdiction to reinstate Mr. Bradley to his employment.

10 CEP now requests an order lifting the stay of proceedings in respect of the Bradley grievances and directing that they be adjudicated in accordance with the provisions of the collective agreement. In the alternative, CEP requests an order amending the claims procedure order so as to permit the Bradley claim to be adjudicated in accordance with the provisions of the collective agreement.

11 For the purposes of this motion and as is obvious from the motion seeking to lift the stay, both CEP and the Monitor agree that the stay did catch the Bradley claim and that it is encompassed by

the definition of claim found in the claims procedure order.

12 Since the commencement of the *CCAA* proceedings, CEP has only sought to lift the stay in respect of one other claim, that being a claim relating to a grievance filed by CEP on behalf of Vicky Anderson. The CMI Entities consented to lifting the stay in respect of Ms. Anderson's claim because at the date of the initial order, there had already been eight days of hearing before an arbitrator, all evidence had already been called, and only one further date was scheduled for final argument. Ultimately, the arbitrator ordered that Ms. Anderson be reinstated but made no order for compensation.

13 Pursuant to Article 12.3 of the applicable collective agreement, discharge grievances are to be heard by a single arbitrator. All other grievances are to be heard by a three person Board of Arbitration unless the parties consent to submit the grievance to a single arbitrator. The single arbitrator is to be selected within 10 days of the notice of referral to arbitration from a list of 5 people drawn by lot. An award is to be given within 30 days of the conclusion of the hearing. The list of arbitrators was negotiated and included in the collective agreement. The arbitrator has the power to reinstate with or without compensation.

14 The evidence before me suggests that adjudications of grievances under collective agreements are typically much more costly and time consuming than adjudications before a claims officer as the latter may determine claims in a summary manner and there is more control over scheduling. The Monitor takes the position that additional cost and delay would arise if the claims were adjudicated pursuant to the terms of the collective agreement rather than pursuant to the terms of the claims procedure order.

Issues

15 Both parties agree that the following two issues are to be considered:

(a) Should this court lift the stay of proceedings in respect of the Bradley grievances and direct that the Bradley grievances be adjudicated in accordance with the provisions of the collective agreement?

(b) Should this court amend the claims procedure order so as to permit the Bradley claim to be adjudicated in accordance with the provisions of the collective agreement?

Positions of the Parties

16 In brief, dealing firstly with the stay, CEP submits that the balance of convenience favours pursuit of the grievances through arbitration. CEP is seeking to compel the employer to comply with fundamental obligations that flow from the collective agreement. This includes the appointment of an arbitrator on consent who has jurisdiction to award reinstatement if he or she determines that there was no just cause to terminate Mr. Bradley's employment. Requiring that the

claim and the grievances be adjudicated in a manner that is inconsistent with the collective agreement would have the effect of depriving the griever of some of the most fundamental rights under a collective agreement. Furthermore, permitting the grievances to proceed to arbitration would prejudice no one.

17 Alternatively, CEP submits that the claims procedure order ought to be amended. It is in conflict with the terms of the collective agreement. Pursuant to section 33 of the *CCAA*, the collective agreement remains in force during the *CCAA* proceedings. The claims procedure order must comply with the express requirements of the *CCAA*. Lastly, orders issued under the *CCAA* should not infringe upon the right to engage in associational activities which are protected by the *Charter of Rights and Freedoms*.

18 The Monitor opposes the relief requested. On the issue of the lifting of the stay, it submits that the *CCAA* is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. The stay of proceedings permits the *CCAA* to accomplish its legislative purpose and in particular enables continuance of the company seeking *CCAA* protection.

19 The lifting of a stay is discretionary. Mr. Bradley is no more prejudiced than any other creditor and the claims procedure established under the order has been uniformly applied. The claims officer has the power to recognize Mr. Bradley's right to reinstatement and monetize that right. The efficacy of *CCAA* proceedings would be undermined if a debtor company was forced to participate in an arbitration outside the *CCAA* proceedings. This would place the resources of an insolvent *CCAA* debtor under strain. The Monitor submits that CEP has not satisfied the onus to demonstrate that the lifting of the stay is appropriate in this case.

20 As for the second issue, the Monitor submits that the claims procedure order should not be amended. Courts regularly affect employee rights arising from collective agreements during *CCAA* proceedings and recent amendments to the *CCAA* do not change the existing case law in this regard. Furthermore, amending the claims procedure order would undermine the purpose of the *CCAA*. Lastly, relying on the Supreme Court of Canada's statements in *Health Services and Support - Facilities Subsector Bargaining Assn. v. British Columbia*[3], the claims procedure order does not interfere with freedom of association.

21 Following argument, I requested additional brief written submissions on certain issues and in particular, to what employment Mr. Bradley would be reinstated if so ordered. I have now received those submissions from both parties.

Discussion

1. Stay of Proceedings

22 The purpose of the *CCAA* has frequently been described but bears repetition. In *Lehndorff*

General Partner Limited [4], Farley J. stated:

> The *CCAA* is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both.

23 The stay provisions in the *CCAA* are discretionary and very broad. Section 11.02 provides that:

> (1) A court may, on an initial application in respect of the 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.
>
> (2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,
>
> (a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an *Act* referred to in paragraph (1)(a);
> (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.

24 As the Court of Appeal noted in *Nortel Networks Corp.* [5], the discretion provided in section 11 is the engine that drives this broad and flexible statutory scheme. The stay of proceedings in section 11 should be broadly construed to accomplish the legislative purpose of the *CCAA* and in particular to enable continuance of the company seeking *CCAA* protection: *Lehndorff General Partner Limited* [6].

25 Section 11 provides an insolvent company with breathing room and by doing so, preserves the status quo to assist the company in its restructuring or arrangement and prevents any particular stakeholder from obtaining an advantage over other stakeholders during the restructuring process. It

is anticipated that one or more creditors may be prejudiced in favour of the collective whole. As stated in *Lendorff General Partner Limited*[7]:

> The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the *CCAA* because this effect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the *CCAA* must be for the debtor and all of the creditors.

26 In *Canwest Global Communications Corp.*[8], I had occasion to address the issue of lifting a stay in a *CCAA* proceeding. I referred to situations in which a court had lifted a stay as described by Paperny J. (as she then was) in *Re Canadian Airlines Corp.*[9] and by Professor McLaren in his book, "*Canadian Commercial Reorganization: Preventing Bankruptcy*"[10]. They included where:

a) a plan is likely to fail;
b) the applicant shows hardship (the hardship must be caused by the stay itself and be independent of any pre-existing condition of the applicant creditor);
c) the applicant shows necessity for payment;
d) the applicant would be significantly prejudiced by refusal to lift the stay and there would be no resulting prejudice to the debtor company or the positions of creditors;
e) it is necessary to permit the applicant to take steps to protect a right that could be lost by the passage of time;
f) after the lapse of a significant period, the insolvent debtor is no closer to a proposal than at the commencement of the stay period;
g) there is a real risk that a creditor's loan will become unsecured during the stay period;
h) it is necessary to allow the applicant to perfect a right that existed prior to the commencement of the stay period;
i) it is in the interests of justice to do so.

27 The lifting of a stay is discretionary. As I wrote in *Canwest Global Communications Corp.*[11]:

> There are no statutory guidelines contained in the Act. According to Professor R.H. McLaren in his book "Canadian Commercial Reorganization: Preventing Bankruptcy", an opposing party faces a very heavy onus if it wishes to apply to the court for an order lifting the stay. In determining whether to lift the stay, the court should consider whether there are sound reasons for doing so consistent with the objectives of the CCAA, including a consideration of the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action: *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.* (2007), 33 C.B.R. (5th) 50 (Sask. C.A.) at para. 68. That decision

also indicated that the judge should consider the good faith and due diligence of the debtor company.

28 There appears to be no real issue that the grievances are caught by the stay of proceedings. In *Luscar Ltd. v. Smoky River Coal Limited*[12], the issue was whether a judge had the discretion under the *CCAA* to establish a procedure for resolving a dispute between parties who had previously agreed by contract to arbitrate their disputes. The question before the court was whether the dispute should be resolved as part of the supervised reorganization of the company under the *CCAA* or whether the court should stay the proceedings while the dispute was resolved by an arbitrator. The presiding judge was of the view that the dispute should be resolved as expeditiously as possible under the *CCAA* proceedings. The Alberta Court of Appeal upheld the decision stating:

> The above jurisprudence persuades me that "proceedings" in section 11 includes the proposed arbitration under the B.C. *Arbitration Act.* The Appellants assert that arbitration is expeditious. That is often, but not always, the case. Arbitration awards can be appealed. Indeed, this is contemplated by section 15(5) of the *Rules*. Arbitration awards, moreover, can be subject to judicial review, further lengthening and complicating the decision making process. Thus, the efficacy of *CCAA* proceedings (many of which are time sensitive) could be seriously undermined if a debtor company was forced to participate in an extra-*CCAA* arbitration. For these reasons, having taken into account the nature and purpose of the *CCAA*, I conclude that, in appropriate cases, arbitration is a "proceeding" that can be stayed under section 11 of the *CCAA*.[13]

29 I do recognize that the *Luscar* decision did not involve a collective agreement but an agreement to arbitrate. That said, the principles described also apply to an arbitration pursuant to the terms of a collective agreement.

30 In considering balance of convenience, CEP's primary concerns are that the claims procedure order does not accord with the rights and obligations contained in the collective agreement. Firstly, a claims officer is the adjudicator rather than an arbitrator chosen pursuant to the terms of the collective agreement and secondly, reinstatement is not an available remedy before a claims officer. Thirdly, an arbitration imports rules of natural justice and procedural fairness whereas the claims procedure is summary in nature.

31 The claims officers who were identified in the claims procedure order are all former respected and experienced judges who are well suited and capable of addressing the issues arising from the Bradley claim. Furthermore, had this been a real issue, CEP could have raised it earlier and identified another claims officer for inclusion in the claims procedure order. Indeed, an additional claims officer still could be appointed but no such request was ever advanced by CEP.

32 Should the claims officer find that CTLP did not have just cause to terminate Mr. Bradley's employment, he can recognize Mr. Bradley's right to reinstatement by monetizing that right. This

was done for a multitude of other claims in the *CCAA* proceedings including claims filed by CEP on behalf of other members. I note that Mr. Bradley would not be receiving treatment different from that of any other creditor participating in the claims process.

33 The claims process is summary in nature for a reason. It reduces delay, streamlines the process, and reduces expense and in so doing promotes the objectives of *CCAA*. Indeed, if grievances were to customarily proceed to arbitration, potential exists to significantly undermine the *CCAA* proceedings. Arbitration of all claims arising from collective agreements would place the already stretched resources of insolvent *CCAA* debtors under significant additional strain and could divert resources away from the restructuring. It is my view that generally speaking, grievances should be adjudicated along with other claims pursuant to the provisions of a claims procedure order within the context of the CCAA proceedings.

34 That said, it seems to me that this case is unique. While the claims procedure order and the meeting order of June 23, 2010 provide that all claims against CTLP and others arising prior to certain dates must be asserted within the claims procedure failing which they are forever extinguished and barred, the stay relating to CTPL was terminated on October 27, 2010. CTLP has emerged from CCAA protection and is currently operating in the normal course having changed its name to Shaw Television Limited Partnership ("STLP"). If the grievance relating to Mr. Bradley's termination is successful, he could be reinstated to his employment at STLP. The position of CEP, Mr. Bradley and the Monitor is that reinstatement, if ordered, would be to STLP. Counsel for CEP advised the court that notice of the motion was given to STLP and that a representative was present in court for the argument of the motion although did not appear on the record. The Monitor has also confirmed that Shaw Communications Inc., the parent of STLP, was aware of the motion and its counsel has confirmed its understanding that any reinstatement of Mr. Bradley, if ordered, would be to STLP.

35 As mentioned, Mr. Bradley was a 20 year employee. While I do not consider the identity of the arbitrator and the natural justice arguments of CEP to be persuasive, given the stage of the CCAA proceedings, the fact that the stay relating to CTLP has been lifted, and Mr. Bradley's employment tenure, I am persuaded that he ought to be given the opportunity to pursue his claim for reinstatement rather than being compelled to have that entitlement monetized by a claims officer if so ordered. Counsel for the Monitor has confirmed that the timing of the distributions would not appear to be affected by the outcome of this motion. No meaningful prejudice would ensue to any stakeholder. It seems to me that the balance of convenience and the interests of justice favour lifting the stay to permit the grievances to proceed through arbitration rather than before the claims procedure officer. Therefore, CEP's motion to lift the stay is granted and the Bradley grievances may be adjudicated in accordance with the terms of the collective agreement.

2. Amendment of the Claims Procedure Order

36 In light of my decision on the stay, it is not strictly necessary to consider whether the claims

procedure order should be amended as requested by CEP as alternative relief. As this issue was argued, however, I will address it.

37 Section 33 of *CCAA* was added to the statute in September, 2009. The relevant sub-sections now provide:

> 33(1) If proceedings under this Act have been commenced in respect of a debtor company, any collective agreement that the company has entered into as the employer remains in force, and may not be altered except as provided in this section or under the laws of the jurisdiction governing collective bargaining between the company and the bargaining agent.
>
> 33(8) For greater certainty, any collective agreement that the company and the bargaining agent have not agreed to revise remains in force, and the court shall not alter its terms.

38 Justice Mongeon of the Québec Superior Court had occasion to address the effect of section 33 of the *CCAA* in *White Birch Paper Holding Company*[14]. He stated that the fact that a collective agreement remains in force under a *CCAA* proceeding does not have the effect of "excluding the entire collective labour relations process from the application of the *CCAA*."[15] He went on to write that:

> It would be tantamount to paralyzing the employer with respect to reducing its costs by any means at all, and to providing the union with a veto with regard to the restructuring process.[16]

39 In *Canwest Global Communications Corp.*[17], I wrote that section 33 of the *CCAA* "maintains the terms and obligations contained in the collective agreement but does not alter priorities or status."[18] In that case when dealing with the issue of immediate payment of severance payments, I wrote:

> There are certain provisions in the amendments that expressly mandate certain employee related payments. In those instances, section 6(5) dealing with a sanction of a plan and section 36 dealing with a sale outside the ordinary course of business being two such examples, Parliament specifically dealt with certain employee claims. If Parliament had intended to make such a significant amendment whereby severance and termination payments (and all other payments under a collective agreement) would take priority over secured creditors, it would have done so expressly.[19]

40 I agree with the Monitor's position that if Parliament had intended to carve grievances out of the claims process, it would have done so expressly. To do so, however, would have undermined

the purpose of the *CCAA* and in particular, the claims process which is designed to streamline the resolution of the multitude of claims against an insolvent debtor in the most time sensitive and cost efficient manner. It is hard to imagine that it was Parliament's intention that grievances under collective agreements be excluded from the reach of the stay provisions of section 11 of the *CCAA* or the ancillary claims process. In my view, such a result would seriously undermine the objectives of the *Act*.

41 Furthermore, I note that over 1,800 claims have been processed and dealt with by way of the claims procedure order, many of them involving claims filed by CEP on behalf of its members. CEP was provided with notice of the motion wherein the claims procedure order and the claims officers were approved. CEP did not raise any objection to the claims procedure order, the claims officers or the inclusion of grievances in the claims procedure at the time that the order was granted. The claims procedure order was not an order made without notice and none of the prerequisites to variation of an order has been met. Had I not lifted the stay, I would not have amended the claims procedure order as requested by CEP.

