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

# REPLY AND RESPONDING BOOK OF AUTHORITIES OF TRIMOR ANNUITY FOCUS LP #5

(Motion returnable June 11, 2014)


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2009 BCCA 602
British Columbia Court of Appeal

Randhawa v. 420413 B.C. Ltd.

2009 CarswellBC 3512, 2009 BCCA 602, [2009] B.C.J. No. 2601, [2010] 3 W.W.R. 225, [2010] B.C.W.L.D. 860, [2010] B.C.W.L.D. 861, [2010] B.C.W.L.D. 924, [2010] B.C.W.L.D. 931, 100 B.C.L.R. (4th) 115, 183 A.C.W.S. (3d) 1171, 281 B.C.A.C. 125, 475 W.A.C. 125, 67 B.L.R. (4th) 1

# Jasvir Kaur Randhawa and Amrik Randhawa (Appellants / Plaintiffs / Third Party) And 420413 B.C. Ltd., Central Valley Taxi Ltd., Central Valley Limousine Ltd., West Coast Limousines Incorporated, Tarsem Buttar, Nirbhai Dhat, Rajinder Kang, Avtar Sumra and Simerdeep Sumra (Respondents / Defendants)

Finch C.J.B.C., Ryan, Chiasson JJ.A.

Heard: June 12, 2009
Judgment: December 29, 2009
Docket: Vancouver CA035541

Proceedings: affirming *Randhawa v. 420413 B.C. Ltd.* (2007), 2007 BCSC 1507, 2007 CarswellBC 2411 (B.C. S.C.)

Counsel: B. Baynham Q.C., J. Sullivan for Appellants
R.H. Hamilton Q.C. for Respondents

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

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Evidence --- Witnesses — Cogency — Credibility — Miscellaneous**

A was one of directors of parent company 420 Ltd. — A's wife, J, was 20 percent shareholder of 420 Ltd. — Dispute arose between J and other directors of 420 Ltd. — J filed petition alleging oppression and asserting that between 1994 and 2004, other directors improperly and secretively diverted monies to themselves from taxi business and failed to report it to Canada Revenue Agency — Other directors admitted that they took cash from taxi business, but alleged that A was architect of unlawful diversion scheme, and that A and J acted in concert with them and shared in monies — Trial was held to determine whether A and J were victims of scheme perpetrated by others — Action was dismissed — A was found to have initiated and participated in scheme — A and J appealed on basis that trial judge improperly developed scenario and that there was no evidence that was both probative and credible that they took cash from taxi business — Appeal dismissed — Judge did not step outside pleadings and case developed by parties to find liability — Judge was entitled to reach determination of likely conduct of parties that did not accord with their direct evidence or positions advanced by them at trial — There was considerable evidence adduced concerning activities not related directly to cash diversion scheme in issue.

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A was one of directors of parent company 420 Ltd. — A's wife, J, was 20 percent shareholder of 420 Ltd. — Dispute arose between J and other directors of 420 Ltd. — J filed petition alleging oppression and asserting that between 1994 and 2004, other directors improperly and secretively diverted monies to themselves from taxi business and failed to report

it to Canada Revenue Agency — Other directors admitted that they took cash from taxi business, but alleged that A was architect of unlawful diversion scheme, and that A and J acted in concert with them and shared in monies — Trial was held to determine whether A and J were victims of scheme perpetrated by others — Action was dismissed — A was found to have initiated and participated in scheme — A and J appealed on basis that trial judge improperly developed scenario and that there was no evidence that was both probative and credible that they took cash from taxi business — Appeal dismissed — Judge did not step outside pleadings and case developed by parties to find liability — Judge was entitled to reach determination of likely conduct of parties that did not accord with their direct evidence or positions advanced by them at trial — There was considerable evidence adduced concerning activities not related directly to cash diversion scheme in issue.

**Evidence — Character — Similar fact evidence — To demonstrate scheme or plan**

A was one of directors of parent company 420 Ltd. — A's wife, J, was 20 percent shareholder of 420 Ltd. — Dispute arose between J and other directors of 420 Ltd. — J filed petition alleging oppression and asserting that between 1994 and 2004, other directors improperly and secretively diverted monies to themselves from taxi business and failed to report it to Canada Revenue Agency — Other directors admitted that they took cash from taxi business, but alleged that A was architect of unlawful diversion scheme, and that A and J acted in concert with them and shared in monies — Trial was held to determine whether A and J were victims of scheme perpetrated by others — Action was dismissed — A was found to have initiated and participated in scheme — A and J appealed on basis that trial judge erred in using similar fact evidence — Appeal dismissed — Judge did not err in her use of similar fact evidence — In part, it related to A's denial that he bragged about cash diversion in his trucking business — It bore on issue of whether A and J initiated scheme — It was not about general propensity — Judge was obliged to decide whether A and J participated in scheme — Fact that they had pattern of concealing cash payments was relevant to that inquiry — Judge's conclusion that A and J initiated and participated in scheme was based on her disbelief of A and J and on her acceptance of direct and indirect evidence that supported conclusion — Judge did not impermissibly use similar fact evidence — She looked at evidence overall, accepting some parts and rejecting others.

**Civil practice and procedure — Actions — Cause of action — Ex turpi causa non oritur actio**

A was one of directors of parent company 420 Ltd. — A's wife, J, was 20 percent shareholder of 420 Ltd. — Dispute arose between J and other directors of 420 Ltd. — J filed petition alleging oppression and asserting that between 1994 and 2004, other directors improperly and secretively diverted monies to themselves from taxi business and failed to report it to Canada Revenue Agency — Other directors admitted that they took cash from taxi business, but alleged that A was architect of unlawful diversion scheme, and that A and J acted in concert with them and shared in monies — Trial was held to determine whether A and J were victims of scheme perpetrated by others — Action was dismissed — A was found to have initiated and participated in scheme — Trial judge found that A and J could not invoke court's assistance to compensate them for their share of illegal cash taken by other directors as doctrine of ex turpi causa non oritur action provides that no action may arise from base cause — A and J appealed on basis that ex turpi causa non oritur action was neither pleaded nor argued and that judge misapplied doctrine without benefit of argument of counsel — Appeal dismissed — It is not necessary to plead doctrine of ex turpi causa — It is question of law — It is necessary to plead material facts to support application of doctrine — That was done in this case — Judge correctly refused to provide assistance of court to enable plaintiffs to participate in illegal scheme — Post-2000 payments were made in secrecy — They were unauthorized and unrecorded by company with purpose of unlawfully avoiding taxation — Doctrine of ex turpi causa had no effect on value of J's shares.

A was one of the directors of the parent company 420 Ltd. A's wife, J, was 20 percent shareholder of 420 Ltd. A dispute arose between J and other directors of 420 Ltd. J filed a petition alleging oppression and asserting that between 1994 and 2004, the other directors improperly and secretively diverted monies to themselves from the taxi business and failed to report it to the Canada Revenue Agency. The other directors admitted that they took cash from the taxi business, but alleged that A was the architect of the unlawful diversion scheme, and that A and J acted in concert with them and shared in the monies. A trial was held to determine whether A and J were victims of a scheme perpetrated by others. The action

was dismissed. A was found to have initiated and participated in the scheme. The trial judge found that A and J could not invoke the court's assistance to compensate them for their share of illegal cash taken by the other directors as the doctrine of ex turpi causa non oritur action provides that no action may arise from a base cause. A and J appealed.

**Held:** The appeal was dismissed.

Per Chiasson J.A. (Finch C.J.B.C. concurring): The judge did not step outside the pleadings and case developed by the parties to find liability. The judge was entitled to reach a determination of the likely conduct of the parties that did not accord with their direct evidence or the positions advanced by them at trial. There was considerable evidence adduced concerning activities not related directly to the cash diversion scheme in issue.

The judge did not err in her use of similar fact evidence. In part, evidence related to A's denial that he bragged about cash diversion in his trucking business. It bore on the issue of whether A and J initiated the scheme. It was not about general propensity. The judge was obliged to decide whether A and J participated in the scheme. The fact that they had a pattern of concealing cash payments was relevant to that inquiry. The judge's conclusion that A and J initiated and participated in the scheme was based on her disbelief of A and J and on her acceptance of direct and indirect evidence that supported the conclusion. The judge did not impermissibly use similar fact evidence. She looked at the evidence overall, accepting some parts and rejecting others.

The ex turpi causa non oritur action doctrine prevents a party from benefiting from illegal or immoral conduct. The justification for the rule is the preservation of the integrity of the judicial system. It is not necessary to plead the doctrine of ex turpi causa. It is a question of law. It is necessary to plead the material facts to support the application of the doctrine. That was done in this case. The judge correctly refused to provide the assistance of the court to enable A and J to participate in the illegal scheme. Post-2000 payments were made in secrecy. They were unauthorized and unrecorded by the company with the purpose of unlawfully avoiding taxation. The doctrine of ex turpi causa had no effect on the value of J's shares.

Per Ryan J.A. (concurring): The appeal was to be dismissed. A trial judge is not limited to the theory of the plaintiff or the defendant, but may make findings of fact reasonably supported by the evidence. There was evidence upon which the trial judge could conclude that all of the parties to this litigation were involved in "skimming cash" from the taxi business. The trial judge did not use the evidence of A's business practices as positive evidence that he engaged in cash-skimming from the taxi business. With respect to the similar fact evidence issue, the common law is clear that evidence of a civil litigant's character is not admissible to prove how he acted on a given occasion. Even if relevant, its probative value would be outweighed by the counterbalancing factors of confusion of issues and undue consumption of trial time. Equally clear is that evidence of bad character may amount to similar fact evidence which is admissible. The trial judge did not use the evidence of A's business practices as positive evidence that he engaged in cash-skimming from the taxi business. The reasons for the judgment reveal that the trial judge mentioned A's business practices in the context of commenting on the credibility of the plaintiff's claim that they did not skim cash from the taxi business. It was open to the trial judge to use evidence of "bad character" for that purpose. Trial judge was not wrong in applying the principle of ex turpi causa in this case.

## Table of Authorities

**Cases considered by *Chiasson J.A.*:**

*Belvoir Finance Co. v. Stapleton* (1970), [1971] 1 Q.B. 210 (Eng. C.A.) — considered

*Bowmakers v. Barnet Instruments Ltd.* (1944), [1945] 1 K.B. 65, [1944] 2 All E.R. 579 (Eng. K.B.) — considered

*Brazier v. Columbia Fishing Resort Group Corp.* (1997), 1997 CarswellBC 1000, 33 B.C.L.R. (3d) 293 (B.C. S.C.) — considered

*British Columbia v. Zastowny* (2008), 2008 CarswellBC 214, 2008 CarswellBC 215, (sub nom. *Zastowny v. MacDougall)* 290 D.L.R. (4th) 219, [2008] 1 S.C.R. 27, 53 C.C.L.T. (3d) 161, (sub nom. *X v. R.D.M.)* 250 B.C.A.C. 3, 2008 SCC 4, [2008] 4 W.W.R. 381, 76 B.C.L.R. (4th) 1, (sub nom. *X. v. R.D.M.)* 370 N.R. 365, (sub nom. *X v. R.D.M.)* 416 W.A.C. 3 (S.C.C.) — referred to

*Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.* (1983), [1983] 1 S.C.R. 452, 145 D.L.R. (3d) 385, 47 N.R. 191, [1983] 6 W.W.R. 385, 21 B.L.R. 254, 24 C.C.L.T. 111, 72 C.P.R. (2d) 1, 1983 CarswellBC 734, 1983 CarswellBC 812 (S.C.C.) — referred to

*David Cooper Investments Ltd. v. Bermuda Tavern Ltd.* (2001), 56 O.R. (3d) 243, 2001 CarswellOnt 3784, 151 O.A.C. 378, 45 R.P.R. (3d) 175 (Ont. C.A.) — referred to

*Foss v. Harbottle* (1843), 67 E.R. 189, 2 Hare 461 (Eng. V.-C.) — referred to

*Hall v. Hebert* (1993), [1993] 4 W.W.R. 113, 152 N.R. 321, 15 C.C.L.T. (2d) 93, 101 D.L.R. (4th) 129, 45 M.V.R. (2d) 1, [1993] 2 S.C.R. 159, 26 B.C.A.C. 161, 44 W.A.C. 161, 78 B.C.L.R. (2d) 113, 1993 CarswellBC 92, 1993 CarswellBC 1260 (S.C.C.) — referred to

*Iannone v. Hoogenraad* (1992), 66 B.C.L.R. (2d) 106, 1992 CarswellBC 94 (B.C. C.A.) — considered

*Miller v. Decker* (1955), 1955 CarswellBC 79, 16 W.W.R. 97, [1955] 4 D.L.R. 92 (B.C. C.A.) — referred to

*R. v. Arp* (1998), 232 N.R. 317, [1999] 5 W.W.R. 545, [1998] 3 S.C.R. 339, 58 B.C.L.R. (3d) 18, 1998 CarswellBC 2545, 1998 CarswellBC 2546, 114 B.C.A.C. 1, 186 W.A.C. 1, 20 C.R. (5th) 1, 166 D.L.R. (4th) 296, 129 C.C.C. (3d) 321 (S.C.C.) — considered

*R. v. B. (C.R.)* (1990), [1990] 3 W.W.R. 385, 109 A.R. 81, 73 Alta. L.R. (2d) 1, 55 C.C.C. (3d) 1, 76 C.R. (3d) 1, [1990] 1 S.C.R. 717, 107 N.R. 241, 1990 CarswellAlta 35, 1990 CarswellAlta 650 (S.C.C.) — considered

*R. v. Handy* (2002), 1 C.R. (6th) 203, 2002 SCC 56, 2002 CarswellOnt 1968, 2002 CarswellOnt 1969, 290 N.R. 1, 164 C.C.C. (3d) 481, 213 D.L.R. (4th) 385, 61 O.R. (3d) 415 (note), 160 O.A.C. 201, [2002] 2 S.C.R. 908 (S.C.C.) — considered

*R. v. Shearing* (2002), 2002 CarswellBC 1661, 2002 CarswellBC 1662, 2002 SCC 58, 290 N.R. 225, 2 B.C.L.R. (4th) 201, 165 C.C.C. (3d) 225, 214 D.L.R. (4th) 215, [2002] 8 W.W.R. 395, 2 C.R. (6th) 213, [2002] 3 S.C.R. 33, 168 B.C.A.C. 161, 275 W.A.C. 161 (S.C.C.) — considered

*Randhawa v. 420413 B.C. Ltd.* (2006), 25 B.L.R. (4th) 82, 2006 CarswellBC 2804, 2006 BCSC 1701 (B.C. S.C.) — referred to

*Rodaro v. Royal Bank* (2002), 49 R.P.R. (3d) 227, 157 O.A.C. 203, 22 B.L.R. (3d) 274, 59 O.R. (3d) 74, 2002 CarswellOnt 1047 (Ont. C.A.) — considered

*Tribe v. Soiseth* (2006), 2006 BCSC 652, 2006 CarswellBC 1005, 44 R.P.R. (4th) 176, 26 R.F.L. (6th) 28 (B.C. S.C.) — considered

*Walker v. Blades* (2007), 58 R.P.R. (4th) 163, 405 W.A.C. 284, 285 D.L.R. (4th) 35, 2007 CarswellBC 2020, 2007 BCCA 436, 70 B.C.L.R. (4th) 226, 245 B.C.A.C. 284 (B.C. C.A.) — considered

**Cases considered by *Ryan J.A.*:**

*MacDonald v. Canada Kelp Co.* (1973), [1973] 5 W.W.R. 689, 1973 CarswellBC 156, 39 D.L.R. (3d) 617 (B.C. C.A.) — referred to

*R. v. G. (S.G.)* (1997), [1997] 2 S.C.R. 716, 8 C.R. (5th) 198, 148 D.L.R. (4th) 423, 214 N.R. 161, 116 C.C.C. (3d) 193, 94 B.C.A.C. 81, 152 W.A.C. 81, 1997 CarswellBC 1292, 1997 CarswellBC 1293, [1997] 7 W.W.R. 629 (S.C.C.) — considered

*R. v. Hogan* (1982), 2 C.C.C. (3d) 557, 1982 CarswellOnt 1238 (Ont. C.A.) — considered

*Statton v. Johnson* (1999), 1999 CarswellBC 545, (sub nom. *Johnston v. Bugera*) 172 D.L.R. (4th) 535, 41 M.V.R. (3d) 21, 120 B.C.A.C. 91, 196 W.A.C. 91, 64 B.C.L.R. (3d) 52, 1999 BCCA 170 (B.C. C.A.) — referred to

**Statutes considered by *Ryan J.A.*:**

*Company Act*, R.S.B.C. 1996, c. 62
Generally — referred to

APPEAL by plaintiffs from judgment reported at *Randhawa v. 420413 B.C. Ltd.* (2007), 2007 BCSC 1507, 2007 CarswellBC 2411 (B.C. S.C.), dismissing action against defendants.

***Chiasson J.A.*:**

**Introduction**

1 The trial judge found that the appellants and the personal respondents "shared an elastic concept of the truth". She described the trial as "a perjurers' paradise" and concluded the parties engaged in a fraudulent scheme to avoid paying income tax by taking unreported cash income from their taxi business. Her reasons are indexed at 2007 BCSC 1507 (B.C. S.C.).

2 This appeal concerns the ability of a trial judge to reach a determination of the likely conduct of parties that does not accord with their direct evidence or positions advanced at trial, the application of the doctrine of *ex turpi causa non oritur actio* and the use of similar fact evidence.

**Background**

3 In July 1993, Mrs. Randhawa purchased 20% of the shares of 420413 B.C. Ltd. (the "Parent Company"), which owns the other corporate parties, one of which, Central Valley Taxi Ltd. ("CVT"), is of particular relevance in this appeal. Although the shares were purchased in the name of Mrs. Randhawa, she was not involved directly in the operation of the business. Her husband, Mr. Randhawa, participated in the affairs of the Parent Company on her behalf. Unless it is essential to refer to an appellant by name, I shall refer to them collectively recognizing that for the most part Mr. Randhawa was the active party.

4 In 1994, the individual defendants, other than Simerdeep Sumra, collectively referred to as the "Kang Group", each acquired 20% of the shares of the Parent Company. Simerdeep is the son of the respondent Avtar Sumra and the nephew of the respondent Rajinder Kang. Simerdeep was the manager of CVT.

5 The litigation began in 2003 when Mrs. Randhawa filed a petition alleging oppression and asserting that between 1994 and 2004 the Kang Group improperly and secretively diverted to themselves income from the taxi business. The claim was compromised by a June 2004 consent order that, *inter alia*, provided for the delivery of a statement of claim to deal with outstanding issues between the parties. This led to the proceeding and decision under appeal. Mr. Randhawa was added as a third party to the proceeding. For convenience I shall refer to him as if he were a plaintiff.

6 The Kang Group admitted it took cash from the taxi business between 1994 and 2002, but asserted the appellants acted in concert with them and shared equally in the money. The judge stated the issue relevant to this appeal as follows: "[d]id Mr. and Mrs. Randhawa take unrecorded cash up to the end of 2002 as did the defendant directors?"

7 The trial judge stated at para. 241 she was "satisfied that, from 1994 until at least 2000, Mr. Randhawa initiated and actively participated in the distribution of unrecorded cash from the CVT taxi drivers". She concluded there was a falling-out among the parties and the most likely scenario was that the appellants ceased to participate in the scheme and the Kang Group continued with it. She held that at some point after 2000 the Kang Group continued to take money from CVT without the appellants' knowledge or participation but, applying the doctrine of *ex turpi causa non oritur actio*, the judge refused to award damages to the appellants.

**Positions of the parties**

8 The appellants advance two grounds of appeal; the judge erred:

1. in finding the appellants took cash in the absence of any evidence supporting such a conclusion;

2. by applying the doctrine of *ex turpi causa* to deny compensation.

9 In their factum, the appellants seek the following relief:

> If ground of appeal #1 is accepted then this Court should grant judgment in accordance with the evidence of the Randhawas' expert, Ronald Parks, in the amount of $646,339 (one-fifth of $3,231,698). Alternatively, if this Court allows ground of appeal #2 then this Court should allow judgment in the amount of $197,339 (one-fifth of the funds taken in the years after 2000, according to Parks). It is respectfully submitted that this Court should grant interest, plus costs in both Courts. Alternatively, if this Court is unable to determine the correct amount payable, then this Court should grant judgment in favour of Jasvir Randhawa, but remit the question of amount to the Supreme Court for determination, pursuant to paragraph 2 of the Notice of Appeal. In either event, the matter should be remitted to the Supreme Court for a determination of the amount of compensation that Jasvir is entitled to for the reduction in the value of her shares as a result of the defendants' wrongful acts.

10 The respondents identify the issues on appeal as:

1. was there evidence to support the trial judge's findings of fact;

2. can the appellants now argue a position different from that taken at trial; and

3. did the judge err applying the doctrine of *ex turpi causa*?

**Discussion**

11 I shall address the trial judgment in the context of the issues advanced by the parties.

***Preliminary observation***

12 The appellants seek a remission of this case to the Supreme Court "for a determination of the amount of compensation that [Mrs. Randhawa] is entitled to for the reduction in the value of her shares as a result of the [respondents'] wrongful acts". This relief is sought in addition to the recovery of 20% of the cash diverted from the company.

13 In their factum, the appellants observe there has been no reconciliation of the cash paid to them versus that which the Kang Group took and state:

> This is despite the trial judge's statement in her (pre-trial) reasons for judgment dismissing [the] appeal of the valuation that: 'If Ms. Randhawa is successful at the trial of the money skimming issue, she will then be entitled to compensation for any reduction in the value of her shares as a result of the respondents' wrongful acts.'

The quoted sentence is said to support the requested determination of the diminution in the value of Mrs. Randhawa's shares.

14 Having looked at the judge's reasons concerning the valuation appeal, which are indexed at 2006 BCSC 1701 (B.C. S.C.), in my view the appellants have taken the judge's comments out of context.

15 On June 15, 2004, the parties entered into a consent order that provided, *inter alia*, for an evaluation of the Parent Company as of December 31, 2004 to permit the purchase and sale of Mrs. Randhawa's shares. It was noted cash had been diverted for many years. On the appeal of the valuation, the appellants sought to introduce new evidence to show cash continued to be diverted after 2004. The trial judge observed that the question of cash diversion expressly was not addressed by the Special Referee by agreement of the parties. In paras. 20- 21 of her reasons in the valuation appeal, the judge stated:

> [20] ...Counsel agreed that Mr. Shultz was directed specifically not to consider that issue. Mr. Shultz confirmed that fact in his Certificate and noted that counsel had been meticulous in avoiding any reference to allegations relating to the oppressions issues. As a result, Mr. Shultz was not concerned with the amounts of cash taken without being recorded in the financial statements. Until the oppression action is tried, it is not known whether the wrongdoers included the petitioner and third party, or how much money was improperly removed and not recorded. It follows that the petitioner, who may or may not be found to be one of the wrongdoers, cannot at this stage be compensated on the basis that the respondents have admitted wrongdoing. If Ms. Randhawa is successful at the trial of the money skimming issue, she will then be entitled to compensation for any reduction in the value of her shares as a result of the respondents' wrongful acts.
>
> [21] It follows that, because Mr. Shultz properly refused to consider evidence of wrongdoing by CVT, the petitioner's application to adduce new evidence must be dismissed.

16 On the view I take of this case, it is not necessary for me to address this relief claimed by the appellants, but compensation for the reduction in the value of their shares by the conduct of their co-shareholders would appear to be counter to the rule in *Foss v. Harbottle* (1843), 2 Hare 461, 67 E.R. 189 (Eng. V.-C.): for a wrong to the company only the company can claim. If the company were made whole, Mrs. Randhawa's shares would be returned to their appropriate value. The usual proceeding for the recovery of the diminution in shared value is a derivative action, which was not the proceeding brought in this case.

17 Looked at in context, in my view, the judge's comments merely reflected the fact that if the appellants were successful in their cash diversion claim and recovered a 20% share of the cash, it would have the effect of compensating Mrs. Randhawa for the diminution in the value of her shares.

*Absence of evidence*

18 The appellants' first two points under this heading are that the judge improperly developed a fourth scenario and there was no evidence that was both probative and credible that the appellants took cash from the taxi business. The first point raises the issue of the extent to which a trial judge can reach a determination of the likely conduct of parties that does not accord with their direct evidence or positions advanced at trial.

19 There is a certain logical inconsistency in the appellants' position because while they reject the so-called fourth scenario, it is that view of the facts that potentially provided some recovery to them and which alternatively they pursue on appeal.

20 The respondents state that at trial both sides took an "all-or-nothing" position. In their reply factum, the appellants assert they did not take that position, but in oral argument counsel for the appellants said that the judge was urged to prefer one side or the other; no middle ground was offered. Each side presented its case on the basis it was correct and the other side was wrong: the appellants stated they did not participate in the scheme; the respondents contended the appellants participated fully. The trial judge rejected both positions.

21 The judge recapitulated three factual scenarios advanced by counsel for the respondents:

> 1. the respondents decided to split unrecorded cash income from the outset and to deprive the appellants of their share;
>
> 2. the respondents did not take cash until 2000 when the relationship between the parties deteriorated and they did so to the detriment of the appellants;
>
> 3. all five owners were involved from the beginning.

22 The first scenario made no sense based on the early relationship between the parties. The second was not espoused by either side. The third was the position of the respondents. The judge articulated a fourth scenario stating:

> [255] The last scenario is of course the defendants' theory but the question remains: why did Mr. Randhawa blow the whistle? In my view, a fourth 'scenario' — that Mr. Randhawa was involved from the beginning but ceased to participate in the skimming scam at some point and the defendants carried on without his knowledge — makes the most sense. It is likely that when he bragged to Mrs. Buttar that he had stopped Mr. Kang's payments, she responded that the defendants were still taking cash.

23 The appellants contend the judge erred in law in concluding that the fourth scenario "makes the most sense". They state the scenario was not based on evidence, but was conjecture by the trial judge. They rely on this Court's decision in *Walker v. Blades*, 2007 BCCA 436, 285 D.L.R. (4th) 35 (B.C. C.A.), and on *Rodaro v. Royal Bank* (2002), 59 O.R. (3d) 74, [2002] O.J. No. 1365 (Ont. C.A.).

24 In *Walker*, the trial judge found in favour of the appellant on all the contested issues, but dismissed the action for specific performance on the basis of a repudiation in relation to an uncontested matter. This Court allowed the appeal on the basis the trial judge erred in relying on an uncontroversial aspect to dismiss the claim.

25 The analysis in *Rodaro* was more detailed. The Court stated:

> [58] The lost opportunity analysis adopted by Spence J. was theoretically sound. I am satisfied, however, that it could not be applied in this case. First, it was never pleaded or otherwise raised by Mr. Rodaro at any stage of the lengthy proceedings. Second, there was no evidence that the disclosure of the confidential information by RBC to Barbican caused Mr. Rodaro to lose the opportunity described by Spence J. To the contrary, to the extent that the evidence speaks to the loss of the opportunity at all, it demonstrates that Mr. Rodaro "lost" the opportunity to negotiate with Barbican for reasons that had nothing to do with the disclosure of the information to Barbican.
>
> [59] Mr. Rodaro did not plead that RBC's improper disclosure to Barbican deprived him of the opportunity to negotiate a "package deal" involving the sale of the debt and his equity in the project. At no time during the months of trial or the course of lengthy argument did Mr. Rodaro suggest that the improper disclosure had caused him to lose the opportunity described by Spence J. That theory appeared for the first time in the reasons of Spence J.
>
> [60] It is fundamental to the litigation process that lawsuits be decided within the boundaries of the pleadings. As Labrosse J.A. said in *460635 Ontario Limited v. 1002953 Ontario Inc.*, [1999] O.J. No. 4071at para. 9 (C.A.) (QL):

> ... The parties to a legal suit are entitled to have a resolution of their differences on the basis of the issues joined in the pleadings. A finding of liability and resulting damages against the defendant on a basis that was not pleaded in the statement of claim cannot stand. It deprives the defendant of the opportunity to address that issue in the evidence at trial....
>
> [61] By stepping outside of the pleadings and the case as developed by the parties to find liability, Spence J. denied RBC and Barbican the right to know the case they had to meet and the right to a fair opportunity to meet that case. The injection of a novel theory of liability into the case via the reasons for judgment was fundamentally unfair to RBC and Barbican.

26 These cases illustrate the proposition that a trial judge should not decide a case on a legal theory not advanced by a party or make findings of fact not based on evidence. They do not erode the right and obligation of trial judges to consider all of the evidence and to reject or accept all or part of it. Inherent in this right and obligation is the possibility that factual scenarios presented by parties will be accepted or rejected in whole or in part.

27 With this background, I turn to the pleadings in this case and to what the judge had to say concerning the so-called fourth scenario.

28 In the statement of claim, the appellants alleged the respondents improperly and secretly diverted income from CVT to themselves and failed to record the diverted income on the books of CVT from September 1994 to 2004. The appellants stated they did not know how much money had been diverted. They sought an accounting of the diverted money, disgorgement of 20% thereof and claimed compensation for the loss of the diverted money. The claim was based on the relationship between the parties as shareholders and the position of the respondents as corporate directors.

29 In their statement of defence, the respondents admitted they took cash from CVT between 1994 and 2004, but stated this was done on the advice and direction of the appellants.

30 As noted, the consent order that resulted in the statement of claim provided for a trial for "the reconciliation of any cash paid to the [appellants] and the [respondents] from the proceeds of [CVT]". The appellants contended they received nothing; the respondents asserted the appellants received 20% of all diverted cash.

31 In my view, the question of who received what over the 10 year period in issue clearly was joined on the pleadings.

32 At trial, the appellants contended the fact they went to CVT to look at the company's books, hired a lawyer, confronted the respondents and sued was "proof that they were not part of the cash skimming scheme". The judge commented in para. 241:

> [241] ... In other circumstances, the logical inference would be that the Randhawas must not have been involved. However, in this case, it would be unsafe to draw such an inference because the whole body of evidence is so riddled with lies that it is difficult to detect any thread of truth in the version of events given by either side. Nevertheless, I am satisfied that, from 1994 until at least 2000, Mr. Randhawa initiated and actively participated in the distribution of unrecorded cash from the CVT taxi drivers.

33 Having concluded the appellants received unrecorded cash to the year 2000, which, of course, they denied, the judge completed the analysis of their claim to the year 2004.

34 Although she considered Mr. Randhawa in many respects not to be a credible witness, she accepted his evidence that he attended no meetings of the owners at CVT's offices after a heated meeting on January 4, 2000. She stated at para. 242, "[h]is absence after this date accords with the evidence of Ms. Sapinsky, one of the few lay witnesses whose evidence I accept completely".

35 The judge rejected Mr. Randhawa's evidence he was never involved in sharing the unrecorded cash, but stated at para. 248, "the [respondents] clearly sought to exaggerate the length of that involvement".

36 It was the judge's view that "[b]y all accounts, the relationship between all of the owners was excellent until ... 2000" when a simmering dispute "came to a head". She observed that "[t]he evidence is overwhelming that Mr. Randhawa and Mr. Kang were fast friends until that time ...." She found that until 2000 "the business expanded and Mr. Randhawa was actively engaged in the company" (at paras. 246-247).

37 Based on "largely uncontradicted evidence" the judge concluded "[t]here is no question that by October 2002, things had gone very wrong". She referred to a meeting between the appellants and the wife of Mr. Kang and to evidence that in response to Mr. Randhawa stopping unrelated payments to Mr. Kang, the wife stated "[y]ou may have stopped that one, but the other owners and Sim are taking money out of the company - $1,000 per week for years. So stop that if you can" (at paras. 249-251).

38 The judge considered and weighed this evidence carefully and stated it "would explain the timing and motive for Mr. Randhawa to go to CVT to examine the company's books and confront the [respondents]...". It was her view, "[i]t is likely that when [Mr. Randhawa] bragged ... that he had stopped Mr. Kang's payments, [the wife] responded that the [respondents] were still taking cash" (at para. 255).

39 In paras. 220 - 221, the judge observed:

> [220] It is trite to say that a trier of fact, whether judge or jury, may believe all of a witness's testimony, some of it, or none of it. It is not necessary for the Court to accept any witness's evidence merely because it has not been contradicted.
>
> [221] In general, it is rare for a witness to be caught in a clumsy lie. However, in this case, virtually all of the parties impeached themselves, the defendants on the circumstances surrounding Mr. Randhawa taking cash, and Mr. Randhawa on numerous other issues. Collectively, they shared an elastic concept of the truth.

40 She noted "the finding that all of the parties were untruthful does not resolve the core issue ..." and stated in para. 223:

> [223] Where does the truth lie? With respect to the parties, I have no hesitation in finding that all of them told the truth when it suited them and lied when it suited them. All of them demonstrated significant indicia of prevarication during their testimony.

41 In para. 227, the judge stated she found Simerdeep Sumra "generally truthful on many issues" and in para. 242 found that "Mr. Randhawa instructed Simerdeep to withhold cash and not record that fact or the amounts".

42 In para. 236, the judge stated:

> [236] The defendants assert that they, together with Mr. Randhawa, skimmed unreported cash between 1994 and 2002, and indeed, that he was the architect of that scheme. Mr. Randhawa adamantly denies that accusation. Mr. Sullivan submits that the court must accept one version or the other. I do not agree. I have no hesitation in concluding that the truth lies beyond the testimony of any one of the witnesses. Only the owners themselves know what actually happened. As I have indicated, I did not find any of the parties to be credible witnesses. It would be artificial and unreasonable to accept either side's version simply because no one testified to an alternative scenario.

I consider this comment to be correct in the somewhat unusual circumstances of this case.

43 In para. 257, the judge found as a fact that "[a]t some point after 2000, the [respondents] continued to take cash from CVT without [the appellants'] knowledge or participation". That conclusion was supported by evidence. It was consistent with the respondents' admission they took cash through to 2002, consistent with the judge's finding of fact the appellants participated at least to 2000 and consistent with the appellants' denial they received cash. It was based on the judge's acceptance and rejection of evidence and her effort to ascertain the truth that lay "beyond the testimony...of the witnesses".

44 The respondents assert that having found the appellants initiated and participated in the cash diversion scheme, it was unnecessary for the judge to consider the fourth scenario. This ignores the appellants' claim to recover the portion of the cash

that was not shared with them through to 2004 and ignores the judge's finding of fact that the respondents "clearly sought to exaggerate the length of [the appellants'] involvement".

45 In my view, the judge did not step "outside of the pleadings and the case as developed by the parties to find liability". In the circumstances of this case, the judge was entitled to reach a determination of the likely conduct of the parties that did not accord with their direct evidence or positions advanced by them at trial.

46 I would not accede to the appellants' contention the judge erred in her consideration of the so-called fourth scenario.

47 The appellants contend there was no evidence that was probative and accepted as credible to support the judge's conclusion the appellants participated in the cash diversion scheme. They refer to six examples of testimony. In my view, apart from the reference to similar fact evidence which I next shall address, these merely identify conflicting testimony that the judge was entitled and obliged to consider and weigh, which she did.

48 Of more significance is the appellants' contention the judge impermissibly drew a prohibited inference from similar fact evidence. They assert the judge's reference to such evidence resulted in "moral" and "reasoning" prejudice and that she transgressed the admonition not to follow a "forbidden chain of reasoning ... to infer guilt from general disposition or propensity".

49 In *R. v. Handy*, 2002 SCC 56, [2002] 2 S.C.R. 908 (S.C.C.), Mr. Justice Binnie had this to say about similar fact evidence in paras. 27- 28:

> [27] The contest over the admissibility of similar fact evidence is all about inferences, i.e., when do they arise? What are they intended to prove? By what process of reasoning do they prove it? How strong is the proof they provide? When are they so unfair as to be excluded on the grounds of judicial policy and the presumption of innocence? The answers to these questions have proven so controversial as to create what Lord Hailsham described as a "pitted battlefield": *Director of Public Prosecutions v. Boardman*, [1975] A.C. 421 (H.L.), at p. 445.
>
> [28] There is more consensus on the nature of the problems than there is on the correctness of the solutions...

50 He dispelled the notion there is a distinction between evidence of propensity and evidence of scheme, system or plan, stating in paras. 59 and 90:

> [59] It is occasionally suggested that once the similar fact evidence is related to an issue other than "mere" propensity or "general" disposition, it somehow ceases to be propensity evidence. I do not think this is true.
>
> . . . . .
>
> [90] ... Similar fact evidence is sometimes said to demonstrate a "system" or "*modus operandi*", but in essence the idea of "*modus operandi*" or "system" is simply the observed pattern of propensity operating in a closely defined and circumscribed context.

51 Referring to *R. v. B. (C.R.)*, [1990] 1 S.C.R. 717 (S.C.C.), Binnie J. observed in para. 50:

> [50] Although evidence relating solely to the accused's disposition will generally be excluded, exceptions to this rule will arise when the probative value of the evidence outweighs its prejudicial effect (at pp. 734-35):
>
> > This review of the jurisprudence leads me to the following conclusions as to the law of similar fact evidence as it now stands in Canada. The analysis of whether the evidence in question is admissible must begin with the recognition of the general exclusionary rule against evidence going merely to disposition. . . . [E]vidence which is adduced solely to show that the accused is the sort of person likely to have committed an offence is, as a rule, inadmissible. Whether the evidence in question constitutes an exception to this general rule depends on whether the probative value of the proposed evidence outweighs its prejudicial effect.

[Emphasis in original.]

52 He observed in para. 91:

> [91] References to "calling cards" or "signatures" or "hallmarks" or "fingerprints" similarly describe propensity at the admissible end of the spectrum precisely because the pattern of circumstances in which an accused is disposed to act in a certain way are so clearly linked to the offence charged that the possibility of mere coincidence, or mistaken identity or a mistake in the character of the act, is so slight as to justify consideration of the similar fact evidence by the trier of fact. The issue at that stage is no longer "pure" propensity or "general disposition" but repeated conduct in a particular and highly specific type of situation. At that point, the evidence of similar facts provides a compelling inference that may fill a remaining gap in the jigsaw puzzle of proof, depending on the view ultimately taken (in this case) by the jury.

53 In para. 63, Binnie J. referred to *R. v. Arp*, [1998] 3 S.C.R. 339, 129 C.C.C. (3d) 321 (S.C.C.), noting that Cory J. "rested admissibility on the improbability of coincidence". Cory J. stated in para. 45:

> ...a principled approach to the admission of similar fact evidence will in all cases rest on the finding that the accused's involvement in the alleged similar acts or counts is unlikely to be the product of coincidence. This conclusion ensures that the evidence has sufficient probative force to be admitted, and will involve different considerations in different contexts.

He also observed in para. 48: "...where similar fact evidence is adduced to prove a fact in issue, in order to be admissible, the trial judge should evaluate the degree of similarity of the alleged acts and decide whether the objective improbability of coincidence has been established".

54 The point was elucidated further by Binnie J. in *R. v. Shearing*, 2002 SCC 58, [2002] 3 S.C.R. 33 (S.C.C.):

> [48] The cogency of the similar fact evidence in this case is said to arise from the repetitive and predictable nature of the appellant's conduct in closely defined circumstances. There must therefore be shown a persuasive degree of connection between the similar fact evidence and the offence charged in order to be *capable* of raising the double inferences. The degree of required similarity is assessed in relation to the issue sought to be established and must be evaluated in relation to the other evidence in the case. If the cumulative result is simply to paint the appellant as a "bad person", it is inadmissible. [Emphasis in original.]

55 It is important that the evidence be linked to a live issue in the case in order to avoid the danger of using the evidence merely to show a general propensity. As Binnie J. stated at para. 73 of *Handy*:

> [73] The requirement to identify the material issue "in question" (i.e., the purpose for which the similar fact evidence is proffered) does not detract from the probative value/prejudice balance, but is in fact essential to it. Probative value cannot be assessed in the abstract. The utility of the evidence lies precisely in its ability to advance or refute a live issue pending before the trier of fact.

56 A useful comment of the correct approach to similar fact evidence was provided by Mr. Justice Rosenberg in Law Society of Upper Canada, *Special Lectures 2003: The Law of Evidence*, (Toronto: Irwin Law, 2004) at 401. He stated:

> While propensity underlies the probative value of true similar fact evidence, the breaking point between general propensity and specific propensity is most easily understood as depending upon the objective improbability of coincidence. This in turn depends upon the circumstances of the particular case and the critical features of nexus or connectedness.

57 In this case, there was considerable evidence adduced concerning activities not related directly to the cash diversion scheme in issue. They were addressed by the judge under the heading "The Randhawas' personal and business affairs - a pattern of dishonesty and failing to disclose revenue".

  

58 It was not entirely clear on what basis the evidence was admitted. There was objection to some of it, but not all. The appellants' concern is the use the judge made of the evidence and her conclusion in para. 219, "[i]n my opinion, the [appellants'] conduct marks them as people who have established a pattern of failing to report income to the CRA". The judge continued:

> [219] ... They do this in part by concealing cash payments. Further, I do not believe that Mr. Randhawa, a man of education and business experience, but intimately familiar with the methods of avoiding the reporting of income tax, would make such a large investment in CVT, and continue to make loans in the order of half a million dollars if he were not involved in the scheme to improperly share CVT's unrecorded revenue. On the basis of my observations of him in Court, I do not believe that he would refrain from being actively involved in the management of the company, or that he would defer to the other owners, some of whom he considered illiterate, or that he would not be concerned that CVT apparently never made any income.

59 The appellants denied they participated in the cash diversion scheme. There was evidence Mr. Randhawa told the respondents he operated the same system in his trucking business and had not been caught, to support using the system for the taxi business. He denied this. Considerable evidence was led concerning his operation of the trucking business. The judge accepted the respondents' evidence "Mr. Randhawa bragged that he cheated the CRA in his own trucking business and that they need not worry that they would be caught taking cash ...." (at para. 245).

60 In my view, the judge did not err in her use of the similar fact evidence. In part, it related to Mr. Randhawa's denial he bragged about cash diversion in his trucking business. It bore on the issue of whether the appellants initiated the scheme. The question was not one of general propensity. It was: did they have a propensity of failing to report income? The judge was obliged to decide whether the appellants participated in the scheme. The fact they had a pattern of concealing cash payments was relevant to that inquiry.

61 The trial judge was faced with a daunting task as is apparent from her comments in paras. 238 - 240:

> [238] Considering all of the evidence, both oral and documentary, I conclude that Mr. Randhawa was involved in the skimming scheme for many years but at some point, most likely as a result of the Aldergrove Conversion Centre dispute, Mr. Randhawa fell out with the others. After that, it is likely that the defendants did indeed cut Mr. Randhawa out of the illegal profits, thus incurring Mr. Randhawa's wrath and threats to expose them to Revenue Canada if they did not restore his share of the unreported cash. Clearly Mr. Randhawa had a motive to deny his initial involvement as an admission of any illegal conduct on his part would invoke the doctrine of *ex turpi causa*. The defendants, on the other hand, had a motive to exaggerate the duration of Mr. Randhawa's involvement.
>
> [239] At the end of the day, there will always be unanswered questions: If Mr. Randhawa was not taking cash, why would he keep loaning money to a company that apparently never ever made money and refrain from looking at the monthly financial statements of CVT that Mr. Kowalski prepared? At the time of the Schultz hearing, the Randhawas' shareholders loans were half a million dollars. Mr. Randhawa is a shrewd businessman who would not make such a large investment over such a long period in an unprofitable business. He is also a "detail man" with a "hands on" personality who would never leave the management of CVT to the Kang Group and Simerdeep, none of whom had any experience at all in the taxi business - or indeed in any business. How would the defendants know how to successfully skim cash from the taxi receipts and manage to hide that fact from Mr. Randhawa for nine years? Why would the Kang Group exclude Mr. Randhawa from the business opportunity to which he had introduced them?
>
> [240] On the other hand, if Mr. Randhawa was taking cash, why would he make a loan of $5,000 to CVT in September 2002 at a time when the defendants say they were withholding his cash? Why would he commence this action, effectively "blowing the whistle" on the goose that had laid so many golden eggs?

62 The similar fact evidence provided a "compelling inference that [filled] a remaining gap in the jigsaw puzzle of proof". The evidence was used to address a "live issue pending before the trier of fact" (*Handy* at paras. 91, 73).

63 The judge did not end her analysis with her finding of propensity. In my view, her approach was consonant with the observation of Cory J. in para. 72 of Arp:

> Similar fact evidence...circumstantial evidence...by its nature...does not carry the potential to be conclusive of guilt. It is just one item of evidence to be considered as part of the Crown's overall case. Its probative value lies in its ability to support, through the improbability of coincidence, other inculpatory evidence.

64 Her conclusion the appellants initiated and participated in the scheme was based on her disbelief of the appellants and on her acceptance of direct and indirect evidence that supported the conclusion. She made it very clear her task was to endeavour to ascertain the truth despite the unreliability of the evidence of the parties. To do so she looked at the evidence overall, accepting some parts and rejecting others.

65 In my view, the judge did not impermissibly use the similar fact evidence. I would not accede to the appellants' contention she did so.

***Ex turpi causa non oritur actio***

66 The *ex turpi causa* doctrine prevents a party from benefiting from illegal or immoral conduct (*Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, [1983] 1 S.C.R. 452 (S.C.C.)). It applies in contract and in tort to maintain the internal consistency of the law (*Hall v. Hebert*, [1993] 2 S.C.R. 159 (S.C.C.), at 185). The justification for the rule is the preservation of the integrity of the legal system; it should be applied sparingly (*British Columbia v. Zastowny*, 2008 SCC 4, [2008] 1 S.C.R. 27 (S.C.C.) at para. 20).

67 The appellants note that *ex turpi causa* was neither pleaded nor argued. They state the judge misapplied the doctrine because she applied it "without considering its doctrinal or public policy underpinnings, and without the benefit of argument from counsel".

68 In my view, it is not necessary to plead the doctrine. It is a question of law. It is necessary to plead the material facts to support the application of the doctrine. In this case that was done (*Miller v. Decker*, [1955] 4 D.L.R. 92 (B.C. C.A.) at paras. 18-19; *David Cooper Investments Ltd. v. Bermuda Tavern Ltd.* (2001), 56 O.R. (3d) 243 (Ont. C.A.) at para. 44) [1].

69 It would have been preferable for the judge to have asked for submissions on the application of the doctrine in this case, but in this Court the parties fully addressed the issue.

70 The appellants contend *ex turpi causa* does not apply because, based on the judge's finding of fact, they did not participate in the illegal scheme for a period between 2002 and 2004 and were entitled to one-fifth of the assets of CVT which were distributed during that period.

71 Although I would not limit the application of the doctrine as narrowly as espoused by the appellants, the simple answer is that the money that was distributed was taken illegally from the company.

72 The focus of the parties appears to have been solely on the relationship between them. This may have resulted from the fact the action began as an oppression action: a shareholder contending other shareholders misappropriated company funds to her detriment. The fact is the scheme involved distributing unrecorded company revenue. The fact all shareholders initially were involved does not detract from the fact money that was the property of the company was diverted. The company did not see the money and the taxing authorities were not aware the money was the revenue of the company.

73 If the appellants were to receive 20% of the funds appropriated by the respondents after 2000, they would be receiving 20% of funds stolen from the company. This is apparent from the appellants' claim. They seek one-fifth of $3,231,698, which is an amount of the net unrecorded revenue of the Parent Company from 1994 to 2004 estimated by an expert (alternatively, they claim one-fifth of $197,339, which is an amount estimated by the same expert for the period after 2000).

74 The appellants assert that their claim is not based on illegality. They contend "[t]he doctrine of *ex turpi causa* does not go so far as to bar someone from the court's assistance just because of some past illegality in her life". It is their position that as a shareholder, Mrs. Randhawa is entitled to 20% of the distributed assets of the company. The appellants rely on a comment by the judge in para. 73 of her reasons: "the diversion of company funds to one or more shareholders to the exclusion of the other shareholders is oppressive and unfairly prejudicial to the excluded shareholder".

75 In my view, the position of the appellants is disingenuous. It disembowels the post-2000 payments from the scheme to defraud and treats them as merely an unequal distribution of company assets.

76 The post-2000 payments, like those made previously, were made in secrecy: unauthorized and unrecorded by the company with the purpose of unlawfully avoiding taxation. The scheme that gave rise to the payments was illegal. It was originated and participated in by the appellants. They did not participate for a period of time after 2000 and they now want to do so. The judge correctly refused to provide the assistance of the court to enable the appellants to participate in the illegal scheme.

77 The appellants rely on *Bowmakers v. Barnet Instruments Ltd.* (1944), [1945] 1 K.B. 65 (Eng. K.B.), and *Belvoir Finance Co. v. Stapleton* (1970), [1971] 1 Q.B. 210 (Eng. C.A.). Both cases concerned the conversion of a plaintiff's property which was acquired legally, although it was used for an illegal purpose. In those cases, the court did not permit the defendants to rely on *ex turpi causa* to defeat the plaintiff's ownership of the property even though the property had been put to an illegal use.

78 To like effect were *Tribe v. Soiseth*, 2006 BCSC 652, 26 R.F.L. (6th) 28 (B.C. S.C.), and *Brazier v. Columbia Fishing Resort Group Corp.* (1997), 33 B.C.L.R. (3d) 293 (B.C. S.C.). In *Tribe*, property was legally acquired by the plaintiff's parents who put the property in their daughter's name to avoid levies. The daughter's husband was not entitled to rely on "illegality" to deprive the parents of the property. In *Brazier*, the court found a mortgage valid despite the fact that it was part of an overall scheme to understate the value of the property to avoid levies.

79 In the present case, the money at issue was not the appellants' money. They seek 20% of cash diverted from the company in accordance with a scheme they initiated for an illegal purpose. They seek the assistance of the court to benefit from that illegal diversion.

80 Returning the question of the value of Mrs. Randhawa's shares, the appellants state in their factum "[t]he taking of cash by the [respondents] *without [the appellants'] participation* has unquestionably decreased the value of [Mrs. Randhawa's] shares" (emphasis added) and "[t]he trial judge's application of *ex turpi causa* has the effect of allowing the [respondents] to acquire her shares at an improperly low price...".

81 The appellants' position is that they are entitled to judgment for 20% of the cash diverted from 1994 to 2004. It was common ground that cash was diverted to 2000 and the judge concluded it was diverted for sometime thereafter. The diversion of cash depleted the assets of the company throughout the relevant period and presumably adversely affected the value of the company's shares. Any derivative action properly framed would seek the re-payment of all cash diverted, including the 20% to which the appellants say they were entitled.

82 In the circumstances of these parties, the doctrine of *ex turpi causa non oritur actio* has no effect on the value of Mrs. Randhawa's shares.

83 I would not accede to the appellants' contention the judge erred in applying the doctrine of *ex turpi causa non oritur actio*.

**Conclusion**

84 I would dismiss this appeal.

***Finch C.J.B.C.*:**

I agree.

*Ryan J.A.*:

85 I agree with my colleague Mr. Justice Chiasson that this appeal should be dismissed. My reasons rest on a slightly different foundation.

86 The judgment appealed in this Court brought to an end four years of litigation in which a number of hearings and orders were made. The history of the litigation is set out in paragraphs 10 - 22 of the reasons of Madam Justice Allan which may be found at 2007 BCSC 1507 (B.C. S.C.). My colleague has also set out a part of the history in his reasons, paras. 3 - 7 above.

87 The appellant, Mrs. Randhawa, is a shareholder and secretary of the defendant 420413 B.C. Ltd., referred to in the reasons of Madam Justice Allan as the Parent Company. Mr. Randhawa is her husband. He was joined in the proceedings as a third party. All but one of the personal respondents (Simerdeep Sumra), are directors of the Parent Company and directors of the other corporate defendants. Mrs. Randhawa is also a shareholder and director of the corporate defendants, Central Valley Taxi Ltd. ("CVT") and West Coast Limousines Incorporated, which in turn are wholly owned by the Parent Company. The Parent Company also owned shares in another numbered company which owned the Blue Boy Motor Hotel. The Blue Boy Motor Hotel owned the Quality Inn Airport Hotel and shares in a company that owned the Sea-Tac Travelodge and two Comfort Inns in Washington State.

88 As set out in Madam Justice Allan's reasons for judgment at para. 10, the litigation between the parties began as a petition in which Mrs. Randhawa alleged that "the affairs of the corporate respondents and the powers of the personal respondents were being [conducted] in a manner oppressive to her and that the corporate respondents had acted in a manner unfairly prejudicial to her." The trial judge referred to it as an oppression action under the provisions of the former *Company Act*. Subsequent to the filing of the petition, various consent orders were made between the parties with the object of resolving some of the issues between the parties and refining others for trial.

89 When the matter came to trial before Madam Justice Allan, the parties framed the issues to be these:

- Did Mr. and Mrs. Randhawa take unrecorded cash up to the end of 2002, as did the defendant directors?
- Did the defendants act to deprive Mrs. Randhawa of the full benefit of her share in the Blue Boy asset?

90 At the end of a 37-day trial, Madam Justice Allan reached the conclusion that she could not accept much or all of the evidence of any of the parties. She dismissed the claims relating to both issues litigated before her.

91 In the usual case if the trial judge disbelieves the plaintiff's evidence, that is the end of the matter; the plaintiff cannot succeed. As I understand this case, however, the defendants agreed early on that they had participated in a scheme to skim cash from the receipts of CVT, the taxi business. They took the position that this was not news to Mrs. Randhawa as her husband had also participated in the scheme on her behalf. The defendants said that it was Mrs. Randhawa's participation in the scheme that prevented her from pursuing her oppression action against them or the company.

92 In this Court, there was no argument directed to whether the oppression action was properly taken in the first place. For that reason, the reasons for judgment in this case should not be taken as an implicit approval of the way this lawsuit was prosecuted.

93 The appellants' grounds of appeal are that the learned trial judge erred:

1. By finding that Amrik Randhawa took cash in the absence of any evidence supporting such conclusion.
2. In applying the doctrine of *ex turpi causa* to deny compensation for Jasvit Randhawa.

94 As a sub-set of the first ground of appeal, the appellants submit that the trial judge erred in finding facts not postulated by any of the parties. I agree with my colleague that a trial judge is not limited to the theory of the plaintiff or of the defendant, but may make findings of fact reasonably supported by the evidence. In my view, there was evidence upon which the trial judge

 

could conclude that all of the parties to this litigation were involved in "skimming cash" from the taxi business. I too would not accede to that ground of appeal.

95 The appellants also launched an attack on the findings of the trial judge with respect to "similar fact" evidence. In the case at bar, the trial judge drew certain inferences from the evidence with respect to the way in which the appellants had approached the handling of their business affairs. In their factum the appellants argue:

> The evidence as to the Randhawas' personal and business affairs was led by defence counsel in an attempt to establish that the Randhawas did not have sufficient funds in the years in question to be able to lend approximately $500,000 to CVT [the taxi business], *unless* the Randhawas took cash from CVT. The defendants were not successful in establishing such point. The trial judge erred when she took this evidence and used it to draw the prohibited inference that ... Amrik Randhawa is a person likely from his conduct or character to have taken cash from CVT.

96 A large part of the reasons for judgment are taken up with the trial judge's reflections on the evidence of the business dealings of the appellants. I will not repeat her conclusions here. She found that each one of the transactions examined at trial was problematic, and almost all demonstrated that business earnings were not declared as income for tax purposes. She said at paras. 218-9:

> [218] However, with respect to all of these issues, both Mr. and Mrs. Randhawa were defensive and unresponsive when cross-examined. They were unable to refute numerous documents that established a pattern of mendacity, particularly with respect to the crucial issues of avoiding the payment of income taxes and engaging in improper practices with the defendants.
>
> [219] In my opinion, the Randhawas' conduct marks them as people who established a pattern of failing to report income to the CRA. They do this in part by concealing cash payments. Further, I do not believe that Mr. Randhawa, a man of education and business experience, but intimately familiar with the methods of avoiding the reporting of income tax, would make such a large investment in CVT, and continue to make loans in the order of half a million dollars if he were not involved in the scheme to improperly share CVT's unrecorded revenue. On the basis of my observations of him in court, I do not believe he would refrain from being actively involved in the management of the company, or that he would defer to the other owners, some of whom he considered illiterate, or that he would not be concerned that CVT apparently never made any income.

97 The common law is clear that evidence of a civil litigant's character is not admissible to prove how he acted on a given occasion. Even if relevant, its probative value would be outweighed by the counterbalancing factors of confusion of issues and undue consumption of trial time. (Stanley Schiff, *Evidence in the Litigation Process* (Toronto: Carswell, 1993 at 1161-2). Equally clear is the fact that evidence of bad character may amount to similar fact evidence which is admissible (*viz.*: *MacDonald v. Canada Kelp Co.* (1973), 39 D.L.R. (3d) 617, [1973] B.C.J. No. 846 (B.C. C.A.); *Statton v. Johnson*, 1999 BCCA 170, 64 B.C.L.R. (3d) 52 (B.C. C.A.)).

98 It may be that the evidence described by the trial judge in the case at bar amounted to similar fact evidence of the business practices of Mr. Randhawa, but I am not persuaded this Court is required to analyze the evidence along those lines. In my view, the trial judge did not use the evidence of Mr. Randhawa's business practices as positive evidence that he engaged in cash-skimming from CVT. First, it does not appear that counsel for the respondents made such an argument to the trial judge. Second, and more importantly, as I read the reasons for judgment that I have produced above, they reveal that the trial judge mentioned Mr. Randhawa's business practices in the context of commenting on the credibility of Mr. and Mrs. Randhawa's claim that they did not skim cash from the taxi business. It was open to the trial judge to use the evidence of "bad character" for that purpose.

99 *R. v. Hogan* (1982 ), 2 C.C.C. (3d) 557, [1982] O.J. No. 189 (Ont. C.A.) provides an example of a case where evidence that could be characterized as evidence of bad character was used to assess the credibility of a litigant (namely, an accused person). In that case the Crown led evidence that the accused's motive to kill the victim was a drug deal that had gone bad. The evidence exposed the accused's criminal lifestyle. The trial judge did not limit the jury's use of the evidence to motive alone,

but told the jury that they could use the evidence of the accused's lifestyle in determining whether he was a person they should believe. In rejecting Hogan's appeal on that point, Martin J.A., speaking for the Court, said this:

> 21 Counsel for the appellant contended that while the evidence of the appellant's "lifestyle" was admissible on the part of the Crown as going to show a motive for the killing and on the part of the defence to explain the appellant's actions prior to and on June 16, 1980, that evidence was not admissible to show that by reason of his bad character the appellant was a person whose evidence was not to be believed.
>
> 22 In *R. v. Davidson, DeRosie and MacArthur* (1974), 20 C.C.C. (2d) 424 this Court said at p. 444:
>
> > ... save for cross-examination as to previous convictions permitted by s. 12 of the *Canada Evidence Act*, an accused may not be cross-examined with respect to misconduct or discreditable associations unrelated to the charge on which he is being tried for the purpose of leading to the conclusion that by reason of his bad character he is a person whose evidence ought not to be believed.
>
> That case stands for the proposition that, subject to the exceptions referred to in the above passage, an accused may not be cross-examined as to previous bad conduct and disreputable associations for the purpose of leading to the conclusion that by reason of his bad character (disposition) the accused is not testimonially trustworthy. It does not, however, hold that where evidence of the accused's bad character is properly before the jury it cannot be used in assessing his credibility. The trial judge correctly charged the jury not only with respect to the limited use that could be made of that evidence but also with respect to the use that could not be made of that evidence.

100 This reasoning was approved by the Supreme Court of Canada in *R. v. G. (S.G.)*, [1997] 2 S.C.R. 716 (S.C.C.) at paras. 67ff.

101 The trial judge had a lot to deal with in the case before her. She was clearly concerned that all of the parties before her had blatantly failed to tell the truth. In working her way to her conclusions about the facts, the trial judge carefully analyzed the evidence and explained why she did not believe the witnesses when they attested to certain events. In the end, however, while not believing much of what the defendants said, she did accept that they were telling the truth when they said that the Randhawas were a part of the scheme to skim money from the income of the taxi business. She did so because the evidence of the defendants on that score was corroborated by other evidence and because the denials by the appellants were not believable. I would not accede to this ground of appeal.

102 I agree with my colleague that the trial judge was not wrong in applying the principle of *ex turpi causa* in this case.

103 I, too, would dismiss the appeal.

*Appeal dismissed.*

Footnotes

1 I am aware that in *Iannone v. Hoogenraad* (1992), 66 B.C.L.R. (2d) 106 (B.C. C.A.) Gibbs J.A. made note of the fact *ex turpi causa* had not be pleaded, but this Court's decision did not turn on the point.

TAB 2

1926 CarswellOnt 29
Ontario Supreme Court, Appellate Division

Bluebird Corp., Re

1926 CarswellOnt 29, [1926] 2 D.L.R. 484, 58 O.L.R. 486, 7 C.B.R. 522

# Re Bluebird Corporation Limited

Latchford, C.J., Riddell, Middleton and Masten, JJ.A.

Judgment: March 5, 1926

Counsel: *W. N. Tilley, K.C.*, and *W. K. Fraser*, for the trustee.
*W. S. Brewster, K.C.*, and *J. L. Sutherland*, for contributories.

Subject: Corporate and Commercial; Insolvency; Estates and Trusts; Contracts; Civil Practice and Procedure; Securities

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy --- Administration of estate — Payment by contributories for shares**

**Contracts --- Illegal contracts — General**

**Corporations --- Shares — Subscription for shares**

**Equity --- Maxims of equity — He who comes into equity must come with clean hands**

**Securities and Commodities --- Trading in securities — Prospectus — Failure to file**

Company — Share Subscriptions — Syndicate Agreement — Alleged Allotment — Absence of Prospectus or Statement in Lieu thereof — Authorized Assignment — Contributories — Dominion Companies Act, R.S.C., 1906, Ch. 79, Secs. 5(1) (1917 (Can.), Ch. 25, Sec. 3) 9, 10, 11, 13 (1917 (Can.), Ch. 25, Sec. 5), 43 c. (1) (1924 (Can.), Ch. 33, Sec. 14).

Before the incorporation of the company, persons who intended to become shareholders in the proposed company signed a document agreeing to become shareholders in the company to be incorporated and agreeing to subscribe for certain amounts of the capital stock of the company and to become shareholders in such company to the said amounts. This agreement was not sent to the Secretary of State's department at the time of the application for the incorporation of the company but the regular application, form A in the schedule to the Dominion *Companies Act*, was sent.

*Held*, that the persons who signed the "subscribers' agreement" were not "subscribers to the memorandum of agreement" within the meaning of sec. 13 of the Dominion *Companies Act* as amended and were not shareholders by statute.

[*Nipissing Planing Mills Ltd., Re* (1909), 18 O.L.R. 80 (Ont. Weekly Ct.), approved. *In re London Speaker Printing Co.; Pearce's Case* (1889), 16 O.A.R. 508, followed].

*Held*, further, there had been no effective allotment to charge the persons who had signed the "subscribers' agreement" as there had been no prospectus or statement in lieu of prospectus filed before the allotment, if any, as required by sec. 43 c. (1) of the Act as enacted by 1924 (Can.), ch. 33, sec. 14.

Appeals by the trustee of the debtor company from the judgments of Logie, J., (1924), 5 C.B.R. 331, 27 O.W.N. 321. Appeals dismissed with costs.

***Latchford, C.J.*, agreed with *Riddell, J.A.*:**

***Riddell, J.A.*:**

2 Appeals from the judgments of Logie, J., (1924), 5 C.B.R. 331, 27 O.W.N. 321, in four issues concerning the liability of alleged shareholders in an incorporated company now in bankruptcy.

3 The appeals were argued together with great care and skill; the points involved are of considerable importance; and the amount of money at stake is by no means insignificant.

4 The facts are not very involved. Taking the evidence and the findings of the learned trial Judge, the following appears: —

5 A syndicate called "The Bluebird Syndicate" was formed in the summer of 1919 to acquire for Canada and the rest of the British Empire the right to manufacture certain electric washing machines made in St. Louis. It was composed of J. B. Detwiler, W. J. Verity, Thomas Hendry, since deceased, Roy E. Secord, Walter C. Boddy, W. T. Henderson, all of Brantford, Ontario, and P. E. Verity of Batavia, New York. This syndicate organized a group of business and professional men in Brantford, and in the autumn of 1919 went to St. Louis, the home of the Bluebird Manufacturing Company of St. Louis, the company manufacturing these machines in the United States. They spent two days there with the idea of forming a company to operate in Canada; of the four persons involved in these appeals, Moule and Gott went with this party, while McEwen and Lipovitch did not.

6 The manufacturing company disposed of their output through another company called "The Blue Bird Appliance Company."

7 The syndicate entered into an agreement with the manufacturing company, manifested by a document (Ex. 21), duly signed and sealed, which provided for the formation of a Dominion of Canada company with a capital of $1,000,000, and for the conveyance to such company of their rights under the agreement.

8 It was recited that it was intended that the Dominion company should enter into a contract with the Bluebird Appliance Company for the sale of its product in the Dominion of Canada, and that it was intended that the agreement with the two American companies should be "interdependent to the extent that this contract shall come into force and effect on the execution of the contract between the parties of the first part and the Bluebird Appliance Company, covering the sale by the Bluebird Appliance Company of the devices to be manufactured by the parties of the first part or by the company to be formed by them."

9 A document (Ex. 22) was also drawn up between the syndicate and the Bluebird Appliance Company, reciting the intention of the syndicate to enter into the agreement with the manufacturing company — and also, "And it is now further recited that the parties to this contract are desirous of having the Bluebird Corporation Limited, when formed, and the Bluebird Appliance Company Limited of Canada, when formed, to enter into a similar contract as now exists between the Bluebird Manufacturing Company of Delaware and the Bluebird Appliance Company of Missouri, concerning the sale of household devices for the Dominion of Canada."

10 The document goes on to provide that the Dominion company to be formed should sell and the appliance company should "buy and receive and pay for within one year from and beginning on the first day of July, 1920, thirty thousand (30,000) Bluebird electric clothes washers of the same design, material and workmanship as said clothes washers now manufactured with such improvements as may be adopted by the Bluebird Manufacturing Company of Delaware, in the city of St. Louis, Missouri."

11 The price of the machines was provisionally fixed at $80 each — which meant, of course, an assured receipt of $240,000 in the first year. This document was executed by the appliance company, but not by any member of the syndicate except Detwiler — the other members of the syndicate were later advised by Mr. Henderson not to sign it and did not sign it at any time.