42 CEP's last argument is that the claims procedure order interferes with Mr. Bradley's freedoms under the Canadian *Charter of Rights and Freedoms*. In this regard I make the following observations. Firstly, this argument was not advanced when the claims procedure order was granted. Secondly, CEP is not challenging the validity of any section of the *CCAA*. Thirdly, nothing in the statute or the claims procedure inhibits the ability to collectively bargain. In *Health Services and Support - Facilities Subsector Bargaining Assn. v. British Columbia*[20], the Supreme Court of Canada stated:

> We conclude that section 2(d) of the *Charter* protects the capacity of members of labour unions to engage, in association, in collective bargaining on fundamental workplace issues. This protection does not cover all aspects of "collective bargaining", as that term is understood in the statutory labour relations regimes that are in place across the country. Nor does it ensure a particular outcome in a labour dispute or guarantee access to any particularly statutory regime. ...
>
> In our view, it is entirely possible to protect the "procedure" known as collective bargaining without mandating constitutional protection for the fruits of that bargaining process.[21]

43 In my view, nothing in the claims procedure or the *CCAA* impacts the procedure known as collective bargaining.

<u>Conclusion</u>

44 Under the circumstances, the request to lift the stay as requested by CEP is granted. Had it been necessary to do so, I would have dismissed the alternative relief requested.

S.E. PEPALL J.

cp/e/qlafr/qljxr/qlana/qlhcs

1 The Filing Date was October 6, 2009, the date of the initial order.

2 The words in brackets were omitted but presumably this was the intention.

3 [2007] S.C.J. No. 27.

4 (1993), 17 C.B.R. (3rd) 24 (Ont. Gen. Div.) at para. 6.

5 [2009] O.J. No. 4967 at para. 33.

6 *Supra,* note 4 at para. 10.

7 *Ibid,* at para. 6.

8 [2009] O.J. No. 5379.

9 (2000) 19 C.B.R. (4th) 1.

10 (Aurora: Canada Law Book, looseleaf) at para. 3.3400.

11 *Supra*, note 8 at para. 32.

12 [1999] A.J. No. 676.

13 *Ibid*, at para. 33.

14 2010, Q.C.C.S. 2590.

15 *Ibid*, at para. 31.

16 *Ibid*, at para. 35.

17 [2010] O.J. No. 2544.

18 *Ibid*, at para. 32.

19 *Ibid*, at para. 33.

20 *Supra*, note 3.

21 *Ibid*, at paras. 19 and 29.

TAB 16

Case Name:
Canwest Global Communications Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, C-36, as amended
AND IN THE MATTER OF a proposed plan of compromise or arrangement of Canwest Global Communications Corp. and the other applicants listed on Schedule "A"

[2009] O.J. No. 5379

61 C.B.R. (5th) 200

2009 CarswellOnt 7882

Court File No. CV-09-8241-OOCL

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

Heard: December 8, 2009.
Judgment: December 15, 2009.

(52 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Claims -- Application in this Companies' Creditors Arrangement Act matter for an order declaring that the relief sought by the "GS Parties" was subject to an Oct. 6, 2009 stay of proceedings granted -- Cross-motion by the GS Parties for an order lifting the stay so that they could pursue their motion challenging pre-filing conduct of the CMI entities, etc., dismissed -- The substance and subject matter of the motion were certainly encompassed by the stay -- The balance of convenience, the assessment of relative prejudice and the relevant merits favoured the position of the CMI Entities on the lift stay motion.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Stays -- Application in this Companies' Creditors Arrangement Act matter for an order declaring that the relief sought by the "GS Parties" was subject to an Oct. 6, 2009 stay of proceedings granted -- Cross-motion by the

GS Parties for an order lifting the stay so that they could pursue their motion challenging pre-filing conduct of the CMI entities, etc., dismissed -- The substance and subject matter of the motion were certainly encompassed by the stay -- The balance of convenience, the assessment of relative prejudice and the relevant merits favoured the position of the CMI Entities on the lift stay motion.

Application by the CCAA applicants and the "CMI entities" for an order declaring that the relief sought by the "GS parties" was subject to the stay of proceedings granted on Oct. 6, 2009. Cross-motion by GS Parties for an order lifting the stay so they could pursue their motion challenging pre-filing conduct of the CMI entities, etc. The Ad Hoc Committee of Noteholders and the Special Committee of the Board of Directors supported the position of the CMI Entities. In essence, the GS Parties' motion sought to undo the transfer of the CW Investments Co. shares from 441 to CMI or to require CMI to perform and not disclaim the shareholders agreement as though the shares had not been transferred.

HELD: GS Parties' motions dismissed, save for a portion dealing with para. 59 of the initial order on consent; CMI Entities' motion granted with the exception of a strike portion, which was moot. The first issue was caught by the stay of proceedings and the second was properly addressed if and when CMI sought to disclaim the shareholders agreement. The substance of the GS Parties' motion was a "proceeding" subject to the stay under para. 15 of the initial order prohibiting the commencement of all proceedings against or in respect of the CMI Entitites, or affecting the CMI business or property. The relief sought would also involve "the exercise of any right or remedy affecting the CMI business or the CMI property" which was stayed under para. 16 of the initial order. The substance and subject matter of the motion were certainly encompassed by the stay. The real question was whether the stay ought to be lifted in this case. If the stay were lifted, the prejudice to CMI would be great and the proceedings contemp lated by the GS Parties would be extraordinarily disruptive. The GS Parties were in no worse position than any other stakeholder who was precluded from relying on rights that arise upon an insolvency default. The balance of convenience, the assessment of relative prejudice and the relevant merits favoured the position of the CMI Entities on the lift stay motion. The onus to lift the stay was on the moving party. The stay was performing the essential function of keeping stakeholders at bay in order to give CMI Entities a reasonable opportunity to develop a restructuring plan.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 32, s. 11.02

Counsel:

Lyndon Barnes, Alex Cobb and Shawn Irving for the CMI Entities.

Alan Mark and Alan Merskey for the Special Committee of the Board of Directors of Canwest.

David Byers and Maria Konyukhova for the Monitor, FTI Consulting Canada Inc.

Benjamin Zarnett and Robert Chadwick for the Ad Hoc Committee of Noteholders.

K. McElcheran and G. Gray for GS Parties.

Hugh O'Reilly and Amanda Darrach for Canwest Retirees and the Canadian Media Guild.

Hilary Clarke for Senior Secured Lenders to LP Entities.

Steve Weisz for CIT Business Credit Canada Inc.

REASONS FOR DECISION

S.E. PEPALL J.:--

Relief Requested

1 The CCAA applicants and partnerships (the "CMI Entities") request an order declaring that the relief sought by GS Capital Partners VI Fund L.P., GSCP VI AA One Holding S.ar.1 and GS VI AA One Parallel Holding S.ar.1 (the "GS Parties") is subject to the stay of proceedings granted in my Initial Order dated October 6, 2009. The GS Parties bring a cross-motion for an order that the stay be lifted so that they may pursue their motion which, among other things, challenges pre-filing conduct of the CMI Entities. The Ad Hoc Committee of Noteholders and the Special Committee of the Board of Directors support the position of the CMI Entities. All of these stakeholders are highly sophisticated. Put differently, no one is a commercial novice. Such is the context of this dispute.

Background Facts

2 Canwest's television broadcast business consists of the CTLP TV business which is comprised of 12 free-to-air television stations and a portfolio of subscription based specialty television channels on the one hand and the Specialty TV Business on the other. The latter consists of 13 specialty television channels that are operated by CMI for the account of CW Investments Co. and its subsidiaries and 4 other specialty television channels in which the CW Investments Co. ownership interest is less than 50%.

3 The Specialty TV Business was acquired jointly with Goldman Sachs from Alliance Atlantis in August, 2007. In January of that year, CMI and Goldman Sachs agreed to acquire the business of Alliance Atlantis through a jointly owned acquisition company which later became CW Investments Co. It is a Nova Scotia Unlimited Liability Corporation ("NSULC").

4 CMI held its shares in CW Investments Co. through its wholly owned subsidiary, 4414616 Canada Inc. ("441"). According to the CMI Entities, the sole purpose of 441 was to insulate CMI from any liabilities of CW Investments Co. As a NSULC, its shareholders may face exposure if the NSULC is liquidated or becomes bankrupt. As such, 441 served as a "blocker" to potential liability. The CMI Entities state that similarly the GS parties served as "blockers" for Goldman Sachs' part of the transaction.

5 According to the GS Parties, the essential elements of the deal were as follows:

(i) GS would acquire at its own expense and at its own risk, the slower growth businesses;
(ii) CW Investments Co. would acquire the Specialty TV Business and that company would be owned by 441 and the GS Parties under the terms of a Shareholders Agreement;
(iii) GS would assist CW Investments Co. in obtaining separate financing for the Specialty TV Business;
(iv) Eventually Canwest would contribute its conventional TV business on a debt free basis to CW Investments Co. in return for an increased ownership stake in CW Investments Co.

6 The GS Parties also state that but for this arrangement, Canwest had no chance of acquiring control of the Specialty TV Business. That business is subject to regulation by the CRTC. Consistent with policy objectives, the CRTC had to satisfy itself that CW Investments Co. was not controlled either at law or in fact by a non-Canadian.

7 A Shareholders Agreement was entered into by the GS parties, CMI, 441, and CW Investments Co. The GS Parties state that 441 was a critical party to this Agreement. The Agreement reflects the share ownership of each of the parties to it: 64.67% held by the GS Parties and 35.33% held by 441. It also provides for control of CW Investments Co. by distribution of voting shares: 33.33% held by the GS Parties and 66.67% held by 441. The Agreement limits certain activities of CW Investments Co. without the affirmative vote of a director nominated to its Board by the GS Parties. The Agreement provides for call and put options that are designed to allow the GS parties to exit from the investment in CW Investments Co. in 2011, 2012, and 2013. Furthermore, in the event of an insolvency of CMI, the GS parties have the ability to effect a sale of their interest in CW Investments Co. and require as well a sale of CMI's interest. This is referred to as the drag-along provision. Specifically, Article 6.10(a) of the Shareholders Agreement states:

> Notwithstanding the other provisions of this Article 6, if an Insolvency Event occurs in respect of CanWest and is continuing, the GS Parties shall be entitled to sell all of their Shares to any *bona fide* Arm's Length third party or parties at a price and on other terms and conditions negotiated by GSCP in its discretion provided that such third party or parties acquires all of the Shares held by the

> CanWest Parties at the same price and on the same terms and conditions, and in such event, the CanWest Parties shall sell their Shares to such third party or parties at such price and on such terms and conditions. The Corporation and the CanWest Parties each agree to cooperate with and assist GSCP with the sale process (including by providing protected purchasers designated by GSCP with confidential information regarding the Corporation (subject to a customary confidentiality agreement) and with access to management).

8 The Agreement also provided that 441 as shareholder could transfer its CW Investments Co. shares to its parent, CMI, at any time, by gift, assignment or otherwise, whether or not for value. While another specified entity could not be dissolved, no prohibition was placed on the dissolution of 441. 441 had certain voting obligations that were to be carried out at the direction of CMI. Furthermore, CMI was responsible for ensuring the performance by 441 of its obligations under the Shareholders Agreement.

9 On October 5, 2009, pursuant to a Dissolution Agreement between 441 and CMI and as part of the winding-up and distribution of its property, 441 transferred all of its property, namely its 352,986 Class A shares and 666 Class B preferred shares of CW Investments Co., to CMI. CMI undertook to pay and discharge all of 441's liabilities and obligations. The material obligations were those contained in the Shareholders Agreement. At the time, 441 and CW Investments Co. were both solvent and CMI was insolvent. 441 was subsequently dissolved.

10 For the purposes of these two motions only, the parties have agreed that the court should assume that the transfer and dissolution of 441 was intended by CMI to provide it with the benefit of all the provisions of the CCAA proceedings in relation to contractual obligations pertaining to those shares. This would presumably include both the stay provisions found in section 11 of the CCAA and the disclaimer provisions in section 32 .

11 The CMI Entities state that CMI's interest in the Specialty TV Business is critical to the restructuring and recapitalization prospects of the CMI Entities and that if the GS parties were able to effect a sale of CW Investments Co. at this time, and on terms that suit them, it would be disastrous to the CMI Entities and their stakeholders. Even the overhanging threat of such a sale is adversely affecting the negotiation of a successful restructuring or recapitalization of the CMI Entities.

12 On October 6, 2009, I granted an Initial Order in these proceedings. CW Investments Co. was not an applicant. The CMI Entities requested a stay of proceedings to allow them to proceed to develop a plan of arrangement or compromise to implement a consensual "pre-packaged" recapitalization transaction. The CMI Entities and the Ad Hoc Committee of 8% Noteholders had agreed on terms of such a transaction that were reflected in a support agreement and term sheet. Those noteholders who support the term sheet have agreed to vote in favour of the plan subject to certain conditions one of which is a requirement that the Shareholders Agreement be amended.

13 The Initial Order included the typical stay of proceedings provisions that are found in the standard form order promulgated by the Commercial List Users Committee. Specifically, the order stated:

> 15. THIS COURT ORDERS that until and including November 5, 2009, or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against or in respect of the CMI Entities, the Monitor or the CMI CRA or affecting the CMI Business or the CMI Property, except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of Proceedings affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of Proceedings affecting the CMI Entities, the CMI property or the CMI Business), the CMI CRA (in respect of Proceedings affecting the CMI CRA), or with leave of this Court, and any and all Proceedings currently under way against or in respect of the CMI Entities or the CMI CRA or affecting the CMI Business or the CMI Property are hereby stayed and suspended pending further Order of this Court. In the case of the CMI CRA, no Proceeding shall be commenced against the CMI CRA or its directors and officers without prior leave of this Court on seven (7) days notice to Stonecrest Capital Inc.
>
> 16. THIS COURT ORDERS that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of the CMI Entities, the Monitor and/or the CMI CRA, or affecting the CMI Business or the CMI Property, are hereby stayed and suspended except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of rights and remedies affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of rights or remedies affecting the CMI CRA), or leave of this Court, provided that nothing in this Order shall (i) empower the CMI Entities to carry on any business which the CMI Entities are not lawfully entitled to carry on, (ii) exempt the CMI Entities from compliance with statutory or regulatory provisions relating to health, safety or the environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

14 The GS parties were not given notice of the CCAA application. On November 2, 2009, they brought a motion that, among other things, seeks to set aside the transfer of the shares from 441 to CMI or, in the alternative, require CMI to perform and not disclaim the Shareholders Agreement as if the shares had not been transferred. On November 10, 2009 the GS parties purported to revive 441 by filing Articles of Revival with the Director of the CBCA. The CMI Entities were not notified nor was any leave of the court sought in this regard. In an amended notice of motion dated

November 19, 2009 (the "main motion"), the GS Parties request an order:

(a) Setting aside and declaring void the transfer of the shares from 441 to CMI;
(b) declaring that the rights and remedies of the GS Parties in respect of the obligations of 441 under the Shareholders Agreement are not affected by these CCAA proceedings in any way whatsoever;
(c) in the alternative to (a) and (b), an order directing CMI to perform all of the obligations that bound 441 immediately prior to the transfer;
(d) in the alternative to (a) and (b), an order declaring that the obligations that bound 441 immediately prior to the transfer, may not be disclaimed by CMI pursuant to section 32 of the CCAA or otherwise; and
(e) if necessary, a trial of the issues arising from the foregoing.

15 They also requested an order amending paragraph 59 of the Initial Order but that issue has now been resolved and I am satisfied with the amendment proposed.

16 The CMI Entities then brought a motion on November 24, 2009 for an order that the GS motion is stayed. As in a game of chess, on December 3, 2009, the GS Parties served a cross-motion in which, if required, they seek leave to proceed with their motion.

17 In furtherance of their main motion, the GS Parties have expressed a desire to examine 4 of the 5 members of the Special Committee of the Board of Directors of Canwest. That Committee was constituted, among other things, to oversee the restructuring. The GS Parties have also demanded an extensive list of documentary production. They also seek to impose significant discovery demands upon the senior management of CanWest.

Issues

18 The issues to be determined on these motions are whether the relief requested by the GS Parties in their main motion is stayed based on the Initial Order and if so, whether the stay should be lifted. In addition, should the relief sought in paragraph 1(e) of the main motion be struck.