12 In January, 1920, a document was drawn up called the "subscribers' agreement" (Ex. 1), which, after reciting the manufacture by the St. Louis company of the household devices, the sale of the product by the appliance company, the formation of the syndicate, that "it is proposed to incorporate and organize a company to engage in the manufacture of electrically operated household devices for the Dominion of Canada and the British Empire, under the trade marks, patents and designs of the Bluebird Corporation of St. Louis, Mo.," proceeded as follows:

> A contract has been entered into between the syndicate and the Bluebird Manufacturing Company of St. Louis by which the syndicate has acquired for the Dominion of Canada and the British Empire the exclusive right to manufacture and deal in Bluebird household devices which have been developed and marketed in the United States by the American company, together with the trade marks, trade names, patents and designs of the Bluebird Corporation.
>
> The syndicate has contracted to organize a manufacturing company which will manufacture, within a period of one year from the 1st of July, 1920, 30,000 electric clothes washing machines of the Bluebird design.
>
> The syndicate has also entered into a contract with the Bluebird Appliance Company of St. Louis by which that company has contracted to purchase 30,000 electric clothes washing machines during the period of one year from the 1st of July, 1920, and to pay cash for same at the factory of the Canadian company to be incorporated, which contract also covers the right to purchase by the Bluebird Appliance Company during succeeding years of the entire output of the proposed company in gradually increasing quantities.
>
> The contract with the Bluebird Appliance Company also provides for the exclusive sale to it of other appliances of which the proposed company shall undertake the manufacture in pursuance of the terms of its contract with the Bluebird Manufacturing Company.

13 It was also recited that

> the members of the syndicate have subscribed the sum of $20,000 each and have undertaken to provide the capital required to insure the successful operation of the company and the performance of its contract for the manufacture of 30,000 washing machines during its first year of operation.

14 Then it is added:

> The syndicate proposes to incorporate a company to be known as "The Blue Bird Corporation Limited," which will acquire the assets of the syndicate and which will manufacture Blue Bird appliances for Canada and the British Empire. This company will be incorporated with an authorized capital of $1,000,000, of which it is intended to issue the sum of $700,000, which it is calculated will be sufficient to enable the company to carry out its programme and afford the necessary equipment and capital therefor. It is to be observed that from the manufacturing standpoint the proposition is one of production. The article to be turned out is made in only one size, and each machine is a duplicate of the other, making an ideal manufacturing proposition.

15 Then comes the agreement:

> We, the undersigned, do hereby severally covenant and agree each with the other and with the syndicate herein named to become shareholders in a company to be incorporated under the provisions of the first part of *The Companies Act* (chapter 79 of the Revised Statutes of Canada, 1906), under the name of "Bluebird Corporation Limited" or such other name as the Secretary of State may give to the company, with an authorized capital of $1,000,000, divided into 10,000 shares of $100 each; and we do hereby severally, and not one for the other, subscribe for and agree each with the other and with the

> members of said syndicate to take the respective amounts of the capital stock of said company set opposite our respective names as hereunder and hereafter written, and to become shareholders in such company to the said amounts.
>
> In accordance with and upon the terms of their agreement referred to herein, the members of the syndicate hereby subscribe for the sum of $20,000 each, making a total of $140,000; and it is understood and agreed that further subscriptions made by the members of the syndicate are in addition to said subscriptions and upon the same terms as other subscribers hereto.
>
> All subscriptions shall be payable in four equal quarterly instalments on the first days of February, March, April, and May respectively.

16 It is alleged by the appellant that the four respondents signed (with a seal as well) a list, part of this "subscribers' agreement," with the amount of $5,000 each.

17 This "subscribers' agreement" was not sent to Ottawa, but an application in form A in the schedule to the Dominion Act was sent with the names of the members of the syndicate only. A memorandum of agreement in form B in the schedule to the Act was also sent with the names of the members of the syndicate only inserted.

18 Letters patent were issued thereon on February 3, 1920, constituting the said seven persons "and all others who may become shareholders in the said company a body corporate and politic by the name of 'Blue Bird Corporation Limited.' " Notice of the granting of letters patent was duly given pursuant to sec. 13 of *The Companies Act*, R.S.C., 1906, ch. 79, as enacted by 1917, (Can.), ch. 25, sec. 5.

19 I pause here to consider the argument pressed upon us by Mr. Tilley that this section makes, "from the date of the letters patent, the persons therein named and such persons as have become subscribers to the memorandum of agreement, or who thereafter become shareholders in the company," a body corporate.

20 The argument is that the persons who signed the "subscribers' agreement" were "subscribers to the memorandum of agreement," within the meaning of this section.

21 This, however, cannot be. The Act, by sec. 5(1), as enacted by *The Companies Act Amendment Act, 1917* (Can.), ch. 25, sec. 3, provides for the Secretary of State granting a charter.

> to any number of persons, not less than five, who apply therefor, constituting such persons, and others who have become subscribers to the memorandum of agreement hereinafter mentioned and who thereafter become shareholders in the company thereby created, a body corporate and politic.

22 The memorandum of agreement is thereinafter mentioned in sec. 9, which provides that the application for a charter "shall be accompanied by a memorandum of agreement in duplicate under seal *** in accordance with form B." Sections 10 and 11 again refer to this memorandum of agreement.

23 Section 13 (after providing for the notice of granting the charter) makes (1) the persons named in the charter, (2) the signatories of "the memorandum of agreement," and (3) those who thereafter become shareholders, a body corporate and politic — "their successors" constitutes a sub-species of class (3).

24 The words "memorandum of agreement" mean the same thing throughout. "It is a sound rule of construction to give the same meaning to the same words occurring in different parts of an act of parliament:" *Courtauld v. Legh* (1869), L.R. 4 Ex. 126, 38 L.J. Ex. 45, 19 L.T. 737, 17 W.R. 466, *per* Cleasby, B., at p. 130.

25 The intention is obvious: a memorandum of agreement and stock book, in form B, is executed under seal in duplicate; some persons not less than five make application for a charter (as will shortly appear they will be of those who have signed the "memorandum of agreement and stock book"), in form A, which contains the statement that

> a stock book has been opened and a memorandum of agreement by the applicants under seal **** has been executed in duplicate, one of the duplicates being transmitted herewith.

26 (It is of no importance here that the statute expressly provides for a memorandum in duplicate being sent with the application, while form A and form B provide for one duplicate only to be so sent).

27 On the receipt of the two documents, the Secretary of State may grant a charter to these applicants. The effect of this charter, after proper notice, is to make not the applicants alone but the applicants "and others who have become subscribers to the memorandum of agreement" a body corporate, into which may come those who thereafter become shareholders.

28 The printed form of charter contemplates the inclusion of the names of all those in the memorandum of agreement, but there is no need of this — if any names be omitted by accident or design the bearers thereof are not excluded from the corporation. Whatever the form of the letters patent, the statute is imperative; and an Act of Parliament may do anything not naturally impossible. If the "subscribers' agreement" had been sent to the Secretary of State and accepted as the "memorandum of agreement and stock book," form B, it would be *nihil ad rem* that the names of only members of the syndicate appear in the charter — the other signatories would, by virtue of the statute, be part of the corporation. And in that case all allegations of fraud would be immaterial.

29 But this was not done — a memorandum of agreement was sent to the Secretary of State, but not the "subscribers' agreement" (Ex. 1); it was consequently the signatories to that memorandum, not those to Ex. 1, who became the corporation.

30 This is just such a case as *Nipissing Planing Mills Ltd., Re* (1909), 18 O.L.R. 80 (Ont. Weekly Ct.), under similar provisions in the Ontario Act of 1897 — and my Lord, then a trial Judge, held that the signatory was not a shareholder by statute. See also *In re London Speaker Printing Co.; Pearce's Case* (1889), 16 O.A.R. 508, 512.

31 Resuming the narrative — the first meeting of the shareholders was held on February 6, 1920, the seven of the syndicate being present — as is stated in the minutes "being all the shareholders of the company" — the seven were elected directors. Then the directors met, and the following took place:

> A contract made between John B. Detwiler *et al.* and this company to provide for the acquiring by this company of the real and personal property known as Plant No. 1 of Motor Trucks Limited and consisting of the lands and buildings, machinery and equipment, miscellaneous supplies, dies, tools, and office furniture more particularly set forth in said agreement and in schedule A thereto, also providing for the assignment to this company of certain contracts between the said parties and Blue-Bird Manufacturing Company of St. Louis, Missouri, and of a further contract between the said parties and the Blue Bird Appliance Company of St. Louis Missouri; also providing for the assignment to this company of a certain memorandum of agreement bearing date the 5th day of January, 1920, made between said parties therein described as a syndicate and the persons whose names are subscribed thereto, and providing for subscriptions to the capital stock of this company, and providing further for the acquirement by this company of all other contracts and property of the syndicate as such, was presented, and it was moved by Mr. W. J. Verity, seconded by Mr. W. C. Boddy, that the same be approved and adopted and that the president and secretary be authorized to execute the same on behalf of the company and to attach the company's seal thereto.

32 The shareholders' meeting, then resumed with the seven, "being all the shareholders of the company," confirmed certain by-laws and passed a resolution

> that the contracts referred to in the minutes of the directors' meeting just held be and the same are hereby adopted, sanctioned, and confirmed by this company.

33 The contract by Detwiler referred to provides for the transfer to the new company of (1) certain real estate; (2) buildings and equipment thereon; (3) the contract with the Blue Bird Manufacturing Company of St. Louis, Ex. 21; (4) that with the Appliance Company, Ex. 22; (5) the "subscribers' agreement," Ex. 1; and (6) all and any other contracts, rights, etc., of the *** syndicate.

34 No prospectus or statement in lieu of prospectus was ever filed as mentioned in the Act; there was no by-law as contemplated by sec. 46 — there was no formal allotment till long after, but the directors seem to have considered the acceptance by the company of the assignment by the syndicate of the "subscribers' agreement" equivalent to an allotment.

35 We have not here to deal with an actual issue of shares paid for and accepted — to which the maxim *Quod fieri non debet factum valet* might apply. I mean we are not dealing with such a case as that of Gott, who accepted and paid for $2,000 par value of stock — and most of the remarks following are not to be considered applied to such a case.

36 The directors contended and the appellant contends that what was done was equivalent to an allotment and that the four subscribers are liable to pay the amount of their subscriptions.

37 It becomes necessary to determine the question whether, assuming an allotment, such an allotment was effective to charge the respondents, there having been no prospectus or statement in lieu of prospectus.

38 The statute is express — sec. 43c.(1) as enacted by *The Companies Act Amending Act, 1924* (Can.), ch. 33, sec. 14:

> A company shall not allot any of its shares or debentures unless before the first allotment of either shares or debentures there has been filed with the Secretary of State of Canada either a prospectus or a statement in lieu of prospectus, in the form and containing the particulars set out in form F in the schedule to this Act, signed by every person who is named therein as a director or a proposed director of the company or by his agent authorized in writing.

39 The statute of 1924 was not in force at the time of the transactions in question herein, and if it should be construed as not governing them, then sec. 43c. of the principal Act as enacted by 1917 (Can.), ch. 25, sec. 7, will govern. It will be seen that it has the same effect in the present instance, as the company did not issue a prospectus or file a statement in lieu of prospectus.

40 The section enacted in 1917 is as follows:

> 43c. (1) A company which does not issue a prospectus on or with reference to its formation, shall not allot any of its shares or debentures unless before the first allotment of either shares or debentures there has been filed with the Secretary of State of Canada a statement in lieu of prospectus signed by every person who is named therein as a director or a proposed director of the company or by his agent authorized in writing, in the form and containing the particulars set out in Form F in the Schedule to this Act.

41 This is taken substantially from sec. 82 of *The Companies (Consolidation) Act*, 1908 (Imp.), ch. 69. The last word has not been said in the English courts in respect of allotment in violation of this section — the latest is somewhat disturbing, the learned Lords not being unanimous, and two of great eminence expressing diametrically different opinions. It is true that the opinions were not necessary for the decision, but nevertheless they must be considered with respect.

42 In *Jubilee Cotton Mills Ltd. (Official Receiver and Liquidator) v. Lewis*, [1924] A.C. 958, 93 L.J. Ch. 414, 68 Sol. Jo. 663, 40 T.L.R. 621, the company, before filing a statement in lieu of prospectus, allotted certain shares and debentures to a promoter, Lewis (the vendor); the pretence was that they were consideration for the purchase, but in reality they were to provide for promotion profits; he sold them and made a profit; the liquidator proceeded against him on a misfeasance summons; he pleaded that they were a nullity, the allotment being in the absence of a statement. Astbury, J., in *In re Jubilee Cotton Mills Ltd.*, [1922] 1 Ch. 100, at p. 118, 91 L.J. Ch. 169, 126 L.T. 324, referred to the *dicta* of Warrington, J., and Swinfen Eady and Phillimore, LL.J., in *In re Blair Open Hearth Furnace Co.*, [1914] 1 Ch. 390, 83 L.J. Ch. 313, 21 Mans. 49, 109 L.T. 839, that such an allotment was void, but (p. 119) did not think it necessary to decide the point and decided that in any case the net money received for the shares and debentures should be paid to the company. In appeal ([1923] 1 Ch. 1, 91 L.J. Ch. 777, [1922] B. & C.R. 229, 67 Sol. Jo. 62, 38 T.L.R. 891, 128 L.T. 200), Warrington, L.J., said, at p. 24:

> I *** venture to adhere to and repeat as my opinion in the present case that the allotment of debentures and shares *** was illegal and void

— and he made this his *ratio decidendi*. Younger, L.J., referring to this opinion, says, at p. 40:

> I also wish to add, that with Warrington, L.J., I am of the opinion that the claim against Lewis fails also on the ground that the issue of the shares and debentures in the present case was entirely void for the reasons given by him. I so entirely agree with the reasoning of the Lord Justice on that subject that I do not deem it fitting further to prolong my judgment by giving my reasons in my own words.

43 Lord Sterndale's decision will be referred to later.

44 In the House of Lords ([1924] A.C. 958, 93 L.J. Ch. 414, 68 Sol. Jo. 663, 40 T.L.R. 621), Lord Dunedin says, at pp. 969, 970:

> The second question was that in terms of sec. 82 no allotment may be made by a company which has not issued a prospectus unless there has been filed with the registrar a statement in lieu of a prospectus, and the statement in this case was admittedly not filed till after the date of the allotment.
>
> On this point, although it was not necessary for decision, we have the opinion of Warrington, J., and Swinfen Eady, L.J., in *In re Blair Open Hearth Furnace Co.*, that the result is that any allotment is void.
>
> I agree with the opinions, and particularly with that of Swinfen Eady, L.J., who says he considers the matter settled by the case of *Whiteman*, [1910] A.C. 514, 79 L.J.K.B. 1050, 54 Sol. Jo. 718, 103 L.T. 296, 26 T.L.R. 655, in this House. He quotes some remarks made by myself in that case, but I wish to add that the same thing, though in somewhat shorter form, was said by Lord Macnaghten. I am, therefore, of opinion that the respondent does make out the first point — namely, that the allotment was a bad allotment. The result would doubtless be that any one holding such allotment could have resisted successfully being put on the list of contributors in the list of liquidation.

45 Lord Sumner says, at pp. 974-976:

> My Lords, as to the second point, I think that sec. 82 does forbid the company to do what those, who then manipulated it, caused it to purport to do on January 6, but I cannot see that the company is therefore entitled, as was suggested, to treat this allotment now as voidable. Whatever possibility there may be of saying that, in the case of a natural person, a statutory avoidance of his liability is one which he need not insist upon unless he chooses, the same cannot be predicated of artificial persons in the same measure, if at all. Sec. 82, subsec. 1, is couched in the terms of a categorical imperative and constitutes a restriction upon the company's legal capacity for action. An artificial person is the creation of the law; how can it elect to do what its creator says it shall not do at all? It has no free will; no power of its own to obey or disobey. Nor, again, is this restriction imposed simply for the benefit or protection of the company. It would appear that members of the public, likely to be led to deal with the company, are also entitled to the benefit of the section and are intended to enjoy the means of knowing what purports to be the condition of the company's affairs, even though it be inaccurate (*In re Blair Open Hearth Furnace Co.*), before they can become bound to it by a purported allotment of its shares. If so, the company cannot treat as merely voidable something which, in the interest of strangers, as well as of itself, the Act has forbidden to be done ***.
>
> On examination of the Act of 1908 it appears to me, with all respect to Warrington, L.J., who thought otherwise, that the allotment of January 6 was not *ultra vires* altogether. The company had then been incorporated, and as such was capable of allotting its shares, unless its capacity in that regard is taken away. I do not think that the prohibiting words of sec. 82, subsec. 1, take away the company's capacity. They only prohibit its exercise.

46 The learned Law Lord concludes, at p. 977:

> For the reason given above, I think that the action of Mr. Lewis, particularly on January 6, involved the company in at least a potential liability to recognize these shares, which constituted for Mr. Lewis a promoter's profit of value, though no consideration for them was received by the company, and, the same thing applying to the debentures, I think he must give up his gains as to both.

47 The result was that the appeal was allowed — Lord Sumner apparently going on the ground of estoppel, the company being estopped *quoad* the public from saying that the stock and debentures were absolutely void — and all agreeing that in any case Lewis received money which he must account for to the company.

48 But even Lord Sumner's opinion should be read in connection with the facts — the company, having put out certain stock and securities as valid, for the protection of those who might be induced to buy, could not be allowed to repudiate them entirely. This lends no support to the proposition that a company can, by doing something forbidden by law, place itself in a better position — stock it has issued it may not repudiate, but that does not imply that it may by a forbidden allotment compel an unwilling subscriber to take stock or to pay for it.

49 It will be well to examine the English cases further.

50 The first case is the well-known *In re Blair Open Hearth Furnace Co.*, [1914] 1 Ch. 390, 83 L.J. Ch. 313, 21 Mans. 49, 109 L.T. 839. Warrington, J., says, at p. 400:

> I am inclined to agree with that argument to this extent, that if no statement at all is filed, then, inasmuch as no consequence is imposed by the Act as the result of a failure to file the statement, it must be taken that the statute prohibits the company from proceeding to an allotment of shares and that any allotment of shares would accordingly be illegal.

But this was *obiter*, as a statement had been filed.

51 In appeal Cozens-Hardy, M.R., did not pass on the point; Swinfen Eady, L.J., says, at pp. 408, 409:

> It is simple enough here where in terms the statute prohibits a company from allotting shares where a statement in lieu of prospectus has not been filed. Therefore, with regard to the second point made by Mr. Gore-Browne, that there was nothing in the statute to render the allotment invalid, I am of opinion that if no statement had been filed the allotment would have been invalid.

Phillimore, L.J., says, at p. 412:

> I accept the argument of the appellants that the effect of sec. 82 is to make an allotment of shares or debentures by a company which is not a private company, and which does not issue a prospectus and does not file a statement in lieu of prospectus, not voidable but void.

Again these expressions are *obiter dicta.*

52 The result is that we find *obiter dictum* of Warrington, J., but made *ratio decidendi* by him as Lord Justice; *obiter dicta* of Astbury, J., Swinfen Eady and Phillimore, LL.J., and of Lord Dunedin, that such an allotment is void: and a *ratio decidendi* of Younger, L.J., to the same effect — while on the other hand we have only an *obiter dictum* of Lord Sumner that the company cannot be allowed to say that stock and debentures actually issued are void.

53 We have a decision of the Court of Appeal based by two out of three Judges on the proposition that such an allotment is void, Lord Sterndale, M.R., ([1923] 1 Ch. 1, at p. 15, 91 L.J. Ch. 777, [1922] B. & C.R. 229, 67 Sol. Jo. 62, 38 T.L.R. 891, 128 L.T. 200), assuming

> that the allotment was void, and that it conferred no right upon the company to enforce obligations, if any, which would otherwise exist upon transferees of the shares or debentures, or impose any liability, except perhaps by estoppel, upon the company in respect of them.

and this view seems to have recommended itself to Lord Finlay, ([1924] A.C. 958, at p. 966, 93 L.J. Ch. 414, 68 Sol. Jo. 663, 40 T.L.R. 621).

54 I find no suggestion by any Judge indicating that stock issued under these circumstances is anything but void except so far as the company is estopped from setting it up — and nowhere is there any suggestion that, contrary to Lord Sterndale's assumption, a company by a forbidden allotment can confer on itself the right "to enforce obligations *** which would not otherwise exist ***"

55 I have gone through our own cases and find no support for the proposition that an allotment without prospectus can give the company any rights. It will suffice to refer to *Premier Trust Co. v. Raymond* (1922), 52 O.L.R. 533, 22 O.W.N. 545 — the reversal of which, in (1923), 55 O.L.R. 30, 25 O.W.N. 244, was due to the discovery of the fact that a prospectus had been filed — there my learned brother Middleton held void a mortgage given to secure debentures issued without prospectus or statement in lieu of prospectus.

56 Whether this will be considered the law when reviewed in the light of the *Jubilee Case* we need not decide — it certainly affords no aid to the company here.

57 Wright, J.'s, decision in *Martin v. Clarkson* (1925), 57 O.L.R. 499, 28 O.W.N. 452, is on the wording of the Ontario Act; and in any case it may well proceed on the ground of estoppel.

58 Nor are we satisfied by the *factum valet* cases — to apply the maxim there must be *factum quid, un fait accompli*, something completed, something *in esse*, nothing *in fieri*. For example in *R. v. Lord Newborough* (1869), L.R. 4 Q.B. 585, 38 L.J.M.C. 129, 20 L.T. 818, 17 W.R. 861, where payment had been made to constables not in accordance with the statute, Lush, J., decided that, as the order for payment had been acted on, the account allowed and the money paid, the matter should not be re-opened — *factum valet*. Moreover, in that case there was no prohibition in the statute 1 & 2 Wm. IV. ch. 41, sec. 1, but only a direction.

59 Blackburn, J., in *Winsor v. R.* (1866), 6 B. & S. 143, at p. 183, does no more than refer to the maxim; and in *Auchterarder Presbytery v. Earl of Kinnoull* (1839), 6 Cl. & F. 646, at p. 708, the omission was immaterial, and the minister actually inducted.

60 The principle upon which the present case is to be decided is the old and well established rule that no one can have the assistance of the Court in an attempt to place himself in better legal position by breaking the law — *Ex turpi causâ non oritur actio*, whether the turpitude is moral or legal, a breach of the moral law or of the law of the land. As is said by Lindley, L.J., in *Scott v. Brown, Doering McNab & Co.*, [1892] 2 Q.B. 724, at p. 728, 61 L.J.Q.B. 738, 4 R. 42, 67 L.T. 782, 41 W.R. 116, 57 J.P. 213:

> This old and well-known legal maxim is founded in good sense, and expresses a clear and well-recognized legal principle, which is not confined to indictable offences. No Court ought to enforce an illegal contract or allow itself to be made the instrument of enforcing obligations alleged to arise out of a contract or transaction which is illegal, if the illegality is duly brought to the notice of the Court, and if the person invoking the aid of the Court is himself implicated in the illegality. It matters not whether the defendant has pleaded the illegality or whether he has not. If the evidence adduced by the plaintiff proves the illegality the Court ought not to assist him. If authority is wanted for this proposition, it will be found in the well-known judgment of Lord Mansfield in *Holman v. Johnson* (1775), 1 Cowp. 341, 343.

61 No right of action can spring out of an illegal contract. See *per* Lord Abinger in *Lewis v. Davison* (1839), 4 M. & W. 654, at p. 657 — the *locus classicus* is Lord Mansfield's judgment in *Holman v. Johnson* (1775), 1 Cowp. 341, at p. 343:

> No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causâ*, or the transgression of a positive law of this country, there the court says he has no right to be assisted. It is upon that ground the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff.

62 Equity is equally pronounced. Lord Eldon, in *Evans v. Richardson* (1817), 3 Mer. 469, himself took the objection (p. 471) that "the contract subsisting between the parties was a contract to defeat the laws of the country." *Whiteman v. Sadler*, [1910]

A.C. 514, 79 L.J.K.B. 1050, 54 Sol. Jo. 718, 103 L.T. 296, 26 T.L.R. 655, is equally emphatic. The Irish case *Gramophone Co. Ltd. v. King*, [1914] 2 I.R. 535, *per* Gibson, J., at p. 539, is also in point.

63 The very highest the company can put its case is that there was a contract on the part of the respondents to take and pay for shares to issue which would involve "the transgression of a positive law of this country," to use the language of Lord Mansfield, "to defeat the laws of the country," to use that of Lord Eldon.

64 In this view it makes no difference whether we dub a statute prohibitive or directory — although in the present case it savours of the absurd to style a statute directory and not prohibitive which does not direct and does nothing but categorically prohibit.

65 There is no contention that the filing of the statement in lieu of prospectus and formal allotment in 1921 could have any effect if the previous informal allotment was wholly invalid.

66 The above is sufficient to dispose of the appeals adversely, and I do not enter upon an investigation of the other formidable difficulties in the way of the appellant.

67 I would dismiss the appeals with costs.

***Masten, J.A.:***

68 The leading facts are fully detailed in the judgment of my brother Riddell, and need not be here repeated, but a chronological list of the more important occurrences may be convenient.

69 The syndicate referred to in the agreements and proceedings was formed in the summer of 1919.

70 Contract between the syndicate and the Blue Bird Manufacturing Company (American), November 25, 1919.

71 Contract between the syndicate and the Blue Bird Appliance Company (American), December, 1919.

72 Subscribers' agreement signed by the respondents (Ex. 1), January 5, 1920.

73 Letters patent issued incorporating the company, February 3, 1920.

74 Organization meeting of the company, February 6, 1920.

75 Action by the company against McEwen and Lipovitch begun, June 29, 1921.

76 Statement in lieu of prospectus filed with the Secretary of State, October 5, 1921.

77 Formal by-law of allotment, October 12, 1921.

78 Notice of allotment to the respondents, October 14, 1921.

79 Assignment in bankruptcy, September 6, 1923.

80 It is admitted by counsel for the appellant that in order to succeed in these appeals he must establish that the respondents were, at the date of the authorized assignment, shareholders of the company or bound by contract to accept and pay for shares.

81 None of the respondents, except Gott, are registered as shareholders of the company, and no certificate of shares has ever been issued to any of the respondents, except Gott. None of the respondents, except Gott, assumed to act as shareholders. Gott attended one meeting, but he was, at the time, the holder of paid-up shares to the value of $2,000.

82 The first question to be considered is, did the respondents apply for allotment to them respectively of shares in the company? Such application, if it exists, must arise out of the subscription agreement (Ex. 1) of January 5, 1921. That document

 

is very fully recited in the judgment of my brother Riddell, but for convenience I repeat here the clause upon which turns, in my opinion the question whether it is an application or not:

> We, the undersigned, do hereby severally covenant and agree each with the other and with the syndicate herein named to become shareholders in a company to be incorporated under the provisions of the first part of *The Companies Act* (chapter 79 of the Revised Statutes of Canada, 1906), under the name of "Bluebird Corporation Limited" or such other name as the Secretary of State may give to the com pany, with an authorized capital of $1,000,000, divided into 10,000 shares of $100 each; and we do hereby severally, and not one for the other, subscribe for and agree each with the other and with the members of said syndicate to take the respective amounts of the capital stock of said company set opposite our respective names as hereunder and hereafter written, and to become shareholders in such company to the said amounts.

83 Such is the only document which the respondents signed, and no oral application to the company for shares is established by the evidence. I am of opinion that we are bound by authority to hold that the subscription quoted above is not an application for shares. The question arose in the Court of Appeal in *In re London Speaker Printing Co.; Pearce's Case* (1889), 16 O.A.R. 508, 512. In that case Pearce signed an instrument purporting to be a subscription for shares in a company "proposed to be incorporated" under *The Ontario Joint Stock Companies Letters Patent Act*, in which he agreed with the company and the signatories thereto to take the number of shares set opposite to his name. Pearce was not an incorporator named in the letters patent, and no shares were in fact ever allotted to him, but he was entered in the books as a shareholder, and notices of meetings and demands for payment on calls were sent to him, and in winding-up proceedings he was placed on the list of contributories. The case was heard before the Court of Appeal, consisting of Burton, Osler, and Maclennan, JJ.A. On p. 514, Osler, J.A., says:

> If any liability is cast upon a person who, prior to the issue of the letters patent, has signed an agreement to subscribe for shares in a projected company, but who is not one of the corporators mentioned in the letters patent, and has subsequently refused to subscribe or apply for or accept shares, it must be a statutory and not a contractual or common law liability, as there can be no privity of contract between him and a company which was not in existence when he became a subscriber. It is hardly necessary to cite authority for this.

84 At the bottom of p. 514, he says:

> There was no application by him (Pearce) to the company for shares, and therefore no authority to them to allot shares or to enter his name as a shareholder, unless they derived it from his subscription to the agreement made before the issue of the letters patent.

85 Again, on pp. 515 and 516, he says:

> Our Act contains no definition of the term subscriber, but, looking at sec. 44, which enacts that the directors may call in and demand from the shareholders all sums of money by them subscribed, when and where and in such payments as the letters patent or the Act or the by-laws of the company prescribe or allow, I think a subscriber may, for the purpose of the Act, be described "as a person who has put down his name to a contract by which he binds himself to contribute to the extent of the number of shares for which he puts down his name." This, however, carries the case no further, for the expression, "a subscriber to stock in the company," must mean by a contract with the company, unless the Act has given it a wider meaning, and this, in my opinion, it has not done.

86 At pp. 517 and 518, he says:

> I have said that the alleged agreement cannot, by itself and without more, constitute an application, for I have no doubt that an application for shares may be prepared and signed previous to the formation of the company, and entrusted to a promoter or broker or other person interested in the company, to be made use of or acted upon afterwards. Or a person desirous to become a shareholder may authorize an agent beforehand to apply for shares on his behalf upon the incorporation of the company *** All I mean to say is, that we cannot infer such authority to any one from the instrument in question, and cannot treat it as an application to a company which had not even an inchoate existence.

It is clear that the appellant is not a shareholder and that the order to settle him on the list of contributories should be discharged.

87 I ought perhaps to add that the agreement signed by Pearce in that case was as follows:

We, whose hands and seals are hereunto set, do hereby severally subscribe for the number of shares of $20 each, set opposite to our respective signatures hereto in the capital stock of the company, whereof the prospectus is hereto prefixed, proposed to be incorporated under the name of "Speaker Printing Company," or such other name as the Lieutenant-Governor shall approve, by letters patent under The Ontario Joint Stock Companies Letters Patent Act, with an authorized capital of $90,000, to be divided into 4,500 shares of $20 each.

And we do hereby severally and respectively agree with the said company, and agree with each other, and with each and any one or more of the others of us, to subscribe for and take the said respective numbers of said shares, and to pay on each of such shares twenty-five per cent. thereof on subscription hereof, or whenever required by the directors or provisional directors of the company; a further twenty-five per cent. within one month after the incorporation of the company, and the residue thereof in such sum or sums as shall be and whenever by the directors required.

88 This judgment was pronounced in the case of a company incorporated under *The Ontario Joint Stock Companies Letters Patent Act*, R.S.O., 1887, ch. 157, but, in so far as it relates to the construction of the subscription agreement signed by the present appellants, the views pronounced by Osler, J.A., are applicable to a company incorporated in 1920 under the Dominion *Companies Act*.

89 No doubt, there is great force in the argument that the subscription agreement under consideration in this case is a continuing application for shares entrusted to the syndicate for delivery to the company after its incorporation. I have read with interest the cases *In re Olympic Fire and General Reinsurance Co. Ltd.*, [1920] 1 Ch. 582, 89 L.J. Ch. 308; [1920] 2 Ch. 341 , 89 L.J. Ch. 544, 123 L.T. 786, 36 T.L.R. 691, and *Premier Briquette Co. Ltd. v. Gray*, [1922] Sess. Cas. 329, cited by Mr. Tilley in his reply, and, if I may respectfully say so, the conclusions in these two cases command my fullest assent. They are both cases where, contemporaneously with or after the incorporation of the company, a sub-underwriter of shares executed and sent to the underwriter a sub-underwriting agreement and other documents which, having regard to the fundamental characteristic of a sub-underwriting transaction, could only be intended to be used as they were used, viz., as applications for allotments of shares and as authority to the chief underwriter to act as the sub-underwriter's agent in presenting or making application to the company accordingly.

90 The subscription agreement (Ex. 1) is an executory agreement of several subscribers *inter se* to be incorporated for the purpose specified and to take and pay for certain shares in the proposed company. It would become executed by an application on the part of the subscriber to the company after its incorporation for allotment of shares to him. It does not expressly or impliedly authorize the syndicate or any one else to act as the agent or attorney of the subscriber in applying in the name of the subscriber to the company for the shares subscribed for. In my view, the syndicate had no right so to apply or to assume to assign such subscriptions to the company, for every other subscriber to the agreement had an interest in the respondent's covenant, which was made with each of them as much as it was made with the syndicate. How then could the syndicate by itself assign it?

91 Even if we were not bound by statute to follow the decision of the Court of Appeal in *Pearce's Case, supra*, I for one would not think of refusing to follow it in the present case, not only for the reasons already indicated, but because it was a considered decision pronounced by most eminent authority, nearly forty years ago; adopted by subsequent judicial decision (see *Nipissing Planing Mills Ltd., Re* (1909), 18 O.L.R. 80 (Ont. Weekly Ct.)), and acted upon by company counsel and conveyancers since 1899. Since the decision, the sections which then corresponded to secs. 5 and 13 of the present Act have been amended, but no alteration has been made which varies or modifies the decision in *Pearce's Case*, and hence by implication the interpretation of a common form as expressed in that case has been adopted by Parliament.

92 I conclude that both on authority and on principle there never was an application by the respondents for the shares in question. The appellant's case therefore fails, in so far as it is sought to found it on the usual basis of an application for shares

— allotment and notice — for there never was an application by the respondents, either directly or through an authorized agent, which the company could accept.

93 Demands by the company after its incorporation for payment by the respondents as alleged shareholders cannot give life to an application that never existed.

94 A second ground put forward by the appellants for making the respondents contributories in the winding-up is that sec. 13 of *The Companies Act* makes the respondents shareholders without any application or allotment, because they were signatories to the subscription agreement of January 15, 1921 (Ex. 1). But that agreement was not filed at Ottawa as part of the application for incorporation, and what was filed was neither a duplicate of Exhibit 1 nor even a copy of it. The agreement mentioned in secs. 5 and 13 of the Dominion *Companies Act* is, in my opinion, the agreement filed on the application for incorporation, and does not embrace a different document (such as Ex. 1) not filed with the Department of the Secretary of State. Pre-incorporation subscription documents which were not filed as part of the application for incorporation have been considered by various courts throughout the Empire, and the opinions expressed lend support in every instance to the conclusion reached by this Court in the present case. I refer to *Guzerat Spinning and Weaving Co. v. Girdharlal Dalpatram* (1880), 5 Ind. L.R. (Bombay) 425, and *Imperial Flour Mills Co. Ltd. v. Lamb* (1888), 12 Ind. L.R. (Bombay) 647. Other cases to a similar effect will be found noted in vol. 9 of the English and Empire Digest, at pp. 186 *et seq.* and 232.

95 On this point I agree fully with the very complete analysis which my brother Riddell has made of the provisions of the Dominion *Companies Act* and concur with his reasoning and result.

96 If I am right in the conclusion that there was no application to the company by the respondents for shares and no subscription to the memorandum of agreement mentioned in sec. 13, it becomes unnecessary to discuss the other questions raised on the appeal, including allotment and notice of allotment.

97 I have no hesitation, however, in expressing my concurrence in the finding of fact by the trial Judge, 5 C.B.R. 331, at p. 337, 27 O.W.N. 321, that Gott compromised the claim against him at $2,000, that he thereby became the holder of twenty shares fully paid, and that any further claim against him was cancelled.

98 I am also of opinion that the effect of our statute is to render void, and not merely voidable, any allotment of shares attempted to be made prior to the filing of a prospectus or a statement in lieu thereof. The unfortunate results which may in some cases flow from that conclusion (see *In re Guardian Permanent Benefit Building Society* (1882), 23 Ch. D. 440, 52 L.J. Ch. 857, 48 L.T. 134, 32 W.R. 73, and *Sinclair v. Brougham*, [1914] A.C. 398, 83 L.J. Ch. 465, 111 L.T. 1, 58 Sol. Jo. 302, 30 T.L.R. 315) are matters which, in my opinion fall to be dealt with by Parliament and not by the Courts.

99 For these reasons I would dismiss the appeals with costs.

100 I add only one word further. In the case of *In re Olympic Fire and General Reinsurance Co. Ltd.*, [1920] 2 Ch. 341, at p. 345, 89 L.J. Ch. 544, 123 L.T. 786, 36 T.L.R. 691, Lord Sterndale, M.R., says:

> On the evidence before us there was not only a clear breach of contract with the Trust, but it seems to me there was a very considerable and grave breach of faith. I do not wish to say anything about that for this reason. Very often in these cases there are matters behind which do not really legally bear upon the question before the Court but which may and often do influence the motives of the parties in their action, and therefore I do not wish to say anything about that. The question we have to decide is simply a question of law.

101 I think that remark applies to the circumstances of this case as between the respondents (other than Gott) and their co-adventurers, the other subscribers to Ex. 1. But the question before us is purely a question of law in regard to which such considerations are irrelevant.

***Middleton, J.A.:***

102 I agree with my brother Masten that the liquidator cannot succeed unless a contract is shewn, and that no contract has been made out. I do not think it necessary or desirable to discuss other questions argued.

*Appeals dismissed.*

# TAB 3

1988 CarswellBC 3186
British Columbia Court of Appeal

**Salo** v. **Royal Bank** of **Canada**

1988 CarswellBC 3186, 11 A.C.W.S. (3d) 148

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

Craig, Macfarlane and Wallace JJ.A

Judgment: May 5, 1988
Docket: CA 005921

Counsel: G.L. Bisaro, Esq., for The Appellants
D.G. Morrison, Esq., for The Respondent **Royal Bank** Of Canada
L. Kancs, Esq., for The Respondent Patrick & Miles Logs Ltd.

Subject: Estates and Trusts

**Headnote**
**Labour and employment law**

***Craig, J.A.*:**

Mr. Justice Wallace will give the first judgment.

***Wallace, J.A.*:**

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.

1 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.

2 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.

3 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.

4 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.

5 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**.

6 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 is 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."

7 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] 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."

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

9 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.

***Craig, J.A.*:**

I agree.

***Macfarlane, J.A.*:**

I agree.

***Craig, J.A.*:**

The appeal is dismissed.

End of Document

TAB 4

2003 CarswellOnt 2460
Ontario Court of Appeal

Outset Media Corp. v. Stewart House Publishing Inc.

2003 CarswellOnt 2460, 34 B.L.R. (3d) 241

# OUTSET MEDIA CORPORATION (Plaintiff/Respondent) v. STEWART HOUSE PUBLISHING INC. and KEN THOMSON (Defendants/Appellants)

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

Heard: June 18, 2003
Judgment: June 18, 2003 *
Docket: CA C39390

Proceedings: reversing *Outset Media Corp. v. Stewart House Publishing Inc.* (2002), 2002 CarswellOnt 4556, 30 B.L.R. (3d) 198 (Ont. S.C.J.); additional reasons at *Outset Media Corp. v. Stewart House Publishing Inc.* (2003), 2003 CarswellOnt 666 (Ont. S.C.J.); additional reasons at *Outset Media Corp. v. Stewart House Publishing Inc.* (2003), 2003 CarswellOnt 2782 (Ont. C.A.)

Counsel: R. Andrew Biggart, John R. Hart for Appellants
Robert C. Taylor for Respondent

Subject: Corporate and Commercial; Estates and Trusts; Contracts; Civil Practice and Procedure

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Corporations --- Directors and officers — Liabilities — Miscellaneous issues**

Motion for summary judgment was brought — Motions judge concluded that there was trust affected against defendant's interest, which was conclusion as much against individual defendant as it was against corporate defendant — Individual defendant was entitled to appeal conclusion — Individual defendant appealed — Appeal allowed — Summary judgment as against individual defendant was set aside and motion for summary judgment dismissed — Motions judge erred in holding that amounts owing to plaintiff were impressed with trust — Motions judge misconstrued legal effect of provision in agreement relating to payments by corporate defendant to plaintiff — Agreement, properly interpreted, did not mean that net proceeds of sale remained property of plaintiff — Agreement provided that corporate defendant was contractually obligated to pay plaintiff 75 per cent of amount invoiced to publishers — Risk of non-payment was assumed by corporate defendant — Arrangement for payment to plaintiff was inconsistent with notion that proceeds received from sales of games were impressed with trust in favour of plaintiff — Agreement made no provision for segregation of funds received by corporate defendant from sale of games.

**Trusts and trustees --- General principles — Miscellaneous issues**

Motion for summary judgment was brought — Motions judge concluded that there was trust affected against defendant's interest, which was conclusion as much against individual defendant as it was against corporate defendant — Individual defendant was entitled to appeal conclusion — Individual defendant appealed — Appeal allowed — Summary judgment as against individual defendant was set aside and motion for summary judgment dismissed — Motions judge erred in holding that amounts owing to plaintiff were impressed with trust — Motions judge misconstrued legal effect of provision

in agreement relating to payments by corporate defendant to plaintiff — Agreement, properly interpreted, did not mean that net proceeds of sale remained property of plaintiff — Agreement provided that corporate defendant was contractually obligated to pay plaintiff 75 per cent of amount invoiced to publishers — Risk of non-payment was assumed by corporate defendant — Arrangement for payment to plaintiff was inconsistent with notion that proceeds received from sales of games were impressed with trust in favour of plaintiff — Agreement made no provision for segregation of funds received by corporate defendant from sale of games.

APPEAL by individual defendant from judgment reported at 2002 CarswellOnt 4556, 30 B.L.R. (3d) 198 (Ont. S.C.J.).

**Endorsement.** ***Per curiam*:**

1 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, 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.

*Appeal allowed.*

Footnotes

* Additional reasons given 2003 CarswellOnt 2782, 34 B.L.R. (3d) 244 (Ont. C.A.).

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# TAB 5

2000 BCSC 1443
British Columbia Supreme Court

Maple Homes Canada Ltd., Re

2000 CarswellBC 2017, 2000 BCSC 1443, [2000] B.C.J. No. 1958, [2001] B.C.W.L.D. 172, 21 C.B.R. (4th) 87

# In the Matter of the Proposal of Maple Homes Canada Ltd.

Smith J.

Heard: September 11 and 12, 2000
Judgment: October 2, 2000
Docket: Vancouver 202788/00

Counsel: *John P. Sullivan*, for Maple Homes Canada Ltd.
*Jeffrey P. Scouten*, for Max Gomez
David Gray, Trustee, for himself

Subject: Civil Practice and Procedure; Insolvency; Torts

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy --- Proposal — Approval by court — Misconduct of bankrupt**

Bankrupt company supplied building materials to international customers — Bankrupt's proposal to liquidate assets, sell interest in property, pay trustee from future income and waive rights to dividends under proposal was passed at meeting of creditors — Proposal was rejected by creditor who paid bankrupt in full for building materials and received only one of two shipments — In months prior to intention to make proposal, bankrupt's director told creditor that delivery was delayed for reasons other than lack of funds — Creditor claimed that director made representations that deposit would be used expressly for creditor's materials — Bankrupt brought application for court approval of proposal — Trustee recommended proposal on grounds that it offered unsecured creditors seven-per-cent return and kept in tact bankrupt's 11 years of goodwill — Creditor opposed proposal on grounds that unsecured creditors were not significantly better off — Creditor brought application for order declaring that bankrupt continued to trade after insolvency — Bankrupt's application granted; creditor's application dismissed — Creditor claimed that fact that large order fell through and director ceased drawing salary and laid off employees indicated that bankrupt knew it was insolvent months prior to filing intention — Director's alleged realization that company could not meet its debts was not admission of insolvency — Bankrupt's efforts to keep company solvent by bidding on and winning large orders were consistent with good faith and reasonable efforts to carry on rather than with knowledge that business would fail — Bankrupt gave notice of intention to make proposal within reasonable time of knowing it was insolvent — Proposal was reasonable and calculated to benefit general body of creditors.

**Bankruptcy --- Effect of bankruptcy on other proceedings — Proceedings against bankrupt — Before discharge of trustee — Granting of leave**

Bankrupt company supplied building materials to international customers — Bankrupt's proposal to liquidate assets, sell interest in property, pay trustee from future income and waive rights to dividends under proposal was passed at meeting of creditors — Proposal was rejected by creditor who paid bankrupt in full for building materials and received only one of two shipments — In months prior to intention to make proposal, bankrupt's director told creditor that delivery was delayed for reasons other than lack of funds — Creditor claimed that director made representations that deposit would

be used expressly for creditor's materials — Bankrupt's proposal was approved by court — Creditor brought application for exemption from stay of proceedings against bankrupt — Application granted — Without exemption, creditor would relinquish all claims against bankrupt and its directors under terms of proposal — Proposal could not compromise all claims against directors that did not relate to obligations of bankrupt where directors were liable in capacity of directors, or claims that were based on allegations of misrepresentations made by directors to creditors or wrongful or oppressive conduct by directors — Creditor's action against bankrupt and director would survive discharge — Action against director could succeed — Creditor had serious claim against director, who deliberately deceived creditor until it was too late to recover funds — It was equitable to grant exemption, as claim could survive discharge and passage of time would be prejudicial to creditor.

**Table of Authorities**

**Cases considered by *Smith J.*:**

*A. Marquette & fils Inc. v. Mercure* (1975), [1977] 1 S.C.R. 547, 10 N.R. 239, 65 D.L.R. (3d) 136 (S.C.C.) — considered

*Advocate Mines Ltd., Re* (1984), 52 C.B.R. (N.S.) 277 (Ont. S.C.) — considered

*Bank of Montreal v. British Columbia (Milk Marketing Board)* (1994), 94 B.C.L.R. (2d) 281 (B.C. S.C.) — applied

*Barclays Bank Ltd. v. Quistclose Investments Ltd.* (1968), [1970] A.C. 567, [1968] 3 All E.R. 651, [1968] 3 W.L.R. 1097 (U.K. H.L.) — considered

*Bond, Re* (May 28, 1993), Doc. Vernon 9760/93 (B.C. Master) — distinguished

*Don Bodkin Leasing Ltd. v. Rayzak* (February 16, 1994), Doc. 92-CQ-23655 (Ont. Gen. Div.) — referred to

*Dutchak Estate v. Seidle* (1998), (sub nom. *Kowtzen v. Seidle*) 176 Sask. R. 99 (Sask. Q.B.) — referred to

*Duvall, Re* (1992), 63 B.C.L.R. (2d) 97, 11 C.B.R. (3d) 264 (B.C. S.C.) — referred to

*Eron Financial Services Ltd. (Receiver of) v. Biller* (1999), 10 C.B.R. (4th) 252 (B.C. S.C.) — considered

*Francisco, Re* (1995), 19 C.L.R. (2d) 146, 32 C.B.R. (3d) 29 (Ont. Bktcy.) — considered

*Henry v. Hammond*, [1913] 2 K.B. 515 (Eng. K.B.) — applied

*J. B. Allen & Co. v. D.E. Witmer Plumbing & Heating Ltd.* (1992), 12 C.B.R. (3d) 272, 1 C.L.R. (2d) 148 (Ont. Bktcy.) — referred to

*Likins v. Francis* (1995), 33 C.B.R. (3d) 259 (Ont. Bktcy.) — referred to

*Ling v. Chinavision Canada Corp.* (1992), 10 O.R. (3d) 79 (Ont. Gen. Div.) — applied

*Lowndes Lambert Group Ltd. v. Specialty Underwriting Services Ltd.* (1986), 11 B.C.L.R. (2d) 308 (B.C. S.C.) — applied

 

*M.A. Hanna Co. v. Provincial Bank of Canada* (1934), [1935] S.C.R. 144, [1935] 1 D.L.R. 545 (S.C.C.) — considered

*Moxam, Re* (1978), 31 C.B.R. (N.S.) 151 (B.C. S.C.) — distinguished

*Pateman, Re* (1991), 5 C.B.R. (3d) 115, 74 Man. R. (2d) 1 (Man. Q.B.) — considered

*Quality Carpets Ltd., Re* (1995), 36 C.B.R. (3d) 143 (B.C. S.C. [In Chambers]) — referred to

*Royal Bank v. Exner* (1993), 23 C.B.R. (3d) 274, 147 A.R. 167 (Alta. Q.B.) — referred to

*Salo v. Royal Bank* (May 5, 1988), Doc. CA005921 (B.C. C.A.) — considered

*Stainton, Re* (1887), 19 Q.B.D. 182, 57 L.T. 202, 35 W.R. 667, 4 Morr. 242 (Eng. Q.B.) — considered

*Toronto-Dominion Bank v. Hayworth Equipment Sales Ltd.* (1985), 36 Alta. L.R. (2d) 373, 60 A.R. 28, 56 C.B.R. (N.S.) 82 (Alta. Q.B.) — considered

*Wychreschuk v. Sellors (Trustee of)* (1988), 71 C.B.R. (N.S.) 37, 55 Man. R. (2d) 89 (Man. Q.B.) — considered

*Wychreschuk v. Sellors (Trustee of)* (1989), 73 C.B.R. (N.S.) 267, 57 Man. R. (2d) 100 (Man. C.A.) — considered

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
Generally — referred to

s. 2 "insolvent person" — considered

s. 50(13) [en. 1997, c. 12, s. 30(6)] — considered

s. 50(14) [en. 1997, c. 12, s. 30(6)] — considered

s. 59 [am. 1997, c. 12, s. 36] — considered

ss. 69-69.3 [en. 1992, c. 27, s. 36(1)] — considered

s. 69(1)(a) [en. 1992, c. 27, s. 36(1)] — considered

s. 69.1(1)(a) [rep. & sub. 1997, c. 12, s. 63(1)] — considered

s. 69.3(1) [en. 1992, c. 27, s. 36(1)] — considered

s. 69.31(1) [rep. & sub. 1997, c. 12, s. 65(1)] — considered

s. 69.31(2) [en. 1997, c. 12, s. 65(1)] — considered

s. 69.4 [rep. & sub. 1997, c. 12, s. 65(1)] — considered

s. 95(2) — considered

s. 143 — referred to

s. 147 — referred to

s. 173 [rep. & sub. 1997, c. 12, s. 103] — referred to

s. 173(1)(c) [rep. & sub. 1997, c. 12, s. 103(1)] — considered

s. 177 — referred to

s. 178(1) [am. R.S.C. 1985, c. 3 (2nd Supp.), s. 28; am. 1992, c. 27, s. 64(1),(2); am. 1997, c. 12, s. 105(1),(2)] — referred to

s. 178(1)(d) — considered

**Rules considered:**

*Rules of Court, 1990*, B.C. Reg. 221/90
R. 19(24) — referred to

APPLICATION by bankrupt for approval of proposal; APPLICATION by creditor for exemption from stay of proceedings against bankrupt.

***Smith J.*:**

1 Maple Homes Canada Ltd. for eleven years has carried on a business of supplying distinctively Canadian building materials for the construction of homes outside Canada, particularly in Japan. It did not produce the materials itself but obtained them from suppliers in Canada and then arranged to have them loaded into containers and shipped to the overseas customer. It would charge a markup on the materials. At peak, in 1995, it employed 12 people and had annual sales of $8.6 million.

2 Maple Homes lodged an Intention to make a Proposal on May 10, 2000. The Trustee under that Proposal, David Gray of Campbell Saunders Ltd., reported on June 30, 2000 that the debtor had assets of an estimated value of $13,000 and liabilities of $664,758.14. He stated the opinion that the causes of insolvency of the debtor were the decline in the Asian market and the bankruptcy of several large customers of Maple Homes. He further stated the opinion that the conduct of the debtor is not subject to censure and that none of the facts mentioned in sections 143 and 147 (it is common ground that he meant to refer to those provisions whose new section numbers are 173 and 177) may be proved against the debtor.

3 The Trustee held a meeting of creditors at which a Special Resolution accepting the Proposal was passed, with 72.2% in favour in terms of the amounts voting.

4 The Trustee reported that in his opinion the debtor's Proposal is an advantageous one for the creditors because the unsecured creditors will receive a dividend in the range of 7 - 8.5%, whereas in bankruptcy the unsecured creditors will not receive a dividend.

5 The Proposal includes provisions that the debtor will liquidate its assets and pay the net proceeds of sale (after satisfaction of valid security interests) to the Trustee; cause Brad Grindler to sell his interest in a property on Pender Island and pay the net proceeds to the Trustee for the general benefit of unsecured creditors; cause Brad Grindler to pay to the Trustee from his future income the sum of $30,000 at the rate of not less than $500 per month; and cause Brad Grindler to waive any right he may have to a dividend under the Proposal. Paragraph 5 of the Proposal states:

> By accepting this Proposal, the unsecured creditors shall agree to accept the amounts paid and payable under paragraph 2, coupled with the waiver referred to in paragraph 4 above as payment in full for an assignment of their provable claims

> against the debtor under the Act, together with all rights of recovery they may have against Brad and Cathie Grindler in that regard. The assignment aforesaid shall be made to the debtor or to whomever it may direct.

6 Mr. Max Gomez voted against the Proposal. Mr. Gomez is a resident of Montera in Cantabria, Spain. He had agreed in July 1999 to purchase materials from Maple Homes for construction of a home. The total purchase price was $177,589. He paid that in two instalments, on July 8, 1999 and September 13, 1999. He received one shipment from Maple Homes in September 1999, worth $76,179.23. Therefore, he is owed roughly $100,000 by the debtor.

7 Before Mr. Gomez sent the first instalment, he received a fax from Mr. Grindler that informed him that the quote was being split up into three shipments, and stated:

> To get things moving, if all is fine with the First Shipment quotation, please sign page 2 of the quote where provided and fax it back to us. Once we confirm your deposit, we will place the orders. Then we will advise on the shipping.

Mr. Gomez signed the "quote" and returned it with his first instalment of $60,000 U.S. He requested that all invoices be made out to his family society, Operadora Cancun 1900, S.L. (I note here that counsel for Maple Homes argued that because of this the contract was really between Operadora Cancun and Maple Homes. Mr. Gomez in an affidavit deposed that Operadora Cancun is his personal and family tax society, which every family is entitled to have under the laws of Spain for tax benefits and the assignation and protection of personal assets. The "quote" was signed by Mr. Gomez, the payments came from him, and except for the one invoice, all other correspondence and dealings were with Mr. Gomez. Therefore, I am proceeding on the basis that the contract was between Maple Homes and Mr. Gomez and that he is the creditor and entitled to oppose approval of the proposal as he has done.)

8 The events that led to Maple Homes's insolvency began in the fall of 1999. As the Trustee stated, the decline in the Asian market and the bankruptcy of some large customers seem to have been the turning points. From 1999 sales of $300,383.92 in August and $210,117.53 in September, there was a dramatic decline to $62,519.13 in October, $73,272.40 in November, $60,097.66 in December, $24,713,28 in January 2000, $16,430.96 in February, with an improvement again in March, 2000 to $117,628.11. As a result, although Maple Homes had actually received payment in full from Mr. Gomez, it proved unable to pay the suppliers (which had begun to demand cash on delivery) and to provide the materials it had contracted to send to Spain. This was despite the efforts described by Mr. Grindler to keep the company afloat — laying off employees, ceasing to draw any salary, and borrowing money from family members to put into the company. Mr. Grindler summarizes in his affidavit:

> I worked exclusively for the Company from its start until the date of the Proposal, and have put an enormous amount of energy and effort into the Company. Until recently, Maple Homes was always a tremendous source of pride for me. As a result, however, it was very difficult for me this Spring to come to accept that Maples Homes could not make ends meet and could not meet its debts. I kept thinking that Maple Homes could turn things around and be a success again. As will be outlined below, I tried just about everything that I could think of, including reducing the number of Maple Homes' staff, borrowing from a family member, foregoing my own salary, seeking financing, and of course bidding on further work. In a particularly difficult period of time, I also sent some emails to Mr. Gomez which were untruthful, and which I deeply regret. During that period of time I was making every effort I could to assist Maple Homes to put together the money to pay the suppliers so that it could ship the products that Mr. Gomez had ordered, and I genuinely believed that Maple Homes would succeed in this regard. Unfortunately, however, that never proved to be possible, despite considerable effort.

9 In the early spring of 2000, Mr. Grindler began to respond to Mr. Gomez's inquiries with untruthful statements in emails and faxes. In some of these he created elaborate lies to explain the delay in the shipment of materials. It was not until April 12, 2000 that Mr. Grindler informed Mr. Gomez that the shipment was not on its way and could not be sent because of the lack of funds in Maple Homes.

10 Mr. Gomez deposes that he trusted Mr. Grindler and believed his representations that the funds Mr. Gomez provided to Maple Homes would be used for the specific purpose for which they were provided.

11 Maple Homes has applied for court approval of the Proposal, which application is opposed by Max Gomez. Mr. Gomez has applied for an order and declaration that sections 69 to 69.3 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, no longer operate in respect of himself. He has commenced an action against Bradley Michael Grindler and Cathie Mae Grindler for damages for breach of trust and for an accounting. He has not sued Maple Homes but wishes to be able to do so. In his affidavit he states that he is concerned that his ability to trace and recover his funds and prove the details of the fraud he alleges will be impaired by the passage of time if his right to pursue action against Maple Homes is stayed.

**ISSUES**

***A. Should the Proposal of Maple Homes Canada Ltd. be approved?***

***B. If the Proposal is approved, should Max Gomez be granted an exemption from the stay of proceedings pursuant to s. 69.4 of the Bankruptcy and Insolvency Act?***

**ANALYSIS**

***A. Should the Proposal of Maple Homes Canada Ltd. be approved?***

12 The relevant provisions of the *Bankruptcy and Insolvency Act* are:

> s.59 (1) The court shall, before approving the Proposal, hear a report of the trustee in the prescribed form respecting the terms thereof and the conduct of the debtor, and, in addition, shall hear the trustee, the debtor, the person making the Proposal, any opposing, objecting or dissenting creditor and such further evidence as the court may require.
>
> (2) Where the court is of the opinion that the terms of the Proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the Proposal, and the court may refuse to approve the Proposal whenever it is established that the debtor has committed any one of the offences mentioned in sections 198 to 200.
>
> (3) Where any of the facts mentioned in sections 173 and 177 are proved against the debtor, the court shall refuse to approve the Proposal unless it provides reasonable security for the payment of not less than fifty cents on the dollar on all the unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct.
>
> s.173 (1) The facts referred to in section 172 are:
>
> ...
>
> (c) the bankrupt has continued to trade after becoming aware of being insolvent; ...

*1. Are the terms of the Proposal reasonable and calculated to benefit the general body of creditors pursuant to s. 59 of the Bankruptcy and Insolvency Act?*

13 The Trustee is recommending approval of the Proposal, pointing out that it will bring the unsecured creditors some return (a dividend of 7 - 8.5%) rather than no return. The Trustee estimated that if Mr. Grindler were petitioned into bankruptcy he would be required to make payments of $500 per month for between nine and twenty-one months (thus, a total of $4,500 - $10,500), rather than the total of $30,000 under the Proposal.

14 The principal of the company, Brad Grindler, is putting into the Proposal what appears to be his only remaining substantial asset, the family recreational property on Pender Island which is worth perhaps $40,000, in addition to $30,000 of his future income. Mr. Sullivan argued that the creditors will thus receive more under the Proposal than they would if they put both Maple Homes and Mr. Grindler into bankruptcy. He urged that if the Proposal is rejected Maple Homes will automatically be bankrupt which would destroy the goodwill it has built up in the market over 11 years.

15 He referred to *Re Pateman* (1991), 5 C.B.R. (3d) 115 (Man. Q.B.) at p. 120 where Oliphant A.C.J.Q.B. wrote:

> The decision of the Newfoundland Supreme Court [In Bankruptcy] in *Irving Oil Ltd. v. Noseworthy* (1982), 42 C.B.R. (N.S.) 302, is authority for the proposition that where the majority of the creditors is in favour of the Proposal and it has not been demonstrated that public policy or good business morality or practice militate against it, the Proposal should be approved.

The Court in *Pateman* also noted that the onus is on the party seeking approval for the Proposal to establish that its terms are reasonable and for the benefit of the general body of creditors, that while the majority of creditors' views should be seriously considered, they are not binding, and that it is the duty of the court to be satisfied that creditors will be better off under the Proposal than in bankruptcy.

16 Mr. Scouten argued that in this respect the Proposal did not meet the standard necessary for approval. He pointed out that Mr. Gomez is one of the largest creditors and perhaps one of the few with claims against Mr. Grindler personally. Thus, he argued, the aspect of the Proposal that Maple Homes cited as a reason for approval (the contribution by Mr. Grindler personally) was actually a reason to reject the Proposal because it may put his major personal asset out of reach of his creditors.

17 Mr. Sullivan argued that approval of the Proposal is consistent with the two overriding objectives of the *Bankruptcy and Insolvency Act*: to ensure the equitable distribution of an insolvent's assets amongst its creditors *pari passu*, and to assist the financial rehabilitation of debtors. Mr. Scouten urged on the other hand that the objectives of the legislation also encompass requiring debtors to act responsibly with respect to their creditors. He pointed to the dishonest statements made by Mr. Grindler to Mr. Gomez and to the possibility that Maple Homes continued to trade after knowing it was insolvent. He also urged that the proposed dividend was very modest, amounting to $700 per $10,000 of claim, and thus only marginally better than bankruptcy.

18 The main ground for Mr. Gomez's position that the Proposal should not be approved was that a "fact mentioned" in s. 173(c) of the *Act* had been proved, namely that Maple Homes continued to trade while it knew it was insolvent. Mr. Scouten argued that at the latest by March 10, 2000, Mr. Grindler as principal of Maple Homes knew that it was insolvent. The definition of "insolvent person" under the *Bankruptcy and Insolvency Act* refers to a person:

> (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 ...

Mr. Scouten pointed to the evidence that the sales of Maple Homes had been in serious decline since September of 1999, having plummeted to 10% of previous levels, that a large prospective order from a German customer had fallen through at the end of February, that the company's suppliers had put it on a "C.O.D." basis, that Mr. Grindler had ceased to draw a salary, had borrowed money from family to put into the company and had laid off employees, and that Mr. Gomez had been demanding shipment of the goods worth roughly $100,000 for which he had already paid. I note that for Maple Homes to have reached the state of $13,000 assets and $664,758.14 liabilities by the date of the Trustee's report in June 2000, it would have to have been in something approaching that state by early March. I also note that, as counsel for Maple Homes urged, the evidence suggests that Mr. Grindler adopted the tactic of lying to Mr. Gomez about his shipment out of desperation.

19 The law on this subject is summarized in Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada*, 3rd ed., at p. 6-92:

> Section 173(1)(c) makes it imperative that a debtor who is aware that he is insolvent should cease trading and either call a meeting of creditors or file an assignment in bankruptcy: *Re Lunenfeld* (1929), 10 C.B.R. 457 (Ont. S.C.). If a debtor continues in business, he has committed a fact under s. 173(1)(c). By continuing to trade, the debtor is continuing in business at the risk of his creditors if business does not improve, and a debtor has no right to do this: *Re Stainton, Ex parte Board of Trade* (1887), 4 Morr. 242 ... .

 

> For the court to find that a fact has been committed under s. 173(1)(c), it is essential to prove that the debtor was aware of his insolvency.

The *Stainton* case [*Re Stainton* (1887), 4 Morr. 242 (Eng. Q.B.)] illustrates that this principle applies even when the debtor has a *bona fide* belief that trade must soon revive. Cave J. wrote at p. 251:

> Now, a man, of course has a perfect right as long as he is solvent, to determine that he will go on with a business, although it may be a losing business. He may trust that before he becomes insolvent matters will change, and he will again be in a condition of prosperity. But the moment he becomes insolvent, then he is no longer going on at his own risk in case of failure; he is going on at the risk of his creditors, in case things do not mend as he hopes they will. In my judgment a man has no right to do that. The moment things have got to such a pitch that he cannot pay 20*s.* in the pound, but he nevertheless thinks that if he goes on he may be able to retrieve his position, in my opinion he ought to call his creditors together, and leave them who will have to bear the loss in case his calculations are wrong, to determine whether that course of going on shall be proceeded with or not.

20 Mr. Scouten submitted that this case provides an opportunity for the Court to make it clear that insolvent persons who are carrying on business at the risk of their creditors will not be allowed to do so without consequences for themselves.

21 Mr. Sullivan, however, suggested that the older authorities must be read with some caution since the more recent trend is to view bankruptcy legislation through a less penal, and more rehabilitative, lens. He argued that an overly strict interpretation of the provisions regarding doing business while insolvent is inconsistent with the objectives of the legislation, and pointed out that since a debtor cannot make a Proposal until it is insolvent, an overly strict view would leave only a very brief opportunity to make a Proposal. He cited *A. Marquette & fils Inc. v. Mercure* (1975), [1977] 1 S.C.R. 547 (S.C.C.) at p. 556 where the Court stated:

> Before going on to another point it is perhaps not inappropriate to recall that the *Bankruptcy Act*, while not business legislation in the strict sense, clearly has its origins in the business world. Interpretation of it must take these origins into account. it concerns relations among businessmen, and to interpret it using an overly narrow, legalistic approach is to misinterpret it. it seems to me that appellant is urging the Court to so interpret it.

22 He referred to *Re Moxam* (1978), 31 C.B.R. (N.S.) 151 (B.C. S.C.) in which Low, L.J.S.C. (as he then was) allowed an application for discharge, stating at p. 153:

> I do not find any evidence that Mr. Moxam continued to trade after knowing that he was insolvent. He merely made reasonable efforts to salvage a situation that involved increasing despair.

23 Mr. Scouten urged that the *Moxam* case is quite different on its facts. The debtor there was found to have been straightforward in his dealings with the creditors, which is not the case here. As well, he argued, in the case of Maple Homes, there was not a gradual decline, inevitable only with hindsight, but a tangible and definite occurrence — the loss of the large order from Germany at the beginning of March — after which Mr. Grindler must have known that Maple Homes was insolvent.

24 Indeed, he argued, Mr. Grindler had admitted this in his affidavit, where he swore:

> Until recently, Maple Homes was always a tremendous source of pride for me. As a result, however, it was very difficult for me this Spring to come to accept that Maple Homes could not make ends meet and could not meet its debts.

However, I do not find this constitutes the admission alleged because the word "Spring" may refer to a season that extends to the beginning of May, which is when Maple Homes gave notice of its intention to make a Proposal to its creditors.

25 Mr. Scouten's submissions, urging that persons in financial difficulty have an obligation to keep optimism in check and to be candid with their creditors, have force. Nevertheless, I have concluded that the evidence does not establish that this debtor continued to trade after it knew it was insolvent. The length of time for which the company had been in business, the

concentrated efforts Mr. Grindler was making to solve the business's problems including continued bids on work, and the fact that a large order such as the one that fell through at the beginning of March could have permitted the company to continue, are consistent with good faith and reasonable efforts to carry on, rather than with knowledge that the business would fail. I am satisfied that, within a reasonable time of knowing that Maple Homes was insolvent, its principal, Mr. Grindler, gave notice of intention to make a Proposal and that a "fact" mentioned in s., 173(*c*) has not been proved.