Positions of Parties

19 In brief, the parties' positions are as follows. The CMI Entities submit that the GS Parties' motion is a "proceeding" that is subject to the stay under paragraph 15 of the Initial Order. In addition, the relief sought by them involves "the exercise of any right or remedy affecting the CMI Business or the CMI Property" which is stayed under paragraph 16 of the Initial Order. The stay is consistent with the purpose of the CCAA. They submit that the subject matter of the motion should be caught so as to prevent the GS parties from gaining an unfair advantage over other stakeholders of the CMI Entities and to ensure that the resources of the CMI Entities are devoted to developing a viable restructuring plan for the benefit of all stakeholders. They also state that CMI's interest in

CW Investments Co. is a significant portion of its enterprise value. They state further that their actions were not in breach of the Shareholders Agreement and in any event, debtor companies are able to organize their affairs in order to benefit from the CCAA stay. Furthermore, any loss suffered by the GS Parties can be quantified.

20 In paragraph 1(e) of the main motion, the GS parties seek to prevent CMI from disclaiming the obligations of 441 that existed immediately prior to the transfer of the shares to CMI. If this relief is not stayed, the CMI Entities submit that it should be struck out pursuant to Rule 25.11(b) and (c) as premature and improper. They also argue that section 32 of the CCAA provides a procedure for disclaimer of agreements which the GS Parties improperly seek to circumvent.

21 Lastly, the CMI Entities state that the bases on which a CCAA stay should be lifted are very limited. Most of the grounds set forth in *Re Canadian Airlines Corp.*[1] which support the lifting of a stay are manifestly inapplicable. As to prejudice, the GS parties are in no worse position than any other stakeholder who is precluded from relying on rights that arise on an insolvency default. In contrast, the prejudice to the CMI Entities would be debilitating and their resources need to be devoted to their restructuring. The GS Parties' rights would not be lost by the passage of time. The GS Parties' motion is all about leverage and a desire to improve the GS Parties' negotiating position submits counsel for the CMI Entities.

22 The Ad Hoc Committee of Noteholders, as mentioned, supports the CMI Entities' position. In examining the context of the dispute, they submit that the Shareholders Agreement permitted and did not prohibit the transfer of 441's shares. Furthermore, the operative obligations in that agreement are obligations of CMI, not 441. It is the substance of the GS Parties' claims and not the form that should govern their ability to pursue them and it is clearly encompassed by the stay. The Committee relies on *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*[2] in support of their position on timing.

23 The Special Committee also supports the CMI Entities. It submits that the primary relief sought by the GS parties is a declaration that their contracts to and with CW Investments cannot or should not be disclaimed. The debate as to whether 441 could properly be assimilated into CMI is no more than an alternate argument as to why such disclaimer can or cannot occur. They state that the subject matter of the GS Parties' motion is premature.

24 The GS Parties submit that the stay does not prevent parties affected by the CCAA proceedings from bringing motions within the CCAA proceedings themselves. The use of CCAA powers and the scope of the stay provided in the Initial Order and whether it applies to the GS Parties' motion are proper questions for the court charged with supervising the CCAA process. They also argue that the motion would facilitate negotiation between key parties, raises the important preliminary issue of the proper scope and application of section 32 of the CCAA, and avoids putting the Monitor in the impossible position of having to draw legal conclusions as to the scope of CMI's power to disclaim. The court should be concerned with pre-filing conduct including the reason for

the share transfer, the timing, and CMI's intentions.

25 Even if the stay is applicable, the GS parties submit that it should be lifted. In this regard, the court should consider the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action. The court should also consider whether the debtor company has acted and is acting in good faith. The GS Parties were the medium by which the Specialty TV Business became part of Canwest. Here, all that is being sought is a reversal of the false and highly prejudicial start to these restructuring proceedings. It is necessary to take steps now to protect a right that could be lost by the passage of time. The transfer of the shares exhibited bad faith on the part of Canwest. 441 insulated CW Investments Co. and the Specialty TV Business from the insolvency of CMI and thereby protected the contractual rights of the GS Parties. The manifest harm to the GS Parties that invited the motion should be given weight in the court's balancing of prejudices. Concerns as to disruption of the restructuring process could be met by imposing conditions on the lifting of a stay as, for example, the establishment of a timetable.

Discussion

(a) Legal Principles

26 First I will address the legal principles applicable to the granting and lifting of a CCAA stay.

27 The stay provisions in the CCAA are discretionary and are extraordinarily broad. Section 11.02 (1) and (2) 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.
> (2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,
> (a) staying until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);
> (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.

28 The underlying purpose of the court's power to stay proceedings has frequently been described in the case law. It is the engine that drives the broad and flexible statutory scheme of the CCAA: *Re Stelco Inc*[3] and the key element of the CCAA process: *Re Canadian Airlines Corp.*[4] The power to grant the stay is to be interpreted broadly in order to permit the CCAA to accomplish its legislative purpose. As noted in *Re Lehndorff General Partner Ltd.*[5], the power to grant a stay extends to effect the position of a company's secured and unsecured creditors as well as other parties who could potentially jeopardize the success of the restructuring plan and the continuance of the company. As stated by Farley J. in that case,

> "It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed. ... The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and *all* of the creditors."[6] (Citations omitted)

29 The all encompassing scope of the CCAA is underscored by section 8 of the Act which precludes parties from contracting out of the statute. See *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*[7] in this regard.

30 Two cases dealing with stays merit specific attention. *Campeau v. Olympia & York Developments Ltd.*[8] was a decision granted in the early stages of the evolution of the CCAA. In that case, the plaintiffs brought an action for damages including the loss of share value and loss of opportunity both against a company under CCAA protection and a bank. The statement of claim had been served before the company's CCAA filing. The plaintiff sought to lift the stay to proceed with its action. The bank sought an order staying the action against it pending the disposition of the CCAA proceedings. Blair J. examined the stay power described in the CCAA, section 106 of the Courts of Justice Act[9] and the court's inherent jurisdiction. He refused to lift the stay and granted the stay in favour of the bank until the expiration of the CCAA stay period. Blair J. stated that the plaintiff's claims may be addressed more expeditiously in the CCAA proceeding itself.[10] Presumably this meant through a claims process and a compromise of claims. The CCAA stay precludes the litigating of claims comparable to the plaintiff's in *Campeau*. If it were otherwise, the stay would have no meaningful impact.

31 The decision of *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* is also germane to the case before me. There, the Bank demanded payment from the debtor company and thereafter the debtor company issued instant trust deeds to qualify for protection under the CCAA. The bank commenced proceedings on debenture security and the next day the company sought relief under the CCAA. The court stayed the bank's enforcement proceedings. The bank appealed the order and asked the appellate court to set aside the stay order insofar as it restrained the bank from exercising its rights under its security. The B.C. Court of Appeal refused to do so having regard to the broad public policy objectives of the CCAA.

32 As with the imposition of a stay, the lifting of a stay is discretionary. There are no statutory guidelines contained in the Act. According to Professor R.H. McLaren in his book "Canadian Commercial Reorganization: Preventing Bankruptcy"[11], an opposing party faces a very heavy onus if it wishes to apply to the court for an order lifting the stay. In determining whether to lift the stay, the court should consider whether there are sound reasons for doing so consistent with the objectives of the CCAA, including a consideration of the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action: *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.*[12]. That decision also indicated that the judge should consider the good faith and due diligence of the debtor company.[13]

33 Professor McLaren enumerates situations in which courts will lift a stay order. The first six were cited by Paperny J. in 2000 in *Re Canadian Airlines Corp.*[14] and Professor McLaren has added three more since then. They are:

1. When the plan is likely to fail.
2. The applicant shows hardship (the hardship must be caused by the stay itself and be independent of any pre-existing condition of the applicant creditor).
3. The applicant shows necessity for payment (where the creditors' financial problems are created by the order or where the failure to pay the creditor would cause it to close and thus jeopardize the debtor's company's existence).
4. The applicant would be significantly prejudiced by refusal to lift the stay and there would be no resulting prejudice to the debtor company or the positions of creditors.
5. It is necessary to permit the applicant to take steps to protect a right which could be lost by the passing of time.
6. After the lapse of a significant time period, the insolvent is no closer to a proposal than at the commencement of the stay period.
7. There is a real risk that a creditor's loan will become unsecured during the stay period.
8. It is necessary to allow the applicant to perfect a right that existed prior to the commencement of the stay period.
9. It is in the interests of justice to do so.

(b) Application

34 Turning then to an application of all of these legal principles to the facts of the case before me, I will first consider whether the subject matter of the main motion of the GS Parties is captured by the stay and then will address whether the stay should be lifted.

35 In analyzing the applicability of the stay, I must examine the substance of the main motion of the GS Parties and the language of the stay found in paragraphs 15 and 16 of my Initial Order.

36 In essence, the GS Parties' motion seeks to:

(i) undo the transfer of the CW Investments Co. shares from 441 to CMI or
(ii) require CMI to perform and not disclaim the Shareholders Agreement as though the shares had not been transferred.

37 It seems to me that the first issue is caught by the stay of proceedings and the second issue is properly addressed if and when CMI seeks to disclaim the Shareholders Agreement.

38 The substance of the GS Parties' motion is a "proceeding" that is subject to the stay under paragraph 15 of the Initial Order which prohibits the commencement of all proceedings against or in respect of the CMI Entities, or affecting the CMI Business or the CMI Property. The relief sought would also involve "the exercise of any right or remedy affecting the CMI Business or the CMI Property" which is stayed under paragraph 16 of the Initial Order.

39 When one examines the relief requested in detail, the application of the stay is clear. The GS Parties ask first for an order setting aside and declaring void the transfer of the shares from 441. As the shares have been transferred to the CMI Entities presumably pursuant to section 6.5(a) of the Shareholders Agreement, this is relief "affecting the CMI Property". Secondly, the GS Parties ask for a declaration that the rights and remedies of the GS Parties in respect of the obligations of 441 are not affected by the CCAA proceedings. This relief would permit the GS Parties to require CMI to tender the shares for sale pursuant to section 6.10 of the Shareholders Agreement. This too is relief affecting the CMI Entities and the CMI Property. Thirdly, they ask for an order directing CMI to perform all of the obligations that bound 441 prior to the transfer. This represents the exercise of a right or remedy against CMI and would affect the CMI Business and CMI Property in violation of paragraph 16 of the Initial Order. This is also stayed by virtue of paragraph 15. Fourthly, the GS Parties seek an order declaring that the obligations that bound 441 prior to the transfer may not be disclaimed. This both violates paragraph 16 of the Initial Order and also seeks to avoid the express provisions contained in the recent amendments to the CCAA that address disclaimer.

40 Accordingly, the substance and subject matter of the GS Parties' motion are certainly encompassed by the stay. As Mr. Barnes for the CMI Entities submitted, had CMI taken the steps it did six months ago and the GS Parties commenced a lawsuit, the action would have been stayed. Certainly to the extent that the GS Parties are seeking the freedom to exercise their drag along

rights, these rights should be captured by the stay.

41 The real question, it seems to me, is whether the stay should be lifted in this case. In considering the request to lift the stay, it is helpful to consider the context and the provisions of the Shareholders Agreement. In his affidavit sworn November 24, 2009, Mr. Strike, the President of Corporate Development & Strategy Implementation of Canwest Global and its Recapitalization Officer, states that the joint acquisition from Alliance Atlantis was intensely and very carefully negotiated by the parties and that the negotiation was extremely complex and difficult. "Every aspect of the deal was carefully scrutinized, including the form, substance and precise terms of the Initial Shareholders Agreement." The Shareholders Agreement was finalized following the CRTC approval hearing. Among other things:

- Article 2.2 (b) provides that CMI is responsible for ensuring the performance by 441 of its obligations under the Shareholders Agreement.
- Article 6.1 contains a restriction on the transfer of shares.
- Article 6.5 addresses permitted transfers. Subsection (a) expressly permits each shareholder to transfer shares to a parent of the shareholder. CMI was the parent of the shareholder, 441.
- Article 6.10 provides that notwithstanding the other provisions of Article 6, if an insolvency event occurs (which includes the commencement of a CCAA proceeding), the GS Parties may sell their shares and cause the Canwest parties to sell their shares on the same terms. This is the drag along provision.
- Article 6.13 prohibits the liquidation or dissolution of another company[15] without the prior written consent of one of the GS Parties[16].

42 The recital of these provisions and the absence of any prohibition against the dissolution of 441 indicate that there is a good arguable case that the Shareholders Agreement, which would inform the reasonable expectations of the parties, permitted the transfer and dissolution.

43 The GS Parties are in no worse position than any other stakeholder who is precluded from relying on rights that arise upon an insolvency default. As stated in *San Francisco Gifts Ltd.*[17]:

> "The Initial Order enjoined all of San Francisco's landlords from enforcing contractual insolvency clauses. This is a common prohibition designed, at least in part, to avoid a creditor frustrating the restructuring by relying on a contractual breach occasioned by the very insolvency that gave rise to proceedings in the first place."[18]

44 Similarly, in *Norcen Energy Resources Ltd.*[19], one of the debtor's joint venture partners in certain petroleum operations was unable to rely on an insolvency clause in an agreement that provided for the immediate replacement of the operator if it became bankrupt or insolvent.

45 If the stay were lifted, the prejudice to CMI would be great and the proceedings contemplated by the GS Parties would be extraordinarily disruptive. The GS Parties have asked to examine 4 of the 5 members of the Special Committee. The Special Committee is a committee of the Board of Directors of Canwest. Its mandate includes, among other things, responsibility for overseeing the implementation of a restructuring with respect to all, or part of the business and/or capital structure of Canwest. The GS Parties have also requested an extensive list of documentary production including all documents considered by the Special Committee and any member of that Committee relating to the matters at issue; all documents considered by the Board of Directors and any member of the Board of Directors relating to the matters at issue; all documents evidencing the deliberations, discussions and decisions of the Special Committee and the Board of Directors relating to the matters at issue; all documents relating to the matters at issue sent to or received by Leonard Asper, Derek Burney, David Drybrough, David Kerr, Richard Leipsic, John Maguire, Margot Micillef, Thomas Strike, and Hap Stephen, the Chief Restructuring Advisor appointed by the court. As stated by Mr. Strike in his affidavit sworn November 24, 2009,

> "The witnesses that the GS Parties propose to examine include the most senior executives of the CMI Entities; those who are most intensely involved in the enormously complex process of achieving a successful going concern restructuring or recapitalization of the CMI Entities. Myself, Mr. Stephen, Mr. Maguire and the others are all working flat out on trying to achieve a successful restructuring or recapitalization of the CMI Entities. Frankly, the last thing we should be doing at this point is preparing for a forensic examination, in minute detail, over events that have taken place over the past several months. At this point in the restructuring/recapitalization process, the proposed examination would be an enormous distraction and would significantly prejudice the CMI Entities' restructuring and recapitalization efforts."

46 While Mr. McElcheran for the GS Parties submits that the examinations and the scope of the examinations could be managed, in my view, the litigating of the subject matter of the motion would undermine the objective of protecting the CMI Entities while they attempt to restructure. The GS Parties continue to own their shares in CW Investments Co. as does CMI. CMI continues to operate the Specialty TV Business. Furthermore, CMI cannot sell the shares without the involvement of the Monitor and the court. None of these facts have changed. The drag along rights are stayed (although as Mr. McElcheran said, it is the cancellation of those rights that the GS Parties are concerned about.)

47 A key issue will be whether the CMI Parties can then disclaim that Agreement or whether they should be required to perform the obligations which previously bound 441. This issue will no doubt arise if and when the CMI Entities seek to disclaim the Shareholders Agreement. It is premature to address that issue now. Furthermore, section 32 of the CCAA now provides a detailed process for disclaimer. It states:

32.(1) Subject to subsections (2) and (3), a debtor company may -- on notice given in the prescribed form and manner to the other parties to the agreement and the monitor -- disclaim or resiliate any agreement to which the company is a party on the day on which proceedings commence under this Act. The company may not give notice unless the monitor approves the proposed disclaimer or resiliation.

(2) Within 15 days after the day on which the company gives notice under subsection (1), a party to the agreement may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement is not to be disclaimed or resiliated.

(3) If the monitor does not approve the proposed disclaimer or resiliation, the company may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement be disclaimed or resiliated.