26 Because I am also otherwise satisfied for the reasons put forward by the Trustee and by counsel for Maple Homes that the Proposal of Maple Homes is reasonable and calculated to benefit the general body of creditors, that Proposal is approved.

***B. Should Mr. Gomez be granted an exemption from the stay of proceedings pursuant to s. 69.4 of the Bankruptcy and Insolvency Act?***

27 The relevant provisions of the *Bankruptcy and Insolvency Act* are:

> 69 (1) Subject to subsections (2) and (3) and sections 69.4 and 69.5, on the filing of a notice of intention under section 50.4 by an insolvent person,
>
> (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy,
>
> ...
>
> until the filing of a Proposal under subsection 62(1) in respect of the insolvent person or the bankruptcy of the insolvent person.
>
> 69.1(1) Subject to subsections (2) to (6) and sections 69.4 and 69.5, on the filing of a Proposal under subsection 62(1) in respect of an insolvent person,
>
> (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged or the insolvent person becomes bankrupt; ...
>
> 69.3(1) Subject to subsection (2) and sections 69.4 and 69.5, on the bankruptcy of any debtor, no creditor has any remedy against the debtor or the debtor's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged.
>
> 69.31(1) Where a notice of intention under subsection 50.4(1) has been filed or a Proposal has been made by an insolvent corporation, no person may commence or continue any action against a director of the corporation on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the corporation where directors are under any law liable in their capacity as directors for the payment of such obligations, until the Proposal, if one has been filed, is approved by the court or the corporation becomes bankrupt.
>
> (2) Subsection (1) does not apply in respect of an action against a director on a guarantee given by the director relating to the corporation's obligations or an action seeking injunctive relief against a director in relation to the corporation.
>
> ...
>
> 69.4 A creditor who is affected by the operation of sections 69 to 69.31 or any other person affected by the operation of section 69.31 may apply to the court for a declaration that those sections no longer operate in respect of that creditor or person, and the court may make such a declaration, subject to any qualifications that the court considers proper, if it is satisfied
>
> (a) that the creditor or person is likely to be materially prejudiced by the continued operation of those sections; or

(b) that it is equitable on other grounds to make such a declaration.

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

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

28 Some grounds on which courts will lift stays of proceedings were set out in *Re Advocate Mines Ltd.* (1984), 52 C.B.R. (N.S.) 277 (Ont. S.C.) at p. 278:

The court may, however, remove the stay of proceedings prescribed by that section in appropriate cases and has done so in the following circumstances:

1. Actions against the bankrupt for a debt to which a discharge would not be a defence.

2. Actions in respect of a contingent or unliquidated debt. the proof of which and valuation has that degree of complexity which makes the summary procedure prescribed by s. 95(2) of the *Bankruptcy Act* inappropriate.

3. Actions in which the bankrupt is a necessary party for the complete adjudication of the matters at issue involving other parties.

4. Actions brought to establish judgment against the bankrupt to enable the plaintiff to recover under a contract of insurance or indemnity or under compensatory legislation.

5. Actions in Ontario which, at the date of bankruptcy, have progressed to a point where logic dictates that the action be permitted to continue to judgment.

29 It was common ground that the burden is on the applicant for a declaration under s. 69.4 to satisfy the court that one or more of those grounds is present and that the applicant is likely to be materially prejudiced or that it is equitable on other grounds to make such a declaration.

30 The authorities establish that it is not for the court to inquire into the merits of the action the applicant wishes to bring. In *Re Francisco* (1995), 32 C.B.R. (3d) 29 (Ont. Bktcy.) the court stated the position thus (at p. 34):

Without intending to usurp the role of the trial judge to decide otherwise on the facts established before him, I am satisfied BPCO has pleaded sufficient allegations to bring its claim, at least arguably, within s. 178(1)(d).

Mr. Sullivan cited *Wychreschuk v. Sellors (Trustee of)* (1988), 71 C.B.R. (N.S.) 37 (Man. Q.B.), appeal dismissed (1989), 73 C.B.R. (N.S.) 267 (Man. C.A.) where Monnin J. observed that the granting of leave is a discretionary matter, and wrote at p. 39:

In order for leave to be granted, an applicant must demonstrate to the court that there exist compelling reasons to permit an action either to commence or to proceed.

However, as Master Tokarek observed in *Bond, Re* (May 28, 1993), Doc. Vernon 9760/93 (B.C. Master), there is little available guidance as to what may be considered a "compelling reason".

31 In *Eron Financial Services Ltd. (Receiver of) v. Biller* (1999), 10 C.B.R. (4th) 252 (B.C. S.C.) the Receiver and Judicial Trustee of the plaintiffs wished to proceed with an action against the defendant before his Trustee in Bankruptcy had been discharged. They wished to bring an action claiming fraud and seeking a declaration of trust. The court decided to permit the action to proceed, stating at p. 256:

The facts of the case are similar to those in *J.B. Allen, supra*, where the Court relied upon the earlier decision in *Cravit, Re* (1984), 54 C.B.R. (N.S.) 214 (Ont. S.C.) where Master Ferron stated at p. 215:

  

> ... in order to come to a conclusion that the plaintiffs should not be permitted to proceed I would have to conclude that the plaintiffs could either not succeed in the action in question or that if they succeeded they could not recover against the [bankrupt's] insurer.
>
> The function of the bankruptcy court is not to inquire into the merit of the action sought to be commenced or continued but rather to be assured that such an action, falling within the s. 49(1) [now s. 69.3] stay, should continue for the reasons which I detailed in *Re Advocate Mines Ltd.*

The bankrupt, Mr. Biller, is a necessary party to the action as he was an officer and director of many, if not all of the plaintiff companies. Further, the claim is based upon a cause of action for which, if successful, will not be defeated by the bankruptcy. Lastly, the Judicial Trustee ought to be able to pursue the action against the other defendants, the bankrupt's wife and their holding company.

32 The parties referred me to a number of other authorities, including *Likins v. Francis* (1995), 33 C.B.R. (3d) 259 (Ont. Bktcy.); *Re Duvall* (1992), 11 C.B.R. (3d) 264 (B.C. S.C.); *Royal Bank v. Exner* (1993), 23 C.B.R. (3d) 274 (Alta. Q.B.); *Dutchak Estate v. Seidle* (1998), 176 Sask. R. 99 (Sask. Q.B.); *J. B. Allen & Co. v. D.E. Witmer Plumbing & Heating Ltd.* (1992), 12 C.B.R. (3d) 272 (Ont. Bktcy.); *Don Bodkin Leasing Ltd. v. Rayzak* (February 16, 1994), Doc. 92-CQ-23655 (Ont. Gen. Div.); and *Re Quality Carpets Ltd.* (1995), 36 C.B.R. (3d) 143 (B.C. S.C. [In Chambers]).

33 The principles that emerge from the jurisprudence may be summarized:

(1) The general scheme of bankruptcy proceedings is that civil actions are stayed against the insolvent person; exemptions are to be made only where there are "compelling reasons". This flows from one of the major purposes of the *Bankruptcy and Insolvency Act*, which is to permit the rehabilitation of the bankrupt unfettered by past debts.

(2) An applicant for exemption from the stay must show that there will be material prejudice to the applicant if the stay is continued or that it is equitable on other grounds to allow the exemption.

(3) The existence of one or more of the factors listed in *Advocate Mines Ltd.* will be an important consideration, but is not determinative.

(4) The court is not to attempt to determine the proposed claim on its merits.

(5) Rather, it must assess whether it is a claim of the nature that would survive discharge, whether it is a claim that could not succeed, and whether if it did succeed it could not result in recovery against the defendants.

34 The standard appears to be somewhat more stringent than that for permitting a cause of action to continue under a rule such as *Supreme Court Rules*, B.C. Reg. 221/90, Rule 19(24), where a proceeding may be struck as disclosing no reasonable claim or defence only if the pleading itself makes it plain and obvious there is none. Given the purpose of bankruptcy legislation and the fact that continuing an action is the exceptional situation, I think that generally there must be more than pleadings or proposed pleadings disclosing a claim. There must also be some evidence supporting the conclusion that there is a fair issue to be tried. However, to expect more than that would be inconsistent with the statutory scheme. The legislation contemplates that claims of fraud or breach of fiduciary duty may survive bankruptcy or insolvency, and it will seldom be possible to prove such cases on a balance of probabilities at an early stage and without discovery.

35 Should the exemption be granted in this case?

36 The first question is whether this would be an action falling within any of the grounds listed in *Advocate Mines Ltd.*, *supra*. The applicant's position is that it is an action against the bankrupt for a debt to which a discharge would not be a defence, and that the company Maple Homes is a necessary party in the action against Bradley and Cathie Grindler.

37 In claiming that the action is one for which discharge would not be a defence, the applicant here relies on s. 178(1)(d). He has issued a writ and statement of claim against Bradley Grindler and Cathie Grindler pleading that Maple Homes and Bradley Grindler, in using the funds Mr. Gomez provided for unauthorized purposes, and concealing that they had done so, committed a breach of trust. He also pleaded that Cathie Grindler was at all material times an active director and participant in Maple Homes and knowingly assisted in the misappropriation by Maple Homes and Bradley Grindler of the payments, the concealment of that misappropriation, and the continuing deceit upon the plaintiff. He further pleaded that the funds were used to pay third parties or to make payments to or for the benefit of the defendants, or to purchase assets now in the possession of the defendants or others, and seeks a tracing remedy in respect of the payments and assets. Maple Homes is not a party to the action.

38 After the close of the hearing, and upon further review of the matter, I requested further submissions from counsel as to the impact of paragraph 5 of the Proposal. It appeared that there might be some question about whether the legislation encompassed a stay of all claims against the Grindlers personally, even though such a stay seemed to be assumed in the provisions of paragraph 5 of the Proposal and in the submissions of counsel for Maple Homes. The response from counsel for Maple Homes clarified that its position is that if the Proposal is approved, Mr. Gomez will lose *all* of his claims (against both the company and Mr. and Mrs. Grindler) except for claims (if any) for non-dischargeable debts under s. 178(1) of the *Bankruptcy and Insolvency Act*.

39 On the other hand, Mr. Scouten argued on behalf of Mr. Gomez that although the Proposal, if approved, would bind Mr. Gomez such that he would require a declaration under s. 69.4 in order to pursue an action against Maple Homes, paragraph 5 of the Proposal, in purporting to cover "all rights of recovery" against the Grindlers personally, goes beyond what is permitted by s. 50(13) and (14) of the *Act*. Those sections provide:

> 50 (13) A Proposal made in respect of a corporation may include in its terms provision for the compromise of claims against directors of the corporation that arose before the commencement of proceedings under this Act and that relate to the obligations of the corporation where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> (14) A provision for the compromise of claims against directors may not include claims that:
>
> (a) relate to contractual rights of one or more creditors arising from contracts with one or more directors; or
>
> (b) are based on allegations of misrepresentation made by directors to creditors or of wrongful or oppressive conduct by directors.

40 Mr. Gomez's position is that the Proposal goes further than the *Act* permits in these ways:

> (1) the claims against Mr. Grindler arising from things done or said by him personally, and otherwise than by law by virtue of his capacity as a director, such as the claims in deceit, are not covered under s. 50(13);
>
> (2) Cathie Grindler has maintained that she was not a director of Maple Homes at the time of the payments made by Mr. Gomez and, if so, claims against her are not covered under s. 50(13); and
>
> (3) in part, Mr. Gomez's claims against Mr. Grindler are based on allegations of misrepresentation and wrongful conduct on the part of Mr. Grindler, which are not covered under s. 50(13).

41 Mr. Scouten argues that the Proposal is therefore bad on its face or, in the alternative, that if approved it can have no effect on the rights of Mr. Gomez to pursue claims against Bradley or Cathie Grindler since those claims either do not "relate to the obligations of the corporation where the directors are by law liable in their capacity as directors", or else (in Mr. Grindler's case) are based on allegations of "misrepresentation made by directors to creditors or of wrongful or oppressive conduct by directors". He argues that the claims do not fall within s. 50(13) in that they do not relate, for example, to a director's liability at law for unpaid statutory remittances, wages or similar debts of the company for which a director is liable *qua* director. He argues that s. 50(13) does not allow a corporate Proposal to include a term compromising *all claims* against directors of the

 

company; the section, properly read, only covers terms compromising claims for conventional "director's liabilities" arising out of the director's legal capacity as a director.

42 In response, Mr. Sullivan argues that the extent to which court approval of this Proposal would affect claims in the action against Bradley and Cathie Grindler will be a matter for the judge to decide in that action. He agrees that if the law does not allow a Proposal to affect a particular type of claim, then regardless of the provisions found within the Proposal, the Proposal cannot affect such claims.

43 I conclude that Mr. Scouten is correct; the Proposal of Maple Homes cannot compromise all claims against Bradley and Cathie Grindler, for the reasons he has put forward.

44 With respect to the application for a declaration permitting an action against Maple Homes, the argument on behalf of Mr. Gomez was that the debt arose out of a breach of trust. Mr. Gomez's position is that when he advanced the funds it was understood that they would be used to pay for the materials required to build his house. In his affidavit, Mr. Gomez deposes:

> Regarding paragraphs 16 through 20 of the Grindler Affidavit, when I met with Mr. Grindler in Vancouver, he specifically informed me that Maple Homes was not a manufacturer and he and Maple Homes would purchase for me and ship materials from different suppliers. I knew there would be a price mark-up for these services. Bradley Grindler took me to see a number of manufacturers/suppliers' show room locations and display facilities, including two display houses, while I was in Vancouver. At that time Mr. Grindler again confirmed the terms of our agreement: He told me "you select what you want and we will buy it for you". At these locations I then selected specific items which Bradley Grindler and Maple homes would purchase and ship to me. These included such items as the Jacuzzi, shower stalls, faucets, kitchen sink, the stairs ... and the mouldings for the walls and ceilings....
>
> Further Bradley Grindler took me and my wife for lunch and at that luncheon meeting, I specifically asked Mr. Grindler how I could be certain that if I paid him my money he would in fact purchase the house materials and ship them to me. He assured me he was a trustworthy person who had been in business for several years, operated a reputable company and I could trust him to buy and deliver all materials to me. I relied on those representations and I trusted that he would, for the price mark-up of Maple Homes, use my monies for the specific purpose of purchasing the materials, paying all suppliers and deliver the Materials to me.
>
> These statements, and Mr. Grindler's conduct in dealing with me throughout, left me with the clear understanding that Maple would be using the money that I sent to it to purchase and pay for the goods from his third party suppliers, and I understood this to be an important and central feature of the arrangement between us for the purchase and supply of products to me.

45 That evidence was not contradicted. Although it is conceded that the funds were kept in the Maple Homes general account, the records show that the funds were tracked separately in that account, as were funds deposited by other customers. Mr. Scouten argued that implicit in a "deposit" is a trust-like notion; a "deposit" does not necessarily create a trust, but shows that the money is to be used for a particular purpose. He relied on a series of cases beginning with *Barclays Bank Ltd. v. Quistclose Investments Ltd.* (1968), [1970] A.C. 567 (U.K. H.L.) in arguing that these arrangements gave rise to a relationship of a fiduciary character or trust in favour of the suppliers of the materials, and, secondly, if that trust failed, in favour of Mr. Gomez.

46 Mr. Sullivan argued, however, that it was the practice of Maple Homes with all of its customers to require payment in advance for their orders, and that although Mr. Gomez had specifically chosen certain materials, those materials could have come from Maple Homes's inventory just as much as from the suppliers under the terms of the contract, which was simply to provide the materials. Acknowledging the seriousness of Mr. Grindler's admitted dishonest statements to Mr. Gomez after the funds were gone, Mr. Sullivan pointed to Mr. Grindler's contrition and to his affidavit stating that he had continued to hope that more orders would come in and he would be able to fulfil the contract. Mr. Sullivan argued that sometimes even honest people say things they regret, that it was a time of panic, and that the lies in that context do not make Mr. Grindler a "fraud artist".

47 The law with respect to "*Quistclose* trusts" is, as Mr. Scouten said, still under development. The *Quistclose Investments Ltd.* case itself involved a loan from Quistclose Investments to Rolls Razor Ltd., which was in financial difficulties. The loan was made on the agreed condition that it would be used to pay a dividend. The cheque was paid into a separate account opened for that purpose with the bank. The bank knew that the money was borrowed, and agreed with Rolls Razor Ltd. that the account would only be used for the purpose of paying the dividend. Before the dividend had been paid, Rolls Razor Ltd. went into voluntary liquidation. Quistclose brought an action claiming that the money had been held by Rolls Razor Ltd. on trust to pay the dividend; that trust having failed, there was then a resulting trust for Quistclose of which the bank had notice. Lord Wilberforce, with whom all other members of the Court agreed, held that the mutual intention of Quistclose and Rolls Razor, and the essence of their bargain, was that "the sum advanced should not become part of the assets of Rolls Razor Ltd., but should be used exclusively for payment of a particular class of its creditors, namely, those entitled to the dividend." He then stated at p. 580:

> That arrangements of this character for the payment of a person's creditors by a third person, give rise to a relationship of a fiduciary character or trust, in favour, as a primary trust, of the creditors, and secondarily, if the primary trust fails, of the third person, has been recognised in a series of cases over some 150 years.

These cases do not detract, the court said, from the principle that in the absence of some special arrangement creating a trust, payments of this kind are made upon the basis that they are to be included in the company's assets. Further, the court rejected the argument that if a transaction was one of loan, giving rise to a legal action of debt, this necessarily excluded the implication of any trust relationship. Lord Wiberforce wrote at p. 581-82:

> There is surely no difficulty in recognising the co-existence in one transaction of legal and equitable rights and remedies: when the money is advanced, the lender acquires an equitable right to see that it is applied for the primary designated purpose ...: when the purpose has been carried out (i.e., the debt paid) the lender has his remedy against the borrower in debt: if the primary purpose cannot be carried out, the question arises if a secondary purpose (i.e., repayment to the lender) has been agreed, expressly or by implication: if it has, the remedies of equity may be invoked to give effect to it, if it has not (and the money is intended to fall within the general fund of the debtor's assets) then there is the appropriate remedy for recovery of a loan. I can appreciate no reason why the flexible interplay of law and equity cannot let in these practical arrangements, and other variations if desired: it would be to the discredit of both systems if they could not. In the present case the intention to create a secondary trust for the benefit of the lender, to arise if the primary trust, to pay the dividend, could not be carried out, is clear and I can find no reason why the law should not give effect to it.

48 Mr. Scouten cited *Ling v. Chinavision Canada Corp.* (1992), 10 O.R. (3d) 79 (Ont. Gen. Div.) which applied the principle stated in *Quistclose Investments Ltd.*.

49 Mr. Sullivan, however, argued that the principle is limited to situations where there is an express agreement that the funds will be kept separate and will be used only for the specified purpose. The fundamental premise articulated in *Henry v. Hammond*, [1913] 2 K.B. 515 (Eng. K.B.) at p. 521, he argued, is solidly accepted:

> 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.

He referred to *Bank of Montreal v. British Columbia (Milk Marketing Board)* (1994), 94 B.C.L.R. (2d) 281 (B.C. S.C.). There the Court held that the principle that where A gives money to B for the specific purpose of paying C, the money is impressed with a trust and may not be appropriated by him, is undoubted. Newbury J. observed, however, that in both the *Quistclose Investments Ltd.* case itself and in *Lowndes Lambert Group Ltd. v. Specialty Underwriting Services Ltd.* (1986), 11 B.C.L.R. (2d) 308 (B.C. S.C.) which applied it, that it appeared that (1) the recipient of the funds was required, either by express terms or the course of dealings between the parties, to keep the money separate from its own funds; and (2) the funds were paid on

 

express conditions of trust which the payees later tried to repudiate. The Court, having commented that the case at bar involved a claim that a trust should be implied from the course of dealings, concluded at p. 288:

> Faced with the clear authority of *Henry v. Hammond*, then, I must conclude that the absence of an obligation on McKinnon in the ordinary course to segregate funds received from the Board from its own funds is fatal to the inference that a trust existed in this case. Regardless of who was a conduit for the payment of funds to whom, and regardless of whether a direct liability existed between the receiving vendors and the defendant producers, such an obligation, express or implied, is "the essential thing" not proven here. It follows that the funds withheld from McKinnon by the Board constitute only a debt owing to the vendor, and that they must be distributed first to secured creditors and thereafter to other claimants in accordance with the *Bankruptcy Act*.

50 *Henry v. Hammond* has been cited and its principle followed a number of times in Canadian law. Mr. Sullivan cited, in addition to the above instance, *M.A. Hanna Co. v. Provincial Bank of Canada* (1934), [1935] S.C.R. 144 (S.C.C.); *Salo v. Royal Bank* (May 5, 1988), Doc. CA005921 (B.C. C.A.) and *Toronto-Dominion Bank v. Hayworth Equipment Sales Ltd.* (1985), 56 C.B.R. (N.S.) 82 (Alta. Q.B.).

51 Given that on its face the proposed action against Maple Homes and Bradley and Cathie Grindler is one that would survive discharge, I must ask whether it is one that could not succeed. There is evidence that the parties had discussions which left Mr. Gomez with the understanding that his funds would be used to purchase and ship the materials he had ordered for his house. Those funds were placed in the Maple Homes general account but were tracked separately. There is some authority that would support the proposed claim, if the evidence were fully developed in a way favourable to the claimant. I conclude that this action meets the required standard.

52 As well, I take into account that the action against Mr. and Mrs. Grindler can proceed despite the Proposal for the reasons set out above, and that action will involve the same events and raise many of the same issues as those in the proposed action.

53 Is there material prejudice if Mr. Gomez is required to wait? Is it equitable to grant the exemption? The allegations are serious ones, relating to breach of fiduciary duty. Mr. Gomez, in all good faith, trusted Maple Homes to use the money he provided for the purchase of materials for his home in Spain. Maple Homes, through Mr. Grindler, proceeded in a course of deception for several months, until it was far too late for Mr. Gomez to try to retrieve his funds. He may or may not succeed at trial in establishing that there was a trust-like relationship, but he is entitled to try. He will be prejudiced due to passage of time in producing his evidence if he is required to wait. In all of the circumstances it would be inequitable to deny his application.

54 Therefore, the exemption sought by Mr. Gomez will be granted.

## CONCLUSIONS

1. The Proposal is approved. It meets the statutory requirements. It has not been established that the debtor continued to trade after it knew it was insolvent.

2. The application by Mr. Gomez for a declaration under s. 69.4 that sections 69 to 69.3 no longer apply to him, is granted. This is because the claim that he wishes to bring against Maple Homes for breach of trust meets the standard required under s. 69.4 in that it is the type of claim that would survive discharge, it could succeed, there would be prejudice to continue the stay and it is equitable to grant the exemption.

*Order accordingly.*

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# TAB 6

2011 ONSC 4223
Ontario Superior Court of Justice [Commercial List]

Tucker v. Aero Inventory (UK) Ltd.

2011 CarswellOnt 8476, 2011 ONSC 4223, [2011] O.J. No. 3816,
206 A.C.W.S. (3d) 466, 338 D.L.R. (4th) 577, 80 C.B.R. (5th) 1

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

And In the Matter of James Robert Tucker, Richard Heis and Allan Watson Graham of KPMG LLP, as Joint Administrators (Applicants)

And In the Matter of Aero Inventory (UK) Limited and Aero Inventory PLC (Respondents)

Application under Section 46 and following of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

Morawetz J.

Judgment: August 18, 2011
Docket: 09-8456-00CL

Counsel: Orestes Pasparakis, Evan Cobb, Vasuda Sinha for Trustee
Sean F. Dunphy, Alexander D. Rose, Kathryn Esaw for Air Canada
John Porter for Lloyds TSB Commercial Finance Limited

Subject: Insolvency; Estates and Trusts

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Practice and procedure — Who may bring application**

Administration proceedings in respect of bankrupt company were commenced in foreign country — Administrators were recognized as foreign representatives under Companies' Creditors Arrangement Act ("CCAA") — Administrators assigned bankrupt into bankruptcy for purpose of pursuing preference action regarding certain transactions with airline — Trustee in bankruptcy brought motion to have such transactions declared void as fraudulent preferences pursuant to s. 95 of Bankruptcy and Insolvency Act ("BIA") — Hearing of threshold issue regarding priority of preferences proceeds was held — Trustee in bankruptcy was only party that could bring preference action in bankruptcy proceedings — Proceeds recovered were brought into estate, but distribution was subject to rights of secured creditors — Section 95 of BIA made it clear transaction declared to be preference was void as against trustee — Trustee had cause of action to declare preference to be void — Proceeds from preferential transaction were returned to estate but subject to rights of secured creditors.

**Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Miscellaneous**

Priority of proceeds from preferences action — Administration proceedings in respect of bankrupt company were commenced in foreign country — Administrators were recognized as foreign representatives under Companies' Creditors

Arrangement Act ("CCAA") — Administrators assigned bankrupt into bankruptcy for purpose of pursuing preference action regarding certain transactions with airline — Trustee in bankruptcy brought motion to have such transactions declared void as fraudulent preferences pursuant to s. 95 of Bankruptcy and Insolvency Act ("BIA") — Hearing of threshold issue regarding priority of preferences proceeds was held — Trustee in bankruptcy was only party that could bring preference action in bankruptcy proceedings — Proceeds from preferential transaction were returned to estate, subject to rights of secured creditors — Ability of trustee to recover monies for estate for benefit of creditors was subject to right of secured creditors — To extent that secured party had rights in collateral in hands of third party, such remedy and priority were not altered because trustee brought preference action — Focus was on whether or not secured creditor had rights in collateral at time of suspect transaction — It was premature to determine whether secured party had rights to recover proceeds from this preferences action.

**Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — General principles — Application of Act — Relationship between Act and Bankruptcy and Insolvency Act**

Administration proceedings in respect of bankrupt company were commenced in foreign country — Administrators were recognized as foreign representatives under Companies' Creditors Arrangement Act ("CCAA") — Administrators assigned bankrupt into bankruptcy for purpose of pursuing preference action regarding certain transactions with airline — Trustee in bankruptcy brought motion to have such transactions declared void as fraudulent preferences pursuant to s. 95 of Bankruptcy and Insolvency Act ("BIA") — Hearing of threshold issue regarding priority of preferences proceeds was held — Trustee in bankruptcy was only party that could bring preference action in bankruptcy proceedings — Proceeds recovered were brought into estate, but distribution was subject to rights of secured creditors — Preference action should proceed under BIA — Section 36.1(1) of CCAA provided preferential provisions in BIA applied in respect of compromise or arrangement — There was no compromise proposed to creditors, nor was any expected to be forthcoming — CCAA could operate in tandem with BIA to return matters to status quo — Procedural order in CCAA proceedings would transition matter to BIA so trustee would not have to start again.

**Bankruptcy and insolvency --- Administration of estate — Trustees — Miscellaneous**

Duty to comply with obligations under Bankruptcy and Insolvency Act.

**Table of Authorities**

**Cases considered by *Morawetz J.*:**

*Agricultural Credit Corp. of Saskatchewan v. Featherstone (Trustee of)* (1996), 1996 CarswellSask 344, (sub nom. *Agricultural Credit Corp. of Saskatchewan v. Featherstone (Bankrupt)*) 145 Sask. R. 161, [1996] 8 W.W.R. 281, 11 P.P.S.A.C. (2d) 194, 45 C.B.R. (3d) 113 (Sask. Q.B.) — considered

*Anderson, Re* (1911), [1911] 1 K.B. 896 (Eng. K.B.) — referred to

*Anron Mechanical Ltd. v. L'Abbé Construction (Ontario) Ltd. (Trustee of)* (1991), 5 C.B.R. (3d) 133, 46 C.L.R. 49, 1991 CarswellOnt 181 (Ont. Gen. Div.) — considered

*ASI Acoustical Supplies Inc., Re* (2000), 22 C.B.R. (4th) 174, 2000 CarswellBC 2585, 2000 BCSC 1838 (B.C. S.C.) — considered

*Bayley v. National Australia Bank Ltd.* (1995), 16 A.C.S.R. 38, [1995] TASSC 13, 4 Tas. R. 226 (Tasmania S.C.) — considered

*Beeston, Re* (1899), [1899] 1 Q.B. 626 (Eng. C.A.) — referred to

  

*Beetown Honey Products Inc., Re* (2003), 2003 CarswellOnt 3755, 46 C.B.R. (4th) 195, 67 O.R. (3d) 511 (Ont. S.C.J.) — referred to

*Beetown Honey Products Inc., Re* (2004), 3 C.B.R. (5th) 204, 2004 CarswellOnt 4316 (Ont. C.A.) — referred to

*Bibra Lake Holdings Pty. Ltd. v. Firmadoor Australia Pty. Ltd.* (1992), 7 A.C.S.R. 380 (Western Australia S.C.) — considered

*Canadian Imperial Bank of Commerce v. Canotek Development Corp.* (1997), 35 O.R. (3d) 247, 48 C.B.R. (3d) 161, 103 O.A.C. 302, 1997 CarswellOnt 3216, 152 D.L.R. (4th) 261, 13 R.P.R. (3d) 187 (Ont. C.A.) — followed

*Cooper, Re* (1875), (1874-75) L.R. 10 Ch. App. 510 (Eng. Ch. App.) — considered

*Fresjac Pty. Ltd. v. Michael Mount PPB* (1995), [1995] SASC 5378, 65 S.A.S.R. 334 (South Australia S.C.) — considered

*Giffen, Re* (1998), 45 B.C.L.R. (3d) 1, 1998 CarswellBC 147, 1998 CarswellBC 148, [1998] 1 S.C.R. 91, (sub nom. *Giffen (Bankrupt), Re)* 101 B.C.A.C. 161, (sub nom. *Giffen (Bankrupt), Re)* 164 W.A.C. 161, 155 D.L.R. (4th) 332, 222 N.R. 29, 1 C.B.R. (4th) 115, [1998] 7 W.W.R. 1, 13 P.P.S.A.C. (2d) 255 (S.C.C.) — referred to

*Homburg v. S-Marque Inc.* (1999), 1999 CarswellNS 73, (sub nom. *S-Marque Inc. v. Homburg Industries Ltd.)* 176 N.S.R. (2d) 218, (sub nom. *S-Marque Inc. v. Homburg Industries Ltd.)* 538 A.P.R. 218 (N.S. C.A.) — referred to

*Hudson v. Benallack* (1975), [1975] 6 W.W.R. 109, 7 N.R. 119, 59 D.L.R. (3d) 1, 1975 CarswellAlta 157, 1975 CarswellAlta 139, [1976] 2 S.C.R. 168, 21 C.B.R. (N.S.) 111 (S.C.C.) — considered

*Innovation Credit Union v. Bank of Montreal* (2010), 500 W.A.C. 1, (sub nom. *Bank of Montreal v. Innovation Credit Union)* [2010] 3 S.C.R. 3, 362 Sask. R. 1, 2010 SCC 47, 2010 CarswellSask 723, 2010 CarswellSask 724, 72 C.B.R. (5th) 23, 407 N.R. 294, 325 D.L.R. (4th) 605, 17 P.P.S.A.C. (3d) 1, [2011] 2 W.W.R. 581 (S.C.C.) — considered

*Johnson v. Smiley* (1853), 51 E.R. 1019, 17 Beav. 223 (Eng. Ch.) — referred to

*Lefebvre, Re* (2004), (sub nom. *Lefebvre (Bankrupt), Re)* 326 N.R. 253 (Eng.), (sub nom. *Lefebvre (Bankrupt), Re)* 326 N.R. 353 (Fr.), 2004 SCC 63, 2004 CarswellQue 2831, 2004 CarswellQue 2832, (sub nom. *Lefebvre (Trustee of), Re)* 244 D.L.R. (4th) 513, (sub nom. *Lefebvre (Trustee of), Re)* [2004] 3 S.C.R. 326, 7 C.B.R. (5th) 243, 1 B.L.R. (4th) 19 (S.C.C.) — referred to

*Mapleback Ex p. Caldecott, Re* (1876), (1876-77) L.R. 4 Ch. D. 150 (Eng. C.A.) — referred to

*Maybank Foods Inc., Re* (1990), 72 O.R. (2d) 93, 78 C.B.R. (N.S.) 79, 1990 CarswellOnt 167 (Ont. S.C.) — considered

*MC Bacon Ltd. (No.2), Re* (1990), [1991] Ch. 127, [1990] 3 W.L.R. 646 (Eng. Ch. Div.) — followed

*Mohawk Sports Equipment Ltd. (No. 2), Re* (1972), 17 C.B.R. (N.S.) 115, 1972 CarswellOnt 72 (Ont. S.C.) — considered

 

*N.A. Kratzmann Pty. Ltd. v. Tucker (No. 2)* (1968), 123 C.L.R. 295 (Australia H.C.) — considered

*N.W. Robbie & Co. v. Witney Warehouse Co.* (1963), [1963] 3 All E.R. 613, [1963] 1 W.L.R. 1324 (Eng. C.A.) — referred to

*Oasis Merchandising Services Ltd., Re* (1996), [1997] 2 W.L.R. 764, [1997] 1 All E.R. 1009, [1998] Ch. 170 (Eng. C.A.) — considered

*Pratchler Agro Services Inc. (Trustee of) v. Cargill Ltd.* (1999), 11 C.B.R. (4th) 104, 1999 CarswellSask 295 (Sask. Q.B.) — referred to

*Ramgotra (Trustee of) v. North American Life Assurance Co.* (1996), 1996 CarswellSask 212F, 1996 CarswellSask 418, [1996] 3 W.W.R. 457, 37 C.B.R. (3d) 141, 10 C.C.P.B. 113, 13 E.T.R. (2d) 1, [1996] 1 C.T.C. 356, (sub nom. *Ramgotra (Bankrupt), Re)* 193 N.R. 186, (sub nom. *Ramgotra (Bankrupt), Re)* 141 Sask. R. 81, (sub nom. *Ramgotra (Bankrupt), Re)* 114 W.A.C. 81, (sub nom. *Royal Bank v. North American Life Assurance Co.)* 132 D.L.R. (4th) 193, (sub nom. *Royal Bank v. North American Life Assurance Co.)* [1996] 1 S.C.R. 325, (sub nom. *Royal Bank v. North American Life Assurance Co.)* 96 D.T.C. 6157 (S.C.C.) — considered

*Royal Bank v. Sparrow Electric Corp.* (1997), 193 A.R. 321, 135 W.A.C. 321, [1997] 2 W.W.R. 457, 208 N.R. 161, 12 P.P.S.A.C. (2d) 68, 1997 CarswellAlta 112, 1997 CarswellAlta 113, 46 Alta. L.R. (3d) 87, (sub nom. *R. v. Royal Bank)* 97 D.T.C. 5089, 143 D.L.R. (4th) 385, 44 C.B.R. (3d) 1, [1997] 1 S.C.R. 411 (S.C.C.) — considered

*S-Marque Inc. v. Homburg Industries Ltd.* (September 2, 1998), Doc. 113589, 113762, 116298 (N.S. S.C.) — considered

*Shapland Inc., Re* (1998), [2000] B.C.C. 106 (Eng. Ch. Div.) — considered

*St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2005), 9 B.L.R. (4th) 1, 2005 NBCA 55, 2005 CarswellNB 285, 2005 CarswellNB 286, 255 D.L.R. (4th) 137, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 286 N.B.R. (2d) 95, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 748 A.P.R. 95, 13 C.B.R. (5th) 125 (N.B. C.A.) — considered

*Ted Leroy Trucking Ltd., Re* (2010), (sub nom. *Century Services Inc. v. Canada (A.G.))* [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, 12 B.C.L.R. (5th) 1, (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 G.T.C. 2006 (Eng.), (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 D.T.C. 5006 (Eng.), (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 503 W.A.C. 1, (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 296 B.C.A.C. 1, 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 409 N.R. 201, (sub nom. *Ted LeRoy Trucking Ltd., Re)* 326 D.L.R. (4th) 577, 72 C.B.R. (5th) 170, [2011] 2 W.W.R. 383 (S.C.C.) — followed

*Tolcher v. National Australia Bank Ltd.* (2003), [2003] NSWSC 207, 44 A.C.S.R. 727 (New South Wales S.C.) — considered

*Tucker v. Aero Inventory (UK) Ltd.* (2010), 2010 CarswellOnt 1094, 2010 ONSC 1196, 65 C.B.R. (5th) 314 (Ont. S.C.J. [Commercial List]) — considered

*Warran Whillans Enterprises Inc. (Trustee of) v. Gazzola* (1989), 38 B.C.L.R. (2d) 27, 4 R.P.R. (2d) 153, [1989] 5 W.W.R. 740, 75 C.B.R. (N.S.) 151, (sub nom. *Thorne Ernst & Whinney Inc. v. Gazzola)* 60 D.L.R. (4th) 590, 1989 CarswellBC 354 (B.C. C.A.) — followed

 

*Willmott* (1886), L.R. 31 Ch. D. 425 (Eng. Ch. Div.) — considered

*Wily v. St. George Partnership Banking Ltd.* (1999), 161 A.L.R. 1, [1999] FCA 33 (Australia Fed. Ct.) — considered

*Yagerphone Ltd., Re* (1935), [1935] 1 Ch. 392 (Eng. Ch. Div.) — followed

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
Generally — referred to

s. 13.4 [en. 1992, c. 27, s. 9(1)] — referred to

s. 38 — referred to

s. 67 — considered

s. 69.3 [en. 1992, c. 27, s. 36(1)] — referred to

s. 70(1) — referred to

s. 71 — referred to

s. 91 — referred to

s. 95 — considered

s. 95(1) — referred to

s. 96 — referred to

s. 96(1) — referred to

s. 136 — considered

s. 136(1) — referred to

s. 136(1)(f) — referred to

s. 141 — referred to

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

Pt. IV — referred to

s. 11 — considered

s. 11.7 [en. 1997, c. 12, s. 124] — referred to

s. 20 — considered

s. 36.1 [en. 2007, c. 36, s. 78] — referred to

s. 42 — referred to

*Excise Tax Act*, R.S.C. 1985, c. E-15
Generally — referred to

s. 222(3) — referred to

*Insolvency Act*, 1986, c. 45
Generally — referred to

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

*Statute of Elizabeth*, 13 Eliz. 1, c. 5
Generally — referred to

HEARING of threshold issue regarding proceeds of preferences transactions in motion by trustee in bankruptcy for declaration certain transactions were void as fraudulent preferences.

***Morawetz J.*:**

1 KPMG Inc., as Trustee in Bankruptcy (the "Trustee") for Aero Inventory (UK) Limited and Aero Inventory plc (together, "Aero") brings this motion to have certain transactions (the "October Transactions") entered into between Aero and Air Canada declared void pursuant to s. 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, ("*BIA*"). The Trustee seeks the return of value in the amount of U.S. $75 million from Air Canada (the "Preference Proceeds").

2 A threshold issue has been identified. The Trustee takes the position that the Preference Proceeds, once recovered, would be subject to the rights of Aero's secured creditors. Air Canada takes the position that any proceeds resulting from this preference motion should only benefit Aero's unsecured creditors.

3 Therefore, at this point, the central issue is a question of law: are the proceeds of a preference action under s. 95 of the *BIA* subject to the rights of secured creditors?

4 In addition to the direction sought with respect to the priority of the Preference Proceeds, Air Canada also seeks an order regularizing the proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, ("*CCAA*"), the parallel proceedings under the *BIA* and the preference motion.

**Background Information**

5 In its factum, Air Canada has provided an account of the events leading up to the October Transactions. In view of the threshold question of law, in my view, it is premature to focus on the facts in respect of the October Transactions. A brief overview of the background is, however, helpful, to put matters into context.

6 On November 11, 2009, Administration proceedings in respect of Aero were commenced in the High Court of Justice of England and Wales (Chancery Division, Companies Court) (the "Foreign Proceedings"). Messrs. Tucker, Heis and Graham of KPMG LLP were appointed as joint administrators (the "Administrators") of Aero.

7 On the same day, this court recognized the appointment of the Administrators as foreign representatives of Aero (the "Foreign Representatives") under Part IV of the *CCAA*.

 

8 Aero reported that its secured creditors would face a shortfall of approximately £150 million, while its unsecured creditors, who are owed approximately £60 million, would receive virtually nothing at all.

9 Following the November 11, 2009 filings, the Foreign Representatives met with Air Canada and discussed, *inter alia*, the October Transactions. From the Foreign Representatives' standpoint, a concern arose that the October Transactions might constitute an unlawful preference.

10 The October Transactions arose out of a relationship between Air Canada and Aero in respect of maintenance required for Air Canada's aircraft. In December 2008 Air Canada and Aero executed an agreement (the "Line Maintenance Agreement") under which Aero became Air Canada's exclusive supplier for practically all of its Category 3 Inventory used for line maintenance.

11 In early 2009, Aero and Air Canada entered into an agreement (the "January Purchase Agreement") under which Aero sold to Air Canada a pool of Category 3 Inventory. Over the course of the year, Aero was expected to purchase parts from this pool of inventory.

12 In return, Air Canada provided Aero with nine U.S. $10 million principal Bills of Exchange (#1 - 9) and one similar Bill of Exchange (#10) for approximately U.S. $10.7 million (collectively, the "Bills of Exchange"). Each of the Bills of Exchange was payable to Aero and drawn on Air Canada. Air Canada contends that with the exception of transfers of the Bills of Exchange to Deutche Forfait (which never, in fact, occurred), the January Purchase Agreement required Air Canada's consent to any transfer of the Bills of Exchange.

13 Air Canada contends that Aero ultimately failed to comply with the most significant provisions of the January Purchase Agreement. Ultimately, Aero and Air Canada reached an agreement under which certain Bills of Exchange were delivered back by Aero to Air Canada. It is this series of transactions as between Aero and Air Canada that the Trustee refers to as the October Transactions.

14 In January 2010, the Foreign Representatives brought a motion to assign the Aero companies into bankruptcy expressly "for the purpose of pursuing a preference action under s. 95(1) or 96(1) of the *BIA*. On January 22, 2010, the court authorized the Administrators to assign Aero into bankruptcy and temporarily lifted the stay for that purpose (the January 2010 "Order").

15 In seeking the January 22, 2010 Order, the Administrators advised the court that they wished to assign Aero into bankruptcy to preserve the right to pursue any reviewable preferences that may have taken place during the statutory review period prescribed by the *BIA*. The Administrators further advised that their security searches had revealed two secured creditors, Lloyds (asserting a general security interest in Aero's assets) and Air Canada.

16 On February 4, 2010, the Trustee reported that although no claims process had been conducted, all creditors had been advised of the Administrators' view that the secured creditors would suffer a significant shortfall and that there would be no funds available for distribution to unsecured creditors. The Trustee further reported its expectation that the secured creditors' security would extend to any funds generated from a preference claim under ss. 95 or 96 of the *BIA*.

17 The Trustee also reported that, in light of the expectation that there would be no recoveries to unsecured creditors, it saw no value in incurring the expense associated with the discharge of its statutory obligations under the *BIA*.

18 On February 4, 2010, the Trustee filed a motion seeking to dispense with certain obligations of the Trustee under the *BIA*. The court granted the order sought by the Trustee (the "February 2010 Order"). Air Canada did not oppose the relief sought. The court issued the February 2010 Order in the *CCAA* proceedings extending the time period for the Trustee to perform its statutory obligations under the *BIA* (including convening a meeting of creditors and holding a vote of the unsecured creditors) until further order. The February 2010 Order further authorized the Administrators to provide direction to, and supervise the Trustee in pursuing the contemplated preference motion, subject to the review of the court.

19 On April 27, 2010, the Trustee brought a motion in the *CCAA* proceedings seeking a declaration that the October Transactions between Air Canada and Aero constituted a preference within the meaning of s. 95(1) of the *BIA*.

20 On June 30, 2010, the Trustee filed a report which included opinions from independent counsel on the validity and enforceability of the security held by a syndicate of secured lenders (the "Lenders") over Aero's assets.

21 Aero financed its business with the U.S. $500 million revolving facility which it obtained from the Lenders. The Lenders hold:

> (a) a general security interest and fixed mortgage over all the personal property of Aero in Canada, which has been duly registered; and
>
> (b) a deed of Hypothec also duly registered in the Province of Quebec.

**The Issues**

22 Three issues need to be determined on this threshold motion:

> (a) Whether secured creditors are entitled to assert priority over the proceeds of a preference action. Put another way, can the Trustee pursue the preference action solely on behalf of, and for the benefit of, a secured creditor?
>
> (b) Is the preference motion properly brought within the *CCAA* proceedings, or should it be reconstituted in the bankruptcy proceedings?
>
> (c) Should the February 2010 Order be varied to provide that the Trustee has to comply with certain obligations under the *BIA*?

23 As the Trustee points out in its factum, on several occasions, Canadian courts have had to consider whether a secured creditor has the right to assert its priority claim over the proceeds of a preference action. The Trustee acknowledges the body of jurisprudence appears unclear, inconsistent and conflicting.

24 It is the Trustee's position that jurisprudence and policy considerations underlying the *BIA* lead to the conclusion that the Preference Proceeds should be paid over to the Lenders by the Trustee.

25 Air Canada, not surprisingly, takes a different position. Air Canada does not contest the Trustee's ability to pursue preference claims in the bankruptcy proceedings. However, Air Canada takes the position that the Trustee cannot pursue a preference claim as an advocate for Lloyds or for Lloyd's exclusive benefit.

**The Parties' Positions**

***1. Are secured creditors entitled to assert priority over the proceeds of a preference action and can the Trustee pursue a preference action solely on behalf of, and for the benefit of, a secured creditor?***

*Air Canada's Position*

26 Air Canada takes the position that a trustee cannot pursue a preference action where the proceeds would accrue to the sole benefit of a secured creditor as to do so is inconsistent with the jurisprudence holding that fraudulent preferences that do not benefit unsecured creditors cannot be pursued. Instead, the right to pursue a fraudulent preference action is a statutory right of the trustee only, and where appropriate to pursue, such preferences are only void as against the trustee, such that the recovered property accrues to the benefit of the general body of unsecured creditors. Finally, Air Canada submits that the proposed preference action is inconsistent with the role of a trustee.

**The purpose of a preference action**

  

27 Air Canada submits that the purpose of a preference action is to allow for the equal distribution of the debtor's assets among the general body of creditors such that a trustee cannot pursue a preference action for the sole benefit of a secured creditor.

28 Further, the purpose of s. 95 of the *BIA* is to ensure that the debtor's money is divisible equally among unsecured creditors, subject to the priorities in s. 136 of the *BIA*. In support of this proposition, counsel to Air Canada cites the Supreme Court of Canada in *Hudson v. Benallack* (1975), [1976] 2 S.C.R. 168 (S.C.C.) at p. 175, where it is noted that the purpose of preference actions is to put all creditors on an equal footing.

29 Counsel further submits that s. 95 of the *BIA* permits a trustee to challenge the debtor's transactions occurring on the eve of bankruptcy, as such transactions reduce the money available for distribution to creditors and presumably fail to treat all of the creditors equally. Conversely, where there would be no benefit to unsecured creditors from the pursuit of a preference action, the Trustee may not undertake a preference action.

30 In this case, the Trustee's position is that the proceeds of the preference action accrue to the benefit of the secured creditor. Counsel to Air Canada submits that this would not constitute a benefit to the general body of creditors such that this action cannot be pursued. Instead, secured creditors' rights are to be exercised outside of bankruptcy as a function of their security agreement and provincial law: *BIA*, ss. 69.3, 70(1), 136(1) and 141.

31 Air Canada takes the position that the jurisprudence is replete with examples of the courts declining to allow a trustee to pursue a preference action where the proceeds would accrue to the sole benefit of secured creditors.

32 Air Canada submits that in *Cooper, Re* (1875), (1874-75) L.R. 10 Ch. App. 510 (Eng. Ch. App.) at p. 511-512, the court found that the trustee ought not to pursue a preference action for the benefit of a single creditor. Instead, preference actions are to be pursued for the benefit of all creditors. In that case, a creditor alleged that he had given the debtor an advance of £2000, secured by a consignment of the debtor's shipment of currants. However, once the shipment arrived, the debtor pledged the bills of lading for that shipment to a subsequent creditor, as security for advances made by that person. The Registrar declined to order the trustee to account to the estate for the value of the currants or take the necessary steps for their recovery, but did order that the first creditor was at liberty to use the trustee's name in any proceeding against the subsequent creditor or the debtor to enforce the delivery of the currants or payment of the proceeds to him. On appeal, the Divisional Court found that the trustee's name could not be used in a preference action by an encumbrancer, unless the secured creditor were to give up the claim on the property for the benefit of all creditors. There could be no fraudulent preference where the preference granted concerned property that did not belong to the bankrupt.

**The right to bring a preference action is a statutory right of the Trustee**

33 Air Canada takes the position that the Trustee's proposed preference action is incompatible with the fact that the right to pursue a preference action is a statutory right provided solely to the Trustee and a secured creditor cannot take advantage of the Trustee's statutory right. Instead, property recovered as a result of the exercise of the Trustee's statutory right is not subject to any security interest.

34 Counsel to Air Canada referenced in *Yagerphone Ltd., Re*, [1935] 1 Ch. 392 (Eng. Ch. Div.) at p. 396, which counsel submits affirms the principle established in *Ex parte Cooper*. In *Yagerphone*, the liquidator sought to attack the provision of certain funds to a creditor, which funds were said to be subject to a debenture. The debenture holder was found to not be entitled to the proceeds of the preference action as he held a general or floating security interest in the debtor's property, rather than a fixed charge over those funds. As a result, the preference action could be pursued and the transfer was considered to be void solely as against the liquidator, with the recovered funds impressed with a trust in favour of the creditors generally.

Bennett J. stated at pp. 395-96:

 

> There have been two cases which establish quite clearly that, whether in bankruptcy or in the liquidation of a company, a secured creditor has no right to enforce for his benefit the remedy which is given to a trustee in bankruptcy or the liquidator of the company of avoiding a payment or setting aside a transaction made or entered into with a view to preferring a creditor of the bankrupt or a company in liquidation. The authorities are *Ex parte Cooper and Willmott v. London Celluloid Co.*
>
> Neither of these cases, as I have said, decides the point which arises on the summons. I propose to decide it in favour of the liquidators on this ground - namely, that, at the time when the securities contained in the debenture issued to H. Yager (London), Ld., crystallised, the 240*l.* 11s. 2d. was not the property of Yagerphone, Ld., the company which issued the debenture.
>
> . . .
>
> The right to recover a sum of money from a creditor who has been preferred is conferred for the purpose of benefitting the general body of creditors, and I think Mr. Montgomery White was right when he said that the sum of money, when recovered by the liquidators by virtue of s. 265 of the Companies Act, 1929, and s. 44 of the Bankruptcy Act, 1914, did not become part of the general assets of Yagerphone, Ld., but was a sum of money received by the liquidators impressed in their hands with a trust for those creditors amongst whom they had to distribute the assets of the company.
>
> [Emphasis added; Citations omitted.]

35 Air Canada submits that the reasoning of *Yagerphone* was adopted in *Maybank Foods Inc., Re* (1990), 72 O.R. (2d) 93 (Ont. S.C.), and *Oasis Merchandising Services Ltd., Re* (1996), [1998] Ch. 170 (Eng. C.A.). In *Maybank Foods*, the respondent had conceded that the proceeds of a preference action are held in trust for the general body of creditors. Air Canada frames the distinction drawn in *Oasis* as between assets which were the debtor's property upon liquidation and may be subject to a charge, and those that were conveyed away to another creditor but recovered pursuant to a preference action, which are not subject to a charge. In other words, the court in *Oasis* drew a distinction between assets over which a secured creditor possesses a fixed charge at the time of liquidation, which are subject to the security, and assets which were conveyed to another creditor and recovered pursuant to a preference action, which were subject to a floating charge and, as such, not subject to the secured creditor's security. *Oasis* dealt with the proceeds of a wrongful trading claim, but the court nevertheless noted that the proceeds of preference actions are not company property, but rather, exist by virtue of liquidation and the liquidator's right of action, and are impressed with a trust in favour of the unsecured creditors. At pp. 181, the Court stated:

> Thus a right of action against directors for misfeasance which the liquidator (amongst others) can enforce under section 212 of the Act of 1986 and the fruits of such an action are property of the company capable of being charged by a debenture, because the right of action arose and was available to the company prior to the winding up. But with this can be contrasted the right of action by a liquidator, and the fruits of such an action, for fraudulent preference or fraudulent or wrongful trading, which are not the property of the company and are not caught by a debenture: see *Gough, Company Charges*, 2nd ed. (1996), p. 122.

36 Similarly, Air Canada notes that Millet J. in *MC Bacon Ltd. (No.2), Re* (1990), [1991] Ch. 127 (Eng. Ch. Div.), a case concerning whether the liquidator was entitled to recover its fees for the pursuit of a preference action, continued to apply *Yagerphone* to the determination of whether that preference action was properly brought so as to constitute an expense of the winding up payable out of the assets of the company. In making that determination, Millet J. noted that a preference action can only be made by a liquidator or administrator, and not a debentureholder because a debenture holder is bound by payments in the ordinary course of business even if the payment is preferential, whereas the liquidator is not. Millet J. wrote at p. 137:

> It was thus established long before 1986 that any sum recovered from a creditor who has been wrongly preferred enures for the benefit of the general body of creditors, not for the benefit of the company or the holder of a floating charge. It does not become part of the company's assets but is received by the liquidator impressed with a trust in favour of those creditors amongst whom he has to distribute the assets of the company: see In Yagerphone Ltd. [1935] Ch. 392.

 

**Fraudulent preferences are only void as against the trustee**

37 Counsel to Air Canada submits that fraudulent preferences under s. 95 of the *BIA* are declared to be void *as against the Trustee* and not as against any other party, including secured creditors. Property recovered pursuant to a preference action is held by the Trustee for the benefit of the general body of creditors.

38 Air Canada submits that the judgment of Hood J. in *S-Marque Inc. v. Homburg Industries Ltd.*, [1998] N.S.J. No. 550 (N.S. S.C.) aff'd for diff't reasons *Homburg v. S-Marque Inc.*, [1999] N.S.J. No. 94 (N.S. C.A.), endorses this view. In that case the deficit in the security of the secured creditor could not be paid in priority from the proceeds of a preference action. Rather the secured creditor could claim for the deficit as an unsecured creditor. Hood J. reviewed the jurisprudence relating to the entitlement to the proceeds of preference actions and concluded at para. 147:

> The effect of all these decisions is that overturning a fraudulent preference puts the property back in the hands of the trustee. The transaction is void as against the trustee in bankruptcy. The property does not, however, revert to the bankrupt to be available as part of the security over which a secured creditor has rights of seizure.
>
> [Emphasis added.]

39 To similar effect, Air Canada submits that the court in *Canadian Imperial Bank of Commerce v. Canotek Development Corp.* (1997), 35 O.R. (3d) 247 (Ont. C.A.) ("*Canotek*"), stated at p. 256 that "[s]ection 95 renders a fraudulent preference void as against the trustee in bankruptcy; it does not render it void as against a secured creditor".

40 In *Canotek*, the bank held a general security agreement and chattel mortgage on the assets of F. Inc. (the debtor), which went bankrupt, but C. Corp, (the landlord of F. Inc.) levied distress against F. Inc without granting sufficient time for the tenant to rectify the situation. The court found that there was a fraudulent preference against the trustee, but not as against the bank. However, the landlord might still have rights under s. 136(1)(f) as a preferred creditor.

41 The court rejected the bank's argument regarding the reversal of priorities, stating at p. 251:

> However, the bank says that but for the premature sale the property distrained would have been property of the bankrupt and, thus, subject to the bankruptcy. In that case, the bank argues, it would have been entitled to its security as against the trustee. In short, the bank argues that it has been deprived of the right to take advantage of the assignment in bankruptcy to gain priority in the goods and their proceeds over the trustee in bankruptcy. Since the trustee would have priority over the landlord's distraint, the bank would thus have priority over the landlord as secured creditor in the bankruptcy. This is a tail-chasing type of priority problem which must be resolved by looking at the relationship between the true parties to the dispute. In this case, the bank never did have a priority over the landlord once the landlord distrained against the goods. The artificiality of looking to the bankruptcy proceedings to give the bank something the law never intended it to have is obvious, and should not be countenanced by the court.

42 Intriguingly, the Court while noting, at p. 256, that "[g]enerally, *provincial law governs priorities between various secured creditors, and also between secured creditors and landlords*", went on to state that ...outside bankruptcy the landlord prevails in facts such as these, and the incidence of bankruptcy *should in no way alter this situation*."[Emphasis added.]

**The Trustee is an impartial officer of the court**

43 Air Canada takes the position that the Trustee's position in respect of the proposed preference action is inconsistent with its role as an impartial officer of the court submitting that a trustee should not act as an advocate for any particular class of creditors. Instead, its role is to gather in the assets of the bankrupt and divide the proceeds in accordance with the scheme of the *BIA*: See *Beetown Honey Products Inc., Re* (2003), 46 C.B.R. (4th) 195 (Ont. S.C.J.) at para. 22, aff'd (2004), 3 C.B.R. (5th) 204 (Ont. C.A.).

44 Air Canada submits that in bringing this preference action, the Trustee seeks to realize a benefit solely for Lloyd's, a secured creditor. The Trustee has also failed to involve the unsecured creditors and it has failed to disclose competing considerations that might indicate that this preference action is unwarranted. While the Trustee may act for a secured creditor pursuant to s. 13.4 of the *BIA*, Air Canada contends that the record does not indicate that it has met the statutory preconditions to assisting a secured creditor. Air Canada submits that the purpose of s. 13.4 is to protect unsecured creditors' rights: See *Pratchler Agro Services Inc. (Trustee of) v. Cargill Ltd.* (1999), 11 C.B.R. (4th) 104 (Sask Q.B.) at para. 9.

45 Section 13.4 of the *BIA* provides:

> (1) No trustee may, while acting as the trustee of an estate, act for or assist a secured creditor to assert a claim against the estate or to realize or otherwise deal with a security that the secured creditor holds, unless the trustee has obtained a written opinion from independent legal counsel that the security is valid and enforceable against the estate.
>
> (1.1) Forthwith on commencing to act for or assist a secured creditor of the estate in the manner set out in subsection (1), a trustee shall notify the Superintendent and the creditors or the inspectors
>
> (a) that the trustee is acting for the secured creditor;
>
> (b) of the basis of any remuneration from the secured creditor; and
>
> (c) of the opinion referred to in subsection (1).
>
> (2) Within two days after receiving a request therefor, a trustee shall provide the Superintendent with a copy of the opinion referred to in subsection (1) and shall also provide a copy to each creditor who has made a request therefor.

46 Air Canada submits that the record before the court does not indicate that the Trustee has obtained a written opinion from independent legal counsel that the security in issue is valid and enforceable against the estate. There is also no evidence that the Trustee has notified the Superintendent in Bankruptcy and other creditors of such an opinion (if it exists), its intention to act for Lloyd's, or the details of any remuneration it may be receiving from the secured creditor.

*The Trustee's Position*

47 The Trustee's position is that the jurisprudence is somewhat unclear, but the weight of jurisprudence favours granting the proceeds of preference action to secured creditors possessing a fixed, rather than floating charge, a finding that is reinforced by the structure of the *BIA* and the policy considerations underlying the *BIA*. As a result, the proceeds of this preference action ought to be paid to the secured creditor.

**The distinction between fixed and floating charges**

48 The Trustee submits that Air Canada avoided a long-standing and obvious distinction between fixed and floating charges. Floating charges have been held to not attach to property that is the subject of a preference action. Conversely, fixed charges do: *Yagerphone*. This is because the secured creditor has no title when a charge is floating, yet gains priority where it is specific: *Innovation Credit Union v. Bank of Montreal*. [2010] 3 S.C.R. 3 (S.C.C.) at para. 46.

49 Counsel to the Trustee submits that certain courts have interpreted *Yagerphone* overbroadly. *Yagerphone* concerned a dispute as to the priority as between a liquidator and a debentureholder over the proceeds of a preference action. The court held that the debentureholder's security did not attach to the assets at the time that they were transferred such that, in that case, the secured creditor had no greater claim to those assets than any other creditor.

50 The Trustee acknowledges that *Maybank Foods* goes beyond the ratio in *Yagerphone*, yet contends that the overbroad interpretation of *Yagerphone* was based on a concession made by the respondent.

 

51 The Trustee submits that the weight of case law favours the view that floating charges do not attach to assets recovered pursuant to a preference action; but, fixed charges do. In support of this position, the Trustee notes that: *MC Bacon Ltd.* (which found that preference action proceeds enure to the benefit of the general body of creditors) concerned a floating, rather than fixed charge; *Oasis* is the product of a technical reading of UK legislation; and *S-Marque Inc.* was affirmed for different reasons at the Court of Appeal, namely, that the debenture had not crystallized at the time that the asset was transferred away, such that the secured creditor was not entitled to the proceeds of a preference action. This is the same finding as the court in *Mohawk Sports Equipment Ltd. (No. 2), Re* (1972), 17 C.B.R. (N.S.) 115 (Ont. S.C.), at paras. 16-17, which prevented the proceeds of a preference action being claimed by the holder of security that had not crystallized at the time of transfer.

52 The Trustee points out that this distinction is found throughout the case law. Roy Goode in *Principles of Corporate Insolvency Law*, 3d ed. (London: Sweet & Maxwell, 2005) notes at s. 11-140:

> All these cases assume that what is recovered by the liquidator either was never the property of the chargee or ceased to be so prior to the winding up as the result of the fact that the transfer in question overrode the charge. In such a case the chargee is not entitled to use the avoidance provisions to recover what he had lost or had never had. Where however, the charge was not overridden by the transfer and the property transferred is recovered, the charge continues to attach to the recovered property. [Emphasis added]

53 The Trustee further submits that in *N.A. Kratzmann Pty. Ltd. v. Tucker (No. 2)* (1968), 123 C.L.R. 295 (Australia H.C.), the court noted in obiter at p. 302 that "if specific property, to which a charge, validly created by the bankrupt prior to his bankruptcy, has attached prior to the time of its disposition, is subsequently recovered as a preference the trustee's title will be no higher or better than that of the bankrupt to which he has succeeded". In arriving at this conclusion, the court draws the distinction between specific property, that is subject to a charge, and over which the secured creditor will enjoy priority even if recovered pursuant to a preference, whereas property subject to a floating charge will not be subject to the charge when recovered by the trustee. The court reasoned at pp. 300-01:

> Now in bankruptcy the property of a bankrupt vests in his trustee upon the making of the sequestration order. The property which so vests is, of course, subject, in the hands of the trustee, to any charges validly created in relation to it by the bankrupt prior to the bankruptcy. The position of a secured creditor who has a charge on specific property is, of course, not in question; such property in the hands of the trustee will still remain subject to the charge. But where security has been given by a bankrupt over all of his assets and a payment to a creditor is made by him out of moneys subject to the charge and the payment is, as against the trustee, subsequently declared void as a preference the moneys paid, when recovered, will not be subject to the charge. In such a case it may be said that although the moneys paid as a preference were at the time of payment subject to the charge, the moneys recovered by the trustee are not the same moneys and that they do not, by virtue of payment to the trustee, become moneys of the bankrupt or in any way subject to the charge; when recovered they become the moneys of the trustee and his title to them does not depend upon his succession to any title which the bankrupt had. It was, we think, in this sense that Bennett J meant in the passage that we have first cited that, applying the bankruptcy rules in a winding up,
>
> > ...the sum of money, when recovered by the liquidators by virtue of s 265 of the Companies Act, 1929, and s 44 of the Bankruptcy Act 1914, did not become part of the general assets of Yagerphone Ltd, but was a sum of money received by the liquidators impressed in their hands with a trust for those creditors amongst whom they had to distribute the assets of the company.
>
> The view which we have formed is, we think, borne out by the observations of Russell L.J. concerning the decision in *Yagerphone* case where, in *N.W. Robbie & Co. Ltd. v Witney Warehouse Co. Ltd.* he said:
>
> > ...that a claim by the liquidator for repayment to him of a fraudulent preference was not subject to the debenture-holder's charge; a statutory right in and only in the liquidator to make such a claim could never have been property of the company subject to the charge.

 

> It is of significance that his Lordship did not think that the decision in any such case could depend upon whether or not the charge had crystallized at the time when the payment to the creditor was made.
>
> The case would be otherwise, of course, where a preference consists of the disposition of specific and identifiable property subject to a charge validly created in relation thereto by a bankrupt prior to his bankruptcy and where the avoidance of the disposition affects title to such property. That this is so seems to us to be clear as a matter of principle....
>
> In such a case the result of the avoidance of the disposition is to revest the property in the trustee subject to the charge which the bankrupt had validly created prior to the bankruptcy. [Emphasis added; Footnotes omitted.]

**The Structure of the BIA**

54 The Trustee submits that the structure of the *BIA* favours giving the proceeds of a preference action to the secured creditor. Successful preference actions render transactions void as against the trustee as per s. 95 of the *BIA*. The property then vests in the Trustee as per ss. 67 and 71 of the *BIA*. However, the Trustee takes the property subject to the rights of secured creditors pursuant to s. 71, as the Trustee cannot obtain a greater interest in the goods than that enjoyed by the bankrupt: *Giffen, Re*, [1998] 1 S.C.R. 91 (S.C.C.) at para. 50; *Lefebvre, Re*, [2004] 3 S.C.R. 326 (S.C.C.) at para. 37. Further, the Trustee reasons that division of the estate is subject to the rights of secured creditors pursuant to s. 136 of the *BIA*. As a result, secured creditors retain priority in those assets over which they had perfected security interests.

55 The Trustee submits that the court in *ASI Acoustical Supplies Inc., Re* (2000), 22 C.B.R. (4th) 174 (B.C. S.C.), noted that the fact that only the trustee can bring a preference action does not disturb the priority rights of creditors to the proceeds of preference actions, stating at para. 20: "[i]n any event the fact that only a Trustee can make a claim alleging *a* fraudulent preference does not change the priority position of a secured creditor.

56 The Trustee further submits that in *Agricultural Credit Corp. of Saskatchewan v. Featherstone (Trustee of)* (1996), 145 Sask. R. 161 (Sask. Q.B.), the court recognized that "[m]onies owing to a bankrupt, when collected by the trustee continued to be the property of the bankrupt and continue to be subject to the existing security interests. This includes monies realized through the efforts of the trustee" (citations omitted).