(4) In deciding whether to make the order, the court is to consider, among other things,

(a) whether the monitor approved the proposed disclaimer or resiliation;

(b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and

(c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

48 Section 32, therefore, provides the scheme and machinery for the disclaimer of an agreement. If the monitor approves the disclaimer, another party may contest it. If the monitor does not approve the disclaimer, permission of the court must be obtained. It seems to me that the issues surrounding any attempt at disclaimer in this case should be canvassed on the basis mandated by Parliament in section 32 of the amended Act.

49 In my view, the balance of convenience, the assessment of relative prejudice and the relevant merits favour the position of the CMI Entities on this lift stay motion. As to the issue of good faith, the question is whether, absent more, one can infer a lack of good faith based on the facts outlined in the materials filed including the agreed upon admission by the CMI Entities. The onus to lift the stay is on the moving party. I decline to exercise my discretion to lift the stay on this basis.

50 Turning then to the factors listed by Professor McLaren, again I am not persuaded that based on the current state of affairs, any of the factors are such that the stay should be lifted. In light of this determination, there is no need to address the motion to strike paragraph 1(e) of the GS Parties' main motion.

51 The stay of proceedings in this case is performing the essential function of keeping stakeholders at bay in order to give the CMI Entities a reasonable opportunity to develop a restructuring plan. The motions of the GS Parties are dismissed (with the exception of that portion dealing with paragraph 59 of the Initial Order which is on consent) and the motion of the CMI Entities is granted with the exception of the strike portion which is moot.

52 The Monitor, reasonably in my view, did not take a position on these motions. Its counsel, Mr. Byers, advised the court that the Monitor was of the view that a commercial resolution was the best way to resolve the GS Parties' issues. It is difficult to disagree with that assessment.

S.E. PEPALL J.

* * * * *

Schedule A

[Editor's note: Schedule A was not attached to the copy received from the Court and therefore is not included in the judgment.]

1 (2000), 19 C.B.R. (4th) 1.

2 [1990] B.C.J. No. 2384 (C.A.) at p. 4.

3 (2005), 75 O.R. (3d) 5 (C.A.) at para. 36.

4 (2000), 19 C.B.R. (4th) 1.

5 (1993), 17 C.B.R. (3d) 24.

6 Ibid, at p. 32.

7 Supra, note 2

8 (1992) 14 C.B.R. (3d) 303.

9 R.S.O. 1990, c. C.43.

10 Supra, note 6 at paras. 24 and 25.

11 (Aurora: Canada Law Book, looseleaf) at para. 3.3400.

12 (2007), 33 C.B.R. (5th) 50 (Sask. C.A.) at para. 68.

13 Ibid, at para. 68.

14 Supra, note 3.

15 This was 4414641 Canada Inc. but not 4414616 Canada Inc., the company in issue before me.

16 Specifically, GS Capital Partners VI Fund, L.P.

17 5 C.B.R. (5th) 92 at para. 37.

18 Ibid, at para. 37.

19 (1988), 72 C.B.R. (N.S.) 1.

TAB 17

Case Name:

Timminco Ltd. (Re)

IN THE MATTER OF 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 Timminco Limited and Bécancour Silicon Inc., Applicants

[2012] O.J. No. 1949

2012 ONSC 2515

Court File Nos. CV-12-9539-00CL and CV-09-378701-00CP

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: March 26, 2012.
Judgment: April 27, 2012.

(25 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Motion by plaintiff in class proceeding/creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Stays -- Motion by plaintiff in class proceeding/ creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Procedure --

Motion by plaintiff in class proceeding/creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Motion by Penneyfeather for an order lifting a January 2012 stay of proceedings to permit Penneyfeather to continue a class proceeding against Timminco and others. Timminco was pursuing a restructuring process intended to maximize recovery for stakeholders. It continued to operate as a going concern with a greatly-reduced staff of 10 employees including the president and three executive officers. The class proceeding was commenced in May 2009. Settlement discussions had been terminated and there was a pending motion to strike portions of the statement of claim. Penneyfeather planned to seek leave to appeal to the Supreme Court of Canada an order declaring that the three-year limitation period provided in the Securities Act was not suspended by the operation of the Class Proceedings Act. Timminco consented to lift the stay to permit Penneyfeather to pursue this leave application only. Timminco submitted that key members of its executive team would have to expend considerable time dealing with Penneyfeather's class proceeding if the stay was lifted completely, thereby taking their focus away from the restructuring process.

HELD: Motion allowed in part. If forced to spend significant amounts of time dealing with Penneyfeather's class action in the coming months, the Timminco executive team would be unable to focus on the sales and restructuring process to the potential detriment of Timminco's other stakeholders. A delay in the sales process could have a negative impact on Timminco. It was premature to lift the stay other than with respect to the leave application.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, S.O. 1992, c. 6, s. 12, s. 28

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36,

Securities Act, R.S.O. 1990, c. S.5, s. 138.14

Counsel:

James C. Orr and N. Mizobuchi, for St. Clair Penneyfeather, Plaintiff in Class Proceeding, *Penneyfeather v. Timminco Limited et al.*

P. O'Kelly and A. Taylor, for the Applicants.

P. LeVay, for the Photon Defendants.

A. Lockhart, for Wacker Chemie AG.

K.D. Kraft, for Chubb Insurance Company of Canada.

D.J. Bell, for John P. Walsh.

A. Hatnay and James Harnum for Mercer Canada, Administrator of the Timminco Haley Plan.

S. Weisz, for FTI Consulting Canada Inc., Monitor.

ENDORSEMENT

1 **G.B. MORAWETZ J.**:-- St. Clair Penneyfeather, the Plaintiff in the *Penneyfeather v. Timminco Limited, et al* action, Court File No. CV-09-378701-00CP (the "Class Action"), brought this motion for an order lifting the stay of proceedings, as provided by the Initial Order of January 3, 2012 and extended by court order dated January 27, 2012, and permitting Mr. Penneyfeather to continue the Class Action against Timminco Limited ("Timminco"), Dr. Heinz Schimmelbusch, Mr. Robert Dietrich, Mr. Rene Boisvert, Mr. Arthur R. Spector, Mr. Jack Messman, Mr. John C. Fox, Mr. Michael D. Winfield, Mr. Mickey M. Yaksich and Mr. John P. Walsh.

2 The Class Action was commenced on May 14, 2009 and has been case managed by Perell J. The following steps have taken place in the litigation:

(a) a carriage motion;
(b) a motion to substitute the Representative Plaintiff;
(c) a motion to force disclosure of insurance policies;
(d) a motion for leave to appeal the result of the insurance motion which was heard by the Divisional Court and dismissed;
(e) settlement discussions;
(f) when settlement discussions were terminated, Perell J. declined an expedited leave hearing and instead declared any limitation period to be stayed;
(g) a motion for particulars; and
(h) a motion served but not heard to strike portions of the Statement of Claim.

3 On February 16, 2012, the Court of Appeal for Ontario set aside the decision of Perell J. declaring that s. 28 of the *Class Proceedings Act* suspended the running of the three-year limitation period under s. 138.14 of the *Securities Act*.

4 The Plaintiffs' counsel received instructions to seek leave to appeal the decision of the Court of Appeal for Ontario to the Supreme Court of Canada. The leave materials were required to be served and filed by April 16, 2012.

5 On April 10, 2012, the following endorsement was released in respect of this motion:

> The portion of the motion dealing with lifting the stay for the Plaintiff to seek leave to appeal the recent decision of the Court of Appeal for Ontario to the Supreme Court of Canada on the limitation period issue was not opposed. This portion of the motion is granted and an order shall issue to give effect to the foregoing. The balance of the requested relief is under reserve.

6 Counsel to Mr. Penneyfeather submits that, apart from the leave to appeal issues, there are steps that may occur before Perell J. as a result of the Court of Appeal ruling. Counsel references that the Defendants may bring motions for partial judgment and the Plaintiff could seek to have the court proceed with leave and certification with any order to be granted *nunc pro tunc* pursuant to s. 12 of the *Class Proceedings Act*.

7 Counsel to Mr. Penneyfeather submits that the three principal objectives of the *Class Proceedings Act* are judicial economy, access to justice and behaviour modification. (See *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534 at paras. 27-29.), and under the *Securities Act*, the deterrent represented by private plaintiffs armed with a realistic remedy is important in ensuring compliance with continuous disclosure rules.

8 Counsel submits that, in this situation, there is only one result that will not do violence to a primary legislative purpose and that is to lift the stay to permit the Class Action to proceed on the condition that any potential execution excludes Timminco's assets. Counsel further submits that, as a practical result, this would limit recovery in the Class Action to the proceeds of the insurance policies, or in the event that the insurers decline coverage because of fraud, to the personal assets of those officers and directors found responsible for the fraud.

9 Counsel to Mr. Penneyfeather takes the position that the requested outcome is consistent with the judicial principal that the CCAA is not meant as a refuge insulating insurers from providing appropriate indemnification. (See *Algoma Steel Corp. v. Royal Bank of Canada*, [1992] O.J. No. 889 at paras. 13-15 (C.A.) and *Re Carey Canada Inc.* [2006] O.J. No. 4905 at paras. 7, 16-17.)

10 In this case, counsel contends that, when examining the relative prejudice to the parties, the examination strongly favours lifting the stay in the manner proposed since the insurance proceeds are not available to other creditors and there would be no financial unfairness caused by lifting the stay.

11 The position put forward by Mr. Penneyfeather must be considered in the context of the CCAA proceedings. As stated in the affidavit of Ms. Konyukhova, the stay of proceedings was put in place in order to allow Timminco and Bécancour Silicon Inc. ("BSI" and, together with Timminco, the "Timminco Entities") to pursue a restructuring and sales process that is intended to maximize recovery for the stakeholders. The Timminco Entities continue to operate as a going concern, but with a substantially reduced management team. The Timminco Entities currently have

only ten active employees, including Mr. Kalins, President, General Counsel and Corporate Secretary and three executive officers (the "Executive Team").

12 Counsel to the Timminco Entities submits that, if Mr. Penneyfeather is permitted to pursue further steps in the Class Action, key members of the Executive Team will be required to spend significant amounts of their time dealing with the Class Action in the coming months, which they contend is a key time in the CCAA proceedings. Counsel contends that the executive team is currently focussing on the CCAA proceedings and the sales process.

13 Counsel to the Timminco Entities points out that the Executive Team has been required to direct most of their time to restructuring efforts and the sales process. Currently, the "stalking horse" sales process will continue into June 2012 and I am satisfied that it will require intensive time commitments from management of the Timminco Entities.

14 It is reasonable to assume that, by late June 2012, all parties will have a much better idea as to when the sales process will be complete.

15 The stay of proceedings is one of the main tools available to achieve the purpose of the CCAA. The stay provides the Timminco Entities with a degree of time in which to attempt to arrange an acceptable restructuring plan or sale of assets in order to maximize recovery for stakeholders. The court's jurisdiction in granting a stay extends to both preserving the *status quo* and facilitating a restructuring. See *Re Stelco Inc.*, [2005] O.J. No. 1171 (C.A.) at para. 36.

16 Further, the party seeking to lift a stay bears a heavy onus as the practical effect of lifting a stay is to create a scenario where one stakeholder is placed in a better position than other stakeholders, rather than treating stakeholders equally in accordance with their priorities. See *Canwest Global Communications Corp. (Re)*, [2011] O.J. No. 1590 (S.C.J.) at para. 27.

17 Courts will consider a number of factors in assessing whether it is appropriate to lift a stay, but those factors can generally be grouped under three headings: (a) the relative prejudice to parties; (b) the balance of convenience; and (c) where relevant, the merits (*i.e.* if the matter has little chance of success, there may not be sound reasons for lifting the stay). See *Canwest Global Communications (Re), supra*, at para. 27.

18 Counsel to the Timminco Entities submits that the relative prejudice to the parties and the balance of convenience clearly favours keeping the stay in place, rather than to allow the Plaintiff to proceed with the SCC leave application. As noted above, leave has been granted to allow the Plaintiff to proceed with the SCC leave application. Counsel to the Timminco Entities further submits that, while the merits are vigorously disputed by the Defendants in the context of a Class Action, the Timminco Entities will not ask this court to make any determinations based on the merits of the Plaintiff's claim.

19 I can well recognize why Mr. Penneyfeather wishes to proceed. The objective of the Plaintiff

in the Class Action is to access insurance proceeds that are not available to other creditors. However, the reality of the situation is that the operating side of Timminco is but a shadow of its former self. I accept the argument put forth by counsel to the Applicant that, if the Executive Team is required to spend significant amounts of time dealing with the Class Action in the coming months, it will detract from the ability of the Executive Team to focus on the sales process in the CCAA proceeding to the potential detriment of the Timminco Entities' other stakeholders. These are two competing interests. It seems to me, however, that the primary focus has to be on the sales process at this time. It is important that the Executive Team devote its energy to ensuring that the sales process is conducted in accordance with the timeliness previously approved. A delay in the sales process may very well have a negative impact on the creditors of Timminco. Conversely, the time sensitivity of the Class Action has been, to a large extent, alleviated by the lifting of the stay so as to permit the leave application to the Supreme Court of Canada.

20 It is also significant to recognize the submission of counsel on behalf of Mr. Walsh. Counsel to Mr. Walsh takes the position that Mr. Penneyfeather has nothing more than an "equity claim" as defined in the CCAA and, as such, his claim (both against the company and its directors who, in turn, would have an equity claim based on indemnity rights) would be subordinated to any creditor claims. Counsel further submits that of all the potential claims to require adjudication, presumably, equity claims would be the least pressing to be adjudicated and do not become relevant until all secured and unsecured claims have been paid in full.

21 In my view, it is not necessary for me to comment on this submission, other than to observe that to the extent that the claim of Mr. Penneyfeather is intended to access certain insurance proceeds, it seems to me that the prosecution of such claim can be put on hold, for a period of time, so as to permit the Executive Team to concentrate on the sales process.

22 Having considered the relative prejudice to the parties and the balance of convenience, I have concluded that it is premature to lift the stay at this time, with respect to the Timminco Entities, other than with respect to the leave application to the Supreme Court of Canada. It also follows, in my view, that the stay should be left in place with respect to the claim as against the directors and officers. Certain members of this group are involved in the Executive Team and, for the reasons stated above, I am satisfied that it is not appropriate to lift the stay as against them.

23 With respect to the claim against Photon, as pointed out by their counsel, it makes no sense to lift the stay only as against Photon and leave it in place with respect to the Timminco Entities. As counsel submits, the Timminco Entities have an interest in both the legal issues and the factual issues that may be advanced if Mr. Penneyfeather proceeds as against Photon, as any such issues as are determined in Timminco's absence may cause unfairness to Timminco, particularly, if Mr. Penneyfeather later seeks to rely on those findings as against Timminco. I am in agreement with counsel's submission that to make such an order would be prejudicial to Timminco's business and property. In addition, I accept the submission that it would also be unfair to Photon to require it to answer Mr. Penneyfeather's allegations in the absence of Timminco as counsel has indicated that

Photon will necessarily rely on documents and information produced by Timminco as part of its own defence.

24 I am also in agreement with the submission that it would be wasteful of judicial resources to permit the class proceedings to proceed as against Photon but not Timminco as, in addition to the duplicative use of court time, there would be the possibility of inconsistent findings on similar or identical factual issues and legal issues. For these reasons, I have concluded that it is not appropriate to lift the stay as against Photon.

25 In the result, the motion dealing with issues not covered by the April 10, 2012 endorsement is dismissed without prejudice to the rights of the Plaintiff to renew his request no sooner than 75 days after today's date.

G.B. MORAWETZ J.

TAB 18

Case Name:

Canwest Global Communications Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, C-36. as amended
AND IN THE MATTER OF a Proposed Plan of Compromise or Arrangement of Canwest Global Communications Corp. and the other applicants listed on schedule "A"

[2009] O.J. No. 4286

59 C.B.R. (5th) 72

2009 CanLII 55114

2009 CarswellOnt 6184

Court File No. CV-09-8241-OOCL

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

October 13, 2009.