57 The case of *Ramgotra (Trustee of) v. North American Life Assurance Co.*, [1996] 1 S.C.R. 325 (S.C.C.), cited by the Trustee, is not analogous, but potentially somewhat informative. The court found that s. 91 (dealing with whether settled property falls back into the estate) is subject to s. 67, insofar as s. 67 governs the disposition of assets in the estate. The court bifurcated the inquiry as follows at paras. 44, 45, 46, 48 and 49:

> In reconciling ss. 67(1)(b) and 91 BIA, it is important to remember that the general scheme through which a bankrupt's estate is divided by the trustee among creditors involves two distinct stages. First, the Act provides that an insolvent person "may make an assignment of all his property for the general benefit of his creditors" (s. 49(1)), or that creditors "may file in court a petition for a receiving order against a debtor" (s. 43(1)). At the time of the assignment or receiving order, the trustee in bankruptcy is obligated to take possession of the assets forming the estate of the bankrupt. Thus, by operation of s. 71(2), the bankrupt's property passes to and vests in the trustee...
>
> Once the bankrupt's property has passed into the possession of the trustee, the Act provides the trustee with the power to administer the estate...
>
> During the property-passing stage of bankruptcy, the trustee is empowered under s. 91 of the Act to set aside certain settlements which have reduced the size of the estate. Thus, s. 91 outlines the circumstances in which a settlement will be voidable at the behest of the trustee in bankruptcy. If a settlement is declared void against the trustee, then the settled property reverts back to the bankrupt's estate, and falls into the possession of the trustee in bankruptcy...
>
> . . .

 

> However, the trustee is barred from dividing two categories of property among creditors: property held by the bankrupt in trust for another person (s. 67(1)(a)), and property rendered exempt from execution or seizure under provincial legislation (s. 67(1)(b)). While such property becomes part of the bankrupt's estate in the possession of the trustee, the trustee may not exercise his or her estate distribution powers over it by reason of s. 67.
>
> Thus, it can be seen that ss. 91 and 67 relate to two different stages of bankruptcy. Section 91 dictates that certain settled property will fall back into the estate of the bankrupt in the possession of the trustee, while s. 67 is directed at the exercise of administrative powers over the estate by the trustee. Where a settlement is void against the trustee under s. 91, then in normal circumstances, the trustee is empowered to administer the settled asset, and use it to satisfy the claims of creditors. However, in the special case where the asset is exempt under s. 67(1)(b), then the trustee is prohibited from exercising his or her distribution powers because the asset is not subject to division among creditors.

58 Counsel to the Trustee also references *Warran Whillans Enterprises Inc. (Trustee of) v. Gazzola* (1989), 60 D.L.R. (4th) 590 (B.C. C.A.). In determining whether a landlord would be entitled to the proceeds of a preference action the Court of Appeal outlined the scheme of distribution as follows:

> Under the Bankruptcy Act the trustee is charged with gathering the assets of the bankrupt for the benefit of creditors and then distributing those assets pursuant to the scheme of distribution set out in s. 136 of the Act. Section 95 is in that part of the Act that deals with schemes and preferences. Pursuant to s. 95 the trustee is entitled to consider any transaction involving a creditor of the bankrupt and if that transaction occurred within three months prior to the bankruptcy, the trustee can take steps to seek to establish that the transaction be deemed fraudulent and void as against the trustee...
>
> . . .
>
> In due course, depending on the claims of secured creditors and those standing in priority to the landlord under the scheme of distribution established by s. 136 of the Act, if there are sufficient assets in the estate the landlord will then receive payment pursuant to the provisions of that section.

59 The Trustee suggests that this reasoning was endorsed in *Canotek* at p. 256 where the Court of Appeal held that provincial law governs priorities between secured creditors and landlords and the incidence of bankruptcy should not disturb the order of priority present outside bankruptcy.

**The policy underlying the BIA**

60 The Trustee submits that the policy underlying the *BIA* favours giving the proceeds of the preference action to the secured creditor, as this interpretation avoids altering priorities and nullifying a secured creditor's claim to collateral simply because a debtor has dealt with those assets preferentially. Otherwise, an insolvent person could defeat secured creditors' rights by granting a preference immediately prior to bankruptcy, with the resulting proceeds flowing to the benefit of unsecured creditors. This would be inconsistent with commercial sense, which the *BIA* seeks to protect.

61 The Trustee notes that the courts have disallowed attempts to alter priorities through unlawful means. In *Anron Mechanical Ltd. v. L'Abbé Construction (Ontario) Ltd. (Trustee of)* (1991), 5 C.B.R. (3d) 133 (Ont. Gen. Div.) at para. 9 (Ont. Gen. Div.), the specific and identifiable property (traceable moneys), that had been impressed with a trust did not lose that quality simply by virtue of being recovered as fraudulent payments:

> If this were not so, a general contractor could then easily divert monies, defeat the rights of the unpaid subcontractors and thwart the whole purpose of the trust section of the Construction Lien Act. If he cannot divert the monies lawfully, as by assignment, then surely he cannot do so unlawfully, as by a fraudulent preference.

62 The Trustee submits that the proceeds of a preference action ought to be paid in accordance with the hierarchy established in the *BIA*. Unsecured creditors do share rateably under s. 141, yet their claim is expressly subordinate to preferred creditors under s. 136, whose claim is itself subject to the rights of secured creditors.

 

63 As a final point, the Trustee submits that this proposed action is not inconsistent with the role of the trustee. The trustee may act for secured creditors pursuant to s. 13.4 of the *BIA* if they have obtained a written opinion from independent legal counsel that the security is valid and enforceable. The Trustee contends that such an opinion was obtained and submitted in the Trustee's report filed on June 30, 2010.

64 The Trustee also contends that it provided notice to the Superintendent and notified creditors before any action was taken on behalf of the lenders in accordance with the February 2010 Order. Further, it has: provided notice of its independent security opinion; posted this notice; and provided notice that it was bringing a preference action with the expectation that it would pay over the proceeds of that action to the secured creditor, Lloyds. As the Trustee is not receiving any remuneration from secured creditors, it provided no notice that it was receiving remuneration from the secured creditor. Instead, the Trustee is funded by the Foreign Representatives who have been funded to date by monies in the estate.

***2. Is the preference motion properly brought within the CCAA proceedings, or should it be reconstituted in the bankruptcy proceedings?***

65 Air Canada submits that this preference action is improperly brought. A preference action pursuant to s. 95 of the *BIA* can only be taken in Bankruptcy proceedings or, pursuant to s. 36.1 of the *CCAA*, a monitor (appointed pursuant to s. 11.7) may pursue a preference action where a plan of compromise or arrangement has been proposed. This preference action is not brought in bankruptcy and is not brought pursuant to a plan of arrangement, while the Trustee, as an Information Officer, is unable to bring an action that is reserved to a monitor.

66 The Trustee submits that this Court dealt with this issue in its February 2010 Order dealt with this issue, with reasons reported at *Tucker v. Aero Inventory (UK) Ltd.*, 2010 ONSC 1196 (Ont. S.C.J. [Commercial List]). It held that concurrent *BIA* and *CCAA* proceedings are contemplated by Part IV; the preference motion is brought to maximize the Debtor Company's assets; failing to allow concurrent proceedings may preclude the review of what may in fact be a preferential transaction which is contrary to public policy; Air Canada commenced and then abandoned an appeal to this motion; such that, these issues are now *res judicata*. In any event, the Trustee contends that s. 42 of the *CCAA* intends for the *CCAA* to operate in tandem with the *BIA*: *Ted Leroy Trucking Ltd., Re*, [2010] 3 S.C.R. 379 (S.C.C.) at para. 76.

***3. Should the February 2010 Order be varied to provide that the Trustee has to comply with certain obligations under the BIA?***

67 Air Canada notes that the February 2010 Order ought to be varied to ensure that the Trustee complies with its statutory obligations. To date, no proofs of claim have been sought from unsecured creditors, and no meeting of creditors has been convened to either consider the bankrupt's affairs, or hold a vote of the unsecured creditors to affirm the appointment of the Trustee, or substitute another trustee in its place, or to appoint inspectors to give direction to the Trustee. As a result, Air Canada submits that an order directing the Trustee to comply with its obligations under the *BIA* ought to be granted.

**Additional Commonwealth Jurisprudence**

68 The case of *Willmott London Celluloid Co.* (1886), L.R. 31 Ch. D. 425 (Eng. Ch. Div.), appears to support the position of Air Canada, as the court held at pp. 435-36 that a preference action can only be pursued by a liquidator, while the proceeds are intended for the benefit of the general body of creditors: See also: *Quality Camera Co. Pty. Ltd., Re* (1965), 83 W.N. (Pt 1) 226 (N.S.W. S.C.); and *Bibra Lake Holdings Pty. Ltd. v. Firmadoor Australia Pty. Ltd.* (1992), 7 A.C.S.R. 380 (Western Australia S.C.).

69 Further support can be found in *Wily v. St. George Partnership Banking Ltd.* (1999), 161 A.L.R. 1 (Australia Fed. Ct.), in which no fraudulent preference was found as the payment was *to* a secured creditor, but the Federal Court of Australia helpfully mentioned three principles applicable to that context. The first being that a debtor is entitled to prefer creditors subject to the *Statute of Elizabeth* 13 Eliz 1 c 5. The second and third principles are detailed at p. 5 as follows:

> ...in insolvency, by which I mean bankruptcy in the case of a natural person and liquidation in the case of a company, legislation provides that, with certain limited exceptions, all unsecured creditors of a bankrupt or an insolvent company are to be treated equally: that is, their liabilities are to be discharged rateably. This principle can be found in bankruptcy statutes dating back to 1542 (see 34 & 35 Hen 8 c 4, s 1 which was concerned with absconding debtors) and in company statutes since the Winding Up Act of 1844 (7 & 8 Vict c 111); see now s 108 of the Bankruptcy Act and s 555 of the Corporations Law.
>
> The third principle is the recognition that certain dispositions made by a debtor who subsequently becomes bankrupt, or by a company that subsequently is wound up, should be recovered and be available to meet the claims of the creditors generally. Section 122 of the Bankruptcy Act is one example of the operation of this principle. Others are to be found in the Bankruptcy Act and the Corporations Law. Many other systems of law have comparable provisions.
>
> [Emphasis added.]

70 In *Wily*, the Court found that if there is no detriment to the unsecured creditors, there can be no preference. Consequently, it would be appear to be the case that if the proceeds of the preference action were to be co-opted entirely to the benefit of the secured creditors there would be no resulting benefit to the unsecured creditors, thereby precluding bringing a preference action in this situation. The Court in *Wily* stated at pp. 9-10:

> If one asks whether there is less money available for the general body of creditors by reason of the three payments to the bank the answer must be a clear No. The reason is that if the payments had not been made the property available for distribution among creditors would not have increased. The bank would have been entitled to receive payment out of the property in the hands of the liquidator in priority to the other creditors. Any payment out of property that is not available to meet the debts due to the other creditors cannot confer a preference in favour of the payee. In this case then, the other creditors are not any the worse off by reason of the payments to the bank.
>
> . . .
>
> the short answer to the liquidator's submission is that provisions such as s 122 are designed to protect the statutory order of priority established by the Bankruptcy Act and, when it applies in a winding up, the statutory order established by the Corporations Law, the statutory order being the right to receive payments pari passu. Section 122 is not concerned to protect the rights of a creditor who is accorded priority by some other legislation, whether State or federal.
>
> [Emphasis added.]

(See also *St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2005), 255 D.L.R. (4th) 137 (N.B. C.A.), which stands for the proposition that where a secured creditor is paid first there can be no fraudulent preference).

71 Additionally, McPherson J.A., who expressed concurring reasons in *Starkey v. Deputy Commissioner of Taxation* (1993), 11 A.C.L.C. 558 (Qld. C.A.) stopped short of endorsing the view in *Yagerphone* that preference proceeds are impressed in the hands of the liquidators with a trust for unsecured creditors, but did accept that since a secured creditor cannot bring a preference action a trustee should not be allowed to bring a preference action for the sole benefit of a secured creditor. The rationale for preventing secured creditors from sharing in the benefits of a right of action of a trustee was elucidated at pp. 566-67:

> If a secured creditor may not set in motion for his own benefit a procedure for avoiding preferences that exists for the benefit of the unsecured creditors, it is a logical consequence that he should not be able to claim the proceeds of avoiding such a preference when recovered. But it is another matter to say that the liquidator holds those proceeds in trust for the unsecured creditors if what is meant by that is a 'trust' in the full sense of the word, under which the unsecured creditors are equitable owners of the assets in winding up. There is little in recent decisions to support that view of the rights of creditors....

 

It is secured creditors who, under the decision in Re Yagerphone Ltd, are denied a share in the proceeds of avoiding preferences in winding up. Unlike the claimant in that case the Commissioner here is not a secured creditor with rights that are enforceable against identified property independently of winding up.

[Emphasis added.]

72 In *Bibra Lake Holdings Pty. Ltd. (in liq.) v. Firmadoor Australia Pty. Ltd.* (1992), 10 A.C.L.C. 726 (W.A.S.C.A.), Ipp J., in concurring reasons, held that fraudulent preferences are rendered void as against the liquidator only and the proceeds thereof do not form part of the assets of the company, writing at pp. 731:

Moneys paid in circumstances which create an undue preference, and which are recoverable under s 451(1), are moneys which are recoverable for the benefit of the creditors and contributories. Such moneys cannot be said to have been the property of the company.

. . .

Undue preferences are void as against liquidators, not as against companies. Section 451 confers upon liquidators the sole right to bring proceedings for the recovery of undue preferences. [Emphasis added.]

73 Since *Yagerphone*, the governing UK law has been amended, including, in particular, by the 1985-86 reforms to the *Insolvency Act* (U.K.), 1986, c. 45, with the consequence that the court can now make an order to restore the *status quo ante* as if there had never been a preference. Nevertheless, despite these broadened powers, Millet J. found in *M.C. Bacon Ltd. (No. 2)* that *Yagerphone* remained applicable at p. 137:

It was thus established long before 1986 that any sum recovered from a creditor who has been wrongly preferred enures for the benefit of the general body of creditors, not for the benefit of the company or the holder of a floating charge. It does not become part of the company's assets but is received by the liquidator impressed with a trust in favour of those creditors amongst whom he has to distribute the assets of the company: see In re Yagerphone Ltd. [1935] Ch. 392....

In my judgment that is still the law, notwithstanding section 239(3) of the Act of 1986 which empowers the court on finding a voidable preference proved to make such order as it thinks fit for "restoring the position to what it would have been if the company had not given that preference," and section 241(1)(c) which empowers the court to "release or discharge ... any security given by the company." Those powers are not intended to be exercised so as to enable a debenture holder to obtain the benefit of the proceedings brought by the liquidator. [Emphasis added.]

74 In *Tolcher v. National Australia Bank Ltd.* (2003), 44 A.C.S.R. 727 (New South Wales S.C.) (N.S.W.S.C.), Palmer J. found that where a settlement was paid from the estate subject to a charge in the form of a general security agreement against all assets of the bankrupt (which was characterised as a floating charge, rather than a specific charge), the monies recovered pursuant to a preference action to impugn that settlement are not subject to the charge as the trustee's title is not dependent on the debtor's title, nor can it be in the case of a statutorily-provided right of action.

75 Somewhat more nuanced support for Air Canada's position can be found in the case of *N.W. Robbie & Co. v. Witney Warehouse Co.*, [1963] 1 W.L.R. 1324 (Eng. C.A.). In that case, which had to do with whether certain debts could be set off rather than whether preference proceeds could accrue to secured creditors, Russell L.J. at p. 1338 rejected the suggestion that *Yagerphone* stands for the proposition that a charge cannot attach to assets acquired after the date of crystallization, noting instead that it stands for the proposition that proceeds from a liquidator's right to pursue a preference action, being a liquidator's right, cannot be property of the company subject to the charge. Russell L.J. stated at p. 1338:

We were referred, in the course of the argument that there is no charge on the post-receivership "future assets," to a phrase in Kerr on Receivers (1963), 13th ed., p. 327, which says the charge would not attach to assets of the company acquired subsequent to the date of crystallisation." The authority cited is In re Yagerphone Ltd. The quotation, divorced from its context, is too wide to be supported, and if so divorced is not justified by that decision, which was that a claim by the

 

> liquidator for repayment to him of a fraudulent preference was not subject to the debenture-holder's charge: a statutory right in and only in the liquidator to make such a claim could never have been property of the company subject to the charge. [Emphasis added.]

76 Further support can be found in the case of *Horn v. York Paper Co. Ltd.* (1991), 5 A.C.S.R. 112 (N.S.W.S.C.), McLellan J. stated at p. 113:

> Where a transaction is avoided as against a liquidator by virtue of the operation of s 451 of the Companies Code (or s 565 of the Corporations Law) the liquidator is a necessary party to proceedings for the recovery of property or money based on such avoidance: see Kent v La Communauté des Soeurs de Charité de la Providence [1903] AC 220 at 226. This is because the transaction is avoided only against the liquidator, and the proceeds of recovery do not necessarily form part of the general assets of the company: see; Re Quality Camera Co Pty Ltd [1965] NSWR 1330; 83 WN (Pt 1) (NSW) 226 and; *N A Kratzmann Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295." [Emphasis added; See also *Bibra Lake*, holding to the same effect.]

77 In *Bayley v. National Australia Bank Ltd.* (1995), 16 A.C.S.R. 38 (Tasmania S.C.), Wright J. was tasked with determining whether funds recovered via a s. 468 action under the Australian *Corporations Law* (which renders dispositions after a winding up void), as well as funds recovered pursuant to a preference action, were subject to a secured creditor's registered floating charge. Wright J. held that the disposition successfully challenged via s. 468 were void for all purposes, as if the payment had never occurred, such that the funds "remained the property of the company at all relevant times and upon being restored to the company by the liquidator's actions became once more subject to the respondent's floating charge." Wright J. then went on to deal with the question of whether the charge attached to the assets recovered pursuant to the preference action.

78 Wright J. held that the proceeds of a preference action were for the benefit of the general body of creditors. Wright J. noted that "unlike dispositions affected by s 468(1), *preferences* coming within the ambit of s 565(1) *are not void in any absolute sense but are void as against the liquidator only.*" It was not necessary for Wright J. to decide whether this would mean that the recovered property could be said to be free and clear of any prior charges, (although it was noted that this may be true of specific property subject to a charge prior to a winding up order) since, in the circumstances of that case, the charge at issue was floating and had not crystallized prior to the liquidation proceedings, such that it did not attach to the funds that were preferred. Instead, those funds were held for the benefit of the general body of creditors. Wright J. concluded:

> ...irrespective of whether for some purposes the recovered funds may be viewed as the "property" of the company being wound up, in the present circumstances they are not property which was or could have been subject to the floating charge at the time that charge crystallised viz, the date upon which liquidation proceedings commenced. Thus, in my opinion, the fund constituted by those moneys is not available to the respondent, but is distributable to the general creditors subject only to the statutory priorities provided by the Corporations Law.

79 The import of the words "void as against the trustee" was the subject of judicial consideration by the New South Wales Court of Appeal in *National Acceptance Corporation Pty. Ltd. v. Benson & Ors* (1988), 13 A.C.L.R. 1 (N.S.W.S.C.A.), where the Court held that the use of the word "void" in s. 368 of the Companies Code in question (which is similar to s. 468 of the Corporations Law considered in *Bayley*) "...means at least void for all purposes related or incidental to the administration of the winding up of the company" in contrast to the use of the word "void against the trustee" in their *Bankruptcy Act* which is more narrow. On this point, the Court noted that in *Commercial Bank of Australia v. Carruthers* (1964), 6 F.L.R. 247 (F.C.A.), Manning J. "*held that the provision did not produce the result that the preferential payment was void against anyone else than the Trustee in Bankruptcy*" (emphasis added).

80 Andrew Keay in "The Effects of a Successful Action by a Liquidator to Avoid a Pre-Liquidation Transaction" (1996) 15 (2) U. Tasm. L. Rev. 236 notes that the Australian bankruptcy regime has changed such that now transactions are no longer said to be "void as against the liquidator" but rather "voidable", and further, recovery vests in the company. He submits at p. 241 that this is a difference without a distinction as in the U.K., where the *Insolvency Act* grants the court broad powers to void fraudulent preferences and restore the position to the *status quo ante*, the courts have continued to apply *Yagerphone*. For

 

instance, in *MC Bacon Ltd.*, *Yagerphone* was again endorsed as holding that secured creditors cannot recoup the proceeds of a preference action despite a similar change in wording as Australia's under the U.K. *Insolvency Act*.

81 In that article, Andrew Keay also notes that *Yagerphone* has existed for a long period of time and the government had the option to disturb this judicial practice but did not do so, nor is there evidence in the speeches of Parliament or the Explanatory Memorandum relating to the U.K. Bill that changed the U.K. *Insolvency Act* most recently that a change in judicial practice was contemplated, let alone required.

82 In addition to Andrew Keay's comments, it should be recalled that s. 95 of the *BIA* is worded more restrictively than the U.K. or Australian preference provisions, rendering fraudulent preferences void against the trustee only.

83 Andrew Keay does not regard reversing priorities as a problem, so much as a function of the legislative scheme itself. He writes at p. 264, in relation to the reversal of priorities:

> With respect, it appears that this argument overlooks the fact that bankruptcy or liquidation changes everything. While the company continues to exist, it is no longer directed by directors, and it is not run for the benefit of the shareholders. A liquidator acts on behalf of the company and he or she does so for the general body of creditors. Liquidation produces a whole new set of relationships and duties. While a secured creditor may argue that the general creditors are sometimes unjustly enriched by receiving the benefits of a recovery, the rebuttal to that might be that those creditors were prejudiced before liquidation because they did not receive any benefit from the voidable transaction and, in any event, they have suffered losses as a result of the liquidation. [Citations omitted; emphasis added.]

84 It could be argued that while priorities may well be reversed, as held in the case law, this stems from the role of the trustee. The status of the trustee is tripartite: as a successor in title, as a representative of creditors and finally, and importantly, the trustee has independent status under either federal or provincial law to avoid certain transactions: *Roderick Wood, Bankruptcy and Insolvency Law* (Irwin Law: Toronto, 2009) at pp. 180-81. As such, as Professor Wood notes at p. 82 the principle that a trustee "steps into the shoes" of the bankrupt and acquires the bankrupt's property "warts and all" "does not operate where bankruptcy or other legislation gives the trustee a power to subordinate or avoid certain property rights of third parties. In such cases, the trustee may have a better right to the asset than that held by the bankrupt."

85 This may constitute an oddity, but the danger of legislative intrusion outweighs any possible unfortunate consequences from the reversal of priorities. While the legislative measure could be an oddity, this would not be anomalous. As Professor Ian Fletcher writes in *The Law of Insolvency*, 4th ed. (London: Sweet & Maxwell, 2009) of the legislative history of British bankruptcy law at pp. 796-97 as follows:

> ...the legislative history is scarcely homogeneous, but is more accurately described as one of almost perpetual accretion and revision amid shifting socio-political influences. It must be submitted that the current position, in terms of policy and principle, is both muddled and confusing. It has resulted from the historic lack of a co-ordinated, thought-through approach to our law of credit, security and insolvency, amounting to a persistent failure...to address the essentially interlocking and inter-dependent nature of these vital areas. Consequently, the law has become beset by anomalies and inconsistencies, particularly concerning the operation of the pari passu principle, which are in some instances squarely at odds with commercial and social realities....

86 However, there is also jurisprudence and commentary in support of the Trustee's position. Doyle C.J., for the majority, in *Fresjac Pty. Ltd. v. Michael Mount PPB* (1995), 65 S.A.S.R. 334 (South Australia S.C.), approved of *N.A. Kratzmann*. This was cited by counsel to the Trustee, and reconciled many of the prior Commonwealth cases mentioned above *by distinguishing the issue of who possesses the right to bring a preference action, from the issue of the entitlement to the proceeds of such actions*. The Court in *Fresjac* was faced with the issue of to whom the proceeds of a s. 468 action by the liquidator, which renders dispositions of property after the commencement of winding up void, accrue. Doyle C.J. noted that the purpose of this section is identical to the purpose underlying preference actions, writing at pp. 341-42 "...both have an eye to the preservation

 

of assets, to the preservation of the *status quo*, and to a later orderly distribution of assets among creditors, *subject to the rights of secured creditors*" (emphasis added).

87 In *Fresjac*, Doyle C.J. disagreed with Wright J.'s conclusion in *Bayley* that funds rendered void under s. 468 were at all times the property of the company and became subject to the charge once restored to the company. Doyle C.J. opined that such a characterization is artificial. The funds recovered were not the same funds, and title could not be revested, although this could occur in the case of land or identifiable chattel. Instead, the company would have a claim to recover an equivalent amount of money and its entitlement to the funds of s. 468 is a separate question from the right to impugn a transaction. Wright J.'s reliance upon the fact that a s. 468 action is "void", whereas a preference action is "void as against the liquidator" is, in Doyle C.J.'s view at p. 344, misplaced, as those words "control who may invalidate the preference, and to identify the liquidator as the person with that right, not to decide or determine who is entitled to the proceeds."

88 In this regard, Doyle C.J.'s analytic framework is noteworthy and worth setting out. It was noted that there is a "need to distinguish between the avoiding effect of the section, the location of the right to recover property disposed of by the company in a transaction avoided by the section, and the entitlement apart from that to rely upon the avoiding effect of the section." Doyle C.J. wrote at p. 344-45:

> The preference cases indicate, in my opinion, that the right to recover property disposed of in a transaction avoided as a preference belongs to a trustee in bankruptcy or liquidator, and property recovered by the exercise of that right will not vest in a secured creditor unless the exercise of the right should cause the revesting of title in specific property subject to a security.
>
> . . .
>
> ...the location of the right to assert voidness does not also determine the location of the right to proceeds recovered after the cancellation of a void transaction.
>
> . . .
>
> The mere right to assert or rely upon voidness cannot, as a matter of logic, give rise to a right to recover the property disposed of by the void transaction.
>
> The right to recover property disposed of in a transaction voided by s 468 is not property of the company, and the proceeds of the exercise of the right do not fall to be treated as property of the company caught by pre-existing charges or security but, in my opinion, specific property the subject of a charge or security will, if recovered, again be subject to that charge or security.
>
> On this approach, the right to recover property the disposition of which is avoided by s 468 is not a right to which a charge or security will attach.
>
> In addition, in my opinion money recovered as the result of the avoidance of a preference or because a payment is void is not to be regarded as property of a company to which a charge or security can attach.
>
> These conclusions emphasise the similarity between the preference provisions and s 468, despite the difference of language (void as against the liquidator and void) and despite the difference in the stages before liquidation to which they apply and the differences in the manner in which they operate.
>
> On the other hand they avoid the oddity (as some would see it) of a better result for a secured creditor in respect of a void payment, and the oddity of a remedy conferred for the purposes of a liquidation working for the benefit of the secured creditor. I do not pretend the result which I have reached is obvious, or that the contrary arguments are lacking in substance. [Emphasis added.]

89 In addition, in *Bank of New Zealand v. Essington Developments Pty. Ltd. & Ors* (1991), 5 A.S.C.R. 86 (N.S.W.S.C.), it was held that a secured creditor has the benefit of a liquidator's recovery of assets *in specie* over which a secured creditor has a charge. McLelland J. wrote at pp. 89-90:

> The position of a creditor with a charge over all the assets of a company and a receiver appointed by that creditor appears to be that if as a result of the avoidance of the transactions property is recovered in specie, then that property is included in the assets of the company which are subject to the charge and which therefore are available to the receiver for the benefit of the secured creditor. On the other hand, moneys which are recovered merely because payments have been avoided as preferencesdo not come within the general assets of the company available for the secured creditor and the receiver, but may be utilised by the liquidator for the purposes of the liquidation, and in particular for the benefit of unsecured creditors. [Emphasis added.]

90 In *Shapland Inc., Re* (1998), [2000] B.C.C. 106 (Eng. Ch. Div.) (Ch.D.), the court appears to be of the view that a trustee can pursue a preference action for which the benefits will accrue to the secured creditor (although in that case unsecured creditors would actually benefit as well) in stating at p. 110:

> Mr Goodison submitted that I should make no such order, on the ground that it would benefit only the bank, which was a secured creditor, and the power under s. 239 was conferred to benefit unsecured creditors, not secured creditors. I am very doubtful that this submission would be correct, even if the bank's claim were fully secured. However, on the facts of this case, it is not: the indebtedness of Shapland to the bank greatly exceeds the value of the property, so that a large part of the bank's claim is unsecured. Furthermore, the bank's security has been challenged, so that it would be wrong for me to proceed on the assumption that it is unquestionably a secured creditor. Lastly, the bank and the liquidator, who is financed in these proceedings by the bank, have agreed that after payment of the costs and expenses of the winding up, ten per cent of the proceeds of sale of the property are to go to unsecured creditors. Accordingly, the setting aside of the charge will benefit unsecured creditors, and the factual basis for Mr Goodison's submission is not made out.
>
> [Emphasis added.]

91 In *The Law of Insolvency*, Professor Fletcher would appear to provide some support for the Trustee's position, in claiming that the purpose of a preference action is to restore the situation to the *status quo ante*, and that the court may make such order to achieve that purpose as it sees fit, such that the idea that the proceeds of the action are not subject to the rights of secured creditors would be put into doubt. The new broad power to strike down fraudulent preferences, declare them void, and make any order that is just, was introduced in the 1985-86 reforms to the *Insolvency Act* in England. However, as previously noted, this form of relief is not replicated in the *BIA*.

92 Professor Fletcher also notes that the trustee's title is subject to various equities. He states at p. 246 that in the individual debtor context, whereby preferences can be declared void to restore the *status quo ante* (much like in the company debtor context), "the trustee is essentially a *successor* to such title as the bankrupt actually had at the time of his adjudication, including any limitation or imperfections in that title, and can enjoy no better position in relation to the property than did the bankrupt himself formerly" (emphasis in original; citations omitted).relying on *Johnson v. Smiley* (1853), 51 E.R. 1019 (Eng. Ch.); *Mapleback Ex p. Caldecott, Re* (1876), (1876-77) L.R. 4 Ch. D. 150 (Eng. C.A.); *Garrud, Re* (1880), 16 Ch. D. 552 (Eng. C.A.), per James L.J.; *Beeston, Re*, [1899] 1 Q.B. 626 (Eng. C.A.) at p. 610 per Lindley M.R.

93 More forcefully, he states at p. 247 "[a]ll such rights as might have been exercised by third parties prior to bankruptcy may be exercised after adjudication, and no action by the trustee can be effective to gain priority over such vested rights: unless the property can be disclaimed, the rights remain undisturbed" relying on *Anderson, Re*, [1911] 1 K.B. 896 (Eng. K.B.).

94 The Trustee's position is supported by additional academic literature. Rebecca Parry in "The Destination of Proceeds of Insolvency Litigation" (2002) 23(2) Comp. Law. 49, is concerned about the reversal of priorities that occurs where secured creditors cannot recoup the benefits of a preference action brought by a trustee under English law, especially given the anomaly that many preference actions could be pursued as misfeasance claims that do not give rise to the same result. This is because in

 

the misfeasance context, amounts recovered are recoverable by secured creditors: See *Re Produce Marketing Consortium Ltd. (No. 2)*, [1989] B.C.L.C. 520 (Ch.D.); *Re Asiatic Electric Co. Pty. Ltd. (in liq.)* (1970), 92 WN (N.S.W.S.C.) at pp. 362-64. The remainder of her article deals primarily with the particular wording of the U.K. law.

95 Lee Eng Beng in "The Avoidance Provisions of the Bankruptcy Act 1995 and their Application to Companies" (1995) Sing J. Legal Stud. 597 notes that even with respect to preferential dispositions of specific property, the right to recover the assets vests in the liquidator such that a chargee cannot be entitled to the fruits of that recovery, especially since the process itself is intended for the benefit of unsecured creditors rather than secured creditors, as the latter exist outside of the bankruptcy regime. Nonetheless, Lee Eng Beng acknowledges the rights of secured creditors to trace monies at p. 632:

> While the property which has been disposed of may have been validly charged. the fact of it being wrongfully disposed of gives rise to the chargee's right under the general law to trace against the disponee and nothing more. The rights and remedies of secured creditors are conferred by the general law and they are not to be reinforced by statutory provisions designed to provide an equitable debt collection system for unsecured creditors. Of course, any right of a secured creditor which exists at general law would override any right of the liquidator or trustee in bankruptcy to proceed against the assets by virtue of any statutory provision, as the latter cannot be in a better position than the company or bankrupt, as the case may be. It follows that if a secured creditor has the right to recover the assets transferred away in breach of his security rights and the liquidator or trustee in bankruptcy recovers the assets pursuant to the statutory provisions, any recovery by the latter must be held for the benefit of the former in so far as they would have been recoverable by the secured creditor. [Emphasis added.]

96 Gerard McCormack in "Swelling Corporate Assets: Changing What is on the Menu" (2006) 6 J. Corp. L. Stud. 39 advances five reasons at pp. 56-57 for doubting the line of cases affirming *Yagerphone*, two of which are not peculiar to the English context:

> 1. *Yagerphone* gives rise to the unprincipled anomaly that certain preference actions can also constitute misfeasance actions, yet only in the latter case are payments subject to the rights of secured creditors.
>
> 2. Too much emphasis is placed on the liquidator's independent status which is merely an administrative convenience. He states that "the fact that proceedings are brought by the liquidator or administrator might be seen as *largely procedural*. The liquidator or administrator are not acting in their own individual rights but rather by virtue of the office they hold in relation to a particular company. In a broad sense the proceedings are brought on behalf of the company in question." (Citations omitted; emphasis added.)

97 Nancy Sanborn supports this interpretation, admittedly in the U.K. context. She writes in "Avoidance Recoveries in Bankruptcy: For the Benefit of the Estate or the Secured Creditor?" (1990) 90 Colum. L. Rev. 1376 at 1399-1400 supports the above authors writing:

> The proposition that all amounts recovered must be available for administrative expenses and unsecured claims and interests, without recognition of any security interest in the recovery because avoidance powers are exercised for the benefit of the estate, fails to distinguish between two separate functions of the bankruptcy process. One function is to maximize the value of the pool of assets to which all claimants and interest holders will look for payment. Transfers are avoided, then preserved or recovered, to serve this function. The estate benefits from the exercise of these powers even if a creditor possesses a security or beneficial interest in the property.
>
> A separate issue, how entitlements to the accumulated pool of assets should be allocated, should be resolved primarily by nonbankruptcy law. A secured creditor should be afforded the same protections that would have been available to it under state law if no bankruptcy had ensued. [Citations omitted].

**Analysis**

 

98 The foregoing review of jurisprudence confirms the submission of the Trustee, namely, that the jurisprudence is unclear and inconsistent. However, it seems to me that, with a consistent application of (i) insolvency principles; and (ii) personal property security principles, the jurisprudence can be reconciled.

99 Both the Trustee and Air Canada make extensive reference to the English decision of *Yagerphone*. *Yagerphone* has been cited by some Canadian courts to stand for the proposition that secured creditors have no claim to the proceeds of a preference action.

100 Counsel to the Trustee submits that, read properly, the holding in *Yagerphone* is, in fact, narrower. I agree.

101 In *Yagerphone*, the court considered a priority dispute between the liquidator and a debenture holder over the proceeds of a preference action. In reaching its conclusion, the court focussed on the nature of the debenture holder's security. The court observed that at the time the preference was given, the debenture holder's charge was still floating and therefore had not attached to the assets of *Yagerphone*:

> On January 17, 1933, the creditor to whom the money was paid and from whom the money was recovered was a creditor Yagerphone, Ld. When Yagerphone, Ld. paid to the creditor the 240*l* 11 s. 2 d. that sum, in my judgment ceased to be the property of Yagerphone, Ld. The payment to that creditor could not have been attacked or impeached, unless within three months from the date of payment, the liquidation of Yagerphone, Ld. had begun, and, in my judgment, at the date when the security contained in the debenture crystallised, the sum of 240*l* 11 s. 2 d. was not the property of Yagerphone, Ld....

102 As counsel to the Trustee points out, at the time the preference was given by the debtor, the assets transferred were not subject to the debenture holder's security and when the debenture holder's security was crystallized, the debtor's estate did not extend to the assets that had already been transferred on account of the preference. On this basis, the court found that the debenture holder's security did not attach to those assets when they were eventually returned to the estate.

103 Counsel to the Trustee goes on to submit that, from a policy perspective, the holding in *Yagerphone* is not unreasonable, as, in particular, because the debenture holder's security was floating it had no claim to the assets. When these assets were brought back into the estate, the court's decision that all creditors share in those assets is consistent with the fact that the "fraud" occurred against all of the debtor's creditors.

104 In *Mohawk Sports Equipment* Houlden J. (as he then was) applied *Yagerphone* in circumstances which involved a floating charge that had not crystallized. The court held that the proceeds "cannot be claimed by the debenture holder as it was not part of the property of the debtor company at the time the security was crystallized".

105 Counsel to the Trustee further submits that in subsequent cases, the holding in *Yagerphone* has been summarized more broadly to apply to secured creditors generally. Reference was made to *Maybank Foods* where at paragraph 2 the court stated:

> It is conceded by the respondent that the monies recoverable by a trustee from a creditor who has been preferred do not become part of the general assets of the bankrupt estate subject to the claims of secured creditors but rather are received by the trustee subject to a trust in favour of the creditors represented by the trustee: Re Yagerphone, Ltd. (1935) 1 Ch. 392 (Ch. D.).

106 It is the Trustee's submission that the concession in *Maybank Foods* goes beyond the ratio in *Yagerphone* as the reasoning in *Yagerphone* does not necessarily follow the circumstances in which a secured creditor holds a fixed charge over the assets of the debtor. Counsel goes on to submit that where the secured creditor holds a fixed charge, the policy considerations are different. Unlike a floating charge, a fixed charge gives the secured creditor a property interest in the debtor's collateral that attaches at the time the charge is granted. Reference was also made to the recent decision of the Supreme Court of Canada in *Innovation Credit Union v. Bank of Montreal*, [2010] 3 S.C.R. 3 (S.C.C.), which, in turn referred to the case of *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.), in which the distinction between a fixed and a floating charge was explained at para. 46:

 

> The critical significance of the characterization of an interest as to being fixed or floating, of course, is that it describes the extent to which a creditor can be said to have a proprietary interest in the collateral. In particular, during the period in which a charge over inventory is floating, the creditor possesses no legal title to that collateral....However, if a security interest can be characterized as a fixed and specific charge, it will take priority over a subsequent statutory lien or charge; in such a case, all that the lien can attach to is the debtor's equity of redemption in the collateral....

107 The distinction between a fixed and floating charge and considering whether the charge has crystallized is not a new concept. The issue was also live in *Maybank Foods*.

108 In *Maybank Foods*, the respondent was a secured creditor of the estate. The estate had been engaged in three actions in Nova Scotia referred to as the Food Group Litigation, the Provisioners Litigation, and the Seaway Litigation, respectively. The trustee requested orders that the proceeds from such litigation were the property of the estate free and clear of the secured claim of the respondent.

109 At para. 2 of the decision, Saunders J. referenced the Provisioners Litigation and the Seaway Litigation as involving claims against preferred creditors. It was in this context that the concession was made by the respondent that the monies recoverable by the trustee would not form part of the general assets of the estate.

110 However, at para. 3 of the decision, Saunders J. addresses the claim against Food Group:

> The claim against Food Group was in respect of an account receivable. Food Group unsuccessfully defended the claim of the trustee on the basis of set-off. It was held that in the circumstances there was no mutuality, because at the time the bankrupt became indebted to Food Group, the receivable was being claimed by another secured creditor, Citibank under a crystallized charge. Upon the bankruptcy, the receivable of Food Group vested in the trustee subject to the secured claim of the predecessor in title of the respondent. Accordingly, the respondent may assert a right to the proceeds of the Food Group Litigation unless defeated by some principle or a statute. The situation is different from the other two actions where the respondent had no charge on the property being claimed by the trustee and the trustee was asserting a statutory right unavailable to the respondent. Here, the respondent has a charge on the receivable being claimed from Food Group. The trustee argued the respondent could not have successfully claimed against Food Group because Food Group would have been entitled to a set-off which in its submission made the situation analogous to the other two actions. I cannot accept that argument. The action of Citibank in crystallizing its charge foreclosed the Food Group from successfully asserting the set-off defence. In my opinion, the respondent who also had a charge against that asset could assert along with the trustee that set-off is not available notwithstanding the charge to the respondent may not have crystallized before the claim of Food Group against the bankrupt arose. There is, in my opinion, no basis in statute or principle preventing the respondent from claiming the net proceeds of the Food Group action.

111 Justice Saunders endorsed the record as follows:

> Net proceeds (after deducting of costs and disbursements) of Food Group Litigation are subject to the secured claim of the respondent. Proceeds of the Provisioners Litigation and the Seaway Litigation are free and clear of such claim. The costs and disbursements with respect to the Provisioners Litigation and the Seaway Litigation should not be paid out of the assets of the estate that are subject to the secured claim of the respondent unless that claim has been satisfied in full. Costs to the trustee and to the respondent out of the estate on a solicitor-and-client basis.

112 The distinction between a fixed charge and a floating charge was also the subject of the decision of the Nova Scotia Court of Appeal in *S-Marque*.

113 In *S-Marque*, the Nova Scotia Supreme Court found that the proceeds of a preference action will inure to the benefit of the unsecured creditors for two reasons:

> (a) first, the court relied on the decision In *Hargreaves*; and

 

(b) second, the court cited a number of decisions to the effect that only a trustee can void a preference action.

114 The decision was affirmed on appeal but the Court of Appeal decided the priority issue for different reasons. The Court of Appeal focussed on the fact that the secured creditor held a floating charge and that the preference occurred "before the debenture crystallized". As counsel to the Trustee reasoned, as in *Mohawk Sports Equipment*, the court determined the matter on the basis that the secured creditor "never had a fixed charge on these assets when the debenture crystallized".

115 Counsel to the Trustee submits that the court considered the priority rights of secured creditors to proceeds from a preference action and that in the 2000 British Columbia Supreme Court decision, in *ASI Acoustical Supplies Inc., Re*, the court squarely addressed the fact that only a trustee can make a claim for fraudulent preference under the *BIA*. Counsel to the Trustee submits that the court noted that, while the *BIA* gave that right to the trustee, it did not change the priority rights of creditors to the proceeds.

116 In my view, the *ASI Acoustical* decision does not stand for the proposition put forth by counsel to the Trustee.

117 The matter came before the court by way of an appeal by the trustee for *ASI Acoustical* from a decision of the Registrar, refusing to approve the payment to the trustee of its fees and disbursements. The Bank of Nova Scotia took security in the form of a general security and assignment of accounts receivable. The security was ultimately assigned to Mr. Willsie.

118 Prior to bankruptcy, ASI bought materials from Winrock and owed Winrock around $56,000. Winrock then bought a substantial amount of ASI inventory. Winrock owed ASI approximately $45,000 for the inventory, but resisted payment claiming a right of "contra account". The trustee wrote to Winrock noting that a subsidiary company Hubcity owed part of the money to ASI and therefore the claim of "contra account" could not be made out. The trustee also alleged that the Winrock claim was a preference on the basis that the sole reason Winrock bought the inventory from ASI was to reduce its claim in the bankruptcy.

119 Ultimately, the matter was settled. The position of the trustee was that the matter was settled on the basis that the purchase of inventory was a fraudulent preference under the provisions of the *BIA* and because this remedy is not available to the secured creditor, the money obtained from the settlement was an asset of the estate.

120 The registrar held that there was no dispute that the account receivable from Winrock was covered by the security interest, and the fact that there were negotiations and the claim was eventually paid because the trustee alleged that there was a fraudulent preference, did not convert the asset into some other kind of asset not subject to the security interest. The registrar therefore found that the proceeds of the claim should not appear on the statement of receipts and disbursements as an amount available to the estate.

121 At the hearing before Martinson J. on appeal, the creditors disputed the characterization of the transaction as a fraudulent preference. The only evidence before the registrar was that there had been an allegation of a fraudulent preference by the trustee, that no claim had been commenced by the trustee and that there was a negotiated settlement with Winrock.

122 Justice Martinson concluded that it was open to the Registrar, based on the material before her, to conclude that the settlement monies were accounts receivable and subject to the security interest. It was in this context that the reference which was cited by counsel to the Trustee: "[i]n any event, the fact that only a trustee can make a claim alleging a fraudulent preference does not change the priority position of a secured creditor" was made.

123 From my reading of *ASI Acoustical*, the significant point is that the court recognized that in the circumstances of that case, the fact that a fraudulent preference action had commenced, did not preclude the ability of a secured creditor to realize on security or to follow the proceeds from security in accordance with the specific security agreement.

124 This position is again recognized in *Agricultural Credit Corp. of Saskatchewan*, where the court noted:

 

> Monies owing to a bankrupt, when collected by the trustee continue to be the property of the bankrupt and continue to be subject to the existing security interests. This includes monies realized through the efforts of the Trustee. (*Holy Rosary Parish (Thorold) Credit Union Limited v. The Premier Trust Company*, (1965), S.C.R. 503); Re Stadnik (Bankrupt) (1991), 90 Sask. R. 12 (QB); Re Moore (Bankrupt) (1989), 79 Sask. R. 63 (C.A.).

125 Counsel to the Trustee submits that the conclusion of the court in *ASI Acoustical* is consistent with a long line of jurisprudence that holds that monies recovered by the trustee are subject to the rights of secured creditors.

126 It seems to me that this statement is too broad. In my view, the focus has to be on whether or not the secured creditor had rights in the collateral at the time of the suspect transaction.

127 In *Yagerphone*, the debenture holder's security was floating and the debenture holder had no claim to the assets recovered by the liquidation.

128 In *Mohawk*, the floating charge had not crystallized.

129 In *Maybank Foods*, the court recognized that the secured creditor could have a claim, under a crystallized charge.

130 In *S-Marque*, the secured creditor held a floating charge and the preference "occurred before the debenture crystallized".

131 In *ASI Acoustical*, the court concluded that it was open to the registrar to conclude that the settlement monies were accounts receivable and subject to the security interest.

132 In *Agricultural Credit Corp.*, monies owing to a bankrupt on account of shares in the Saskatchewan Wheat Pool, when collected by the trustee continued to be the property of the bankrupt and subject to the existing security interest. It was not a preference action.

133 *Yagerphone* arose in the context of a regime dominated by fixed and floating charge debentures. In Ontario, since the enactment of the *Personal Property Security Act*, R.S.O. 1990, c. P-10 ("*PPSA*"), security agreement do not generally refer to fixed and floating security, but the concepts of fixed and floating charges is still recognized. (See *Bank of Montreal v. Innovation Credit Union*, *supra*.)

134 Under the *PPSA* regime, the issue that has to be analyzed is whether or not the debtor had the ability to transfer the collateral charged by the security agreement to a third party free and clear of the security interest.

135 It seems to me that, if the debtor was in a position to transfer the collateral free and clear of the interest of the secured party, the *Yagerphone* analysis and conclusions remains valid. Conversely, if the collateral remains subject to the claims of a secured party, the secured party may retain the ability to enforce its rights as against the collateral or any proceeds arising from the collateral.

136 It seems to me that this outcome is consistent with the views of Doyle C.J. in *Fresjac Pty. Ltd. (In liq), Re*, *supra*, which are summarized at [86] - [88] above. I am in agreement with the views and conclusions set out by Doyle C.J. in that case. The outcome is also consistent with the approach of Lee Eng Beng in the emphasized part of [95]. The outcome is also consistent with the approach outlined by Gerald McCormack at [96] and by Nancy Sanborn at [97].

137 Section 95 of the *BIA* makes it clear that a transaction that is declared to be a preference is void as against the trustee. This, in my view, makes it clear that it is the trustee that has the cause of action to declare a preference to be void. But, as stated in *Fresjac Pty. Ltd. (In Lq.)*, *supra*, the issue of who possesses the right to bring a preference action does not necessarily determine entitlement to proceeds.

138 The s. 95 cause of action remedy is designed to ensure that there is *pari passu* treatment as between unsecured creditors. The recipient of a preferential transfer is not entitled to keep the preferential proceeds if the elements of s. 95 are proven. The

 

subject of the preference is returned to the estate but subject to the rights of secured creditors. In the words of Lee Eng Beng at [95] above, "...if a secured creditor has the right to recover the assets transferred away in breach of his security rights and the liquidator or trustee in bankruptcy recovers the assets pursuant to the statutory provisions, any recovery by the latter must be held for the benefit of the former in so far as they would have been recoverable by the secured creditor."

139 Ultimately, distributions of the bankrupt's estate are made pursuant to s. 136 of the *BIA* and again are preferenced with the *proviso*: "subject to the rights of secured creditors".

140 The ability of a trustee to recover monies for the estate for the benefit of creditors is, in its entirety, subject to the rights of secured creditors. If a secured creditor still has rights in the collateral, there is nothing in the fraudulent preference remedy regime that would appear to preclude the secured creditor from exercising its rights. To the extent that the secured party has rights in the collateral and has a remedy against the collateral in the hands of the third party, such remedy and the resulting priority is not, in my view, altered because a trustee embarks on a preference action.

141 This analysis is consistent, in my view, with the structure of the *BIA*. The *BIA* respects the rights of secured creditors. Over time, modifications have been made to the statute to harmonize it with statutes providing for remedies to secured creditors. But, the priority regime has not changed. If the secured creditor has rights to the collateral, the secured creditor takes priority over the claims of unsecured creditors.

142 Counsel to the Trustee also referenced *Thorne Ernst & Whinney and Gazzola, Re* in connection with an explanation as to the interplay of the preference provisions and priority distributions. The case involved a dispute between a landlord of a bankrupt tenant and the trustee. The landlord appealed from a judgment holding that a distress levied by the landlord was fraudulent and void as a preference as against the lessee's trustee.

143 Justice Hickson opined that under the *BIA*, the trustee is charged with gathering the assets of the bankrupt for the benefit of the creditors and then distributing those assets pursuant to the scheme of distribution set out in s. 136 of the Act. In the context of a preference, the trustee can bring an application under s. 95 and, if successful, the landlord would be required to pay over the proceeds of the transaction to the trustee. Hickson J.A. went on to state that "in due course, depending on the claims of secured creditors and those standing in priority to the landlord under the scheme of distribution established by s. 136 of the Act, if there are sufficient assets in the estate the landlord will then receive payment pursuant to the provisions of that section".

144 Counsel to the Trustee went on to submit that in a similar case involving a preference action against the landlord, the Court of Appeal for Ontario considered and followed *Gazzola* and, citing concurring reasons in *Gazzola*, the court noted that the preference proceeds are to be distributed in accordance with the scheme in s. 136, which is subject to the rights of secured creditors: See *Canadian Imperial Bank of Commerce v. Canotek Development Corp., supra.*

145 In reviewing both the *Gazzola* decision and the *Canotek* decision, I do not see any finding that it is inconsistent with the views that I have expressed above. Simply put, a trustee can pursue a preference action. If the trustee recovers proceeds, they are to be distributed in accordance with s. 136. The reference "which is subject to the rights of secured creditors" restates the position that if secured creditors have rights in the collateral, such priority is to be respected by the trustee.

146 I do not read into the words "subject to the rights of secured creditors" as putting the position of the secured creditor at an even higher level. Specifically, I do not interpret this phrase as enabling a secured party to step into and occupy the position of the trustee. The trustee's rights are established under the *BIA*. The rights of a secured creditor are provided for in security agreements and the *PPSA* and the process by which realization takes place is provided for in court orders, security agreements, the *PPSA*, and in this case, the *BIA*.

147 Counsel to the Trustee also raises a number of policy considerations underlying the *BIA* in support of its position. Specifically, counsel submits that the proposition that unsecured creditors have priority to the proceeds of a preference action may lead to anomalous results insofar as an insolvent person could defeat the rights of a secured creditor by simply granting a preference immediately prior to assigning itself into bankruptcy. The consequences of reversing the preference would be such that the proceeds would benefit unsecured creditors. Counsel submits that it cannot be correct that by dealing with collateral

 

in a preferential fashion, an insolvent person can alter bankruptcy priorities and nullify a secured creditor's exclusive claim to that collateral.

148 This theme has also been recognized in certain academic writings. For example, Professor Fletcher, in *The Law of Insolvency*, provides support for the trustee's position. In stating that the purpose of a preference action is to restore the situation to the *status quo ante*, he puts into doubt the notion that the proceeds of the action are not subject to the rights of secured creditors.

149 The answer to the concern posed by counsel to the Trustee is not easy. To some extent, secured creditors are protected by an ability to take action for recovery as a result of the provisions of their particular security agreement. The *BIA* does not extinguish the rights of secured creditors to follow collateral if circumstances are such that it is lawful and appropriate to follow the collateral.

150 If, for example, the transaction is out of the ordinary course of business or, if the recipient is on notice that it is an improper transaction, the secured party may very well have rights to recover the collateral or proceeds. However, if the debtor was in a position to lawfully dispose of the collateral free and clear of the security interest, and has done so, it could very well be that the only recovery for the secured creditor would be to participate in a distribution to unsecured creditors under s. 136 of the *BIA*. This, of course, would happen if the secured creditor declares part of its indebtedness to be unsecured. This outcome is a consequence, however, not of some realignment or readjustment of priorities under the *BIA*, but rather, it is a consequence of a factual scenario under which the debtor could lawfully transfer the collateral. This outcome is, in my view, consistent with the *Yagerphone* analysis.

151 In the final analysis, I have concluded that:

> (i) a trustee in bankruptcy (or a section 38 *BIA* assignee) is the only party that can bring a preference action in bankruptcy proceedings;
>
> (ii) the proceeds recovered by the trustee are brought into the estate;
>
> (iii) distribution under the *BIA* is subject to the rights of recovery of secured creditors;
>
> (iv) the bringing of a preference action and the recovery of proceeds does not preclude secured creditors from pursuing whatever remedies they may have under the provisions of the security agreement and relevant statutes.

152 There is also nothing, in my view, that would preclude a secured creditor from pursuing appropriate remedies in conjunction with the trustee pursuing its remedies. For example, at the outset of a proceeding, when investigations may not have been complete, it may be difficult to pinpoint a specific remedy. This would likely require a cooperative effort as between secured creditors and a trustee and some sort of formal agreement to recognize how matters are to be prosecuted and how proceeds of litigation are to be allocated. An example of such an arrangement is referenced in *Re Sharpland Inc.*, *supra*.

153 Overall, the objective of the preference action is to void preferential transactions for the benefit of creditors, while recognizing legitimate security interests.

154 Air Canada has taken issue with the role of the Trustee in this case and makes specific reference to s. 13.4 of the *BIA* which explicitly contemplates that a trustee may act for or assist a secured creditor in certain circumstances. These submissions from counsel to Air Canada have been put forth in an effort to persuade the court that the Trustee should, in this case, be following the requirements of the *BIA*. Counsel to Air Canada also questions whether this court has the jurisdiction to allow a trustee to pursue a *BIA* preference action within the context of a *CCAA* proceeding.

155 The *CCAA* does address the issue of preferences and transfers under value. Section 36.1(1) provides that the preferential provisions of the *BIA* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement, unless the compromise or arrangement provides otherwise.

 

156 In this case, there is no compromise or arrangement that has been proposed to creditors, nor is it expected to flow from the type of proceeding that is currently before the court.

157 This leads to a straight-forward conclusion, in my view, that the preference action should proceed under the *BIA*.

158 However, this conclusion leads to the subject of coordination of proceedings under the *CCAA* and the *BIA*. This subject was addressed by the Supreme Court of Canada in *Ted Leroy Trucking Ltd., Re*, [2010] 3 S.C.R. 379 (S.C.C.).

159 In *Century Services*, the majority noted that the *CCAA* is a flexible statute designed to preserve the value of a business as a going-concern through a court supervised re-organization. In that case, a re-organization under the *CCAA* had failed and the Crown brought a motion for payment of its statutory deemed trusts pursuant to s. 222(3) of the *Excise Tax Act*, R.S.C. 1985, c. E-15. Brenner C.J. denied the motion and allowed the assignment of the company into bankruptcy. The British Columbia Court of Appeal had found that while the Crown could not seek repayment of GST source deductions in priority to other claims during a *CCAA* or *BIA* proceeding, it could do so after the reorganization efforts had failed and prior to the commencement of a *BIA* proceeding, such that the trial judge was bound to allow the motion and apply the provisions of the *Excise Tax Act*. The majority of the Supreme Court rejected this reasoning noting at para. 47 that an interpretation giving the *Excise Tax Act* priority over the *CCAA* would result in a "strange asymmetry" which would encourage statute shopping.

160 Justice Deschamps, writing for the majority, rejected the contention that Brenner C.J. had exceeded his authority by continuing the stay of the Crown's GST claims while temporarily lifting the general stay to allow for the assignment in bankruptcy. Section 11 of the *CCAA*, subject to certain restrictions, provides the court with broad authority to make an order that is appropriate in the circumstances — a power which is not subject to explicit temporal limitations and is buttressed by the court's inherent jurisdiction, as well as s. 20 (now s. 42) of the *CCAA*.

161 At para. 76 of *Century Services*, it is noted that the *CCAA*'s objectives permit for a bridge between the *CCAA* and *BIA* proceedings. As recently noted by the Supreme Court of Canada regarding section 20 of the *CCAA*:

> That section provides that the *CCAA* "may be applied together with the provisions of any Act of Parliament ... that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA*. Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate in tandem with other insolvency legislation, such as the *BIA*.

162 Further, Deschamps J. wrote at para. 78:

> Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy.

163 This passage from *Century Services* clearly states, in my view, that the courts should be taking a pragmatic approach in determining issues which arise in proceedings where the *CCAA* overlaps with the *BIA*. This is one such proceeding. The overall objective should be to create a system under which the court can review transactions entered into between the debtor and creditors in the period just prior to formal insolvency proceedings. The policy should be to ensure that there is an appropriate review mechanism in place to challenge transactions that are not consistent with ordinary course activities and have had the effect of unfairly transferring value to a third party during the review period. It seems to me that the *CCAA* can operate in tandem with the *BIA* in an effort to return matters to the *status quo*.

 

164 Applying the principles of *Century Services*, it seems to me, that the preference motion should proceed in the *BIA* proceedings. However, in my view, this can be accomplished by a procedural order in *CCAA* proceedings which transitions the matter to the *BIA*. There is no necessity or principled reasons to require the trustee to start from square one. This outcome is consistent with my endorsement of February 24, 2010 at paras. 29 - 32.

165 It is also appropriate, at this time, and in view of the contemplated continuation of the preference motion, that proceedings be regularized with the Trustee taking the necessary steps to comply with its obligation under the *BIA*.

**Disposition**

166 In the result, a declaration shall issue to incorporate the conclusions set out at [151] which, for ease of reference, is repeated:

> (i) a trustee in bankruptcy (or a Section 38 *BIA* assignee) is the only party that can bring a preference action in bankruptcy proceedings;
>
> (ii) the proceeds recovered by the trustee are brought into the estate;
>
> (iii) distribution under the *BIA* is subject to the rights of recovery of secured creditors;
>
> (iv) the bringing of a preference action and the recovery of proceeds does not preclude secured creditors from pursuing whatever remedies they may have under the provisions of the security agreement and relevant statutes.

167 I have also concluded that, if it is determined that the transaction is void as being a preference, at that point, the appropriate determination can be made as to which party, be it either the trustee or the secured party, is entitled to the proceeds. This determination should be based on whether the secured party has the right to recover the assets transferred, or any proceeds resulting from such transfer. In my view, it is premature to comment on this issue, in the circumstances of this case, as the factual record has not been fully determined.

168 In the context of this particular case, if it is the intention of the secured party to work in conjunction with the Trustee and for the Trustee to utilize the preference provisions, the appropriate notifications should be provided in accordance with s. 13.4 of the *BIA* and the Trustee should move forward to fulfill its statutory obligations in the conduct of its administration.

169 To the extent that further directions are required in respect of this endorsement, the parties may contact the Commercial List Office to set up a 9:30 a.m. appointment.

*Order accordingly.*

End of Document 

 

# TAB 7

2011 ONSC 5820
Ontario Superior Court of Justice [Commercial List]

Verdellen v. Monaghan Mushrooms Ltd.

2011 CarswellOnt 11612, 2011 ONSC 5820, 207 A.C.W.S. (3d) 553, 97 C.P.R. (4th) 196

# Jack Verdellen, Applicant and Monaghan Mushrooms Ltd., Pricewaterhousecoopers Inc., Respondents

Newbould J.

Heard: September 27, 2011
Judgment: October 7, 2011
Docket: CV-11-9162-CL

Proceedings: additional reasons at *Verdellen v. Monaghan Mushrooms Ltd.* (2011), 2011 ONSC 6506, 2011 CarswellOnt 12810 (Ont. S.C.J.)

Counsel: Patrick J. Cotter, for Applicant
Paul J. Martin, Sarah J. Armstrong, for Respondent, Monaghan Mushrooms Ltd.
T. Van Klink, for Respondent, PricewaterhouseCoopers Inc.

Subject: Intellectual Property

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Intellectual property --- Patents — Transfer of interest — Assignment**

Invention was said to have occurred while JV was employed by R Ltd. — JV claimed ownership under agreement between him and R Ltd. said to have been negotiated orally and put in writing dated December 1, 2008 — Business of R Ltd. was sold to M Ltd. — Applicant JV applied for declaration that he was owner of certain patent rights outside of North America for invention which involved method of inhibiting green mould in mushrooms — Application dismissed — It was declared that purported agreement of December 1, 2008 between JV and R Ltd. and any purported oral agreement between them regarding same matters, was void as against M Ltd. as bona fide purchaser for value from R Ltd. without notice of any such agreements — It was clear from evidence that prior to closing of purchase of business by M Ltd. from R Ltd., M Ltd. was never provided, nor did it learn of, any information of JV's alleged interest in patent, in spite of M Ltd.'s due diligence process.

**Table of Authorities**

**Cases considered by *Newbould J.*:**

*Apotex Inc. v. Wellcome Foundation Ltd.* (2000), 2000 CarswellNat 2643, 195 D.L.R. (4th) 641, [2001] 1 F.C. 495, 2000 CarswellNat 3414, 10 C.P.R. (4th) 65, 186 F.T.R. 274 (note), 262 N.R. 137 (Fed. C.A.) — considered

*DiGuilo v. Boland* (1958), [1958] O.R. 384, (sub nom. *Di Guilo v. Boland*) 13 D.L.R. (2d) 510, 1958 CarswellOnt 102 (Ont. C.A.) — considered

*Grant Forest Products Inc., Re* (2009), 58 C.B.R. (5th) 127, 2009 CarswellOnt 6099 (Ont. S.C.J. [Commercial List]) — referred to

*Grant Forest Products Inc., Re* (2010), 276 O.A.C. 43, 101 O.R. (3d) 383, 67 C.B.R. (5th) 23, 2010 CarswellOnt 3001, 2010 ONCA 355, 318 D.L.R. (4th) 598 (Ont. C.A.) — considered

*R. Griggs Group Ltd. v. Evans (No. 2)* (2004), [2004] EWHC 1088, [2005] Ch. 153, [2005] 2 W.L.R. 513, [2004] F.S.R. 48 (Eng. Ch. Div.) — referred to

*Society of Composers, Authors & Music Publishers of Canada v. Canadian Assn. of Internet Providers* (2004), (sub nom. *SOCAN v. Canadian Assn. of Internet Providers*) 240 D.L.R. (4th) 193, 2004 SCC 45, 2004 CarswellNat 1919, 2004 CarswellNat 1920, 322 N.R. 306, (sub nom. *Socan v. Canadian Assn. of Internet Providers*) [2004] 2 S.C.R. 427, (sub nom. *SOCAN v. Canadian Assn. of Internet Providers*) 32 C.P.R. (4th) 1 (S.C.C.) — referred to

*Tucker v. Aero Inventory (UK) Ltd.* (2011), 2011 CarswellOnt 8476, 2011 ONSC 4223, 80 C.B.R. (5th) 1 (Ont. S.C.J. [Commercial List]) — referred to

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
s. 38 — considered

s. 95 — considered

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

s. 36.1 [en. 2007, c. 36, s. 78] — referred to

*Patent Act*, R.S.C. 1985, c. P-4
Generally — referred to

s. 49(2) — considered

s. 50(2) — considered

s. 51 — considered

*Patents Act*, 1977, c. 37
Generally — referred to

*Patents Act 1990*, No. 83, 1990
Generally — referred to

**Rules considered:**

*Patent Rules*, SOR/96-423
Generally — referred to

  

s. 59 — considered

APPLICATION by JV for declaration that he was owner of certain patent rights outside of North America for invention which involved method of inhibiting green mould in mushrooms.

***Newbould J.*:**

1 The applicant Jack Verdellen applies for a declaration that he is the owner of certain patent rights outside of North America for an invention which involves a method of inhibiting green mould in mushrooms. The invention was said to have occurred while Mr. Verdellen was employed by Rol-land Farms Limited ("Rolland"). Mr. Verdellen claims ownership under an agreement between him and Rolland said to have been negotiated orally and put in writing dated December 1, 2008

2 Rolland applied for protection under the CCAA on December 10, 2008 and the Initial Order was made that day. A sale process in the CCAA proceedings was undertaken and the respondent Monaghan Mushrooms Ltd. ("Monaghan") purchased the business of Rolland under an agreement of purchase and sale dated September 21, 2009. That agreement closed on November 6, 2009 under an amended vesting order dated October 27, 2009. Monaghan takes the position that Mr. Verdellen cannot establish an agreement between him and Rolland and that Monaghan acquired the patent rights in question in good faith for value without notice of any rights of Mr. Verdellen to the patent rights under a court ordered process that provided Monaghan with a vesting order. Monaghan also takes the position that if there were an agreement, it would be void under s. 51 of the Patent Act and as a preference under s. 95 of the BIA.

**Existence of agreement**

3 Mr. Verdellen's evidence is that he commenced work at Rolland as a consultant in 1994- 1995 and became Vice-President, Production in November 2006. His evidence is that at that time, he orally agreed with Mr. Vander Pol, the president and chief executive officer of Rolland, that he would own the rights to whatever he invented provided that Rolland was able to get the benefit of the rights in North America. In July 2007 he and another Rolland employee invented materials and methods to be used for the prevention and/or control of green mould in the production of mushrooms.

4 Mr. Verdellen's further evidence is that in late 2008 he told Mr. Vander Pol that he intended to leave the company and go back to Holland but that in order to keep him, a proposal was made by Rolland in writing in a document dated December 1, 2008 which confirmed his ownership of the invention and the patent rights outside of North America. The contractual rights claimed by Mr. Verdellen are contained in a document dated December 1, 2008 signed by Mr. Vander Pol on behalf of Rolland and by Mr. Verdellen. Mr. Verdellen is unable to say when he signed the document. He has never produced the original document. The date of December 1, 2008 is three days after BMO delivered a notice of intention to enforce security against Rolland and shortly before Rolland commenced its CCAA proceedings.