(60 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Application of Act -- Affiliated debtor companies -- Application by Canwest Global for relief under the Companies' Creditors Arrangement Act and to have the stay of proceedings and other provisions extend to several partnerships allowed -- Applicant Canwest Global owned CMI which was insolvent -- CMI Entities and Ad Hoc Committee of noteholders had agreed on terms of a going concern recapitalization transaction -- Stay under Act was extended to several partnerships that were intertwined with the applicants' ongoing operations -- DIP and administration charges approved -- Applicants were also permitted to pay pre-filing liabilities to their critical suppliers.

Application by Canwest Global for relief under the Companies' Creditors Arrangement Act and to

have the stay of proceedings and other provisions extend to several partnerships. The applicants were affiliated debtor companies with total claims against them exceeding $5 million. The partnerships were intertwined with the applicants' ongoing operations. Canwest was a leading Canadian media company. Canwest Global owned 100 per cent of CMI. CMI had direct or indirect ownership interests in all of the other CMI Entities. The CMI Entities generated the majority of their revenue from the sale of advertising. Fuelled by a deteriorating economic environment, they experienced a decline in their advertising revenues. This caused problems with cash flow and circumstances were exacerbated by their high fixed operating costs. CMI breached certain of the financial covenants in its secured credit facility. The stay of proceedings was sought so as to allow the CMI Entities to proceed to develop a plan of arrangement or compromise to implement a consensual pre-packaged recapitalization transaction. The CMI Entities and an Ad Hoc Committee of noteholders had agreed on the terms of a going concern recapitalization transaction which was intended to form the basis of the plan. The applicants anticipated that a substantial number of the businesses operated by the CMI Entities would continue as going concerns thereby preserving enterprise value for stakeholders and maintaining employment for as many as possible. Certain steps designed to implement the recapitalization transaction had already been taken prior to the commencement of these proceedings.

HELD: Application allowed. The CMI Entities were unable to satisfy their debts as they come due and were insolvent. Absent these proceedings, the applicants would lack liquidity and would be unable to continue as going concerns. It was just and convenient to grant the relief requested with respect to the partnerships. The operations and obligations of the partnerships were so intertwined with those of the applicants that irreparable harm would ensue if the requested stay were not granted. The DIP charge for up to $100 million was appropriate and required having regard to the debtors' cash-flow statement. The administration charge was also approved. Notice had been given to the secured creditors likely to be affected by the charge, the amount was appropriate, and the charge should extend to all of the proposed beneficiaries. The applicants were also permitted to pay pre-filing liabilities to their critical suppliers.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. c. 36, s. 11, s. 11(2), s. 11.2, s. 11.2(1), s. 11.52

Counsel:

Lyndon Barnes, Edward Sellers and Jeremy Dacks, for the Applicants.

Alan Merskey, for the Special Committee of the Board of Directors.

David Byers and Maria Konyukhova,> for the Proposed Monitor, FTI Consulting Canada Inc.

Benjamin Zarnett and Robert Chadwick, for Ad Hoc Committee of Noteholders.

Edmond Lamek, for the Asper Family.

Peter H. Griffin and Peter J. Osborne, for the Management Directors and Royal Bank of Canada.

Hilary Clarke, for Bank of Nova Scotia,

Steve Weisz, for CIT Business Credit Canada Inc.

REASONS FOR DECISION

S.E. PEPALL J.:--

Relief Requested

1 Canwest Global Communications Corp. ("Canwest Global"), its principal operating subsidiary, Canwest Media Inc. ("CMI"), and the other applicants listed on Schedule "A" of the Notice of Application apply for relief pursuant to the *Companies' Creditors Arrangement Act.*[1] The applicants also seek to have the stay of proceedings and other provisions extend to the following partnerships: Canwest Television Limited Partnership ("CTLP"), Fox Sports World Canada Partnership and The National Post Company/La Publication National Post ("The National Post Company"). The businesses operated by the applicants and the aforementioned partnerships include (i) Canwest's free-to-air television broadcast business (ie. the Global Television Network stations); (ii) certain subscription-based specialty television channels that are wholly owned and operated by CTLP; and (iii) the National Post.

2 The Canwest Global enterprise as a whole includes the applicants, the partnerships and Canwest Global's other subsidiaries that are not applicants. The term Canwest will be used to refer to the entire enterprise. The term CMI Entities will be used to refer to the applicants and the three aforementioned partnerships. The following entities are not applicants nor is a stay sought in respect of any of them: the entities in Canwest's newspaper publishing and digital media business in Canada (other than the National Post Company) namely the Canwest Limited Partnership, Canwest Publishing Inc./Publications Canwest Inc., Canwest Books Inc., and Canwest (Canada) Inc.; the Canadian subscription based specialty television channels acquired from Alliance Atlantis Communications Inc. in August, 2007 which are held jointly with Goldman Sachs Capital Partners and operated by CW Investments Co. and its subsidiaries; and subscription-based specialty television channels which are not wholly owned by CTLP.

3 No one appearing opposed the relief requested.

Backround Facts

4 Canwest is a leading Canadian media company with interests in twelve free-to-air television stations comprising the Global Television Network, subscription-based specialty television channels and newspaper publishing and digital media operations.

5 As of October 1, 2009, Canwest employed the full time equivalent of approximately 7,400 employees around the world. Of that number, the full time equivalent of approximately 1,700 are employed by the CMI Entities, the vast majority of whom work in Canada and 850 of whom work in Ontario.

6 Canwest Global owns 100% of CMI. CMI has direct or indirect ownership interests in all of the other CMI Entities. Ontario is the chief place of business of the CMI Entities.

7 Canwest Global is a public company continued under the *Canada Business Corporations Act*[2]. It has authorized capital consisting of an unlimited number of preference shares, multiple voting shares, subordinate voting shares, and non-voting shares. It is a "constrained-share company" which means that at least 66 2/3% of its voting shares must be beneficially owned by Canadians. The Asper family built the Canwest enterprise and family members hold various classes of shares. In April and May, 2009, corporate decision making was consolidated and streamlined.

8 The CMI Entities generate the majority of their revenue from the sale of advertising (approximately 77% on a consolidated basis). Fuelled by a deteriorating economic environment in Canada and elsewhere, in 2008 and 2009, they experienced a decline in their advertising revenues. This caused problems with cash flow and circumstances were exacerbated by their high fixed operating costs. In response to these conditions, the CMI Entities took steps to improve cash flow and to strengthen their balance sheets. They commenced workforce reductions and cost saving measures, sold certain interests and assets, and engaged in discussions with the CRTC and the Federal government on issues of concern.

9 Economic conditions did not improve nor did the financial circumstances of the CMI Entities. They experienced significant tightening of credit from critical suppliers and trade creditors, a further reduction of advertising commitments, demands for reduced credit terms by newsprint and printing suppliers, and restrictions on or cancellation of credit cards for certain employees.

10 In February, 2009, CMI breached certain of the financial covenants in its secured credit facility. It subsequently received waivers of the borrowing conditions on six occasions. On March 15, 2009, it failed to make an interest payment of US$30.4 million due on 8% senior subordinated notes. CMI entered into negotiations with an ad hoc committee of the 8% senior subordinated noteholders holding approximately 72% of the notes (the "Ad Hoc Committee"). An agreement was reached wherein CMI and its subsidiary CTLP agreed to issue US$105 million in 12% secured notes to members of the Ad Hoc Committee. At the same time, CMI entered into an agreement with CIT Business Credit Canada Inc. ("CIT") in which CIT agreed to provide a senior secured revolving asset based loan facility of up to $75 million. CMI used the funds generated for operations and to repay amounts owing on the senior credit facility with a syndicate of lenders of which the Bank of

Nova Scotia was the administrative agent. These funds were also used to settle related swap obligations.

11 Canwest Global reports its financial results on a consolidated basis. As at May 31, 2009, it had total consolidated assets with a net book value of $4.855 billion and total consolidated liabilities of $5.846 billion. The subsidiaries of Canwest Global that are not applicants or partnerships in this proceeding had short and long term debt totalling $2.742 billion as at May 31, 2009 and the CMI Entities had indebtedness of approximately $954 million. For the 9 months ended May 31, 2009, Canwest Global's consolidated revenues decreased by $272 million or 11% compared to the same period in 2008. In addition, operating income before amortization decreased by $253 million or 47%. It reported a consolidated net loss of $1.578 billion compared to $22 million for the same period in 2008. CMI reported that revenues for the Canadian television operations decreased by $8 million or 4% in the third quarter of 2009 and operating profit was $21 million compared to $39 million in the same period in 2008.

12 The board of directors of Canwest Global struck a special committee of the board ("the Special Committee") with a mandate to explore and consider strategic alternatives in order to maximize value. That committee appointed Thomas Strike, who is the President, Corporate Development and Strategy Implementation of Canwest Global, as Recapitalization Officer and retained Hap Stephen, who is the Chairman and CEO of Stonecrest Capital Inc., as a Restructuring Advisor ("CRA").

13 On September 15, 2009, CMI failed to pay US$30.4 million in interest payments due on the 8% senior subordinated notes.

14 On September 22, 2009, the board of directors of Canwest Global authorized the sale of all of the shares of Ten Network Holdings Limited (Australia) ("Ten Holdings") held by its subsidiary, Canwest Mediaworks Ireland Holdings ("CMIH"). Prior to the sale, the CMI Entities had consolidated indebtedness totalling US$939.9 million pursuant to three facilities. CMI had issued 8% unsecured notes in an aggregate principal amount of US$761,054,211. They were guaranteed by all of the CMI Entities except Canwest Global, and 30109, LLC. CMI had also issued 12% secured notes in an aggregate principal amount of US$94 million. They were guaranteed by the CMI Entities. Amongst others, Canwest's subsidiary, CMIH, was a guarantor of both of these facilities. The 12% notes were secured by first ranking charges against all of the property of CMI, CTLP and the guarantors. In addition, pursuant to a credit agreement dated May 22, 2009 and subsequently amended, CMI has a senior secured revolving asset-based loan facility in the maximum amount of $75 million with CIT Business Credit Canada Inc. ("CIT"). Prior to the sale, the debt amounted to $23.4 million not including certain letters of credit. The facility is guaranteed by CTLP, CMIH and others and secured by first ranking charges against all of the property of CMI, CTLP, CMIH and other guarantors. Significant terms of the credit agreement are described in paragraph 37 of the proposed Monitor's report. Upon a CCAA filing by CMI and commencement of proceedings under Chapter 15 of the Bankruptcy Code, the CIT facility converts into a DIP financing arrangement and

increases to a maximum of $100 million.

15 Consents from a majority of the 8% senior subordinated noteholders were necessary to allow the sale of the Ten Holdings shares. A Use of Cash Collateral and Consent Agreement was entered into by CMI, CMIH, certain consenting noteholders and others wherein CMIH was allowed to lend the proceeds of sale to CMI.

16 The sale of CMIH's interest in Ten Holdings was settled on October 1, 2009. Gross proceeds of approximately $634 million were realized. The proceeds were applied to fund general liquidity and operating costs of CMI, pay all amounts owing under the 12% secured notes and all amounts outstanding under the CIT facility except for certain letters of credit in an aggregate face amount of $10.7 million. In addition, a portion of the proceeds was used to reduce the amount outstanding with respect to the 8% senior subordinated notes leaving an outstanding indebtedness thereunder of US$393.25 million.

17 In consideration for the loan provided by CMIH to CMI, CMI issued a secured intercompany note in favour of CMIH in the principal amount of $187.3 million and an unsecured promissory note in the principal amount of $430.6 million. The secured note is subordinated to the CIT facility and is secured by a first ranking charge on the property of CMI and the guarantors. The payment of all amounts owing under the unsecured promissory note are subordinated and postponed in favour of amounts owing under the CIT facility. Canwest Global, CTLP and others have guaranteed the notes. It is contemplated that the debt that is the subject matter of the unsecured note will be compromised.

18 Without the funds advanced under the intercompany notes, the CMI Entities would be unable to meet their liabilities as they come due. The consent of the noteholders to the use of the Ten Holdings proceeds was predicated on the CMI Entities making this application for an Initial Order under the CCAA. Failure to do so and to take certain other steps constitute an event of default under the Use of Cash Collateral and Consent Agreement, the CIT facility and other agreements. The CMI Entities have insufficient funds to satisfy their obligations including those under the intercompany notes and the 8% senior subordinated notes.

19 The stay of proceedings under the CCAA is sought so as to allow the CMI Entities to proceed to develop a plan of arrangement or compromise to implement a consensual "pre-packaged" recapitalization transaction. The CMI Entities and the Ad Hoc Committee of noteholders have agreed on the terms of a going concern recapitalization transaction which is intended to form the basis of the plan. The terms are reflected in a support agreement and term sheet. The recapitalization transaction contemplates amongst other things, a significant reduction of debt and a debt for equity restructuring. The applicants anticipate that a substantial number of the businesses operated by the CMI Entities will continue as going concerns thereby preserving enterprise value for stakeholders and maintaining employment for as many as possible. As mentioned, certain steps designed to implement the recapitalization transaction have already been taken prior to the

commencement of these proceedings.

20 CMI has agreed to maintain not more than $2.5 million as cash collateral in a deposit account with the Bank of Nova Scotia to secure cash management obligations owed to BNS. BNS holds first ranking security against those funds and no court ordered charge attaches to the funds in the account.

21 The CMI Entities maintain eleven defined benefit pension plans and four defined contribution pension plans. There is an aggregate solvency deficiency of $13.3 million as at the last valuation date and a wind up deficiency of $32.8 million. There are twelve television collective agreements eleven of which are negotiated with the Communications, Energy and Paperworkers Union of Canada. The Canadian Union of Public Employees negotiated the twelfth television collective agreement. It expires on December 31, 2010. The other collective agreements are in expired status. None of the approximately 250 employees of the National Post Company are unionized. The CMI Entities propose to honour their payroll obligations to their employees, including all pre-filing wages and employee benefits outstanding as at the date of the commencement of the CCAA proceedings and payments in connection with their pension obligations.

Proposed Monitor

22 The applicants propose that FTI Consulting Canada Inc. serve as the Monitor in these proceedings. It is clearly qualified to act and has provided the Court with its consent to act. Neither FTI nor any of its representatives have served in any of the capacities prohibited by section of the amendments to the CCAA.

Proposed Order

23 I have reviewed in some detail the history that preceded this application. It culminated in the presentation of the within application and proposed order. Having reviewed the materials and heard submissions, I was satisfied that the relief requested should be granted.

24 This case involves a consideration of the amendments to the CCAA that were proclaimed in force on September 18, 2009. While these were long awaited, in many instances they reflect practices and principles that have been adopted by insolvency practitioners and developed in the jurisprudence and academic writings on the subject of the CCAA. In no way do the amendments change or detract from the underlying purpose of the CCAA, namely to provide debtor companies with the opportunity to extract themselves from financial difficulties notwithstanding insolvency and to reorganize their affairs for the benefit of stakeholders. In my view, the amendments should be interpreted and applied with that objective in mind.

(a) Threshhold Issues

25 Firstly, the applicants qualify as debtor companies under the CCAA. Their chief place of

business is in Ontario. The applicants are affiliated debtor companies with total claims against them exceeding $5 million. The CMI Entities are in default of their obligations. CMI does not have the necessary liquidity to make an interest payment in the amount of US$30.4 million that was due on September 15, 2009 and none of the other CMI Entities who are all guarantors are able to make such a payment either. The assets of the CMI Entities are insufficient to discharge all of the liabilities. The CMI Entities are unable to satisfy their debts as they come due and they are insolvent. They are insolvent both under the *Bankruptcy and Insolvency Act*[3] definition and under the more expansive definition of insolvency used in Re Stelco[4]. Absent these CCAA proceedings, the applicants would lack liquidity and would be unable to continue as going concerns. The CMI Entities have acknowledged their insolvency in the affidavit filed in support of the application.

26 Secondly, the required statement of projected cash-flow and other financial documents required under section 11(2) of the CCAA have been filed.

(b) Stay of Proceedings

27 Under section 11 of the CCAA, the Court has broad jurisdiction to grant a stay of proceedings and to give a debtor company a chance to develop a plan of compromise or arrangement. In my view, given the facts outlined, a stay is necessary to create stability and to allow the CMI Entities to pursue their restructuring.