5 The December 1, 2008 document includes the following:

> The information below summarizes how the R&D findings are to be handled to the mutual benefit of Rol-land Farms and Jack Verdellen:
>
> It is jointly recognized that the R&D activities carried on to date would not have been possible without the combined efforts of Jack Verdellen, Nader Gheshlaghi and Rol-land Farms. Jack has provided the ideas, Nader has carried out the research and Rol-land has funded the activities.
>
> . . .
>
> Given Jack's contributions to Rol-land's operations over the past 3 years, and given Rol-land's contributions to the R&D program over that same time period, Rol-land and Jack agree to the following settlement:

- Rol-land will transfer the world rights to "Pepe" to Jack to continue with a world application.

- Rol-land must retain the North American rights to "Pepe" in order to protect its competitive advantage.

. . .

This agreement is not transferable without the written consent of both Jack Verdellen and Rol-land Farms

6 Monaghan refers to several pieces of evidence and suspicious circumstances to assert that there was never any agreement between Mr. Verdellen and Rolland. It also asserts that there was no agreement on all essential terms, there was no consideration flowing to Rolland and there is no evidence of communication of any acceptance by Mr. Verdellen to Rolland.

7 This is an application. In my view there are too many contested factual issues to determine at this stage whether or not there was a binding agreement between Mr. Verdellen and Rolland. During the course of the oral argument I made that determination.

8 What remains is whether on the assumption that a binding agreement as claimed by Mr. Verdellen was made, there are any grounds available to support a declaration of the rights of the parties.

**Purchase agreement and vesting order**

9 The agreement of purchase and sale dated September 21, 2009 between Rolland and Monaghan closed on November 6, 2009. Approval to the agreement and a vesting order was made on October 5, 2009 and an amended approval and vesting order was made on October 27, 2009. Mr. Verdellen takes the position that the agreement of purchase and sale did not transfer to Monaghan the rights to the patent outside of North America and further takes the position that if necessary, the vesting order should be amended to make that clear.

10 The agreement of purchase and sale provided for the sale of a number of assets, including the Intellectual Property. Intellectual Property was broadly defined as follows, in part:

> "Intellectual Property" means all of the intellectual property of whatever nature and kind owned by or licensed to the Vendor in respect of or associated with the Business as presently constituted, including all domestic and foreign trademarks,... and all patents... whether registered or unregistered, and all applications for registration thereof, and... inventions...; in which, for further certainty, includes... all products, processes and inventions developed by or for or used by the Business in connection with the control or eradication of green mould disease, including any patent applications for strains of biological control for green mould for the treatment of spawn;

11 It is to be noted that this definition of Intellectual Property is in respect of the "Business". Mr. Verdellen asserts that the definition of Business in the agreement of purchase and sale excludes any patent rights outside of North America. Business is defined in the agreement to have the meaning set out in the recitals. The recital refers to the order under which the Monitor was authorized and directed to conduct a sale process for offers for the sale "of the mushroom production and marketing business" of Rolland. Mr. Verdellen asserts that because Rolland only carried on its mushroom business in North America, any patent rights outside of North America were not included in the agreement of purchase and sale.

12 I cannot accept that contention. The definition of Business in the agreement of purchase and sale as being "the mushroom production and marketing business" of Rolland by its language did not restrict that business to any particular locality or jurisdiction. The business of Rolland included making patent applications for the invention in question, being an invention to control or eradicate green mould disease. Prior to the sale, Rolland had filed an international PCT application, which was an application to commence exploiting patent rights throughout the world. That was part of its business.

13 On the day of the closing, Rolland executed and delivered to Monaghan an assignment of patent rights that specifically contained worldwide rights to the invention in question. The recitals in the assignment referred to the invention for which PCT

  

and U.S. applications had been filed and recited that under the agreement of purchase and sale Rolland had agreed to sell that invention to Monaghan. The operative provisions of the assignment contained, in part, the following:

> The Assignor does hereby sell, assign and transfer to Monaghan and its successors and assigns:
>
> > (i) all of Assignor's entire right, title and interest to the Patent, including any and all inventions described therein, and in any and all national phase patent applications, continuations-in-part, continuations, divisions, substitutes, re-issues, re-examinations, or extensions thereof, and all other applications for the Patent relating thereto which have been filed, or hereafter shall be filed in all the countries of the world, including in Canada;

14 It is clear in my view that the agreement of purchase and sale covered the worldwide patent rights for the invention in question.

15 The vesting order as amended vested in Monaghan the assets described in the agreement of purchase and sale. This included the worldwide patent rights for the invention in question. Thus the vesting order should not be amended.

**Purchaser for value without notice**

16 The evidence appears clear that prior to the closing of the purchase of the mushroom business by Monaghan from Rolland, the publicly available information regarding ownership of the invention in question and any related patent applications disclosed Rolland as the owner.

17 On February 26, 2008, a U.S. patent application was filed in which Mr. Verdellen and another Rolland employee named Nader Gheshlaghi were named as the applicants and inventors and Rolland was named as the assignee for the patent application. On March 18, 2008 Mr. Verdellen and Mr. Gheshlaghi executed a written assignment in favour of Rolland in which they assigned to Rolland Farms their entire right, title and an interest throughout the world in the inventions which were the subject of the U.S. patent application. This assignment was recorded in the U.S. patent office on May 13, 2008. Also on March 18, 2008 a power of attorney was signed by Rolland as assignee which indicated that Rolland was the owner of the U.S. application and this power of attorney was also recorded in U.S. patent office on May 13, 2008.

18 Prior to the closing of the purchase, Monaghan and its advisers conducted due diligence regarding the business to be acquired, including information on patents. All of the information provided to Monaghan was consistent with the publicly available information that Rolland held the ownership interest in the patent rights in question. Also, at no relevant time was the Monitor aware of any interest of any third party, including Mr. Verdellen, in the patent rights and Mr. Verdellen never told the Monitor of his alleged interest even though a representative of the Monitor met with Mr. Verdellen on a number of occasions. At no relevant time did representatives of Rolland advice the Monitor or Monaghan of any alleged interest of Mr. Verdellen in the patent, including at a meeting on November 2, 2009, four days before the closing of the sale, which was held in part to address an issue of an apparent deletion of research and development from Rolland's computer system.

19 Counsel for Mr. Verdellen refers to evidence that on October 2, 2009 Mr. Verdellen met with a lawyer at Gowlings, the solicitors for Rolland dealing with patent applications for the invention in question, and told the lawyer that an international patent application filed under the Patent Cooperation Treaty by Rolland belonged to him. The lawyer, who was a junior lawyer not acting on the matter, advised Mr. Verdellen that there was a conflict and that the firm could not act for him. The lawyer made a memorandum to file. Although Rolland had authorized Gowlings to disclose all of the information in their patent files to Monaghan prior to closing, the physical files were not received by Monaghan until early December 2009, at least one month after the sale transaction closed. There is no evidence, however, that Monaghan was told by Gowlings or anyone else prior to the closing of Mr. Verdellen's alleged ownership interest in the patent.

20 In my view, it is clear from the evidence that prior to the closing of the purchase of the business by Monaghan from Rolland, Monaghan was never provided, nor did it learn of, any information of Mr. Verdellen's alleged interest in the patent, in spite of Monaghan's due diligence process.

 

21 Monaghan contends that if there is a binding agreement between Mr. Verdellen and Rolland regarding patent rights, the interest of Mr. Verdellen is equitable and that as Monaghan, is a *bona fide* purchaser for value without notice of the agreement between Mr. Verdellen and Rolland, it took title to the patent rights free and clear of any equitable interest of Mr. Verdellen.

22 The doctrine of *bona fide* purchaser for value without notice is described by Prof. Ziff in B. Ziff, *Principles of Property Law*, 5th ed. (Carswell: Toronto, 2010) at page 460 as follows:

> Equity acts on the conscience of the relevant parties; that is why a *bona fide* purchaser for value of the legal title who buys land without notice of an equitable interest will not be bound by that interest. The good faith purchaser has what we would now call a clear conscience, and the present of such a person can alter the ordering of rights.

23 Although this statement refers to land, there is no principled reason why the principle would not apply to any form of property. A contractual right to intellectual property is property not taken by physical possession. It is a chose in action. This is made clear from the judgment of Morden J.A. in *DiGuilo v. Boland*, [1958] O.R. 384 (Ont. C.A.) in which he sated the following:

> To determine the legal issue thus presented, it is necessary to consider the law relating to choses in action and their assignability, first in England then in Ontario. In *Torkington v. Magee*, [1902] 2 K.B. 427, Channell, J., said, at p. 430:-
>
> > 'Chose in action' is a known legal expression used to describe all personal rights of property which can only be claimed or enforced by action, and not in taking physical possession.
>
> The term covers multifarious rights, many diverse in their essential nature, such as debts, company shares, negotiable instruments and rights of action founded on tort or breach of contract.
>
> . . .
>
> The nature of the rights of a purchaser under an agreement of sale of land should, at this point, be briefly considered. His rights are choses in action and are capable of assignment in equity: *Wood v. Griffith* (1818), 1 Swan. 43, at pp. 55-6. The right to specific performance was and is an equitable chose and the right to damages a legal chose in action.

24 See also Prof. Ziff at p. 76 in which he states that the right to assign choses took a long time to mature but eventually the scope of the category was extended to include a wide range of other intangibles, including copyrights, trademarks, patents etc.

25 Gordon Henderson, Q.C., at one time the undoubted leader of the intellectual property bar in Canada, described the doctrine of a *bona fide* purchaser for value without notice as it related to patents in G. Henderson, "Problems Involved in the Assignment of Patents and Patent Rights", *Canadian Patent Reporter*, Vol. 60, p. 237 at pp. 248-9 as follows:

> An equitable assignment exists where there is an agreement rather than a complete and absolute assignment.
>
> In equity (and therefore apart from s. 53 of the Patent Act) an assignee of a patent takes title subject to the equities. Accordingly, a subsequent purchaser of a patent who has knowledge of a prior equitable assignment takes title subject to the prior equitable interest. But an assignee who purchases a patent for valuable consideration without notice of a prior equitable assignment takes free and clear of it.

26 The doctrine of *bona fide* purchaser for value without notice has been applied in intellectual property cases. See *R. Griggs Group Ltd. v. Evans (No. 2)* (2004), [2005] Ch. 153 (Eng. Ch. Div.), [2004] at para. 54.

27 What is the interest of Mr. Verdellen in his contract with Rolland, assuming the contract to exist? Mr. Verdellen takes the position that the agreement transferred the patent rights to him with no necessity for any further transfer, and he has attempted to have his rights under the agreement recognized in the European Patent Office based on that agreement.

28 Monaghan contends that Mr. Verdellen's interest under the agreement, assuming it to exist, is an equitable interest as the agreement states that Rolland "will transfer" the world patent rights to Mr. Verdellen. That is, it is an agreement to transfer those rights rather than an agreement under which the rights have been transferred to Mr. Verdellen. Monaghan compares the contract with an agreement of purchase and sale of land in which it is clear that the interest of the purchaser before closing is an equitable interest.

29 The agreement between Mr. Verdellen and Rolland is not as clear as a typical agreement of purchase and sale in which a future closing date is specified. However in my view, in the circumstances in which the agreement was made, and taking into account the express language "The information below summarizes how the R&D findings are to be handled..." and "Rol-and will transfer...to Jack", the agreement was an executory agreement in that the transfer did not take place in the agreement itself but rather was a promise that it would take place at some time in the future. Thus the interest of Mr. Verdellen under the contract was a chose in action and the right to specific performance was, as stated by Morden J.A., an equitable chose an action. That is, Mr. Verdellen rights under the contract, assuming they existed, were equitable rather than legal.

30 This notion of Mr. Verdellen's interest being an equitable interest is captured by the maxim when something is to be done under an agreement that "equity considers done what ought to be done". See *Grant Forest Products Inc., Re* (2010), 101 O.R. (3d) 383 (Ont. C.A.), aff'g (2009), 58 C.B.R. (5th) 127 (Ont. S.C.J. [Commercial List]).

31 In the circumstances, in my view, Monaghan is correct in its position that even if Mr. Verdellen had a binding contract with Rolland covering the patent rights in issue, Monaghan acquired those patent rights as a good faith purchaser without notice of Mr. Verdellen's rights and thus acquired them free and clear of any interest Mr. Verdellen might otherwise have had in them.

**Section 51 of the Patent Act**

32 Apart from the doctrine of being a bona fide purchaser for value without notice, Monaghan relies upon section 51 of the Patent Act to defeat any interest that Mr. Verdellen might otherwise have in the patent rights in dispute. That section, and the preceding two sections provide:

> **49.** (2) Where an applicant for a patent has, after filing the application, assigned his right to obtain the patent, or where the applicant has either before or after filing the application assigned in writing the whole or part of his property or interest in the invention, the assignee may register the assignment in the Patent Office in such manner as may be determined by the Commissioner, and no application for a patent may be withdrawn without the consent in writing of every such registered assignee.
>
> **50.** (2) Every assignment of a patent, and every grant and conveyance of any exclusive right to make and use and to grant to others the right to make and use the invention patented, within and throughout Canada or any part thereof, shall be registered in the Patent Office in the manner determined by the Commissioner.
>
> **51.** Every assignment affecting a patent for invention, whether it is one referred to in section 49 or 50, is void against any subsequent assignee, unless the assignment is registered as prescribed by those sections, before the registration of the instrument under which the subsequent assignee claims.

33 The effect of section 51 of the Patent Act seems obvious. In *Apotex Inc. v. Wellcome Foundation Ltd.*, [2000] F.C.J. No. 1770 (Fed. C.A.) Rothstein J.A. stated at para. S00:

> Having regard to both sections [Sections 50(2) and 51], it is clear that a purpose of registration under subsection 50(2) is to secure an assignee's priority as against subsequent assignees. Failure to register will deprive an assignee of priority against subsequent assignees and, as between them, an unregistered assignment is "void".

34 Mr. Verdellen takes the position that section 51 has no application to the patent rights in question, being the worldwide rights outside of North America, as he asserts that the section deals only with registration in Canada.

 

35 Monaghan looks to the process in which a foreign patent application was made and then brought into Canada and contends that the effect of the Patent Rules under the Patent Act makes section 51 of the Patent Act applicable to the foreign patent rights outside of North America.

36 The Patent Cooperation Treaty ("PCT") is an international patent law treaty to which Canada is a signatory providing a unified procedure for filing patent applications to protect inventions in each of its contracting states. A patent application filed under the PCT is called an international application, or PCT application. The PCT provides for the filing of one patent application, in one language, with effect in each of its contracting states, instead of filing several separate national and/or regional patent applications. A PCT application does not itself result in the grant of a patent, since there is no such thing as an "international patent" or a "PCT patent". A PCT application, which establishes a filing date in all contracting states, must be followed up with the step of entering into national and/or regional phases in order to proceed towards the grant of national and/or regional patents.

37 On February 26, 2009, a PCT application was filed by Rolland in the Canadian Intellectual Property Office. On August 10, 2010, after the completion of its purchase from Rolland, Monaghan caused the PCT application to enter the national phase in Canada so as to become a Canadian patent application. This was filed with the Canadian Intellectual Property Office. At the same time Monaghan registered with that office the assignment of patent rights that it had acquired from Rolland on the closing of its purchase from Rolland.

38 Section 59 of the Patent Rules under the Patent Act provide:

> 59. When an international application becomes a PCT national phase application, the application shall thereafter be deemed to be an application filed in Canada and the Act and these Rules shall thereafter apply in respect of that Application.

39 Thus by virtue of that section, when the PCT application became a Canadian national phase application on August 10, 2010, the application was deemed to be an application filed in Canada and the Patent Act thereafter applied to it.

40 Monaghan asserts that once engaged, section 51 does not merely prohibit a prior unregistered assignment from affecting title to a Canadian patent or application in respect of which a subsequent assignment has been registered but rather renders the entire prior unregistered assignment "void as against any subsequent assignee". Therefore, Monaghan asserts, the December 1, 2008 agreement relied upon by Mr. Verdellen, which was not registered before August 10, 2010, is void as against the assignment from Rolland registered on that day by Monaghan both in respect of Canadian patent or application rights and such rights elsewhere in the world.

41 It is understandable that when an international PCT application becomes a national phase application in Canada, the national phase application becomes subject to the Patent Act and a contest between two claimants to those Canadian patent rights would be governed by the registration provisions in section 51 of the Patent Act. Can it be said, however, that a contest between those two claimants to foreign patent rights would be governed by section 51 of the Patent Act? In my view it cannot.

42 While the Parliament of Canada has the legislative competence to enact laws having extraterritorial effect, it is presumed not to intend to do so, in the absence of clear words or necessary implication to the contrary. See *Society of Composers, Authors & Music Publishers of Canada v. Canadian Assn. of Internet Providers*, [2004] 2 S.C.R. 427 (S.C.C.) at para. 54 per Binnie J. Neither section 51 of the Patent Act nor section 59 of the Patent Rules expressly state that the provisions of section 51 are applicable to a contest between patent claimants in a foreign jurisdiction, nor can it be said that it is a necessary implication to come to that result. In my view it would be in the interests of international comity to leave such foreign contests to the laws of the foreign states in question.

43 Monaghan refers to the European Patent Convention which provides that the applicable law in each Contract State in Europe governs a patent application and to the provisions of the U.K. Patent Act which contain provisions similar to section 51 of the Canadian Patent Act. It also refers to similar provisions in the Australian Patent Act. It does so because Mr. Verdellen has asserted ownership of the patent rights in both Europe and in Australia. Monaghan asserts that the application of section 51

 

of the Patent Act would thus be consistent with international patent practice. To my mind the fact that these other jurisdictions have provisions governing a contest between patent claimants in those jurisdictions is all the more reason based on principles of international comity to construe section 59 of the patent rules and section 51 of the Patent Act as not being applicable to disputes between patent claimants in those jurisdictions.

44 Thus in my view Monaghan gains no protection for its patent rights against Mr. Verdellen under section 51 of the Patent Act insofar as those rights involve the rights to Europe or elsewhere outside of Canada.

**S. 95 preference**

45 Monaghan takes the position that the purported agreement relied upon by Mr. Verdellen is dated December 1, 2008, within three months of the filing of the CCAA application, and is therefore void under section 95 of the BIA. Section 95 of the BIA is applicable to a proceeding under the CCAA by virtue of section 36.1 of the CCAA.

46 In my view Monaghan has no status to act under section 95 the BIA. The right under section 95 to commence an application is one that in bankruptcy can only be brought by a trustee in bankruptcy. See *Tucker v. Aero Inventory (UK) Ltd.*, [2011] O.J. No. 3816 (Ont. S.C.J. [Commercial List]) per Morawetz J. at paras. 137 and 166. By virtue of section 36.1 of the CCAA, it is the Monitor who would have the right to make an application under section 95 of the BIA. Monaghan is not a creditor and thus would not be in a position to apply under section 38 of the BIA, also applicable to a CCAA proceeding, to acquire any right of action under section 95 of the BIA from the Monitor.

47 Even if Monaghan had status to act under section 95 the BIA, it would not be possible on an application to make a determination of the matter as there are facts in dispute.

**Conclusion**

48 The application of Mr. Verdellen is dismissed. The cross-application of Monaghan is allowed in part. It is declared that the purported agreement of December 1, 2008 between Mr. Verdellen and Rolland and any purported oral agreement between them regarding the same matters, is void as against Monaghan as a *bone fide* purchaser for value from Rolland without notice of any such agreements,

49 Monaghan is entitled to its costs. If the costs cannot be agreed, Monaghan may make written submissions, not exceeding three pages in length, along with a proper cost outline, within 10 days and Mr. Verdellen may make reply submissions, no longer than three pages in length, within a further 10 days.

*Application dismissed.*

End of Document 

# TAB 8

2013 ONSC 578
Ontario Superior Court of Justice [Commercial List]

Dilollo, Re

2013 CarswellOnt 781, 2013 ONSC 578, 225 A.C.W.S. (3d) 913, 97 C.B.R. (5th) 182

# In the Matter of the bankruptcy of Cosimo Dilollo

D.M. Brown J.

Heard: January 17, 2013
Judgment: January 29, 2013
Docket: 31-OR-207435-T

Counsel: H. Chaiton, D. Bourassa for Moving Parties, I.F. Propco Holdings (Ontario) 36 Ltd.
P. Cho for msi Spergel Inc., Trustee in bankruptcy of the estate of Cosimo Dilollo

Subject: Insolvency; Contracts: Corporate and Commercial; Estates and Trusts; Torts

## Headnote

**Bankruptcy and insolvency — Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Miscellaneous**

Creditor obtained default judgment against debtor — Creditor began bankruptcy proceedings against debtor — Parties reached settlement order, which was paid although bankruptcy application remained — Debtor was forced into bankruptcy — Debtor appealed order, which was ultimately dismissed — Trustee brought motion for order that settlement was fraudulent preference, creditor brought motion to dismiss trustee's motion — Trustee's motion dismissed; creditor's motion granted — Trustee's motion was barred by limitation period — Limitation period began to run from date of Bankruptcy Order — Two year limitation period set out in s. 4 of Limitations Act, 2002 governed — Limitation period expired well before trustee initiated motion — Stay pending appeal did not alter conclusion of limitation period — It was open to trustee to seek lifting of stay if trustee thought preference motion might be prejudiced by appeal — Trustee had ample time following the dismissal of appeal to commence its preference motion.

## Table of Authorities

**Cases considered by *D.M. Brown J.*:**

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*Bernard Motors Ltd., Re* (1960), 38 C.B.R. 162, 22 D.L.R. (2d) 689, 1960 CarswellNB 3, [1960] S.C.R. 385 (S.C.C.) — referred to

*C.C. Petroleum Ltd. v. Steinberg, Morton & Frymer* (2003), 2003 CarswellOnt 1085, 41 C.B.R. (4th) 10 (Ont. S.C.J.) — referred to

*Canada (Attorney General) v. Fekete* (1999), 242 A.R. 196, 1999 CarswellAlta 297, 10 C.B.R. (4th) 102, 1999 ABQB 262 (Alta. Master) — considered

*Dilollo, Re* (2010), 62 C.B.R. (5th) 223, 2010 CarswellOnt 104, 2010 ONSC 129 (Ont. S.C.J. [Commercial List]) — referred to

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*Edwards, Re* (2011), 79 C.B.R. (5th) 264, 2011 CarswellOnt 6139, 2011 ONCA 497, 336 D.L.R. (4th) 719 (Ont. C.A.) — referred to

*Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd.* (1976), 1976 CarswellQue 32, [1978] 1 S.C.R. 230, 26 C.B.R. (N.S.) 84, 75 D.L.R. (3d) 63, (sub nom. *Employers' Liability Assurance Corp. v. Ideal Petroleum (1969) Ltd.)* 14 N.R. 503, 1976 CarswellQue 25 (S.C.C.) — referred to

*Gingras v. General Motors Products of Canada Ltd.* (1974), 13 N.R. 361, 1974 CarswellQue 59, 1974 CarswellQue 59F, [1976] 1 S.C.R. 426, 57 D.L.R. (3d) 705 (S.C.C.) — referred to

*Homburg v. S-Marque Inc.* (1999), 1999 CarswellNS 73, (sub nom. *S-Marque Inc. v. Homburg Industries Ltd.)* 176 N.S.R. (2d) 218, (sub nom. *S-Marque Inc. v. Homburg Industries Ltd.)* 538 A.P.R. 218 (N.S. C.A.) — considered

*Hudson v. Benallack* (1975), [1975] 6 W.W.R. 109, 7 N.R. 119, 59 D.L.R. (3d) 1, 1975 CarswellAlta 157, 1975 CarswellAlta 139, [1976] 2 S.C.R. 168, 21 C.B.R. (N.S.) 111 (S.C.C.) — referred to

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*Lakehead Newsprint (1990) Ltd. v. 893499 Ontario Ltd.* (2001), 2001 CarswellOnt 34, 23 C.B.R. (4th) 170 (Ont. S.C.J.) — considered

*Lawrason's Chemicals Ltd., Re* (1999), (sub nom. *Lawrason's Chemicals Ltd. (Bankrupt), Re)* 127 O.A.C. 51, 1999 CarswellOnt 392, 87 C.P.R. (3d) 213 (Ont. C.A.) — distinguished

*Mawji, Re* (2011), 2011 CarswellOnt 1313, 2011 ONSC 1432 (Ont. S.C.J.) — considered

*Piikani Nation v. Piikani Energy Corp.* (2012), 58 Alta. L.R. (5th) 219, 88 C.B.R. (5th) 1, 2012 ABQB 187, 2012 CarswellAlta 459 (Alta. Q.B.) — considered

*Principal Group Ltd. (Trustee of) v. Anderson* (1997), (sub nom. *Principal Group Ltd. (Bankrupt) v. Anderson)* 146 W.A.C. 169, (sub nom. *Principal Group Ltd. (Bankrupt) v. Anderson)* 200 A.R. 169, [1997] 8 W.W.R. 689, 1997 CarswellAlta 463, 32 B.L.R. (2d) 42, [1997] 7 W.W.R. 336, (sub nom. *Ernst & Young Inc. v. Anderson)* 147 D.L.R. (4th) 229, 46 C.B.R. (3d) 101, 51 Alta. L.R. (3d) 45 (Alta. C.A.) — considered

*Tucker v. Aero Inventory (UK) Ltd.* (2011), 2011 CarswellOnt 8476, 2011 ONSC 4223, (sub nom. *Tucker (Re))* 338 D.L.R. (4th) 577, 80 C.B.R. (5th) 1 (Ont. S.C.J. [Commercial List]) — referred to

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
Generally — referred to

s. 38 — considered

s. 95 — considered

s. 95(1) — considered

s. 95(1)(a) — considered

s. 136 — referred to

s. 195 — considered

*Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29
Generally — referred to

s. 2 — considered

*Limitations Act, 2002*, S.O. 2002, c. 24, Sched. B
Generally — referred to

s. 4 — considered

s. 5 — considered

s. 19 — considered

s. 19(1) — considered

s. 20 — considered

**Words and phrases considered:**

**stay of proceedings**

A stay of proceedings pending the hearing of an appeal is not the functional equivalent of a limitation period. Limitation periods set deadlines by which a person must initiate legal process in respect of a cause of action. Stays pending appeal are engaged following the initial disposition of the legal process in which the cause of action was asserted. Limitation periods and stays pending appeal conceptually are quite different creatures.

MOTIONS by trustee for declaration that transaction was fraudulent preference and by creditor to set aside trustee's motion.

***D.M. Brown J.*:**

**I. Motion to dismiss Trustee's fraudulent preference motion as statute-barred**

1 On August 24, 2013, msi Spergel Inc., the trustee in bankruptcy of the estate of Cosimo Dilollo, initiated a motion under section 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, for a declaration that $1.136 million in payments made by the bankrupt to I.F. Propco Holdings (Ontario) 36 Ltd., pursuant to minutes of settlement, constituted a preference, and the Trustee sought an order that Propco repay that sum to the Trustee (the "Preference Motion").

2 Propco, in turn, has brought this motion seeking an order that the relief sought by the Trustee is statute-barred by operation of the *Limitations Act, 2002*, S.O. 2002, c. 24, Sch. B., and its motion should be dismissed. Alternatively, Propco seeks an order

 

that in the event the Trustee's motion is not statute-barred, Propco is entitled to file a proof of claim in the bankrupt's estate for the full amount of its $22,031,787.67 judgment against the bankrupt.

**II. Facts**

3 The facts are not in dispute. On July 6, 2006, Propco obtained default judgment against Dilollo in the amount of $22,031,787.67 (the "Judgment"). On December 15, 2006 Propco commenced a bankruptcy application against Dilollo, which the latter opposed. Settlement discussions resulted in Propco and Dilollo entering into Minutes of Settlement on August 30, 2007 under which Dilollo agreed to pay Propco $1.2 million (the "Settlement").

4 Between August and December, 2007, Dilollo paid Propco $1,136,500 pursuant to the Settlement.

5 It was a term of the Settlement that if Dilollo paid Propco the $1.2 million, both parties would consent to a dismissal of the bankruptcy application brought against Dilollo and the parties would exchange full and mutual releases. No dismissal of the bankruptcy application was obtained, and the parties did not exchange releases.

6 As a result, come early 2008, Propco's bankruptcy application against Dilollo remained outstanding. By order dated May 22, 2008, Es-Lea Holdings Limited, Rino De Piero and Sam Stern were added as applicants to the bankruptcy application.

7 Morawetz, J. granted the bankruptcy application on January 11, 2010, and Schwartz Levitsky Feldman Inc. was appointed Trustee. Nine days later, on January 20, 2010, Dilollo initiated an appeal from the Bankruptcy Order. The Court of Appeal dismissed his appeal on September 27, 2010 [2010 CarswellOnt 7217 (Ont. C.A.)].

8 The first meeting of creditors was held on May 31, 2011, at which time SLF was replaced as Trustee by msi Spergel Inc. On August 24, 2012 the Trustee initiated its Preference Motion to set aside the payments under the Settlement.

**III. Positions of the parties on the limitations issue**

9 Propco submitted that the two-year limitation period contained in the *Limitations Act, 2002* governed. Propco argued that the fact of the Settlement was known to the Trustee on January 11, 2010, the date of the Bankruptcy Order, so time started to run at that point. The two-year limitation period expired on January 11, 2012, some seven months before the Trustee initiated its Preference Motion and, consequently, that motion was statute-barred.

10 The Trustee accepted that the limitation period to bring the Preference Motion commenced on the date of the Bankruptcy Order, but the Trustee argued that the bankrupt's launching of an appeal of the Order suspended the running of the limitation period until the Court of Appeal disposed of the appeal. Accordingly, the Trustee submitted, the two-year limitation period did not expire until September 18, 2012, several weeks *after* the Trustee had initiated its Preference Motion.

11 The narrow issue for determination, therefore, is whether the stay of proceedings on the filing of an appeal contained in section 195 of the *BIA* operated to suspend the running of the limitation period under the *Limitations Act, 2002* for the Trustee's Preference Motion.

**IV. Analysis on the limitations issue**

12 General limitation periods in provincial statutes apply to bankruptcy proceedings, [1] and the Court of Appeal has held that no conflict exists between the general limitations provision contained in section 4 of the *Limitations Act, 2002* and section 95 of the *BIA*. [2] Section 4 of the *Limitations Act, 2002* provides:

> Unless this Act provides otherwise, a proceeding shall not be commenced in respect of a claim after the second anniversary of the day on which the claim was discovered.

 

The discoverability rules are set out in section 5 of the *Limitations Act, 2002*. As mentioned, the Trustee accepted that the claim was discovered on, and the limitation period began to run on, January 11, 2010, the date of the Bankruptcy Order. In his Reasons released that date, Morawetz J. specifically referred to the fact of the Settlement between Propco and the bankrupt. [3]

13 Section 195 of the *BIA* provides for a stay pending an appeal from an order or judgment made under the *BIA*:

> Except to the extent that an order or judgment appealed from is subject to provisional execution notwithstanding any appeal therefrom, all proceedings under an order or judgment appealed from shall be stayed until the appeal is disposed of, but the Court of Appeal or a judge thereof may vary or cancel the stay or the order for provisional execution if it appears that the appeal is not being prosecuted diligently, or for such other reason as the Court of Appeal or a judge thereof may deem proper.

Does the stay of an order pending appeal pursuant to *BIA* s. 195 affect the running of the limitation period under the *Limitation Acts, 2002*?

14 Two provisions of the *Limitations Act, 2002* consider the impact of limitation periods contained in other legislation on the running of limitation periods prescribed by that Act. Specifically, sections 19(1) and 20 provide:

> 19.(1) A limitation period set out in or under another Act that applies to a claim to which this Act applies is of no effect unless,
>
> (a) the provision establishing it is listed in the Schedule to this Act; or
>
> (b) the provision establishing it,
>
> (i) is in existence on January 1, 2004, and
>
> (ii) incorporates by reference a provision listed in the Schedule to this Act.
>
> 20. This Act does not affect the extension, suspension or other variation of a limitation period or other time limit by or under another Act.

15 Section 19 does not apply in this case because the Schedule to the *Limitations Act, 2002* does not refer to the *BIA*. Turning to section 20, does section 195 of the *BIA* provide for the suspension of a limitation period? The Trustee submitted that the automatic stay of proceedings under *BIA* s. 195 tolled the operation of the limitation period because the stay meant that no person could take any step in respect of the bankrupt's estate, including bringing the Preference Motion.

16 I disagree. To engage section 20 of the *Limitations Act, 2002* requires that some other statute provides for a limitation period and also provides for the "extension, suspension or other variation of a limitation period or other time limit by or under another Act". [4] Section 195 of the *BIA* does not contain any limitation period or provide for the "extension, suspension or other variation" of a limitation period. Since *BIA* s. 195 does not purport to extend, suspend or vary a limitation period contained in the *BIA*, section 20 of the *Limitations Act, 2002* does not apply. Since no other suspension provision contained in the *Limitations Act, 2002* would apply in the circumstances of this case, the basic two year limitation period set out in section 4 governs. The parties agreed that time started to run on the day the Bankruptcy Order was made, so the basic two-year limitation period expired on January 11, 2012, well before the Trustee initiated the Preference Motion. That motion, therefore, is statute-barred.

17 That a stay pending appeal might prevent a person from taking some step does not alter that conclusion. A stay of proceedings pending the hearing of an appeal is not the functional equivalent of a limitation period. Limitation periods set deadlines by which a person must initiate legal process in respect of a cause of action. Stays pending appeal are engaged following the initial disposition of the legal process in which the cause of action was asserted. Limitation periods and stays pending appeal conceptually are quite different creatures. If a stay might operate to prejudice a person's legal rights, recourse generally is available to seek a lifting of the stay from the court. Section 195 of the *BIA* specifically provides that "the Court

 

of Appeal or a judge thereof may vary or cancel the stay...for such other reason as the Court of Appeal or judge thereof may deem proper". In the present case it was always open to the Trustee to seek a lifting of the stay from the Court of Appeal if the Trustee thought that its ability to initiate a preference motion might be prejudiced by the appeal. [5] As matters transpired, the Trustee was left with ample time following the dismissal of the appeal to commence its Preference Motion.

18 For these reasons, I grant the motion of Propco, declare that the Preference Motion is statute-barred by operation of the *Limitations Act*, and I dismiss the Preference Motion.

**V. Alternative Issue: The effect of voiding the Settlement as a preference**

***A. The issue stated***

19 That conclusion is sufficient to deal with Propco's motion. However, both parties filed and made extensive arguments on the alternative issue — the effect of a voiding of the Settlement on Propco's ability to file a proof of claim. The Trustee did not take the position that it would be premature to consider that issue nor did it oppose the determination of that issue at this time. From the materials I gleaned that the reason for the Trustee's position was that the estate lacks any funds, and if Propco could file a proof of claim for the amount of its Judgment, its *pro rata* share of any distribution essentially would overwhelm the shares of the other creditors. Consequently, the practical reality of the financial circumstances of the estate supports proceeding to determine the alternative issue, so I will decide that issue in the event that it is later found I erred in my determination of the limitations issue.

20 To recall the facts, Propco obtained a $22,031,787.67 Judgment against Dilollo, which it compromised in the Minutes of Settlement for payments totaling $1.2 million. Propco submitted that in the event the Trustee succeeded in voiding the Settlement under *BIA* s. 95, then Propco should be entitled to file a proof of claim in the bankruptcy for the full amount of its Judgment. The Trustee disagreed, arguing that in the event the payment of $1,136,500 under the Settlement was declared void, then Propco would be limited to filing a proof of claim for the amount of the Settlement, not the much larger amount of the Judgment.

***B. The legal positions of the parties***

21 The Trustee submitted that a finding that a payment made to a creditor was void as against the trustee as a preference under section 95 of the *BIA* did not affect the transaction as between the parties to it — the creditor and the bankrupt - with the result that the parties to the transaction remained bound by the bargain which they had struck. Accordingly, in the event that the payment made under the Settlement was found to be void as against the Trustee and the payment ordered returned, the Trustee argued that the other terms of the Settlement between Propco and the bankrupt would remain valid and binding. The Trustee submitted that one such term would include Propco's compromise of its claim under its $22 million Judgment down to $1.2 million.

22 On its part, Propco contended that if the payment made under the Settlement were to be declared void and set aside as a preference, then the Settlement would be void for all purposes. As a result, upon the repayment of the Settlement amount to the Trustee, Propco would be entitled to file a claim for the full amount of its Judgment.

23 Counsel stated they had been unable to find any authorities bearing directly on this issue.

***C. Analysis***

*C.1 The purpose of the BIA's preference provisions*

24 Section 95 of the *BIA* is one of several sections comprising a system under which a court can review transactions entered into between a debtor and its creditors in the period just prior to formal insolvency proceedings. [6] The Supreme Court of Canada described the place of the *BIA*'s preference provisions in the overall bankruptcy scheme as follows:

  

> The object of the bankruptcy law is to ensure the division of the property of the debtor rateably among all his creditors in the event of his bankruptcy. Section 112 of the Act provides that, subject to the Act, all claims proved in the bankruptcy shall be paid *pari passu*. The Act is intended to put all creditors upon an equal footing. Generally, until a debtor is insolvent or has an act of bankruptcy in contemplation, he is quite free to deal with his property as he wills and he may prefer one creditor over another but, upon becoming insolvent, he can no longer do any act out of the ordinary course of business which has the effect of preferring a particular creditor over other creditors. If one creditor receives a preference over other creditors as a result of the debtor acting intentionally and in fraud of the law, this defeats the equality of the bankruptcy laws. [7]

25 As put by the Alberta Court of Queen's Bench in *Piikani Nation v. Piikani Energy Corp.*:

> The aim of s. 95 of the *BIA* is to prevent one creditor or group of creditors from getting an unfair advantage over other creditors when a debtor is insolvent. The remedy is not to "punish" the benefiting creditor, but rather to require it to repay the monies received so that payments out of the debtor's estate can be made respecting priorities *and shared properly amongst all creditors*. [8]

In *Tucker v. Aero Inventory (UK) Ltd.*, Morawetz J. stated:

> The s. 95 cause of action remedy is designed to ensure that there is *pari passu* treatment as between unsecured creditors. The recipient of a preferential transfer is not entitled to keep the preferential proceeds if the elements of s. 95 are proven. The subject of the preference is returned to the estate but subject to the rights of secured creditors. [9]

26 The cause of action to declare a transaction void as a preference rests with the trustee. [10] The right of the trustee in respect of a preferential payment is "to have such payment declared void and the consequential right to recover the amount of the payment". [11] A fraudulent preference claim by a trustee is not a claim that sounds in damages but rather, pursuant to s. 95(1) of the *BIA*, to a declaration that such payments be deemed fraudulent and void as against the trustee. [12]

*C.2 The case law on the effect of voiding a preference-type transaction*

27 By its terms section 95(1)(a) of the *BIA* renders an offending transaction void as against the Trustee:

> 95. (1) A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person
>
> > (a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against - or, in Quebec, may not be set up against - the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy...

28 If section 95 of the *BIA* is designed to ensure the class equality of the bankruptcy laws and to prevent a form of "queue-jumping" amongst unsecured creditors during a stipulated period prior to the date of the bankruptcy, what happens when the trustee successfully challenges the queue-jumper under section 95, requires it to repay the preference it received and, in effect, forces it to go back and stand, *pari passu*, with the other creditors of the debtor to await a distribution of the estate under *BIA* s. 136? The parties brought to my attention three sets of cases.

**Whether secured creditors share in the proceeds of a voided preference**

29 First, Propco referred to the decision of Morawetz J. in *Tucker v. Aero Inventory (UK) Ltd.*, and the Trustee referred to the Nova Scotia Court of Appeal decision in *Homburg v. S-Marque Inc.* [1999 CarswellNS 73 (N.S. C.A.)], [13] (which Morawetz J. considered in the *Tucker* case), but those cases principally dealt with the question of the entitlement of secured creditors to

 

the proceeds obtained by a trustee as a result of a successful preference claim. Those cases did not consider the position of an unsecured creditor who has been required to return a payment found to be a preference.

**Reviving rights in the property of a voided transaction: the *Bray* and *Lawrason's Chemicals Ltd., Re* cases**

30 Second, the Trustee pointed to the Court of Appeal decision in *Bank of Montreal v. Bray* [1997 CarswellOnt 3903 (Ont. C.A.)] [14] for the proposition that the voiding of a transaction as a fraudulent one does not affect the transaction as between the parties to the transaction. That case involved a proceeding under section 2 of the Ontario *Fraudulent Conveyances Act* ("*FCA*") which rendered a conveyance of real property made with the intent to defeat creditors "void as against such persons and their assigns". The husband, Mr. Bray, had guaranteed the indebtedness of his company to a bank. His company encountered financial difficulties. Mr. Bray held title to the matrimonial home as a joint tenant with his wife. He conveyed his interest in the matrimonial home to his wife for one dollar thereby severing the joint tenancy. Several months later the bank made a demand on his guarantee and then commenced an action under the *FCA*. Mr. Bray died. The bank obtained default judgment on the guarantee. The parties agreed that the conveyance contravened the *FCA*. The issue then became: if the conveyance was set aside under the *FCA*, was Mr. Bray's one-half interest available for execution by the bank, or did Mrs. Bray enjoy title to the matrimonial home on the basis that by setting aside the fraudulent conveyance, the joint tenancy was restored?

31 The Court of Appeal held that the conveyance from Mr. Bray to his wife severed the joint tenancy. The Court noted that section 2 of the *FCA* made a fraudulent conveyance void as against the debtor's creditors, but the section did not render the transaction void as against the parties to the transaction. Section 2 of the *FCA* rendered a transaction voidable; the impugned transaction was not void *ab initio*. The Court of Appeal stated:

> Cartwright J. writing for the Court in *Re Bernard Motors Ltd.* [1960] S.C.R. 385 at 390 considering language in the former s. 64(1) of the *Bankruptcy Act*, which deemed certain transactions "fraudulent and void as against the trustee in the bankruptcy", adopted the following statement from Halsbury, 3rd ed., vol. 2, p. 560:
>
> > If a payment or other disposition of property, otherwise valid, be made in circumstances that amount to a fraudulent preference, the payment, at the time it is made, is a good payment, and so remains unless and, until it is set aside as a fraudulent preference. [Emphasis added.]
>
> Similarly, in this case the transaction although void against creditors was otherwise valid and remained so until it was set aside. Accordingly, I am unable to adopt the course suggested by Schulman J. and in effect notionally reinstate the joint tenancy between Mrs. Bray and her deceased husband so as to allow Mrs. Bray to take the property as the surviving joint tenant free of any claim by the Bank. To do so, in my view, would stretch the concept of legal fiction beyond all reasonable bounds. [15]

32 The Nova Scotia Court of Appeal, in the *Homburg v. S-Marque Inc.* case, also held that when a transaction is found to constitute a preference, the transaction is voidable, not void *ab initio*, with the result that the transactions were valid as between the parties "until set aside". [16]

33 Building on the *Bray* case, the Trustee relied on the decision of the Court of Appeal in *Lawrason's Chemicals Ltd., Re* [1999 CarswellOnt 392 (Ont. C.A.)]. [17] The bankrupt company, Lawrason's Chemicals Ltd., owed money to Min-Chem. Pursuant to a general security agreement, the latter held a security interest in all of Lawrason's assets, including trademarks. Lawrason's transferred a trademark to Min-Chem for nominal consideration. Within a year a petition had been filed against Lawrason's and subsequently a receiving order was made. Min-Chem sold all of Lawrason's assets pursuant to its security; Min-Chem contended that it had suffered a shortfall. Another creditor of Lawrason's, Hydrotech Chemical, obtained a *BIA* s. 38 order to commence an action to set aside the transfer of the trademark. Min-Chem consented to an order finding that the transfer of the trademark was void as against creditors under the *Fraudulent Conveyances Act*. The parties agreed to sell the trademark at public auction.

 

34 Min-Chem took the position that in the event the transfer of the trademark was set aside, then its former security interest in the trademark would revive. Hydrotech argued that although the transfer was void under the *FCA*, it was still a valid and subsisting transfer between the original parties to it. The Court of Appeal agreed with Hydrotech's position, following its earlier decision in *Bray*:

> If the trustee had sued and recovered pursuant to the provisions of s. 2 of the *Fraudulent Conveyances Act*, he could only have sued on behalf of those creditors whose interests were defeated, hindered, delayed or defrauded by the transfer of the trademark. However, because of the specific provisions of s. 38(3), the benefit derived from the action would belong to the estate to be shared by all creditors, and not just those whose interests were affected. *As between the parties to the transaction, the transfer would be a good and valid one. That being the case, there could be no revival of the respondent's security interest in the trademark: it could not be the owner of and a secured creditor in the same property. Nonetheless, in my opinion, it would be entitled to share in the estate as an unsecured creditor.* [18]

In the result, the Court of Appeal found that Min-Chem did not have a security interest in the proceeds of the sale of the trademark, but Min-Chem was entitled to claim as an unsecured creditor for any amount of the indebtedness to it not recovered on the realization of other assets over which it held security.

35 The decisions in *Bray* and *Lawrason's* are binding on me. I would note, however, that the Alberta Court of Appeal has expressed a somewhat different view about the effect of a declaration that a transaction is void under *BIA* s. 95, albeit in quite different circumstances than those considered in the *Bray* and *Lawrason's* cases. The case of *Principal Group Ltd. (Trustee of) v. Anderson* involved the payment out by an investment fund of monies to investors less than three months before the fund went into bankruptcy. The trustee sued to recover the payments as preferences. Some investors argued that it would be inequitable to permit the recovery of such funds because they had changed their position by spending or disposing of the payments before the trustee had initiated suit. In the course of rejecting such a defence to a preference action the Alberta Court of Appeal stated:

> The *Act* does more than forbid preferences and allow a suit to recover them. It makes such payments fraudulent and void: s. 95(1). *If they are void, then no property passed, and the payees are in possession of some of the bankrupt's property.* The duty of the trustee to collect the property of the bankrupt is elementary. [19]

The Alberta Court of Appeal did not discuss what recourse the investors might have against the estate of the bankrupt fund after having repaid the preference amounts.

**Remedies available to the creditor in a voided preference: Re Bernard Motors**

36 Finally, Propco referred to the decision of the Supreme Court of Canada in *Bernard Motors Ltd., Re.* [20] In that case a company had borrowed money from a bank on the strength of a promissory note. Four individual guarantors provided a guarantee to the bank of the company's indebtedness. At a time when the company was insolvent, it deposited money into its bank account sufficient to satisfy the company's indebtedness to the bank. Two of the guarantors, who were involved in the management of the company, asked the bank to satisfy what was owed to it out of the company's bank account and then to return the guarantee to them. The bank did so. About two months later the company went into bankruptcy. The trustee sought to set aside the payment to the bank as a preference under the *BIA*.

37 In light of the positions taken by the parties on the disposition of the issues by the lower courts, the Supreme Court of Canada held that since it was *res judicata* as between the bank and the trustee that the payment was good, then the guarantors were discharged because the debt to the bank for which they stood as sureties had been paid in full. In *obiter*, however, the Supreme Court of Canada stated:

> With respect, I incline to the view that it having been found as a fact that the intention of the insolvent was to prefer both the bank and the guarantors and that the intention of the latter, although not of the former, was to be preferred, it should have been held that the payment was void, *the bank should have been ordered to repay the $10,000 to the trustee and*

 

> *left to exercise its rights against the guarantors.* I do not, however, have to reach a final conclusion as to this because it is too late to make any such order.

This *obiter* would suggest that having repaid the preference amounts to the trustee, the debtor's indebtedness to the bank would remain, and the bank could proceed to recover that debt from the guarantors. The Supreme Court of Canada made no comment on what rights the bank would have to file a proof of claim in the bankrupt's estate.

*C.3 Application to the facts of the present case*

38 As the cases reveal, section 95(1)(a) of the *BIA* creates a mechanism by which a trustee may recover property of the bankrupt which had been transferred or paid out to an arm's-length creditor, in preference to other creditors, during the period which starts three months immediately prior to the date of the initial bankruptcy event and ends on the date of the bankruptcy. The property or payment recovered then stands available for sharing by all unsecured creditors, on a *pari passu* basis, subject to the rights of secured creditors as described in the *Tucker v. Aero Inventory (UK) Ltd.* case.

39 For the purpose of this part of the motion Propco has accepted that the payments made to it by Dilollo under the Settlement constituted a preference pursuant to section 95(1)(a) of the *BIA*. In those circumstances Propco would be required to repay the settlement amounts to the Trustee.

40 What claim would Propco then have against the estate? Under the analysis set out in the *Bray* and *Lawrason's* cases, the Settlement was voidable and therefore remained valid up until the time it was set aside. Unlike the transactions at issue in the *Bray* and *Lawrason's* cases, in this case the impugned transaction — the Settlement - did not convey title in real or personal property. Instead, under the Settlement Propco agreed to compromise its claim against Dilollo, and Dilollo agreed to pay $1.2 million to Propco. When he did so, Propco would consent to the dismissal of the bankruptcy application and Propco would provide Dilollo with a full, mutual release. Although Dilollo did not pay the full $1.2 million, Propco accepted what he did pay as the full discharge of his payment obligations, as can be seen from the letter dated April 11, 2011 from counsel for Propco which stated that:

> On December 18, 2007, Propco received a CIBC bank draft in the amount of $85,000 which it agreed to accept in lieu of the $150,000 which Dilollo previously agreed to pay.

From this it follows that Dilollo fulfilled his promises to pay the settlement amount as set out in sections 1 and 2 of the Settlement.

41 Although the parties to the Settlement never exchanged mutual releases, under the terms of the Settlement Propco was obligated to deliver, and Dilollo was entitled to receive, a full release. That would have included a release of the amounts due under the Judgment. In light of that obligation of Propco, I think the analysis must proceed on the basis that upon receipt of the $1.136 million Propco must be taken to have released Dilollo from the amount of the Judgment.

42 In sum, the Settlement enabled Propco, during the period beginning three months before the date of the initial bankruptcy event and ending on the date of bankruptcy, to jump the queue over other creditors and obtain a preference by securing payment of part of Dilollo's indebtedness to it. To achieve that result Propco was prepared to compromise its Judgment by a significant amount. Propco received some value for its Judgment, while the amount of the bankrupt's property available for other creditors was reduced.

43 The effect of a declaration that the Settlement payment was void under *BIA* s. 95(1) should be to return Propco to the position it was in before it received the preferential payments. That is, Propco would be denied the preferential benefit represented by the settlement payments because it would have to return those payments to the Trustee. But, as stated in the *Piikani Nation* case, the purpose of section 95 is not to punish a benefiting creditor, but to prevent that creditor from securing an unfair advantage over other creditors. Requiring the preferred creditor to repay the monies achieves that goal, and then "payments out of the debtor's estate can be made respecting priorities *and shared properly amongst all creditors.*" [21]

 

44 Following that reasoning, if the Settlement payments were voided as preferences under *BIA* s. 95(1)(a), then the Settlement as a whole would be void, and Propco then would be left to file a proof of claim, like all other unsecured creditors, for the amount of the debt it was owed. That would mean that Propco could submit a proof of claim for the amount of its Judgment which the Trustee would then have to review in the ordinary course of the administration of the estate with the other proofs of claims filed by unsecured creditors.

45 The Trustee submitted that any proof of claim by Propco should be limited to the amount agreed upon in the Settlement. I do not accept that submission for three reasons. First, the Trustee, in which all property of the bankrupt has now vested, cannot seek to set aside part of a transaction in order to recover some of the bankrupt's property, but then attempt to rely on another part of the impugned transaction to block or reduce a claim against the estate by the creditor. That would smack of cherry-picking.

46 Second, when I asked Trustee's counsel during argument whether the Trustee's position that Propco must be held to its compromise meant that effect had to be given to the full release of the Judgment agreed to in the Settlement and therefore Propco should not be allowed to file a proof of claim for *any* amount, the Trustee stated it was not taking that position. That was a reasonable submission by Trustee's counsel. It would be a very harsh result indeed were a creditor required to repay the entire consideration for its compromise of rights, yet be held strictly to its release of those rights. The purpose of section 95 of the *BIA* would be fulfilled simply by denying the creditor the benefit of the preference transaction and requiring the creditor to assert the amount of its pre-preference transaction claim by way of proof of claim with the other unsecured creditors. That would unwind the queue-jumping engaged in by the preferred creditor.

47 Third, I do not see this result as inconsistent with the reasoning of the Court of Appeal in the *Bray* and *Lawrason's* cases. In both those cases the impugned conveyances were done for nominal consideration, whereas the present case involved the compromise of approximately $20 million in debt. Care must be taken when analogizing from the well-established legal consequences of severing a joint tenancy to the effect of other transactions which may be found void as a fraudulent conveyance or a preference. Moreover, *Bray* involved an action under the *Fraudulent Conveyances Act* where the impugned transaction was rendered void as against other creditors. In the present case, a finding of a preference under section 95 of the *BIA* would void the Settlement as against the Trustee, the person in whom all property of the bankrupt has vested. It is interesting to observe that in the *Lawrason's* case that while the Court of Appeal was not prepared to unwind the transfer of the trademark so as to restore Min-Chem's original position as possessing a security interest in the trademark, it did state that Mid-Chem would be entitled to share in the estate as an unsecured creditor to the extent of its shortfall. Since the transfer of the trademark was done for nominal consideration, no issue arose about Min-Chem's ability to file a claim for the consideration it had paid for the trademark.

48 For these reasons, I conclude that in the event the Trustee's claim under section 95(1)(a) of the *BIA* was not statute-barred and in the event it was found that the Settlement was void under that section, then Propco would be entitled to file, for review by the Trustee, a proof of claim for the full amount of its Judgment, together with applicable interest.

**VI. Summary and Costs**

49 By way of summary, I grant Propco's motion and dismiss the Trustee's Preference Motion as statute-barred.

50 As part of its motion Propco requested an order that the Trustee should be liable personally for costs awarded against it in the Preference Motion. I deferred argument on that point. Having now determined the first two issues raised by Propco, I would encourage the parties to try to settle the costs of this motion. I would observe that both issues raised by Propco were novel in the sense that neither counsel was able to find any cases directly on point. The parties might well wish to take into account the novelty of the issues in their discussions about the costs of the motion. If the parties cannot agree on costs, Propco may serve and file with my office written cost submissions, together with a Bill of Costs, by February 8, 2013. The Trustee may serve and file with my office responding written cost submissions by February 22, 2013. The costs submissions shall not exceed three pages in length, excluding the Bill of Costs.

*Order accordingly.*

 

Footnotes

1 *Gingras v. General Motors Products of Canada Ltd.* (1974), [1976] 1 S.C.R. 426 (S.C.C.); *Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd.* (1976), [1978] 1 S.C.R. 230 (S.C.C.).

2 *Edwards, Re*, 2011 ONCA 497 (Ont. C.A.), para. 6.

3 2010 ONSC 129 (Ont. S.C.J. [Commercial List]), paras. 58 and 73.

4 *Joseph v. Paramount Canada's Wonderland*, 2008 ONCA 469 (Ont. C.A.), paras. 8and 9.

5 The case of *Lakehead Newsprint (1990) Ltd. v. 863499 Ontario Ltd.* [2001 CarswellOnt 34 (Ont. S.C.J.)], 2001 CanLII 28443 does not assist the Trustee, dealing as it did with the effect of a bankruptcy order on the running of the limitations period in respect of a debt, not the effect of a stay pending appeal on the right of the trustee to initiate a claim following the making of a bankruptcy order. Nor does the case of *Canada (Attorney General) v. Fekete*, 1999 ABQB 262 (Alta. Master), para. 9, which did not deal with the comprehensive limitations scheme created by the Ontario *Limitations Act, 2002*. *Mawji, Re*, 2011 ONSC 1432 (Ont. S.C.J.) relied on the *Fekete* decision and did not conduct any specific analysis under the *Limitations Act, 2002*.

6 *Tucker v. Aero Inventory (UK) Ltd.* (2011), 338 D.L.R. (4th) 577 (Ont. S.C.J. [Commercial List]), para. 163.

7 *Hudson v. Benallack* (1975), [1976] 2 S.C.R. 168 (S.C.C.), para. 21.

8 (2012), 88 C.B.R. (5th) 1 (Alta. Q.B.), para. 118.

9 *Tucker*, *supra.*, para. 138.

10 *Ibid.*, para. 137.

11 *Bernard Motors Ltd., Re*, [1960] S.C.R. 385 (S.C.C.), at 399.

12 *C.C. Petroleum Ltd. v. Steinberg, Morton & Frymer* (2003), 43 C.B.R. (4th) 10 (Ont. S.C.J.), para. 3.

13 1999 CanLII 1591.

14 1997 CanLII 545.

15 *Bank of Montreal v. Bray*, *supra.*, paras. 26 and 27.

16 *Homburg*, *supra.*, para. 83.

17 1999 CanLII 4635.

18 *Ibid.*, para. 8, emphasis added.

19 *Principal Group Ltd. (Trustee of) v. Anderson* (1997), 147 D.L.R. (4th) 229 (Alta. C.A.), para. 11.

20 [1960] S.C.R. 385 (S.C.C.).

21 (2012), 88 C.B.R. (5th) 1 (Alta. Q.B.), para. 118.

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TAB 9

2011 MBCA 41
Manitoba Court of Appeal

Keith G. Collins Ltd. v. Canadian Imperial Bank of Commerce

2011 CarswellMan 196, 2011 MBCA 41, [2011] 7 W.W.R. 458, 203 A.C.W.S. (3d) 695, 268 Man. R. (2d) 30, 333 D.L.R. (4th) 740, 77 C.B.R. (5th) 180

# Keith G. Collins Ltd. (Applicant / Appellant) and Canadian Imperial Bank of Commerce (Respondent / Respondent)

Barbara M. Hamilton, Martin H. Freedman, Holly C. Beard JJ.A.

Heard: November 2, 2010
Judgment: May 9, 2011
Docket: AI 10-30-07303

Proceedings: reversing *Keith G. Collins Ltd. v. Canadian Imperial Bank of Commerce* (2010), 63 C.B.R. (5th) 32, [2010] 5 W.W.R. 56, 2010 MBQB 2, 2010 CarswellMan 15, (sub nom. *Forbes (Bankrupt), Re)* 248 Man. R. (2d) 206 (Man. Q.B.)

Counsel: R.W. Schwartz for Appellant
I.D. Perlov for Respondent

Subject: Insolvency; Estates and Trusts

### Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

### Headnote

**Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Insolvency of debtor at time of transaction**

On September 29, bankrupt settled his credit card account with respondent bank out of proceeds of new mortgage on his house — On October 27, bankrupt made assignment in bankruptcy citing indebtedness on three other credit cards (other cards) — Trustee in bankruptcy demanded repayment from bank — Bank refused to repay amount it received from bankrupt — Trustee brought unsuccessful application to have payment received by bank declared invalid as fraudulent preference under s. 95 of Bankruptcy and Insolvency Act — Application judge concluded there was insufficient evidence to prove bankrupt was insolvent at time of payment to bank or that bankrupt's intention was to prefer bank over other creditors — Trustee appealed — Appeal allowed — Payment to bank was void as fraudulent preference — Application judge erred when he failed to consider evidence of indebtedness and concluded evidence was insufficient to establish bankrupt was insolvent on date of payment to bank — This was palpable and overriding error — Review of evidence properly included bankrupt's declarations as to his assets and liabilities — Facts spoke to bankrupt's inability to pay his credit card indebtedness as it became due — Evidence established, at least on prima facie basis, that other three credit card debts existed on September 29 — None of bank's evidence rebutted this prima facie evidence — Only reasonable inference to be drawn from all evidence, when considered in totality, was that bankrupt's accounts for other credit cards existed on September 29 and were unpaid — Given that bankrupt lacked sufficient assets to pay those debts on September 29, trustee did establish on balance of probabilities that on that date, bankrupt was unable to meet his obligations as they became due.

**Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Intention other than to prefer — Miscellaneous**

On September 29, bankrupt settled his credit card account with respondent bank out of proceeds of new mortgage on his house — On October 27, bankrupt made assignment in bankruptcy citing indebtedness on three other credit cards (other cards) — Trustee in bankruptcy demanded repayment from bank — Bank refused to repay amount it received from bankrupt — Trustee brought unsuccessful application to have payment received by bank declared invalid as fraudulent preference under s. 95 of Bankruptcy and Insolvency Act — Application judge concluded there was insufficient evidence to prove bankrupt was insolvent at time of payment to bank or that bankrupt's intention was to prefer bank over other creditors — Trustee appealed — Appeal allowed — Payment to bank was void as fraudulent preference — Application judge erred in concluding that evidence did not establish bankrupt had intention to prefer bank to other creditors — Judge made palpable and overriding errors — Judge wrongly focussed on absence of evidence — Judge placed too much emphasis on bankrupt's subjective intention — Payment to bank had effect of preferring bank over other three creditors — There was preference in fact — In such circumstances, s. 95(2) of Act comes into play — Presumed intent to prefer arising from preference in fact in favour of bank was not rebutted — Plan by insolvent person to reorganize his or her financial affairs must be objectively reasonable to rebut presumption — Bankrupt's conduct, viewed objectively, was that he preferred bank to other three creditors that existed on September 29 — Bankrupt's plan was not objectively reasonable.

**Table of Authorities**

**Cases considered by *Barbara M. Hamilton J.A.*:**

*Black & White Hat Shop Ltd., Re* (1925), [1925] 1 W.W.R. 1121, 35 Man. R. 9, [1925] 3 D.L.R. 670, 5 C.B.R. 690, 1925 CarswellMan 1 (Man. C.A.) — referred to

*Canada (Director of Investigation & Research) v. Southam Inc.* (1997), 50 Admin. L.R. (2d) 199, 144 D.L.R. (4th) 1, 71 C.P.R. (3d) 417, [1997] 1 S.C.R. 748, 209 N.R. 20, 1997 CarswellNat 368, 1997 CarswellNat 369 (S.C.C.) — referred to

*Coast Wire Rope & Supply Ltd. (Trustee of) v. Trans Pacific Hardware Inc.* (1999), 1999 CarswellBC 638, (sub nom. *Coast Wire Rope & Supply Ltd. (Bankrupt) v. Trans Pacific Hardware Inc.)* 122 B.C.A.C. 257, (sub nom. *Coast Wire Rope & Supply Ltd. (Bankrupt) v. Trans Pacific Hardware Inc.)* 200 W.A.C. 257, 1999 BCCA 217, 9 C.B.R. (4th) 255 (B.C. C.A.) — considered

*Dubois-Vandale (Trustee of) v. MBNA Canada Bank* (2006), (sub nom. *Dubois-Vandale (Bankrupt) v. MBNA Canada Bank)* 209 Man. R. (2d) 268, 26 C.B.R. (5th) 261, 2006 CarswellMan 377, 2006 MBQB 258 (Man. Q.B.) — considered

*Holt Motors Ltd., Re* (1966), 56 W.W.R. 182, 57 D.L.R. (2d) 180, 1966 CarswellMan 3, 9 C.B.R. (N.S.) 92 (Man. Q.B.) — considered

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

*Knock v. Dumontier* (2006), 2006 MBCA 99, 2006 CarswellMan 311, 208 Man. R. (2d) 121, 383 W.A.C. 121, 56 C.L.R. (3d) 1, [2006] 11 W.W.R. 148 (Man. C.A.) — referred to

*Krawchenko (Trustee of) v. Minister of National Revenue* (2005), (sub nom. *Krawchenko (Bankrupt), Re)* 198 Man. R. (2d) 120, 2005 CarswellMan 172, 2005 MBQB 97, 11 C.B.R. (5th) 238, [2006] 6 W.W.R. 575 (Man. Q.B.) — referred to

  

*L. (H.) v. Canada (Attorney General)* (2005), 2005 SCC 25, 2005 CarswellSask 268, 2005 CarswellSask 273, 333 N.R. 1, 8 C.P.C. (6th) 199, 24 Admin. L.R. (4th) 1, 262 Sask. R. 1, 347 W.A.C. 1, [2005] 8 W.W.R. 1, 29 C.C.L.T. (3d) 1, 251 D.L.R. (4th) 604, [2005] 1 S.C.R. 401 (S.C.C.) — referred to

*Lotito Estate v. Scantlebury-MacDougall* (1996), (sub nom. *Lotito v. Scantlebury)* 146 Nfld. & P.E.I.R. 337, 456 A.P.R. 337, 1996 CarswellPEI 107, 43 C.B.R. (3d) 23 (P.E.I. C.A.) — considered

*Norris, Re* (1996), 45 Alta. L.R. (3d) 1, [1997] 2 W.W.R. 281, (sub nom. *Norris (Bankrupt), Re)* 193 A.R. 15, 135 W.A.C. 15, 44 C.B.R. (3d) 218, 1996 CarswellAlta 884 (Alta. C.A.) — considered

*Robinson v. Countrywide Factors Ltd.* (1977), 1977 CarswellSask 5, [1978] 1 S.C.R. 753, 72 D.L.R. (3d) 500, 14 N.R. 91, 23 C.B.R. (N.S.) 97, [1977] 2 W.W.R. 111, 1977 CarswellSask 138 (S.C.C.) — referred to

*St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2005), 9 B.L.R. (4th) 1, 2005 NBCA 55, 2005 CarswellNB 285, 2005 CarswellNB 286, 255 D.L.R. (4th) 137, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 286 N.B.R. (2d) 95, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 748 A.P.R. 95, 13 C.B.R. (5th) 125 (N.B. C.A.) — referred to

*Van der Liek, Re* (1970), 14 C.B.R. (N.S.) 229, 1970 CarswellOnt 82 (Ont. S.C.) — referred to

*West End Furniture Co. (Trustee of) v. Sinnott's Ltd.* (1989), 75 C.B.R. (N.S.) 209, (sub nom. *Janes Noseworthy Ltd. v. Sinnott's Ltd.)* 81 Nfld. & P.E.I.R. 302, (sub nom. *Janes Noseworthy Ltd. v. Sinnott's Ltd.)* 255 A.P.R. 302, 1989 CarswellNfld 11 (Nfld. C.A.) — referred to

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
Generally — referred to

s. 2 "insolvent person" — considered

s. 2 "person" — referred to

s. 95 — considered

s. 95 [rep & sub. 2007, c. 26, s. 42] — considered

s. 95(1)(a) — considered

s. 95(2) — considered

APPEAL by trustee in bankruptcy from judgment, reported at *Keith G. Collins Ltd. v. Canadian Imperial Bank of Commerce* (2010), 63 C.B.R. (5th) 32, [2010] 5 W.W.R. 56, 2010 MBQB 2, 2010 CarswellMan 15, (sub nom. *Forbes (Bankrupt), Re)* 248 Man. R. (2d) 206 (Man. Q.B.), dismissing trustee's application to have payment made to bank declared invalid as fraudulent preference.

***Barbara M. Hamilton J.A.*:**

1 The appellant trustee in bankruptcy (the trustee) appeals the dismissal of its application to have a payment received by the respondent bank (CIBC) declared invalid as a fraudulent preference under s. 95 of the *Bankruptcy and Insolvency Act* (the *BIA*).

2 On September 29, 2006, Franklin Forbes (the bankrupt) settled his TD and CIBC Visa accounts out of the proceeds of a new mortgage on his house. One month later, on October 27, 2006, he declared bankruptcy, citing indebtedness on three other credit cards.

3 After the trustee's demand for repayment, TD Visa repaid the amount it received from the bankrupt to the bankrupt's estate. CIBC refused, taking the position that the payment was not a preference under s. 95.

4 The application judge dismissed the trustee's application. He concluded that the evidence was insufficient to prove that the bankrupt was insolvent at the time of the payment to CIBC or that the bankrupt's intention was to prefer CIBC over other creditors.

5 The trustee's appeal of this decision is accompanied by its motion to have fresh evidence considered by this court.

**The BIA**

6 The pertinent portions of s. 95 read as follows:

> **Preferences**
>
> **95. (1)** ... [A] payment made ... by an insolvent person
>
> > (a) in favour of a creditor who is dealing at arm's length with the insolvent person ... with a view to giving that creditor a preference over another creditor is void as against ... the trustee if it is made ... during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy; ...
> >
> > . . . . .
>
> **Preference presumed**
>
> **(2)** If the ... payment ... has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made ... with a view to giving the creditor the preference — even if it was made ... under pressure — and evidence of pressure is not admissible to support the transaction.

7 Section 2 of the *BIA* defines "insolvent person" by three different tests:

> **Definitions**
>
> **2.** In this Act,
>
> . . . . .
>
> "insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> > (a) who is for any reason unable to meet his obligations as they generally become due,
> >
> > (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
> >
> > (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;
> >
> > . . . . .

8 Amendments to s. 95 were proclaimed in force while this case was on reserve in the court below. See S.C. 2007, c. 36, s. 42, proclaimed in force on September 18, 2009. The judge cited the current version of s. 95 in his reasons and counsel agreed

that he was correct to do so. Because no substantive changes were made to s. 95 that must be considered for this appeal, I have cited the current version as well.

**The Section 95 Application and the Evidence**

9 In support of its application, the trustee filed the affidavit of Douglas Collins. He attached various documents and correspondence to his affidavit, including the bankrupt's Assignment for the General Benefit of Creditors and Statement of Affairs (Non-Business Bankruptcy), as well as correspondence related to the settlement and payment of the bankrupt's CIBC Visa account. In his affidavit, Mr. Collins referred to the bankrupt's "three other credit card accounts":

> As appears from his Statement of Affairs, the Bankrupt had at least three other credit card accounts, none of which were paid any of the refinancing proceeds. Given that CIBC and TD VISA were paid only one month prior to bankruptcy, then, it appeared to me that those two creditors had been preferred.

10 In response, CIBC filed the affidavit of Jeffrey Loranger, an employee of CBV Collection Services Ltd., the collection agent for CIBC. Mr. Loranger outlined the dealings that he had with respect to the settlement of the CIBC Visa account. He concluded his affidavit by stating:

> Based on my conversations with [the bankrupt] and [the mortgage broker], I do verily believe that [the bankrupt] had carried out an arrangement to restructure debts of his to make his situation more manageable with his creditors, and that the payment of $15,000.00 to CIBC was part of that arrangement.

11 Mr. Loranger attached to his affidavit a copy of the summary of account from CIBC Credit Card Services for the bankrupt's CIBC Visa account for the period from September 14, 2006, to October 13, 2006.

12 Neither party cross-examined on the other's affidavit and neither party provided evidence directly from the bankrupt.

***The Evidence from the Affidavits***

13 The bankrupt, who was retired, made his assignment in bankruptcy on the basis of "being unable to pay my debts as they become due." He declared a modest pension income of less than $1,000 monthly and unsecured indebtedness of $22,001 to three creditors, identified as follows:

1) Bank One - Visa ($8,795);

2) Citibank Canada Mastercard ($6,715); and

3) Hudson's Bay Company - Recovery Department ($6,491).

14 He also declared that he owed Sun Mortgage Company $45,000, which was secured by the new mortgage (shown on title to be in the amount of $39,000) against his house, which he valued at $55,000. His other assets (cash, furniture and personal assets) were minimal, totalling only $1,459.

15 In the information accompanying his Statement of Affairs, he declared that he had not "[m]ade payments in excess of the regular payments to creditors" within the 12 months prior to the date of the bankruptcy.

16 By September 29, 2006, TD Visa had obtained judgment against the bankrupt (for an amount not made known to the judge) and the summary of account for the CIBC Visa account showed that the "[t]otal minimum payment due" was $18,223:

| **Account summary** | | | |
|---|---|---|---|
| Previous balance | | | $17,902.42 |
| | Interest | .... 320.59 | |
| Total debits | | | + 320.59 |

| | | |
|---|---|---|
| **New Balance** | | **=$18,223.01** |
| Minimum payment due | | |
| You must immediately pay the greater of: | | |
| The amount over your credit limit | $1,723.01 | |
| or | | |
| The amount past due from last month | 17,902.42 | 17,902.42 |
| **Please pay the current Amount due by Nov 8** | | + 320.59 |
| **Total minimum payment due** | | **= $18,223.01** |

17 At the time of the bankrupt's discharge in June 2007, the trustee was unaware of any potential payments offending s. 95.

18 After investigating the payments made to TD Visa and CIBC Visa in the spring of 2008, the trustee demanded that the payments be repaid to the bankrupt's estate. After CIBC refused, the trustee brought its application under s. 95.

**The Law**

19 Section 95 applies to a payment that was made by a bankrupt (described as "the debtor" in the rest of this section on "The Law") prior to bankruptcy, provided that: 1) it was made within the prescribed period of time prior to the date of bankruptcy; 2) the debtor was insolvent on the date of the impugned payment; and 3) the debtor had the intention to prefer one creditor over another. On this appeal, there is no issue that the bankrupt's payment to CIBC fell within the applicable three-month period prescribed by s. 95.

20 The trustee has the initial burden to prove the debtor was insolvent by establishing that at least one of the three tests set out in the definition of insolvent person existed on the date of the impugned payment. The court is not to presume insolvency. See *Black & White Hat Shop Ltd., Re* (1925), 35 Man. R. 9 (Man. C.A.), and *Van der Liek, Re* (1970), 14 C.B.R. (N.S.) 229 (Ont. S.C.). Some cases describe the need for the evidence of insolvency to be "clear and convincing." For example, see *Krawchenko (Trustee of) v. Minister of National Revenue*, 2005 MBQB 97 (Man. Q.B.) at para. 11, (2005), 198 Man. R. (2d) 120 (Man. Q.B.).

21 While I have no quarrel with that description, it must be understood in its proper context of a shifting evidentiary onus. Once the trustee establishes a *prima facie* case of insolvency, the onus shifts to the defendant creditor to adduce evidence to rebut that *prima facie* case. See *Robinson v. Countrywide Factors Ltd.* (1977), [1978] 1 S.C.R. 753 (S.C.C.). McQuaid J.A. explained the onus in *Lotito Estate v. Scantlebury-MacDougall* (1996), 43 C.B.R. (3d) 23 (P.E.I. C.A.)) (at para. 14):

> .... The appellant had the burden of establishing a *prima facie* case that one of these three alternative situations [under s. 95] existed. If, on a balance of probabilities, the appellant established such a *prima facie* case, the evidentiary onus shifted to [the creditor] to rebut the *prima facie* evidence. See: *Robinson v. Countrywide Factors Ltd.* (1977), 23 C.B.R. (N.S.) 97 (S.C.C.) at pp. 135-136 ....

22 Once the trustee has established that the debtor was insolvent on the date of the impugned payment, the next question is whether the debtor had the intention to prefer one creditor over another by that payment.

23 It is not enough that a payment creates a preference in fact. The trustee must establish that the debtor had the intent to prefer one creditor over another. The cases refer to this intent as "the dominant intent." The intent of the creditor who received the payment is irrelevant. As stated by Belzil J.A. in *Norris, Re* (1996), 44 C.B.R. (3d) 218 (Alta. C.A.) (at para. 16):

> .... The state of mind of the debtor at the time of making the payment is ultimately the paramount consideration to be addressed by the court. The intent or state of mind of the preferred creditor is irrelevant, *Hudson v. Benallack* (1975), 21 C.B.R. (N.S.) 111 (S.C.C.).

24 The dominant intent is based on an objective assessment of the circumstances. In other words, the intention will be what the debtor's conduct objectively demonstrates when reasonably construed and not what the debtor (or others) may claim was

his or her intention long after the payment was made. The point is made in the oft-cited decision in *Holt Motors Ltd., Re* (1966), 9 C.B.R. (N.S.) 92 (Man. Q.B.) (at p. 95):

> .... 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.

25 In *Coast Wire Rope & Supply Ltd. (Trustee of) v. Trans Pacific Hardware Inc.*, 1999 BCCA 217, 9 C.B.R. (4th) 255 (B.C. C.A.), Finch J.A. also emphasized the objective nature of the test (at para. 8):

> .... ... [T]his Court has held in *Ferrostaal Metals Canada Ltd. v. Olympic Steel Ltd. (Trustee of)*, [[1985] B.C.J. No. 2276 (QL)], at p. 6, that the intention of the debtor is to be determined objectively and not subjectively. Mr. Justice Carrothers for the Court said at para. 17:
>
> > The relevant intention governing determination of whether the prima facie presumption of a preference has been rebutted is that intention which the conduct of the parties bears when reasonably construed. It is an objective rather than a subjective test.
>
> In other words, the conduct of the parties may be a better measure of the debtor's intention than his expressed words.

See also *West End Furniture Co. (Trustee of) v. Sinnott's Ltd.* (1989), 75 C.B.R. (N.S.) 209 (Nfld. C.A.) and *St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.*, 2005 NBCA 55, 13 C.B.R. (5th) 125 (N.B. C.A.).

26 Section 95(2) is crucial to the analysis. It creates the presumption of preference referred to by Finch J.A. in the above quote. Once a preference in fact has been established, this presumption of intent to prefer applies. The creditor receiving the payment must rebut the presumption. M.A. Springman, George R. Stewart & J.J. Morrison, *Frauds on Creditors: Fraudulent Conveyances and Preferences*, looseleaf (Toronto: Thomson Reuters Canada Limited, 2009), describes the presumption and the process (at p. 20-37):

> .... ... [T]he threshold issue for the trustee on the question of intent should be whether the transaction had the effect of conferring a preference. If it can be established that the transaction in question had that effect then, pursuant to section 95(2) of the Act, the intention to prefer will be presumed unless the creditor preferred can establish on the evidence that there was no intention to prefer. Therefore, where the presumption of section 95(2) arises, the question of intention should arise only where the presumption has been established and the creditor is called upon to rebut it. When the question of intent arises, the creditor must argue from the circumstances that the intent of the debtor was something other than to prefer the creditor. ....

**The Judge's Decision**

27 The judge identified the two questions that he had to address: 1) whether the bankrupt was insolvent on the date the payment was made to CIBC (September 29, 2006); and 2) if he was insolvent, whether the payment was a preference under s. 95. He answered both questions in favour of CIBC and dismissed the trustee's application.

28 When answering the first question, the judge highlighted the lack of evidence from the trustee concerning the existence of the "three other credit cards" on September 29, 2006. As a result, he was "not satisfied that the bankrupt was 'insolvent' on the date of payment (September 29, 2006)" (at para. 13).

29 The judge addressed the second question in the event he was wrong in concluding that the bankrupt was not insolvent on September 29, 2006. He concluded that (at para. 14):

> .... ... CIBC has established that this is one of those "diligent creditor" scenarios referred to in the authorities. ... [T]hat the bankrupt's dominant intention at the time of the payments to CIBC and TD Visa was to obtain new financing at a lower interest rate ....

30 Just before stating this conclusion, he again focussed on the absence of evidence about the existence of the "three other credit cards" on September 29, 2006 (*ibid.*):

> .... Clearly, if the three credit card accounts ... were in existence on September 29, 2006, any such plan [to refinance] was improvident and unreasonable. However, I have no proper evidence before me to support that conclusion. Again, particulars of these debts could have been proven by the Trustee and may well have supported the overall positions of the Trustee. ....

**Positions of the Parties**

***The Trustee***

31 The essence of the trustee's position is that the judge erred when he focussed on the absence of evidence rather than the evidence before him. The trustee does not assert that the judge did not explain the law correctly, rather it says that he applied it incorrectly to the evidence.

32 The trustee argues that the evidence establishes that the bankrupt was insolvent on September 29, 2006, under any of the three applicable tests. However, it says that one need not go further than the first test because the evidence demonstrates that the bankrupt was "unable to meet his obligations as they generally [became] due."

33 The trustee asserts that the judge made several palpable and overriding errors, such as:

> 1) concluding that the bankrupt's monthly payment to CIBC was $320 when the account was in collection and the total amount was due and owing;
>
> 2) failing to infer that the bankrupt had not been meeting his obligations as they became due in the face of the evidence that the indebtedness to TD Visa was by way of judgment; and
>
> 3) failing to consider the three other creditors listed in the bankrupt's Statement of Affairs.

34 Further, the trustee argues that the judge failed to take into account that the bankrupt lied when he declared he had not paid any creditors in excess of the regular payments within 12 months of the date of bankruptcy when, in fact, he had paid out TD Visa and CIBC, and that Mr. Collins's unchallenged opinion as an officer of the court was that the bankrupt was insolvent at the material time.

35 With respect to the preference issue, the trustee asserts that the judge erred when he found that CIBC had rebutted the presumption of preference. It says that given the preference in fact to CIBC, the presumption applied and the judge erred in not applying it properly. It says that the effect of the judge's approach was to shift the onus incorrectly onto the trustee when he should have drawn an adverse inference against CIBC for not adducing evidence from the bankrupt. The trustee says that this is a palpable and overriding error, if not an error of law.

***CIBC***

36 CIBC responds that the judge made no errors of law and no palpable and overriding errors and therefore, this court cannot intervene and must show deference to the findings of the judge.

37 More particularly, CIBC asserts that the judge could not give credence to the bankrupt's information in the Statement of Affairs because the bankrupt was not credible for the very reason argued by the trustee. In any event, it says that the Statement of Affairs spoke from the date of bankruptcy and not as of the date of the payment to CIBC, one month earlier. Further, it says that the judge was entitled to conclude that the evidence of insolvency was "sketchy" (at para. 13) and therefore did not meet the standard to prove insolvency.

 

38 With respect to the preference issue, CIBC acknowledges that it had the onus to prove that the bankrupt did not make the payment to CIBC with the intention of giving it a preference. It says that Mr. Loranger's evidence demonstrates that CIBC was pressing the bankrupt for payment, which resulted in the payment to settle the indebtedness. The payment, it asserts, was part of a reasonable plan to avoid bankruptcy by refinancing and restructuring and was in response to CIBC acting as a diligent creditor.

39 CIBC acknowledges that the judge made a palpable error when he stated that the bankrupt was only required to pay $320 monthly to CIBC rather than payment in full of $18,223. However, it asserts that the error was not overriding given the evidence that, on the date of payment, the bankrupt had reached a settlement with CIBC to pay $15,000.

40 Finally, CIBC says that the judge did not err when he did not draw an adverse inference against CIBC for not adducing evidence from the bankrupt and that there was no shifting of onus, as argued by the trustee. As for the judge's comments that he had no evidence of the amounts owing by the bankrupt at the date of payment, CIBC asserts that the judge was simply pointing out that the trustee had failed to meet its initial onus of proving insolvency and a preference in fact.

**Analysis and Decision**

***Issues and Standard of Review***

41 This appeal is not about how the judge articulated the law or the issues. Rather, it is about how he applied the legal tests to the evidence before him and the inferences that he made or failed to make. Thus, the issues raised by the trustee are either questions of fact or questions of mixed fact and law which do not entail any extricable legal principles. The standard of review is therefore palpable and overriding error. See *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.) at para. 35; *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (S.C.C.); *L. (H.) v. Canada (Attorney General)*, 2005 SCC 25, [2005] 1 S.C.R. 401 (S.C.C.); and *Knock v. Dumontier*, 2006 MBCA 99, 208 Man. R. (2d) 121 (Man. C.A.).

42 The two overarching issues in this appeal are:

1) Did the judge err in not finding the bankrupt insolvent on September 29, 2006?

2) If the bankrupt was insolvent on September 29, 2006, did the judge err when he did not find that the payment to CIBC was a preference under s. 95?

***Did the Judge Err in Not Finding the Bankrupt Insolvent on September 29, 2006?***

43 After explaining the onus on the trustee to prove insolvency, the judge commented upon the absence of evidence from the trustee (at para. 10):

> .... Here, there is proof that the bankrupt was having some financial problems in August and September 2006 in that he was not meeting some of his obligations (to CIBC and TD Visa). There is no evidence as to whether he was making payments on any other debts he owed at that time. I have no evidence from the bankrupt himself, no evidence of the amounts of any other unsecured accounts that may have existed as at the date of the payment (September 29, 2006), and no evidence of the amount owed or paid to TD Visa as at that date (albeit, whatever the amount was, it was subsequently recovered by the Trustee). ....
>
> [emphasis added]

44 Because of this absence of evidence, he concluded that the trustee had not met its onus to establish that the bankrupt was insolvent on September 29, 2006 (at paras. 11-13):

> Dealing firstly with the third test noted above [para. (c)], I am not prepared to infer or conclude, absent evidence which was readily available and compellable, that the three credit card accounts referred to in the October 27, 2006 statement of affairs

existed and (or) were in arrears as at September 29, 2006. Clearly, the amounts and the dates create a suspicion; however, to conclude this without specific evidence (particularly when that evidence is available) would be mere speculation.

As to the other two tests (paras. (a) and (b) noted above), I respectfully disagree with the conclusions urged by the Trustee. Prior to the settlement with CIBC, the monthly payment on this indebtedness was $320.59. I have no evidence as to what amount was owed to TD Visa or what regular payment was required, although it appears that this debt was reduced to judgment and probably required payment in full. Absent proof of any other existing debts at September 29, 2006 (other than the new mortgage loan used to pay CIBC and TD Visa), the evidence falls short of establishing that the bankrupt was "unable" to meet his obligations as they generally became due or that he had ceased paying his current obligations as they generally came due. At best, he had decided to refinance these two loans by way of a more manageable mortgage loan. Clearly, the monthly payment owed to CIBC was a significant portion of the bankrupt's gross monthly income. However, this debt carried interest at 24% per annum and the bankrupt may well have been able to meet the monthly payment on the new mortgage. The mortgage would probably bear interest at a considerably lower rate than either CIBC or TD Visa (whatever amount was owed to TD Visa).

... [T]he Trustee's evidence on this issue is "sketchy", "less than clear and convincing", and "does not meet the standard required" (see para. 12 of the decision of Suche J. in **Krawchenko**, supra). I am not satisfied that the bankrupt was "insolvent" on the date of payment (September 29, 2006), notwithstanding that the evidence establishes his insolvency on the date of bankruptcy (October 27, 2006). ....

[emphasis added]

45 The judge had every reason to note the evidence that he did not have and to be critical of the trustee for not providing it. More direct evidence about the existence of the three credit card debts on September 29, 2006, would have been helpful and preferable. Having said that, there was evidence that had to be considered and by focussing on the absence of evidence as the judge did, he failed to do so.

46 The question for the judge was whether the evidence that he did have from the trustee was sufficient to infer, on a *prima facie* basis, that the indebtedness that existed on October 27, 2006, also existed on September 29, 2006. In my view, the only reasonable inference to be drawn from that evidence is that the indebtedness that existed on October 27, 2006, or at least almost all of it, was far more likely than not in existence one month earlier.

47 A review of the evidence properly includes the declarations of the bankrupt as to his assets and liabilities. I do not accept CIBC's argument that this evidence was not credible because the bankrupt declared that he had not paid any creditors within the 12 months prior to his bankruptcy. In my view, the evidence pertaining to the bankrupt's assets and liabilities as at October 27, 2006, was properly considered because it was not challenged in any way by other evidence.

48 I review the evidence to demonstrate my conclusion. As of September 29, 2006, TD Visa had obtained judgment against the bankrupt on its credit card account and the CIBC Visa account was in collection. Both accounts were paid out of the new mortgage proceeds. Obviously, the bankrupt had not been paying these accounts as they became due. As of October 27, 2006, the bankrupt had assets, apart from his house, totalling $1,459 and he owed $22,001 on the "three other credit cards." His income was minimal and he said that he was "unable to pay my debts as they become due." His Hudson's Bay account was noted as being with the "Recovery Department."

49 Simply put, these facts speak to the bankrupt's inability to pay his credit card indebtedness as it became due. When the bankrupt declared he was unable to pay his indebtedness as it became due on the three credit cards, the only reasonable inference is that he was unable to pay them one month earlier. Therefore, the evidence establishes, at least on a *prima facie* basis, that the three credit card debts existed on September 29, 2006.

50 None of the evidence filed by CIBC rebutted this *prima facie* evidence. In fact, it supported it. It confirmed the bankrupt's inability to pay his debts as they became due as the monthly payments to CIBC Visa were not current and the account was in collection.

  

51 To conclude, the only reasonable inference to be drawn from all of the evidence, when considered in totality, is that the bankrupt's accounts for the "three other credit cards" existed on September 29, 2006, and were unpaid. Given that the bankrupt did not have sufficient assets to pay these debts on September 29, 2006, the trustee did establish on the balance of probabilities that on that date, the bankrupt was unable to meet his obligations as they became due.

52 Given that conclusion, I need not address whether the trustee established insolvency under the other two tests.

53 However, I wish to comment briefly on the second test. The definition of person in the *BIA* is broad and includes "a partnership, an unincorporated association, a corporation, a cooperative society or a cooperative organization." The second test for insolvency is whether the person "ceased paying his current obligations in the ordinary course of business as they generally become due." It appears from the record and the judge's reasons that the second test was at play. I question the applicability of the second test to the circumstances here because the bankrupt was retired and not carrying on business. Given that this question was not an issue before the judge, or on appeal, I simply highlight my query and suggest that any party relying on this provision in the future address the question of whether it applies to any person or only those who were carrying on business.

***Did the Judge Err When He Did Not Find that the Payment to CIBC was a Preference Under Section 95?***

54 The judge addressed this question in the event that he was wrong in his conclusion that the trustee had not demonstrated that the bankrupt was insolvent on September 29, 2006, because of his indebtedness on the "three other credit cards." As will be explained, I am of the view that the judge made two palpable and overriding errors in his analysis.

55 The first was that he wrongly focussed on the absence of evidence. The judge wrote (at para. 14):

> .... ... [I]f the three credit card accounts evidenced in his statement of affairs (totalling $22,001) were in existence on September 29, 2006, any such plan was improvident and unreasonable. However, I have no proper evidence before me to support this conclusion. ....
>
> [emphasis added]

56 This was an error because, at this stage of the inquiry, he had to assume that the trustee had proven the bankrupt's insolvency on the basis of the very existence of the indebtedness on the "three other credit cards."

57 The second error was that the judge placed too much emphasis on the bankrupt's subjective intention, as established through Mr. Loranger. In effect, he placed the onus on the trustee and failed to give effect to the presumption under s. 95(2), as argued by the trustee.

58 There can be no question that the payment to CIBC had the effect of preferring CIBC over the three other creditors. In other words, there was a preference in fact. In these circumstances, s. 95(2) comes into play and the intention of the bankrupt to prefer is presumed unless CIBC has shown that the bankrupt did not have that intention. There is no such evidence.

59 The evidence of Mr. Loranger was that he understood that the bankrupt was attempting to reorganize his affairs. However, as explained earlier, the bankrupt's intention is determined based on an objective analysis of the circumstances and not the subjective intent of the bankrupt, or the intent of the creditor.

60 A plan by an insolvent person to reorganize his or her financial affairs must be objectively reasonable to rebut the presumption. See *Coast Wire Rope & Supply*. In *Dubois-Vandale (Trustee of) v. MBNA Canada Bank*, 2006 MBQB 258, 209 Man. R. (2d) 268 (Man. Q.B.), Hanssen J. explained this well (at paras. 16-18):

> To rebut the presumption, MBNA must show on a balance of probabilities that Ms. Dubois-Vandale's dominant intention was not to prefer a creditor. The court must look at all of the circumstances and determine if there was in fact an intention on her part to give MBNA a preference. Where, as here, a bankrupt asserts that it was her intention to reorganize her affairs

  

> and avoid bankruptcy, her intention must also be objectively reasonable. See **Holt Motors Ltd., Re** (1966), 9 C.B.R. (N.S.) 92 (Man. Q.B.).
>
> MBNA has failed to show, on a balance of probabilities, that Ms. Dubois-Vandale's dominant intention was not to prefer it. Ms. Dubois-Vandale selected the accounts which she wanted to pay in full on January 28, 2004. She paid these accounts knowing that other debts would receive only a minimal payment or no payment whatsoever.
>
> While I am satisfied Ms. Dubois-Vandale's plan was to try to secure financing to consolidate the remainder of her debts and avoid bankruptcy, her plan was not objectively reasonable. She was hopelessly insolvent. Her debts greatly exceeded her [assets] and she did not have sufficient income to service a loan of the magnitude she required to consolidate her debts.
>
> [emphasis added]

61 Here, the bankrupt's conduct, viewed objectively, is that he preferred CIBC to the other three creditors that existed on September 29, 2006. His plan was "improvident and unreasonable" (at para. 14), using the judge's own words. It was not objectively reasonable.

62 Therefore, the payment to CIBC is a fraudulent preference pursuant to s. 95 and is void.

**Conclusion**

63 The judge erred when he failed to consider evidence of indebtedness and concluded that the evidence was insufficient to establish that the bankrupt was insolvent on the date of payment to CIBC. The judge also erred when he concluded that the evidence did not establish that the bankrupt had the intention to prefer CIBC to other creditors. Because these errors are palpable and overriding, the conclusions of the judge are not entitled to deference.

64 For the reasons set out above, I am of the view that the trustee established that the bankrupt was unable to pay his obligations as they became due on September 29, 2006, and, therefore, he was an insolvent person on that date. I am also of the view that the presumed intent to prefer arising from the preference in fact in favour of CIBC was not rebutted by CIBC. Therefore, the payment to CIBC on September 29, 2006, is void as a preference under s. 95 of the *BIA*.

65 Given the foregoing, the fresh evidence motion is moot and need not be addressed.

66 I would allow the trustee's appeal, declare that CIBC received a preference in the amount of $15,000 and order that CIBC pay the trustee $15,000 plus interest calculated at five per cent per annum from the date of bankruptcy to the date of payment, as sought by the trustee in its notice of application. I would order costs in favour of the trustee in this court and the court below.

***Holly C. Beard J.A.*:**

I agree.

***Martin H. Freedman J.A.*:**

I agree.

*Appeal allowed.*

# TAB 10

2002 BCSC 1022, 2002 CarswellBC 1642, [2002] B.C.W.L.D. 861, 35 C.B.R. (4th) 165

2002 BCSC 1022
British Columbia Supreme Court

Abou-Rached, Re

2002 CarswellBC 1642, 2002 BCSC 1022, [2002] B.C.W.L.D. 861, 35 C.B.R. (4th) 165

# In the Matter of the Proposal of Roger Georges Abou-Rached

In the Matter of the Proposal of R.A.R. Investments Ltd.

Ross J.

Heard: April 9-11, 24-26, 2002
Judgment: July 8, 2002
Docket: Vancouver 219307VA01, 219301VA01

Counsel: *David A. Gray*, *M. Nielsen*, for Trustee, Campbell Saunders Ltd.
*Bruce E. McLeod*, for Genesee Enterprises Ltd.
*Alan E. Keats*, for Jean de Grasse, Robert de Grasse, Andre de Grasse, Claire de Grasse, Frank de Grasse, Eric Boulton, D'Arcy Boulton, Gurdrun Kate Parkes, Kenneth James Parkes, Michael A. Parkes, Greg Findlay, Susan Findlay, Phil Argue, Glenn Morris and Four Weal Ventures Ltd.
*Andrew G. Sandilands*, for Roger Abou-Rached, R.A.R. Investments Ltd.
*Jennifer L. Harry*, for Stanley Rodham Investments Ltd., Randers International Ltd., Rosebar Enterprises Limited, Sirmac International Ltd., Veda Consult S.A., Yarold Trading Ltd.
*Heather M. Ferris*, for Georges Abou-Rached, Hilda Abou-Rached, RAR Consulting Ltd., Garmeco Canada International Consulting Engineers Ltd.

Subject: Insolvency; Civil Practice and Procedure

### Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

### Headnote

**Bankruptcy --- Proposal — Approval by court — Conditions — Reasonable terms**

Individual debtor developed new construction technology — Debtor purchased rights to technology from employer — Debtor incorporated four companies, in which he held 100 per cent interest, to license technology — Debtor executed guarantees and pledged shares to companies' investors — Investors' repeated requests for conversion of shares were refused — Investors commenced action against individual and corporate debtors for oppression and conflict of interest — As result of litigation, investors were awarded $982,746 in damages — Debtors' major creditor issued demand — Trustee in bankruptcy recommended two proposals put forward by debtors — First proposal estimated creditors would receive 15 cents on dollar — Second proposal offered creditors right to elect potential recovery of all claims — Eighty-five per cent of creditors voted in favour of proposals — Debtors brought application for approval of proposals — Application granted — In event of bankruptcy, no unencumbered assets existed that could be available to unsecured creditors — Amount of excess income was minimal — Guaranteed payment existed for some recovery by unsecured creditors — Proposals had reasonable prospect of succeeding according to terms — Proposals were not filed solely to avoid judgment — Recovery would be greater under proposals than in bankruptcy — Proposals were in interests of creditors.

**Bankruptcy --- Proposal — Approval by court — Conditions — Interests of creditors**

Individual debtor developed new construction technology — Debtor purchased rights to technology from employer — Debtor incorporated four companies, in which he held 100 per cent interest, to license technology — Debtor executed guarantees and pledged shares to companies' investors — Investors' repeated requests for conversion of shares were refused — Investors commenced action against individual and corporate debtors for oppression and conflict of interest — As result of litigation, investors were awarded $982,746 in damages — Debtors' major creditor issued demand — Trustee in bankruptcy recommended two proposals put forward by debtors — First proposal estimated creditors would receive 15 cents on dollar — Second proposal offered creditors right to elect potential recovery of all claims — Eighty-five per cent of creditors voted in favour of proposals — Debtors brought application for approval of proposals — Application granted — In event of bankruptcy, no unencumbered assets existed that could be available to unsecured creditors — Amount of excess income was minimal — Guaranteed payment existed for some recovery by unsecured creditors — Proposals had reasonable prospect of succeeding according to terms — Proposals were not filed solely to avoid judgment — Recovery would be greater under proposals than in bankruptcy — Proposals were in interests of creditors.

**Bankruptcy --- Proposal — Approval by court — Bankrupt offering less than 50¢ on dollar**

Individual debtor developed new construction technology — Debtor purchased rights to technology from employer — Debtor incorporated four companies, in which he held 100 per cent interest, to license technology — Debtor executed guarantees and pledged shares to companies' investors — Investors' repeated requests for conversion of shares were refused — Investors commenced action against individual and corporate debtors for oppression and conflict of interest — As result of litigation, investors were awarded $982,746 in damages — Debtors' major creditor issued demand — Trustee in bankruptcy recommended two proposals put forward by debtors — First proposal estimated creditors would receive 15 cents on dollar — Second proposal offered creditors right to elect potential recovery of all claims — Majority of creditors voted in favour of proposals — Debtors brought application for approval of proposals — Application granted — Debtors' assets were less than 50 cents on dollar for unsecured liabilities — Individual debtor had assets to support guarantees at time guarantees were given — Debtors were not responsible for shortfall in value of assets — Shortfall was attributed to circumstances for which debtors could not be held responsible — Debtors gave satisfactory account for loss of assets or deficiency of assets.

**Bankruptcy --- Proposal — Approval by court — Misconduct of bankrupt**

Individual debtor developed new construction technology — Debtor purchased rights to technology from employer — Debtor incorporated four companies, in which he held 100 per cent interest, to license technology — Debtor executed guarantees and pledged shares to companies' investors — Investors' repeated requests for conversion of shares were refused — Investors commenced action against individual and corporate debtors for oppression and conflict of interest — As result of litigation, investors were awarded $982,746 in damages — Debtors' major creditor issued demand — Trustee in bankruptcy recommended two proposals put forward by debtors — First proposal estimated creditors would receive 15 cents on dollar — Second proposal offered creditors right to elect potential recovery of all claims — Majority of creditors voted in favour of proposals — Debtors brought application for approval of proposals — Application granted — Debtors' conduct during litigation was reprehensible — Dissenting creditors established pursuant to s. 173(1)(f) of Bankruptcy and Insolvency Act that debtors' defence was frivolous and vexatious — Trustee examined transactions conducted prior to litigation and concluded further investigation was necessary to determine whether transactions were settlement or fraudulent preference — Since no conviction or finding of fraud existed against debtors from judgment in criminal or civil court, finding of fraud could not be made on allegations — More than mere suspicion required to find proposals were not reasonable by virtue of debtors' conduct — Proposals were still reasonable within meaning of s. 59 of Act — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 59, 173(1)(f).

**Bankruptcy --- Meeting of creditors — Voting — Who may vote**

Individual debtor developed new construction technology — Debtor purchased rights to technology from employer — Debtor incorporated four companies, in which he held 100 per cent interest, to license technology — Debtor executed guarantees and pledged shares to companies' investors — Investors' repeated requests for conversion of shares were refused — Investors commenced action against individual and corporate debtors for oppression and conflict of interest — As

result of litigation, investors were awarded $982,746 in damages — Debtors' major creditor issued demand — Trustee in bankruptcy recommended two proposals put forward by debtors — Majority of creditors voted in favour of proposals — Dissenting creditors appealed trustee's decision to allow certain creditors to vote at meeting of creditors — Appeal dismissed — Trustee found creditors' claims were sufficient and that promissory notes held by creditors were evidence of debt — Creditors showed they had claims provable in proposal — No evidence existed that corporate creditor's debts were not bona fide — Corporate creditor was not related person to either individual or corporate bankrupt pursuant to s. 4 of Bankruptcy and Insolvency Act — No evidence of bonds of dependence, control, influence or moral pressure existed to indicate debtors and corporate creditor were not dealing at arms' length — No evidence existed that transactions entered by individual debtor after commencement of litigation with dissenting creditors were directed to collusive end so as to prevent dissenting creditors from collecting award from litigation — Transactions in dispute were of investments in development of technology — No evidence existed that investment funds were diverted or used for other purposes — No basis existed to disallow creditors in question from voting on proposal — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 4.

**Bankruptcy --- Practice and procedure in courts — Discovery and examinations — By creditor**

Individual debtor developed new construction technology — Debtor purchased rights to technology from employer — Debtor incorporated four companies, in which he held 100 per cent interest, to license technology — Debtor executed guarantees and pledged shares to companies' investors — Investors' repeated requests for conversion of shares were refused — Investors commenced action against individual and corporate debtors for oppression and conflict of interest — As result of litigation, investors were awarded $982,746 in damages — Debtors' major creditor issued demand — Trustee in bankruptcy recommended two proposals put forward by debtors — Majority of creditors voted in favour of proposals — Dissenting creditors brought application for order for cross-examination of individuals — Application dismissed — Dissenting creditors did not meet threshold of sufficient cause so as to order examinations.

## Table of Authorities

**Cases considered by *Ross J.*:**

*DeGrasse v. Stephenson* (June 9, 1995), Doc. Vancouver A943129 (B.C. S.C.) — considered

*Forsberg, Re*, 26 C.B.R. (4th) 204, 2001 SKQB 289, 2001 CarswellSask 445, (sub nom. *Forsberg (Bankrupt), Re)* 209 Sask. R. 196 (Sask. Q.B.) — referred to

*Genesee Enterprises Ltd. v. Abou-Rached*, 2001 BCSC 59, 2001 CarswellBC 84, 84 B.C.L.R. (3d) 277 (B.C. S.C.) — referred to

*Gingras, Robitaille, Marcoux Ltée v. Beaudry*, [1980] C.S. 468, (sub nom. *Tremblay, Re)* 36 C.B.R. (N.S.) 111, 1980 CarswellQue 59 (Que. S.C.) — followed

*Grobstein v. Brock Mills Ltd.*, (sub nom. *Orchid Fashions Inc., Re)* 2 C.B.R. (N.S.) 103, 1961 CarswellQue 29 (Que. S.C.) — referred to

*Gustafson Pontiac Buick Cadillac GMC Ltd., Re*, 30 C.B.R. (3d) 280, (sub nom. *Gustafson Pontiac Buick Cadillac GMC Ltd. (Bankrupt), Re)* 129 Sask. R. 293, 1995 CarswellSask 4 (Sask. Q.B.) — considered

*Hartland Pipeline Services Ltd. (Trustee of) v. Bennett Jones*, 2000 CarswellAlta 592, 18 C.B.R. (4th) 28, (sub nom. *Hartland Pipeline Services Ltd. (Bankrupt) v. Bennett Jones)* 272 A.R. 319 (Alta. Q.B.) — considered

*Herd, Re*, 77 C.B.R. (N.S.) 209, 1989 CarswellBC 377 (B.C. C.A.) — distinguished

*Lofchik, Re*, 1998 CarswellOnt 194, 1 C.B.R. (4th) 245 (Ont. Bktcy.) — considered

*McNamara v. McNamara*, 53 C.B.R. (N.S.) 240, 1984 CarswellOnt 186 (Ont. Bktcy.) — referred to

*NsC Diesel Power Inc., Re*, 1997 CarswellNS 406, 49 C.B.R. (3d) 213 (N.S. S.C. [In Chambers]) — referred to

*NsC Diesel Power Inc., Re*, 1998 CarswellNS 331, (sub nom. *NsC Diesel Power Inc. (Bankrupt), Re)* 170 N.S.R. (2d) 236, (sub nom. *NsC Diesel Power Inc. (Bankrupt), Re)* 515 A.P.R. 236, 6 C.B.R. (4th) 96 (N.S. C.A.) — referred to

*Paskauskas, Re*, 36 C.B.R. (3d) 288, 1995 CarswellOnt 948 (Ont. Bktcy.) — referred to

*R.L. Coolsaet of Canada Ltd., Re*, 45 C.B.R. (3d) 30, 1996 CarswellOnt 5202 (Ont. Bktcy.) — considered

*Touhey v. Barnabe*, 1995 CarswellOnt 3495 (Ont. Bktcy.) — considered

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3

Generally — considered

s. 3 — considered

s. 4 — considered

s. 4(1) "related group" — considered

s. 4(1) "unrelated group" — considered

s. 59 — considered

s. 59(2) — considered

s. 59(3) — considered

s. 91(1) — referred to

s. 109(6) — considered

s. 111 — considered

s. 172 — considered

s. 163(1) — referred to

s. 163(2) — considered

s. 173 — considered

s. 173(1)(a) — considered

s. 173(1)(d) — considered

s. 173(1)(f) — considered

s. 173(1)(g) — considered

s. 173(1)(k) — considered

*Bills of Exchange Act*, R.S.C. 1985, c. B-4
s. 179(2) — considered

APPLICATION by debtors to approve proposal; APPEAL by dissenting creditors of trustee in bankruptcy's decision to allow certain creditors to vote at meeting of creditors; CROSS-APPLICATION by dissenting creditors for order to cross-examination of individuals.

***Ross J.*:**

**I Introduction**

1 This was a hearing to deal with several matters in relation to two proposals filed under the *Bankruptcy and Insolvency Act*, RSC 1985 c. B-3 (the "*Act*").

2 The parties are:

(a) the Trustee, Campbell Saunders Ltd.;

(b) Mr. Abou-Rached and RAR Investments Ltd. ("RAR") who each filed a proposal;

(c) two groups of creditors supporting the proposals:

(i) Stanley Rodham Investments ("SRI"), Randers International Ltd., Rosebar Enterprises Ltd., Sirmac International Ltd., Veda Consult S.A., and Yarold Trading Ltd.; and

(ii) RAR Consulting Ltd. ("RARC"), Garmeco Canada International Consulting Engineers Ltd., Georges Abou-Rached, and Hilda Abou-Rached;

(d) two creditors who are in opposition to the proposal:

(i) Genesee Enterprises Ltd., a judgment creditor ("Genesee"); and

(ii) Jean de Grasse, Robert de Grasse, Andre de Grasse, Claire de Grasse, Frank de Grasse, Eric Boulton, D'Arcy Boulton, Gurdrun Kate Parkes, Kenneth James Parkes, Michael A. Parkes, Greg Findlay, Susan Findlay, Phil Argue, Glenn Morris and Four Weal Ventures Ltd., defendants by counterclaim in litigation involving Genesee as plaintiff (the "Defendants by Counterclaim")

(collectively the "dissenting creditors".)

3 The matters are:

(a) appeals by the dissenting creditors from the decision of the Trustee to permit certain creditors to vote at the meeting of creditors;

(b) applications for court approval of the Proposals. These are opposed by the dissenting creditors on the grounds that the Proposals do not meet the criteria under s. 59 of the *Act* and that facts under s. 173 of the *Act* are present;

(c) an application by the dissenting creditors for orders for the cross-examination of several individuals.

4 On the basis of the reasons that follow, I have approved the Proposals and dismissed the balance of the relief sought.

**II BACKGROUND**

5 Mr. Roger Abou-Rached was born in Beirut, Lebanon in 1951. He is an engineer who received his training at the American University in Beirut and at Stanford University in California.

6 Mr. Abou-Rached's father, George Abou-Rached, is a prominent engineer. He held the position of Dean and Professor of Engineering at the American University in Beirut. In addition, he was involved in engineering projects in the Middle East, Asia and Africa through his company Garmeco International Consultants Ltd. ("Garmeco").

7 Garmeco employed Roger Abou-Rached as an engineer, at first, in Lebanon. His employment later continued in Canada when the family fled the Lebanese civil war in 1989 and immigrated to this country.

8 During the time that he was employed by Garmeco, Roger Abou-Rached developed a new construction technology (the "Technology"). The Technology is said to employ "a special reinforced concrete/pre-formed rigid insulation/cold formed metals method of construction" that utilized built-in, rectangular, hollow, metal section tubing as panel framing members. The system is said to be extremely flexible with respect to the type and quality of interior and exterior finish. It provides greater safety, energy efficiency, sound insulation and resistance to insect infestation. The system is also said to provide an environmentally sound building method potentially using recycled ferrous, plastics and organic fibers.

9 Mr. Abou-Rached acquired the rights to the Technology from Garmeco. Over the next several years a number of corporate entities became involved in the development. There were, in addition, a series of transactions, which are characterized by Mr. Abou-Rached and the creditors supporting the Proposals as being in relation to continuing efforts to raise funds in pursuit of that development. These transactions were primarily with SRI, an investment group in Europe, several private investors, as well as members of Mr. Abou-Rached's family and related companies.

10 Mr. Abou-Rached has stated that in excess of $20,000,000 has been invested in the development of the Technology, primarily by SRI, his family and related companies. He stated that in order to obtain these funds, he executed guarantees and transferred and pledged shares in his companies to the investors.

11 The transactions are characterized by the dissenting creditors as collusive efforts to prejudice them. In the background and at the root of the issue is litigation between Mr. Abou-Rached and these dissenting creditors, the judgment of which is reported at *Genesee Enterprises Ltd. v. Abou-Rached*, 2001 BCSC 59 (B.C. S.C.) (the "Litigation").

12 The principal entities in respect of the development of the Technology are described in the Trustee's Report and the reasons of Justice Levine in the Litigation. Mr. Abou-Rached incorporated four companies, holding 100% of the shares of each at the outset. These companies were:

(a) RARC,

(b) R.A.R. International Assets Inc. ("RARI"),

(c) Canadian High-Tech Manufacturing Ltd ("CHT"), and

(d) RAR.

13 Roger Abou-Rached obtained the rights to the Technology from Garmeco pursuant to an Assignment of Technology effective September 11, 1990 and executed on August 31, 1993. The purchase price was $5,000,000 US. There was a written and executed promissory note from Mr. Abou-Rached in the amount of $5,000,000 US in favour of Garmeco dated September 12, 1990. In addition, there was an agreement that provided that the debt was to be repaid on a pro-rated basis from net cash flow from dividends paid by CHT to Roger Abou-Rached.

14 Effective April 1991, by agreement executed August 31, 1993, Mr. Abou-Rached assigned the absolute rights in the Technology to RARC. RARC granted a licence to CHT for the use of the Technology in Canada and a right of first refusal for its use in any other territory in the world.

15 In May 1993, Roger Abou-Rached transferred 65% of his shares in CHT to a publicly traded company, International Hi-Tech Industries Ltd. ("IHI") and acquired control of IHI in a "reverse take over" on the Vancouver Stock Exchange. CHT transferred the rights to the Technology in Canada to IHI. IHI is currently developing and marketing the Technology.

16 In 1990 and 1991, a number of individuals had made investments in various instruments related to CHT. These individuals were either members of the de Grasse family or introduced to Mr. Abou-Rached by the de Grasse family. In late 1991, Jean de Grasse, Robert de Grasse and Mr. Abou-Rached discussed a mechanism by which these investors could convert their investments into equity in CHT. It was substantially agreed that one entity, Genesee, would hold in trust all of the CHT shares issued to these investors. RAR had an option to buy, on notice given by CHT before November 1, 1996, any or all of the CHT shares held by Genesee for a purchase price calculated according to a formula, payable at Genesee's option, in cash or shares in IHI. This agreement was finally executed in mid-1992 (the "Genesee Agreement").

17 In late 1993 several individuals who were parties to the Genesee Agreement requested conversion of their shares of CHT pursuant to that agreement. They were informed that the requests could not be honoured because the requests, pursuant to the Agreement, had to be made by Genesee.

18 Jean de Grasse, as President of Genesee, then gave notice of conversion on their behalf. That notice in turn was refused because it had not been approved by Genesee's Board of Directors.

19 The Board met, but the requests for conversion were not approved because of a deadlock on the Board. One director, Michael Stephenson, a director of both Genesee and IHI, and on behalf of Hang Guong, the fourth director, refused to approve the conversions.

20 In the result, an action was commenced in which a claim of oppression and conflict of interest was advanced. In *De Grasse v. Stephenson* (June 9, 1995), Doc. Vancouver A943129 (B.C. S.C.) ( the "Petition"), Mr. Stephenson was found to be in a conflict of interest. Genesee was ordered to give notice of the requests for conversion. The requests were issued on July 7, 1995.

21 The requests were not honoured. Mr. Abou-Rached and RAR claimed that the Genesee Agreement did not provide for the conversion right claimed. The Litigation was commenced. In addition to raising several defences with respect to the Genesee Agreement, the defendants claimed that the Agreement should be rescinded on the basis of fraudulent misrepresentation. Claims of conspiracy and breach of fiduciary duty were also raised by the defendants.

22 The individuals who had sought conversion through Genesee, the Defendants by Counterclaim, were named in a counterclaim which repeated the allegations raised in the defence.

23 In June 1995, RARC granted a licence agreement for the international rights to the Technology, excluding Canada, to IHI International Holdings Ltd. ("IHIL"). IHIL is owned 51% by IHI and 49% by Mr. Abou-Rached's family.

24 Judgment in the Litigation was pronounced January 9, 2001. The plaintiff, Genesee, was awarded damages of $982,746.94 plus interest. The counterclaim was dismissed. In supplementary reasons for judgment, reported at 2001 BCSC 1172 (B.C. S.C.), Justice Levine awarded the plaintiff and the Defendants by Counterclaim special costs.

25 Following the pronouncement of the reasons for judgment SRI, one of the major creditors of Mr. Abou-Rached and RAR, issued a demand. Mr. Abou-Rached and RAR each then filed a Notice of Intention to File a Proposal, as they were unable to meet their financial obligations as they became due. Mr. Abou-Rached and RAR, after obtaining two extensions from the court, ultimately filed the Proposals on January 7, 2002.

26 Campbell Saunders Ltd. is the Trustee under the Proposals.

27 The Proposals were summarized by the Trustee as follows

**Option A**

a) An amount totaling $150,000 CDN, to be provided by SRI ($75,000) and the Debtor's parents or other family members ("the family") ($75,000);

b) Common shares in the capital of IHI having a market value of $150,000 as at the date of the initial bankruptcy event, to be provided by SRI ($75,000) and the family ($75,000); and

c) (a) and (b) above are to be delivered to the Trustee no later than 31 days following Court approval.

The shares will be issued in or transferred in the name of the Creditor(s), to be held and distributed by an Authorized Representative agreed upon by the Creditor(s).

The Debtor also agrees that for a period of two years from the date of Court Approval, he shall deliver to the Trustee:

- 5% of any common shares, warrants, options or escrow shares he may receive from or in the capital of IHI; or
- anytime after 120 days following Court approval of the Proposal, provide $100,000 CDN in cash; or
- that number of common shares in the capital of IHI equal to $100,000 CDN.

The future shares delivered to the Trustee shall be issued in the name of the Authorized Representative in trust for the Creditors.

The Authorized Representative shall not sell the common shares and/or future shares at a rate exceeding 2% of the original total number of common shares and/or future shares each day.

**Option B**

The claim of the Creditors who elect this Option will survive for seven (7) years (or as agreed to by the Debtor and the Creditors).

The Creditors will be entitled to accrue or charge a maximum of 2% interest per annum to the amount of their claim.

With the exception of 2,600,000 stock options in the capital of IHI and 21,684,958 common shares held in escrow in the capital of IHI that are held in the name of Mira Mar Overseas Ltd. and all rights or entitlement accruing in relation thereto (the "Existing Encumbered Shares"), the Debtor shall for a period not exceeding seven years (or such other period of time as may hereafter be agreed to by the Debtor and the Creditors who elect to Option B of the Proposal) from the date of filing of the initial bankruptcy event, pledge and deliver to the Trustee 30% of any options, warrants, common or preferred shares whether held in escrow or not that the Debtor may receive or be entitled to receive in the capital of IHI from and after the date of the initial bankruptcy event (hereinafter any future right to receive options, warrants, common or preferred shares, whether held in escrow or not shall collectively be referred to as the "Option B Future Shares"). For greater certainty, the Option B Future Shares do not include the existing encumbered shares.

The Option B Future Shares shall be issued in the name of the Authorized Representative in trust for the Creditors and delivered to the Trustee within 30 days of receipt or soon thereafter as may be reasonable.

The Trustee shall forward to the Authorized Representative and the Authorized Representative shall not sell the shares at a rate greater than 2,000 common shares each trading day.

The Authorized Representative shall sell the shares upon receipt of written instructions delivered to it by the Creditors.

If the Creditors' claims are not paid by the last day of the seventh year (or such other period of time as may be agreed to by the Debtor and Creditors), such claim shall be released and shall not be recoverable.

Prior to the Creditors' Meeting, the Debtor will obtain from SRI and the Family irrevocable direction agreeing that they will elect to participate in Option B and waive or release any right or entitlement of the Option A Future Shares that they may have pursuant to any security given by the Debtor prior to the initial bankruptcy event.

The Debtor will only be obligated to deliver the Option B Future Shares to the Trustee to the extent necessary to repay in full the claims of those creditors who elect Option B.

The Debtor can at any time deliver to the Trustee the sum of money or number of shares in the capital of IHI necessary to repay in full the claims of the Creditors.

Upon delivery the Debtor shall be released and proved discharges.

28 In the course of these proceedings the Proposals were amended as follows:

- All creditors, except credit cards, banks, Canada Customs and Revenue Agency, and contingent creditors, have agreed to accept Proposal Option B;

- Within 30 days of Court Approval, the Proposal will provide that the Trustee will receive $150,000 cash;

- Within 30 days of Court Approval, the Proposal will provide that the Trustee will receive the shares as stated in Paragraph 15 of the Proposal. Should the Trustee be unable to realize a total of $150,000 within 90 days of Court Approval, the Proposal will provide that the Trustee will receive the additional funds in cash;

- Within 90 days of Court Approval, the Proposal will provide that the Trustee will receive shares to a value of $100,000 and should the Trustee be unable to realize a total of $100,000 within 150 days of Court Approval, the Proposal will provide that the Trustee will receive the additional funds in cash;

- The retainer held by the Trustee in the amount of $27,500, will be applied to the Trustee's fees and Mr. Rached's parents, who provided the retainer, will have no claim in the estate for that amount.

29 The Trustee estimates that, with the amendment, the creditors in Option A will realize at least 15 cents on the dollar for their claims.

30 The Trustee recommended the Proposals, stating:

According to the Statement of Affairs, there are no unencumbered assets that would be available to the unsecured creditors in a Bankruptcy scenario. The amount of excess income that would be available is minimal and, in all likelihood, would be less than the Trustee's fees and disbursements.

The only potential recovery available to the Estate would require the voiding of the various transfers, sales and pledges described herein. As indicated in this report, this would require further investigation and, in all likelihood, expensive litigation. The cost of this process would be great and beyond the availability of funds from tangible assets. Any effort in this regard would therefore require funding by the Creditors and there is no certainty that the required funding would be forthcoming. Finally, the conclusion of further investigation may be that all of the transactions are bona fide and for fair consideration.

Accordingly, at this time we are unable to estimate with any degree of certainty the estimated realization in a Bankruptcy scenario. The terms of the Proposal, on the other hand, offer the creditors certainty as to recovery with the right to elect the potential recovery of all of their claims (under Option B) or a portion of their claims (under Option A).

In fact, the situation at the outset of the hearing and prior to the amendment was that recovery under the Proposals would have been in the order of 4 or 5 cents on the dollar.

31 The meeting of creditors was held on January 28, 2002. In the Proposal of Roger Georges Abou-Rached, the following was the result of the creditors' vote:

| | | |
|---|---|---|
| For: 48 | $13,198,794.64 | 87.78% |
| Against: 2 | $ 1,837,369.98 | 12.22% |
| | $15,036,164.62 | |

In the Proposal of R.A.R. Investments Ltd., the following was the result of the creditors' vote:

| | | |
|---|---|---|
| For: 48 | $11,542,876.46 | 86.26% |
| Against: 2 | $ 1,837,369.98 | 13.74% |
| | $13,380,846.44 | |

32 Creditors Genesee and the Defendants by Counterclaim voted against the Proposals. Their claims were with respect to the judgment arising from the litigation and the award of special costs.

33 Following the meeting of creditors, a series of appeals were brought. Registrar Sainty, in reasons dated April 3, 2002, with respect to one appeal, allowed the unsecured claim of the Defendants by Counterclaim at 70% rather than the 50% allowed by the Trustee in the RAR proposal. Accordingly, the dollars voted against that Proposal were increased, but not by enough to change the outcome of the vote.

## III. APPEAL FROM THE TRUSTEE'S DECISION TO ALLOW CERTAIN CREDITORS TO VOTE ON THE PROPOSALS

34 The dissenting creditors appealed against the Trustee's decision to permit certain creditors to vote on the Proposals. First, the dissenting creditors submit that the Trustee erred in allowing the claims of Ka Po Cheung, Larry Coston, and the Five Small Creditors; namely, Han Hoang, IACS Technologies Inc., Thinh Le, Nhan Thi Le and Hong Dinh Le.

35 Han Hoang is a former director of Genesee. The dissenting creditors asserted that, following the ruling of Justice Henderson in the Petition, Ms. Hoang avoided attending the directors meeting of Genesee, which was required in order to permit Genesee to formally request conversion of the shares, and thereby assisted Mr. Abou-Rached and RAR in their opposition to the conversion requests.

36 Ms. Hoang submitted three proofs of claim in Mr. Abou-Rached's Proposal, for $1,000, $1,500 and $300,000. The $1,000 claim arises from a cheque of Ms. Hoang in the amount of $5,000, said to represent five $1,000 loans from the Five Small Creditors. She was only permitted to vote with respect to the first two claims as the Trustee concluded that the large claim was a contingent claim. In the RAR Proposal, Ms. Hoang claims $1,000 and $300,000. The Trustee's decision with respect to voting was the same with respect to that Proposal.

37 Ko Po Cheung filed a proof of claim in the Proposal of Mr. Abou-Rached in the amount of $2,159.12, Larry Coston filed a proof of claim in the amount of $1,500, The Five Small Creditors filed proofs of claim in the amount of $1,000 each.

38 The dissenting creditors' complaints with respect to these claims are that:

- There is no evidence that any consideration was given for the promissory notes provided by Mr. Abou-Rached and RAR.

• There is no evidence that Ms. Hoang received $1,000 each from IACS Technologies Inc., Thinh Le, Nhan Thi Le and Hong Dinh Le in relation to the $5,000 cheque.

• The $5,000 cheque is made out to I.H.I. Holdings Ltd. The Promissory Note is signed by Mr. Abou-Rached on behalf of both himself and RAR with no explanation.

• The timing of the debt is questionable. It arises shortly after judgment in the Litigation. Prior to that, there was no debt between the Small Five Creditors and CHT.

39 In addition, they note that Mr. Coston voted on behalf of 27 creditors with similar cheques and promissory notes filed as proofs of claim or invoices and agreements to pay. Moreover, he was observed at the meeting soliciting the assistance of Mr. Abou-Rached and his counsel in filling out the forms.

40 The Trustee submits that the proofs of claim had been reviewed by both the Trustee and representative from the office of the Superintendent of Bankruptcy. They concluded that the claims were sufficient. He submits further that a promissory note is evidence of a debt and noted that there were warnings with respect to false filings on the proof of claim forms. These claims were for amounts smaller than the potential fines. He observed that the documentation with respect to these claims was in fact more extensive than that frequently encountered in bankruptcy proceedings.

41 Upon a review of the evidence and submissions, I have concluded, for the reasons as stated by the Trustee, that the creditors Cheung, Coston, Hoang, IACS, Thinh Le, Nhan Thi Le and Hong Dinh Le have, on the balance of probabilities, and based on the evidence before me, have established that they have claims provable in the proposal.

42 The dissenting creditors also appeal the decision of the Trustee to allow SRI to vote on the proposals. The dissenting creditors submitted that SRI was not dealing at arms length, and that the debts claimed were not *bona fide*.

43 Section 109(6) of the *Act* provides:

**Creditor not dealing at arm's length** — Except as otherwise provided by this Act, a creditor is not entitled to vote at any meeting of creditors if the creditor did not, at all times within the period beginning on the day that is one year before the date of the initial bankruptcy event in respect of the debtor and ending on the date of the bankruptcy, both dates included, deal with the debtor at arm's length.

44 The question of what is meant by arms length, for purposes of the *Act*, is dealt with in ss. 3 and 4, which provide:

3.(1) **Reviewable transaction** — for the purposes of this Act, a person who has entered into a transaction with another person otherwise than at arm's length shall be deemed to have entered into a reviewable transaction.

(2) **Question of fact** — It is a question of fact whether persons not related to one another within the meaning of section 4 were at a particular time dealing with each other at arm's length.

(3) **Presumption** — Persons related to each other within the meaning of section 4 shall be deemed not to deal with each other at arm's length while so related.

4.(1) **Definitions** — In this section

"related group" means a group of persons each member of which is related to every other member of the group;

"unrelated group" means a group of persons that is not a related group.

(2) **Definition of "related persons"** — For the purposes of this Act, persons are related to each other and are "related persons" if they are

  

(a) individuals connected by blood relationship, marriage, common-law partnership or adoption;

(b) a corporation and

(i) a person who controls the corporation, if it is controlled by one person,

(ii) a person who is a member of a related group that controls the corporation, or

(iii) any person connected in the manner set out in paragraph (a) to a person described in subparagraph (i) or (ii); or

(c) two corporations

(i) controlled by the same person or group of persons,

(ii) each of which is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation,

(iii) one of which is controlled by one person and that person is related to any member of a related group that controls the other corporation,

(iv) one of which is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,

(v) one of which is controlled by a related group a member of which is related to each member of an unrelated group that controls the other corporation, or

(vi) one of which is controlled by an unrelated group each member of which is related to at least one member of an unrelated group that controls the other corporation.

(3) **Relationships** — For the purposes of this section,

(a) where two corporations are related to the same corporation within the meaning of subsection (2), they shall be deemed to be related to each other;

(b) where a related group is in a position to control a corporation, it shall be deemed to be a related group that controls the corporation whether or not it is part of a larger group by whom the corporation is in fact controlled;

(c) a person who has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, shares in a corporation, or to control the voting rights of shares in a corporation, shall, except where the contract provides that the right is not exercisable until the death of an individual designated therein, be deemed to have the same position in relation to the control of the corporation as if he owned the shares;

d) where a person owns shares in two or more corporations, he shall, as shareholder of one of the corporations, be deemed to be related to himself as shareholder of each of the other corporations;

(e) persons are connected by blood relationship if one is the child or other descendant of the other or one is the brother or sister of the other;

(f) persons are connected by marriage if one is married to the other or to a person who is connected by blood relationship or adoption to the other;

  

> (f.1) persons are connected by common-law partnership if one is in a common-law partnership with the other or with a person who is connected by blood relationship or adoption to the other; and
>
> (g) persons are connected by adoption if one has been adopted, either legally or in fact, as the child of the other or as the child of a person who is connected by blood relationship, otherwise than as a brother or a sister to the other.

45 There is no evidence before me that SRI is a related person with respect to either Mr. Abou-Rached or RAR within the meaning of section 4 of the *Act*.

46 The next question is whether SRI is, in any event, not dealing at arm's length with Mr. Abou-Rached or RAR. This is a question of fact. The test articulated in *Gingras, Robitaille, Marcoux Ltée v. Beaudry* (1980), 36 C.B.R. (N.S.) 111 (Que. S.C.), at 112 is:

> . . . a transaction at arm's length could be considered to be a transaction between persons between whom there are no bonds of dependence, control or influence, in the sense that neither of the two co-contracting parties has available any moral or psychological leverage sufficient to diminish or possibly influence the free decision-making of the other. Inversely, the transaction is not at arm's length where one of the co-contracting parties is in a situation where he may exercise a control, influence or moral pressure on the free will of the other. Where one of the co-contracting parties is, by reason of his influence or superiority, in a position to pervert the ordinary rule of supply and demand and force the other to transact for a consideration which is substantially different than adequate, normal or fair market value, the transaction in question is not at arm's length.

47 While considerable time was spent in submissions with respect to this issue, there is, in my view, no evidence before me of bonds of dependence, control, influence or moral pressure between Mr. Abou-Rached and SRI such that the ordinary rules of supply and demand are not operative. The dissenting creditors have not satisfied me on a balance of probabilities that SRI and Mr. Abou-Rached were not dealing at arm's length.

48 The dissenting creditors submit that the debts of SRI and the Group of Five; namely, Randers International Ltd., Rosebar Enterprises Limited, Sirmac International Ltd., Veda consult S.A. and Yarold Trading Ltd. are not *bona fide*, but rather represent a collusive effort on the part of Mr. Abou-Rached and the creditors to deprive the dissenting creditors of the fruits of the judgment in the Litigation. This argument is premised upon the assumption that virtually every transaction entered into by Mr. Abou-Rached or his associated companies since the first attempt at conversion was in fact directed to this collusive end. There is, however, no evidence before me in support of this fundamental assumption.

49 There is another, and perhaps simpler, explanation for the transactions; namely, that the investors were investing in the development of the Technology. The Technology is a real innovation, apparently of some promise. The dissenting creditors, whatever their current views of Mr. Abou-Rached, believed in the promise of the Technology, at least at the outset. They invested in the development of the Technology. There is no reason to believe that other investors would not and did not have the same faith in the Technology as that of the dissenting creditors.

50 There is also no evidence that funds were diverted or used for some other purpose, although in fairness to the dissenting creditors, they do question whether and to what extent the funds represented by some of the proofs of claim were advanced at all. Again, however, there is no evidence before me that funds were not advanced.

51 The Trustee drew some comfort from the fact that the majority of these transactions occurred before judgment was pronounced in the Litigation and that the basic nature and kind of documentation of the transactions was similar from the very outset.

52 The dissenting creditors submit that there is reason to question the dates of many of the transactions. However, while the transactions may be questionable, there is no evidence before me which would support a conclusion that the transactions did not occur as reflected in the documents.

53 The dissenting creditors also submit that the date of judgment is not the critical date, but rather the key point is the date of the first request for conversion. However, that date is very close to the inception of the whole enterprise. Thus the period during which the dissenting creditors allege these collusive transactions occurred covers effectively the entire period during which investors were being sought to develop the Technology. Again there is no evidence before me that the impugned transactions were other than what they purport to be.

54 In short, I am unable to conclude that the transactions criticized by the dissenting creditors are other than *bona fide*.

55 Finally, the dissenting creditors rely upon s. 111 of the *Act*. That section provides:

> 111. **Creditor secured by bill or note** — A creditor shall not vote in respect of any claim on or secured by a current bill of exchange or promissory note held by him, unless he is willing to treat the liability to him thereon of every person who is liable thereon antecedently to the debtor, and who is not a bankrupt, as a security in his hands and to estimate the value thereof and for the purposes of voting, but not for the purposes of dividend, to deduct it from his claim.

56 The submission with respect to s. 111 was that, with respect to the claim of the Five Small Creditors, IHI was primarily liable for the debt and the debtor was a guarantor, secondarily liable. Since IHI is not a bankrupt or filing a proposal, when the IHI amount is deducted, the value of the claim is reduced to zero.

57 A similar argument was made with respect to all but the first $1.5 million of the SRI claim. The loan was made, it was submitted, to RARC, which is neither a party to the Proposals nor a bankrupt. It is the primary debtor and RAR was merely the guarantor. The amount to which the non-bankrupt party, RARC, is liable should therefore be subtracted from the claim for voting purposes.

58 Counsel were not able to provide any authorities commenting upon the interpretation of this provision of the *Act*.

59 Counsel for SRI and the Group of Five submitted that, pursuant to s. 179(2) of the *Bills of Exchange Act*, the relevant promissory notes are, in fact, joint and several promissory notes in that the notes bear the words "I promise to pay" and are signed by two or more people.

60 Second, SRI submitted that s. 111 does not require the reduction of any claim by reason of cross guarantees. Where there is a guarantee, the guaranteed amount can be claimed in full. The Trustee also submitted that, in his experience, this represents the practice.

61 Finally, counsel notes that SRI did in fact estimate the value of its security and subtract it from the amount of its claim. Its full claim was $18,812,876.46 from which it deducted $7,425,000 representing the security it holds.

62 I have concluded that the disputed claims are evidenced by loan agreements and promissory notes. The promissory notes are joint and several notes. The value of security held by the creditor has been deducted from the claims. There is no basis on which to disallow these claims from voting with respect to the proposal.

63 Accordingly, the appeals from the Trustee's decision to permit these creditors to vote with respect to the Proposals is dismissed.

## IV. REVIEW OF THE PROPOSALS PURSUANT TO SECTION 59 OF THE *ACT*

64 The process with respect to court approval of a proposal is set out in s. 59 of the *Act* which provides in part:

> (2) Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal, and the court may refuse to approve the proposal whenever it is established that the debtor has committed any one of the offences mentioned in sections 198 to 200.