(b) Partnerships and Foreign Subsidiaries

28 The applicants seek to extend the stay of proceedings and other relief to the aforementioned partnerships. The partnerships are intertwined with the applicants' ongoing operations. They own the National Post daily newspaper and Canadian free-to-air television assets and certain of its specialty television channels and some other television assets. These businesses constitute a significant portion of the overall enterprise value of the CMI Entities. The partnerships are also guarantors of the 8% senior subordinated notes.

29 While the CCAA definition of a company does not include a partnership or limited partnership, courts have repeatedly exercised their inherent jurisdiction to extend the scope of CCAA proceedings to encompass them. See for example Re Lehndorff General Partners Ltd.[5]; Re Smurfit-Stone Container Canada Inc.[6]; and *Re Calpine Canada Energy Ltd.*[7]. In this case, the partnerships carry on operations that are integral and closely interrelated to the business of the applicants. The operations and obligations of the partnerships are so intertwined with those of the applicants that irreparable harm would ensue if the requested stay were not granted. In my view, it is just and convenient to grant the relief requested with respect to the partnerships.

30 Certain applicants are foreign subsidiaries of CMI. Each is a guarantor under the 8% senior subordinated notes, the CIT credit agreement (and therefore the DIP facility), the intercompany notes and is party to the support agreement and the Use of Cash Collateral and Consent Agreement. If the stay of proceedings was not extended to these entities, creditors could seek to enforce their

guarantees. I am persuaded that the foreign subsidiary applicants as that term is defined in the affidavit filed are debtor companies within the meaning of section 2 of the CCAA and that I have jurisdiction and ought to grant the order requested as it relates to them. In this regard, I note that they are insolvent and each holds assets in Ontario in that they each maintain funds on deposit at the Bank of Nova Scotia in Toronto. See in this regard *Re Cadillac Fairview*[8] and *Re Global Light Telecommunications Ltd.*[9]

(c) DIP Financing

31 Turning to the DIP financing, the premise underlying approval of DIP financing is that it is a benefit to all stakeholders as it allows the debtors to protect going-concern value while they attempt to devise a plan acceptable to creditors. While in the past, courts relied on inherent jurisdiction to approve the terms of a DIP financing charge, the September 18, 2009 amendments to the CCAA now expressly provide jurisdiction to grant a DIP financing charge. Section 11.2 of the Act states:

> (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge -- in an amount that the court considers appropriate -- in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.
>
> (2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> (3) The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order was made.
>
> (4) In deciding whether to make an order, the court is to consider, among other things,
>
> (*a*a) the period during which the company is expected to be subject to proceedings under this Act;
>
> (*b*) how the company's business and financial affairs are to be managed during the proceedings;
>
> (*c*) whether the company's management has the confidence of its major creditors;

> (*d*) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;
>
> (*e*) the nature and value of the company's property;
>
> (*f*) whether any creditor would be materially prejudiced as a result of the security or charge; and
>
> (*g*) the monitor's report referred to in paragraph 23(1)(*b*), if any.

32 In light of the language of section 11.2(1), the first issue to consider is whether notice has been given to secured creditors who are likely to be affected by the security or charge. Paragraph 57 of the proposed order affords priority to the DIP charge, the administration charge, the Directors' and Officers' charge and the KERP charge with the following exception: "any validly perfected purchase money security interest in favour of a secured creditor or any statutory encumbrance existing on the date of this order in favour of any person which is a "secured creditor" as defined in the CCAA in respect of any of source deductions from wages, employer health tax, workers compensation, GST/QST, PST payables, vacation pay and banked overtime for employees, and amounts under the Wage Earners' Protection Program that are subject to a super priority claim under the BIA". This provision coupled with the notice that was provided satisfied me that secured creditors either were served or are unaffected by the DIP charge. This approach is both consistent with the legislation and practical.

33 Secondly, the Court must determine that the amount of the DIP is appropriate and required having regard to the debtors' cash-flow statement. The DIP charge is for up to $100 million. Prior to entering into the CIT facility, the CMI Entities sought proposals from other third party lenders for a credit facility that would convert to a DIP facility should the CMI Entities be required to file for protection under the CCAA. The CIT facility was the best proposal submitted. In this case, it is contemplated that implementation of the plan will occur no later than April 15, 2010. The total amount of cash on hand is expected to be down to approximately $10 million by late December, 2009 based on the cash flow forecast. The applicants state that this is an insufficient cushion for an enterprise of this magnitude. The cash-flow statements project the need for the liquidity provided by the DIP facility for the recapitalization transaction to be finalized. The facility is to accommodate additional liquidity requirements during the CCAA proceedings. It will enable the CMI Entities to operate as going concerns while pursuing the implementation and completion of a viable plan and will provide creditors with assurances of same. I also note that the proposed facility is simply a conversion of the pre-existing CIT facility and as such, it is expected that there would be no material prejudice to any of the creditors of the CMI Entities that arises from the granting of the DIP charge. I am persuaded that the amount is appropriate and required.

34 Thirdly, the DIP charge must not and does not secure an obligation that existed before the order was made. The only amount outstanding on the CIT facility is $10.7 in outstanding letters of credit. These letters of credit are secured by existing security and it is proposed that that security rank ahead of the DIP charge.

35 Lastly, I must consider amongst others, the enumerated factors in paragraph 11.2(4) of the Act. I have already addressed some of them. The Management Directors of the applicants as that term is used in the materials filed will continue to manage the CMI Entities during the CCAA proceedings. It would appear that management has the confidence of its major creditors. The CMI Entities have appointed a CRA and a Restructuring Officer to negotiate and implement the recapitalization transaction and the aforementioned directors will continue to manage the CMI Entities during the CCAA proceedings. The DIP facility will enhance the prospects of a completed restructuring. CIT has stated that it will not convert the CIT facility into a DIP facility if the DIP charge is not approved. In its report, the proposed Monitor observes that the ability to borrow funds from a court approved DIP facility secured by the DIP charge is crucial to retain the confidence of the CMI Entities' creditors, employees and suppliers and would enhance the prospects of a viable compromise or arrangement being made. The proposed Monitor is supportive of the DIP facility and charge.

36 For all of these reasons, I was prepared to approve the DIP facility and charge.

(d) Administration Charge

37 While an administration charge was customarily granted by courts to secure the fees and disbursements of the professional advisors who guided a debtor company through the CCAA process, as a result of the amendments to the CCAA, there is now statutory authority to grant such a charge. Section 11.52 of the CCAA states:

> (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge -- in an amount that the court considers appropriate -- in respect of the fees and expenses of
>
> (*a*) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;
>
> (*b*) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and

> (*c*) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

> (2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

38 I must therefore be convinced that (1) notice has been given to the secured creditors likely to be affected by the charge; (2) the amount is appropriate; and (3) the charge should extend to all of the proposed beneficiaries.

39 As with the DIP charge, the issue relating to notice to affected secured creditors has been addressed appropriately by the applicants. The amount requested is up to $15 million. The beneficiaries of the charge are: the Monitor and its counsel; counsel to the CMI Entities; the financial advisor to the Special Committee and its counsel; counsel to the Management Directors; the CRA; the financial advisor to the Ad Hoc Committee; and RBC Capital Markets and its counsel. The proposed Monitor supports the aforementioned charge and considers it to be required and reasonable in the circumstances in order to preserve the going concern operations of the CMI Entities. The applicants submit that the above-note professionals who have played a necessary and integral role in the restructuring activities to date are necessary to implement the recapitalization transaction.

40 Estimating quantum is an inexact exercise but I am prepared to accept the amount as being appropriate. There has obviously been extensive negotiation by stakeholders and the restructuring is of considerable magnitude and complexity. I was prepared to accept the submissions relating to the administration charge. I have not included any requirement that all of these professionals be required to have their accounts scrutinized and approved by the Court but they should not preclude this possibility.

(e) Critical Suppliers

41 The next issue to consider is the applicants' request for authorization to pay pre-filing amounts owed to critical suppliers. In recognition that one of the purposes of the CCAA is to permit an insolvent corporation to remain in business, typically courts exercised their inherent jurisdiction to grant such authorization and a charge with respect to the provision of essential goods and services. In the recent amendments, Parliament codified the practice of permitting the payment of pre-filing amounts to critical suppliers and the provision of a charge. Specifically, section 11.4 provides:

> (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring a person to be a critical supplier to the company if the court is satisfied that the person is a supplier of goods or services to the company and that the

goods or services that are supplied are critical to the company's continued operation.

(2) If the court declares a person to be a critical supplier, the court may make an order requiring the person to supply any goods or services specified by the court to the company on any terms and conditions that are consistent with the supply relationship or that the court considers appropriate.

(3) If the court makes an order under subsection (2), the court shall, in the order, declare that all or part of the property of the company is subject to a security or charge in favour of the person declared to be a critical supplier, in an amount equal to the value of the goods or services supplied under the terms of the order.

(4) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

42 Under these provisions, the Court must be satisfied that there has been notice to creditors likely to be affected by the charge, the person is a supplier of goods or services to the company, and that the goods or services that are supplied are critical to the company's continued operation. While one might interpret section 11.4 (3) as requiring a charge any time a person is declared to be a critical supplier, in my view, this provision only applies when a court is compelling a person to supply. The charge then provides protection to the unwilling supplier.

43 In this case, no charge is requested and no additional notice is therefore required. Indeed, there is an issue as to whether in the absence of a request for a charge, section 11.4 is even applicable and the Court is left to rely on inherent jurisdiction. The section seems to be primarily directed to the conditions surrounding the granting of a charge to secure critical suppliers. That said, even if it is applicable, I am satisfied that the applicants have met the requirements. The CMI Entities seek authorization to make certain payments to third parties that provide goods and services integral to their business. These include television programming suppliers given the need for continuous and undisturbed flow of programming, newsprint suppliers given the dependency of the National Post on a continuous and uninterrupted supply of newsprint to enable it to publish and on newspaper distributors, and the American Express Corporate Card Program and Central Billed Accounts that are required for CMI Entity employees to perform their job functions. No payment would be made without the consent of the Monitor. I accept that these suppliers are critical in nature. The CMI Entities also seek more general authorization allowing them to pay other suppliers if in the opinion of the CMI Entities, the supplier is critical. Again, no payment would be made without the consent of the Monitor. In addition, again no charge securing any payments is sought. This is not contrary to the language of section 11.4 (1) or to its purpose. The CMI Entities seek the ability to pay other suppliers if in their opinion the supplier is critical to their business and ongoing operations. The order requested is facilitative and practical in nature. The proposed Monitor supports the applicants' request and states that it will work to ensure that payments to suppliers in respect of pre-filing liabilities are minimized. The Monitor is of course an officer of the Court and is always able to seek direction from the Court if necessary. In addition, it will report on any such additional payments when it files its reports for Court approval. In the circumstances outlined, I am prepared to grant the

relief requested in this regard.

(f) Directors' and Officers' Charge

44 The applicants also seek a directors' and officers' ("D &O") charge in the amount of $20 million. The proposed charge would rank after the administration charge, the existing CIT security, and the DIP charge. It would rank pari passu with the KERP charge discussed subsequently in this endorsement but postponed in right of payment to the extent of the first $85 million payable under the secured intercompany note.

45 Again, the recent amendments to the CCAA allow for such a charge. Section 11.51 provides that:

> (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge -- in an amount that the court considers appropriate -- in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company
>
> (2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> (3) The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.
>
> (4) The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

46 I have already addressed the issue of notice to affected secured creditors. I must also be satisfied with the amount and that the charge is for obligations and liabilities the directors and officers may incur after the commencement of proceedings. It is not to extend to coverage of wilful misconduct or gross negligence and no order should be granted if adequate insurance at a reasonable cost could be obtained.

47 The proposed Monitor reports that the amount of $20 million was estimated taking into consideration the existing D&O insurance and the potential liabilities which may attach including certain employee related and tax related obligations. The amount was negotiated with the DIP lender and the Ad Hoc Committee. The order proposed speaks of indemnification relating to the failure of any of the CMI Entities, after the date of the order, to make certain payments. It also excludes gross negligence and wilful misconduct. The D&O insurance provides for $30 million in

coverage and $10 million in excess coverage for a total of $40 million. It will expire in a matter of weeks and Canwest Global has been unable to obtain additional or replacement coverage. I am advised that it also extends to others in the Canwest enterprise and not just to the CMI Entities. The directors and senior management are described as highly experienced, fully functional and qualified. The directors have indicated that they cannot continue in the restructuring effort unless the order includes the requested directors' charge.

48 The purpose of such a charge is to keep the directors and officers in place during the restructuring by providing them with protection against liabilities they could incur during the restructuring: *Re General Publishing Co.*[10] Retaining the current directors and officers of the applicants would avoid destabilization and would assist in the restructuring. The proposed charge would enable the applicants to keep the experienced board of directors supported by experienced senior management. The proposed Monitor believes that the charge is required and is reasonable in the circumstances and also observes that it will not cover all of the directors' and officers' liabilities in the worst case scenario. In all of these circumstances, I approved the request.

(g) Key Employee Retention Plans

49 Approval of a KERP and a KERP charge are matters of discretion. In this case, the CMI Entities have developed KERPs that are designed to facilitate and encourage the continued participation of certain of the CMI Entities' senior executives and other key employees who are required to guide the CMI Entities through a successful restructuring with a view to preserving enterprise value. There are 20 KERP participants all of whom are described by the applicants as being critical to the successful restructuring of the CMI Entities. Details of the KERPs are outlined in the materials and the proposed Monitor's report. A charge of $5.9 million is requested. The three Management Directors are seasoned executives with extensive experience in the broadcasting and publishing industries. They have played critical roles in the restructuring initiatives taken to date. The applicants state that it is probable that they would consider other employment opportunities if the KERPs were not secured by a KERP charge. The other proposed participants are also described as being crucial to the restructuring and it would be extremely difficult to find replacements for them.

50 Significantly in my view, the Monitor who has scrutinized the proposed KERPs and charge is supportive. Furthermore, they have been approved by the Board, the Special Committee, the Human Resources Committee of Canwest Global and the Ad Hoc Committee. The factors enumerated in *Re Grant Forest*[11] have all been met and I am persuaded that the relief in this regard should be granted.

51 The applicants ask that the Confidential Supplement containing unredacted copies of the KERPs that reveal individually identifiable information and compensation information be sealed. Generally speaking, judges are most reluctant to grant sealing orders. An open court and public access are fundamental to our system of justice. Section 137(2) of the *Courts of Justice Act* provides authority to grant a sealing order and the Supreme Court of Canada's decision in *Sierra Club of*

Canada v. Canada (Minister of Finance)[12] provides guidance on the appropriate legal principles to be applied. Firstly, the Court must be satisfied that the order is necessary in order to prevent a serious risk to an important interest, including a commercial interest, in the context of litigation because reasonable alternative measures will not prevent the risk. Secondly, the salutary effects of the order should outweigh its deleterious effects including the effects on the right to free expression which includes the public interest in open and accessible court proceedings.

52 In this case, the unredacted KERPs reveal individually identifiable information including compensation information. Protection of sensitive personal and compensation information the disclosure of which could cause harm to the individuals and to the CMI Entities is an important commercial interest that should be protected. The KERP participants have a reasonable expectation that their personal information would be kept confidential. As to the second branch of the test, the aggregate amount of the KERPs has been disclosed and the individual personal information adds nothing. It seems to me that this second branch of the test has been met. The relief requested is granted.

Annual Meeting

53 The CMI Entities seek an order postponing the annual general meeting of shareholders of Canwest Global. Pursuant to section 133 (1)(b) of the CBCA, a corporation is required to call an annual meeting by no later than February 28, 2010, being six months after the end of its preceding financial year which ended on August 31, 2009. Pursuant to section 133 (3), despite subsection (1), the corporation may apply to the court for an order extending the time for calling an annual meeting.

54 CCAA courts have commonly granted extensions of time for the calling of an annual general meeting. In this case, the CMI Entities including Canwest Global are devoting their time to stabilizing business and implementing a plan. Time and resources would be diverted if the time was not extended as requested and the preparation for and the holding of the annual meeting would likely impede the timely and desirable restructuring of the CMI Entities. Under section 106(6) of the CBCA, if directors of a corporation are not elected, the incumbent directors continue. Financial and other information will be available on the proposed Monitor's website. An extension is properly granted.

Other

55 The applicants request authorization to commence Chapter 15 proceedings in the U.S. Continued timely supply of U.S. network and other programming is necessary to preserve going concern value. Commencement of Chapter 15 proceedings to have the CCAA proceedings recognized as "foreign main proceedings" is a prerequisite to the conversion of the CIT facility into the DIP facility. Authorization is granted.

56 Canwest's various corporate and other entities share certain business services. They are

seeking to continue to provide and receive inter-company services in the ordinary course during the CCAA proceedings. This is supported by the proposed Monitor and FTI will monitor and report to the Court on matters pertaining to the provision of inter-company services.

57 Section 23 of the amended CCAA now addresses certain duties and functions of the Monitor including the provision of notice of an Initial Order although the Court may order otherwise. Here the financial threshold for notice to creditors has been increased from $1000 to $5000 so as to reduce the burden and cost of such a process. The proceedings will be widely published in the media and the Initial Order is to be posted on the Monitor's website. Other meritorious adjustments were also made to the notice provisions.

58 This is a "pre-packaged" restructuring and as such, stakeholders have negotiated and agreed on the terms of the requested order. That said, not every stakeholder was before me. For this reason, interested parties are reminded that the order includes the usual come back provision. The return date of any motion to vary, rescind or affect the provisions relating to the CIT credit agreement or the CMI DIP must be no later than November 5, 2009.

59 I have obviously not addressed every provision in the order but have attempted to address some key provisions. In support of the requested relief, the applicants filed a factum and the proposed Monitor filed a report. These were most helpful. A factum is required under Rule 38.09 of the Rules of Civil Procedure. Both a factum and a proposed Monitor's report should customarily be filed with a request for an Initial Order under the CCAA.

Conclusion

60 Weak economic conditions and a high debt load do not a happy couple make but clearly many of the stakeholders have been working hard to produce as desirable an outcome as possible in the circumstances. Hopefully the cooperation will persist.

S.E. PEPALL J.

* * * * *

SCHEDULE A

[Editor's note: Schedule "A" was not attached to the copy received by LexisNexis Canada and therefore is not included in the judgment.]

1 *R.S.C. 1985, c. C. 36, as amended*

2 R.S.C. 1985, c.C.44.

3 R.S.C. 1985, c. B-3, as amended.

4 *(2004), 48 C.B.R. (4th) 299; leave to appeal refused, [2004] O.J. No. 1903, 2004 CarswellOnt 2936 (C.A.).*

5 *(1993), 9 B.L.R. (2d) 275.*

6 [2009] O.J. No. 349.

7 (2006), 19 C.B.R. (5th) 187.

8 (1995), 30 C.B.R. (3d) 29.

9 (2004), 33 B.C.L.R. (4th) 155.

10 *(2003), 39 C.B.R. (4th) 216.*

11 [2009] O.J. No. 3344. That said, given the nature of the relationship between a board of directors and senior management, it may not always be appropriate to give undue consideration to the principle of business judgment.

12 [2002] 2 S.C.R. 522.

TAB 19

Case Name:

Steels Industrial Products Ltd. (Re)

IN THE MATTER OF 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 0487826 B.C. Ltd., formerly known as Steels Industrial Products Ltd., Petitioner

[2012] B.C.J. No. 2091

2012 BCSC 1501

221 A.C.W.S. (3d) 263

97 C.B.R. (5th) 105

2012 CarswellBC 3079

Docket: S122514

Registry: Vancouver

British Columbia Supreme Court
Vancouver, British Columbia

S.C. Fitzpatrick J.

Heard: September 19, 2012.
Judgment: October 11, 2012.

(57 paras.)

Bankruptcy and insolvency law -- Creditors and claims -- Claims -- Provable claims -- Validity -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- With unsecured creditors -- Claims -- Application by unsecured creditors for funding in Companies' Creditors Arrangement Act proceeding for investigation of claims of related party creditors allowed -- Independent review of related parties's claims should be undertaken -- Support for validity of related party proofs of claim was sparse -- It would have been unfair for disputing creditors to bear

costs of forensic accounting -- Priority charge for accounting on assets was necessary for effective participation by disputing creditors.

Application by unsecured creditors of petitioner Steels for funding in a Companies' Creditors Arrangement Act proceeding for investigation of the claims of creditors related to Steels. Steels had sought protection from its creditors and its assets were sold. A claims process order was granted. A substantial portion of the claims advanced against the proceeds of the sale were related parties, in particular Fama and S.I.P., whose claims stood to recover 62 per cent of the amount available for distribution. Woods was appointed as Chief Restructuring Officer of Steels. The unsecured creditors asserted a forensic accountant should be retained to assist in reviewing and assessing the claims of Fama and S.I.P, and sought to have the fees and expenses of those services secured by a priority charge on Steels's assets. Steels/S.I.P /Fama argued further review of the related party claims was not necessary as the financial statements had been audited and the amounts owing confirmed and Woods had independently reviewed the claims and further that the application was premature.

HELD: Application allowed. An independent review of the related parties's claims should be undertaken. An adequate review of the claims had not been made as was contemplated by the claims process order. Neither the Monitor nor Steels's financial advisor had assisted Steels or Woods in reviewing the proofs of claim. Support for the related party proofs of claim was sparse in terms of particulars. Woods had not provided clarification about the related party claims. The application was not premature: it did not appear there was cooperation between the parties with respect to providing the necessary information and backup documentation and forensic accounting would be necessary in any event. It would be unfair for the disputing creditors to bear the costs of the forensic accounting, as it would provide the independent review initially contemplated and potentially benefit unsecured creditors as a whole. A priority charge in favour of the forensic accountants was necessary for the effective participation by the disputing creditors.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 135

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.52(1)(c)

Counsel:

Counsel for the Petitioner: D.E. Gruber.

Counsel for the Monitor, McMillan LLP: P.J. Reardon.

Counsel for S.I.P. Holdings Ltd. and Fama Holdings Ltd.: D. Hyndman.

Counsel for Henry Company Canada Inc. and Stone Industries Inc.: J. McLean, Q.C.

[Editor's note: A corrigendum was released by the Court December 3, 2012; the correction has been made to the text and the corrigendum is appended to this document.]

Reasons for Judgment

1 S.C. FITZPATRICK J.:-- The question raised on this application is whether certain unsecured creditors should obtain funding within this *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*") proceeding for the purpose of investigating the claims of other creditors who are related to the petitioner, 0487826 B.C. Ltd., formerly known as Steels Industrial Products Ltd. ("Steels").

Background Facts

2 Steels was a supplier of construction materials in British Columbia and Alberta. It operated from various leased premises across those provinces. On April 5, 2012, Steels sought protection from its creditors pursuant to the *CCAA*. On that same date, I granted an initial order staying proceedings and granting other ancillary relief. Alvarez & Marsal Canada Inc. was appointed as Monitor.

3 The ancillary relief included the appointment of Wayne Wood as Chief Restructuring Officer ("CRO") of Steels, since all the directors had resigned. Mr. Wood was the Vice-President, Finance and Administration of Steels. It was intended that he would be assisted in his duties relating to the restructuring to some extent by Steels' financial advisor, Ernst & Young Inc. ("E&Y").

4 Steels resolved fairly quickly, with the assistance of E&Y and with the concurrence of the Monitor, to commence a sale and investment solicitation process toward selling its assets. On July 30, 2012, I approved a sale of the majority of Steels' assets to Brock White Canada Company, LLC. That sale has now completed and net proceeds of sale, which are discussed in more detail below, are being held for the benefit of unsecured creditors.

5 In anticipation of a sale of the assets, I approved a Claims Process Order on June 8, 2012.

6 By the date of the granting of the Claims Process Order, it was apparent that a substantial portion of the claims would be advanced by related parties. In fact, Mr. Wood discussed these claims in his affidavit sworn April 5, 2012 in support of the granting of the Initial Order.

7 Mr. Wood's evidence indicated that Steels is a wholly owned subsidiary of S.I.P. Holdings Ltd. ("S.I.P. Holdings") and that S.I.P. Holdings is, in turn, a wholly owned subsidiary of Fama Industrial Supplies Ltd., a privately owned company. Mr. Wood's evidence further indicated that S.I.P. Holdings also owns Steels Holdings (BTC) Ltd. ("Holdings BTC"). Mr. Wood attached various financial documentation in respect of claims against Steels by both S.I.P. Holdings and

another company, Fama Holdings Ltd. ("Fama Holdings"):

a) S.I.P. Holdings' audited consolidated financial statements for the 12 months ending December 31, 2010. These consolidated financial statements included both Steels and Holdings BTC;
b) Unaudited financial statements for Steels for the 12 months ending December 31, 2011; and
c) Steels' unaudited financial statements for the two months ending February 29, 2012.

8 Mr. Wood stated that there is a shareholder loan in the amount of approximately $17.3 million owed to Fama Holdings. He stated:

> The Shareholder Loan is owed to Fama Holdings Ltd. ("FHL"). It does not bear interest, and there are no repayment terms. In 2005, Steels consolidated with Gasmaster Industries Ltd. ("Gasmaster") for the purposes of utilizing Gasmaster's tax losses to offset Steels' profits. Gasmaster owed the amount of $17.3 million to FHL. Gasmaster is no longer a division of Steels, having been spun off, but the amount owing from Gasmaster to FHL remains on Steels' books.

9 Indeed, Note 9 of the consolidated balance sheet in the 2010 audited financial statements (entitled "Related Party Balances and Transactions") does reference an amount owing to Fama Holdings in the amount of approximately $17.3 million as at the end of 2010. The statements refer to Fama Holdings as a "company under common control", although the relationship between Fama Holdings, on the one hand, and S.I.P. Holdings and Steels, on the other, is not apparent.

10 Similarly, the unaudited financial statements as at December 31, 2011 indicate a "shareholder loan" owing in the amount of approximately $17.3 million.

11 In his April 5 affidavit, Mr. Wood also referred to a balance due to "affiliated companies" of approximately $7.9 million. With respect to this amount, he stated as follows:

> The balance owing to affiliated companies is due to SIP Holdings. This amount relates to certain proceeds from the sale of the Lands. Some of the Lands were transferred to Steels before the sale, so the amount owing to SIP [Holdings] is in respect of the purchase price paid for the Lands.

12 Given that the 2010 audited financial statements are consolidated and include both Steels and S.I.P. Holdings, there is no reference in those statements to the amount said to be due to S.I.P. Holdings by Steels. Nevertheless, the unaudited financial statements of Steels as at December 31, 2011 do reference an amount owing to "affiliated companies" of $7,018,037.

13 Despite the above evidence of Mr. Wood relating to these claims at the outset of this

proceeding, there was no question in the minds of Steels, and in particular that of Mr. Wood as the CRO, that issues might be raised with respect to these related party claims. The Claims Process Order, in paragraph 21, provided that filed Proofs of Claim were to be reviewed by Steels with the assistance of both the Monitor and E&Y. The Claims Process Order further provided:

> 25. Any Creditor (a "Disputing Creditor") may apply to this Court to dispute any such accepted Claim by filing a Notice of Application ... Upon receipt of any such filed application, the Petitioner shall provide the Disputing Creditor with any Proof of Claim and other material documents in its possession in respect of the disputed Claim, and paragraphs 26, 27 and 28 of this Order apply.
>
> 26. In the event that the Petitioner, with the assistance of the Monitor, is unable to resolve a dispute regarding any Claim with a Creditor or between two Creditors, the Petitioner shall so notify the Monitor and the Creditor, and either of the Petitioner, Monitor, or Creditor may apply to the Court to resolve the dispute. ...
>
> 27. In the event an application is filed pursuant to paragraphs 25 or 26 of this Order, there shall be a preliminary hearing before the Court to determine the procedure for the application and to determine whether the matter will be decided based on the material before the Petitioner or on a *de novo* basis.

14 This additional procedure by which another creditor could challenge any claim was a matter raised by the Monitor in relation to these third party claims. The Monitor stated in its Third Report dated June 6, 2012, in support of the application for the Claims Process Order, that "any creditor(s) will have the right, possibly at its (their) own cost, to challenge the claims of others":

> ... in order to provide additional stakeholder protection before any distribution is made to creditors ...

15 Accordingly, the Claims Process Order specifically contemplated a procedure by which other unsecured creditors, who might be affected by the acceptance of the related party claims, were entitled to take steps to independently review those proofs of claim and have the dispute heard by the Court if it could not be resolved otherwise.

16 In July 2012, S.I.P. Holdings and Fama Holdings filed their Proofs of Claim with Steels.

17 Fama Holdings' Proof of Claim is in the amount of $13,159,689.25. Few particulars are provided. The amount is said to be derived from the $17.3 million figure from the 2010 audited financial statements (which are attached) less reductions in the amounts of $1,776,634, which is identified as a credit from a portion of the proceeds of sale of real estate owned by S.I.P. Holdings, and $4,101,845. This latter figure is stated to have "occurred as reflected in the financial statements of Steels, as prepared by Steels and accordingly, details of the constitution of the loan repayment are known to Steels". No other documentation is provided in support of this claim.

18 S.I.P. Holdings' Proof of Claim is in the amount of $5,954,155.75. Documents in support

include the 2010 consolidated financial statements (which do not in fact disclose any amount owed to S.I.P. Holdings, as noted above), together with various promissory notes dated January 1, February 1, March 1 and July 1, 2011. As with the Fama Holdings Proof of Claim, some particulars are also provided. Specifically, the Proof of Claim refers to Steels being indebted to S.I.P. Holdings in the amount of $7,018,036.85 as of July 1, 2005. This is the amount reflected on the 2011 unaudited financial statements. The Proof of Claim also indicates:

> ... Subsequent to that date, SIP sold real estate in Surrey, Kamloops, Calgary and Edmonton occupied by Steels as tenant to Steels in consideration of preferred shares and $7,924,498.29 evidenced by promissory notes as follows:
>
> (i) Surrey property: $2,150,780.64
> (ii) Kamloops property: $573,539.00
> (iii) Calgary property: $2,016,181.46
> (iv) Edmonton property: $3,183,989.19
>
> for a total indebtedness of $14,942,527.14. This indebtedness was reduced during the course of 2011 and 2012 by $8,988,372.26 through payment by Steels of lease payments and other real estate related indebtedness. The particulars of such payments are known to Steels and are reflected in the financial statements of Steels.

19 No detail is provided by S.I.P. Holdings with respect to the origins of the original $7,018,036.85 said to be owed as of July 1, 2005.

20 In its Fifth Report dated July 26, 2012, the Monitor states that Steels and the CRO had accepted the claims of S.I.P. Holdings and Fama Holdings, together with a small claim by another related party. Importantly, the Monitor also stated that Steels did not request the assistance of E&Y with respect to the review and evaluation of these claims. Nor did the Monitor perform any further work on these claims - beyond a review of the documentation provided - pending a determination as to whether any other creditors wished to challenge the claims under paragraph 25 of the Claims Process Order.

21 The significance of these related party claims cannot be understated. The amount available for distribution to unsecured creditors is expected to be in the range of $4 to $4.2 million. The total claims filed to date pursuant to the Claims Process Order amount to approximately $31 million, which indicates an estimated recovery of between 13% and 14%. Given that the amounts claimed by both Fama Holdings and S.I.P. Holdings total approximately $19.2 million, these two creditors alone stand to recover approximately 62% of the total monies that will be available for distribution to unsecured creditors.

Discussion

22 This application is brought by two unsecured creditors: Henry Company Canada Inc. and Canadian Stone Industries Inc. These two creditors are owed approximately $900,000. They say Wolrige Mahon Ltd., a forensic accountant, should be retained to assist them in reviewing and assessing the claims of Fama Holdings and S.I.P. Holdings. They are applying for an order that the reasonable fees and expenses of Wolrige Mahon Ltd.'s services be secured by a priority charge on Steels' assets ranking in priority to all other charges except for the existing Administrative Charge. They seek a priority charge not to exceed $50,000.