 

65 The court is not bound to approve a proposal even if it has an unqualified recommendation of the Trustee and the overwhelming support of creditors, see *Grobstein v. Brock Mills Ltd.* (1961), 2 C.B.R. (N.S.) 103 (Que. S.C.). However, where, as here, a proposal has been approved by a large majority of creditors and recommended by the Trustee, substantial deference will be given to their views.

66 For example, the Court in *Gustafson Pontiac Buick Cadillac GMC Ltd., Re* (1995), 30 C.B.R. (3d) 280 (Sask. Q.B.) cited the following passage from Houlden & Morawetz, *Bankruptcy and Insolvency Law of Canada*, 3rd ed., (Toronto: Carswell, 1993) in refusing to reject a proposal approved by a majority of creditors: "If, however, a large majority of creditors, i.e., substantially in excess of the statutory majority, have voted for acceptance of a proposal, it will take strong reasons for the court to substitute its judgment for that of the creditors".

67 In determining whether to approve a proposal, the court must consider the wishes and interests of the creditors, the conduct and interest of the debtor, the interests of the public and future creditors and the requirements of commercial morality, see *Lofchik, Re* (1998), 1 C.B.R. (4th) 245 (Ont. Bktcy.).

***A. Are the Terms of the Proposal Reasonable?***

68 The first question to be addressed is whether the terms of the proposal are reasonable. Reasonable in this context has been determined to mean that the proposal must have a reasonable possibility of being successfully completed in accordance with its terms. In addition, the proposal must meet the requirements of commercial morality and must maintain the integrity of the bankruptcy system, see *Lofchik, Re, supra.*

69 The onus is on the Trustee and the creditors who support the proposal to establish that the proposal is reasonable, see *McNamara v. McNamara* (1984), 53 C.B.R. (N.S.) 240 (Ont. Bktcy.).

70 The Trustee in this case concluded that there were no unencumbered assets of any value which could be ascertained that would be available to unsecured creditors in the event of a bankruptcy. The amount of excess income was minimal and likely less than the Trustee's fees and disbursements.

71 The Proposals provide for certain recovery for the unsecured creditors. There is a guaranteed payment by means of an infusion of cash.

72 The dissenting creditors submit that the Proposals are simply another attempt by the debtors to avoid honouring the judgment debt owed to Genesee and the costs awarded to the Defendants by Counterclaim in the Litigation. They submit that the proposals are not reasonable. The factors on which they rely include: the past conduct of the debtor, the reviewable transactions, the limited recovery provided by the proposal, and the fact that the proposals would preclude full investigation of the reviewable transactions. They add to this the fact that the proposal requires them to release the debtors with respect to any claims under the *Act* and any claims of fraudulent preferences, conveyance, settlement or trust.

73 It is clear that the proposal has a reasonable prospect of succeeding according to its terms. For the reasons cited by the Trustee, it is in the interests of the creditors.

74 The debtors have minimal assets. The Proposals contemplate an injection of cash and shares at a guaranteed value such that payments under the Proposals will be secured.

75 The assets which are the subjects of the allegedly fraudulent dispositions are, in any event, encumbered beyond their market value in favor of secured creditors.

76 Reprehensible conduct on the part of the debtor has been considered a basis for concluding that a discharge or proposal is not reasonable. In *Touhey v. Barnabe*, [1995] O.J. No. 2337 (Ont. Bktcy.), one such case, a discharge was refused. The grounds for refusal were summarized in the headnote as follows:

> . . . At the date of bankruptcy the bankrupt was not insolvent, and the evidence established that he declared bankruptcy solely to avoid the $100,000 debt resulting from the judgment. The bankrupt never made any payment to the creditors, nor did he ever attempt to settle with them. With the income available to him over such a long period of time it was inconceivable that the bankrupt actually had no personal assets. He had inappropriate expenses in light of his obligations. The bankrupt attempted to flaunt the system and his behaviour was reprehensible. He did not merit a discharge.

77 In the present case, Justice Levine found Mr. Abou-Rached's conduct in the Litigation to be worthy of rebuke. I have concluded that that conduct fell within the scope of s. 173(f) of the *Act*. However, I have not concluded, nor did the Trustee, that the Proposals were filed solely to avoid the judgment; that other s. 173 facts have been made out; or that there has been other reprehensible conduct such as dissipation or diversion of assets. Without for a moment condoning Mr. Abou-Rached's conduct in the course of the Litigation, I have nonetheless concluded that the requirements of commercial morality do not necessitate a refusal to approve the Proposals. I find the Proposals to be reasonable.

***B. Are the Proposals Calculated to Benefit the General Body of Creditors?***

78 Courts have refused to approve proposals on this basis where, for example, the proposal serves the interests of persons other than the creditors; where there has not been full disclosure of the assets of the debtor and the encumbrances against those assets; where the proposal, by it terms, is bound to fail; or where the Trustee is able to delegate his duties to a group of the creditors, see *Houlden & Morawetz, 2001 Annotated, Bankruptcy & Insolvency Act* at para. E15(10)(c); *Lofchik, Re, supra*.

79 In the case of these Proposals, the Trustee and supporting creditors note that the Proposals provide for an evenhanded distribution. The claims of the family have not been included; nor have claims of related parties. There has been, it is submitted, full disclosure of assets and encumbrances. Moreover, it is submitted that the recovery is greater under the Proposals than it would be in the event of a bankruptcy.

80 The dissenting creditors submit that the Proposals are not in the interests of the creditors. They rely upon the arguments advanced in connection with the reasonableness of the proposal.

81 In addition, they submit that there has not been proper disclosure of the debtors' assets. Two matters in particular are raised in this connection:

(a) the disposition of personal assets valued by Mr. Abou-Rached in 1995 at $700,000;

(b) certain payments or income of the debtor;

82 With respect to the latter, the Trustee notes that he was aware of the payments or income. The Proposals are not dependent upon the cash flow of the debtors. They are funded by an infusion of cash from third parties. Hence the income has no effect upon the viability of the Proposals. In addition, the amounts at issue are modest.

83 With respect to the personal assets, the Trustee was aware of the issue and considered it in coming to his opinion. He was of the view, first, that the assets had been accounted for, and second, that their realizable value was not anywhere near $700,000.

84 For the reasons enumerated by the Trustee and in the earlier discussion with respect to reasonableness, I have concluded that the Proposals are in the interests of the creditors.

**V. ARE ANY OF THE FACTS ENUMERATED IN SECTION 172 MADE OUT AGAINST THE DEBTORS?**

85 Section 59(3) of the *Act* provides:

> Where any of the facts mentioned in s. 173 are proved against the debtor, the court shall refuse to approve the proposal unless it provides reasonable security for the payments of not less than fifty cents on the dollar on all the unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct.

86 In this case, the dissenting creditors submit that the Proposals should not be approved because s. 173 facts are present and the Proposals do not provide for recovery of fifty cents on the dollar.

87 The following provisions of s. 173 of the *Act* are at issue in these proceedings:

> 173.(1) The facts referred to in section 172 are:
>
> (a) the assets of the bankrupt are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities, unless the bankrupt satisfies the court that the fact that the assets are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities has arisen from circumstances for which the bankrupt cannot justly be held responsible;
>
> . . . . .
>
> (d) the bankrupt has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet the bankrupt's liabilities;
>
> . . . . .
>
> (f) the bankrupt has put any of the bankrupt's creditors to unnecessary expense by a frivolous or vexatious defence to any action properly brought against the bankrupt;
>
> . . . . .
>
> (k) the bankrupt has been guilty of any fraud or fraudulent breach of trust;

***A. Value less than fifty cents on the dollar***

88 It is common ground that the debtors' assets are less than fifty cents on the dollar of the unsecured liabilities. The question, therefore, is whether this shortfall has arisen from circumstances for which the bankrupt cannot justly be held responsible.

89 The Trustee concluded that the debtors were not responsible for the shortfall of the assets. His report states:

> 1. In order to raise money to finance the operations of IHI and to develop the technology licensed to IHI, the Debtor was required to pledge all of his interest in IHI as well as guarantee (directly and indirectly) various investments made by others in IHI;
>
> 2. A downturn in the stock market, and a decrease in the trading price of shares in IHI in the stock market made it more difficult to raise funds for the ongoing operations of IHI and the Debtor continued to incur further financial obligations;
>
> 3. A Judgment was pronounced and a legal action commenced against the Debtor, R.A.R. Investments Ltd. ("RAR") and CHT. The legal action that led to the Judgment was ongoing for approximately four and one-half years and throughout that time, the Debtor steadfastly believed the Plaintiff's claim would be dismissed in its entirety. A significant portion of that claim resulted in a Judgment being pronounced against the Debtor and RAR. The Debtor had not expected any part of the Plaintiff's claim to be successful. The amount of that Judgement was approximately $975,000 (excluding costs);
>
> 4. One of the Debtor's major Creditors made demand upon learning of the said Judgment; and
>
> 5. Although an appeal of the Judgment has been filed, the Debtor concluded that it would be in the best interest of his Creditors and himself if his remaining sources of funds and energy were directed to payment of all of his Creditors rather than to prosecuting the appeal.

 

90 The dissenting creditors, relying on *Forsberg, Re* (2001), 26 C.B.R. (4th) 204 (Sask. Q.B.), submit that Mr. Abou-Rached is responsible for the shortfall in assets because he provided guarantees in circumstances in which he knew that he did not have sufficient assets to satisfy the guarantees.

91 Counsel for Mr. Abou-Rached disputes this claim noting that, although the majority of the shares had not yet been released from escrow, Mr. Abou-Rached held some 25,000,000 shares in IHI. Between 1995 and 1999, the median share price was $2.41 (see *Genesee Enterprises Ltd., supra*, at p. 337). Thus, at the time he provided the guarantees, he had assets to support the guarantees given.

92 I have concluded that the dissenting creditors have not established that the debtors are responsible for the shortfall in the value of their assets.

***B. Has the debtor failed to account satisfactorily for any loss of assets or for any deficiency of assets?***

93 The submissions with respect to this allegation have been dealt with above. In order for the dissenting creditors to make out this allegation, they must rely upon the values set out by Mr. Abou-Rached in earlier statements of net worth that he prepared. Mr. Abou-Rached deposed that these values were overstated. I put little weight on this assertion; however, the Trustee was of the same opinion, in other words, that the net worth statements upon which the dissenting creditors rely, do not reflect the realizable value of the assets.

94 I have concluded that the dissenting creditors have not established that the debtor has not given a satisfactory account for loss of assets or deficiency of assets.

***C. Has the debtor put any of his creditors to unnecessary expense by a frivolous or vexatious defence to any action properly brought against him?***

95 The dissenting creditors submit that the reasons of Justice Levine in the Litigation establish that this fact has been made out. That the action was properly brought is established by the fact that the plaintiff enjoyed substantial success, being awarded damages of $982,746.94 plus court order interest. However, it must also be noted that the plaintiff's success was not complete; the recovery was substantially less than the amount claimed.

96 Justice Levine made extensive findings with respect to Mr. Abou-Rached's credibility and conduct in the Litigation. First, with respect to credibility:

> Mr. Abou-Rached accuses Robert de Grasse in particular of fabricating evidence, including documents, and stealing documents relevant to the proof of the defendants' case. He claims that Jean de Grasse and the other defendants by counterclaim either misstated the facts or failed to accurately recall them.
>
> . . . . .
>
> In general, however, I find myself skeptical about the credibility of the evidence of Mr. Abou-Rached with respect to many of the details of events, documents or transactions.

97 After a second hearing to deal with costs, Justice Levine ordered special costs to the plaintiff of its claim for 45 of the 49 days of trial, special costs to the plaintiff and the Defendants by Counterclaims of defending the counterclaim . Her reasons state:

> [6] This litigation is almost a case-study on the factors that the courts have considered in awarding special costs. I have no trouble finding that the conduct of the defendants was "reprehensible, deserving of reproof or rebuke", and in some cases, "scandalous and outrageous" (*Garcia v. Crestbrook Forest Industries Ltd.* (1997), 9 B.C.L.R. (3d) 242 at 249 (C.A.)).
>
> [7] The conduct of the defendants that I find justifies an order of special costs includes improper allegations of fraud, unlawful conspiracy, breach of fiduciary duty and criminal conduct; improper conduct during the proceedings; and improper motive for bringing the proceedings.

**(a) Improper allegations of fraud, unlawful conspiracy, breach of fiduciary duty and criminal conduct**

[8] The allegations of criminal conduct included a claim that the plaintiff was claiming interest in excess of the criminal rate set by the ***Criminal Code***. This allegation was withdrawn on the eve of trial.

[9] At examination for discovery and during his testimony at trial, Mr. Abou-Rached accused Robert de Grasse of forging Mr. Abou-Rached's signature on documents, preparing false documents and stealing documents from the defendants. He accused plaintiff's counsel of obstruction of justice, including witness tampering. There was no evidence to support any of these claims.

[10] The defendants' claims of fraudulent misrepresentation, unlawful conspiracy and breach of fiduciary duty were all dismissed. The evidence simply did not support them. The defendants repeatedly failed to give the plaintiff and defendants by counterclaim particulars of the alleged fraud, conspiracy, breach of fiduciary duty, or damages, and failed to provide any particulars of damages in their closing submissions at trial.

. . . . .

[13] The defendants conducted themselves improperly during the proceedings in a number of ways.

[14] Firstly, the defendants did not disclose documents in the manner required by the ***Rules of Court***, standards of practice, or in response to court orders. In *Clayburn Industries v. Piper* (1998), 62 B.C.L.R. (3d) 24 at 51 (S.C.), the failure to produce documents was a significant factor in determining that special costs were appropriate.

. . . . .

[16] Some documents were produced in part only (for example, one page of several of a memorandum) and documents which would have been in the defendants' possession and control were never produced (such as the executed Genesee Agreement for each investor, letters sent to prospective investors in CHT and employment records of Robert de Grasse). The defendants produced documents that supported their case (such as the "Fadel Agreement" and a document with handwritten notes purporting to confirm Mr. Abou-Rached's conversations with Robert de Grasse concerning this agreement), but did not produce those which contradicted it (such as the "Gougassian agreement").

[17] Secondly, Mr. Abou-Rached, the key witness for the defendants, was deliberately non-responsive during both examination for discovery and at trial. I commented on Mr. Abou-Rached's testimony in my reasons for judgment at paras. 31 through 38, and need not repeat those comments here.

[18] Thirdly, some of Mr. Abou-Rached's testimony was obviously fabricated. These include his claim that he discussed the terms of the "Fadel Agreement" with Robert de Grasse and the document containing the handwritten notes purporting to record that conversation; his continual denial that he signed or read documents that were supportive of the plaintiff and DCCs; and his reference to a chart setting out the value of an investment in Genesee which he purportedly discussed with Jean de Grasse and Robert de Grasse. The testimony of Sandy Lucas and Robert de Grasse regarding documents purportedly signed by Sheik Fadel must lead to the conclusion that at least some of those were signed by Mr. Abou-Rached, which he denied.

[19] I am prepared to accept that some of Mr. Abou-Rached's fabrications were not deliberate or dishonest lies, but resulted from his belief in the strength of his case. On the other hand, some of his testimony was too contrived, particularly with respect to his relationship (personal and business) with Sheik Fadel, to accept as anything other than calculated to deceive the court.

[20] Fourthly, Mr. Abou-Rached's behavior during examination for discovery and at trial was often inappropriate to the point of accurately being described as "outrageous" or "scandalous". Mr. Abou-Rached insulted the DCCs, who were also witnesses for the plaintiff, and counsel. As already noted, he accused plaintiff's counsel of obstruction of justice and witness tampering, and questioned the competence of counsel for the plaintiff and DCCs.

**(c) Improper motive**

[21] The defendants' conduct throughout these proceedings indicates that they sought to delay and hinder the plaintiff from recovering its claim under the Genesee Agreement and to harass the DCCs.

[22] The defendants' claims that the parties had entered into a collateral "Investment Agreement", in addition to the claims of fraudulent misrepresentation, conspiracy and breach of fiduciary duty, had the direct effect of prolonging the trial so that the entire history of the parties' relationship, in particular that of Mr. Abou-Rached, Jean de Grasse and Robert de Grasse, could be explored in great detail. All of these claims were dismissed.

[23] The claims against the 13 DCCs other than Jean de Grasse and Robert de Grasse were particularly without merit, and were all but abandoned halfway through the trial. These DCCs had attempted to have their cases resolved by an aborted Rule 18A application, but the defendants refused to cooperate. They then sought to have their evidence admitted by affidavit, which the defendants again resisted. In ordering the 13 DCCs to attend the trial to be cross-examined, I noted that if their evidence proved not to be controversial or did not materially add to the information in the affidavits, costs could be ordered to remedy the situation (see Rules 40(50) and (51)). The 13 DCCs, other than Jean de Grasse and Robert de Grasse, are entitled to their costs of attending the trial, which their counsel has advised total $8,548.47.

[24] As I pointed out in my reasons for judgment, most of the evidence about Shiek Fadel, his existence and role in the Genesee Agreement, was interesting but unnecessary. The only issue (other than Mr. Abou-Rached's credibility) that related to Shiek Fadel was whether the Fadel Agreement amended the Genesee Agreement. I found no legal basis for that part of the defendants' claim. The pre-trial applications, evidence and argument on this issue unduly prolonged the trial in support of a clearly unmeritorious claim.

[25] The defendants delayed and hindered these proceedings by refusing to comply with the rules relating to document disclosure, as outlined above. Mr. Abou-Rached's non-responsiveness on examination for discovery and at trial prolonged both pre-trial proceedings and the trial, increasing the expense for all parties.

. . . . .

[28] Mr. Abou-Rached took an interest in the ability of the plaintiff and DCCs to afford this litigation. He admitted at trial that he commented at his examination for discovery that he wondered how the DCCs were financing the litigation and that someone must be paying their legal expenses. At trial, he said that the plaintiff and DCCs could not afford to litigate.

[29] Some of the factors described above could support, on their own, an award of special costs. Taken together, I find that this is an appropriate case to exercise my discretion and order that the plaintiff and DCCs recover special costs.

98 The Trustee relied upon Mr. Abou-Rached's professed conviction in the merits of his defence in support of his conclusion that the facts in s. 173(f) were not made out.

99 Counsel for Mr. Abou-Rached and RAR submits that the defence cannot be said to have been frivolous or vexatious because it was substantially successful in that the plaintiff obtained judgment, but for significantly less than the original claim.

100 Counsel conceded that the claim against the Defendants by Counterclaim was frivolous and vexatious, but submits that since the counterclaim was a claim advanced by the debtors, it fell under s. 173 (g) of the *Act* and not 173(f). Section 173(g) has a three month time limitation period from the original bankruptcy event. In this case, the original bankruptcy event was October 1, 2001. Accordingly, the counterclaim falls outside the limitation period and s. 173(g) therefore also does not apply.

101 I have concluded that the dissenting creditors have established the s. 173(f) facts in that the conduct of the defence was frivolous and vexatious. It is clear from Justice Levine's reasons and disposition with respect to costs, and from a review of the pleadings in the action, that the distinction between the defence and the prosecution of the counterclaim urged upon me cannot be supported.

102 Moreover, the scope of the section embraces the conduct of the litigation, hence neither the debtor's belief in the merits of his position, nor the fact that he enjoyed a measure of success in the outcome is a complete answer, see *Paskauskas, Re* (1995), 36 C.B.R. (3d) 288 (Ont. Bktcy.) and *Touhey, supra*. Here there is reprehensible conduct including deliberate deceit and delay, and a finding of improper motive. This is, in my view, clearly sufficient evidence to support a finding of a frivolous or vexatious defence under the section.

***D. Have the debtors been guilty of fraud or fraudulent breach of trust?***

103 The dissenting creditors alleged that the following transactions were fraudulent dispositions of property:

(a) in late 1999 and early 2000, Roger Abou-Rached transferred 2,733,333 IHI shares to Garmeco (Lebanon) at a value of $0.75 per share.

(b) In mid 2001, Roger Abou-Rached transferred to his parents for no, or alternatively inadequate consideration, all his interests in Lebanese real estate that he had variously valued in the past at $1.8 million or in excess of $4 million (USD).

(c) In August, 2000, R.A.R. transferred its interests in commercial property on West 10th Avenue, Vancouver, B.C. to a numbered company wholly owned by Roger Abou-Rached's mother.

(d) In late 1999 and 2000 Roger Abou-Rached transferred or pledged all his interests in R.A.R. and in R.A.R. Consulting Ltd. to his parents' companies or to a group of foreign corporations represented by Marco Becker.

(e) Roger Abou-Rached has not accounted for the transfer of personal property estimated by him to be worth $700,000 in 1995. (This claim is dealt with earlier in these reasons).

*1. IHI Shares*

104 The essence of this claim is that Mr. Abou-Rached, on the eve of the trial of the Litigation, transferred 2 million IHI shares to Garmeco Lebanon. In February 2000, a further 733,333 shares were transferred. Mr. Abou-Rached testified that these transfers went to repay the $5 million debt owed to Garmeco Lebanon incurred from the purchase of the Technology. However, counsel submits that the money was to be repaid only from cash flow or dividends.

105 The documents in relation to the agreement to transfer the Technology are as follows:

(a) Assignment of Technology signed August 31, 1993, effective September 11, 1990;

(b) Letter dated September 12, 1990 from Garmeco to Wild Horse Industries Ltd (later IHI). This document states in part:

> As well, Garmeco and Garmeco Int'l acknowledge the transfer of the technology of the building system developed by Roger Abou-Rached while employed by Garmeco Int'l which will be utilized by Canadian HI-TECH Manufacturing Ltd.. In return for the transfer of this technology to Mr. Roger Abou-Rached, he will provide remuneration for the direct expenses incurred by Garmeco Int'l (i.e. employee wages, materials, purchase of equipment and computers, purchase of software, software development, consultation, etc.) during the research and development of the technology. The remuneration from Mr. Roger Abou-Rached to Garmeco Int'l will comprise of $5,000,000 US Dollars and will be paid on a prorata basis based on the following formula: $100,000 of every $1,000,000 of net cash flow from Canadian Hi-Tech Manufacturing Ltd. dividends to Roger Abou-Rached.

(c) a promissory note dated September 12, 1990 which provides in part:

> FOR VALUE RECEIVED THE UNDERSIGNED HEREBY ACKNOWLEDGES ITSELF INDEBTED AND PROMISES TO PAY THE ABOVE PRINCIPAL SUM, ON DEMAND, TO OR TO THE ORDER OF GARMECO INTERNATIONAL CONS. (LEB) (THE "HOLDER") AND/OR ANY OF ITS NOMINEE AND/OR ANY

ASSOCIATES AND/OR ANY AFFILIATED PERSONS OR ENTITIES THE HOLDER MAY DIRECT IN WRITING.

THE UNDERSIGNED MAY PAY THIS NOTE IN WHOLE OR IN PART WITHOUT NOTICE WITH 10% DISCOUNT TO BE CALCULATED AFTER THE WHOLE PRINCIPAL SUM IS PAID & PRIOR TO THE HOLDER SENDING ANY DEMAND NOTICE FOR PAYMENT OF THE ABOVE PRINCIPAL SUM IN FULL OR IN PART.

106 In response, counsel submit that there is no remedy under the *Act* with respect to this transaction because:

(a) it is not a settlement pursuant to s. 91(1) of the *Act* as it was not a gift, nor was any beneficial interest retained and it was to repay a debt;

(b) the initial bankruptcy event for both debtors was October 1, 2001 when the Notices of Intention to File Proposals were filed. The transactions fall outside the relevant limitation periods for review under the Act.

107 It is further submitted that the transactions are not reviewable under the Provincial legislation because there is no evidence that the transfers were made to delay or hinder creditors, or that they were made when the debtor was in insolvent circumstances. Moreover, it is submitted that the transfers were made for valuable consideration.

*2. Lebanon Properties*

108 Mr. Abou-Rached held interests in Lebanese real estate. The dissenting creditors assert that this real estate, valued in 1992 by Mr. Abou-Rached at $1,800,000, was transferred to his parents in the summer of 2001 for inadequate consideration. They asserted in addition that no transfer documents had been produced.

109 In response, it was asserted that the agreement to transfer the real estate was made on September 29, 1997. The consent of SRI was required for the transfer. Thus, there was a binding agreement to transfer the property well before the relevant limitation period, made at a time when the debtor was not insolvent.

110 It was further submitted that the transfer was made for fair and reasonable consideration. There was no evidence that it was made with an intent to hinder, delay or defraud creditors.

111 The registration of the transfer was not made until mid-2001; however, the reason for the delay in the registration was the negotiation to secure SRI's consent to the transfer.

*3. RARC and RARI shares*

112 The dissenting creditors also question a series of transactions which occurred at the beginning of the trial of the Litigation in which Mr. Abou-Rached transferred his interests in RARC and RARI to various companies, mainly SRI and five companies represented by Mr. Marco Becker, the principal representative of SRI. Mr. Abou-Rached transferred his interests in RARC to his parent's companies, Garmeco Canada and Garmeco Lebanon.

113 All pledges and transfers are subject to Mr. Abou-Rached recovering the shares on payment of an appropriate sum. The shareholders are obliged to maintain Mr. Abou-Rached as manager and director.

114 In response, it is submitted that these transfers were all made for fair consideration at a time when Mr. Abou-Rached was not insolvent. The transactions were not made with the intention to hinder or defeat creditors. They occurred outside the relevant limitation periods under the *Act*. In short, it is submitted that these are not reviewable transactions under the *Act* or under Provincial legislation.

*4. 1096 West 10th Ave. Property*

115 The final disputed transaction is in reference to the property located at 1096 West 10th Avenue, Vancouver. The dissenting creditors assert that RAR granted a second mortgage on the property to a numbered company wholly owned by Hilda Abou-Rached, 434088 B.C. Ltd. In June 1995, following the hearing of the Petition before Henderson J., Abou-Rached increased the value of the second mortgage from $400,000 to $1 million. Roger Abou-Rached has not explained or accounted for the increase.

116 RAR transferred the property to 434088 B.C. Ltd. August 2000, shortly after the conclusion of the Genesee trial. The reported consideration of $1,250,000 has not been documented. The consideration falls short of the value of $3,000,000 given by Abou-Rached in 1995.

117 In response, it is submitted that the property was owned by RARI not by Mr. Abou-Rached. In 1995, Hilda Abou-Rached, Mr. Abou-Rached's mother, purchased 434088 B.C. Ltd. (the "Company") for the amount due on the mortgage of the 1096 property when Mr. Abou-Rached could not refinance. At the time, Robert de Grasse was a director of the Company.

118 In August 2000, the property was transferred to the Company. The consideration was:

(a) the assignment of the liability under the existing mortgages; namely $700,000 to CIBC Mortgage Corporation, $600,000 to the Company and $1,500,000 to SRI,

(b) $50,000 for chattels, and

(c) payment of a fee of $100,000 to SRI to permit assignment of the mortgage.

119 The value of the property at the time of the transfer was approximately $735,000. The property has an assessed value of $330,000.

120 It was submitted that the transaction was for fair consideration and is not a reviewable transaction. The debtor was not in insolvent circumstances when the transaction was entered into. Nor is there evidence that the transfer was made with the intent to defeat, hinder, delay or defraud creditors to give the Company a preference.

121 The Trustee reviewed these and other transactions and concluded:

> Further information and review is required before the Trustee can draw any definitive conclusions as to whether or not any particular transaction constitutes a settlement or fraudulent preference under the provisions of the ***Bankruptcy and Insolvency Act***. It is our preliminary view, however, certain transactions may be reviewable and warrant further investigation. To properly evaluate these transactions, an extensive forensic investigation or audit would be required and judicial consideration of the matters may be required. The time involved, expense, and risk of this process would be significant to the creditors. Moreover, if on completion of the forensic investigation or audit the inspectors and/or the creditors were of the view that one or more transactions were potentially voidable and they wished to challenge the validity of these transactions in Court, we are advised that any such challenges would be vigorously defended by the various secured and/or related parties. Therefore, although there may be an unknown recovery, there may also be a significant loss.

122 The jurisprudence in this province, binding upon me, is clear that, with respect to the factors enumerated in s. 173, an allegation of fraud or breach of trust can only be found where there had been a conviction or a finding of fraud by a judgment in a criminal or civil court, see *Herd, Re* (1989), 77 C.B.R. (N.S.) 209 (B.C. C.A.). There has been no such finding in this case.

123 The dissenting creditors submit that the *Act* is a federal statute and is to be applied consistently across Canada. There are jurisdictions in which a prior civil or criminal finding of fraud is not required. All jurisdictions require proof of fraud to have been met on at least the civil standard.

124 I am bound to follow the British Columbia jurisprudence and since there is no prior finding of fraud, that is the end of the matter. However, even if I were not so bound, I am satisfied that fraud has not been established on the evidence before me.

125 Questions arise with respect to the transactions in relation to their timing, the parties, and the underlying motivation. Mr. Abou-Rached's conduct in the Litigation was such as to give rise to questions in relation to any and all of his dealings. However, a substantial gulf separates questions and suspicions from a finding of fraud.

126 The dissenting creditors then submit, in the alternative, that if I conclude that there are "grounds for concern", the concern should form a basis upon which to conclude that the Proposals are not reasonable.

127 In the face of the Trustee's report and the approval of the majority of creditors, I am of the view that more than suspicion or grounds for concern must be shown in order for the Proposals to be found not to be reasonable. On a review of all of the circumstances, I remain satisfied that the Proposals are reasonable within the meaning of s. 59 of the *Act*.

## VI. ORDER FOR CROSS-EXAMINATION

128 In the further alternative, the dissenting creditors seek orders, pursuant to s. 163(2) of the *Act* to cross examine some fifteen individuals.

129 Section 163(2) provides:

> On the application to the court by the Superintendent, any creditor or other interested person and on sufficient cause being shown, an order may be made for the examination under oath, before the registrar or other authorized person, of the trustee, the bankrupt, an inspector or a creditor, or any other person named in the order, for the purpose of investigating the administration of the estate of any bankrupt, and the court may further order any person liable to be so examined to produce any books, documents, correspondence or papers in the person's possession or power relating in all or in part to the bankrupt, the trustee or any creditor, the costs of the examination and investigation to be in the discretion of the court. (emphasis added)

130 Counsel for SRI submits that sufficient cause has not been shown so as to justify the order sought. She relies upon *Hartland Pipeline Services Ltd. (Trustee of) v. Bennett Jones* (2000), 18 C.B.R. (4th) 28 (Alta. Q.B.), a decision in which two secured creditors sought cross-examination on an affidavit of a principal of the bankrupt company after the trustee had conducted an examination under section 163(1). In that decision, Paperny J. approved of the following passage from *NsC Diesel Power Inc., Re* (1997), 49 C.B.R. (3d) 213 (N.S. S.C. [In Chambers]):

> There must be some demonstrated connection between evidence, if any, of something being amiss and the ability of the named person to shed some light on it as it relates to the administration of the estate.

131 Counsel also made reference to the following statement from the Nova Scotia Court of Appeal in *NsC Diesel Power Inc., Re* (1998), 6 C.B.R. (4th) 96 (N.S. C.A.).

> The wording of s. 163(2) of the Act that requires an applicant to show sufficient cause to warrant the order being granted requires that the applicant put forth factual information in affidavit form or in sworn testimony that would disclose something more than a desire to go on a fishing expedition.

132 I have concluded that the material before me does not meet the threshold of sufficient cause. In my view the application suffers from the same lack of focus identified in *R.L. Coolsaet of Canada Ltd., Re* (1996), 45 C.B.R. (3d) 30 (Ont. Bktcy.), at 33, namely, " . . . a request in such broad terms suggests a lack of focus and a speculation that in a plethora of examinations some information may be forthcoming on which to frame an action."

133 The application for cross-examination is denied.

## VII. REASONABLE SECURITY

134 The final issue, a fact pursuant to s. 173 having been proved, is whether the Proposal should be approved. It is common ground that the Proposals do not provide reasonable security for the payment of not less than fifty cents on the dollar on all the unsecured claims. The question is whether, pursuant to s. 59(3) of the *Act*, the court is prepared to grant approval on the basis of some lesser recovery.

135 Given that the Proposals are viable and secured and given the paucity of assets of the debtors otherwise available to the creditors, I am prepared to exercise my discretion under s. 59(3) and approve the Proposals as amended.

## VII. DISPOSITION

136 In the result, the Proposals of Mr. Abou-Rached and RAR, as amended, are approved. The appeals from the decision of the Trustee are dismissed. The application for cross-examination is dismissed.

*Order accordingly.*

End of Document

# TAB 11

2013 ONSC 2212
Ontario Superior Court of Justice

917488 Ontario Inc. v. Sam Mortgages Ltd.

2013 CarswellOnt 4413, 2013 ONSC 2212, 228 A.C.W.S. (3d) 549

# 917488 Ontario Inc. Plaintiff (Defendant by Counterclaim) and Sam Mortgages Ltd. Defendant (Plaintiff by Counterclaim)

Robbie D. Gordon J.

Heard: March 22, 2013
Judgment: April 15, 2013
Docket: C-2023-12

Counsel: Laura L. Pinkerton (Agent) for Plaintiff / Defendant by Counterclaim
Sonja Turajlich for Defendant / Plaintiff by Counterclaim

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

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Real property --- Mortgages — Possession and ejectment — Right of mortgagee to possession — Miscellaneous**

Defendant held mortgage over plaintiff's property — Defendant issued notice of sale — Plaintiff brought action for declarations that it was entitled to redeem property and that notice of sale was defective — Defendant counterclaimed for judgment for amount due on mortgage and for possession — Defendant brought for summary judgment on counterclaim — Motion granted; defendant awarded possession and judgment for $654,706 — There could be little doubt that plaintiff was in default — Plaintiff failed to make payment for March 2012, or for 13 months thereafter — Plaintiff had recently remitted equivalent of 13 months' payments, but defendant was entitled to accelerated full payment — Defendant was entitled to bring action for possession of all or part of mortgaged property — It was not for court, at this stage of proceedings, to question defendant's decision to proceed as it had — Where mortgagee was acting lawfully, court would not intervene to dictate manner of realization — As plaintiff was not insolvent person under Bankruptcy and Insolvency Act, defendant's failure to give notice under s. 244 of Act was of no consequence.

**Bankruptcy and insolvency --- Miscellaneous**

Defendant held mortgage over plaintiff's property — Defendant issued notice of sale — Plaintiff brought action for declarations that it was entitled to redeem property and that notice of sale was defective — Defendant counterclaimed for judgment for amount due on mortgage and for possession — Defendant brought for summary judgment on counterclaim — Motion granted; defendant awarded possession and judgment for $654,706 — There could be little doubt that plaintiff was in default — Plaintiff failed to make payment for March 2012, or for 13 months thereafter — Plaintiff had recently remitted equivalent of 13 months' payments, but defendant was entitled to accelerated full payment — Defendant was entitled to bring action for possession of all or part of mortgaged property — It was not for court, at this stage of proceedings, to question defendant's decision to proceed as it had — Where mortgagee was acting lawfully, court would not intervene to dictate manner of realization — As plaintiff was not insolvent person under Bankruptcy and Insolvency Act, defendant's failure to give notice under s. 244 of Act was of no consequence.

**Table of Authorities**

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
Generally — referred to

s. 2 "insolvent person" — considered

s. 69 — considered

s. 244 — considered

s. 244(1) — considered

s. 248 — considered

*Planning Act*, R.S.O. 1990, c. P.13
Generally — referred to

*Registry Act*, R.S.O. 1990, c. R.20
Generally — referred to

**Rules considered:**

*Rules of Civil Procedure*, R.R.O. 1990, Reg. 194
R. 20.01(1) — considered

MOTION by defendant mortgagee for summary judgment on its counterclaim for amount due under mortgage and for possession.

***Robbie D. Gordon J.*:**

**Overview**

1 The Defendant is the holder of a mortgage on property owned by the Plaintiff. It says the mortgage is in default and issued a Notice of Sale.

2 In response to the Notice of Sale, the Plaintiff brought this action for a declaration that it is entitled to redeem the property and a declaration that the Notice of Sale is defective.

3 The Defendant counterclaimed seeking judgment for the amount due under the mortgage and possession of the mortgaged property.

4 This decision deals with the Defendant's motion for summary judgment on its counterclaim.

**Background Facts**

5 The Plaintiff is owner of property known municipally as 1 Water Street, Gore Bay, Ontario (hereinafter referred to as "the property"). It is a commercial resort known as Gordon's Lodge.

6 By way of mortgage dated December 6, 2007 and registered December 12, 2007, the Plaintiff mortgaged the property to Interbay Funding Corp. That mortgage was subsequently assigned to BLG Canada Corporation and then to the Defendant by a document registered October 27, 2009.

7 The mortgage was initially for $681,000 and called for monthly payments in the amount of $6,806.68 to and including January 1, 2013, and thereafter in accordance with the loan agreement between the parties. On March 1, 2012 the Plaintiff failed to remit the required payment and until recently made no further payments.

8 On May 7, 2012 the Defendant issued its Notice of Sale indicating, among other things, the outstanding principle balance of $627,381.02, accrued interest of $5,521.03, NSF fees of $45.90, a prepayment penalty of $32,886.10, and legal fees and disbursements of $5,000.

9 There ensued a good deal of correspondence between counsel in which the Plaintiff indicated a desire to redeem, provided reasonable legal costs could be agreed upon and the prepayment penalty waived. While these negotiations took place, the Plaintiff continued in default of its monthly payments.

10 In response to the Notice of Sale, the Plaintiff brought its action to redeem and have the Notice of Sale declared invalid.

11 The Defendant, taking the position its Notice of Sale was valid, requisitioned an appraisal of the property and responded to the Plaintiff's action with a counterclaim seeking judgment for the amount owing under the mortgage and possession of the property.

12 Investigation revealed the municipal taxes were unpaid.

13 Legal fees continued to mount for all parties.

14 The negotiations between the parties did not bear fruit. Although there were many and varied proposals and counterproposals, no consensus could be reached. Both parties brought motions for summary judgment returnable in November of 2012. Both motions were adjourned with the Defendant's motion eventually made returnable before me.

15 On or about February 26, 2013, the Plaintiff registered a second mortgage against the property for the sum of $305,000. It is not readily apparent where all of those funds went, but $88,512.84 was forwarded to counsel for the Defendant on account of the mortgage. This would seem to be an amount sufficient to make current the required monthly payments from March 1, 2012 to and including March 1, 2013. Municipal taxes were also made current.

16 The Plaintiff has paid nothing towards the legal fees and other costs incurred by the Defendant in attempting to realize on its security.

**The Issues**

17 The Plaintiff admits that it did not, for some thirteen months, make the monthly payments required by the mortgage. At this motion, it made three arguments in support of its position that the Defendant should not be granted the requested relief:

> (1) That the outstanding mortgage payments have been made current and municipal taxes paid so there is no mortgage default;
>
> (2) The Defendant's Notice of Sale and Counterclaim do not include all property that was the subject of the mortgage; and
>
> (3) The Defendant failed to give notice under section 244 of the *Bankruptcy and Insolvency Act* (the "BIA").

18 As mentioned, the Plaintiff has an outstanding motion for summary judgment to have the Defendant's Notice of Sale declared invalid. That motion is not before me. What I am dealing with is the Defendant's entitlement to summary judgment for the mortgage debt and possession of the property.

**Analysis**

19 This is a motion for summary judgment under Rule 20.01(1) of the *Rules of Civil Procedure*, alleging there is no genuine issue for trial. As the law currently stands, whether a matter may proceed by way of summary judgment requires a consideration of whether the material filed on the motion allows for a full appreciation of the issues and evidence, or whether a trial is required. That determination is made bearing in mind the parties' responsibility to put their best foot forward on a motion for summary judgment and to lead all facts and evidence that show there is a real issue to be tried.

20 I am content that this matter can be resolved by way of summary judgment. This is a relatively straight forward contractual dispute. The pertinent facts are largely agreed. There is no need for a trial to address the issues raised by the parties.

***Is the Plaintiff In Default?***

21 Article 9.1 of the Standard Mortgage Terms, incorporated in the Mortgage by reference, defines events of default. Default is defined to occur, *inter alia*, when an amount owing by the mortgagor is not paid on or prior to the date it is due.

22 Article 9.2 provides that upon an occurrence of default all obligations of the mortgagor shall, at the option of the mortgagee, immediately become due and payable.

23 Having regard to these provisions, there can be little doubt the Plaintiff is in default. On March 1, 2012, and for 13 months thereafter, it failed to make its payments. The Defendant, as it was entitled to do, required payment of the mortgage in full.

24 Although the Plaintiff recently remitted the equivalent of 13 monthly payments, the Defendant, in accordance with the terms of the mortgage, was and is entitled to the accelerated payment of the mortgage in full and is entitled to be paid the reasonable costs it has incurred in protecting its interests and realizing upon its security.

***The Effect of the Notice of Sale and Counterclaim Not Including All Property***

25 This issue arises out of the conversion of the property from Registry to Land Titles and from traditional recording to the current electronic format.

26 When the mortgage was first entered into, the property was in the *Registry Act* system and the land registration records had not yet been converted to an electronic format. The Plaintiff contends that when the property was converted to Land Titles and to electronic format (and assigned PIN #47108-0394 (LT) - the property described in the Defendant's Notice of Sale and Counterclaim) not all property covered by the mortgage was converted. The result, it is argued, is that the Defendant's Notice of Sale and Counterclaim do not cover all of the land which was contained in the mortgage.

27 Assuming this is correct, it was not the position of the Plaintiff that the *Planning Act* would operate so as to prohibit the Defendant's actions. That is, it was not alleged that the land omitted from the Power of Sale abuts the property the Defendant wishes to deal with. The Plaintiff's argument is that the Defendant's dealing with only the property described in the Power of Sale and Counterclaim will have the effect of dividing the resort property, thereby lessening the value of the asset. Essentially, it contends the property is likely to be of much more value if dealt with as a single entity and the Defendant should be prohibited from proceeding in the manner proposed.

28 Provided a mortgagee is acting lawfully in the realization of its security, the court will generally not intervene to dictate the manner in which that realization takes place. The mortgagee must, of course, act in a commercially reasonable manner and is obliged to account to the mortgagor following disposition of mortgaged property. To that extent, if it has realized on the security in a manner which does not yield a fair value, the Plaintiff may then be entitled to relief.

29 The mortgagee is entitled to sue for possession of all or part of the mortgaged property. It is not for the court, at this stage of the proceedings, to question its decision to proceed as it has.

***The Effect of Failure to Give Notice Under the Bankruptcy and Insolvency Act***

30 Section 244 of the *Bankruptcy and Insolvency Act* provides as follows:

> 244.(1) A secured creditor who intends to enforce security on all or substantially all of
>
> (a) the inventory,
>
> (b) the accounts receivable, or
>
> (c) the other property
>
> of an insolvent person that was acquired for, or is used in relation to, a business carried on by the insolvent person shall send to that insolvent person, in prescribed form and manner, a notice of that intention.

31 The Defendant admits it did not serve the required notice in this instance. The Plaintiff contends the Defendant is therefore prohibited from proceeding with this action for possession or its power of sale.

32 Although section 244, standing alone, seems to impose a clear precondition to a secured creditor realizing on its security, it must be read in conjunction with other related provisions of the BIA in order to determine its full meaning.

33 In that regard, it is to be noted that section 69 of the BIA entitles an insolvent person to file a proposal and thereby prevent a secured creditor from enforcing its security unless the creditor has sent the prescribed notice more than ten days earlier. Put another way, a secured creditor who is required to send a notice under section 244 and fails to do so will find its ability to realize on the security stayed if the debtor files a proposal.

34 Section 248 provides that a court may, on application of an insolvent person, if satisfied a secured creditor has failed to give the appropriate notice under section 244, direct the notice to be given or restrain the secured creditor from taking further action until the notice has been given.

35 When considered in the context of these additional sections, two things become apparent: Firstly, specific consequences for failing to provide the required notice are provided for in the act; and secondly, those consequences arise through action by the debtor.

36 The significance of requiring the relief to be sought by the debtor is the allocation to it of the onus of establishing the section applies, that notice has not been given, and that relief is appropriate in all of the circumstances.

37 In the case before me there is no suggestion that a proposal has been filed by the Plaintiff and, accordingly, no statutory stay of the Defendant's enforcement is in place.

38 An application under section 248 must be made by an insolvent person. The onus of proving insolvency is on the applicant, on a balance of probabilities. The definition of an "insolvent person" is found in section 2 of the BIA. Having regard to that definition, although I am satisfied the Plaintiff is not bankrupt, carries on business in Canada, and has liabilities in excess of $1,000, there has been no evidence led upon which I could find it is unable to meet its obligations in the ordinary course of business, has ceased paying its current obligations in the ordinary course of business as they generally become due, or that the aggregate of its property is not, at a fair valuation, sufficient, if disposed of at a fairly conducted sale under legal process, to enable payment of all its obligations.

39 I am not satisfied the Plaintiff is an insolvent person as defined in the BIA. Accordingly, that the Defendant did not comply with section 244 is of no consequence on the facts currently before me.

**Conclusion**

40 I am satisfied the Plaintiff is in default of its obligations under the terms of the mortgage. In the event of default, the mortgage provides that possession be given to the mortgagee. It is so ordered.

41 With respect to judgment for the amount due and owing to the Defendant, I make the following findings:

(1) The principal balance at the date of default was $627,381.02.

(2) Interest on this amount at the rate of 10.75 percent per annum results in a per diem interest charge of $184.78, which would apply until March 21, 2013 (385 days) for a total of $71,140.30.

(3) Payment in the amount of $88,512.84 was made March 22, 2013, thereby paying off accrued interest and reducing the principal amount of the mortgage by $17,372.54 to $610,008.48.

(4) Interest on $610,008.48 at the rate of 10.75 percent per annum results in a per diem interest charge of $179.66 from March 22, 2013 to April 15, being the date of this judgment, which amounts to $4,311.84.

(5) The Defendant is entitled to prepayment consideration of $32,886.10, as it is specifically provided for in the mortgage and fairly represents liquidated damages having regard to the interest rate and term of the mortgage.

(6) The Defendant is entitled to its legal fees relative to its counterclaim and motion for summary judgment which I fix in the amount of $7,500.00. The Defendant's legal and other costs related to its power of sale proceedings are more properly the subject of an accounting following completion of a sale as they were not claimed as relief in the counterclaim and were not sufficiently particularized to allow a proper analysis.

42 The result is that judgment shall issue in favour of the Defendant in the amount of $654,706.42, inclusive of costs, with post judgment interest to accrue from April 15, 2013 at the rate of 10.75 per annum.

*Motion granted.*

End of Document

TAB 12

1978 CarswellOnt 197
Ontario Supreme Court, In Bankruptcy

King Petroleum Ltd., Re

1978 CarswellOnt 197, 29 C.B.R. (N.S.) 76

# RE KING PETROLEUM LIMITED; CLARKSON COMPANY LIMITED v. KING

Steele J.

Heard: October 12 and 13, 1978
Judgment: November 7, 1978

Counsel: *T. M. Dolan*, for trustee.
*D. G. Bent*, for defendant.

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — General**

Fraudulent preferences — Test of insolvency — View to create preference — Payment to president of bankrupt company held fraudulent preference — The Bankruptcy Act, ss. 2, 73.

This was an application by the trustee in bankruptcy to have a payment by the bankrupt company to its president within three months before bankruptcy declared fraudulent and void as against the trustee as a preference within the meaning of s. 73 of the Bankruptcy Act.

**Held:**

The payments constituted a fraudulent preference, and there should be judgment against the defendant in favour of the trustee for the amount of the payments.

As a result of the payments of money, the company was placed in the position that it was unable to meet its obligations as they would generally come due. The company had placed itself in the position that it would not be able to pay the obligations that it knew it had incurred and which it knew would become due in the immediate future. Accordingly, the company, at the time of payment, was an "insolvent person" within the meaning of s. 2 of the Bankruptcy Act.

The moneys paid by the company to its president were used by him to repay his personal bank loans so that he would avoid personal liability. Accordingly the payments were made with a view to creating a preference over other creditors.

**Table of Authorities**

**Statute considered:**

Bankruptcy Act, R.S.C. 1970. c. B-3, ss. 2, 73.

Application by the trustee to have certain payments made to the president of the company declared fraudulent and void as against the trustee as a preference.

***Steele J.:***

1 The defendant was the beneficial owner of all of the outstanding shares of the bankrupt, King Petroleum Limited (the "company"), and at all material times was its president and chief executive officer. The petition in bankruptcy against the company was filed on 17th July 1973, and the Clarkson Company Limited (the "trustee") was appointed interim trustee. A receiving order was subsequently made on 4th December 1973, appointing the plaintiff as trustee. There was no invested capital in the company other than $3 in payment of the incorporators' shares. The bulk of the working capital of the company was derived from personal loans made by the defendant to the company. This money was obtained by him from various banks in the United States on a personal loan basis.

2 The company operated the business of purchasing gasoline for resale at wholesale to others and also for selling at retail through gasoline service bars. The predominant business was the wholesale portion. This was also the more profitable part of the business. In May 1973 the company was told by Imperial Oil Limited ("Imperial Oil"), its principal supplier, that its future supply of gasoline would be drastically reduced. I find that this reduction was such that it would effectively prevent the company from operating its wholesale business but would leave the company sufficient gasoline to operate its retail outlets. I find that there was no violation of any agreement by Imperial Oil in making this reduction. At the same time, in May 1973, there were rumours and and announcements of substantial price increases of gasoline to take effect on 1st June 1973. As a result of these rumours the customers of the company, who operated on a credit slip basis, took delivery of substantially increased quantities of gasoline from Imperial Oil. I find that the company was aware of the price increases and the fact that its customers were taking large quantities of gasoline; in fact, the company itself took as much gasoline as it could obtain from Imperial Oil during the month of May.

3 The action before me is to determine whether payments made by the company to the defendant on 23rd May 1973 and 15th June 1973 in the total amount of $374,106 are fraudulent and void as against the trustee as a preference within the provisions of s. 73 of the Bankruptcy Act, R.S.C. 1970, c. B-3, and whether the trustee is entitled to judgment against the defendant in this amount.

4 I find that at the time the payments were made the principal creditors of the company were Imperial Oil and the defendant. The terms of payment to Imperial Oil were to be 30 days from the date of invoice on all deliveries or within 10 days from the receipt of the statement. I find that all such accounts up to and including those outstanding at the end of April 1973 were paid by the company during the month of May. I find that at 31st May the company owed Imperial Oil Limited $559,413 and that at the end of June it owed a total of $861,816. There is no evidence before me as to the exact dates of deliveries or invoices, although I find that numerous invoices were given to the company during the months of May and June. The statements for the end of May and June respectively were in normal course sent out by Imperial Oil sometime during the first week of the following month. There is no evidence as to the exact date upon which the statements were received. It may be that they were received substantially later than the first week in the month. As a result I find that the plaintiff has failed in its onus to prove that the payments to Imperial Oil were in arrears at the time of the payments in dispute in this action.

5 I find that on 18th May the defendant became aware that Imperial Oil would not continue to supply the company with large quantities of gasoline. I also find that the company and the defendant were aware that without the large supplies of gasoline they would not be able to operate a profitable business.

6 In order that the payments in question be deemed fraudulent and void, it must be shown that the company was insolvent at the time and that they were made with a view to giving the defendant a preference over other creditors and were made within three months of the date of the petition in bankruptcy. It is clear that the payments were made within the three-month period.

Also, I find that the payments were made with a view to giving the defendant a preference over other creditors. The defendant, being the president and chief executive officer of the company, knew as much of the transaction as the company itself did. There is no doubt in my mind but that the company repaid this money to the defendant with a view to repaying his personal bank loans so that he would avoid personal liability. The defendant stated that the money was repaid so that he could retain his bank credit for continuing loans. No such loans were in fact obtained, and therefore I do not accept his evidence. Regardless of what may have been said by any official of Imperial Oil to the company, there is no question but that the payments were made with a view to creating a preference over creditors.

7 The major issue is whether the company was an "insolvent person" when the payments were made. I find that at the time the company knew that it was in financial difficulties and would have difficulty in paying its debts, but this does not in itself mean that the company was insolvent. Section 2 of the Bankruptcy Act defines an insolvent person as follows:

> 'insolvent person' 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, or
>
> (*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.

8 Clause (*b*) speaks in the past tense, and on the facts of this case I find that the company had not ceased paying its current obligations in the ordinary course of business as they generally became due, and therefore the clause is not applicable.

9 With respect to cl. (*a*), it was argued that at the time the disputed payments were made the company was able to meet its obligations as they generally became due because no major debts were in fact due at that time. This was premised on the fact that the moneys owed to Imperial Oil were not due until ten days after the receipt of the statements and that the statements had not then been received. I am of the opinion that this is not a proper interpretation of cl. (*a*). Clause (*a*) speaks in the present and future tenses and not in the past. I am of the opinion that the company was an "insolvent person" within the meaning of cl. (*a*) because by the very payment-out of the money in question it placed itself in a position that it was unable to meet its obligations as they would generally become due. In other words, it had placed itself in a position that it would not be able to pay the obligations that it knew it had incurred and which it knew would become due in the immediate future.

10 While there were no specific financial statements of the company on 23rd May or 15th June, it is obvious from the audited financial statements for the year ended 31st July 1972 and the interim period ended 28th February 1973 and the unaudited financial statement for the period ended 30th June 1973 that the company had a serious working capital deficit at all times. Having reviewed the transactions with Imperial Oil of May 1973 and even assuming that the money that would be received would include a profit over the money that would have to be paid out, I am of the opinion that these interim transactions could not have placed the company in a position at any time between 28th February 1973 and 30th June 1973 where it would have been in a position that it could meet its obligations as they generally became due once the money had been paid out to the defendant on 23rd May, and still less after the payment on 15th June.

11 To consider the question of insolvency under cl. (*c*) I must look to the aggregate property of the company and come to a conclusion as to whether or not it would be sufficient to enable payment of all obligations due and accruing due. There are two tests to be applied: first, its fair value and, secondly, its value if disposed of at a fairly conducted sale under legal process. The balance sheet is the starting point, but the evidence relating to the fair value of the assets and what they might realize if disposed of at a fairly conducted sale under legal process must be reviewed in interpreting it. In this case, I find no difficulty in accepting the obligations shown as liabilities because they are known. I have more difficulty with respect to the assets.

12 No specific appraisal was made of the fixed assets shown on the balance sheet at the time in May or June when the cheques in question were issued. The land, buildings and equipment of the service stations and the leasehold improvements

thereto shown on the balance sheet are valued at approximately $555,000 at 30th June 1973. The same general category of asset is valued at approximately $500,000 as at 28th February 1973. No depreciation has specifically been attributed to these assets. Even if all depreciation shown on the two statements were attributable to the service stations, the resulting value is substantially in excess of the value of the service stations on the statement of affairs sworn to by the defendant on 2nd January 1974. I do not accept the evidence of the defendant that he signed the statement of affairs sworn on 2nd January 1974 without proper consideration. I find that it was freely signed by him after he had reviewed it in detail. On the first and many subsequent pages his solicitor's writing shows numerous changes initialled by him. This statement shows the value of the real estate, which in fact was the service stations, at $315,000. Even if all of the machinery, equipment and plant were added to this, the value is considerably less than shown on the two balance sheets above referred to. Also, on 13th August 1973 the defendant, through his solicitor, made a tentative offer to purchase the service stations, or a substantial portion of them, at values close to the valuation set out for the individual stations in the statement of affairs. Some time later, when the trustee sold the stations, the total price was close to the value in the statement of affairs. I find the value shown on the statement of affairs as being more accurate than that shown on the balance sheets.

13 On the balance sheets there are substantial trade accounts receivable and, to a lesser extent, other accounts receivable. No allowance is taken for doubtful accounts. This is not in accordance with normal accounting principles, and no evidence was given by the defendant to explain any special circumstances to warrant this departure.

14 These two items indicate to me that the assets shown on the balance sheets do not show their fair valuation nor the value that they would derive if disposed of at a fairly conducted sale under legal process. I am therefore of the opinion that the company was an "insolvent person" within the provisions of cl. (*c*) in s. 2.

15 Having come to the conclusion that I cannot accept the evidence of the defendant with respect to the signing of the statement of affairs by him and bearing in mind that there was an interim receivership from July 1973 until the date of 2nd January 1974, when he signed the statement of affairs, I do not accept his statement that he was forced to sign the statement. As I have stated, I am of the opinion that he fully considered the statement and freely signed it. This goes to the credibility of the defendant. I find that he was not a credible witness. It is with this view that I consider his evidence with respect to his statement that he was told by one Johns, an employee of Imperial Oil, that he should pay off his own indebtedness and that Imperial Oil would give him an additional line of credit to pay its account later. In itself this is an incredible statement for any creditor to make to a debtor. This is particularly so at a time when that same creditor is arguing with the debtor over future supplies. I accept the evidence of Mr. LePage of Imperial Oil that he was sent to endeavour to collect the money from the company and that in early July he was told by the defendant that the company could not pay its total debt at that time. I find that this is consistent with the position of Imperial Oil that it was at all times endeavouring to collect its account. The plaintiff gave no explanation for not calling Mr. Johns of Imperial Oil, and I conclude that his evidence would be unfavourable to the plaintiff. Even if it would have confirmed the defendant's statement as to what was supposedly said by Mr. Johns, I find that the defendant could not have seriously believed that Mr. Johns had authority to consent to the payments by the company to the defendant, even if Johns had authority to extend the time of payment to Imperial Oil. However, the more important aspect is that Imperial Oil was only one of the creditors of the company, even if it was the largest. The issue is whether the payments were made with a view to giving the defendant a preference over other creditors, and I have so found.

16 I therefore find that the payments made on 23rd May 1973 and 15th June 1973 to the defendant, Bille Wayne King, are fraudulent and void as against the trustee as a preference within the provisions of s. 73 of the Bankruptcy Act, and judgment will issue in favour of the trustee against the defendant in the amount of $374,106. The plaintiff is entitled to its costs against the defendant.

*Application granted; judgment issued in favour of trustee.*

# TAB 13

1966 CarswellMan 3
Manitoba Court of Queen's Bench

Holt Motors Ltd., Re

1966 CarswellMan 3, 56 W.W.R. 182, 57 D.L.R. (2d) 180, 9 C.B.R. (N.S.) 92

# Re Holt Motors Ltd.; Canadian Credit Men's Association Limited v. Stonewall Credit Union Society Limited

Bastin J. [in Chambers]

Judgment: April 13, 1966

Counsel: *J. F. R. Taylor*, for applicant.
*A. H. Mackling* and *H. R. Pawley*, for respondent.

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy — Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Onus of proof**

Fraudulent preference — Security given within three months of bankruptcy — Trustee proving essential elements to raise presumption — No rebuttal of presumption — Objective test to be applied in determining intention of parties — Concurrent intent proved on facts.

H., a director of respondent credit union, commenced business in 1962 as a car dealer and garage operator. He subsequently incorporated his business and obtained from the respondent overdraft privileges limited to $10,000. An unregistered chattel mortgage covering accounts receivable and stock-in-trade was given as security. Over a period of time, the $10,000 limit was considerably exceeded, until in July 1965, the debtor company had total loans from the respondent of some $44,000. Under pressure, H., on behalf of the company, executed a chattel mortgage and assignment of book debts in favour of the respondent. In September 1965, the company made an assignment in bankruptcy. The trustee in bankruptcy applied to set aside the chattel mortgage and assignment of book debts on the ground that they were fraudulent preferences within s. 64 of the Bankruptcy Act.

*Held*, the application should be granted.

1. The transaction had taken place within three months of bankruptcy.

2. The debtor company was insolvent at the time that the security was given. At the date of the bankruptcy, there was a large deficiency and it was a reasonable assumption that little change would have occurred in the six week period between the giving of the security and the date of the bankruptcy.

3. The effect of the transaction was to give the respondent a preference over other creditors.

The trustee having proven these three requirements had established sufficient to raise the presumption that the security was fraudulent and void.

In order to meet the presumption created by s. 64, it was necessary for the respondent to show that the purpose of creating the security was not to place itself in a preferred position over other creditors. In determining the intention of the parties, the Court must apply an objective test, not a subjective one; that is, the intention which should be attributed to the parties will 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.

Knowledge of insolvency will be imputed when the creditor knows that his own debt was not being paid when due. In the circumstances, both H., the president of the debtor company, and the directors of the respondent, had information which should have made them aware that the debtor company was insolvent. There was affirmative proof of an intent on the part of the bankrupt company to give and of the respondent to receive a preference over other creditors.

There had been no *bona fide* expectation and belief that the giving of the securities would permit the debtor company to carry on business. Furthermore, the security was not given pursuant to an agreement made prior to the commencement of the three month period. The chattel mortgage and assignment of book debts were given in place of the invalid chattel mortgage and were intended to protect the position of the respondent at the expense of other creditors.

***Bastin J.*:**

1 This is an application by the trustee in bankruptcy of the estate of Holt Motors Ltd. to set aside a chattel mortgage, dated 23rd July 1965, on garage and office equipment and used cars not otherwise financed, and an assignment of all book debts, dated 22nd July 1965, given by the bankrupt company to the respondent, as being fraudulent preferences. In fact, both documents were executed in the early hours of 24th July 1965.

2 Section 64 of the Bankruptcy Act is as follows:

64. (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 such creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering the same becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in the bankruptcy.

(2) Where any such conveyance, transfer, payment, obligation or judicial proceeding has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed *prima facie* to have been made, incurred, taken, paid or suffered with a view to giving such creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be receivable or avail to support such transaction.

(3) For the purposes of this section, the expression 'creditor' includes a surety or guarantor for the debt due to such creditor.

3 To raise a presumption that the securities were fraudulent and void, the trustee must prove three things:

4 (1) That the transaction took place within three months of the bankruptcy. As the bankrupt company made an assignment in bankruptcy on 7th September 1965, this requirement is satisfied.

5 (2) That the debtor was insolvent at the time the securities were given. The statement of the affairs of the bankrupt company shows the amount of preference claims as $3,828.44 and of secured claims as $43,314.87. It showed the following secured creditors: Polaris Enterprises Ltd. with a claim of $8,691.42 secured by chattel mortgage on rent and equipment; Delta Acceptance Corporation with claim of $19,830 secured by chattel mortgage on stock in trade; Stonewall Credit Union with

claim of $44,600 secured by accounts receivable and personal note for $15,000. The respondent also held the chattel mortgage which is being attacked in these proceedings. The book debts of the bankrupt company were valued at $7,264.42 and used cars and farm implements at $2,405. It is certain that there will be a large deficiency and it is a reasonable assumption that little change would have occurred in the period of approximately six weeks between 23rd July 1965, and the date of the bankruptcy. Mr. Thomas A. Holt, the president of the bankrupt company, confirmed that this was so. It appears from these figures that prior to the respondent acquiring its security on 23rd July 1965, the only assets available to pay the unsecured creditors of the bankrupt company, totalling $87,914.87, were these book debts which have been valued at $7,264.42 and some used cars and implements valued at $2,405, so the bankrupt company was hopelessly insolvent on 23rd July 1965.

6 (3) That the effect of the transactions which are impugned was to give the respondent a preference over other creditors. Since the chattel mortgage and assignment of book debts acquired by the respondent covered the only assets available to unsecured creditors, I hold that these securities did give the respondent a preference over other creditors.

7 On a literal reading of s. 64, the intent to give a preference would appear to be that of the insolvent person and this seems to be borne out by the concluding words of subs. (2) stating that "evidence of pressure shall not be receivable or avail to support such transaction." Prior to the enactment of this provision a creditor could prove that the intention of the debtor was not to prefer the interested creditor but to avoid threatened legal action. There are always two parties to such a transaction and it must be very seldom that their intentions do not coincide. In this case the bankrupt company and the respondent acted together to create the securities and I ascribe the same intent to both of them.

8 In order to meet the presumption created by s. 64 the respondent must show that the purpose of creating the securities was not to place the respondent in a preferred position over the other creditors. In the light of all the circumstances existing on 23rd July 1965, 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.

9 To decide the issue it is necessary to review the events which led up to the giving of the security. Thomas A. Holt, a resident of Stonewall for many years, commenced business as a car dealer and garage operator in Stonewall in August 1962. He was a director of the Stonewall Credit Union and on 16th April 1964, he applied for a credit of $6,000 to be in the form of overdraft privileges payable on demand and this application was approved by the credit committee. There is no evidence of his using the overdraft privilege but the respondent produced an unregistered chattel mortgage dated 23rd July 1964 given by Thomas A. Holt to the respondent to secure a loan of $5,000 covering a 1957 Fordson tractor and its equipment, to be paid when the unit was sold. There was evidence that this loan was repaid on 28th January 1965. On 30th June 1964, Thomas A. Holt incorporated Holt Motors Ltd. to take over the business in return for $7,500 in preferred shares and he put in an additional $500 as capital. The respondent produced an application, dated 8th October 1964, for a credit of $10,000 described in one place in the form as overdraft privileges and in another as a line of credit and this was signed by Thomas A. Holt and approved by the credit committee. It must be assumed that this credit was to be extended to Holt Motors Ltd. since an unregistered chattel mortgage for $10,000 dated 30th October 1964, from this company to the respondent, was executed by Thomas A. Holt and his brother, purporting to cover "Accounts Receivable — $16,000.00 to $20,000.00 — Stock in Trade — Parts $12,000.00," repayment on demand. It was argued by counsel for the respondent that the credit committee of the respondent intended that the bankrupt company should have a line of credit of the total of these two applications, namely, $16,000. I cannot accept this interpretation since the words $10,000 line of credit have only one possible meaning, which is that the borrowing is to be restricted to a maximum of $10,000. Furthermore, the evidence shows that the respondent, in its dealings, made a distinction between Holt as an individual and the company.

10 Evidence was given by the respondent as to the amount of the indebtedness of the bankrupt company to the respondent at the end of each month, commencing with 31st December 1964. The figures are as follows: 31st December 1964, $12,753.82; 31st January 1965, $11,837.21; 28th February 1965, $12,937.80; 31st March 1965, $16,687.53; 30th April 1965, $22,550.61; 31st May 1965, $28,175; 30th June 1965, $35,006.88; 22nd July 1965, $44,767.28.

11 The evidence is that none of the directors of the credit union was aware of the extent of this indebtedness which far exceeded the amount that the credit committee had approved. The manager, Robert Doubleday, was dismissed when the situation came to light and was not called to testify. What brought the situation to the attention of the directors was a report dated 28th June 1965, by the supervisor of credit unions, following an audit which began on 8th June 1965. This report made the following reference to Holt Motors Ltd. account which in the books of the respondent bore the number 440:

> *Overdrawn Deposit Accounts*: These are strictly forbidden in a Credit Union. The following are drawn to your attention:
> --- #440 $12,781.83
>
> The Board and Credit Committee should deal with #440 immediately. An overdrawn account of such an amount is considered an unauthorized loan.