23 It appears that other unsecured creditors of Steels have joined with the applicants. At this time, the total unsecured creditor group (who I will refer to as the "Disputing Creditors") who wish to have these related claims investigated have aggregated claims of approximately $2.6 million, which represents 8% of the present claims.

24 The Disputing Creditors assert that given the nature of the Fama Holdings and S.I.P. Holdings claims, it is not possible to assess them without the assistance of an accountant with forensic experience. The expertise of Michael Cheevers, President of Wolrige Mahon Ltd., is well known to this Court. In fact, Mr. Cheevers has been appointed by this Court in many instances as a receiver, trustee and bankruptcy monitor. In addition, Mr. Cheevers practices as a forensic accountant and his qualifications in that area are not in question.

25 Mr. Cheevers indicates that he expects that if appointed, he would review the accounting records of Steels, including banking records and relevant contracts, going back as far as 2005 (which is a date referred to in the S.I.P. Holdings Proof of Claim). He estimates that the fees of Wolrige Mahon Ltd. to undertake this engagement would be between $25,000 and $50,000.

26 As mentioned earlier in these reasons, it is clear that, contrary to the terms of paragraph 21 of the Claims Process Order, neither the Monitor nor E&Y, as Steels' financial advisors, have assisted Steels or Mr. Wood as CRO in reviewing these Proofs of Claim toward either accepting or revising or rejecting them. The Monitor acknowledges that it was never intended that a review by only Mr. Wood as CRO would be sufficient for a final determination in respect of the Proofs of Claim to be accepted for distribution.

27 The only evidence from Mr. Wood filed on this application was a very general response on August 23, 2012:

> I have also spent significant time managing the Petitioner's claims process, the details of which are set out [in] the Monitor's Fifth Report to Court filed in this proceeding. I understand that certain creditors have sought information related to those related parties claims, and I have spent time reviewing information related thereto and expect to spend more time on that issue going forward.

28 Notwithstanding Mr. Wood's comment, he has not engaged in any meaningful dialogue with the Disputing Creditors toward providing clarification about these related party claims. I was advised by counsel there has been some exchange of correspondence between counsel for the Disputing Creditors and counsel acting for both Steels and the CRO (the same counsel acts for both Steels and the CRO). Despite being invited to provide further information concerning these claims, and despite what appears to have been his earlier intention, Mr. Wood has declined to provide further detail or documentation regarding these claims, save in response to a specific request which the Disputing Creditors did not provide.

29 Counsel for Steels/the CRO and S.I.P. Holdings and Fama Holdings argue that any further review of the related party claims is not necessary. They say that the 2010 financial statements were audited and thus confirmed the amounts owing in that document. In addition, they say that Mr. Wood, as the CRO and the accountant of Steels, has "independently" reviewed these claims. It is apparent from Mr. Wood's prior involvement with Steels, as the Vice-President of Finance and Administration, that he would have some knowledge of these claims. They further argue that as the CRO, he is an independent officer of the court and, in particular, independent of the related parties. The suggestion is made that his review of the claims is entitled to substantial deference and that funding for any further review should be refused. I would note again, however, that even as late as August 23, 2012, Mr. Wood indicated that he was still in the process of reviewing information regarding these claims.

30 For all that Mr. Wood appears to have some knowledge of these claims, it is of some significance to me that he has provided no assistance, as an officer of this Court, to the Court in terms of the level of his knowledge with respect to all aspects of these claims. Nor has he disclosed any further work that he has done in reviewing these claims subsequent to receiving the Proofs of Claim and the objections of the Disputing Creditors.

31 Furthermore, I consider that the Proofs of Claim, with the limited information disclosed and limited documentation attached, leave much to be desired in terms of fully understanding these claims.

32 There is absolutely no backup with respect to the amounts claimed by S.I.P. Holdings as of July 1, 2005. There appear to be complex transactions after that date involving sales of real estate and tenancy arrangements. No doubt, there is a wealth of documentation which supports those transactions and presumably, the amounts or debts said to arise from those transactions and reductions or payments made.

33 With respect to the Fama Holdings claim, I appreciate that this amount is referenced in the audited 2010 financial statements. But later reductions are said to arise from real estate sales by S.I.P. Holdings and no details relating to those transactions are provided.

34 Support for both Proofs of Claim is sparse in terms of particulars provided; there appear to be only vague references to figures that are "reflected in the financial statements of Steels" or "known

to Steels". Such general statements do little to provide the necessary backup so that other creditors may fully understand these claims and determine whether they are valid.

35 To a large extent, the submissions made by Steels/the CRO, S.I.P. Holdings and Fama Holdings amount to them saying "trust the auditors" and "trust me". Despite this, the Disputing Creditors continue to harbour concerns and I think justifiably so.

36 We are therefore at the stage where, despite some efforts, the parties have failed to advance a better understanding of these related party claims through the provision of further information and documentation. The Disputing Creditors' position is, in any event, that a forensic accountant, such as Mr. Cheevers, will be required to fully review the matter.

37 Under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), the claims process is undertaken by a trustee in bankruptcy. Pursuant to s. 135, a trustee is required to examine every proof of claim and may require further evidence in support of a claim prior to determining, valuing or disallowing a claim. The cost of that review is borne by the estate as a whole since it is intended to benefit the body of creditors.

38 Similar issues often arise in *CCAA* proceedings where counsel and the Court must be mindful of issues that may arise in relation to the determination of claims in that proceeding. There are no set rules, but care must be taken in the drafting of the claims process order to ensure that the process by which claims are determined is fair and reasonable to all stakeholders, including those who will be directly affected by the acceptance of other claims. In *Winalta Inc. (Re)*, 2011 ABQB 399, Madam Justice Topolniski stated that "[p]ublic confidence in the insolvency system is dependent on it being fair, just and accessible".

39 Many *CCAA* proceedings provide for an independently run claims process (for example, by the monitor), the cost of which again would be borne by the general body of creditors: see for example, *Pine Valley Mining Corp. (Re)*, 2008 BCSC 356. To this extent, the statutory procedure under the *BIA* and the claims process under the *CCAA* will have similar features, which is understandable since the overriding intention under both is to conduct a proper claims process: see *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60 at paras. 24 and 47.

40 Indeed, this was the underlying basis upon which the Claims Process Order was granted, particularly as it related to a review of the third party claims. That Order clearly contemplated that other creditors would have the ability to challenge these third party claims, even in the face of the claims process as originally crafted. Again, as stated above, the process set out in the Order was not followed in that there was no independent involvement or assistance by the Monitor or E&Y, as was initially intended. Nor did Steels provide any of the Disputing Creditors with "other material documents in its possession" as contemplated by paragraph 25 of that Order.

41 In this case, no report from the Monitor has been prepared in any case. As for Mr. Wood in his capacity as CRO, I do not accede to the arguments that this Court should grant any particular

deference to his review or conclusions, particularly in the face of the evidentiary deficiencies with respect to the Proof of Claims and his failure to further assist the Court in addressing such deficiencies. Fama Holdings and S.I.P. Holdings have the burden of proving their claims, and this requires more than providing general statements and unclear financial statements.

42 In all of these circumstances, I have no hesitation in concluding that an independent review of these related parties claims is appropriate and should be undertaken. In addition to understanding how these particular transactions arose and the financial consequences arising from those transactions, an independent review would also focus on the proper characterization of the amounts said to be owed. It is possible, as suggested by counsel for the Disputing Creditors, that some or all of these amounts may have been equity investments in Steels, as opposed to debt. In that event, such equity claims would only be satisfied after all unsecured claims were paid. A similar issue was raised by the disputing creditors in *Pine Valley Mining*.

43 Counsel for Steels/the CRO and also counsel for S.I.P. Holdings and Fama Holdings contend that the application is premature. Counsel for Steels/the CRO states that Mr. Wood will cooperate in speaking to counsel for the Disputing Creditors in providing documents as requested. No similar offer has been made by S.I.P. Holdings and Fama Holdings. Further, it is suggested that paragraph 27 of the Claims Process Order contemplates a preliminary hearing to discuss the claims and that the issues, including the provision of any further information and documentation, can be addressed at that time.

44 I would not accede to these arguments that the application is premature. The related party claims have been presented and it does not appear that there is cooperation between the parties, at least to this point in time, with respect to providing the necessary information and backup documentation. In addition, even once such information and documentation is provided to counsel for the Disputing Creditors, it is evident to me that a forensic accounting of these claims will be required in the circumstances. I see no need to engage the court process in addressing these claims until that full review has taken place and positions are crystallized. It may be, for example, that upon that full review, the Disputing Creditors are satisfied that there are no issues to be addressed and that these are valid claims.

45 I would also note that there is some urgency in dealing with these third party claims. I understand that matters relating to the assets sale are moving to a conclusion which will dictate the actual amount of funds to be distributed. It is intended that a plan will be submitted later this year which will provide for distributions to unsecured creditors. A failure to resolve issues relating to these claims, or resolve them in a timely manner, will result in delayed payment to all unsecured creditors. This is to be avoided if at all possible.

46 In conclusion, an independent review of these claims is necessary in the circumstances. An adequate review of these related party claims has not been made. The consequences of a successful challenge to some or all of these claims would have significant financial repercussions to the

Disputing Creditors and other unsecured creditors who have also proved their claims. To deny an independent review at this time would be to deny any creditor the fair, reasonable and transparent process that is expected in insolvency proceedings in determining claims before any distribution of estate assets is made.

47 The question then becomes who should complete this independent review and who should bear the costs of the review.

48 The Monitor to this point in time has risen above the fray while these procedural matters are being sorted out. Nevertheless, the Monitor indicates that if directed by the Court, it will, of course, complete an independent review of the claims. In that event, as with any review of a claim that they would have undertaken from the outset, the cost will be borne by the estate. The Monitor, however, raises the issue that if it completes such a review and prepares a report, it would share that report with others who would be interested in the issue.

49 Counsel for the Disputing Creditors submits that Wolrige Mahon Ltd. should be the party to complete this review. At this stage, it is, at least on the face of it, an adversarial process and the Monitor can remain as the neutral third party in respect of the matter. There would not appear to be any costs considerations in that respect; the Monitor has no vested knowledge of the related party claims that would reduce the cost of completing this review. It is also stated that Wolrige Mahon Ltd.'s expertise with respect to forensic accounting is of particular importance in this case, while the Monitor does not advocate any particular expertise in that regard.

50 I noted that in *Pine Valley Mining*, the monitor had reviewed and accepted the claim that was the subject of the dispute in *CCAA* proceedings. Madam Justice Garson (as she then was), at para. 13, concluded that the role of the monitor was to determine the validity and amount of the claim, but that it did not do so in an adversarial process. As such, while the monitor's report was to be considered in the dispute, there was no deference to be accorded to that report "in the sense that would alter the burden of proof ordinarily imposed on the claimant".

51 In my view, the appropriate disposition of this matter is to have the review completed by Wolrige Mahon Ltd. In that event, counsel for the Disputing Creditors can deal directly with Wolrige Mahon Ltd. in terms of the review, which may not necessarily result in a formal report being prepared. This may alleviate the higher costs normally associated with preparing a formal report.

52 The next issue is whether the results of Wolrige Mahon Ltd.'s review should be shared. Under a *BIA* claims process, a trustee in bankruptcy would review claims. Normally, a trustee would seek the input of the inspectors appointed, however, it may not do so if, for example, there was some concern that an inspector had an interest relating to a potentially disputed claim. If the cost of the report is to be borne as an administrative cost, there is no reason why other interested parties should not have equal access to Wolrige Mahon Ltd.'s work product in respect of this independent review. Accordingly, I am ordering that Wolrige Mahon Ltd.'s work product be shared with the Monitor and

any other unsecured creditor (other than the related parties) who wishes to join in a challenge of the related party claims, on terms as might be agreed between then.

53 The Disputing Creditors seek a charge in favour of Wolrige Mahon Ltd. in an amount limited to $50,000. The *CCAA* provides:

> s. 11.52(1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge - in an amount that the court considers appropriate - in respect of the fees and expenses of:
>
> ...
>
> (*c*) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

54 I consider that it would be unfair to the Disputing Creditors for them to bear the costs of retaining Wolrige Mahon Ltd., which will not only provide the independent review that was contemplated by the Claims Process Order, but will also potentially benefit the unsecured creditors as a whole. In my view, this charge in favour of Wolrige Mahon Ltd. is necessary for the effective participation by the Disputing Creditors in these proceedings (and perhaps others who might join in or benefit from such a review).

55 The final issue is raised by S.I.P. Holdings and Fama Holdings. They take the position that while a charge may be granted at this time, there should be a provision in the order allowing them to seek recovery of some or all of the amounts paid to Wolrige Mahon Ltd. in the event that a review of the related party claims is not fruitful or alternatively, any challenge to those claims is not successful. Such a "comeback" provision is opposed by the Disputing Creditors.

56 Usually, the cost of an independent review would be borne by the estate and would be indirectly borne by the creditors whose claims were potentially subject to challenge. In this case, I see no reason to depart from the usual manner in which this independent review is to be conducted, which would not include any ability to recoup these expenses. I would note, in any event, that if a challenge to these related party claims is brought against S.I.P. Holdings and Fama Holdings, and that challenge is ultimately unsuccessful, then the related parties will have the ability to seek costs against the unsuccessful applicant creditors at the end of the day.

57 Accordingly, the order sought is granted. There will be a priority charge in favour of Wolrige Mahon Ltd. not to exceed $50,000, for the purpose of Wolrige Mahon Ltd. assisting the Disputing Creditors to review and assess the claims of Fama Holdings and S.I.P. Holdings. This charge is to

rank in priority to all other charges except for the existing Administrative Charge.

S.C. FITZPATRICK J.

* * * * *

CORRIGENDUM

Released: December 3, 2012.

[1] S.C. FITZPATRICK J.:-- This is a corrigendum to my Reasons for Judgment issued October 11, 2012. Paragraph 28 of those Reasons is amended to read as follows:

> [28] Notwithstanding Mr. Wood's comment, he has not engaged in any meaningful dialogue with the Disputing Creditors toward providing clarification about these related party claims. I was advised by counsel there has been some exchange of correspondence between counsel for the Disputing Creditors and counsel acting for both Steels and the CRO (the same counsel acts for both Steels and the CRO). Despite being invited to provide further information concerning these claims, and despite what appears to have been his earlier intention, Mr. Wood has declined to provide further detail or documentation regarding these claims, save in response to a specific request which the Disputing Creditors did not provide.

S.C. FITZPATRICK J.

cp/e/qlrds/qllmr/qlmdl/qljac

IN THE MATTER OF 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 THE CASH STORE FINANCIAL SERVICES INC., et al.

Court File No: CV-14-10518-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF COLISEUM CAPITAL PARTNERS, LP, COLISEUM CAPITAL PARTNERS II, LP, BLACKWELL PARTNERS, LLC, ALTA FUNDAMENTAL ADVISORS MASTER LP AND THE AD HOC COMMITTEE OF CASH STORE NOTEHOLDERS IN THEIR RESPECTIVE CAPACITIES AS DIP LENDERS, FIRST LIEN NOTEHOLDERS AND HOLDERS OF SENIOR SECURED NOTES

Norton Rose Fulbright Canada LLP
Royal Bank Plaza, South Tower
Suite 3800, 200 Bay Street, P.O. Box 84
Toronto, Ontario M5J 2Z4

Orestes Pasparakis
Tel: 1.416.216.4815
Alan B. Merskey
Tel: 1.416.216.4805
alan.merskey@nortonrosefulbright.com

Fax: 1.416.216.3930

Lawyers for Coliseum Capital Partners, LP, Coliseum Capital Partners II, LP, Blackwell Partners, LLC, Alta Fundamental Advisors Master LP and the Ad Hoc Committee of Cash Store Noteholders in their respective capacities as DIP Lenders, First Lien Noteholders and Holders of Senior Secured Notes