12 If the line of credit given to the company by the credit committee was limited to $10,000, the amount of the unauthorized loan at 23rd July 1965 was $34,767.28 and this amount would be due and forthwith payable. When the members of the board looked into this account they were, as one member stated, "appalled" at the situation. They had several interviews with Thomas A. Holt and at a meeting of the board held on 23rd July 1965, passed the following resolution:

> Moved by Evancic and Seconded by Slatcher that we instruct our Solicitor to take all legal steps to execute on our mortgage and garnishee the Holt Motors Accounts receivable and have our Solicitor and Manager, Mr. Bob Doubleday contact Tom Holt to obtain required signatures on loan. Carried.

13 I assume it was about this time their solicitor informed the board that the chattel mortgage from the company, dated 30th October 1964, was invalid. Following the passing of this resolution, Thomas A. Holt was summoned from his bed and told that he must give security. Holt explained that his solicitor had advised him not to give security and Holt at first refused to do so, but under pressure of the members of the board, who were old friends and associates, he agreed to consult his solicitor by telephone and when he was unable to reach his solicitor he acquiesced and he and his brother signed the two documents. The explanation for inserting in the documents the figure of $39,000 as the indebtedness was that the postings to the company account were not up to date and the amount shown in the account was about this figure.

14 One factor which has been considered important in an inquiry such as this is knowledge by the creditor of the insolvency of the debtor. The Act defines insolvency as follows:

> 2. (*j*) 'insolvent person' 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
>
> (i) who is for any reason unable to meet his obligations as they generally become due, or
>
> (ii) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
>
> (iii) 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; ...

15 Knowledge of insolvency will be imputed when the creditor knows his own debt was not being paid when due: *In re Shortt* (1922), 22 O.W.N. 539, 2 C.B.R. 449, 3 Can. Abr. (2nd) 2550. Where a creditor either knows of the insolvent position of the debtor, or has ample means of knowing it if he made proper inquiries, he cannot relieve the onus placed on him by s. 64: *In re Hatt & Son* (1922), 3 C.B.R. 433, 3 Can. Abr. (2nd) 2495. Knowledge of a debtor's insolvency exists in contemplation of law where the creditor, obtaining a preference, knew of circumstances from which ordinary men of business would conclude that the debtor was unable to meet his liabilities: *In re Progressive Farmers' Co.; Ex parte Brown Bros. & Burmstad Ltd.*, 3 C.B.R. 702, [1923] 1 W.W.R. 833, 3 Can. Abr. (2nd) 2501. These principles relate to the knowledge of the creditor; but since s. 64 is concerned with the intent of the debtor, his knowledge is of equal, if not of more, importance. The Court is entitled to assume that both the creditor and the debtor possessed the capacity of ordinary business men to appreciate facts which were available to them. The glaring fact known to both parties on 28th July 1965, was that since 31st January 1965, the debtor had received more

than $27,000 without the approval of the directors which was morally and legally forthwith payable without demand. Inquiry would have revealed that in the same period unsecured debts of the company had increased to approximately $40,000 quite apart from the sum of $44,767.28 owing to the respondent. Inquiry would also have revealed that the stock of parts, garage equipment and new and used cars was subject to various forms of security held by Polaris Enterprises, Delta Finance Co. and Ford Motor Co., and that the only other asset consisted of book accounts, claimed to total $25,000, of which more than half were over 90 days in arrears. The directors apparently limited their inquiries to an examination of the book accounts and a financial statement showing the position of the company at 31st December 1964. This statement provided no depreciation on equipment and no reserve for losses on accounts receivable or on used cars. It also showed that the profit on new car sales was offset by the loss on the sale of used cars. The failure of the directors to examine the company accounts to ascertain its condition in July, and to trace the unauthorized borrowing from the respondent of $34,767.28, shows a wilful refusal to pursue essential investigations when put upon inquiry. I consider that both Thomas A. Holt, the president of the bankrupt company, and the directors of the respondent had information which should have made them aware on 23rd July 1965, that the bankrupt company was insolvent. I make a finding that they had this knowledge.

16 In an attempt to rebut the statutory presumption, counsel for the respondent has sought to rely on the principle that where a transaction is entered into by the debtor with the sole object and in the *bona fide* expectation and belief of being thereby enabled to successfully carry on his business, and not with the view of preferring one party to the detriment of other creditors, the transaction will not be set aside. I hold that if the directors of the respondent had not either deliberately or stupidly closed their eyes, they would have known that the bankrupt company had been operating at a loss for months and had no chance of surviving. Their action in withdrawing all credits shows their lack of confidence in the company and, as they might well have known, this brought its operations to a halt. It cannot be said there was any *bona fide* expectation that the bankrupt company could be put on a paying basis.

17 Another principle to which counsel for the respondent referred was that the presumption of an intention to create a preference may be rebutted by evidence that security given within the three-month period was provided pursuant to an agreement made prior to the commencement of this period. This principle was applied in *Re Blenkarn Planer Ltd.* (1958), 37 C.B.R. 147, 26 W.W.R. 168, 14 D.L.R. (2d) 719, 3 Can. Abr. (2nd) 2600. In support of this argument counsel referred to the form of chattel mortgage dated 30th October 1964, by which the bankrupt company purported to give security for $10,000 on "Accounts Receivable — $16,000.00 to $20,000.00 — Stock in Trade — Parts $12,000.00" — as indicating an intention on the part of the company to give security. I have held that Thomas A. Holt, president of the bankrupt company, and the directors of the respondent were aware of the insolvency of the company on 23rd July 1965. I am bound to hold that the execution of proper forms of chattel mortgage and assignment of book debts in place of the invalid document was intended to protect the position of the respondent at the expense of other creditors. There is, therefore, affirmative proof of an intent on the part of the bankrupt company to give, and of the respondent to receive, a preference over other creditors.

18 I hold that the chattel mortgage and assignment of book debts which have been attacked are invalid against the trustee. The trustee will have his costs, to be taxed, with a *fiat* for discovery.

TAB 14

1983 CarswellOnt 201
Ontario Supreme Court, In Bankruptcy

Thorne Riddell v. Fleishman

1983 CarswellOnt 201, 47 C.B.R. (N.S.) 233

# Re TOYERAMA LIMITED; THORNE RIDDELL v. FLEISHMAN

Saunders J.

Heard: April 26-27, 1983
Judgment: September 15, 1983

Counsel: *T.R. Hawkins* , for plaintiff.
*F.M. Catzman Q.C.* , for defendant.

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Insolvency of debtor at time of transaction**

**Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Intention other than to prefer**

Presumption of fraudulent preference rebutted.

On an application by the trustee to declare a certain payment and the giving of a debenture as fraudulent preferences, held, the onus was on the trustee to establish on the balance of probabilities that the debtor was insolvent when it made the payment and agreed to give the debenture to the defendant. To satisfy this onus, the trustee must meet the test in one of the paras. (*a* ), (*b* ) and (*c* ) in the statutory definition of insolvency in s. 2 of the Bankruptcy Act. The word "unable" in para. (*a* ) does not mean "unwilling". If a person has ample funds to meet obligations and chooses not to do so, he is not insolvent by reason of para. (*a* ) of the definition. The unpaid creditors may enforce their claims if they choose to do so. With respect to para. (*b* ), although there were unpaid creditors in substantial amounts, some of the amounts were disputed and many creditors had either agreed to wait or understood that they would not be paid until later on, and there was no direct evidence from any of the unpaid creditors which might have affirmed or denied the arrangements suggested by the defendant. Therefore the court was unable to find, on the evidence, that the debtor had ceased to pay its current obligations in the ordinary course of business as they generally became due. With respect to para. (*c* ), there was no evidence of the fair valuation of assets. Accordingly, there was no basis for finding the debtor to be insolvent.

If the "preferred" 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, the onus has been satisfied. The test is an objective one. In this case the defendant satisfied the court, on the balance of probabilities, that the defendant did not enter the impugned transactions with a view of giving the defendant a preference over other creditors.

**Table of Authorities**

**Cases considered:**

*Holt Motors Ltd., Re; Can. Credit Men's Assn. Ltd. v. Stonewall Credit Union Soc. Ltd.* (1966), 9 C.B.R. (N.S.) 92, 56 W.W.R. 182, 57 D.L.R. (2d) 180 (Man. Q.B.) — *applied*

*Mac-Wall Contr. Ltd., Re* (1970), 14 C.B.R. (N.S.) 52 (Ont. S.C.) — *applied*

*Van der Liek, Re* (1970), 14 C.B.R. (N.S.) 229 (Ont. S.C.) — *applied*

**Statutes considered:**

Bankruptcy Act, R.S.C. 1970, c. B-3, ss. 2 "insolvent person", 73.

Application by trustee to declare payment and debenture fraudulent preference.

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

1 This is a trial of an issue ordered by Hollingworth J. The issues are whether a payment of $37,862.82 by the bankrupt, Toyerama Limited ("Toyerama"), to Edith Fleishman, and the giving of a bearer debenture in the principal amount of $35,000 by Toyerama to her, are fraudulent and void as against the trustee as preferences within the provisions of s. 73 of the Bankruptcy Act, R.S.C. 1970, c. B-3.

2 The business of Toyerama was the acquisition of toys from manufacturers. The acquisitions were usually of surplus stock which the manufacturers had not disposed of in the previous season. The toys were acquired by Toyerama under many different arrangements in the spectrum from outright cash sales to pure consignments. The toys were sold either to retailers or to consumers through leased retail outlets of Toyerama.

3 The Christmas season plays a predominant part in the toy industry. December is the largest selling month and the period from 1st October to 31st December is the largest selling quarter (61 per cent of 1978 Toyerama sales). Toyerama would often accept delivery early in the year and store the toys in its warehouse in anticipation of sale the following autumn. Manufacturers were anxious at the end of a season to deliver their surplus inventory to Toyerama, knowing that Toyerama would be unable to sell it until the next season. This, no doubt, was to make way for new products. A substantial number of manufacturers did not expect to be paid by Toyerama until the next season was over in late December or the following January.

4 The 1978 season was not good for the toy industry and, accordingly, not good for Toyerama. In January 1979 Toyerama had a large unsold inventory on hand and considerable indebtedness. Also, the manufacturers had larger than usual amounts of surplus stock available for disposal. Toyerama made an informal proposal to certain of its creditors in January 1979 whereby the creditors were asked to postpone payment for one year until the end of the 1979 season. It would appear that creditors with an aggregate indebtedness of $190,000 accepted the proposal.

5 Unfortunately, the 1979 season was worse than 1978 and on 25th January 1980 Toyerama made an assignment in bankruptcy.

6 In these proceedings the trustee attacks two transactions between Toyerama and the defendant Edith Fleishman. Edith Fleishman is the former wife of Marvin Fleishman, the president and principal shareholder of Toyerama. Their marriage took place in 1952. There were four children. The couple separated in the summer of 1977 and were divorced in 1982. Since the separation they have dealt with each other at arm's length, but, it would appear, with relatively little rancour. Their son Allan

Fleishman is an officer and shareholder of Toyerama Limited and was employed by it. He appears to have been on good terms with both his mother and father.

7 Shortly after the separation in 1977, Edith Fleishman established a retail business under the name of "Toyaround" which was substantially the same business as Toyerama. Her business was not successful and closed down with considerable inventory on hand. Toyerama, in November 1978, agreed to buy the inventory from her for $37,862.82 which it was said was its retail value less 35 per cent. Toyerama agreed to pay her for the inventory one year later and to pay monthly interest in the interim. Its obligation was evidenced by a promissory note which came due on 9th November 1979.

8 Mr. and Mrs. Fleishman had made a separation agreement in September 1977, shortly after their separation, but that agreement was replaced by a second agreement dated 20th November 1978. While the second agreement does not say so, both Edith Fleishman and Marvin Fleishman testified that the purchase of the inventory by Toyerama was a condition precedent to Edith Fleishman entering it.

9 The second agreement obliged Marvin Fleishman to make certain lump sum payments to his wife. It was agreed that he would cause Toyerama to execute a second floating charge in favour of his wife whereby amounts owing by him to her and certain amounts owing to her by Toyerama and others would be secured. She, in turn, agreed to provide a mortgage on the former matrimonial home as collateral security for part of the bank indebtedness of Toyerama. By debenture dated 12th January 1979, Toyerama agreed to pay Edith Fleishman the sum of $274,596.81 with interest at 10 per cent on 31st January 1980. The debenture contained a second floating charge on all its assets subject to a first charge in favour of the Royal Bank of Canada. In para. 14 of the debenture, Edith Fleishman (who did not execute the debenture in her personal capacity but only as secretary-treasurer of Toyerama) acknowledged that she was the beneficiary of the principal amount of the indebtedness to the extent of $42,191.54 and that the beneficiaries of the remainder were certain trusts bearing the name of members of the Fleishman family.

10 Shortly before 9th November 1979 Marvin Fleishman says he received an "amusing" card from his wife reminding him of the due date for payment of the inventory. Toyerama Limited made the payment by cheque dated on the due date and its bank account was debited with the amount paid on the following 13th November. The payment to Edith Fleishman for the inventory is the first transaction attacked by the trustee in these proceedings.

11 By agreement dated 20th September 1979 Toyerama purchased all the shares and shareholder loans of Yogi Yogurt Limited for an aggregate purchase price of $28,840. Marvin Fleishman testified that he considered the purchase a good investment for Toyerama because Yogi Yogurt had the benefit of certain contracts as well as some assets which would be available for disposal. He felt that the purchase was a normal business transaction even though at that time Toyerama was not doing very well. While this transaction is not attacked by the trustee in these proceedings, it is noted that both Marvin Fleishman and his son Allan Fleishman were shareholders in Yogi Yogurt Limited and received from the purchase $6,970 in the aggregate. The records of Toyerama indicate that approximately $97,000 was advanced by Toyerama to Yogi Yogurt Limited between 1st October and 31st December 1979.

12 Edith Fleishman was asked to loan $35,000 to Toyerama to assist it in the Yogi Yogurt purchase. Marvin Fleishman said that while that was the expressed reason for the request, he was more concerned that she did not deal with the inventory payment in an improvident fashion. Allan Fleishman seems to have had the same opinion and to have also felt that it was better to obtain the funds from his mother than from the bank. In what can be assumed to be a simultaneous transaction with the inventory payment, Edith Fleishman, by cheque dated 9th November 1979, advanced $35,000 to Toyerama. The cheque was credited to the Toyerama bank account on 13th November 1979, the same day as the inventory payment was debited. In return Toyerama gave Edith Fleishman a demand promissory note, dated 10th November 1979, for $35,000 bearing interest at 17 $^{1}/_{2}$ per cent per annum. Subsequently, by demand debenture, dated 29th November 1979, Toyerama agreed to pay Edith Fleishman $35,000 with interest at 15 per cent. The debenture contained a fixed and floating charge on its assets. Allan Fleishman said he discussed providing this security with his mother when she was considering making the loan. Marvin Fleishman says that the debenture was given at the insistence of her lawyers and that he was prepared to accede to their request. It is to be recalled that Edith Fleishman had received a floating charge debenture the previous January for the indebtedness to the trusts and to her under the separation agreement. The giving of the $35,000 debenture is the second transaction attacked by the trustee.

13 Section 73 of the Bankruptcy Act provides as follows:

> 73.(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 such creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering the same becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in bankruptcy.
>
> (2) Where any such conveyance, transfer, payment, obligation or judicial proceeding has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed *prima facie* to have been made, incurred, taken, paid or suffered with a view to giving such creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be receivable or avail to support such transaction.
>
> (3) For the purposes of this section, the expression "creditor" includes a surety or guarantor for the debt due to such creditor.

14 The two impugned transactions fall within those described in s. 73 and took place within three months of the bankruptcy. At the time they were made, there were unpaid creditors of the bankrupt and it is not disputed that the transaction had the effect of giving Edith Fleishman a preference over those creditors. There are, therefore, two issues to be decided:

15 (1) Was Toyerama an insolvent person at the time the transactions were entered into? The onus of establishing that Toyerama was insolvent is on the trustee and if it is unable to satisfy that onus its claim must be dismissed.

16 (2) If Toyerama was an insolvent person, were the impugned transactions entered into with a view of giving Edith Fleishman a preference over the other creditors? Because of the provisions of s. 73(2) the onus here is on Edith Fleishman to show that the transactions were not entered into with such a view.

17 On both issues it is important to consider the circumstances and general activity of Toyerama. There had been a bad season in 1978 which necessitated the informal proposal to creditors made in January 1979. The 1979 season was worse. The October sales were off by 16 per cent from the previous year. It was to get much worse. December sales dropped by 42 per cent and Marvin Fleishman described this as a disaster. The trustee is understandably concerned about the pattern of payments made by Toyerama in the months preceding its bankruptcy. There were relatively few payments to trade creditors, but Edith Fleishman received payment for her inventory in November 1979, and her loan of $35,000 and the January 1979 debenture in her favour were paid off in January 1980. The indebtedness to the bank which was guaranteed to a limited extent by both Marvin Fleishman and Allan Fleishman was reduced and available credit from that source not fully utilized. Such a pattern is consistent with an intention to reduce the potential personal loss to members of the Fleishman family at the expense of creditors in the event of a bankruptcy. On the other hand, there is an explanation for the pattern. Because of the nature of the business, a number of trade creditors had formally postponed their claims and others were not expecting payment until January 1979. Marvin Fleishman made a strenuous effort in December to persuade Edith Fleishman to postpone the payment of the 1979 debenture and to continue her agreement to guarantee a portion of the bank indebtedness. She refused to do so on the advice of her solicitors and, believing her security to be in jeopardy, issued a writ with respect to the $35,000 loan on 21st January 1979. Toyerama was legally obliged to make the payments due to her and other members of the family in January 1980. The reduction of the bank loan out of cash flow reduced interest cost. It should also be noted that in December 1979 Toyerama made a substantial investment in Yogi Yogurt and also entered into a new warehouse lease.

18 The situation of Toyerama at the beginning of 1979 was not good but had not yet reached a disastrous state. It is my conclusion on the basis of the evidence that when Edith Fleishman was paid for the inventory and given security for the $35,000 loan that Toyerama then intended to continue to carry on business for an indefinite period and was not contemplating either ceasing such business or making an assignment in bankruptcy.

19 Section 2 of the Bankruptcy Act defines "insolvent person" as follows:

2. In this Act ...

"insolvent person" 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, or

(*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; ...

20 Evidence was given about the books and records of Toyerama by Mr. Leyshon-Hughes, a vice-president of the trustee, and by Miss E. Bentley, one of its estates officers. In the opinion of Leyshon-Hughes, the books of Toyerama were current and had been adequately maintained. Either or both of Mr. Leyshon-Hughes and Miss Bentley had reviewed the invoices, files and other documents available to them. From these sources several tables were prepared which were put in evidence concerning the financial situation of Toyerama. In addition, there were unaudited financial statements prepared by a chartered accountant as at 30th September 1979 (the Toyerama year-end) which showed an excess of liabilities over assets and a substantial operating loss for the period covered by the statements. The evidence indicated that there were a number of unpaid creditors. Some had agreed in writing to defer payment until January 1980 or to some other date. Some had stipulated payment terms on their invoices which had not been met, while others showed no payment terms but had rendered bills prior to 9th November 1979. Marvin Fleishman testified that many of the creditors whose invoices indicated that their account was overdue did not expect payment until after the 1979 season or had verbally agreed to defer payment. Mr. Leyshon-Hughes said that the trustee did not inquire into these circumstances. No unpaid creditors were called by the trustee and the evidence of Marvin Fleishman on the arrangements he had made, although somewhat vague, stands uncontradicted.

21 The onus is on the trustee to establish on the balance of probabilities that Toyerama Limited was insolvent when it made the payment for the inventory and agreed to give the debenture for $35,000 to Edith Fleishman. To satisfy this onus, it must meet the test in one of paras. (*a*), (*b*) and (*c*) in the statutory definition of insolvency.

22 In dealing with para. (*a*), the evidence is that Toyerama in the last calendar quarter of 1979 had funds in its bank account and further bank credit available. Counsel for the trustee argued that it was a management decision not to pay the trade creditors and that Toyerama, having been prevented by its management from making the payments, was "unable" to do so. I do not agree with that submission. I agree with counsel for Mrs. Fleishman that "unable" does not mean "unwilling". If a person has ample funds to meet obligations and chooses not to do so, he, in my opinion, is not insolvent by reason of para. (*a*) of the definition. The unpaid creditors may enforce their claims if they choose to do so. In the context of the definition I see no difference between a person who has the funds and a person who has the funds available to him if he chooses. The trustee has not satisfied me on the balance of probabilities that in November 1979 Toyerama Limited was unable to meet its obligations as they generally became due.

23 The issue raised by para. (*b*) is more difficult. There were unpaid creditors in substantial amounts. Marvin Fleishman said that some amounts were disputed and that many creditors had either agreed to wait or understood that they would not be paid until the end of the 1979 season. This was because of the nature of the business where most of the sales were made in the last quarter of the year. No doubt there were some creditors who had not agreed or who had not accepted the understanding that payment would be late. No inquiry was made by the trustee as to these arrangements. Some trade creditors were paid in November and December 1979, and of these some may have been dealing with Toyerama on a C.O.D. basis. The problem is that there is no direct evidence from any of the unpaid creditors which might affirm or deny the arrangements Marvin Fleishman says were made. Leyshon-Hughes on cross-examination said he could not say either way whether the bankrupt was meeting its current obligations. I am unable to find, on the evidence, that in November 1979 Toyerama Limited had ceased to pay its current obligations in the ordinary course of business as they generally became due.

24 Finally, with respect to para. (*c*), the unaudited balance sheet of Toyerama as at 30th September 1979 showed an excess of liabilities over assets. It would be a fair inference that the situation did not improve in October or November 1979. The principal property of Toyerama was its accounts receivable and inventory. Its fixed assets were shown on the financial statement at a cost of approximately $57,000. There was no evidence of the fair valuation of the assets and as previously indicated the amount of obligations due and accruing due is uncertain. There is no basis for finding Toyerama insolvent because of para. (*c*) of the definition.

25 I conclude that the trustee has not satisfied the onus on it to show on the balance of probabilities that Toyerama was an insolvent person in November 1979. The claim by the trustee must therefore be dismissed.

26 The second issue should, nevertheless, be considered in the event that I am wrong in my conclusion on insolvency. On this issue, Edith Fleishman has the onus of establishing that the transactions were not entered into with a view to giving her a preference over other creditors. In several cases, it has been said that if a 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, the onus has been satisfied: see *Re Mac-Wall Contr. Ltd.* (1970), 14 C.B.R. (N.S.) 52 (Ont. S.C.) ; and *Re Van der Liek* (1970), 14 C.B.R. (N.S.) 229 (Ont. S.C.) . The test is an objective one and in *Re Holt Motors Ltd.; Can. Credit Men's Assn. Ltd. v. Stonewall Credit Union Soc. Ltd.* (1966), 9 C.B.R. (N.S.) 92, 56 W.W.R. 182, 57 D.L.R. (2d) 180 (Man. Q.B.) , Bastin J. said at p. 95:

> In order to meet the presumption created by s. 64 [now s. 73] the respondent must show that the purpose of creating the securities was not to place the respondent in a preferred position over the other creditors. In light of all the circumstances existing on 23rd July 1965, 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.

27 As previously stated, I have found that there was no intention on the part of the Toyerama management in November 1979 to cease carrying on business. The relationships amongst Toyerama, Edith Fleishman, Marvin Fleishman and Allan Fleishman were complex. Edith Fleishman and Marvin Fleishman dealt with each other at arm's length. Allan Fleishman worked with his father, but appeared to have a good relationship with his mother. They owned a joint bank account and he was in the habit of giving her financial advice. There was a firm obligation to pay her for the inventory and Edith Fleishman was insisting in November 1979 that it be paid for on time; likewise, in the following December she refused to extend the payment date for the debenture given the previous January. In November 1979 Allan Fleishman says there was no discussion as to whether or not to pay his mother and she was paid promptly on the due date. There were other creditors at that time, but the arrangements with them are uncertain. Marvin Fleishman says he proposed the loan of $35,000 because he was apprehensive as to what Edith Fleishman might do with the inventory payment. He says that he wanted to protect her. He had more than an altruistic interest in doing so because of his continuing support obligations to her. He agreed to give her security for the loan because she and her solicitor asked for it and this was consistent with the arrangement that had been made with respect to the indebtedness covered by the January 1979 debenture. It seems to me that the purpose of the transactions with Edith Fleishman was to preserve the delicate relationship between her and her former husband and was not to prefer her over other creditors. There was no intention that I can infer from the evidence of an intention not to pay the other creditors in due course. Mrs. Fleishman has, therefore, satisfied me on the balance of probabilities that Toyerama did not enter the impugned transactions with a view of giving Edith Fleishman a preference over other creditors.

28 In the result, the claim is dismissed. Both the trustee and Edith Fleishman should have their costs out of the estate.

*Application dismissed.*

End of Document



 

# TAB 15

1936 CarswellSask 15
Saskatchewan King's Bench

A.R. Colquhoun & Son Ltd., Re

1936 CarswellSask 15, [1937] 1 W.W.R. 222, 18 C.B.R. 124

# In re A. R. Colquhoun & Son Limited

Canadian Credit Men's Trust Association Limited v. Campbell, Wilson & Strathdee Limited

MacDonald, J.

Judgment: November 25, 1936

Counsel: *J. L. McDougall, K.C.*, for trustee.
*H. F. Thomson, K.C.*, for defendant.

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Intention other than to prefer — Intention to remain in business**

Fraudulent Preference — Payments Made by Retailer to Wholesaler Within Three Months of Bankruptcy — Motion to Set Aside Dismissed — Debtor Hoping to Extricate Himself — Exchange of Goods — The Bankruptcy Act, S. 64, 9 C.B.R. 141.

Payments made and goods returned by a retailer to a creditor, a wholesaler, within three months of the former's bankruptcy, the payments being for goods delivered during that period or for goods delivered previously the credit for which had expired during said period, held not to be a preference within sec. 64 of *The Bankruptcy Act*, since it was also found that during that period there was the hope on the part of the debtor that he would be able to extricate himself from his difficulties and the goods were supplied by the wholesaler with the hope of enabling him to do so; and the goods which were returned in exchange for other goods and the assets of the bankrupt available for distribution among his creditors were not affected by the exchange, because if the goods had not been returned the new goods supplied in lieu thereof would have had to be paid for in cash.

[*Tomkins v. Saffery*, 3 App. Cas. 213, at 235, 47 L.J. Bk. 11, applied].

A motion on behalf of the trustee in bankruptcy to set aside payments of money and transfers of property made by the debtor to Campbell, Wilson & Strathdee Ltd. on the ground that the same gave a preference to Campbell, Wilson & Strathdee Ltd. over the other creditors within the meaning of sec. 64 of *The Bankruptcy Act* [9 C.B.R. 141]. The motion was also for an accounting for certain goods which had been returned by the debtor to said company within three months prior to the filing of the petition in bankruptcy. The debtor in order to hold a sale by which he hoped to reduce his stock and accumulate some ready money had exchanged with said company said goods, then unsaleable, for other goods which were more readily saleable.

***MacDonald, J.* (oral) (after stating the nature of the motion):**

1 Before any such payment or transfer of property can be set aside these conditions must be fulfilled as summarized in 2 *Halsbury*, 1st ed., p. 280:

> (1)The debtor must at the date of the transaction be unable to pay from his own money his debts as they fall due; (2) the transaction must be in favour of a creditor, or of some person in trust for a creditor; (3) the debtor must have acted with the view of giving such creditor a preference over his other creditors; (4) the debtor must be adjudged bankrupt on a bankruptcy petition presented within three months after the date of the transaction sought to be impeached.

2 Now in this case I find on the evidence the following facts: That any payment made by the debtor to Campbell, Wilson & Strathdee Ltd. within the three months in question were payments made for goods delivered during that period or for goods delivered in the month prior thereto, the ordinary time of credit for which expired during the period in question. I also find as a fact that during all that time there was the hope, however ill founded on the part of the debtor, that he would be able to extricate himself from his financial difficulties and that these goods were supplied with the hope of enabling the debtor to realize his expectations. As to the return of goods by the debtor to the creditor I am satisfied on the evidence that the same was done through an arrangement by which other goods would be supplied to the debtor in their place and the fact exchanges were made did not affect the assets of the bankrupt available for distribution among other creditors, because if these goods had not been returned to Campbell, Wilson & Strathdee Ltd. the new goods supplied in lieu thereof would have had to be paid for in cash.

3 Under this state of facts the question arises whether what the debtor did was done with a view of giving a preference to Campbell, Wilson & Strathdee Ltd. In *2 Halsbury*, 1st ed., p. 282, I find the following:

> Again, in order that a transaction may be a fraudulent preference, not only must the person who derives the advantage from the transaction be a creditor, but the act must have been done in his favour, and not in favour of anyone else. Where, therefore, although the creditor be in fact preferred in the sense of obtaining a benefit not shared by the debtor's other creditors, yet the act was done by the debtor with a view of benefiting himself, and not the creditor, then, even if all the other elements of fraudulent preference be present, the transaction cannot, on the ground that the creditor derives an advantage, be set aside.

4 For instance in *Sharp v. Jackson*, [1899] A.C. 419, 68 L.J. Q.B. 866, the facts were that a trustee who was in solvent circumstances and had committed a breach of trust, on the eve of insolvency, conveyed properties to make good his breaches of trust. It was held that as such conveyance took place with a view of protecting the trustee from the consequences of the breaches of trust, it was not a preference within the meaning of the Act. But perhaps the statement of the law which best fits the facts of this case is that by Blackburn, L.J., in *Tomkins v. Saffery* (1877), 3 App. Cas. 213, at 235, [1] where he says:

> Now I think you must say it is not with a view to give an undue preference, if a man makes a payment to a creditor in the ordinary course of business. Supposing a bankrupt, although knowing that he is very likely to stop payment next week, struggles on and makes a payment without being particularly asked; supposing he pays his debts and sends his money to meet his bills on those days on which they become due, and does other things so as to keep himself alive and in good credit for the time; that would not have been undue preference I think, because those payments were not made 'in favour of' certain creditors as against others, but were made in the hope — a desperate hope perhaps — that if he were able to keep himself alive something might turn up in his favour.

5 That is a statement so applicable to the facts of the present matter that I find it unnecessary to add anything. The motion is dismissed.

Footnotes

1 Although the Law Journal reports the same case, 47 L.J. Bk. 11, the report therein does not include the statement quoted. — Ed.

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# TAB 16

1994 CarswellAlta 353
Alberta Court of Queen's Bench, In Bankruptcy

Norris, Re

1994 CarswellAlta 353, [1994] A.W.L.D. 831, [1994] A.J. No. 699, [1995] 1 W.W.R. 292, 161 A.R. 77, 23 Alta. L.R. (3d) 397, 28 C.B.R. (3d) 167

# Re Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended; Re bankruptcy of DAVID CARL NORRIS

Agrios J.

Judgment: September 21, 1994
Docket: Doc. Edmonton BKCY 39553

Counsel: *K.A. Rowan* , for Browning, Smith Inc., trustee in bankruptcy of David Carl Norris.
*S.J. Bocock* , for Minister of National Revenue.

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bankruptcy --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Doctrine of pressure**

Revenue Canada required to pay trustee amount received from bankrupt.

Revenue Canada was owed money by the bankrupt. It made several demands for payment. The bankrupt requested and was granted a one-month grace period, after which he paid $8,548.40 to Revenue Canada. Two months later, he made an assignment in bankruptcy. The trustee in bankruptcy applied for a declaration that the payment to Revenue Canada was a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act* and for an order requiring the payment to the trustee of $8,548.40.

**Held:**

The application was allowed.

Revenue Canada could rebut the statutory presumption under s. 95 by showing either that: (1) it was a diligent creditor, or (2) the payment was made in the ordinary course of business. Revenue Canada's forwarding of three letters to the bankrupt and the granting of a grace period could be described as steps that an ordinary creditor would take. Its actions were not sufficiently aggressive as to create an imminent business or personal crisis for the bankrupt. Had they been so, Revenue Canada would have rebutted the statutory presumption. As Revenue Canada did not constitute a trade creditor of the bankrupt, it could not be said that it received the payment in the ordinary course of business.

**Table of Authorities**

**Cases considered:**

*Coopers & Lybrand Ltd. v. O'Brien Electric Co.* (1983), 47 C.B.R. (N.S.) 243, 48 N.B.R. (2d) 189, 126 A.P.R. 189 (Q.B.) — *referred to*

*Houston v. Thornton* (1973), 18 C.B.R. (N.S.) 102 (Ont. S.C.) — *referred to*

**Statutes considered:**

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 —

s. 95

s. 95(2)

Application by trustee in bankruptcy for declaration that payment to Revenue Canada was fraudulent preference.

***Agrios J.*** **:**

1 In this bankruptcy I held that a payment of $8,548.40 made to Revenue Canada was a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act* .

2 At the time the decision was rendered, I indicated to counsel that should they require written reasons I would be happy to provide such and I now do so at the request of counsel for Revenue Canada.

**Facts**

3 The facts are not in issue. On November 25, 1992 Revenue Canada received a payment on taxes of $8,548.40 from David Carl Norris. On January 26, 1993 Mr. Norris made a voluntary assignment into bankruptcy.

4 Revenue Canada had made a series of demands on the bankrupt. There was a letter on September 12, 1992, a notice of October 9, 1992 amending the balance owing and again demanding payment, and a final letter on October 24, 1992 making still a further demand and stating that if arrangements were not made for payment, legal action such as garnishee of income or instructions to the Sheriff to seize and sell assets might be made. On October 29, 1992 the bankrupt called Revenue Canada in response to the last letter, and requested a one-month grace period, which was granted and the aforementioned payment was received on November 25, 1992.

**Issues**

5 There is no serious dispute that the prima facie presumption under s. 95 as raised by the Trustee had established the three required criteria, namely:

1. that the transfer took place within three months of bankruptcy;

2. that at the date the transfer was made, it gave the creditor a preference in fact;

3. that the debtor was an insolvent person at the date of the payment.

6 Section 95(2) of the Act provides that the presumption may be rebutted on a balance of probabilities that the dominant intention of the debtor was not to prefer the creditor. There were only two issues that Revenue Canada could use to rebut the presumption:

1. they were a diligent creditor;

2. alternatively, the payment was made in the ordinary course of business.

**Ordinary Course of Business**

7 I have accepted the submission of counsel for the Trustee. As stated in its brief of law, all of the cases cited by Revenue Canada can fairly be characterized as payments made by the debtor in the ordinary course of its business to trade creditors for two reasons Firstly, so that the bankrupt might take advantage of favourable payment terms or, secondly, to secure a continued supply of goods and services from those trade creditors in order that it might continue in its business. There is no doubt that evidence that after payment on account, goods were supplied to the bankrupt by a trade creditor which, under normal circumstances, rebut the presumption. I accept Mr. Rowan's submission that Revenue Canada was not a trade creditor and there was no evidence that would assist Revenue Canada to be considered a trade creditor in having received a payment in the ordinary course of business.

**Diligent Creditor**

8 The case of *Houston v. Thornton* (1973), 18 C.B.R. (N.S.) 102 (Ont. S.C.) , followed by *Coopers & Lybrand Ltd. v. O'Brien Electric Co.* (1983), 47 C.B.R. (N.S.) 243 (N.B. Q.B.) , is cited for the following proposition [p. 103]:

> Both creditors had substantially overdue accounts and both were exerting every effort to obtain payment of their accounts. As has been so often said, our law does not penalize a diligent creditor. In order for me to set aside these transactions, I must find that there was a fraudulent scheme on the part of the debtor to prefer these creditors over other creditors.
>
> On the evidence, I cannot find any such scheme. Rather, I think it is a situation where diligent creditors have managed to obtain substantial payments on their accounts at a time when other creditors, who were not as diligent, did not obtain payment.
>
> ... The only reason for making the payments to the respondents was because the respondents were pressing more vigorously than other creditors for payment of their accounts.

9 I have again accepted the submissions of counsel for the Trustee that these authorities are characterized by a theme of an extremely aggressive creditor whose actions would cause an imminent business crisis unless they were dealt with. As Mr. Rowan stated: "The payments were motivated by a desire to 'get the creditor off the debtor's back', and because the continued actions of the creditor would cause an immediate business crisis."

10 Frankly, in my view, the forwarding of three letters, one of which threatened legal action and the subsequent granting of one month's grace period, could best be described as steps that any ordinary creditor would take, making demands and threatening legal proceedings. I accept the proposition that the actions of Revenue Canada, when compared with those in the cited authorities, did not amount to such aggressive action such as to create an imminent business or personal crisis for the bankrupt. Had Revenue Canada in fact taken garnishee proceedings or instructed seizure, I should have held otherwise.

11 Accordingly, as the presumed intention was not, in my view, rebutted on the balance of probabilities, I ordered that Revenue Canada pay the Trustee the sum of $8,546.40.

*Application allowed.*

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TAB 17

2005 NBCA 55
New Brunswick Court of Appeal

St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.

2005 CarswellNB 285, 2005 CarswellNB 286, 2005 NBCA 55, [2005] N.B.J. No. 204, 13 C.B.R. (5th) 125, 255 D.L.R. (4th) 137, 286 N.B.R. (2d) 95, 748 A.P.R. 95, 9 B.L.R. (4th) 1

# In the Matter of the Bankruptcy of St. Anne Nackawic Pulp Company Ltd.

Logistec Stevedoring (Atlantic) Inc. (Respondent / Appellant) and A.C. Poirier & Associates Inc., Trustee in Bankruptcy of St. Anne Nackawic Pulp Company Ltd. (Applicant / Respondent)

Turnbull, Deschênes, Robertson JJ.A.

Heard: March 22, 2005
Judgment: June 2, 2005
Docket: 186/04/CA

Proceedings: reversing *A. C. Poirier & Associates Inc. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2004), 2004 CarswellNB 633, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 276 N.B.R. (2d) 147, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 724 A.P.R. 147, 7 C.B.R. (5th) 1, 2004 NBQB 457 (N.B. Q.B.)

Counsel: D. Leslie Smith, Q.C. for Appellant
G. Patrick Gorman, Q.C. for Respondent

Subject: Contracts; Corporate and Commercial; Torts; Insolvency

### Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

### Headnote

**Debtors and creditors --- Fraudulent conveyances — What constituting**

LS Inc. provided storage and loading services to bankrupt — At date of bankruptcy, bankrupt had paper stored in warehouses of LS Inc. — On date bankruptcy declared, bankrupt paid LS Inc. $562,574.72 — Trustee moved successfully for declaration that payment was fraudulent conveyance within meaning of s. 95 of Bankruptcy and Insolvency Act ("BIA") — LS Inc. appealed — Appeal allowed — Mere establishment of preference in fact does not lead to conclusion that payment qualifies as fraudulent preference within meaning of s. 95 of BIA — Where insolvent debtor pays one creditor at expense of another for purposes of carrying on business, payment will more likely than not be deemed not to constitute fraudulent preference — Bankrupt made payment in order to honour its contractual obligations to its customers who had purchased pulp and, hence, to ensure that goods were duly shipped — Bankrupt's dominant intent was to maximize its recovery on its secured debt — Transaction between bankrupt and LS Inc. made good commercial sense.

**Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Intention other than to prefer — Transaction in ordinary course of business**

LS Inc. provided storage and loading services to bankrupt — At date of bankruptcy, bankrupt had paper stored in warehouses of LS Inc. — On date bankruptcy declared, bankrupt paid LS Inc. $562,574.72 — Trustee moved successfully for declaration that payment was fraudulent conveyance within meaning of s. 95 of Bankruptcy and Insolvency Act ("BIA") — LS Inc. appealed — Appeal allowed — Mere establishment of preference in fact does not lead to conclusion that payment qualifies as fraudulent preference within meaning of s. 95 of BIA — Where insolvent debtor pays one creditor

at expense of another for purposes of carrying on business, payment will more likely than not be deemed not to constitute fraudulent preference — Bankrupt made payment in order to honour its contractual obligations to its customers who had purchased pulp and, hence, to ensure that goods were duly shipped — Bankrupt's dominant intent was to maximize its recovery on its secured debt — Transaction between bankrupt and LS Inc. made good commercial sense.

**Table of Authorities**

**Cases considered by *Robertson J.A.*:**

*Craig (Trustee of) v. Devlin Estate* (1989), 63 Man. R. (2d) 122, (sub nom. *Craig (Trustee of) v. Craig)* 76 C.B.R. (N.S.) 256, 1989 CarswellMan 31 (Man. C.A.) — referred to

*Davis v. Ducan Industries Ltd.* (1983), 45 C.B.R. (N.S.) 290, 1983 CarswellAlta 249 (Alta. Q.B.) — considered

*Econ Consulting Ltd. (Trustee of) v. Deloitte Haskins & Sells* (1985), 56 C.B.R. (N.S.) 60, (sub nom. *Coopers & Lybrand Ltd. v. Deloitte Haskins & Sells)* 31 Man. R. (2d) 313, 1985 CarswellMan 23 (Man. C.A.) — considered

*Hudson v. Benallack* (1975), [1976] 2 S.C.R. 168, 21 C.B.R. (N.S.) 111, [1975] 6 W.W.R. 109, 7 N.R. 119, 59 D.L.R. (3d) 1, 1975 CarswellAlta 157, 1975 CarswellAlta 139 (S.C.C.) — referred to

*Norris, Re* (1996), 45 Alta. L.R. (3d) 1, [1997] 2 W.W.R. 281, (sub nom. *Norris (Bankrupt), Re)* 193 A.R. 15, 135 W.A.C. 15, 44 C.B.R. (3d) 218, 1996 CarswellAlta 884 (Alta. C.A.) — referred to

*Royal City Chrysler Plymouth Ltd., Re* (1998), 1998 CarswellOnt 1041, 38 O.R. (3d) 380, 3 C.B.R. (4th) 167 (Ont. C.A.) — referred to

*Speedy Roofing Ltd., Re* (1990), (sub nom. *Royal Bank v. Roofmart Ontario Ltd.)* 74 O.R. (2d) 633, 79 C.B.R. (N.S.) 58, (sub nom. *Royal Bank v. Roofmart Ontario Ltd.)* 38 O.A.C. 136, 1990 CarswellOnt 180 (Ont. C.A.) — referred to

*Van der Liek, Re* (1970), 14 C.B.R. (N.S.) 229, 1970 CarswellOnt 82 (Ont. S.C.) — referred to

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
s. 95 — considered

s. 95(1) — considered

s. 95(2) — considered

*Fraudulent Conveyances Act*, 1571 (13 Eliz. 1), c. 5
Generally — referred to

APPEAL by creditor from judgment reported at *St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2004), 2004 CarswellNB 633, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 276 N.B.R. (2d) 147, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 724 A.P.R. 147, 7 C.B.R. (5th) 1, 2004 NBQB 457 (N.B. Q.B.), declaring that payment made by bankrupt was fraudulent preference within meaning of s. 95 of *Bankruptcy and Insolvency Act.*

***Robertson J.A.*:**

 

1 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 (N.B. Q.B.). 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.

**95.** (1) Sont tenus pour frauduleux et inopposables au syndic dans la faillite tout transport ou transfert de biens ou charge les grevant, tout paiement fait, toute obligation contractée et toute instance judiciaire intentée ou subie par une personne insolvable en faveur d'un créancier ou d'une personne en fiducie pour un créancier, en vue de procurer à celui-ci une préférence sur les autres créanciers, s'ils surviennent au cours de la période allant du premier jour du troisième mois précédant l'ouverture de la faillite jusqu'à la date de la faillite inclusivement.

(2) Lorsqu'un tel transport, transfert, charge, paiement, obligation ou instance judiciaire a pour effet de procurer à un créancier une préférence sur d'autres créanciers, ou sur un ou plusieurs d'entre eux, il est réputé, sauf preuve contraire, avoir été fait, contracté, intenté, payé ou subi en vue de procurer à ce créancier une préférence sur d'autres créanciers, qu'il ait été fait ou non volontairement ou par contrainte, et la preuve de la contrainte ne sera pas recevable pour justifier pareille 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 *Van der Liek, Re* (1970), 14 C.B.R. (N.S.) 229 (Ont. S.C.).

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 *Van der Liek, Re*, 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* (1975), [1976] 2 S.C.R. 168 (S.C.C.), 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 *Norris, Re* (1996), 193 A.R. 15 (Alta. C.A.) at para. 16:

> 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 (Man. 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 *Speedy Roofing Ltd., Re* (1990), 74 O.R. (2d) 633 (Ont. C.A.) and also *Royal City Chrysler Plymouth Ltd., Re* (1998), 38 O.R. (3d) 380 (Ont. 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 (Man. 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.

*Appeal allowed.*

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# TAB 18

HMANALY F§210
Houlden & Morawetz Analysis F§210

# Houlden and Morawetz Bankruptcy and Insolvency Analysis

Bankruptcy and Insolvency Act
Part IV (ss. 67-101.2)

L.W. Houlden and Geoffrey B. Morawetz

## F§210 — Rebutting The Presumption

**F§210 — Rebutting The Presumption**

See ss. 95, 96

Once the amendments are proclaimed in force, the cases in this section will not be accurate; however, some of the previous caselaw may be helpful in interpreting the new provisions.

**(1) — Generally**

The presumption created by s. 95(2) is not an absolute or conclusive presumption; it is capable of being rebutted: *Salter & Arnold Ltd. v. Dominion Bank* (1926), 7 C.B.R. 639 (S.C.C.). The Supreme Court of Canada said, in the *Salter* case, that it is a question of fact whether the presumption has been displaced. There have been innumerable cases on whether the presumption has been rebutted, and it is difficult to draw general principles from them, since each case turns on its own particular facts. It is impossible to lay down any general rule as to the nature and character of the evidence that is sufficient to rebut the presumption: *Re McGrogan* (1926), 7 C.B.R. 584 (Ont. S.C.).

Once the three conditions precedent to a finding of a fraudulent preference are met, a rebuttable presumption arises that the payment was made with a view to giving that creditor a preference over other creditors, and the onus is on the creditor to show on a balance of probabilities that the dominant intent of the debtor was not to prefer the creditor, with dominant intent being an objective, not subjective, test: *A.C. Poirier & Associates Inc. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2005), 13 C.B.R. (5th) 125, 2005 CarswellNB 285, 2005 CarswellNB 286, 2005 NBCA 55 (N.B.C.A.).

There is considerable discussion in the cases about "dominant view" or "dominant intent" of the debtor. This concept is useful in distinguishing motive from intent, "motive" being the underlying reason or emotion prompting the debtor's actions, such as friendship, fear, *etc.*, "intent", on the other hand, being the object aimed at by the debtor when he or she made the conveyance, transfer, payment, *etc.* Thus, if a debtor makes a payment to a creditor within three months of bankruptcy because the creditor is a friend and the debtor wishes to prefer him or her over other creditors, the motive for the payment is friendship, but the intent is to prefer.

The distinction between motive and intent is also useful where a debtor has more than one intent, *e.g.*, where he or she intended to give preferential treatment to the creditor but made the payment in order to avoid arrest. For a discussion of the problem, see *Re Cutts* (1956), 1 W.L.R. 728, [1956] 2 All E.R. 537, 100 Sol. Jo 449 (C.A.).

The Manitoba Court of Queen's Bench held that there is not a specific standard to be met by a creditor in establishing the notion of a "diligent creditor" when rebutting the presumption of a fraudulent preference under (previous) s. 95(2) of the *BIA* (i.e., it does not apply only where the actions of the creditor would cause an imminent business or commercial crisis); rather, this is a question of fact to be determined from all of the circumstances. The court was satisfied that it could make an inference concerning the debtor's dominant intention in making a challenged payment, as the *CRA* collection officer had vigorously pursued the bankrupt; there was no evidence to suggest that the bankrupt was being pursued by other creditors; the bankrupt

agreed to pay the debt six months before the assignment in bankruptcy; and the payment itself was made only a few days within the three month prohibited period under s. 95(1): *Krawchenko (Trustee of) v. Minister of National Revenue* (2005), 2005 CarswellMan 172, 2005 MBQB 97, 11 C.B.R. (5th) 238 (Man. Q.B.).

Even if the bankrupt or an officer of the bankrupt company testifies that there was no intention to prefer, the court must look at all circumstance and determine if there was, in fact, an intention to prefer: *Re Krisandra Yachts* (1973), 18 C.B.R. (N.S.) 39 (Ont. S.C.).

Although the subjective intent of the debtor is relevant in deciding whether the presumption has been rebutted, the trial judge must determine objectively whether that intent is reasonable in the circumstances: *Jean Fortin & Associés Syndic Inc. c. Francon-Lafarge*, 23 C.B.R. (4th) 158, [1997] R.J.Q. 866, (sub nom. *Excavation Boyer & Frères Inc., Re)* 1997 CarswellQue 219 (Que. C.A.).

If, after considering all the evidence, the court is satisfied on a balance of probabilities that the debtor was pursuing a purpose other than that of favouring the particular creditor over other creditors, the presumption is displaced and the trustee's application will be dismissed: *Re Norris* (1996), 44 C.B.R. (3d) 218, 45 Alta. L.R. (3d) 1, [1997] 2 W.W.R. 281, 193 A.R. 15, 135 W.A.C. 15, 1996 CarswellAlta 884 (C.A.).

Where there was ample evidence that a bankrupt was insolvent at the time of payments to a creditor, payments were deemed to be fraudulent preferences in the absence of evidence to the contrary; and a bankrupt's evidence that he made credit card debt payments over the minimum payment required in preference to any payments to Canada Revenue Agency in order to avoid high interest rates on the credit card did not amount to evidence to rebut the presumption: *Re Ramsey* (2006), 2006 CarswellAlta 669, 2006 ABQB 337, 60 Alta. L.R. (4th) 374, [2006] 9 W.W.R. 756, 21 C.B.R. (5th) 213 (Alta. Q.B.).

Where a bankrupt operated a sole proprietorship and used the proceeds from a mortgage on the bankrupt's home to pay debts to credit card companies, and shortly thereafter filed bankruptcy upon finding that an expected tax refund was in fact a tax liability, the court dismissed the trustee's action to declare the payments constituted a fraudulent preference. It held that while the trustee was entitled to rely on the presumption in s. 95(2) of the *BIA*, the presumption had been rebutted on the basis that it was not the bankrupt's dominant intention to prefer a creditor and that the bankrupt's intention was objectively reasonable. The bankrupt had an honest belief at the time of the payments that the bankrupt could avoid bankruptcy as a means of dealing with the financial distress, and the loss of expected revenue served as a crucial and unexpected event forcing the assignment: *Coderre (Trustee of) v. MBNA Canada Bank* (2006), 2006 CarswellMan 369, 26 C.B.R. (5th) 175, 2006 MBQB 245 (Man. Q.B.).

Where a bankrupt used money from a marital property equalization payment to pay a large amount of credit card debt to the bank and pay other selected creditors and then filed for bankruptcy when the bank declined a loan to avoid bankruptcy, the court held that the payments were a preference within the meaning of s. 95 of the *BIA* (as previously worded). The bankrupt was insolvent at the date of the payment and failed to rebut the statutory presumption that her dominant intention was to give the bank a preference. The bankrupt selected accounts to pay in full, knowing that other creditors would receive minimal or no payment and her plan to consolidate her debts under a bank loan was not objectively reasonable. The bank also failed to prove that it would have initiated legal proceedings to recover the debt: *Dubois-Vandale (Trustee of) v. MBNA Canada Bank* (2006), 2006 CarswellMan 377, 26 C.B.R. (5th) 261, 2006 MBQB 258 (Man. Q.B.).

The Manitoba Court of Appeal dismissed the appeal of the Minister of National Revenue (MNR) from an order declaring certain payments made by the debtor were fraudulent preferences on the basis that the Minister had not rebutted the presumption under s. 95 of the *BIA*. The debtor had made two payments of income tax to the MNR within three months prior to her bankruptcy. The trustee successfully challenged those payments as fraudulent preferences under s. 95 and MNR appealed. The court held that the applicant has the initial onus of establishing a *prima facie* case that the debtor made a payment to a creditor within three months prior to the date of bankruptcy; the debtor was insolvent person at the time of the payment; and the payment was made with a view to giving that creditor a preference over the other creditors. If the application judge is satisfied that the onus has been met, the onus shifts to the deemed preferred creditor to rebut the presumption. At that point, the application judge will review the evidence adduced by that creditor; and to be successful, the deemed preferred creditor must establish, on a balance of

probabilities, that at least one of the three factors did not exist when the debtor made the payment. The dominant intent is based on an objective assessment of the circumstances. The court held that the application judge correctly stated the legal principles to be applied. A key factor was that MNR had not appealed the application judge's ruling that the applicant had established a *prima facie* case that the debtor was insolvent and intended to prefer the MNR at the time she made the payments. As a result, the payments gave the MNR a preference in fact and the presumption of intent to prefer applied. The onus had shifted from the applicant to the MNR. On the evidentiary record before the application judge, it was open for the judge to find, first, that there was no satisfactory explanation given for the increased expenditure rate and, second, that her repayment plan to avoid bankruptcy was not objectively reasonable: *Andrews (Trustee of) v. Minister of National Revenue*, 2011 CarswellMan 613, 85 C.B.R. (5th) 286, 2011 MBCA 93 (Man. C.A.).

See Gordon Levine and Anastasia Flouris, "Rebutting the Presumption, Prior Agreements and Section 95 of the *BIA*", in J. Sarra, ed., *Annual Review of Insolvency Law, 2008* (Toronto: Carswell, 2009).

The Alberta Court of Appeal analyzed preferential payments under s. 95 of the *BIA*. A trustee applied for a declaration that a payment to a creditor was void by virtue of s. 95(1)(a). The court observed that in *Piikani Nation v. Piikani Energy Corp.*, 2012 CarswellAlta 459, 88 C.B.R. (5th) 1, 2012 ABQB 187 (Alta. C.A.), it was found that the use of the term "fraudulent" is sometimes inappropriate and may wrongly impugn the integrity of the creditor receiving the payment because the creditor may not know that it is being paid in preference to others; and may 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. The fact that such payment has had the effect of conferring a preference may only be apparent with the benefit of hindsight. The Court of Appeal indicated that a preferable phrase to describe these potentially voidable payments is preferential payment. If the payment confers a preference in fact, the presumption will be that the payment was intended to confer a preference; and if the presumption is not rebutted, the payment will be void as against the trustee. The onus or burden of rebutting the presumption in s. 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 it is the intention of the insolvent debtor that governs. A payment made in the ordinary course of business will not be found to have been made with a view to giving a preference; and what constitutes a payment made in the ordinary course of business is fact dependent. In this case, the judge sitting in bankruptcy 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 the debtor wanted to liquidate it, which the judge found that to be a legitimate and sensible business decision. The Court of Appeal observed that under s. 95(2), evidence of pressure is not admissible to validate a preferential payment; however, it may not be necessary to deal with the pressure argument because if there was evidence rebutting the presumption, then the fact that there might also have been evidence of pressure was irrelevant. In this case, the bankruptcy judge concluded that the payment was commercially necessary in order to secure access to an asset that could be sold to generate revenue and it was not therefore made with a view to giving a preference. The Court of Appeal held that the judge's conclusion must be accorded deference: *Orion Industries Ltd. (Trustee of) v. Neil's General Contracting Ltd.*, 2013 CarswellAlta 1795, 2013 ABCA 330 (Alta. C.A.).

**(2) — Ordinary Course of Business**

If the court, after examining all relevant evidence, concludes that a payment was made in the ordinary course of business and not with intent to prefer, the presumption will have been rebutted and the payment will stand: *Touche Ross Ltd. v. Weldwood of Canada Sales Ltd.* (1983), 48 C.B.R. (N.S.) 83; additional reasons at 49 C.B.R. (N.S.) 284 (Ont. S.C.).

Whether or not a payment was made in the ordinary course of business or with intent to prefer depends on the facts of the case and the nature of the business engaged in by the debtor and the creditor: *Deloitte & Touche Inc. v. White Veal Meat Packers Ltd.* (2000), 16 C.B.R. (4th) 74, 143 Man. R. (2d) 289, 2000 CarswellAlta 72 (Q.B.); affirmed (2000), 21 C.B.R. (4th) 234, 2000 MBCA 120, 153 Man. R. (2d) 81, 238 W.A.C. 81, 2000 CarswellMan 602 (C.A.). The court should not attempt to formulate a comprehensive definition of "ordinary course of business". The approach of the court should be objective, i.e., the court must ask itself whether, regarded objectively, solvent persons would, in the normal course of business, have acted in the same way as the parties concerned in the impugned transaction. In other words, is the transaction one that would not to the ordinary businessperson appear anomalous or unbusinesslike or surprising? The fact that a payment is made by the debtor after its due date does not *ipso facto* mean that it was not made in the ordinary course of business: *Re Totem Painting Co.* (1960), 1 C.B.R.

(N.S.) 38, 32 W.W.R. 143 (B.C. S.C.); *Cargill Ltd. v. Compton Agro Inc.* (1998), 7 C.B.R. (4th) 132, [1999] G.S.T.C. 25, 99 G.T.C. 7044, 132 Man. R. (2d) 110, 1998 CarswellMan 502 (Q.B.); reversed on other grounds 1 B.L.R. (3d) 38, 15 C.B.R. (4th) 35, [2000] G.S.T.C. 4, [2000] 3 W.W.R. 189, 142 Man. R. (2d) 130, 212 W.A.C. 130, 2000 CarswellMan 42 (C.A.); application for a re-hearing denied 2000 MBCA 29, 17 C.B.R. (4th) 42, [2000] 5 W.W.R. 550, [2000] G.S.T.C. 23, 145 Man. R. (2d) 227, 218 W.A.C. 227, 2000 CarswellMan 216 (Man. C.A.). If the payment was normal in the context of the business relations between the parties and standard for their particular industry, it will be in the ordinary course of business, even though it is overdue: *Re Pacific Mobile Corp.* (1985), 55 C.B.R. (N.S.) 32, [1985] 1 S.C.R. 290, 16 D.L.R. (4th) 319, 57 N.R. 63; affirming (1982), 44 C.B.R. (N.S.) 190, [1982] C.A. 501, 141 D.L.R. (3d) 696 (Que. C.A.); reversing (1979), 34 C.B.R. (N.S.) 8 (Que. S.C.); *Re Consol. Seed Exports Ltd.* (1986), 62 C.B.R. (N.S.) 156, 69 B.C.L.R. 273 (S.C.); *Re Checkout Foodmarts Ltd.* (1977), 24 C.B.R. (N.S.) 286 (Ont. H.C.).

Although the subjective intent of the debtor to remain in business is relevant in deciding whether the presumption has been rebutted, the trial judge must determine objectively whether that intent is reasonable in the circumstances. In order for the judge to find that the debtor's intent to continue in business was reasonable, it is not necessary for the creditor who received the alleged preference to prove that the debtor was able at the relevant time to pay all his creditors in full: *Jean Fortin & Associés Syndic Inc. c. Francon-Lafarge*, 23 C.B.R. (4th) 158, [1997] R.J.Q. 866, (sub nom. *Excavation Boyer & Frères Inc., Re)* 1997 CarswellQue 219 (Que. C.A.)

Payments in the ordinary course of business will ordinarily be made for one of two reasons: (a) so that the bankrupt might take advantage of favourable payment terms, or (b) to secure a continued supply of goods or services from the trade creditor so that the bankrupt could continue in business: *Re Norris* (1994), 28 C.B.R. (3d) 167, 1994 CarswellAlta 353 (Alta. Q.B.).

If a creditor is not a trade creditor, *e.g.*, Revenue Canada, it cannot claim that a payment that it received was made in the ordinary course of business: *Re Norris, supra.*

A payment by the debtor at a time when it is insolvent and on the eve of bankruptcy to a related company is not made in the ordinary course of business: *Re Moureaux, Hauspy, Forrest Design Inc.* (1995), 33 C.B.R. (3d) 42, 1995 CarswellOnt 314 (Ont. Gen. Div.).

Where the payments made to a creditor are disproportionately large, the court may conclude that the payments are not made in the ordinary course of business, even though the creditor at the date of bankruptcy is owed more than other creditors: *Deloitte & Touche Inc. v. White Veal Meat Packers Ltd.* (2000), 16 C.B.R. (4th) 74, 143 Man. R. (2d) 289, 2000 CarswellMan 72 (Q.B.); affirmed (2000), 21 C.B.R. (4th) 234, 2000 MBCA 120, 153 Man. R. (2d) 81, 238 W.A.C. 81, 2000 CarswellMan 602 (C.A.).

In *S.R. Petroleum Sales Ltd. (Receiver of) v. Arlyn Enterprises Ltd.* (2000), 21 C.B.R. (4th) 296, 2000 ABQB 928, 2000 CarswellAlta 1397 (Master), it was held that a return of inventory in the three-month period prior to bankruptcy was not made in the ordinary course of business where (a) there was no practice of returning inventory; (b) the returned inventory constituted the bankrupt's entire inventory; and (c) there was no provision in the agreement between the bankrupt and the creditor for the return of inventory.

Even though the payment was not made in the ordinary course of business, it may still not be caught by s. 95(1) if it can be shown that there was no intent on the part of the debtor to prefer: *Re K. & C. Thermoglass Ltd.* (1979), 32 C.B.R. (N.S.) 166, 16 B.C.L.R. 33 (S.C.); *Re Consol. Seed Exports Ltd., supra.*

**(3) — Diligent Creditors**

The courts have held that where creditors acted diligently, the "intent to prefer" presumption was rebutted. The 2009 amendments will specify that evidence of pressure is not admissible to support the transaction: s. 95(2) (2007, c. 36 proclaimed in force as of September 18, 2009). Section 95(2) specifies that if the transfer, charge, payment, obligation or judicial proceeding has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made with a view to giving the creditor the preference, even if it was made, incurred, taken or suffered under pressure.

The Court has previously held that the law does not penalize a diligent creditor. If the court finds that the creditor in obtaining the payment or security was only acting as a diligent creditor and that there was no intent to prefer, the presumption will be rebutted: *Re Bois de la Malbaie Ltee* (1980), 36 C.B.R. (N.S.) 85 (Que. C.A.); *Re Reliable Gutter Shop on Wheels Ltd. (Reliable Exteriors)* (1985), 58 C.B.R. (N.S.) 156, 68 B.C.L.R. 67 (S.C.); *Re Consol. Seed Exports Ltd.* (1986), 62 C.B.R. (N.S.) 156 (B.C. S.C.); *Houston v. Thornton* (1973), 18 C.B.R. (N.S.) 102 (Ont. S.C.); *Re Totem Painting Co.* (1960), 1 C.B.R. (N.S.) 38, 32 W.W.R. 143 (B.C. S.C.); *Coopers & Lybrand Ltd. v. O'Brien Electric Co.* (1983), 47 C.B.R. (N.S.) 243, 48 N.B.R. (2d) 189, 126 A.P.R. 189 (Q.B.).

The court held, under the previous wording of the provision, that a creditor being paid in the ordinary course of its business or diligently pursuing collection efforts with success should not be penalized simply because there is a preference in fact. However, the preference in fact once found results in a presumption (in the absence of evidence to the contrary) that payment was made with a view to give the creditor preference over other editors. The issue must be looked at in the context not only of the presumption but also in the context of the motive and/or intention of the payor. Where payment of a creditor's overdue account was not the result of due diligence by the creditor but was made so that the debtor could obtain credit and inventory for a new company which had been formed by him, the court found that the payment was made with a view to giving the creditor a preference: *Medler-McKay Holdings Ltd. (Trustee of) v. Teac Canada Ltd.* (1994), 26 C.B.R. (3d) 147, 1994 CarswellOnt 284 (Ont. Gen. Div.); affirmed (1997), 50 C.B.R. (3d) 55, 1997 CarswellOnt 2192 (Ont. C.A.).

There is not a specific standard to be met by a creditor in establishing the notion of a "diligent creditor" when rebutting the presumption of a fraudulent preference under the previously worded s. 95(2) of the *BIA*; it does not apply only where the actions of the creditor would cause an imminent business or commercial crisis. Rather, this is a question of fact to be determined from all of the circumstances and the court can make an inference concerning the debtor's dominant intention in making a challenged payment, absent any direct evidence from the debtor, where the relevant creditor can establish that it was paid due to its diligent collection efforts and that the payment in question was not made with the intention of favouring one creditor over another: *Krawchenko (Trustee of) v. Minister of National Revenue* (2005), 2005 CarswellMan 172, 2005 MBQB 97, 11 C.B.R. (5th) 238 (Man. Q.B.).

A demand for a certified cheque by a creditor is not such an unusual matter as to constitute proof of intent to prefer: *Re Arthur Lennox Contractors Ltd. (No. 2)* (1959), 38 C.B.R. 125 (Ont. S.C.).

Previously, for the defence of "diligent creditor" to rebut the presumption, the evidence had to establish that the payment was made to get an aggressive creditor off the debtor's back and that the actions of the creditor would cause an imminent crisis unless they were dealt with immediately: *Re Norris* (1994), 28 C.B.R. (3d) 167, 1994 CarswellAlta 353 (Alta. Q.B.); reversed on other grounds (1996), 45 Alta. L.R. (3d) 1, [1997] 2 W.W.R. 281, 193 A.R. 15, 135 W.A.C. 15, 44 C.B.R. (3d) 218, 1996 CarswellAlta 884 (C.A.). The statutory language effective 2009 expressly states that pressure is not evidence sufficient to support the transaction.

The Ontario Superior Court of Justice, in dismissing a trustee's motion to declare that certain payments made to a landlord constituted a fraudulent preference, held that the presumption created by the statute had been met, but in view of the evidence, found that the presumption had been rebutted. The intent of the debtor was to avoid obligations to all creditors, not simply to prefer one creditor, the landlord, which took reasonable steps to notify other creditors of its intention to distrain. The second issue that arose related to the value of the goods distrained and the court found that the value of the assets should be based on an appraisal as opposed to a value that might be ascribed to the assets in an agreement of purchase and sale for the business: *Re Johnny Bourbon's (Newmarket) Inc.* (2006), 2006 CarswellOnt 7843, 26 C.B.R. (5th) 229 (Ont. S.C.J.).

Where a trustee moves to set aside payment pursuant to a consent judgment obtained in favour of an unsecured creditor only weeks prior to bankruptcy, the diligent creditor defence will not be available if the bankrupt was already in crisis and the judgment was not consented to in order to keep the bankrupt afloat: *Re Advent Sales & Marketing Corp.* (2003), 46 C.B.R. (4th) 163, 2003 CarswellOnt 3486 (Ont. S.C.J.).

End of Document

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

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

*ONTARIO*
**SUPERIOR COURT OF JUSTICE - COMMERCIAL LIST**

Proceeding commenced at Toronto

# REPLY AND RESPONDING BOOK OF AUTHORITIES OF TRIMOR ANNUITY FOCUS LP #5

(Motion returnable June 11, 2014)

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